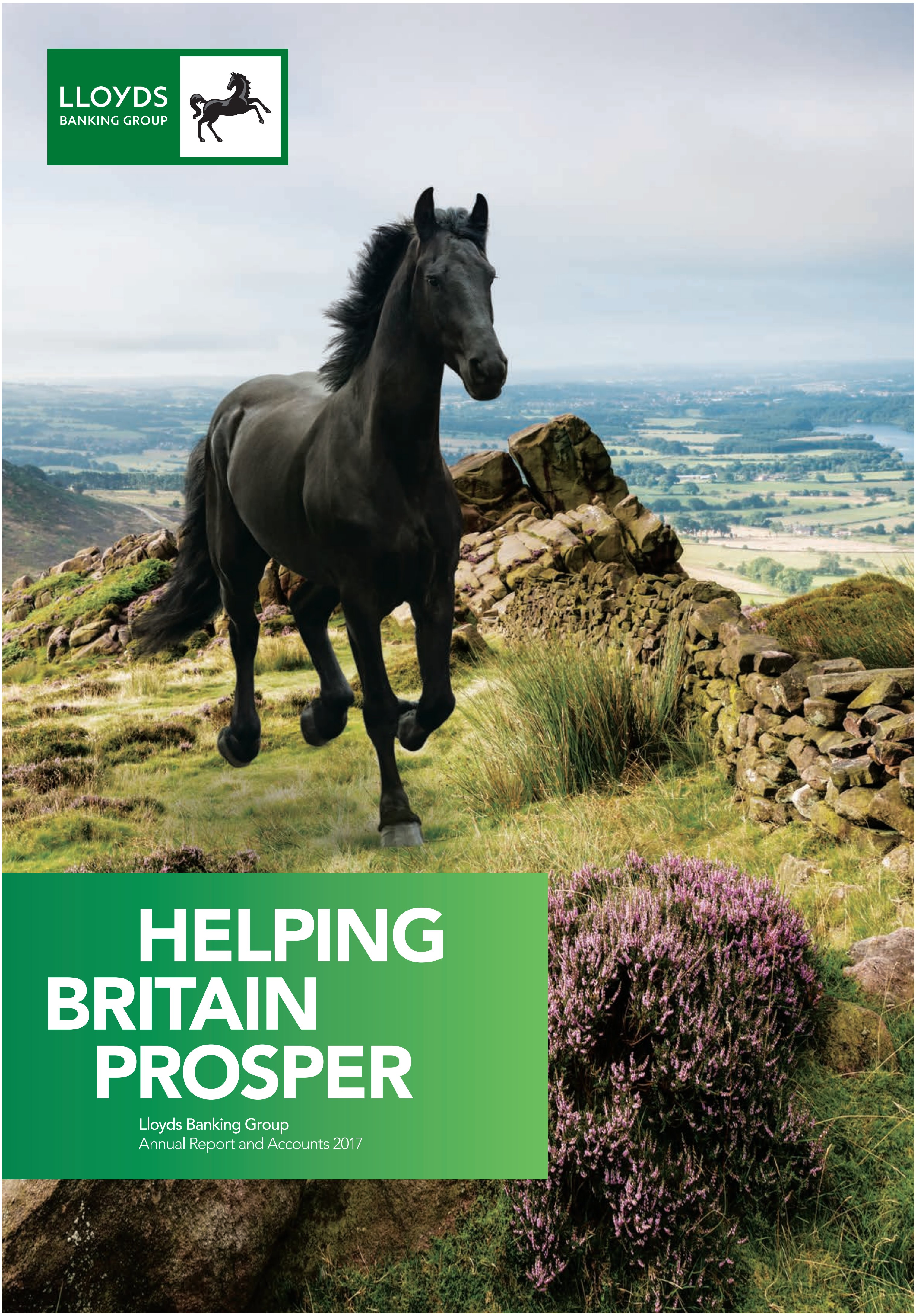
LLOYDS BANKING GROUP



HELPING BRITAIN PROSPER

Lloyds Banking Group
Annual Report and Accounts 2017

About us

We are a UK financial services provider with around 27 million customers and a presence in nearly every community.

Our main business activities are retail and commercial banking, general insurance and long-term savings, provided under well recognised brands including Lloyds Bank, Halifax, Bank of Scotland and Scottish Widows.

Our shares are quoted on the London and New York stock exchanges and we are one of the largest companies in the FTSE 100 index.

Reporting

Just as we operate in an integrated way, we aim to report in an integrated way.

We have taken further steps towards this goal this year. As well as reporting our financial results, we also report on our approach to operating responsibly and take into account relevant economic, political, social, regulatory and environmental factors.

This Annual Report and Accounts contains forward looking statements with respect to certain of the Group's plans and its current goals and expectations relating to its future financial condition, performance, results, strategic initiatives and objectives. For further details, reference should be made to the forward looking statements on page 265.

This icon appears throughout this report highlighting how we are Helping Britain Prosper. Read more online at **www.lloydsbankinggroup.com**

View our Annual Report and Accounts and other information about Lloyds Banking Group at **www.lloydsbankinggroup.com**

The 2017 Annual Report and Accounts incorporates the strategic report and the consolidated financial statements, both of which have been approved by the Board of Directors.

On behalf of the Board
Lord Blackwell
Chairman
Lloyds Banking Group
20 February 2018

Our purpose is to help Britain prosper. We are creating a responsible business that better meets our customers' needs and a culture where our colleagues put customers first. This is key to our long-term success and to fulfilling our aim to become the best bank for customers, colleagues and shareholders.

See more about how we create value for all our stakeholders on **pages 18–27**

Inside this year's Annual Report

Group highlights

Significant strategic progress and a strong financial performance

£5.3bn
+24%
Statutory profit before tax increased significantly

£8.5bn
+8%
Underlying profit increased

245bps
+55bps
Strong CET1 capital generation pre ordinary dividend and share buyback

13.9%
+0.9pp
Pro forma CET1 ratio after ordinary dividend and share buyback

3.05p
+20%
Ordinary dividend per share

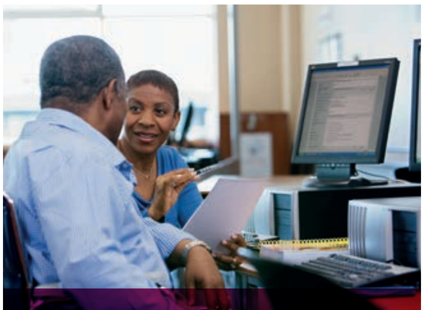
18bps
+3bps
Asset quality ratio remains strong, reflecting effective risk management and the continued benign credit environment

46.8%
-1.9pp
Our market leading cost:income ratio further improved

62.0pts
-0.7pts
Our net promoter score, a respected measure of customer satisfaction, remains strong

See our key performance indicators on **pages 6–7**

How we've helped Britain prosper in 2017



>708,000
individuals, charities and businesses trained in digital skills.

This includes around 300 local people in Wolverhampton who have been helped by our Digital Champions to learn new skills and stay safe online.

>124,000
businesses of all kinds and sizes helped to start up.

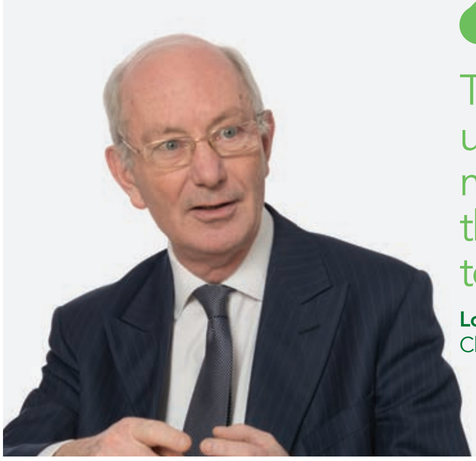
This includes Karen in Lowestoft who has opened her own hairdressing salon with support from Lloyds Bank.

>£20m
given to the Group's independent charitable Foundations.

The Foundations have helped more than 2,800 charities across the country, including Newry Muay Thai in Northern Ireland, which received a grant from the Halifax Foundation.

Find out more about our Helping Britain Prosper Plan on **page 20**

Chairman's statement
Transforming the Group for success in a digital world



> The transformation now being undertaken will ensure we maintain the core values of the past while equipping us to succeed in the future.

Lord Blackwell
Chairman

Overview and strategy

I am pleased to report that 2017 has been another successful year with significant progress both financially and strategically. We have continued to transform the Group to become a safer, more agile and customer focused organisation whilst increasing profitability. As a result of this progress, the UK government was able to conclude its share sale in May, more than recovering its initial investment and allowing the Group to return to full private ownership. This landmark event is a tribute to the hard work of all our colleagues in recent years.

The UK financial services sector continues to face a number of near term challenges. The economic environment remains uncertain, the level of regulatory change remains high, competition continues to be fierce and the pace of technological change requires continuing innovation while posing new threats from data and cyber security. This reinforces our conviction that our differentiated, customer focused, simple and low risk business model is the right approach. It has helped us deliver over the last few years and will, I believe continue to do so going forward.

However, the rapid pace of technological change also brings new opportunities to improve our service to customers with faster, more convenient and more extensive propositions tailored to meet their needs. To meet our customer needs effectively in this new world we will need to transform our business operations while building on our traditional strengths. As a Board we have spent considerable time over the past two years discussing the path we need to follow to succeed as a 'Bank of the Future'. This provided a solid base for us to develop the next phase of our strategy with the senior management team. The transformation we have now embarked on will ensure we maintain the core values of the past while equipping us to succeed in the future. It will also ensure we use all our capabilities across the Group to serve our customer needs seamlessly as an integrated financial service provider. The pace and scale of this transformation will be challenging to every bank, but we have a very strong foundation from which to move forward. I am confident that our new strategy will provide the capabilities to continue to deliver for customers, colleagues and shareholders and support the communities in which we operate.

Capital return

As a result of the financial progress in the year, I am pleased to announce that the Board has recommended a final ordinary dividend of 2.05 pence per share, bringing the total ordinary dividend for 2017 to 3.05 pence per share, an increase of 20 per cent on last year. In addition the Board intends to implement a share buyback of up to £1 billion. This is in line with the Group's policy to deliver a progressive and sustainable ordinary dividend whilst distributing surplus capital when appropriate to do so.

Our purpose

The strong motivation for all of us in Lloyds is the central role we play in Britain's economy as the UK's leading financial services provider. We are clear our purpose as a Group is to Help Britain Prosper. This means not only providing outstanding service to our customers, but also responding to the UK's social and economic issues which we believe we are best placed to address.

We are enormously proud of this role. Through our products and services, we have been helping the people, businesses and communities of Britain for more than 250 years. But we want to do even more; we want to

Helping Britain Prosper and our contribution to the UK

As the UK's leading financial services provider we are making a significant impact on the UK economy

Colleagues
- One of the largest employers in the UK

Communities
- £58m given to help communities in 2017
- 260,000 hours volunteered

Payments
- £14 trillion of payments processed in 2017 = 7 x UK GDP

Tax
- £2.5bn taxes paid in 2017
- The UK's largest corporate tax payer

Lending
- £65bn SME and Mid Markets lending portfolio
- Biggest mortgage lender in UK with c.£290bn portfolio

Dividends
- £2.2bn paid in dividends to 2.4 million shareholders

be a bank for Britain. Our Helping Britain Prosper Plan takes us beyond our business as usual activities by using our scale and reach, and unites our Group to meet some bold commitments. When Britain prospers we prosper, so the Plan is an important investment in our long-term success.

Corporate culture

The Board and senior management have a vital role to play in shaping and embedding a healthy corporate culture, and this continued to be a focus in 2017. Trust is the foundation for our customer franchise and I believe that our performance in the year has helped to rebuild trust not just in the Group but in the future stability and sustainability of the banking sector.

Our responsible, inclusive and diverse culture ensures our colleagues consistently do the right thing for customers. Over the last year we have taken steps to become even more transparent in the way we communicate with all our stakeholders. Of course, there is always more to do and getting this culture right is critical to our success in an increasingly competitive environment.

Customers

We aim to treat all our customers fairly and inclusively, making it easy for them to find, understand and access products that are right for them, whatever their circumstances. During the year I have seen first-hand how the way we serve our customers has continued to improve, with colleagues embracing new technology and ways of working to meet changing customer needs.

Communities

I am extremely proud of the way we support communities across the country and help British people and businesses prosper and am pleased that so many of our colleagues have once again taken the time to volunteer and raise funds for charities and community groups. Over the course of 2017 our colleagues donated 260,000 hours of their time by sharing their skills and experience to help make sustainable differences to local charities, schools, colleges and businesses.

I have also had the opportunity to travel around the country to see some of this work, speaking with teams who work directly with vulnerable customers and visiting charities who receive support from our independent Foundations.

I am delighted that we have raised more than £4 million for our 2017-2018 charity partner Mental Health UK in the past 12 months. There is a growing recognition that mental health and financial health are closely linked and together we are creating the perfect partnership to start developing this support for people across the UK.

Directors

We review the Board's composition and diversity regularly and are committed to ensuring we have the right balance of skills and experience within the Board.

As announced previously, two of our Non-Executive Directors, Anthony Watson and Nick Luff, stepped down following the AGM in May. Anthony was succeeded as Senior Independent Director by Anita Frew and Nick as Audit Committee Chairman by Simon Henry.

In June Lord Lupton joined the Board as an independent Non-Executive Director and Chairman of the non ring-fenced bank. James brings not just his experience of UK banking and capital markets, but also extensive corporate advisory experience which will be of particular value to our overall Commercial Banking activities.

Remuneration

Our approach to reward aims to provide a clear link between remuneration and delivery of the Group's key strategic objectives, namely, becoming the best bank for customers whilst delivering long-term, superior and sustainable returns to shareholders. We believe in offering fair reward where colleagues are rewarded for performance aligned to the long-term sustainable success of the business, our commitment to rebuilding trust and changing the culture of the Group.

Despite the uncertain environment, the Group has reported increased statutory and underlying profits, strong capital generation, has announced an increased ordinary dividend and intends to implement a share buyback.

As a result, the Group's total Group Performance Share (GPS) outcome has increased to £414.7 million (an increase of approximately 5.5 per cent on 2016). This is after a 21 per cent collective performance adjustment, and reflects both strong performance against stretching Group strategic objectives and issues impacting negatively on profitability and shareholder returns, customers, conduct and the Group's reputation.

Total GPS outcome remains a small proportion of underlying profit at 4.7 per cent. Cash GPS awards are capped at £2,000 with additional amounts paid in shares and subject to deferral and performance adjustment. More information on how we ensure our approach to remuneration supports our new strategy can be found in the Directors' remuneration report on page 97.

Outlook

There is of course much more to do as we face into a rapidly changing and challenging world. However, given our clear strategy and approach to transforming the business, our strong track record of delivery, our customer focused values and the dedication and commitment of our colleagues, we have all the components to succeed - building a great British institution we can all be proud of.

Lord Blackwell
Chairman

Group Chief Executive's review

A landmark year with strong strategic and financial performance

"Our continued strong performance positions us well to succeed in a digital world.

António Horta-Osório
Group Chief Executive

2017 has been a landmark year for the Group. In May the UK government completed the sell-down of its shares and the Group returned to full private ownership. This was enabled by the significant strategic progress and strong financial performance in recent years and was down to the hard work of all our people and I thank them for it.

During the year we successfully completed the second phase of our strategy with significant improvement in customer service, development of our market leading digital proposition including an open banking platform, targeted growth and delivery of Simplification savings ahead of target. We now have the largest and top rated digital bank in the UK alongside the largest branch network. We also completed the acquisition of MBNA's prime credit card business, the Group's first major acquisition since the financial crisis and announced the acquisition of Zurich's UK workplace pensions and savings business later in the year, giving us a strong platform on which to develop the next stage of our strategy in the financial planning and retirement business.

2017 has also been a pivotal year for the UK. The Bank of England increased the bank rate for the first time in more than 10 years and the government triggered Article 50 and launched EU exit negotiations. Although the precise nature of the UK's future relationship with Europe remains unclear and the economic outlook is therefore uncertain, the economy has been resilient with low unemployment, stable house prices, record employment and GDP growth of 1.8 per cent.

Financial performance

We have delivered another year of strong financial performance in 2017 with increased profits and returns on both a statutory and underlying basis, strong capital generation and increased capital returns.

Statutory profit before tax increased 24 per cent to £5.3 billion, reflecting higher underlying profit and lower below the line charges. Underlying profit was £8.5 billion, an increase of 8 per cent, with improved income and positive operating jaws resulting in an improved cost:income ratio of 46.8 per cent. Asset quality remains strong and the Group's gross asset quality ratio remains unchanged at 28 basis points, while the net asset quality ratio increased to 18 basis points as a result of expected lower releases and write-backs. Additional PPI provisions of £1.7 billion and conduct costs of £865 million were taken in the year. The increased PPI provision reflects increased complaint levels including the impact of the first FCA advertising campaign for the August 2019 industry deadline.

During the year, loans and advances increased to £456 billion with open mortgage book growth, increased SME balances and continued growth in consumer lending whilst also consolidating the MBNA book. Our balance sheet remains strong with a pro forma CET1 ratio of 13.9 per cent (after ordinary dividends and allowing for the share buyback), a total capital ratio of 21.2 per cent and a pro forma UK leverage ratio of 5.4 per cent.

In line with our progressive and sustainable ordinary dividend policy, the Board has recommended a final ordinary dividend of 2.05 pence per share, taking the total ordinary dividend for 2017 to 3.05 pence per share, up 20 per cent on 2016. Given our strong capital generation the Board has also announced its intention to implement a share buyback of up to £1 billion, equivalent to up to 1.4 pence per share.

Strategic progress

In 2017 we successfully completed the second phase of our strategic plan, achieving our strategic priorities of creating the best customer experience, becoming simpler and more efficient and delivering sustainable growth.

Creating the best customer experience

We have been committed to meeting customers' evolving needs through our multi-brand and multi-channel approach and as a result customer satisfaction, as measured by net promoter score (NPS), has increased to 62.0 from 58.6 in 2014 and from 42.5 in 2011. We operate the UK's largest branch network and the largest digital bank with 13.4 million active online users, of which 9.3 million are on mobile. We have focused on transforming key customer journeys and have made significant improvements, including faster processing of new mortgage applications and simpler processes for account opening. In addition we have developed an open banking platform in line with regulatory timescales.

We remain committed to delivering the best service for our customers and addressing historic conduct issues. We have continued to pay compensation to victims of the legacy fraud at HBOS Reading, and have now made offers to 57 customers, which represents more than 80 per cent of the customers in the review.

Becoming simpler and more efficient

Cost management has been a strategic priority and we remain focused on maintaining our competitive advantage in cost leadership. Our Simplification programme has delivered £1.4 billion of run-rate cost savings, ahead of our original £1 billion target, and costs have fallen every year (excluding the impact of MBNA). Our market leading cost:income ratio improved to 46.8 per cent in 2017, with further improvements targeted.

Our achievements in 2017

- UK government share sale completed, allowing the Group to be returned to full private ownership
- Statutory profit of £5.3 billion, an increase of 24 per cent on 2016
- Underlying profit of £8.5 billion, an increase of 8 per cent on 2016
- Completed the acquisition of prime credit card business MBNA and announced the acquisition of Zurich's UK workplace pensions and savings business
- Increased ordinary dividend of 3.05 pence per share with an additional share buyback of up to £1 billion

Delivering sustainable growth
When we outlined our strategic vision in October 2014, we targeted sustainable growth in line with our low risk appetite, committing to grow in areas where we were under-represented. We have increased net lending to SME clients by £3 billion since 2014, significantly ahead of the market, while also increasing UK consumer assets by over £6 billion and acquiring the £8 billion MBNA credit card portfolio. In the competitive low growth mortgage market we have focused on protecting margin rather than achieving volume growth over the last couple of years though the open mortgage book returned to growth in 2017. The Group also announced the acquisition of Zurich's workplace pensions and savings business in late 2017.

We remain committed to building the best team, creating an inclusive and diverse workforce that represents a changing Britain. Colleague engagement is at an all-time high, and in line with top performing corporates. In 2017 we were awarded number one employer for lesbian, gay, bisexual and transgender people at the Stonewall Awards and named the world's best bank for diversity and inclusion by Euromoney magazine.

Helping Britain Prosper Plan

In 2014 we launched our Helping Britain Prosper Plan to support the people, businesses and communities in the UK. The financial success of the Group is inextricably linked to the health of the UK and we are working hard to support the whole economy. Since the launch of the plan four years ago, we have lent more than £47 billion to first-time buyers, supported more than 440,000 start-ups, been the largest UK corporate tax payer and donated £72 million to the Group's independent Foundations. Also, in 2017 we have trained over 700,000 individuals, businesses and charities in digital skills. In 2014 we were the first FTSE 100 company to make a commitment on the number of senior positions held by women. At that time women made up 29 per cent of senior management. In 2017 we met our 34 per cent target and we are on track to achieve 40 per cent by 2020. We also recently became the first FTSE 100 company to set a target to increase the proportion of senior roles held by Black, Asian and Minority Ethnic colleagues. Our target is 8 per cent by 2020 for senior managers and 10 per cent for the overall Group.

Strategy overview

As we look to the future, we see the external environment evolving rapidly. Changing customer behaviours, the pace of technological evolution and changes in regulation all present opportunities. Given our strong capabilities and the significant progress made in recent years we believe we are in a unique position to compete and win in this environment by developing additional competitive advantages. We will continue to transform ourselves to succeed in this digital world and the next phase of our strategy will ensure we have the capabilities to deliver future success.

Strategic priorities

We have identified four strategic priorities focused on the financial needs and behaviours of the customer of the future: further enhancing our leading customer experience; further digitising the Group; maximising Group capabilities; and transforming ways of working. We will invest more than £3 billion in these strategic initiatives through the plan period that will drive our transformation into a digitised, simple, low risk, customer focused UK financial services provider.

Delivering a leading customer experience
We will drive stronger customer relationships through best in class propositions while continuing to provide our customers with brilliant servicing and a seamless experience across all channels. This will include:

- remaining the number 1 digital bank in the UK with open banking functionality;
- unrivalled reach with UK's largest branch network serving complex needs; and
- data-driven and personalised customer propositions.

Digitising the Group
We will deploy new technology to drive additional operational efficiencies that will make banking simple and easier for customers whilst reducing operating costs, pursuing the following initiatives:

- deeper end-to-end transformation targeting over 70 per cent of cost base;
- simplification and progressive modernisation of our data and IT infrastructure; and
- technology enabled productivity improvements across the business.

Maximising the Group's capabilities
We will deepen customer relationships, grow in targeted segments and better address our customers' banking and insurance needs as an integrated financial services provider. This will include:

- increasing Financial Planning and Retirement (FP&R) open book assets by more than £50 billion by 2020 with more than 1 million new pension customers;
- implementing an integrated FP&R proposition with single customer view; and
- start-up, SME and Mid Market net lending growth (more than £6 billion in the plan period).

Transforming ways of working
We are making our biggest ever investment in people, increasing colleague training and development by 50 per cent to 4.4 million hours per annum and embracing new technology to drive better customer outcomes. The hard work, commitment and expertise of our colleagues has enabled us to deliver to date and we will further invest in capabilities and agile working practices. We have already restructured the business and reorganised the leadership team to ensure effective implementation of the new strategy.

Financial returns

The UK economy has proven resilient and going forward our plans and projections assume this performance continues with a steady increase in base rate to 1.25 per cent by the end of 2020.

The strategy outlined will enable the Group to deliver strong statutory profit growth supported by targeted asset growth in key segments, a resilient net interest margin, lower operating costs, strong asset quality and lower remediation costs, whilst delivering strong capital generation and sustainable and superior shareholder returns.

Costs will continue to be a competitive advantage as we deliver market leading efficiency. We expect operating costs to be less than £8 billion in 2020. We also expect to achieve a cost:income ratio in the low 40s as we exit 2020, including future remediation costs. We continue to expect improvements in the cost:income ratio every year.

Asset quality remains strong and, given our low risk business model and the significant portfolio improvements in recent years, we now expect an asset quality ratio of around 35 basis points through the cycle and less than 30 basis points through the plan period.

We expect to deliver an improved return on tangible equity (RoTE) of 14.0–15.0 per cent from 2019 onwards on a higher CET1 capital base of c.13 per cent plus a management buffer of around 1 per cent.

Capital generation is expected to remain strong with 170-200 basis points of capital generation per year pre dividend and as a result we expect to deliver progressive and sustainable ordinary dividends whilst maintaining the flexibility to return surplus capital to shareholders.

Summary

Our strong foundations, differentiated business model and strategic capabilities combined with the new strategic plan and a highly engaged team positions us well to succeed in a digital world and continue to help Britain prosper.

António Horta-Osório
Group Chief Executive

Key performance indicators
Our strategy has delivered strong performance

Delivering for all our stakeholders

Our key performance indicators have been considered by the Board and identify the most effective output measures for assessing financial and non-financial performance and progress towards becoming the best bank for customers, colleagues and shareholders.

As a result of significant strategic progress in 2017, we have reported increased statutory and underlying profits, strong capital generation and have announced an increased ordinary dividend and our intention to implement a share buyback.

Customer relationships are key to our strategy and we specifically measure customer satisfaction and complaint levels. We also track our performance against the targets of our Helping Britain Prosper Plan, about which you can read more on page 20.

Pay for performance across the Group

To ensure our employees act in the best interests of customers and shareholders, remuneration at all levels of the organisation is aligned to the strategic priorities and financial performance of the business and also takes into account specific risk management controls. Variable remuneration for all colleagues, including our Executive Directors, is based on the performance of the individual, the business area and the Group as a whole.

Performance is assessed against a balanced scorecard of objectives across five areas (customer, people, control environment, building the business, finance) which are reviewed on a regular basis. Executive management are also eligible to participate in a long-term incentive plan (the Group Ownership Share plan), which encourages delivery of superior and sustainable long-term returns for shareholders, whilst supporting the Group's aim of becoming the best bank for customers, colleagues and shareholders and helping Britain prosper. KPIs that are directly linked to remuneration are marked with this symbol.

Financial

Underlying profit before tax

£m

2017	**8,493**
2016	7,867
2015	8,112
2014	7,756

Underlying profit increased in 2017, largely due to higher income, positive operating jaws and strong asset quality.

Statutory profit before tax

£m

2017	**5,275**
2016	4,238
2015	1,644
2014	1,762

Pre-tax statutory profit increased significantly, largely driven by strong underlying performance and lower charges below the line.

Ordinary dividend

p

2017	**3.05**
2016	2.55
2015	2.25
2014	0.75

An increased ordinary dividend of 3.05 pence per share, in line with our progressive and sustainable dividend policy. In addition, the Board intends to implement a share buyback of up to £1 billion.

Statutory return on tangible equity

%

2017	**8.9**
2016	6.6
2015	2.6
2014	4.4

The statutory return on tangible equity increased in 2017 as the gap between underlying and statutory profit continues to reduce.

We previously reported underlying return on required equity but changed to statutory return on tangible equity at full year 2016 to aid comparability with our peers.

Earnings per share

p

2017	**4.4**
2016	2.9
2015	0.8
2014	1.7

Earnings per share increased in the year, largely due to the significant increase in statutory profit.

Common equity tier 1 ratio

%

2017[1]	**13.9**
2016[1]	13.0
2015[1]	13.0
2014	12.8

Our common equity tier 1 ratio remains one of the strongest of the major UK banks.

1 Pro forma, reflecting insurance dividend and ordinary dividend. Also reflecting MBNA in 2016 and intended share buyback in 2017.

Read about performance at a divisional level on **pages 28–31**

Cost:income ratio
%

2017	**46.8**
2016	48.7
2015	49.3
2014	49.8

Our cost:income ratio further improved to 46.8 per cent and remains the lowest of our major UK banking peers.

Asset quality ratio
bp

2017	**18**
2016	15
2015	14
2014	23

Our asset quality ratio remains strong, reflecting our effective risk management and the continued benign credit environment. The increase reflects lower write-backs and recoveries rather than any deterioration in the underlying portfolio.

Total shareholder return
%

2017	**14**
2016	(10)
2015	(2)
2014	(4)

Our share price increased by 9 per cent in 2017, and when dividends are included, our total shareholder return was 14 per cent.

Non-Financial

Customer satisfaction

2017	**62.0**
2016	62.7
2015	58.9
2014	58.6

Our net promoter score is the measure of customer service at key touch points and the likelihood of customers recommending us. Despite being slightly down in the year it remains nearly 50 per cent higher than at the end of 2011.

Best bank for customers
% favourable

2017	**80**
2016[1]	77
2015	78
2014	72

The index is the outcome of a survey of more than 62,000 colleagues which shows an increasing number of colleagues believe we are committed to becoming the best bank for customers.

1 New baseline score introduced to tie in with new Group behaviours.

Employee engagement index
% favourable

2017	**76**
2016	71
2015	71
2014	60

Colleague engagement remains at its highest ever level with our employee engagement index 5 points higher than 2016. Our performance excellence index also improved, indicating our colleagues strongly believe we are committed to delivering great products and services for customers.

Digital active customer base
m

2017	**13.4**
2016	12.5
2015	11.5
2014	10.4

Reflecting the pace of digital adoption, the number of active digital customers increased in the year. The number of mobile banking users also increased in the year, to 9.3 million, many of whom use our award winning Lloyds Bank app.

Customer complaints*
FCA reportable complaints per 1,000 accounts

H1 2017	**4.1**
H2 2016	4.3

*Excluding PPI

The FCA changed the approach to complaint reporting from 30 June 2016 so our complaint reporting is now presented on this basis. Overall incoming complaints excluding PPI and claims management companies have fallen by nearly 70 per cent since 2011 and by around 18 per cent since 2016.

Helping Britain Prosper Plan targets achieved

2017	**21/22**
2016	20/24
2015	27/28
2014	20/25

Since we launched the Plan in 2014 we have made strong progress. In 2017, we achieved 21 out of 22 targets to help people, businesses and communities. Find out more about our Plan on page 20.

Our strategic journey

1 The external environment

2 Intrinsic strengths and challenges — See page 10

3 Creating value for our stakeholders — See page 11

4 What we have achieved over the last three years — See page 12

5 Our strategic planning process — See page 13

1 2 3 4 5

The external environment

See how risks associated with these factors impact upon our principal risks and strategy on **page 33**

Economy

Key messages

- Given our UK focus, our prospects are closely linked to the strength of the UK economy
- Despite near-term uncertainties about the future relationship with the EU, the UK economy is expected to remain resilient in 2018, growing at a similar pace to 2017. Longer term growth potential is still expected to be faster than the Eurozone and similar to the US
- Interest rates are expected to remain low, with gradual rises beneficial to our savings customers and the Group

Overview

As a UK focused financial services provider, our prospects are closely aligned to the strength of and outlook for the UK economy. In the period following the decision to leave the EU, the UK economy has remained resilient. Growth has slowed only a little below its trend rate, unemployment has continued to fall to a 40-year low, and property prices have continued to rise slowly. In the absence of any sudden shocks to business or consumer confidence, this recent resilience is expected to continue in 2018 and the next few years. In common with many other countries, the biggest uncertainty for longer term growth is the degree to which productivity growth improves from its weak rate of the past decade.

Opportunities

The economy's resilience bodes well for us and our customers. While interest rates are expected to increase only gradually, the Bank of England's first increase in Bank Rate in over 10 years has benefited savers, many of whom will have dealt with low rates for a prolonged period, and will support banking margins. In recent years, low interest rates and our low risk approach have been reflected in low and falling levels of impairments against our lending balances.

Looking ahead, impairments are expected to remain at benign levels at an industry level, with contributing factors including the slow pace of expected interest rate increases, unemployment remaining close to its current 40-year low, and the benefit of both continuing to support property prices. Meanwhile, business confidence has to date held up well in the face of global and domestic uncertainties. Manufacturers and exporters have been aided by sterling's depreciation since late 2015, and businesses generally are benefiting from low debt service costs.

Challenges

Households' spending power has been squeezed over the past year as the rise in inflation to 3 per cent by the end of 2017 has outpaced growth in pay that has remained subdued in a broadly 2-2.5 per cent range over the year, partly reflecting weak productivity growth. While inflation is expected to slow, it is likely to trend towards 2 per cent only gradually through the next three year chapter of our strategy, and whilst we expect wage growth to improve and end the spending power squeeze, it is uncertain how quickly this will happen. Meanwhile, the economy is more reliant than normal on business investment and exports to drive growth.

Business investment is likely to have been impacted by the uncertainty around the UK's future trading relationship with the EU but as negotiations progress and that relationship becomes clearer, investment spending should be supported. Operational impacts of the UK's exit from the EU present risks for some of our customers' businesses, although the UK's continued competitive advantages in innovation and high value services, and the flexible labour market should enable the economy to prosper longer term in growing world markets.

Outlook

Barring unexpected sudden shocks to consumer or business confidence, the near-term outlook for both the UK economy and the Group remains relatively benign. A tight labour market and gradual productivity improvements should over time underpin quickening wage growth, whilst inflation is expected to start falling through 2018, the combination gradually ending the squeeze on households' spending power. With unemployment remaining close to its current 40-year lows, Bank Rate is expected to continue to rise, but only slowly. House prices are expected to rise marginally, with the affordability impact of slightly higher interest rates offset by improving disposable incomes.

The Group is not immune to the challenges facing the near-term and medium-term economic outlook, but our UK focus means that the current benign conditions and resilience of the UK economy will be supportive to the Group's performance through the delivery of the next chapter our strategy. Direct operational impacts from EU exit are also limited.

Regulation

Key messages

- The UK financial services sector is expected to remain highly regulated
- There is increasing clarity on impending regulation with a number of key regulatory programmes now agreed or to be finalised in the near future

Open banking and customer data

In January 2018 open banking regulation was implemented in the UK, with the aim of enabling customers to view their personal financial data in one place. Customer protection is at the heart of this and other upcoming regulations regarding personal data, with robust data systems and processes having been developed to ensure that customer data can be transferred securely, and only once consent has been given.

Capital regulation

The Group continues to monitor and prepare for a number of regulatory capital developments taking effect over the next few years. Uncertainty remains around the implementation and impact of some regulatory developments, including the finalisation of Basel III, which will be subject to EU and UK implementation. The highly capital generative nature of the Group means that it remains relatively well-positioned to meet any changes arising.

Ring-fencing

From January 2019, the Group and its peers will have to comply with the ring-fencing regulations introduced by the Financial Services (Banking Reform) Act 2013. This legislation has been developed in response to the global financial crisis, with the aim of ensuring that ordinary depositors and other stakeholders, such as shareholders, would be protected in the event of a similar crisis occurring in the future. While this will result in some structural and operational changes for the Group, our simple business model and UK focus mean they are likely to be less onerous than for our major peers.

Other

Over the next three years a number of other regulations will be introduced or take effect including the effectiveness of competition and customer choice and the deadline for customers to claim compensation for mis-sold PPI.

Given our simple, low risk business model, we are well placed to meet these requirements and welcome the positive effect that they will have on the industry, its customers, and other stakeholders.

Customer

Key messages

- Customer behaviours are changing, with a greater focus on personalised customer experiences and instantly accessible services
- Evolving demographics and life patterns are changing the financial needs of our customers, in particular increasing focus on the ability to plan for retirement

Market challenge

The needs and expectations of our customers continue to evolve, driven by changing demographics and life patterns along with increased choice, both in terms of provider and channel. The increasing use of digital has also reduced brand affinity and loyalty across a number of sectors.

As we have seen in a number of other industries, incumbents who do not respond to changing customer preferences and behaviours are at the greatest risk.

Opportunities

Strong customer satisfaction scores demonstrate our ability to provide products and services that our customers value but it is imperative that we keep pace with market developments in order to maintain relevance with our customer base.

Our multi-channel offering, including the largest branch network and digital bank in the UK, enables customers to interact with us in whichever way they prefer. In addition, our customer data provides the Group with a wealth of information that can be utilised to facilitate greater personalisation, while ensuring we meet all of our customers' evolving banking and insurance needs.

Outlook

Changes to customer expectations and behaviour, demographics and life patterns mean that we cannot be complacent. While we have a number of competitive advantages in the current environment, including our differentiated multi-channel and multi-brand propositions, securing and enhancing the relationships with our customers will be paramount to our future success.

Technology

Key messages

- The pace of digital adoption continues to surpass expectations and is likely to increase further in the coming years. Addressing customer expectations in this area is key to future success
- Cyber security and the protection of customer data are increasingly important factors in retaining customer trust

Market challenge

The pace of digital adoption has surpassed expectations in recent years and this trend is likely to accelerate further. The increasing role of digital has heightened customer expectations for personalisation while transforming the manner in which customers interact with banks. New entrants to the financial services market are increasing disruption through the innovative use of technology and data, often specifically targeting small, profitable niches.

Security and resilience remain important factors, with the ability to respond to heightened cyber and fraud risks key to retaining customer trust in a digital environment.

Opportunities

As the UK's largest digital bank, further technological improvements are an important enabler of enhancing the customer experience. The increasing use of intelligent systems provides an opportunity to respond to customers' growing expectations for personalisation and relevance, while the automation of simple transactions increases our capacity to focus on complex, value adding transactions. In addition, the use of technology provides organisational benefits in terms of efficiency, our ability to respond to an evolving operating environment, as well as aiding risk taking decisions and mitigating fraud.

Outlook

Building upon our strong starting position, we have a unique opportunity to further enhance the customer experience and improve operational efficiency through the use of technology. In doing this, we must ensure that we continue to respond to innovation and meet the needs of our diverse customer base whilst ensuring system resilience and security.

Competition

Key messages

- Competition within the UK markets continues to increase
- The competitive landscape is changing with new entrants such as FinTechs and tech giants increasing disruption through innovation, while incumbent banks continue to re-focus on the UK

Market challenge

Our competitive landscape continues to evolve. A number of domestic incumbents are intensifying their focus on the UK market, with restructuring phases largely complete. In addition, collaboration among non-traditional competitors is increasing in order to build scale and drive efficiency. Tech giants such as Apple and Google are also posing an increasing threat to the financial services sector, underpinned by large customer bases, strong brand loyalty, access to significant customer data and a focus on delivering great customer experiences.

While the extent to which non-traditional lenders and tech giants will attempt to disintermediate our markets is unclear, intensified competition within our markets is likely. This will place pressure on income and margins across the sector and place an increasing focus on innovation.

Opportunities

With customers becoming more empowered as a result of greater choice than ever before, we must be responsive to their changing expectations and ensure that we continue to offer products and services they value. These expectations are likely to be increasingly influenced by non traditional competitors in other industries as they continue to the raise bar for innovation.

Our leading cost position, combined with our simple business model, provides us with the operational flexibility to compete effectively. However, we must go further to respond to these threats.

Outlook

While greater competition increases choice for consumers and reinforces the need to further improve the customer experience, the breadth of our multi-brand offering along with our efficiency and customer satisfaction means we start from a position of strength.

1 2 3 4 5

Our business model
Intrinsic strengths and challenges

We have several distinctive competitive strengths, which enable us to create sustainable value for our stakeholders.

UK's largest digital bank, branch reach and customer franchise

Our scale and reach across the UK means that our customer franchise extends to around 27 million customers with more than 13 million active online users.

Multi-channel approach

Operating in an integrated way through a range of distribution channels ensures our customers can interact with us when and how they want.

Prudent, low risk participation choices with strong capital position

Being low risk is fundamental to our business model. Our low risk appetite is reflected through the low level of non-performing loans and run-off assets, as well as our credit default swap spread, which is amongst the best in the banking sector worldwide. Our financial strength has been transformed in recent years with our capital position amongst the strongest in the sector worldwide.

Market leading efficiency position

Our simpler operating model and focus on operational efficiency provide a cost advantage which benefits both customers and shareholders.

Rigorous execution and management discipline

Experience of delivering change and transformation in recent years provides benefit as we further transform the business.

We will look to build upon these strong foundations in the next phase of our strategy, thereby creating new competitive strengths. Implementation will ensure we can compete effectively and create value in a digital world.

Further detail is available on page 14.

Multi-brand proposition

Offering our services through a number of recognised brands enables us to address the needs of different customer segments more effectively.

LLOYDS BANK | BANK OF SCOTLAND | HALIFAX
SCOTTISH WIDOWS | blackhorse | LEX AUTOLEASE
LDC | AMC | mbna

Due to the nature of our business as a large, UK focused financial services provider, we face a number of external and internal challenges.

EXTERNAL

As previously discussed on pages 8–9, the main external challenges we face are:

- Evolving and uncertain economic environment
- Ever increasing levels of regulation
- Evolving customer needs
- Responding to technology innovations
- Managing pressure from increased competition

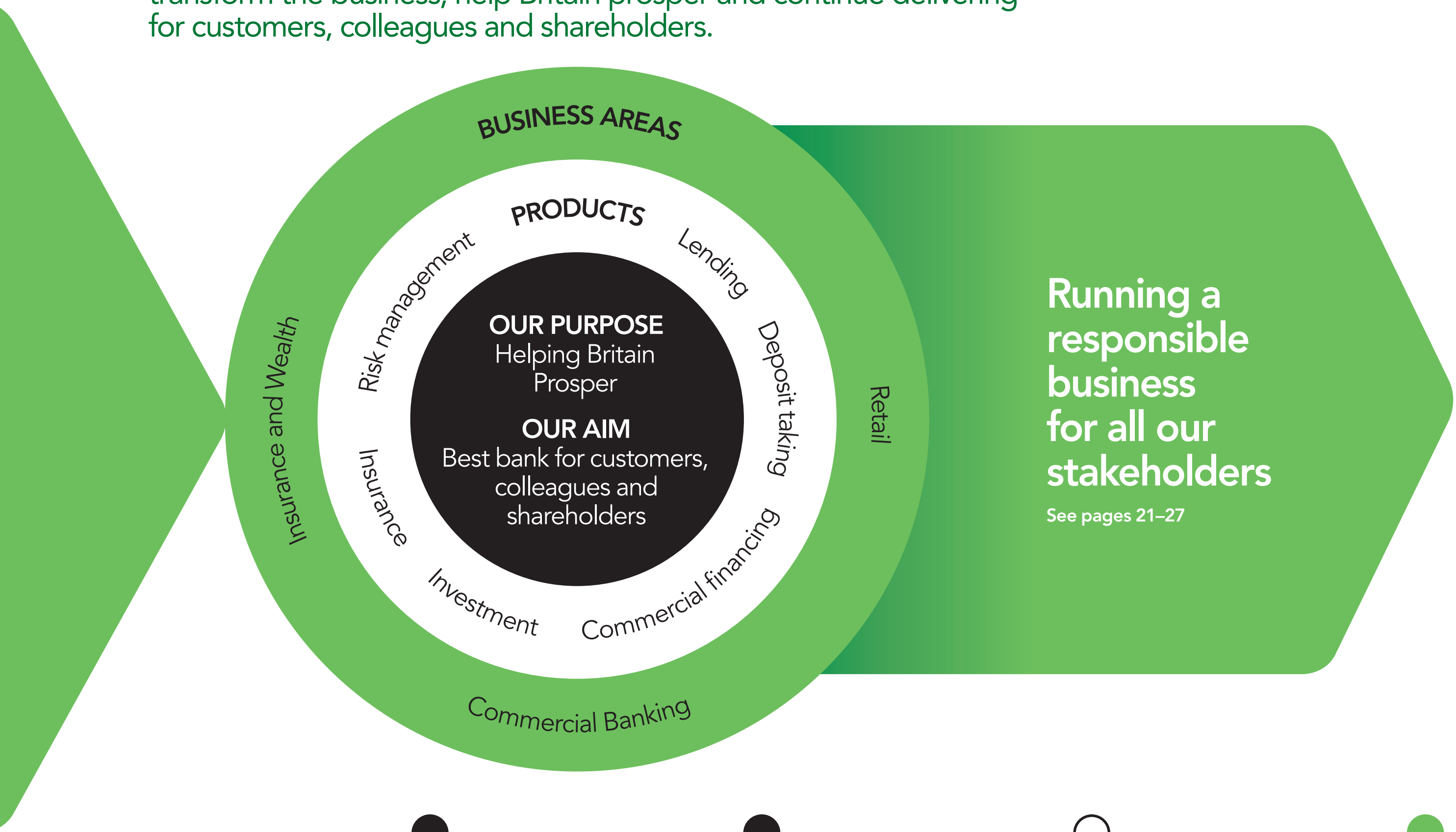
INTERNAL

We also face a number of internal challenges, which are being addressed as part of the next phase of our strategy:

- Operating as efficiently as possible while remaining the best bank for customers
- Ensuring we have the right people and culture to meet evolving customer needs
- Ensuring IT systems are effective and resilient and that we are prepared for the threat of cyber risk

Creating value for our stakeholders

Our simple, low risk, customer focused business model is driven by our competitive positioning. As we enter the next phase of our strategy we will enhance our competitive strengths to further transform the business, help Britain prosper and continue delivering for customers, colleagues and shareholders.



OUR PURPOSE
Helping Britain Prosper

We are a responsible business, focused on succeeding over the longer-term, and we believe that helping to make Britain a more inclusive and prosperous country is fundamental to that aim.

We are proud to take a leading role in helping the UK economy, whether through supporting housing, trade and business growth or by tackling disadvantage.

Our Helping Britain Prosper Plan, launched in 2014, takes us well beyond business as usual by setting measurable targets in the areas where we can make the biggest difference.

For more about our approach to responsible business and the Plan see **pages 18–20**

OUR AIM
Best bank for customers, colleagues and shareholders

Doing the right thing for our customers, colleagues and shareholders by meeting their financial needs, helping them succeed, improving our service proposition and creating value for them, is fundamental to our business model and the long-term sustainability of the business.

PRODUCTS

Our product range is driven by our customers' needs and is informed through comprehensive customer analysis and insight.

Lending
Mortgages, credit cards, personal and business loans

Deposit taking
Current accounts and savings accounts

Insurance
Home insurance, motor insurance and protection

Investment
Pensions and investment products

Commercial financing
Term lending, debt capital markets and private equity

Risk management
Interest rate hedging, currency and liquidity

BUSINESS AREAS

Our business areas are structured according to the products and services we provide to best serve our customers' financial needs.

We currently have three business areas:

Retail

Commercial Banking

Insurance and Wealth

Read more:
Retail see **pages 28–29**
Commercial Banking see **page 30**
Insurance and Wealth see **page 31**

What we have achieved over the last three years

We have made significant progress against our strategic priorities over the last three years and are well positioned as we head into the next chapter of our strategy.

STRATEGIC PRIORITIES 2015 – 2017

Creating the best customer experience

- We are now the UK's largest digital bank, with 13.4 million online customers and a mobile customer base of 9.3 million
- We have continued to invest in the UK's largest branch network, reformatting branches to reflect changing customer needs
- We have improved customer satisfaction with our seamless, multi-brand, multi-channel offering, reflected in increasing Net Promoter Scores (NPS), while customer complaints continued to trend downwards

Performance highlights

- 68 per cent of customer needs met via digital (versus forecast range of 50-70 per cent set out in 2014)
- NPS score of 62.0, up from 58.6
- 55 per cent of customers receiving mortgage offer within less than 14 days, up 18pp

Becoming simpler and more efficient

- We have demonstrated our ability to actively respond to changes in the operating environment, accelerating cost delivery and achieving significant efficiency savings
- The transformation of customer journeys has made it simpler, faster and more convenient for us to meet customers' evolving needs
- We have maintained our cost leadership position amongst UK high street banks

Performance highlights

- Cost:income ratio of 46.8 per cent, down from 49.8 per cent
- £1.4 billion of Simplification savings achieved, ahead of our original target
- Operating costs reduced every year during the course of the last six years (excluding the impact of MBNA in 2017)

Delivering sustainable growth

- Despite the uncertain macroeconomic environment, we have continued to support the UK economy while operating within our prudent risk appetite
- We have maintained market leadership across our key retail business lines, while growing in a number of targeted areas where we were under-represented including SME, Mid Markets, credit cards and motor finance
- We have helped Britain prosper through a number of strategic commitments, including supporting more first-time buyers than anybody else

Performance highlights

- Net lending to SMEs up by £3 billion, ahead of market
- £8 billion of MBNA credit card assets acquired in June 2017
- More than £35 billion lent to first-time buyers

Building the best team

- We have made progress towards building a business our colleagues are proud to work for by creating the best environment for our colleagues to succeed
- We are creating an honest and open environment where colleagues feel valued, reflected in all-time high colleague engagement scores that are also above the norm for high performing organisations
- We continue to encourage diversity, believing that everybody should have the opportunity to reach their full potential

Performance highlights

- 76pts – employee engagement at an all-time high
- 34 per cent of senior roles held by women, up 5 per cent
- Named world's best bank for diversity and inclusion by Euromoney magazine

Our strategic planning process

Over the past two years we have developed a new strategy to further transform the Group and deliver sustainable value to our stakeholders.

Why the change?
Since 2011, we have significantly transformed our business for the benefit of our customers and other stakeholders. However we are not complacent and recognise that unprecedented change in customer expectations, technology, the competitive environment and regulation require a bold response for the next chapter of our strategy.

Stages in the process

up to June 2016

Bank of the Future discussion

We regularly review our strategy in the light of the changing external environment to ensure that our focus remains the right one for our customers and other stakeholders. As part of this process, the Board specifically discusses strategic issues at a strategy offsite meeting every year.

In June 2016, the Board and the executive management team took part in an intensive two-day strategy meeting to discuss the strategic challenges and opportunities the Group could face in the future, based on four scenarios for how banking could evolve over the next 10 years.

The Board debated the transformation required to become 'Bank of the Future' and underpin our continued competitiveness in each of these scenarios. This provided a solid foundation for us to develop the next phase of our strategy.

up to June 2017

Development of high level strategic options

Using this foundation, coupled with the ongoing monitoring of both internal and external stakeholder trends and best practice, our main focus in 2017 was the development of the Group's strategy for the three year period from 2018 to 2020.

At the start of the year we identified four major strategic themes, each of which was developed further by dedicated teams, with support and challenge provided centrally and by executive management.

During the course of the year, the Board discussed and reviewed the proposed change initiatives in a number of deep dive sessions and at mid-year the Board debated at length the preliminary findings and broad strategic options for each of these priority themes over the course of two days. This resulted in a set of clear strategic priorities for further development.

up to February 2018

Finalisation of strategy and communication

A number of changes to the Group's operating structure and executive management were announced in July to put in place the right team and structure to lead the development and delivery of the strategy.

The priorities identified by the Board were subsequently developed into detailed strategic plans with measurable operating and financial metrics and targets which support our strategic aspirations for the next three years and beyond.

The Board reviewed the more detailed plan and immediate priorities in an extended session in November 2017, placing particular emphasis on the effective management of the programme and the mitigation of potential execution risks.

At the same time, executive management and the Board have been engaged in the development of the communication plan, to ensure that all our stakeholders clearly understand the strategy and what it means for them.

2018–2020

Our next chapter

Over the page, we outline the strategic priorities for the business to 2020.

Our next chapter
Transforming the Group for success in a digital world

Our new strategy will enable us to seize new opportunities by building on our existing competitive advantages. The transformation planned will ensure we become a digitised, simple, low risk, customer focused, UK financial services provider.

OUR PURPOSE Helping Britain Prosper
OUR AIM Best bank for customers, colleagues and shareholders
OUR BUSINESS MODEL Digitised, simple, low risk, customer focused, UK financial services provider

Our strategic priorities

Leading customer experience
Driving stronger customer relationships through best-in-class propositions while continuing to provide our customers with brilliant servicing and a seamless experience across all channels.

Digitising the Group
Deploying new technology to improve our efficiency and make banking simpler and easier for customers.

Maximising the Group's capabilities
Aligning the Group's capabilities as the sole UK banking and insurance provider to deepen customer relationships and grow in targeted segments.

Transforming ways of working
Enhancing colleague skills and processes, investing in agile working practices and embracing new technology to drive better outcomes for customers.

Enhancing our competitive strengths

- Differentiated multi-brand, multi-channel propositions with **data-driven customer experience**
- Market leading efficiency through **tech-enabled productivity improvements**
- Largest digital bank, branch reach and customer franchise with **leading integrated propositions**
- Prudent, low risk participation choices with strong capital position
- Rigorous execution and management discipline focusing on key **skills of the future**

Aiming to deliver for our stakeholders

Customers
- Market leading digital proposition with UK's largest branch network
- Single home for our customers' banking and insurance needs
- Personalised customer propositions
- Better experience across channels

Colleagues
- Evolved culture
- Transformed ways of working
- Enhanced colleague skills and capabilities
- Compelling colleague proposition

Shareholders
- Sustainable and low risk growth
- Market leading efficiency
- Superior returns and lower cost of equity
- Strong capital generation and attractive distribution policy

For more about our 2018 – 2020 strategic priorities **see pages 15–17**

For more about our purpose **see pages 20–21**

Why this is important

In order to be the best bank for customers, we recognise that we must continue to adapt to changes in customer behaviour, technology-driven competition and regulation. Our propositions must be reflective of heightened customer expectations for ease of access, personalisation and relevance, as well as the needs created by changing life patterns.

Key objectives for 2020

To achieve our aim of being best bank for customers, we will deliver best-in-class propositions while continuing to provide our customers with brilliant servicing and a seamless experience across all our channels.

- Remain number 1 UK digital bank with open banking functionality
- Unrivalled reach with UK's largest branch network, serving complex needs
- Data-driven and personalised customer propositions

Tailoring our multi-channel approach
We will build on the strength of our multi-channel model by responding to the evolving ways in which our customers are choosing to interact with us, ensuring that they continue to benefit from seamless multi-channel services in a way that best fits their needs.

Our customers are increasingly choosing digital channels to meet their simple banking needs. We will therefore continue to invest in the development of new digital technologies, to enable the delivery of best-in-class self-serve functionality for these simpler needs. We will also provide new customer tools to increase confidence and trust in using our digital channels.

While basic transaction volumes within branches continue to decline, there remains strong demand for face-to-face interaction for more complex needs and advice. We will therefore maintain our leading branch market share.

As part of this approach, we will tailor the format of our branches to the needs of the customers and communities they serve.

Building a market leading digital experience
The recent introduction of open banking regulation has provided an opportunity to enhance our propositions and engage our customers in new ways, whilst keeping them safe. We are the largest digital bank in the UK and aim to build on this position by creating a market leading digital financial services experience with open banking functionality. In doing this, we recognise that customers want to be in control of their finances in a secure and trusted way.

Personalising our customer propositions
As the UK's largest banking franchise, we will invest in developing our data capabilities, with the aim of delivering more personalised and data-driven propositions and services for our customers.

Why this is important

Our market leading cost position and customer franchise are sources of competitive advantage. However, we must not be complacent and must further digitise the Group to drive additional operational efficiencies, improve the experience of our customers and colleagues and allow us to invest more for the future. In addition, we must continue to simplify and progressively transform our IT architecture in order to use data more efficiently, enhance our multi-channel customer engagement and create a scalable and resilient infrastructure.

Key objectives for 2020

By digitising the Group, we are expecting to transform our cost base as well as the experience of our customers and colleagues.

- Deeper end-to-end transformation targeting 70 per cent of our cost base
- Simplification and progressive modernisation of our data and IT infrastructure
- Technology enabled productivity improvements across the business

Broadening the digital transformation of our processes

Over the past three years we have transformed a number of key customer journeys on an end-to-end basis. This has led to significant improvements in the experience of our customers, as well as delivering significant operational efficiencies. Looking ahead, we will materially scale-up our transformation, going deeper in the transformation of the customer journeys we have already addressed to cover additional brands and segments, as well as more activities along the value chain.

Over the next three years we will also bring a number of new customer journeys into scope for transformation as well as a number of our internal processes, or enterprise journeys, within our central functions.

Overall, we expect this next phase of our digital transformation to lead to a better experience for our customers and colleagues as well as improvements to risk management and the resilience of our business. In addition, we expect to achieve further structural efficiency gains, which will enable us to maintain our competitive advantage and compete with emerging new competitors, including digital disruptors.

Leveraging new technologies

To support our transformation and deliver further efficiency savings, we will simplify and modernise our IT architecture while deploying new technologies such as cloud computing to enhance our capabilities and increase resilience.

To generate additional efficiencies and improve customer experiences we will also increase our use of machine learning and cognitive engines, such as chatbots to help both colleagues and customers. To enable us to tailor our propositions to our customers' specific needs, we will need to be able to access customer data more effectively. We will therefore invest to create a single, scalable and modern data platform through which this data can be accessed more easily. This will enable us to provide personalised experiences based on deeper insight and analysis, greater security and resilience as well as enabling further innovation to our platforms.

Why this is important

To better address our customers' banking and insurance needs as an integrated financial services provider and improve their overall experience, we will make better use of our competitive Group strengths and unique business model.

Opportunities exist across the Group with those in financial planning and retirement and Commercial Banking described in further detail below.

Meeting our customers' growing financial planning and retirement needs

The ageing population and recent regulatory changes are leading to greater customer demand for long-term savings and investment products as well as for high quality, low cost advice and personalised solutions.

Given our business model, comprising banking and insurance operations and leading digital capabilities, we are uniquely positioned to respond to this demand. We are therefore aiming to capture the significant opportunity arising from the growing financial planning and retirement market. We recognise that customer needs vary and will offer a range of solutions from an execution only level of service to full specialist advice, ensuring that our customers enjoy a seamless experience regardless of the channels they use. Given our wealth of customer data and the investment we are making in technology, we will be able to offer a single customer view capability across our customers' financial holdings, including insurance and banking products. In addition, we will seek to capture the significant opportunities arising from auto-enrolment and the increased demand for digitised service. We will therefore strengthen our corporate pensions proposition, leveraging our existing commercial banking relationships and the enhanced capabilities that we will gain through

Key objectives for 2020

By maximising the Group's capabilities and sources of competitive advantage more effectively, we expect to deepen customer relationships and grow in targeted segments.

- +£50 billion financial planning and retirement open book assets under administration growth
- >1 million new pensions customers
- +£6 billion of additional net lending to start-ups, SMEs and Mid Markets

the acquisition of Zurich's UK workplace pensions business. To access faster growing segments and improve customer experience, we will enhance our distribution model across both intermediary and direct channels.

Transforming our Commercial Banking proposition
We will strengthen our simple, low risk and relationship-led Commercial Banking offering to reflect our clients' evolving expectations as a result of the continued innovation in our business.

We will enhance our digital capabilities to enable our clients to self-serve their simpler banking needs while ensuring that they continue to have relationship manager support for their more complex needs.

We will develop these enhancements to our client offering according to the specific needs of our different client segments, with the expectation of achieving growth in our SME and Mid Markets client segments and deepening our relationships with our Global Corporate and Financial Institutions clients. Through this approach, we will improve the customer experience by shortening the time clients have to wait for simple banking decisions and broadening our product range.

At the same time, the role of our relationship managers will evolve, with better access to data, new digital tools and analytics. These will enable them to create more value in strategic conversations with their clients.

Transforming ways of working

Why this is important

Our colleagues are crucial to the success of our business. In order to deliver our transformation over the next three years, and beyond, our colleagues will require new skills and capabilities to reflect the changing needs of the business as it adapts to the evolving operating environment. At the same time, colleague expectations of their employers are changing. As a result, we must devise solutions to continue to attract, develop and retain these skills and capabilities, while fostering a culture that supports a way of working that is agile, trust-based and reinforces the Group's values.

Key objectives for 2020

We are making our biggest ever investment in people and by transforming our ways of working, we are aiming to achieve a culture of inclusiveness and collaboration, while also upskilling our colleagues for future needs and new career paths.

- 50 per cent increase in training and development to 4.4 million hours per annum
- Up to 30 per cent change efficiency improvement

Transforming our approach to people
To develop the new set of skills and capabilities we will need our colleagues to have in the future, we will launch a significant upskilling programme, using new technologies and tailored content to deliver appropriate training in the most efficient way. For certain skills, we will need to recruit externally, with a number of these future requirements relating to very specific technical capabilities that are in short supply in the market, and for which there will be intense competition. We will therefore transform our recruitment and onboarding processes, while also developing a compelling colleague proposition and building on the strength of the Group's brands to attract future employees.

In addition to meeting our future skills requirements, we will seek to achieve a shift in the Group's culture to ensure our values and behaviours around simplicity, collaboration, agility and trust are fully embedded. As part of this, we will change the way that we communicate with our colleagues to increase engagement and will develop our leaders as role models for the required change.

Adopting new ways of working and an agile approach to change
In order to deliver the digital transformation of the Group more effectively and efficiently, we will embrace new ways of working, including automated software engineering processes and agile change methodologies that will improve our responsiveness to innovation and customer feedback. To foster greater collaboration and innovation, we will also co-locate our change teams where appropriate.

Developing a compelling colleague proposition
In order to attract, develop and retain the skills we need in the future as well as embed our desired culture, we will also make a number of positive changes to the processes, systems and the physical environment that directly affect our colleagues. This will include the simplification of the organisation to make it less hierarchical, providing our colleagues with clearer career paths, more flexibility and greater mobility across the Group. Other initiatives to support this aim include improvements to our performance management process to create a better balance between past performance evaluation and future development.

Doing business responsibly
Supporting our strategic priorities and our purpose to help Britain prosper

A sustainable and responsible approach is integral to what we do and how we operate. Doing business responsibly underpins our purpose and is supported by our Group values and Code of Responsibility.

We can only achieve our strategic priorities and help Britain prosper if we continue to operate responsibly. We know that if Britain prospers we can too, so we must continue to use our scale and reach to make a difference to people, businesses and communities across the UK.

How the Group is run

Our Group Policies and standards, including our values and Code of Responsibility, guide our behaviour and are embedded and tracked as part of our risk appetite and policy framework.

You can read more about the Group Policy framework and how these Policies are monitored and embedded on **page 111**

We actively support major national and international codes and conventions related to responsible business, including the UN Global Compact.

SUSTAINABLE DEVELOPMENT GOALS FTSE4Good UN GLOBAL COMPACT CDP

Governance

Good governance requires an effective structure and the combined effort of engaged and well-informed colleagues. It is essential that it is embedded into the processes, planning and delivery of the Group's objectives and strategy.

Our governance structure extends from our Group Board and Board level Responsible Business Committee, through the executive level Responsible Business Management Committee, which implements our responsible business strategy. At the end of 2017, this executive level committee became our Sustainability Committee. The Committee will increase its focus on the implementation of our Group-wide sustainability strategy as well as overseeing material responsible business issues. Our responsible approach then extends onwards through the efforts of managers and colleagues at all levels.

Stakeholder engagement

We know that engaging with different stakeholder groups is extremely important. It enables us to understand the issues they face, and their expectations from the Group. Their contributions influence our strategic thinking and also help us to shape our corporate reporting.

We engage with stakeholders in many different ways: during our business activities; in face-to-face meetings on specific issues, such as regulation; and also through new media such as digital broadcasts.

Read more on **pages 62–63**

Our Responsible Business Committee

In 2017 our Board-level committee focused on developing the Helping Britain Prosper Plan and how the Group's approach to doing business responsibly should evolve. The Group's sustainability strategy was discussed with colleagues from relevant business areas and external advisors.

Read more on **page 80**

"Our businesses have roots going back 250 years and have stood the test of time. Our purpose, to help Britain prosper, is more important than ever to the UK's successful transformation into a digitally enabled low carbon economy.

Sara Weller
Independent Director and Chairman, Responsible Business Committee

Responsible business highlights

We are doing business responsibly and making a significant impact

- One of Britain's largest corporate tax payers
- Lending £13 billion to first-time homebuyers
- Supporting more than 124,000 start-up businesses
- Transforming our business to meet customers' needs, including the 13.4m banking digitally
- Given 260,000 hours of colleague volunteering to help good causes
- £58 million given to help communities, including more than £20 million given to our independent charitable Foundations
- Our fundraising enabled Mental Health UK to launch the UK's first Mental Health and Money Advice Service
- Building Britain's most inclusive and diverse bank
- More than 5 million sq. ft. of real estate helped to become energy efficient

Helping Britain Prosper

Through our products and services we have been serving Britain for more than 250 years, but our Helping Britain Prosper Plan takes us beyond business as usual and is an important investment in our long-term success.

We launched the Plan in 2014, drawing on advice from our senior leaders and many external partners, including our independent stakeholder panel and charitable Foundations. Since its launch we have achieved a lot for Britain, meeting 20 of our 25 targets in 2014, 27 of our 28 targets in 2015 and 20 of our of 24 targets in 2016.

Our performance in 2017

This year we have made good progress in helping people, businesses and communities, meeting 21 of our 22 targets for the year.

Helping people

We're helping people with the issues that really matter to them, whether that is buying a home, saving for later life, or finding a rewarding job.

This year, we delivered £13 billion of lending to help first-time homebuyers, created more than 1,200 new apprenticeship positions in the Group and provided support and guidance to help almost 89,000 customers plan for retirement. Through our support for the School for Social Entrepreneurs we helped a further 260 social entrepreneurs start or grow their businesses. We also made good progress against our target to train 1.8 million individuals, businesses and charities in digital skills by 2020, having trained more than 708,000 in 2017.

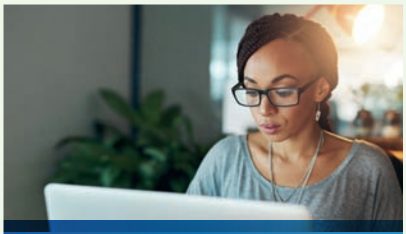
Helping businesses

We're helping businesses of all types and sizes to start-up, grow, improve productivity, build their skills base and become successful exporters.

We provide support to businesses of all types and sizes. In 2017, we delivered £1 billion of financial support to the manufacturing sector, exceeding our target, and extended our support for the Lloyds Bank Advanced Manufacturing Centre, helping to train 500 apprentices, graduates and engineers. We also met our target to support UK infrastructure projects collectively worth more than £31 billion. We have now retired this target from our Plan.

We increased net lending to SME and Mid Markets companies by £0.9 billion, but fell short of our £2 billion target. The shortfall reflects similar challenges across the market. Since the beginning of 2011, our net lending to SMEs has increased by 31 per cent whilst the market has contracted by 11 per cent. Since 2012, our lending to Mid Markets companies has increased by 17 per cent compared to a market that has remained flat. Our 2018 target is to deliver £2 billion of net lending across start-up, SME and Mid Markets businesses.

Read more on **page 23**



Helping communities

We're helping communities to become more cohesive by providing vital support for some of the most disadvantaged people living in Britain today. We also champion diversity.

Through our four independent charitable Foundations we helped more than 2,800 charities and supported colleagues to volunteer their expertise, including their mentoring skills, to help these charities become more effective and financially sustainable. This year, colleagues gave almost 260,000 volunteering hours to support local communities.

Through our partnership with Mental Health UK, we're promoting awareness of the link between mental health and money problems. This year we exceeded our target and raised £4.8 million thanks to the efforts of our colleagues and customers. This fundraising enabled Mental Health UK to launch Mental Health and Money Advice – the UK's first service dedicated to helping people understand, manage and improve their financial and mental health.

We made further progress towards our target of women holding 40 per cent of our senior roles by 2020, with 34 per cent ✓ of these roles now held by women. You can read more about inclusion and diversity on page 21. We also met our 2020 colleague engagement targets, three years ahead of schedule, and reached engagement levels of 70 per cent amongst Black, Asian and Minority Ethnic (BAME) and Lesbian, Gay, Bisexual (LGB) colleagues as well as colleagues with disabilities. We will continue to promote inclusion with our business but have now retired these targets from our Plan.

Read more on **page 25**

✓ Indicator is subject to Limited ISAE3000 (revised) assurance by Deloitte LLP for the 2017 Annual Responsible Business Reporting. Deloitte's 2017 assurance statement and the 2017 Reporting Criteria are available online at lloydsbankinggroup.com/RBdownloads

Doing business responsibly continued

2018 Helping Britain Prosper Plan

We have developed the Plan for 2018 and beyond, to ensure it supports the next phase of our strategy and focuses on the areas where we believe we can make the biggest difference: addressing Britain's housing needs, saving for the future, building digital skills, helping businesses start up and grow, championing Britain's diversity and tackling disadvantage.

Evolving the Plan

To show our continuing support for the low carbon economy, we have added a new target: to help provide power for 5 million homes in the UK by 2020 through our support for renewable energy projects. We are still focused on supporting business growth and building an inclusive and diverse business. We have set two new targets to increase the percentage of roles held by BAME colleagues to 10 per cent and to increase the percentage of senior roles held by BAME colleagues to 8 per cent by 2020.

You can read more about all of our Helping Britain Prosper Plan targets online

Our areas of focus

Through our full Plan, we are tracking our performance against 22 stretching targets in total. We have prioritised six of these to focus on in 2018, as shown in the table below. These support the UN Sustainable Development Goals, which aim to tackle the world's most pressing challenges by promoting sustainable development.

As a UK focused retail and commercial bank, we are inextricably linked to the British economy. Our success is the British economy's success and we are fully committed to help people, businesses and communities in Britain prosper.

António Horta-Osório
Group Chief Executive

Our areas of focus

Target	2018	2020[1]	How we are supporting the UN Sustainable Development Goals
Helping Britain get a home Amount of lending committed to help people buy their first home	£10bn	£30bn	8 DECENT WORK AND ECONOMIC GROWTH
Helping save for the future Growth in assets that we hold on behalf of customers in retirement and investment products[2]	£8bn	£50bn	
Building digital skills Number of individuals, SMEs and charities trained in digital skills including internet banking	700,000	1.8m	4 QUALITY EDUCATION
Supporting businesses to start up and grow Increased amount of net lending to start-up, SME and Mid Markets businesses	£2bn	£6bn	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE; 8 DECENT WORK AND ECONOMIC GROWTH
Championing Britain's diversity Percentage of senior roles held by women	36%	40%	5 GENDER EQUALITY
Percentage of roles held by Black, Asian and Minority Ethnic colleagues	8.9%	10%	
Tackling disadvantage across Britain Number of charities we will support as a result of our £100 million[3] commitment to the Group's independent charitable Foundations	2,500	7,500	10 REDUCED INEQUALITIES

1 2020 targets are cumulative from 2018–2020 and are in line with the next phase of the Group's strategic plan.
2 Growth in assets under administration in our front books.
3 Between 2014–2020.

Running a responsible business for all our stakeholders

We seek to run our business responsibly, sustainably and successfully, delivering value for all our stakeholders.

Addressing the issues that matter most

This year we asked our stakeholders – including colleagues, customers, investors, community groups, special interest groups and opinion formers – to participate in our materiality survey, to help us shape our reporting.

They were particularly interested in issues related to how the Group is run; building trust; supporting communities and society; economic performance and contribution; responsible and accessible products; human rights, diversity and equality; and people management and development.

We have structured our responsible business reporting around our key stakeholder groups. The issues they prioritised are listed at relevant points to help you find those of most interest to you.

Colleagues

Our colleagues take pride in working for an inclusive and diverse bank and with their support we're building a culture in which everyone feels included, empowered and inspired to do the right thing for customers.

Key issues for our stakeholders
Equality, inclusion and diversity
Human rights
Health, safety and wellbeing
Learning and development

Equality, inclusion and diversity

We continued to make good progress against our inclusion and diversity (I&D) strategy. The proportion of colleagues who agree that the Group is an inclusive place to work increased to 89 per cent, 3 per cent more than in 2016, and almost half of our colleagues are members or supporters of one of our five diversity networks. We met our target to increase the engagement levels of Black, Asian and Minority Ethnic colleagues, colleagues with disabilities and Lesbian, Gay and Bisexual colleagues above 70 per cent, three years earlier than our target date of 2020.

We continue to promote I&D through our Group Executive Committee. Several of our senior executives are I&D sponsors, and an Operational Committee overseas how our I&D plans are implemented.

We have committed to ensure that women hold 40 per cent of our senior roles by 2020, and to help reach this target we monitor gender diversity on candidate lists for senior appointments. Over 400 women have now completed our Women in Leadership programme, with 100 achieving promotion. We've continued to develop and promote our Authentic Leadership Programme for Black, Asian and Minority Ethnic leaders. We foster cultural awareness through promoting role models and communication campaigns.

Other achievements include being rated number 1 in the Stonewall Top 100 2017 LGBT employers and included in the Stonewall inaugural list of Transgender Inclusive Employers 2018; being named the best bank in the world for diversity and inclusion by Euromoney; and once again, a Top 10 Employer for Working Families and Times Top 50 Employer for Women. We also won awards for our approach to agile hiring. You can read more about agility on page 22.

Gender pay gap

We recognise that supporting gender equality and diversity more broadly supports the success of the UK as a whole. We regularly review our pay levels to ensure that men and women are paid equally for doing equivalent roles across the Group. We support the government's requirement for all large companies to publish their gender pay gap information. We remain committed to increasing the proportion of women in senior roles and building a diverse senior management team.

Supporting colleagues with disabilities

This year, the Department for Work and Pensions designated the Group as a Disability Confident Leader for our inclusive

Our inclusion and diversity data

		2017	2016[1]
Gender			
Board members	Male	**9**	10
	Female	**3**	3
Senior managers[2]	Male	**4,939**	5,138
	Female	**2,544**	2,457
Colleagues[2]	Male	**31,216**	33,149
	Female	**42,956**	45,769
Ethnic background			
Percentage of colleagues from a BAME background		**8.3%**	7.9%
BAME managers		**8.3%**	6.4%
BAME senior managers		**5.6%**	4.8%
Disability			
Percentage of colleagues who disclose they have a disability		**2.6%**	2.2%
Sexual orientation			
Percentage of colleagues who disclose they are lesbian, gay, bisexual or transgender		**1.7%**	1.5%

1 Restated to include International and parental leave colleagues comparable with other gender reporting. Includes subsidiary Non-Executive Directors.
2 Reporting scope: payroll headcount includes established and fixed term contract colleagues, parental leavers and Internationals. Excludes leavers, Group Non-Executive Directors, contractors, temps and agency staff. Also excludes MBNA colleagues, who became part of Lloyds Banking Group plc in June 2017, as they are currently on a separate grading structure.

Diversity scope: Payroll headcount including parental leavers. Excludes MBNA colleagues, who became part of Lloyds Banking Group plc in June 2017, as they are currently on a separate grading structure. Also excludes contractors. Gender information includes International colleagues. All other diversity information is UK Payroll only.

Senior Managers: Grades F+. Managers: Grade D-E.

Data source: HR system (HR Online). Apart from gender data, all diversity information is based on colleagues' voluntary self-declaration. As a result this data is not 100 per cent representative; our systems do not record diversity data for the proportion of colleagues who have not declared this information.

Running a responsible business for all our stakeholders continued

28,000
colleagues received mental health awareness training in 2017.

recruitment process and in November, we won a 'Nothing about us without us' Disability Smart Award, recognising the way we gather insights about disability from colleagues, customers and charities, then use them to inform our decisions. As a member of the Business Disability Forum, we are proud to have retained our Gold accreditation in the Disability Standard. Our colleague disability network, Access, ran a successful national event, while more than 2,300 colleagues completed our industry leading workplace adjustment process.

We offer bespoke development programmes and recruitment processes for colleagues and job applicants with disabilities. We aim to appoint the best candidate into any role and give full and fair consideration to job applications from those with disabilities, and we are unbiased in the way we assess, select, appoint, train and promote people. We offer a guaranteed interview scheme for candidates who declare a disability and meet the minimum requirements of the role. We continue to run a Disability Work Experience Programme in partnership with Remploy. This is one of the largest disability-focused work experience initiatives in the financial services sector; we've increased our number of candidates from 96 in 2016 to 392 in 2017.

Human rights

We aspire to conduct business in a way that values and respects the human rights of all the stakeholders we work with. We respect and support the United Nations Universal Declaration of Human Rights, together with the International Labour Organisation (ILO) Fundamental Conventions, covering freedom of association, the abolition of forced labour, equality and the elimination of child labour. We comply with all relevant legislation, including the UK Modern Slavery Act. We also support relevant voluntary standards, such as the UN Guiding Principles on Business and Human Rights and take steps to make sure colleagues understand our position on these issues and can help us live up to the standards they demand. You can read our Anti-Slavery and Trafficking statement online.

Health, safety and wellbeing

We care about the physical and mental health, safety and wellbeing of our colleagues. We provide them with a growing range of health and wellbeing resources, including company paid private medical cover, occupational health services and an employee assistance programme. We publish advice about health topics on our intranet and actively encourage colleagues to support external health and wellbeing campaigns.

We have policies, standards and relevant mandatory training in place to help colleagues work safely at all times. We also work closely with external health and safety agencies through our participation in the Health and Safety Primary Authority Scheme and Fire Primary Authority partnership. In 2017, we achieved a 7 per cent decrease in our total recorded accidents compared to 2016. You can read more about health and safety in our 2017 Responsible Business update.

Supporting colleagues' mental health

We worked with Mental Health UK to develop and deliver mental health awareness training to over 28,000 colleagues and we estimate that more than 25 per cent of colleagues discussed mental health this year. This included our Group Chief Executive António Horta-Osório, who shared his story about executive stress. We have improved the mental health support colleagues receive through our third-party healthcare suppliers and are supporting our top 120 leaders to develop their mental resilience.

Agile working

To respond to the changing business environment and in recognition of the changing ways colleagues live and work, we encourage our colleagues to embrace agile working. Approximately 41 per cent of them are now working in a flexible way compared to 33 per cent two years ago. In 2017 we launched a workforce agility Line Manager toolkit to help teams implement new ways of working.

Learning and development

Investing in learning and development equips colleagues to do their best for customers. During 2017, colleagues spent more than 410,000 days on learning, an average of 5.6 days each. We made it easier for them to access learning by creating new business learning catalogues and Group-wide Learning Resource Centres. We also ran 'Values in Action' sessions for all colleagues, supporting the introduction of our new Group and Leadership Behaviours, and unified our learning for line managers and leaders in a new Leadership Academy. This offers a new curriculum for senior colleagues, 'pathways' to guide those preparing for a new line management role, and leadership apprenticeships.

Our Strategic Leaders Programme, which 175 colleagues completed, concluded this year. From 2018, colleagues in our Strategic Leadership Group will undertake a new 'Horizon' development programme that supports our 'Bank of the Future' objectives. 80 per cent of colleagues who completed our 'Building the Best Team' survey confirmed that they get the support they need to improve their skills and meet customer demands, an annual increase of 3 per cent and 18 per cent above the UK norm.

CREATING MORE APPRENTICESHIPS WITHIN OUR GROUP

During 2017, we created more than 1,200 apprenticeship positions within the Group, bringing the total to more than 5,500 since 2012. Around 44 per cent of the new apprenticeships were taken up by external candidates from some of the UK's most disadvantaged areas. We are proud of the fact that many of our apprentices flourish with us after qualification including Vickie McRae, a mother of two who joined the Group in 2015.

We improved our digital offer, enhancing our Skillsoft resource, which won a Gold International Brandon Hall Excellence Award, and adding a video library, Lynda.com, to resources.

Engaging colleagues

We want colleagues to be engaged and enthusiastic about our strategy, responsible approach and culture. We regularly and systematically update them on the Group's performance and changes in the economic and regulatory environment including matters that concern their role. We also want them to share their ideas and views to help us shape our future. One of the most effective ways they do this is through the 'Best Bank for Customers' and 'Building the Best Team' surveys that are run by an independent third-party every year. They give colleagues the opportunity to share their thoughts in order to inform decisions and support improvements in team performance. This year, 86 per cent of colleagues participated in the two surveys – 2 per cent more than in 2016 and 5 per cent

89%
of colleagues believe the Group is committed to being a responsible business (2016: 86%).

above the external best practice response rate. We believe the surveys confirm that colleagues are engaged and believe the Group is moving forward in key areas.

Rewarding colleagues
We offer a competitive and fair reward package that supports our aims as a responsible business – with customer-facing colleagues in Retail incentivised on the basis of actions and behaviours that put customers first. We offer colleague share schemes to encourage shared ownership of our Group.

Read more on **pages 84**

Customers

We aim to treat our customers fairly and inclusively, making it easy for them to find, understand and access responsible products that are right for them, whatever their circumstances.

Key issues for our stakeholders
Customer privacy and data security
Support for Britain's businesses and entrepreneurs
Widening financial inclusion and supporting vulnerable customers
Responsible and accessible products
Responsible and ethical lending

Customer privacy and data security

We use advanced technology to protect customers' money and data, including secure log on and log off features and systems that prevent fraud or that detect fraudulent payments in real time. In 2017, as part of the multi-stakeholder Joint Fraud Task Force, we helped to set the strategic direction for fraud prevention. We also championed the national rollout of the Banking Protocol, which now includes 38 police forces. This enables colleagues to request immediate police support when customers are at risk. An estimated £9 million of fraud was prevented through the Protocol this year and 100 arrests were made.

We help and educate customers to improve their own banking and data security and champion industry-wide public information campaigns, including Take 5, a national education and awareness campaign. We offer support to colleagues to protect our customers and they can access our Anti-Money Laundering and Counter Terrorist Policies and specialist training if required.

Looking ahead, our key priorities are to further strengthen our cyber defences and to meet the requirements of the upcoming EU General Data Protection Regulation which will apply from May 2018.

Support for Britain's businesses and entrepreneurs

We helped 6,800 clients to export for the first time in 2017, as part of a wider commitment to help 25,000 businesses trade overseas for the first time by 2020. We also supported more than 124,000 start-up businesses. In 2017, we handled over 54 million payments totalling in excess of £1.4 trillion in digital transactions for our commercial clients.

We met our 2017 target to provide £1 billion in funding support for the manufacturing sector and launched a £500 million fund to help manufacturers access asset finance to invest in new capital to improve productivity. We've also supported more than 500 apprentices, graduates and engineers at the Lloyds Bank Advanced Manufacturing Training Centre in Coventry.

Through our partnership with the School for Social Entrepreneurs, we've helped more than 1,500 social entrepreneurs to start-up or grow their businesses since 2012. Our colleagues have worked with more than 250 social entrepreneurs as mentors to help them build sustainable social businesses. In 2017 the Group became the first financial services company to partner the pioneering Match Trading™ initiative; a new funding model which incentivises social entrepreneurs to grow their business through trading.

Widening financial inclusion and supporting customers in vulnerable circumstances

Through our financial inclusion strategy and financial education programmes we focus on improving access to financial services and building skills. Read more about financial education on page 25. This year we opened almost 271,000 new basic bank accounts and helped 99,700 customers upgrade from basic to mainstream products. We also simplified our unplanned overdraft approach. More than 9 in 10 personal current account customers of Lloyds Bank, Bank of Scotland and Halifax are now better off or unaffected financially by the changes.

We want all customers to have easy access to our products and services. We've worked hard to track vulnerable customers' needs, particularly in our Community Bank, and developed a Group-wide dashboard to identify emerging vulnerability trends. In 2017, our specialist support team helped 1,900 customers with cancer, through financial advice and with medical and emotional support from our partners Macmillan. To help colleagues do more for vulnerable customers, we provided 90,000 hours of vulnerability training.

MEETING CHANGING CUSTOMER NEEDS

We are investing significantly in a major branch transformation programme to better serve our customers now and for many years to come. We have expanded our mobile branch service this year and we now have 28 mobile branches, which visit 169 different locations to support rural communities across Scotland, England and Wales.

Supporting customers with disabilities
Digital access can transform banking for vulnerable customers, particularly for those with health conditions and disabilities that make it difficult to get to a branch. Following a review in 2016, the charity Abilitynet accredited our Halifax and Lloyds Bank digital platforms based on their accessibility for disabled customers.

We are piloting a new 'Easy Read' format, endorsed by the RNIB, to make bank statements accessible and understandable for customers with a range of learning difficulties and disabilities. This year we agreed our Autism Friendly plans for customers and colleagues, which we have developed in partnership with the National Autistic Society.

Running a responsible business for all our stakeholders continued

Responsible and accessible products

We have made significant progress over the last three years to improve the customer experience across many of our key products and services as part of our far-reaching Customer Journey Transformation initiative. In 2017, we launched the last two of our 10 journeys, each of which is intended to put customers at the heart of any changes we make. This year, we issued colleagues in branches with more than 4,000 iPad Pros so they can open accounts faster and introduced new digital services to help colleagues advise customers about corporate pensions or loan eligibility and to process mortgage offers and accounts and small loans for SMEs in less time than ever before.

Responsible and ethical lending

As a lender and pension provider we play an important role in promoting responsible lending and investment decisions that take into account a broad range of environmental, social and governance factors. The Group remains a signatory to the Equator Principles, the Stewardship Code and the UN Principles of Responsible Investment. As an active and responsible asset owner, we consider our obligations during the selection, appointment, monitoring and retention of our fund managers. The management of risk for investment funds offered to customers by Scottish Widows is effected through a robust and comprehensive process, including our Responsible Investment Governance Framework. In 2017 we completed an initial assessment of the responsible investment capabilities of our lead asset managers and the majority of external fund managers, and we launched a social bond fund in addition to the ethical and environmental funds in our range.

Partners

As a direct and indirect economic contributor to the UK economy, we value our relationships with external stakeholders and partners, including suppliers, government bodies and legislators.

Key issues for our stakeholders
Responsible conduct and culture
Direct and indirect economic contribution
Working with suppliers

Responsible conduct and culture

We are building a responsible, inclusive and diverse culture based on our values, which help colleagues consistently do the right thing for customers. The 2017 launch of our Group and leadership behaviours has given colleagues clear guidance about how to live our values at work. Throughout the year we reinforced our values and behaviours through numerous initiatives and embedded the behaviours in our processes and policies.

We equip and encourage colleagues to work in line with our values, our Code of Responsibility and all other standards relevant to their role. We also encourage them to speak up, challenge and act if they witness or suspect wrongdoing by contacting our Colleague Conduct Management Team or using our independent whistleblowing service 'Speak Up', which is accessible by phone, online or mobile app. During 2017, colleagues reported 372 concerns of which 181 were progressed to investigation. 57 per cent of the concerns investigated were upheld and remedial action taken where appropriate.

We aim to comply with all laws and regulations wherever we operate and have a comprehensive anti-bribery policy that applies to all colleagues, including directors, contractors and others acting on our behalf. All colleagues and contractors complete annual anti-bribery training and we encourage them to report suspected bribery. The Group is a member of Transparency International UK's Business Integrity Forum, a network of major international companies committed to anti-corruption and high ethical standards in business practices.

Building trust

Our performance as a responsible business during the past year has helped to rebuild trust in our Group and in the future stability and sustainability of the banking sector. In May we returned to full private ownership and the sale marked the successful delivery of our strategy to transform into a simple, low risk, UK focused retail and commercial bank. In 2017 we continued to build trust by taking steps to become even more transparent in the way we communicate with our stakeholders, providing them with greater detail about where we stand on environmental, social, governance and ethical issues.

Customer satisfaction

We measure customer satisfaction using the industry standard Net Promoter Score. In 2017, this was 62.0, down slightly from 62.7 in 2016 but remains nearly 50 per cent higher than at the end of 2011. When customers do complain, we act as quickly as possible, focusing on achieving fair outcomes. We continue to target understanding and eradicating the root causes of customer complaints reducing incoming complaints by 18 per cent from 2016 to 2017 (excluding PPI and claims management companies). Read more on page 7.

MOBILISING COLLEAGUES TO SUPPORT MENTAL HEALTH

In September, a group of 62 colleagues completed the Fourtitude Challenge and raised over £317,000 for our charity partner Mental Health UK. Our 'Fourtituders' tackled a mental agility challenge, hiked up the highest peak in their home nation, cycled 100 miles through the Peak District and completed a half marathon. An additional 250 colleagues took part as day participants and Mental Health UK's Chief Executive, Brian Dow, also participated, running the half marathon.

Direct and indirect economic contribution

We make significant direct and indirect contributions to the economy. We employ approximately 68,000 colleagues (full time equivalent) and are helping to create additional jobs and bring talented people into our business through our Graduate and Apprenticeship schemes. We've created more than 5,500 apprenticeships since 2012. In 2017, 38 per cent of our new apprenticeships were offered to external candidates.

£2.5bn

of taxes paid in 2017

We are helping the housing sector as a whole. In 2017 we lent more than £42 billion to home buyers and exceeded our target to build 1,500 homes through our Housing Growth Partnership. We also helped the construction sector acquire skills through the London-based Construction Skills Centre, where 166 people obtained an industry recognised qualification. We also provided a further £2 billion of new funding support to the social housing sector.

Our tax contribution

The Group continues to be one of the largest contributors to UK tax revenues. We were ranked as the highest payer of UK taxes in the most recent PwC Total Tax Contribution Survey for the 100 Group, which is broadly the FTSE 100 and some large UK private companies. In 2017, we paid £2.5 billion in tax (2016: £2.3 billion). We are also a major tax collector, gathering £1.7 billion on behalf of HMRC in 2017 (2016: £2 billion).

Our approach to tax is governed by our Tax Policy which is part of our Board-approved Group Risk Management Framework. We have discussed this Policy with HMRC and we comply with their Code of Practice on Taxation for Banks and the Confederation of British Industry's Statement of Tax Principles. We do not interpret tax laws in a way that we believe is contrary to the intention of Parliament, and we do not promote tax avoidance products to our customers. You can read more about our Tax Strategy online.

Shareholders

Engaging with our shareholders helps us understand their issues, shape our strategic thinking and improve our corporate reporting. We held more than 800 meetings with investors in 2017, including a number with SRI investors. We also ran a number of webinars, roadshows and meetings to update shareholders, investment analysts and ratings agencies about our performance.

Government

We engage with government bodies, including central and local government and the devolved governments in Scotland, Wales and Northern Ireland. We keep them informed about our activity as a responsible business, which in 2017 included party conference fringe meetings held with Mental Health UK, the launch of a report on the challenges facing the private rental sector, and briefings on economic development. To support the UK's nations and regions, our 10 Ambassadors, who are all senior colleagues, have a mandate from the Group Chief Executive to support economic and social progress in their local area. In 2017, our Ambassadors focused on issues connected to housing, skills development and business growth.

Working with suppliers

We aim to source responsibly and sustainably, requiring our suppliers to comply with our Code of Supplier Responsibility. We source a range of products and services from an active supply base of around 4,000 suppliers. In 2017, our supplier expenditure was £5.0 billion (£5.3 billion in 2016) with 94 per cent of this spent with UK-based suppliers. Our responsible business objectives are embedded into our sourcing and supplier activities. For example, we further enhanced the questions we ask prospective and existing suppliers in our Financial Supplier Qualification System in relation to issues such as human trafficking and slavery, and have implemented new contractual requirements. We have also worked with key suppliers to build partnerships with social enterprises and embed social responsibility practices.

Communities

We invest in local communities across Britain to help them prosper economically and build social cohesion by tackling disadvantage.

Key issues for our stakeholders
Financial education and inclusion
Community investment

Financial education and inclusion

Our award winning Money for Life programme is specifically designed to help vulnerable 16-25 year olds to improve their financial competencies. Since the programme was relaunched in October 2016 we have engaged more than 450,000 young people and over 11,300 money masterclasses have been delivered face-to-face in youth centres across England, Wales, Scotland and Northern Ireland. In addition to this colleagues have delivered financial literacy sessions in primary and secondary schools in local communities. Thanks to our 'StandingOut' programme we remain one of the largest providers of school and academy governors in Britain, with 577 colleagues currently involved.

Community investment

Our support for local communities focuses on education, employability and enterprise. Our total community investment in 2017 was around £58 million. This includes our colleagues' time, direct donations, and the money we give to our independent charitable Foundations, which receive a share of the Group's profits annually. Through the Group's Foundations, we reach and help some of the most disadvantaged communities in Britain, giving more than £20 million in 2017.

TACKLING SOCIAL DISADVANTAGE ACROSS BRITAIN

Through the Lloyds Bank Foundation for the Channel Islands, we are supporting Autism Jersey, a charity that provides much-needed advice and respite for people on the autism spectrum, their families and carers. The charity, which is using a grant of £50,000 over three years to help pay salaries, has grown significantly in the past five years and has helped many individuals obtain care for the first time without travelling to the mainland.

Our charity partner

In 2017 we raised £4.8 million for Mental Health UK. This money will have a significant impact across the UK and has funded the first helpline dedicated to supporting people experiencing mental health and money management issues, which was launched in November 2017. We also aim to increase awareness and reduce the stigma associated with mental health so that our colleagues can support themselves, each other and our customers.

Read more on **page 22**

Indicator is subject to Limited ISAE3000 (revised) assurance by Deloitte LLP for the 2017 Annual Responsible Business Reporting. Deloitte's 2017 assurance statement and the 2017 Reporting Criteria are available online at lloydsbankinggroup.com/RBdownloads

Environment

A sustainable and responsible approach is integral to how we operate

We need to use scarce natural resources more sustainably, manage our environmental impacts and support our customers by financing opportunities created by the transition to a low carbon economy.

Key issues for our stakeholders

The impact of climate risks

Managing environmental impacts

Delivering the science-based carbon reduction and climate resilience targets set out in the Paris Agreement will have significant structural implications for the economy and the businesses and communities we serve. That is why we are evolving our Group-wide sustainability strategy.

This year, our overall carbon emissions were 292,848 of CO_2e, a decrease of 14 per cent year-on-year and of 48 per cent against our 2009 baseline. This is mainly attributable to the reduction in consumption of gas and electricity, which make up the largest proportion of our emissions, as a result of our extensive energy management programme. In 2017, we also reduced the CO_2e related to our business travel by promoting our 'No Travel Week', encouraging travel alternatives and the successful roll out of 'WebEx', Group-wide.

Read more about our emissions in the Directors' report on **page 83**

Supporting the low carbon economy

We are helping more of our commercial clients to understand and manage their sustainability risks and we complete an environmental risk assessment at the start of every new client relationship. We are currently exploring ways to build sustainability considerations into our policies and risk management processes. We offer customers products and services that help them embrace sustainability. In 2016, we launched an innovative £1 billion Green Loan Initiative to incentivise commercial real estate to become more energy efficient and this year exceeded our target to help 2 million square feet of real estate.

At the end of 2017, our UK team had financed renewable projects with a combined capacity of over 2.75GW (2016: 1.78GW) and internationally our existing investments in renewables exceed 8.9GW (2016: 7.4GW). In 2017 Lloyds Bank played an important part in Macquarie's acquisition of the Green Investment Bank (now Green Investment Group), providing financing for a significant portfolio of operational offshore wind farms including Sheringham Shoal, Gwynt y Mor, Rhyl Flats and projects in construction, including Galloper and Rampion offshore wind farms. Together the projects have a total capacity of approximately 2.4GW, which is enough to power over 1.7 million homes and they will support a significant number of jobs across the UK through the supply chain and maintenance of the wind farms.

The impact of climate risk

We welcome the recommendations of the Financial Stability Board Taskforce on Climate-related Financial Disclosures (TCFD) and have mapped our approach to them. We are developing a strategy and implementing processes to:

- Assess the materiality of climate risk across our business
- Identify and define a range of scenarios, including relevant physical and transition risk
- Evaluate the business impacts
- Identify potential responses to manage the risks and opportunities

We will address a number of these and will disclose further information on our work in this important area.

HELPING INCENTIVISE GREEN REAL ESTATE

We're incentivising Unibail-Rodamco, Europe's largest commercial real estate business, to become more environmentally sustainable – by linking the margin on their five year €650 million revolving credit facility to green key performance indicators. The interest margins set through this innovative refinancing deal, will take into account the Unibail-Rodamco's performance against KPIs based on its own 'Sustainability Vision' and 'Better Places 2030' strategies.

CO_2e emissions

	Oct 16 - Sept 17	Oct 15 - Sept 16[1,2]	Oct 14 - Sept 15[1,2]
Total CO_2 e	**292,848** ✓	340,382	395,543
Total Scope 1	**52,160** ✓	53,026	58,851
Total Scope 2	**166,617** ✓	202,414	239,709
Total Scope 3	**74,071** ✓	84,943	96,983

1 Restated 2014/2015 and 2015/2016 emissions data to improve the accuracy of reporting, using actual data to replace estimates.

2 Restated all historic years to reflect improved methodology in assigning road travel between reporting scopes.

Emissions in tonnes CO_2 e in line with the GHG Protocol Corporate Standard (2004). We are in the process of transitioning to the revised Scope 2 guidance. Criteria used to measure and report Scope 1, 2, 3 emissions is provided in the Lloyds Banking Group Reporting Criteria statement available online at www.lloydsbankinggroup.com/responsible-business.

Scope 1 emissions include mobile and stationary combustion of fuel and operation of facilities.

Scope 2 emissions have been calculated using a location based methodology, as set out by the GHG Protocol.

✓ Indicator is subject to Limited ISAE3000 (revised) assurance by Deloitte LLP for the 2017 Annual Responsible Business Reporting. Deloitte's 2017 assurance statement and the 2017 Reporting Criteria are available online at www.lloydsbankinggroup.com/rbdownloads

Our climate related financial disclosures

Our strategy

In 2017, we reviewed how we integrate environmental sustainability into our strategy and risk management processes, taking advice from external advisors and working with all parts of the business to understand work already in plan and where we need to do more. We are committed to supporting the transition to a low carbon economy through our financial products and services, including renewable energy services.

Governance of climate change

The Responsible Business Committee, a sub-committee of the Board, will take overall responsibility for the Group's climate-related impacts and risks from 2018. It is chaired by an Independent Director, Sara Weller, and meets regularly throughout the year. We have refocused our executive-level Responsible Business Management Committee to become our Sustainability Committee and will ensure that colleagues with operational responsibilities across the Group's key divisions are actively involved in the development and implementation of a comprehensive environmental sustainability strategy. Discussions involving these Committees and the Commercial Banking leadership team were held in 2017 to start to examine the strategic implications of environmental challenges, including climate change.

Risk management

The Sustainability Committee will oversee the assessment of our climate-related risks, escalating to the Responsible Business Committee and the Board Risk Committee as appropriate. Our divisions are each exposed to different levels of climate risk. For example, as a large home insurer, we are aware that global warming is projected to increase the risk of flooding and consequently weather-related insurance claims. It is important that we continue to work with our customers, industry peers and government to ensure this risk is minimised and mitigated to keep flood insurance affordable.

You can read more about environmental risk management on **page 133**

Metrics and targets

We are working to develop strategic commitments and targets in response to climate-related risks and opportunities, with different parts of the business feeding into this target setting process. This builds on our work to reduce the environmental impact of our own operations.

Our target is to reduce our overall CO_2e by 60 per cent by 2030 and 80 per cent by 2050, in line with the UK's emission reduction targets. This follows a science-based target setting methodology. As part of our Green Loan Initiative, our target is to fund 5 million square feet of commercial real estate to become more energy efficient by 2020, the equivalent of five London Shards. We have set a new target to help provide power for 5 million homes through our investment in renewable energy by 2020.

We will also consider the supplementary industry specific recommendations for the financial sector.

Non-financial information statement

We aim to comply with the new Non-Financial Reporting requirements contained in sections 414CA and 414CB of the Companies Act 2006. The below table, and information it refers to, is intended to help stakeholders understand our position on key non-financial matters. This builds on existing reporting that we already do under the following frameworks: CDP, Global Reporting Initiative, Guidance on the Strategic Report (UK Financial Reporting Council), UN Global Compact, UN Sustainable Development Goals and UN Guiding Principles.

Reporting requirement	Policies and standards which govern our approach	Risk management and additional information	
Environmental matters	Environmental statement	Environment, pages 26–27	Environmental risk management, page 133
Employees	Ethics and Responsible Business Policy[1] Ethical Policy Statement Colleague Policy[1] Code of Responsibility Health and Safety Policy[1]	Equality, inclusion and diversity, page 21 Health, safety and wellbeing, page 22 Learning and development, page 22 Responsible conduct and culture, page 24 Diversity, skills and composition, page 58	Board Diversity Policy, page 72 People risk, page 136 Governance risk, page 150
Human rights	Human Rights Policy statement Colleague Policy[1] Pre-Employment vetting standards[1] Data Privacy Policy[1] Anti-Slavery and Trafficking Statement Information and Cyber Security Policy	Human rights, page 22 Responsible and ethical lending, page 24 Working with suppliers, page 25	
Social matters	Volunteering standards[1] Matched giving guidelines[1]	Helping communities, page 19	Communities, page 25
Anti-corruption and anti-bribery	Anti-bribery Policy[1] Anti-bribery policy statement Anti-money laundering and counter terrorist financing Policy[1] Fraud Risk Management Policy[1]	Customer privacy and data security, page 23 Responsible conduct and culture, page 24 Operational risk, pages 135–136	
Policy embedding[2], due diligence and outcomes		Risk overview, pages 32–33	Risk management, pages 107–156
Description of principal risks and impact of business activity		External environment, pages 8–9 Creating value for our stakeholders, page 11 Addressing the issues that matter most, page 21	Direct and indirect economic contribution, page 24 Risk overview, pages 32–33 Principal risks, pages 34–37
Description of the business model		Our business model, pages 10–11	Our next chapter, page 14
Non-financial key performance indicators		Key performance indicators, page 7 What we have achieved over the past three years, page 12 Doing business responsibly, page 18 Helping Britain Prosper, pages 19–20	Running a responsible business, pages 21–25 Environment, pages 26–27

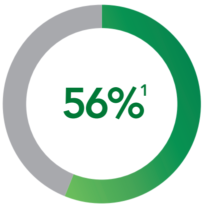
1 Certain Group Policies and internal standards and guidelines are not published externally.

2 The policies mentioned above form part of the Group's Policy Framework which is founded on key risk management principles. The policies which underpin the principles define mandatory requirements for risk management. Robust processes and controls to identify and report policy outcomes are in place and were followed in 2017.

Divisional overview
Retail

Retail offers a broad range of financial service products, including current accounts, savings, mortgages, credit cards, motor finance and unsecured loans to personal and business banking customers.

£4,403m
Underlying profit



1 Proportion of Group underlying profit excluding run-off and central items.

£13bn
Lending to first-time buyers

£1.0bn
Open mortgage book growth

>124,000
business start-ups supported

>100,000
Lex Autolease fleet growth within 5 year ambition

UK's largest digital bank

	Active online users (m)	Mobile users (m)
2017	**13.4**	**9.3**
2016	12.5	8.0
2015	11.5	6.6
2014	10.4	5.2

Its aim is to be the best bank for customers in the UK, by building deep and enduring relationships that deliver value to customers, and by providing them with greater choice and flexibility. Retail operates a multi-brand and multi-channel strategy and continues to simplify the business and provide more transparent products, helping to improve service levels and reduce conduct risks, whilst working within a prudent risk appetite.

Progress against strategic priorities

Creating the best customer experience

- Delivered a new approach to current account overdrafts that is simple, clear and puts customers in control as well as redesigning the account opening journey to reduce account opening times.
- Largest UK digital bank with 13.4 million active online users including 9.3 million mobile users.
- Now able to provide bespoke financial support to customers suffering from cancer, following training from Macmillan.
- Retail complaint volumes (excluding PPI) down 17 per cent compared to 2016.

Becoming simpler and more efficient

- Maintained the UK's largest branch network, with 21 per cent market share. Responding to changing customer usage and preferences resulted in an overall net reduction in branches, the introduction of new branch formats in selected locations and an increase in mobile branches to 28, supporting 169 communities.
- Improved digital capability simplifying processes for customers:
  - Rolled out over 4,440 iPad Pros across our branches, integrating the multi-channel customer experience
  - Simplified online processes for mortgage intermediaries to offer a faster service
  - Customers now able to check both loan and credit card eligibility up front

Delivering sustainable growth

- Successfully completed the acquisition of MBNA from Bank of America, consolidating the Group's position as Britain's largest prime credit card issuer, with 25 per cent market share of balances.
- Continued to support first-time home buyers, lending £13 billion compared to the £10 billion target.
- Supported over 124,000 start-up businesses, exceeding the commitment to support 100,000.
- Lex Autolease exceeded its five year ambition to grow its fleet by 100,000 vehicles, cementing its position as the UK's leading vehicle leasing company.

Financial performance

- 2017 results include completion of the acquisition of MBNA on 1 June. MBNA has performed ahead of expectations and generated incremental income of £448 million, operating costs of £135 million and impairments of £118 million.
- Underlying profit increased 9 per cent to £4,403 million.
- Net interest income increased 8 per cent (3 per cent excluding MBNA) reflecting a 14 basis points improvement in net interest margin, driven by deposit repricing offsetting mortgage margin pressures.
- Other income was 3 per cent higher, driven by fleet growth in Lex Autolease. Operating lease depreciation increased reflecting fleet growth and increased conservatism in residual value management.
- Operating costs increased 2 per cent to £4,857 million. Excluding MBNA, costs decreased by 1 per cent driven by efficiency savings partly offset by increased investment spend and pay related growth.
- Impairment charges increased 10 per cent to £717 million. Excluding MBNA, impairments were £55 million lower than in 2016, reflecting the resilient economic environment. Asset quality ratio excluding MBNA was down 2 basis points.
- Loans and advances to customers were up 3 per cent to £339.7 billion (including MBNA £8 billion) driven by the Black Horse business and growth in the open mortgage book, up £1.0 billion to £267.1 billion.
- Customer deposits were down 1 per cent to £253.1 billion, with a continued reduction in tactical balances.
- Risk-weighted assets increased by £6.2 billion to £90.8 billion following the acquisition of MBNA.

Strengthening our retail offer

In June 2017 we completed our acquisition of MBNA, a specialist credit card provider which serves around 2.5 million UK customers and provides around £8 billion of UK prime credit card lending. MBNA facilitates 480,000 transactions per day and is accepted and used all around the world.

MBNA is a strong, profitable and prime credit card business, with an experienced management team and an advanced data analytics capability, which will benefit the wider Group. This is the largest integration of a credit card business ever undertaken in Europe. The integration is progressing well and will be completed by the end of the first quarter of 2019.

Following the acquisition the combined business is now the largest prime credit card issuer in the UK.

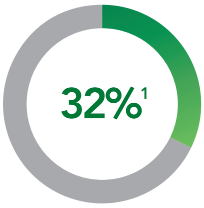
25%
market share of credit card balances

Divisional overview continued

Commercial Banking

Commercial Banking has a client-led, low risk, capital efficient strategy, helping UK-based clients and international clients with a link to the UK.

£2,489m
Underlying profit



1 Proportion of Group underlying profit excluding run-off and central items.

2%
growth in SME lending

2%
growth in Mid Corporate lending

37bps
increase in return on risk-weighted assets to 2.82%

Funding for UK manufacturers £bn

2017	1.1
2016	1.2
2015	1.4
2014	1.0

Through its four client facing segments – SME, Mid Markets, Global Corporates and Financial Institutions – it provides clients with a range of products and services such as lending, transactional banking, working capital management, risk management and debt capital markets services.

Progress against strategic priorities

Commercial Banking delivered a return on risk-weighted assets of 2.82 per cent in 2017, exceeding the commitment of a return of 2.40 per cent, while continuing to focus on improving the client experience grow lending in key client segments.

Creating the best customer experience

- Awarded Business Bank of the Year at the FDs' Excellence Awards for the 13th consecutive year; scoring highest against peers across all three assessment criteria; service, relationship managers and value for money.
- Supported c.6,800 clients in 2017 to export for the first time and helped clients break into new markets through the International Trade Portal.

Becoming simpler and more efficient

- Over 16,000 SME business accounts opened using the transformed end-to-end process.
- The transformed process includes additional digital functionality, such as the option to review and approve banking agreements online and upload signatures.

Delivering sustainable growth

- Following the launch of the Green Loan Initiative in 2016, the Group has provided in excess of £0.5 billion of green lending, improving the energy efficiency of over 5 million square feet of real estate.
- Exceeded the £4 billion Helping Britain Prosper funding commitment for manufacturing businesses, for the four years to 2017. In addition, continued to support the Lloyds Bank Advanced Manufacturing Training Centre, investing £1 million a year since 2014; and to date have trained over 500 manufacturing graduates, engineers and apprentices, building towards the target of 1,000 by 2020.
- SME lending up 2 per cent, outperforming the market and providing valuable support to the economy.

Financial performance

- Underlying profit increased 5 per cent to £2,489 million, driven by income growth and active cost management, delivering improvement in cost:income ratio to 45.8 per cent.
- Return on risk-weighted assets of 2.82 per cent, reflecting proactive portfolio optimisation and increased profit.
- Income increased by 3 per cent to £4,847 million with broad based franchise growth.
- Net interest margin increased 18 basis points to 3.54 per cent as a result of lower funding costs.
- Other income resilient at £1,761 million (2016: £1,756 million), with fewer significant transactions in the second half and reduced client activity compared to 2016.
- Operating lease depreciation reduced due to lower accelerated charges compared with 2016.
- Continued investment in the business offset by efficiencies, leading to flat operating costs.
- The increase in impairment charge to £115 million and asset quality ratio to 12 basis points is due to a lower level of write-backs and provision releases and also includes a single large corporate impairment.
- Loans and advances decreased 2 per cent to £100.0 billion, with year-on-year lending growth of 2 per cent in SME remaining at above market growth levels, offset by reductions in Global Corporates.
- Deposits increased by 4 per cent to £147.6 billion, with continued momentum in attracting high quality transactional banking deposits.
- Continued portfolio optimisation, including capital efficient securitisation activity, to achieve an 8 per cent reduction in risk-weighted assets to £85.6 billion.

Insurance and Wealth

Insurance and Wealth offers insurance, investment and wealth management products and services.

£939m
Underlying profit

1 Proportion of Group underlying profit excluding run-off and central items.

>9m
Life, pensions and investments customers

£670m
of long duration loans funded

Workplace, planning and retirement customer assets under administration £bn

2017	**42.7**
2016	37.1
2015	30.0
2014	27.4

Annualised annuity payments to customers in retirement £m

2017	**968**
2016	932
2015	798
2014	787

It supports over 9 million customers with total customer assets under administration of £145 billion and annualised annuity payments to customers in retirement of c.£1 billion. The division's strategic aim is to be the best insurer and wealth management business in the UK. It is committed to providing trusted, value for money products and services to meet the needs of its customers.

Progress against strategic priorities

The Group continues to direct significant investment towards developing Insurance and Wealth, seeking to grow in areas where it has competitive advantage and is under-represented, for the benefit of both customers and shareholders.

Creating the best customer experience

- Scottish Widows won 'Company of the Year' and 5 star service awards in individual categories of Life and Pensions and Investments at the Financial Adviser Service Awards 2017.
- Home insurance net promoter scores increased by 10 per cent and life, pensions and investments by 13 per cent.
- Improved the Wealth customer experience through reduction in time taken to provide customer advice by up to 40 per cent, which allows the Group to help more customers.

Becoming simpler and more efficient

- Simplifying insurance systems and processes through long-term partnerships with Diligenta and Jardine Lloyd Thomson, enabling customers to better manage their policies with Scottish Widows.
- Following its launch in 2016, the employer digital service now reaches all eligible workplace schemes, significantly reducing processing time for monthly pension scheme management.

Delivering sustainable growth

- Announced the acquisition of Zurich's UK workplace pensions and savings business, which has customer funds of £21 billion and c.595,000 customers. The acquisition will enhance Scottish Widows' current offering, giving a strong platform on which to develop the next stage of its strategy in financial planning and retirement.
- Helping Britain prosper by funding £670 million of long duration loans in the year to finance affordable housing, infrastructure and commercial real estate projects whilst supporting a growing annuitant portfolio.
- Since market entry in 2015, we have written £2.5 billion of bulk annuity business (of which £0.6 billion in 2017) and continue to see significant demand from UK defined benefit pension schemes using bulk annuities to manage risk.
- Workplace, planning and retirement customer assets under administration increased by 15 per cent to £43 billion reflecting net inflows and positive market movements.
- Wealth customer assets increased by 7 per cent to £25 billion, reflecting positive market movements.

Financial performance

- Income in insurance and overall costs remained flat, with higher investment costs offset by lower business as usual costs. Underlying profit has decreased by 3 per cent to £939 million as a result of lower Wealth income.
- Total life and pensions sales increased by 12 per cent, driven by 29 per cent increase across workplace, planning and retirement and protection, partly offset by lower bulk annuity sales where we have maintained a strong pricing discipline whilst actively quoting in a very competitive market.
- The total underwritten household premiums decreased by 12 per cent reflecting the highly competitive marketplace, despite achieving an increase in underwritten new business premiums of 12 per cent supported by the new flexible Direct proposition launched during 2016.

Insurance capital

- Estimated pre final dividend Solvency II ratio is unchanged at 160 per cent (31 December 2016: 160 per cent) and represents the shareholder view of Solvency II surplus. The ratio reflects in-year earnings, capital management actions and favourable market movements offset by capital invested in new business and dividends paid in the year.
- Capital management actions include successful conclusion of a £1.3 billion annuitant longevity reinsurance transaction with Prudential Insurance Company of America.
- Estimated excess capital of £890 million was generated in 2017 from which dividends totalling £575 million were paid in the year with a further dividend of £600 million paid to the Group in February 2018.

Risk overview
Effective risk management and control

As a Group, managing risk effectively is fundamental to our strategy and to operating successfully. We are a simple, low risk, UK focused bank with a culture founded on a prudent through the cycle risk appetite.

A strong risk management culture is crucial for sustainable growth and within Lloyds it is at the heart of everything we do.

Our approach to risk is founded on an effective control framework, which guides how our colleagues work, behave and the decisions they make. Risk appetite – the amount and type of risk we are prepared to seek, accept or tolerate – is approved by the Board and embedded in policies, authorities and limits across the Group.

Our prudent risk culture and appetite, along with close collaboration between Risk division and the business, supports effective decision making and has enabled us to continue to deliver against our strategic priorities in 2017, simplifying and strengthening the business whilst growing in targeted areas. We have created a strong foundation to enable this progress, ensuring we react appropriately to the ever changing macroeconomic and regulatory environment.

Risk as a strategic differentiator

Group strategy and risk appetite are developed together to ensure one informs the other to deliver on our purpose to help Britain prosper whilst becoming the best bank for customers, colleagues and shareholders.

Risks are identified, managed and mitigated using our comprehensive Risk Management Framework (see below), and our well articulated risk appetite provides a clear framework for effective decision making. The principal risks we face, which could significantly impact the delivery of our strategy, are discussed on pages 34–37.

We believe effective risk management can be a strategic differentiator, in particular:

Prudent approach to risk
Implementing a prudent approach to risk across the Group and embedding a strong risk culture ensures alignment to our strategy.

Strong control framework
The Group's Risk Management Framework is the foundation for the delivery of effective risk control and ensures that the Group risk appetite is continually developed and adhered to.

Business focus and accountability
Effective risk management is a key focus and is included in key performance measures against which business units are assessed. Business units in the first line of defence are accountable for risk with oversight from a strong and independent, second line of defence Risk division.

Effective risk analysis, management and reporting
Continuing to deliver regular close monitoring and stringent reporting to all levels of management and the Board ensures appetite limits are maintained and subject to stressed analysis at a risk type and portfolio level.

Sustainable growth
Embedding a risk culture that ensures proactive support and constructive challenge takes place across the business is important for delivering sustainable growth.

Our risk management framework

The diagram below outlines the framework in place for risk management across the Group.

Accountability for ensuring risk is managed consistently with the Risk Management Framework approved by the Board		Confirmation of the effectiveness of the Risk Management Framework and underlying risk and control
Setting risk appetite and strategy. Approval of the Risk Management Framework and Group-wide risk principles	Board role	Board authorities
Review risk appetite, frameworks and principles to be recommended to the Board. Be exemplars of risk management	Senior management role	Through Board-delegated executive authorities there is effective oversight of risk management consistent with risk appetite
Determined by the Board and senior management. Business units formulate their strategy in line with the Group's risk appetite	Risk appetite	The risk appetite framework ensures our risks are managed in line with our risk appetite
Supporting a consistent approach to Group-wide behaviour and risk decision making. Consistency is delivered through the policy framework and risk committee structures	Governance framework	Supports a consistent approach to enterprise-wide behaviour and decision making
Monitoring, oversight and assurance ensure effective risk management across the Group	Three lines of defence	Maintains a robust control framework, identifying and escalating emerging risks and supporting sustainable growth
Defined processes exist to identify, measure and control our current and emerging risks	Risk and control cycle from identification to reporting	Carried out by all three lines of defence and is an integral part of our control effectiveness assessment
In line with our code of responsibility. Culture ensures performance, risk and reward are aligned	Risk culture / Risk resources and capabilities	Processes and infrastructure are being invested in to further improve our risk management capabilities
Risk-specific needs defined in detail for implementation by each business	Primary risk categories	Risk-type specific sub-frameworks e.g. credit risk

Risk considerations

The potential risks and impacts arising from the external environment are outlined below. They are grouped using the same classification as on pages 8–9, with links to our principal risks and strategic priorities. For information on how we manage our emerging risks, see page 110.

Economy

Risk and potential impact
Economic headwinds such as rising inflation could impact households' disposable income and businesses' profitability, impairing customers' ability to repay their borrowing, and potentially hindering sustainable growth.

The impact of EU exit on our portfolios remains uncertain. Operational changes are likely to be limited given our UK focus but the impact on the UK economy may affect business performance.

We consider an array of scenarios as part of our operating plan and stress testing exercises, to identify and implement appropriate mitigating actions.

Link to principal risks
Credit
Operational
Insurance underwriting
Capital
Funding and liquidity
Market

Link to strategic priorities
Maximising the Group's capabilities

Regulation and legal

Risk and potential impact
The financial services industry continues to experience significant legislative and regulatory change and interpretation giving rise to uncertainty surrounding the nature, scale and complexity of implementation requirements.

This has the potential to impact, for example, the resource and investment available to allocate to the Group's strategic priorities.

The Group has a proven track record in implementing complex legal and regulatory programmes and will continue to manage any potential impact by remaining actively engaged with governmental bodies, regulatory authorities and industry associations.

Link to principal risks
Credit
Regulatory and legal
Capital
Funding and liquidity
Market

Link to strategic priorities
Delivering a leading customer experience

Customer

Risk and potential impact
The availability and delivery of services through digital channels is becoming increasingly important for customer satisfaction. Accelerated change in customer behaviour and expectations may require increased agility to accommodate the pace and scale of change and could lead to customer detriment if this change is poorly executed.

The Group will continue to focus on change execution whilst keeping pace with developments to meet new and evolving customer needs.

Link to principal risks
Regulatory and legal
Conduct
Operational

Link to strategic priorities
Delivering a leading customer experience

Technology

Risk and potential impact
New technologies such as public cloud and artificial intelligence along with growing interconnectivity between the Group, customers, and third parties create new risks.

Increasing capabilities of cyber-attackers and higher volumes of connected devices increases the potential for cyber-enabled fraud and other crime, including attacks that could disrupt service for customers.

We continue to optimise our approach to operational resilience by enhancing systems that support the Group's critical business processes, evolving controls within new technologies and channels, and making significant investment to improve data privacy, including the security of data.

Link to principal risks
Conduct
Operational

Link to strategic priorities
Delivering a leading customer experience
Digitising the Group

Competition

Risk and potential impact
Technological change is driving an increase in the number, and changing the nature of competitors in the UK financial services industry, opening up opportunities for consumers even as levels of regulatory focus rise.

We must ensure that an unexpectedly fast pace of change, which may accelerate customer disintermediation, does not lead to our involvement in anti-competitive practices, or prevent certain customer groups from having equal access to our products and services.

We will continue to address this through innovation and developing new products that respond to market trends and meet customer changing needs.

Link to principal risks
Regulatory and legal
Conduct
Operational
People

Link to strategic priorities
Delivering a leading customer experience
Maximising the Group's capabilities

The links shown here between these five factors and our principal risks and strategic priorities are not an exhaustive list.

Find further discussion on the impact of these factors on our business on **pages 8–9**

Risk overview continued

Principal risks

The most significant risks which could impact the delivery of our long-term strategic objectives and our approach to each risk, are detailed below.

As part of the Group's ongoing assessment of the potential implications of the UK leaving the European Union, the Group continues to consider the impact to its customers, colleagues and products – as well as legal, regulatory, tax, financial and capital implications.

There remains continued uncertainty around both the UK and global political and macroeconomic environment. The potential impacts of external factors have been considered in all principal risks to ensure any material uncertainties continue to be monitored and are appropriately mitigated.

Principal risks and uncertainties are reviewed and reported regularly. This year we have added a new principal risk, model risk, to reflect the Group's increasing use of analytics and models to make decisions.

Credit

The risk that parties with whom we have contracted, fail to meet their financial obligations (both on and off balance sheet).

Example

- Adverse impact on profitability due to an increase in impairment losses, write downs and/or decrease in asset valuations which can occur for a number of reasons, including adverse changes in the economic, geopolitical and market environment. For example, low interest rates have helped customer affordability, but there is a risk of increased defaults as interest rates rise.

Key mitigating actions

- Credit policy, incorporating prudent lending criteria, aligned with Board approved risk appetite, to effectively manage risk.
- 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, well-established governance process supported by independent credit risk assurance.
- Early identification of signs of stress leading to prompt action in engaging the customer.

Key risk indicators

Impairment charge
£795m
2016: £645m

Impaired assets
£7,841m
2016: £8,495m

Alignment to strategic priorities and future focus

Maximising the Group's capabilities

We seek to support sustainable growth in our targeted segments. We have a conservative and well balanced credit portfolio, managed through the economic cycle and supported by strong credit portfolio management.

We are committed to better addressing our customers' banking needs through consistent, fair and responsible credit risk decisions, aligned to customers' circumstances, whilst staying within prudent risk appetite.

Impairments remain below long-term levels and are expected to increase as the level of write-backs and releases reduces and impairments normalise.

Read more on pages 116–133

Regulatory and legal

The risks of changing legislation, regulation, policies, voluntary codes of practice and their interpretation in the markets in which we operate may have a significant impact on the Group's operations, business prospects, structure, costs and/or capital requirements and ability to enforce contractual obligations.

Examples

- Increased regulatory oversight and prudential regulatory requirements.
- Increased legislative requirements, such as ring-fencing legislation, Payment Services Directive 2 (PSD2), Open Banking and General Data Protection Regulation (GDPR).

Key mitigating actions

- Ensure we develop comprehensive plans for delivery of all legal and regulatory changes and track their progress. Group-wide projects implemented to address significant impacts.
- Continued investment in people, processes, training and IT to assess impact and help meet our legal and regulatory commitments.
- Engage with regulatory authorities and industry bodies on forthcoming regulatory changes, market reviews and investigations.

Key risk indicators

Mandatory, legal and regulatory investment spend
£886m
2016: £555m

Alignment to strategic priorities and future focus

Delivering a leading customer experience

We are committed to operating sustainably and responsibly, and commit significant resource and expense to ensure we meet our legal and regulatory obligations.

We respond as appropriate to impending legislation, regulation and associated consultations and participate in industry bodies. We continue to be subject to significant ongoing and new legislation, regulation and court proceedings.

Read more on page 133

Conduct

Conduct risk can arise from a number of areas including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customers' expectations; failing to promote effective competition in the interest of customers; and exhibiting behaviours which could impact on the integrity of the market or undermine wider regulatory standards.

Example

- The most significant conduct cost in recent years has been PPI mis-selling.

Key mitigating actions

- Conduct risk appetite metrics provide a granular view of how our products and services are performing for customers.
- Product approval, continuous product review processes and customer outcome testing (across products and services) supported by conduct management information.
- Learning from past mistakes through 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 customers in vulnerable circumstances.

Key risk indicators
Conduct risk appetite metric performance-Group

92.3%

2016: 92.1%

Alignment to strategic priorities and future focus

Delivering a leading customer experience

As we transform our business, minimising conduct risk is critical to achieving our strategic goals and meeting regulatory standards.

Our focus on embedding a customer-centric culture and delivering good outcomes through good conduct is subject to robust review by the Group Customer First Committee. This supports our vision of being the best bank for customers, enabling the delivery of a leading customer experience through effective root cause analysis and learning from customer feedback.

Read more on page 134

Operational

We face significant operational risks which may disrupt services to customers, cause reputational damage, and result in financial loss. These include the availability, resilience and security of our core IT systems, unlawful or inappropriate use of customer data, theft of sensitive data, fraud and financial crime threats, and the potential for failings in our customer processes.

Example

- The dynamic threat posed by cyber risk to the confidentiality and integrity of electronic data or the availability of systems.

Key mitigating actions

- Investing in enhanced cyber controls to protect against external threats to the confidentiality or integrity of electronic data, or the availability of systems, and to ensure effective third party assurance.
- Enhancing the resilience of systems that support critical business processes with independent verification of progress on an annual basis.
- Significant investment in compliance with GDPR and Basel Committee on Banking Supervision standards.
- Working with industry bodies and law enforcement agencies to identify and combat fraud and money laundering.

Key risk indicators
Availability of core systems

99.98%

2016: 99.97%

Alignment to strategic priorities and future focus

Delivering a leading customer experience

We recognise that resilient and secure technology, and appropriate use of data, is critical to delivering a leading customer experience and maintaining trust across the wider industry.

The availability and resilience of IT systems remains a key strategic priority and the Cyber Programme continues to focus on enhancing cyber security controls. Internal programmes ensure that data is used correctly, and the control environment is regularly assessed through both internal and third party testing.

Read more on pages 135–136

People

Key people risks include the risk that we fail to maintain organisational skills, capability, resilience and capacity levels in response to organisational, political and external market change and evolving business needs.

Example

- Inability to attract or retain colleagues with key skills could impact the achievement of business objectives.

Key mitigating actions

- Focused action to attract, retain and develop high calibre people. Delivering initiatives which reinforce behaviours to generate the best outcomes for customers and colleagues.
- Managing organisational capability and capacity to ensure there are the right skills and resources to meet our customers' needs.
- Effective remuneration arrangements to promote appropriate colleague behaviours and meet regulatory expectations.

Key risk indicators
Best bank for customers index

80%

2016: 77%

Alignment to strategic priorities and future focus

Transforming ways of working

Continued regulatory change relating to personal accountability and remuneration rules could affect the Group's ability to attract and retain the calibre of colleagues required to meet our changing customer needs. We will continue to invest in the development of colleague capabilities and agile working practices in order to deliver a leading customer experience, and to respond quickly to the rapidly evolving change in customers' decision making in an increasingly digital marketplace.

Read more on page 136

Risk overview continued

Insurance underwriting

Key insurance underwriting risks within the Insurance business are longevity, persistency and property insurance. Longevity risk is expected to increase as our presence in the bulk annuity market increases.

Example

- Uncertain property insurance claims impact Insurance earnings and capital, e.g. extreme weather conditions, such as flooding, can result in high property damage claims.

Key mitigating actions

- Processes for underwriting, claims management, pricing and product design seek to control exposure. Longevity and bulk pricing experts support the bulk annuity proposition.
- The merits of longevity risk transfer and hedging solutions are regularly reviewed for the Insurance business.
- Property insurance exposures are mitigated by a broad reinsurance programme.

Key risk indicators

Insurance (Life and Pensions) present value of new business premiums	General Insurance underwritten total gross written premiums
£9,951m	£733m
2016: £8,919m	2016: £831m

Alignment to strategic priorities and future focus

Delivering a leading customer experience

We are committed to meeting the changing needs of customers by working to provide a range of insurance products via multiple channels. The focus is on delivering a leading customer experience by helping customers protect themselves today whilst preparing for a secure financial future.

Strategic growth initiatives within Insurance are developed and managed in line with a defined risk appetite, aligned to the Group risk appetite and strategy.

Read more on page 137

Capital

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

Example

- A worsening macroeconomic environment could lead to adverse financial performance, which could deplete capital resources and/or increase capital requirements due to a deterioration in customers' creditworthiness.

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 risk appetite.
- Comprehensive stress testing analyses to evidence capital adequacy under various adverse scenarios.

Key risk indicators

Common equity tier 1 ratio[1,2]	UK leverage ratio[1,3]
13.9%	5.4%
2016: 13.0%	2016: 5.3%

Alignment to strategic priorities and future focus

Maximising the Group's capabilities

Ensuring we hold an appropriate level of capital to maintain financial resilience and market confidence, underpins our strategic objectives of supporting the UK economy and growth in targeted segments.

1 Pro forma.

2 CET1 ratio after ordinary dividends and share buyback. 2016 adjusted for MBNA.

3 Calculated in accordance with the UK Leverage Ratio Framework which requires qualifying central bank claims to be excluded from the leverage exposure measure.

Read more on pages 137–144

Funding and liquidity

The risk that we have insufficient financial resources to meet our commitments as they fall due.

Example

- A deterioration in either the Group's or the UK's credit rating, or a sudden and significant withdrawal of customer deposits, would adversely impact our funding and liquidity position.

Key mitigating actions

- Holding liquid assets to cover potential cash and collateral outflows and to meet regulatory requirements. In addition, maintaining a further pool of assets that can be used to access central bank liquidity facilities.
- Undertaking daily monitoring against a number of market and Group-specific early warning indicators.
- Maintaining a contingency funding plan detailing actions and strategies available in stressed conditions.

Key risk indicators

LCR eligible assets	Loan to deposit ratio
£121bn	110%
2016: £121bn	2016: 109%

Alignment to strategic priorities and future focus

Maximising the Group's capabilities

We maintain a strong funding position in line with our low risk strategy and the loan to deposit ratio remains within our target range. Our funding position allows the Group to grow targeted business segments and better address our customers' needs.

Read more on pages 144–149

Governance

Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from meeting the requirements to ring-fence core UK financial services and activities from January 2019 and further requirements under the Senior Manager & Certification Regime (SM&CR).

Examples

- Inadequate or complex governance arrangements to address ring-fencing requirements could result in a weaker control environment, delays in decision making and lack of clear accountability.
- Non-compliance with or breaches of SM&CR requirements could result in lack of clear accountability and legal and regulatory consequences.

Key mitigating actions

- Leveraging our considerable change experience to meet ring-fencing requirements before the regulatory deadlines, and the continuing evolution of SM&CR.
- Programme in place to address ring-fencing. In close and regular contact with regulators to develop and deploy our planned operating and legal structure.
- Evolving risk and governance arrangements to continue to be appropriate to comply with regulatory objectives.

Key risk indicators
N/A

Alignment to strategic priorities and future focus

Delivering a leading customer experience

Ring-fencing will ensure we become safer and continue to deliver a leading customer experience by providing further protection to core retail and SME deposits, increasing transparency of our operations and facilitating the options available in resolution.

Our governance framework and strong culture of ownership and accountability enabled effective, on time, compliance with the SM&CR requirements and enable us to demonstrate clear accountability for decisions.

Read more on page 150

Market

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

Examples

- Earnings are impacted by our ability to forecast and model customer behaviour accurately and establish appropriate hedging strategies.
- The Insurance business is exposed indirectly to equity risk through the value of future management charges on policyholder funds. Credit spread risk within the Insurance business primarily arises from bonds and loans used to back annuities.
- Narrowing credit spreads will increase the cost of pension scheme benefits.

Key mitigating actions

- Structural hedge programmes implemented to manage liability margins and margin compression.
- Equity and credit spread risks are closely monitored and, where appropriate, asset and liability matching is undertaken.
- The Group's DB pension schemes have increased their credit allocation and hedged against nominal rate and inflation movements.

Key risk indicators
IAS19 Pension surplus

£509m

2016: £(244)m

Alignment to strategic priorities and future focus

Maximising the Group's capabilities

We actively manage our exposure to movements in market rates, to drive lower volatility earnings and offer a comprehensive customer proposition with hedging strategies to support strategic aims. Mitigating actions are implemented to reduce the impact of market movements, resulting in a more stable capital position. Effective interest rate and inflation hedging has kept volatility in the Group's DB pension schemes low and helped to return the schemes to IAS19 surplus in 2017. This allows us to more efficiently utilise available capital resources to better enable the Group to maximise its capabilities.

Read more on pages 151–156

Model NEW

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

Examples

Examples of the consequences of inadequate models include:

- Inappropriate levels of capital or impairments.
- Inappropriate credit or pricing decisions.
- Adverse impacts on funding or liquidity, or the Group's earnings and profits.

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 ongoing maintenance.
- Regular model monitoring.
- Independent review of models.
- Periodic validation and re-approval of models.

Key risk indicators
N/A

Alignment to strategic priorities and future focus

Digitising the Group

The Group's models play a vital role in supporting Group strategy to ensure profitable growth in targeted segments and the Group's drive toward automation and digital solutions to enhance customer outcomes. Model risk management helps ensure these models are implemented in a controlled and safe manner for both the Group and customers.

Read more on page 156

FINANCIAL RESULTS

HELPING BRITAIN'S BUSINESSES BECOME GREENER

Through our £1 billion Green Loan Initiative, we are supporting Britain's businesses to make their real estate more energy efficient. In 2017, we agreed a £50 million loan to help Ei Group, Britain's largest leased and tenanted pub company, introduce energy saving upgrades across its network. This is the first loan made outside the commercial real estate sector through the Initiative, which we launched in 2016.

>5m

square feet of real estate we've helped to become energy efficient in 2017

Visit www.lloydsbankinggroup.com/prosperplan

Summary of Group results

Strong financial performance with improved profit and returns on both statutory and underlying bases

The Group's statutory profit before tax was £5,275 million, 24 per cent higher than in 2016 driven by increased underlying profit and lower volatility and other items which more than offset the increased PPI charge. Statutory profit after tax increased by 41 per cent to £3,547 million (2016: £2,514 million) and the return on tangible equity was 8.9 per cent.

Underlying profit was £8,493 million, 8 per cent higher than 2016 with higher income and positive operating jaws. The underlying return on tangible equity increased to 15.6 per cent. Underlying profit in the fourth quarter was £1,926 million, 7 per cent higher than the same period in 2016 with a 5 per cent increase in net income.

The balance sheet remains strong and the Group generated 245 basis points of CET1 capital in the year. The pro forma CET1 ratio at 31 December 2017 after accruing for ordinary dividends and allowing for the share buyback was 13.9 per cent compared to 13.0 per cent (pro forma after dividends and adjusting for MBNA) at 31 December 2016. The pro forma leverage ratio increased to 5.4 per cent (31 December 2016: 5.3 per cent) and tangible net assets per share were 53.3 pence.

Given the strong capital generation in the year, the Board has recommended a final ordinary dividend of 2.05 pence per share, making a total ordinary dividend of 3.05 pence per share, an increase of 20 per cent on 2016 and in line with our progressive and sustainable ordinary dividend policy. In addition, the Board intends to implement a share buyback of up to £1 billion, equivalent to up to 1.4 pence per share.

Total income

	2017 £ million	2016 £ million	Change %
Net interest income	**12,320**	11,435	8
Other income	**6,205**	6,065	2
Total income	**18,525**	17,500	6
Operating lease depreciation[1]	**(1,053)**	(895)	(18)
Net income	**17,472**	16,605	5
Banking net interest margin	**2.86%**	2.71%	15bp
Average interest-earning banking assets	**£434.9bn**	£435.9bn	–

1 Net of profits on disposal of operating lease assets of £32 million (2016: £58 million).

Net income of £17,472 million was 5 per cent higher than in 2016 with an 8 per cent increase in net interest income, which included £430 million from MBNA, and a 2 per cent increase in other income, while operating lease depreciation increased 18 per cent reflecting fleet growth in Lex Autolease.

Net interest income increased by £885 million to £12,320 million. The net interest margin increased by 15 basis points to 2.86 per cent reflecting lower deposit and wholesale funding costs, which more than offset continued pressure on asset margins and also included a 7 basis points benefit from MBNA. Average interest-earning assets were broadly unchanged with reductions in run-off, global corporates and the closed mortgage book offset by MBNA.

The Group expects the net interest margin for 2018 to be around 2.90 per cent, in line with the margin of 2.90 per cent in the fourth quarter of 2017.

The Group manages the risk to its earnings and capital from movements in interest rates centrally by hedging the net liabilities which are stable or less sensitive to movements in rates. These liabilities include certain current account and savings balances, together with the Group's equity. As at 31 December 2017 the Group's hedge had a nominal balance of £165 billion (31 December 2016: £111 billion), broadly in line with the underlying hedgeable balances. The hedge had an average duration of around 3 years and a fixed earnings rate of approximately 1.1 per cent over LIBOR (2016: 1.6 per cent). The benefit from the hedge in the year was £1.9 billion over LIBOR (2016: £1.7 billion).

Other income was £6,205 million, an increase of 2 per cent in the year. The increase reflected continued growth in the Lex Autolease business, the £146 million gain on sale of the Group's interest in Vocalink and £274 million (2016: £112 million) of gains from the sale of £14 billion of gilts and other available-for-sale assets (2016: c.£5 billion). The increase was partly offset by lower income from the run-off portfolio and reduced income from bulk annuities reflecting the timing of transactions.

Operating costs

	2017 £ million	2016 £ million	Change %
Operating costs	**8,184**	8,093	(1)
Cost:income ratio	**46.8%**	48.7%	(1.9) pp
Operating jaws	**4%**		
Simplification savings annual run-rate	**1,422**	947	

Operating costs at £8,184 million increased slightly during the year, but excluding MBNA costs of £135 million fell 1 per cent. Savings from Simplification more than offset increased investment in the business and inflation.

In 2017 the Group continued to focus on tight cost control while investing significant amounts in developing its digital capability, improving the branch network and simplifying processes. The Simplification programme has achieved the annual run-rate savings target of £1.4 billion since 2014, ahead of the original £1 billion target.

Our market leading cost:income ratio continues to provide competitive advantage and improved further to 46.8 per cent with positive operating jaws of 4 per cent.

The Group expects operating costs of less than £8 billion in 2020; the Group also expects the cost:income ratio to improve every year and reach the low 40s exiting 2020, including future remediation costs.

Summary of Group results continued

Impairment

	2017 £ million	2016 £ million	Change %
Impairment charge	**795**	645	(23)
Asset quality ratio	**0.18%**	0.15%	3bp
Gross asset quality ratio	**0.28%**	0.28%	–
	At 31 Dec 2017	At 31 Dec 2016	Change
Impaired loans as a % of closing advances	**1.6%**	1.8%	(0.2) pp
Provisions as a % of impaired loans	**45.6%**	43.4%	2.2pp

Asset quality remains strong with portfolios continuing to benefit from the Group's proactive approach to risk management, continued low interest rates and a resilient UK economy.

The impairment charge increased to £795 million from £645 million in 2016, reflecting lower releases and write-backs and the consolidation of MBNA. The asset quality ratio increased from 15 basis points to 18 basis points reflecting the expected lower provision write-backs and releases while the gross asset quality ratio was stable year-on-year at 28 basis points including the 2 basis points impact of MBNA in 2017.

The Group expects an asset quality ratio of around 35 basis points through the cycle and less than 30 basis points through the plan period and in 2018. The Group continues to expect the asset quality to remain strong but with further reductions in releases and write-backs, however, following the implementation of IFRS 9, the Group anticipates some additional volatility in impairment.

Total impaired loans fell by £0.7 billion to £7.8 billion (31 December 2016: £8.5 billion) and represent 1.6 per cent of closing advances to customers (31 December 2016: 1.8 per cent). Provisions as a percentage of impaired loans increased to 45.6 per cent (31 December 2016: 43.4 per cent).

Overall credit performance in the UK Retail mortgage book remains stable. The average indexed loan to value (LTV) improved to 43.6 per cent (31 December 2016: 44.0 per cent) and the value of lending with an indexed LTV of greater than 80 per cent fell to £30.7 billion (31 December 2016: £32.4 billion). Impaired loans as a percentage of closing advances were 1.3 per cent (31 December 2016: 1.4 per cent).

The UK Motor Finance book continues to benefit from conservative residual values and prudent provisioning and impaired loans as a percentage of closing advances were stable at 1.0 per cent. The credit card book also continued to perform strongly with the MBNA portfolio performing in line with the Group's expectations. Impaired credit card balances as a percentage of closing advances improved to 2.3 per cent (31 December 2016: 3.1 per cent).

The Commercial Banking portfolio continues to benefit from effective risk management, a resilient economic environment and continued low interest rates. Impaired loans as a percentage of closing advances reduced to 1.9 per cent (31 December 2016: 2.1 per cent).

Statutory profit

	2017 £ million	2016 £ million	Change %
Underlying profit	**8,493**	7,867	8
Volatility and other items			
Enhanced Capital Notes	**–**	(790)	
Market volatility and asset sales	**279**	439	
Amortisation of purchased intangibles	**(91)**	(340)	
Restructuring costs	**(621)**	(622)	
Fair value unwind and other	**(270)**	(231)	
	(703)	(1,544)	
PPI provision	**(1,650)**	(1,000)	
Other conduct provisions	**(865)**	(1,085)	
Statutory profit before tax	**5,275**	4,238	24
Tax expense	**(1,728)**	(1,724)	–
Profit for the year	**3,547**	2,514	41

Statutory profit before tax increased 24 per cent to £5,275 million (2016: £4,238 million) driven by higher underlying profit and lower volatility and other items. Statutory profit after tax increased by 41 per cent to £3,547 million (2016: £2,514 million).

The charge of £790 million for Enhanced Capital Notes in 2016 represented the write-off of the embedded derivative and premium paid on redemption of the remaining notes.

Market volatility and asset sales of £279 million included positive insurance volatility of £286 million. The credit of £439 million in 2016 included the £484 million gain on sale of the Group's interest in Visa Europe.

Amortisation of purchased intangibles was lower at £91 million (2016: £340 million) as certain intangible assets are now fully amortised.

Restructuring costs were £621 million (2016: £622 million) and included costs relating to the Simplification programme, the rationalisation of the non-branch property portfolio, implementation of the ring-fencing requirements and MBNA integration costs.

The PPI charge of £1,650 million included an additional £600 million in the fourth quarter reflecting an increase in expected weekly complaints from 9,000 to 11,000, which is the average level of complaints for the last nine months. The outstanding balance sheet provision at 31 December 2017 was £2.4 billion.

The other conduct provisions of £865 million included an additional £325 million charged in the fourth quarter which covers a number of items including packaged bank accounts, arrears handling and smaller legacy issues.

Taxation

The tax expense was £1,728 million (2016: £1,724 million) representing an effective tax rate of 33 per cent (2016: 41 per cent). The high effective tax rate largely reflects the restrictions on deductibility of conduct provisions and the banking surcharge. The effective tax rate of 41 per cent in 2016 was higher as it also included the negative impact on the net deferred tax asset of both the change in corporation tax rate and the expected utilisation by the insurance business. The Group expects the effective tax rate to reduce to around 25 per cent by 2020.

Return on tangible equity

The underlying return on tangible equity increased to 15.6 per cent (2016: 14.1 per cent) primarily reflecting increased underlying profit. The return on tangible equity was 8.9 per cent up from 6.6 per cent in 2016, reflecting the increase in statutory profit after tax.

Going forward the Group remains confident in its future prospects and expects the return on tangible equity to trend towards the underlying level and expects to generate a statutory return on tangible equity of between 14.0 and 15.0 per cent in 2019, on a higher capital base.

Balance sheet

	At 31 Dec 2017	At 31 Dec 2016	Change %
Loans and advances to customers[1]	**£456bn**	£450bn	1
Customer deposits[2]	**£416bn**	£413bn	1
Loan to deposit ratio	**110%**	109%	1pp
Wholesale funding	**£101bn**	£111bn	(9)
Wholesale funding <1 year maturity	**£29bn**	£35bn	(19)
Of which money-market funding <1 year maturity[3]	**£15bn**	£14bn	6
Liquidity coverage ratio – eligible assets	**£121bn**	£121bn	–

1 Excludes reverse repos of £16.8 billion (31 December 2016: £8.3 billion).

2 Excludes repos of £2.6 billion (31 December 2016: £2.5 billion).

3 Excludes balances relating to margins of £2.1 billion (31 December 2016: £3.2 billion) and settlement accounts of £1.5 billion (31 December 2016: £1.8 billion).

Loans and advances to customers increased by 1 per cent to £456 billion compared with £450 billion at 31 December 2016 mainly due to the acquisition of the MBNA prime credit card portfolio (£8 billion), growth in the open mortgage book, UK Motor Finance and SME, partly offset by reductions in run-off and the closed mortgage book.

The loan to deposit ratio was broadly stable at 110 per cent. Wholesale funding reduced by 9 per cent to £101 billion compared with £111 billion at 31 December 2016. In addition, the Group made use of central bank funding schemes and by the end of 2017 the Group had fully utilised its £20 billion capacity from the Bank of England's Term Funding Scheme.

The Group's liquidity surplus exceeds the regulatory minimum and internal risk appetite with a Liquidity Coverage Ratio of 127 per cent based on the EU Delegated Act at 31 December 2017.

Capital ratios and risk-weighted assets

	At 31 Dec 2017	At 31 Dec 2016	Change %
Pro forma CET1 ratio pre dividend and share buyback[1]	**15.5%**	14.1%	1.4pp
Pro forma CET1 ratio post dividend[1,2]	**14.4%**	13.0%	1.4pp
Pro forma CET1 ratio post dividend and share buyback[1]	**13.9%**	13.0%	0.9pp
Transitional tier 1 capital ratio[2]	**17.2%**	17.0%	0.2pp
Transitional total capital ratio[2]	**21.2%**	21.4%	(0.2)pp
Pro forma UK leverage ratio[1,2,3]	**5.4%**	5.3%	0.1pp
Risk-weighted assets	**£211bn**	£216bn	(2)
Shareholders' equity	**£44bn**	£43bn	1
Tangible net assets per share pre dividend[4,5]	**56.5p**	54.8p	1.7p
Tangible net assets per share[5]	**53.3p**	54.8p	(1.5)p

1 The CET1 and leverage ratios at 31 December 2017 and 2016 are reported on a pro forma basis, reflecting the dividends paid by the Insurance business in February 2018 and February 2017, respectively, in relation to prior year earnings. In addition the CET1 ratios at 31 December 2016 have been adjusted for the acquisition of MBNA.

2 The 2017 capital and leverage ratios do not, unless otherwise indicated, recognise the share buyback as this will be reflected in 2018.

3 Calculated in accordance with the UK Leverage Ratio Framework. Excludes qualifying central bank claims.

4 Pre final 2016 and interim 2017 dividends.

5 Tangible net assets per share at 31 December 2016 equivalent to 53.4 pence after adjusting for the impact of MBNA.

Summary of Group results continued

The Group's CET1 ratio has strengthened to 15.5 per cent on a pro forma basis before ordinary dividends and the share buyback. After ordinary dividends and allowing for the share buyback, the CET1 ratio remains strong at 13.9 per cent.

The Group generated 245 basis points of CET1 capital (pre ordinary dividends and share buyback) in the year. This included c.250 basis points from underlying capital generation; the Group also had a benefit of c.80 basis points from the reduction in risk-weighted assets and c.40 basis points from market and other movements, which were offset by the c.120 basis point impact of conduct provisions.

The Group remains highly capital generative and continues to expect ongoing capital generation of 170 to 200 basis points per annum.

As reported in the Q3 IMS, the Group's Pillar 2A CET1 requirement has increased by 0.5 per cent to 3 per cent. In addition, the Countercyclical Capital Buffer on UK exposures will be introduced during 2018 and the Systemic Risk Buffer will come into effect in early 2019. The Group is also pleased to announce that the PRA has now completed its annual review of the Group's PRA Buffer requirement. As a consequence, the Board's view of the level of CET1 capital required is c.13 per cent plus a management buffer of around 1 per cent. The Group's CET1 ratio as at 31 December 2017, including the Insurance dividend and after the ordinary dividend and allowing for the share buyback, was 13.9 per cent.

The Group's total capital ratio remains strong at 21.2 per cent which, when combined with eligible senior unsecured securities issued by Lloyds Banking Group plc, has left the Group well positioned to meet its Minimum Requirement for Own Funds and Eligible Liabilities (MREL) from 2020.

The leverage ratio on a pro forma basis increased to 5.4 per cent (31 December 2016: 5.3 per cent), largely reflecting both the increase in fully loaded tier 1 capital and reductions in balance sheet assets.

Tangible net assets per share at 31 December 2016 was 54.8 pence, or 53.4 pence after adjusting for the acquisition of MBNA. The movement from the adjusted 2016 tangible net assets per share to 53.3 pence at 31 December 2017 comprises an increase of 3.1 pence due to the strong financial performance offset by a reduction of 3.2 pence for dividends paid during the year.

Dividend

The Board has recommended a final ordinary dividend of 2.05 pence per share. This is in addition to the interim ordinary dividend of 1.0 pence per share that was announced at the 2017 half year results. The total ordinary dividend per share for 2017 of 3.05 pence per share has increased by 20 per cent from 2.55 pence per share in 2016.

The Board continues to give due consideration at each year end to the return of any surplus capital and for 2017, the Board intends to implement a share buyback of up to £1 billion, equivalent to up to 1.4 pence per share. This represents the return of capital over and above the Board's view of the current level of capital required to grow the business, meet regulatory requirements and cover uncertainties. The share buyback programme will commence in March 2018 and is expected to be completed during the next 12 months.

Given the total ordinary dividend of 3.05 pence per share and the intended share buyback, equivalent to up to 1.4 pence per ordinary share, the total capital return for 2017 will be up to 4.45 pence per share, an increase of up to 46 per cent on the prior year, equivalent to up to £3.2 billion.

In prior years, the Board has distributed surplus capital by means of a special dividend. The Board's current preference is to return surplus capital by way of a buyback programme given the amount of surplus capital (£1 billion in 2017 versus £350 million in 2016), the normalisation of ordinary dividends, our return to full private ownership and the flexibility that a buyback programme offers.

The Group intends to maintain a progressive and sustainable ordinary dividend policy. The rate of growth of the ordinary dividend will be decided by the Board in light of circumstances at the time and, having grown very significantly in the last three years, going forward the ordinary dividend is likely to grow at a more normalised rate, whilst being supplemented by buybacks or special dividends.

Pensions

The Group's defined benefit schemes have been significantly derisked over recent years including being materially hedged for both interest rates and inflation.

Terms have now been agreed in principle with the Trustee in respect of the valuations of the Group's three main defined benefit pension schemes. The valuations showed an aggregate ongoing funding deficit of £7.3 billion as at 31 December 2016 (£5.2 billion deficit at 30 June 2014). The increase in the ongoing deficit over the period was mainly driven by lower gilt yields, offset primarily by hedging and asset returns.

Under the previous recovery plans, deficit contributions were committed of £0.3 billion in 2018 and 2019 and c.£0.9 billion per annum thereafter. Under the new recovery plans, deficit contributions of £0.4 billion are payable in 2018, £0.6 billion in 2019, £0.8 billion in 2020 and £1.3 billion per annum from 2021 to 2024. The Group also continues to provide security to these pension schemes, with corporate guarantees and collateral pledged, while also making additional annual contributions for future service. All of the Group's defined benefit pension schemes will be located within the ring-fenced bank and these revised contributions are included in the Group's latest capital guidance.

Ring-fencing

The Group is making good progress with the implementation of its ring-fencing programme, including the establishment of the non ring-fenced bank, Lloyds Bank Corporate Markets plc (LBCM), and remains on track to meet the legal and regulatory requirements by 1 January 2019. As a predominantly UK retail and commercial bank, the impact on the Group is relatively limited, with minimal impact for the majority of the Group's retail and commercial customers.

Over the course of 2018, in order to comply with the ring-fencing legislation, certain businesses will be transferred out of Lloyds Bank plc and its subsidiaries to other parts of the Group, by means of statutory or contractual transfers. This will include the transfer of certain wholesale and international businesses to Lloyds Bank Corporate Markets and the transfer of Scottish Widows Group and other insurance subsidiaries to Lloyds Banking Group plc.

Due to the Group's UK retail and commercial focus, the vast majority of the Group's business will continue to be held by Lloyds Bank plc and its subsidiaries (together the ring-fenced bank) and as a result these transfers will not have a material impact on the financial strength of Lloyds Bank plc.

IFRS 9

The Group implemented IFRS 9 (Financial Instruments) on 1 January 2018. The adoption of the new Standard resulted in a reduction in shareholders' equity of £1.2 billion largely reflecting an increase in impairment provisions of £1.3 billion. The impact on the Group's CET1 capital ratio before transitional relief at 1 January 2018 was a reduction of c.30 basis points after taking account of the offset against regulatory expected losses. After transitional relief the impact was c.1 basis point.

Other matters

In 2014 the FCA removed the requirement to publish quarterly interim management statements, however the Group has continued to publish detailed statements. Going forward, given the simple and more stable nature of the Group's business, we will review the length and content of the Q1 and Q3 interim management statements.

Underlying basis – segmental analysis

2017	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Run-off and Central items £m	Group £m
Net interest income	8,706	3,086	133	395	12,320
Other income	2,217	1,761	1,846	381	6,205
Total income	10,923	4,847	1,979	776	18,525
Operating lease depreciation	(946)	(44)	–	(63)	(1,053)
Net income	9,977	4,803	1,979	713	17,472
Operating costs	(4,857)	(2,199)	(1,040)	(88)	(8,184)
Impairment	(717)	(115)	–	37	(795)
Underlying profit	4,403	2,489	939	662	8,493
Banking net interest margin	2.61%	3.54%			2.86%
Average interest-earning banking assets	£337.4bn	£86.0bn	£0.8bn	£10.7bn	£434.9bn
Asset quality ratio	0.21%	0.12%			0.18%
Return on risk-weighted assets	4.92%	2.82%			3.95%
Loans and advances to customers[1]	£339.7bn	£100.0bn	£0.8bn	£15.2bn	£455.7bn
Customer deposits[2]	£253.1bn	£147.6bn	£13.8bn	£1.0bn	£415.5bn
Risk-weighted assets	£90.8bn	£85.6bn	£1.3bn	£33.2bn	£210.9bn

2016[3]	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Run-off and Central items £m	Group £m
Net interest income	8,073	2,934	80	348	11,435
Other income	2,162	1,756	1,939	208	6,065
Total income	10,235	4,690	2,019	556	17,500
Operating lease depreciation	(775)	(105)	–	(15)	(895)
Net income	9,460	4,585	2,019	541	16,605
Operating costs	(4,748)	(2,189)	(1,046)	(110)	(8,093)
Impairment	(654)	(17)	–	26	(645)
Underlying profit	4,058	2,379	973	457	7,867
Banking net interest margin	2.47%	3.36%			2.71%
Average interest-earning banking assets	£334.5bn	£89.9bn	£0.8bn	£10.7bn	£435.9bn
Asset quality ratio	0.20%	0.02%			0.15%
Return on risk-weighted assets	4.85%	2.45%			3.55%
Loans and advances to customers[2]	£330.8bn	£101.6bn	£0.8bn	£16.5bn	£449.7bn
Customer deposits[2]	£256.5bn	£141.3bn	£13.8bn	£1.4bn	£413.0bn
Risk-weighted assets	£84.6bn	£92.6bn	£1.7bn	£36.6bn	£215.5bn

1 Excludes reverse repos of £16.8 billion (31 December 2016: £8.3 billion).

2 Excludes repos of £2.6 billion (31 December 2016: £2.5 billion).

3 Restated. See page 181.

Alternative performance measures

The Group uses a number of alternative performance measures, including underlying profit, in the discussion of its business performance and financial position. Further information is provided on page 267.

Underlying basis

In order to allow a comparison of the Group's underlying performance, the results are adjusted for certain items including losses on redemption of the Enhanced Capital Notes and the volatility in the value of the embedded equity conversion feature; market volatility and asset sales, which includes the effects of certain asset sales, the volatility relating to the Group's own debt and hedging arrangements and that arising in the insurance businesses and insurance gross up; the unwind of acquisition-related fair value adjustments and the amortisation of purchased intangible assets; restructuring costs, comprising severance related costs relating to the Simplification programme, the costs of implementing regulatory reform and ring-fencing, the rationalisation of the non-branch property portfolio and the integration of MBNA; and payment protection insurance and other conduct provisions.

Summary of Group results continued

Consolidated income statement – underlying basis

	2017 £ million	2016 £ million	Change %
Net interest income	12,320	11,435	8
Other income	6,205	6,065	2
Total income	18,525	17,500	6
Operating lease depreciation	(1,053)	(895)	(18)
Net income	17,472	16,605	5
Operating costs	(8,184)	(8,093)	(1)
Impairment	(795)	(645)	(23)
Underlying profit	8,493	7,867	8
Volatility and other items	(703)	(1,544)	
PPI provision	(1,650)	(1,000)	
Other conduct provisions	(865)	(1,085)	
Statutory profit before tax	5,275	4,238	24
Tax expense	(1,728)	(1,724)	–
Profit for the year	3,547	2,514	41
Earnings per share	4.4p	2.9p	52
Dividends per share – ordinary	3.05p	2.55p	20
Dividends per share – special	–	0.50p	
Share buyback up to £1 billion	1.40p	–	
Banking net interest margin	2.86%	2.71%	15bp
Average interest-earning banking assets	£435bn	£436bn	–
Cost:income ratio	46.8%	48.7%	(1.9)pp
Asset quality ratio	0.18%	0.15%	3bp
Return on risk-weighted assets	3.95%	3.55%	40bp
Underlying return on tangible equity	15.6%	14.1%	1.5pp
Return on tangible equity	8.9%	6.6%	2.3pp

Balance sheet and key ratios

	At 31 Dec 2017	At 31 Dec 2016	Change %
Loans and advances to customers[1]	£456bn	£450bn	1
Customer deposits[2]	£416bn	£413bn	1
Loan to deposit ratio	110%	109%	1pp
Total assets	£812bn	£818bn	(1)
Pro forma CET1 ratio pre dividend and share buyback[3]	15.5%	14.1%	1.4pp
Pro forma CET1 ratio post dividend[3,4]	14.4%	13.0%	1.4pp
Pro forma CET1 ratio post dividend and share buyback[3]	13.9%	13.0%	0.9pp
Transitional total capital ratio[4]	21.2%	21.4%	(0.2)pp
Pro forma UK leverage ratio[3,4,5]	5.4%	5.3%	0.1pp
Risk-weighted assets	£211bn	£216bn	(2)
Tangible net assets per share pre dividend[6]	56.5p	54.8p	1.7p
Tangible net assets per share	53.3p	54.8p	(1.5)p

1 Excludes reverse repos of £16.8 billion (31 December 2016: £8.3 billion).

2 Excludes repos of £2.6 billion (31 December 2016: £2.5 billion).

3 The CET1 and leverage ratios at 31 December 2017 and 2016 are reported on a pro forma basis, reflecting the dividends paid by the Insurance business in February 2018 and February 2017, respectively, in relation to prior year earnings. In addition the CET1 ratios at 31 December 2016 have been adjusted for the acquisition of MBNA.

4 The 2017 capital and leverage ratios do not, unless otherwise indicated, recognise the share buyback as this will be reflected in 2018.

5 Calculated in accordance with the UK Leverage Ratio Framework. Excludes qualifying central bank claims.

6 Pre final 2016 and interim 2017 dividend.

Divisional results
Retail

Performance summary

	2017 £m	2016[1] £m	Change %
Net interest income	**8,706**	8,073	8
Other income	**2,217**	2,162	3
Total income	**10,923**	10,235	7
Operating lease depreciation	**(946)**	(775)	(22)
Net income	**9,977**	9,460	5
Operating costs	**(4,857)**	(4,748)	(2)
Impairment	**(717)**	(654)	(10)
Underlying profit	**4,403**	4,058	9
Banking net interest margin	**2.61%**	2.47%	14bp
Average interest-earning banking a ssets	**£337.4bn**	£334.5bn	1
Asset quality ratio	**0.21%**	0.20%	1bp
Impaired loans as % of closing advances	**1.4%**	1.5%	(0.1)pp
Return on risk-weighted assets	**4.92%**	4.85%	7bp

	At 31 Dec 2017 £bn	At 31 Dec 2016[1] £bn	Change %
Open mortgage book	**267.1**	266.1	–
Closed mortgage book	**23.6**	26.7	(12)
Credit cards	**18.1**	9.7	87
Loans	**7.9**	7.7	3
UK Motor Finance	**13.6**	11.4	19
Europe[2]	**7.1**	6.3	13
Other	**2.3**	2.9	(21)
Loans and advances to customers	**339.7**	330.8	3
Operating lease assets	**4.7**	4.1	15
Total customer assets	**344.4**	334.9	3
Relationship balances	**240.0**	239.3	–
Tactical balances	**13.1**	17.2	(24)
Customer deposits	**253.1**	256.5	(1)
Risk-weighted assets	**90.8**	84.6	7

1 Restated. See page 181.

2 Includes the Netherlands mortgage lending business.

Divisional results continued

Commercial Banking

Performance summary

	2017 £m	2016[1] £m	Change %
Net interest income	3,086	2,934	5
Other income	1,761	1,756	–
Total income	4,847	4,690	3
Operating lease depreciation	(44)	(105)	58
Net income	4,803	4,585	5
Operating costs	(2,199)	(2,189)	–
Impairment charge	(115)	(17)	
Underlying profit	2,489	2,379	5

Banking net interest margin	3.54%	3.36%	18bp
Average interest-earning banking assets	£86.0bn	£89.9bn	(4)
Asset quality ratio	0.12%	0.02%	10bp
Impaired loans as % of closing advances	1.9%	2.1%	(0.2) pp
Return on risk-weighted assets	2.82%	2.45%	37bp

	At 31 Dec 2017 £bn	At 31 Dec 2016[1] £bn	Change %
SME	30.7	30.2	2
Mid Corporates	19.9	19.5	2
Other Mid Markets	14.3	15.0	(5)
Mid Markets	34.2	34.5	(1)
Other[2]	41.8	43.4	(4)
Loans sold to Insurance business[3]	(6.7)	(6.5)	
Loans and advances to customers	100.0	101.6	(2)
Customer deposits	147.6	141.3	4
Risk-weighted assets	85.6	92.6	(8)

1 Restated. See page 181.

2 Mainly lending to Global Corporates and Financial Institutions clients.

3 The customer segment balances include lower risk loans that were originated by Commercial Banking and subsequently sold to the Insurance business to back annuitant liabilities. These loans are reported in Central items but have been included in this table to aid comparison with prior periods.

Insurance and Wealth

Performance summary

	2017 £m	2016[1] £m	Change %
Net interest income	**133**	80	66
Other income	**1,846**	1,939	(5)
Total income	**1,979**	2,019	(2)
Operating costs	**(1,040)**	(1,046)	1
Underlying profit	**939**	973	(3)
Life and pensions sales (PVNBP)[2]	**9,951**	8,919	12
General insurance underwritten new GWP[3]	**84**	75	12
General insurance underwritten total GWP[3]	**733**	831	(12)
General insurance combined ratio	**87%**	85%	2pp

	At 31 Dec 2017 £bn	At 31 Dec 2016[1] £bn	Change %
Insurance Solvency II ratio[4]	**160%**	160%	–
Wealth loans and advances to customers	**0.8**	0.8	–
Wealth customer deposits	**13.8**	13.8	–
Wealth risk-weighted assets	**1.3**	1.7	(24)
Total customer assets under administration	**145.4**	137.8	6

Income by product group

	2017			2016[1]		
	New business £m	Existing business £m	Total £m	New business £m	Existing business £m	Total £m
Workplace	**107**	**96**	**203**	123	103	226
Planning and retirement	**95**	**91**	**186**	109	95	204
Bulk annuities	**54**	**26**	**80**	121	16	137
Protection	**13**	**20**	**33**	19	17	36
Longstanding LP&I	**12**	**440**	**452**	9	441	450
	281	**673**	**954**	381	672	1,053
Life and pensions experience			**358**			202
General insurance			**298**			354
			1,610			1,609
Wealth			**369**			410
Total income			**1,979**			2,019

1 Restated. See page 181.

2 Present value of new business premiums.

3 Gross written premiums.

4 Equivalent regulatory view of ratio (including With Profits funds) is 154 per cent at 31 December 2017 (31 December 2016: 154 per cent).

Excluding bulk annuities and 2016 with profits fund annuity transfer within planning and retirement, new business income remains stable, reflecting lower margins as a result of the competitive environment and strengthening of underlying assumptions. Existing business income is flat with positive impact of economics offset by legacy products run-off.

Experience and other items contributed a net benefit of £358 million (2016: £202 million), including benefits as a result of changes to longevity assumptions. These include both experience in the annuity portfolio and the adoption of a new industry model reflecting an updated view of future life expectancy.

Divisional results continued

Run-off and Central Items

Run-off

	2017 £m	2016 £m	Change %
Net interest income	(91)	(110)	17
Other income	42	120	(65)
Total income	(49)	10	
Operating lease depreciation	(63)	(15)	
Net income	(112)	(5)	
Operating costs	(54)	(77)	30
Impairment release	41	26	58
Underlying loss	(125)	(56)	

	At 31 Dec 2017 £bn	At 31 Dec 2016 £bn	Change %
Loans and advances to customers	8.1	9.6	(16)
Total assets	9.1	11.3	(19)
Risk-weighted assets	7.3	8.5	(14)

The lower income and costs reflect further reductions in the run-off portfolios. The run-off portfolio largely comprises the Group's Irish mortgage book and a number of other corporate and specialist finance portfolios.

Central items

	2017 £m	2016[1] £m
Total income	825	546
Costs	(34)	(33)
Impairment	(4)	–
Underlying profit	787	513

1 Restated. See page 181.

Central items includes income and expenditure not attributed to divisions, including the costs of certain central and head office functions and the Group's private equity business, Lloyds Development Capital.

Total income increased to £825 million (2016: £546 million) largely as a result of the gains on sales of liquid assets including gilts of £274 million (2016: £112 million) and the gain of £146 million on the sale of the Group's interest in Vocalink.

Other financial information

Banking net interest margin

The net interest margin is calculated by dividing underlying banking net interest income by average interest-earning banking assets.

Non-banking net interest income largely comprises subordinated debt costs incurred by the Insurance business. Non-banking assets largely comprise fee based loans and advances within Commercial Banking and loans sold by Commercial Banking and Retail to Insurance and Wealth to back annuitant liabilities.

The table below shows the reconciliation between statutory net interest income and the underlying net interest income.

	2017 £m	2016 £m
Group net interest income – statutory basis	**10,912**	9,274
Insurance gross up	**1,180**	1,898
Volatility and other items	**228**	263
Group net interest income – underlying basis	**12,320**	11,435
Non-banking net interest expense	**111**	391
Banking net interest income – underlying basis	**12,431**	11,826
Average interest-earning banking assets	**£434.9bn**	£435.9bn
Banking net interest margin	**2.86%**	2.71%

The table below shows the reconciliation between the statutory net interest income and the underlying net interest income.

	Quarter ended 31 Dec 2017 £bn	Quarter ended 30 Sept 2017 £bn	Quarter ended 30 June 2017 £bn	Quarter ended 31 Mar 2017 £bn	Quarter ended 31 Dec 2016 £bn
Net loans and advances to customers[1]	**455.7**	**454.6**	**453.2**	**444.7**	449.7
Impairment provision and fair value adjustments	**3.2**	**3.4**	**3.3**	**3.6**	3.7
Non-banking items:					
Fee based loans and advances	**(8.1)**	**(7.4)**	**(7.4)**	**(8.5)**	(9.4)
Sale of assets to Insurance	**(6.9)**	**(6.8)**	**(6.8)**	**(6.6)**	(6.7)
Other non-banking	**(4.0)**	**(4.7)**	**(4.2)**	**(3.4)**	(5.0)
Gross banking loans and advances	**439.9**	**439.1**	**438.1**	**429.8**	432.3
Averaging	**(0.7)**	**(0.8)**	**(7.1)**	**1.1**	1.7
Average interest-earning banking assets (quarter)	**439.2**	**438.3**	**431.0**	**430.9**	434.0
Average interest-earning banking assets (year-to-date)	**434.9**	**433.4**	**430.9**	**430.9**	435.9

1 Excludes reverse repos of £16.8 billion (31 December 2016: £8.3 billion).

Volatility arising in insurance businesses

Volatility included in the Group's statutory results before tax comprises the following:

	2017 £m	2016 £m
Insurance volatility	**196**	(152)
Policyholder interests volatility	**190**	241
Total volatility	**386**	89
Insurance hedging arrangements	**(100)**	(180)
Total	**286**	(91)

Insurance volatility

The Group's insurance business has policyholder liabilities that are supported by substantial holdings of investments. IFRS requires that the changes in both the value of the liabilities and investments are reflected within the income statement. The value of the liabilities does not move exactly in line with changes in the value of the investments. As the investments are substantial, movements in their value can have a significant impact on the profitability of the Group. Management believes that it is appropriate to disclose the Insurance and Wealth division's results on the basis of an expected return in addition to results based on the actual return. The impact of the actual return on these investments differing from the expected return is included within insurance volatility.

Other financial information continued

Tangible net assets per share

The table below sets out a reconciliation of the Group's shareholders' equity to its tangible net assets.

	2017 £m	2016 £m
Shareholders' equity	43,551	43,020
Goodwill	(2,310)	(2,016)
Intangible assets	(2,835)	(1,681)
Purchased value of in-force business	(306)	(340)
Other, including deferred tax effects	254	170
Tangible net assets	38,354	39,153

Ordinary shares in issue, excluding own shares	71,944m	71,413m
Tangible net assets per share	53.3p	54.8p
Tangible net assets per share pre dividend[1]	56.5p	54.8p

1 Pre final 2016 and interim 2017 dividends.

Tangible net assets per share at 31 December 2016 was 54.8 pence, or 53.4 pence after adjusting for the acquisition of MBNA. The movement from the adjusted 2016 tangible net assets per share to 53.3 pence at 31 December 2017 comprises an increase of 3.1 pence due to the strong financial performance offset by a reduction of 3.2 pence for dividends paid during the year.

Return on tangible equity

The Group's underlying return on tangible equity was 15.6 per cent (2016: 14.1 per cent) and statutory return on tangible equity was 8.9 per cent, 2.3 percentage points higher year-on-year as a result of higher underlying profit and lower volatility and other items.

	2017	2016
Underlying return on tangible equity		
Average shareholders' equity (£bn)	43.4	42.7
Average intangible assets (£bn)	(4.6)	(3.8)
Average tangible equity (£bn)	38.8	38.9
Underlying profit after tax (£m)	6,244	5,731
Add back amortisation of intangible assets (post tax) (£m)	219	174
Less profit attributable to other equity holders (£m)	(313)	(321)
Less profit attributable to non-controlling interests (£m)	(90)	(101)
Adjusted underlying profit after tax (£m)	6,060	5,483
Underlying return on tangible equity	15.6%	14.1%
Statutory return on tangible equity		
Group statutory profit after tax (£m)	3,547	2,514
Add back amortisation of intangible assets (post tax) (£m)	219	174
Add back amortisation of purchased intangible assets (post tax) (£m)	101	299
Less profit attributable to other equity holders (£m)	(313)	(321)
Less profit attributable to non-controlling interests (£m)	(90)	(101)
Adjusted statutory profit after tax (£m)	3,464	2,565
Statutory return on tangible equity	8.9%	6.6%

Number of employees (full-time equivalent)

	At 31 Dec 2017	At 31 Dec 2016[1]
Retail[2]	32,760	33,246
Commercial Banking	6,735	6,838
Insurance and Wealth	6,445	6,882
Group functions and services	23,786	24,922
	69,726	71,888
Agency staff	(1,821)	(1,455)
Total number of employees	67,905	70,433

1 Restated. See page 181.

2 Includes 1,703 MBNA employees in 2017.

GOVERNANCE

SUPPORTING BRITAIN'S SOCIAL ENTREPRENEURS

In 2017 we helped a further 260 social entrepreneurs through our School for Social Entrepreneurs programme.

They include Nikki Markham of Battling On, who trains armed forces veterans across Cornwall to become mentors and instructors for vulnerable young people from disadvantaged backgrounds and adults with disabilities. Battling On offers nationally recognised vocational training, numeracy and literacy support and work experience on community projects. Nikki was a finalist in the 2017 Social Entrepreneur of the Year Awards.

1,500

social entrepreneurs helped to start-up and grow their social businesses since 2012

Visit www.lloydsbankinggroup.com/prosperplan

A letter from our Chairman
Building robust stakeholder relationships

Good governance is vitally important as it underpins the delivery of our strategy to help Britain prosper and become the best bank for customers, colleagues and shareholders.

Lord Blackwell
Chairman

Dear Shareholders

I am pleased to present our corporate governance report for 2017. This report sets out our approach to governance in practice, how the Board works, how it has spent its time during the year, how it has evaluated its performance, and includes reports from each of the Board's Committees.

Good governance is vitally important as it underpins the delivery of our strategy to help Britain prosper and become the best bank for customers, colleagues and shareholders. It is essential to ensure good corporate governance and the associated values are embedded into the thinking and processes of the business, and driven by the Board.

Board changes

The Nomination and Governance Committee is responsible for reviewing the composition of the Board and its Committees and assessing whether the balance of skills, experience, knowledge and independence is appropriate to enable them to operate effectively. It went through a rigorous process leading to the appointment of Lord Lupton as a new independent Non-Executive Director with the additional role of chairing our new non ring-fenced bank. Lord Lupton joined the Board on 1 June 2017, bringing with him extensive international corporate experience (see page 55 for further details). Both Nick Luff and Anthony Watson stepped down from the Board in May 2017, having made significant contributions to the Group. As a result of the two retirements, our Deputy Chairman Anita Frew was appointed as the new Senior Independent Director, and Simon Henry succeeded Nick Luff as the Audit Committee Chairman. The names and biographies of current Directors are set out on pages 54–55. The roles and responsibilities of the Board members are set out on page 68.

The Group's strategic transformation

On 16 May 2017, the Group returned to full private ownership after the government sold its remaining stake. The sale demonstrated the successful delivery of the Group's strategy to transform itself into a simple, low risk, UK focused retail and commercial bank. Since the government first acquired shares in 2009, the Group has repaired its balance sheet, reduced its cost base, cut complexity and international exposure, built and sold TSB, and addressed legacy issues. The Group returned to profitability in 2013 and resumed paying dividends in 2014.

The sale marked the final step in the rescue and rejuvenation of Lloyds Banking Group. The combination of our strong financial performance and the progress we have made towards our strategic priorities has enabled over £21.2 billion to be returned to the government, more than repaying the amount that taxpayers invested.

However, we are not complacent. While we are proud of the progress we have made over the last few years, we recognise we now have an equally challenging task to transform Lloyds Banking Group into a bank that can deliver outstanding service for customers in the future technology environment and play our full role in helping Britain prosper. The Board has spent considerable time over the past two years working with the executive team to understand the requirements to compete successfully as the 'Bank of the Future', and to translate that into the new strategic plan announced with our results. The oversight of this new transformation programme, including the associated cultural changes that will be required, will be a major focus of our ongoing governance activities.

Non ring-fenced bank

One of the largest change initiatives for the Group this year is the implementation of the ring-fencing regulatory requirements which come into effect on 1 January 2019. The Group's approach aims to minimise the impact on both colleagues and customers and for the vast majority there will be no changes. There has been significant progress during the year towards the establishment of the new non ring-fenced bank, Lloyds Bank Corporate Markets plc ('LBCM'). The Board has played an active role in identifying and appointing members of the LBCM board, as well as helping to establish the governance framework to ensure that the framework is both fit for purpose for the new bank and complements that of the Group. An overview by the Chairman of LBCM, Lord Lupton, of the establishment and governance structures of LBCM can be found on page 60.

Board effectiveness

The Board carried out an annual evaluation of its effectiveness during the year. This was an internal evaluation overseen by the Nomination and Governance Committee. The process which was undertaken and the findings of the review are set out on pages 66–67, together with information about our progress against the 2016 review actions.

Diversity

Being able to attract, develop, fully utilise and retain top talent is highly important to us, ensuring everyone has the opportunity to progress and realise their potential. For this reason, the Group has made a commitment to be a leader in diversity, removing the barriers that stand in the way of equal opportunity.

The Board sees it as an important objective for its membership to reflect diversity in its broadest sense. A mix of different backgrounds and experience on the Board, as in the executive team, is important in providing a range of perspectives, insights and challenge needed to support good decision making.

As a Group, we have committed to maintaining at least three female Board members, and recognise the Davies/Hampton-Alexander target for FTSE companies to move towards 33 per cent female representation. We are looking to take opportunities to increase the number of female Board members over time where that is consistent with other skills and diversity requirements. The Group has also made the public commitment to increase the proportion of senior roles held by women to 40 per cent by 2020. For more information on current levels of diversity and inclusion see page 21.

In addition to this, the Group recognises the importance of the diversity of colleagues, reflecting the diversity of our customers, to allow us to better understand customers' needs and create deeper relationships.

The Group's aim is to increase ethnic diversity in our workforce and unlock the potential of our ethnic minority colleagues. The Group has publicly committed to increase the proportion of senior roles held by Black, Asian and Minority Ethnic colleagues to eight per cent by 2020. This is being achieved through career development programmes, a programme of visible role models, and a focus on increasing cultural awareness to help all colleagues interact more effectively, regardless of ethnic background. Our commitment to diversity is led from the top, with Executive Committee sponsorship of the initiatives. More information on both diversity and the importance of succession planning is provided on page 72.

Lord Blackwell
Chairman

Development of our transformation strategy

In early 2016, following discussions with the Chairman and Board, the Group Chief Executive initiated a major exercise to explore the characteristics required to succeed as the 'Bank of the Future'. Working groups across the Group were engaged in looking forward to the likely impact of changing technology, customer needs and competition, and developing scenarios for different economic backdrops.

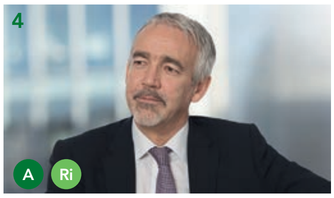
The emerging analysis was debated at a two day offsite session involving both the Board and Group Executive Committee in June 2016, and led to the conclusion that a major transformation would be required in evolving our customer propositions, re-engineering our core business processes to incorporate new technology, changing our ways of working and developing new skills and capabilities.

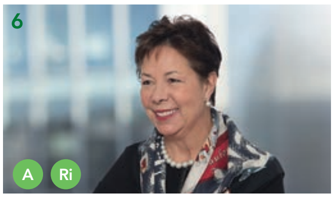
These conclusions were then developed into a programme of change initiatives which were discussed and reviewed in subsequent Board deep dive sessions and, as a whole, in the joint Board and Executive offsite meeting in June 2017.

Having agreed the key initiatives and the overall scale and pace of the transformation, the Board reviewed the more detailed plan and immediate priorities in an extended session in November 2017, placing particular emphasis on the effective management of the programme and the mitigation of potential execution risks. The final proposals were reviewed again in January and confirmed with the 2018 budget in February.

Board of Directors

Comprising Directors with the right mix of skills and experience, the Board is collectively responsible for overseeing delivery of the Group's strategy.





A Member of Audit Committee

Re Member of Remuneration Committee

RB Member of Responsible Business Committee

Ri Member of Board Risk Committee

NG Member of Nomination and Governance Committee

● Committee Chairman

1. Lord Blackwell Chairman

Appointed: June 2012 (Board), April 2014 (Chairman)

Skills and experience:

- Deep financial services knowledge including in insurance and banking
- Significant experience with strategic planning and implementation
- Regulatory and public policy experience gained from senior positions in Downing Street, Regulators and a wide range of industries
- Credibility with key stakeholders
- Strong leadership qualities

Lord Blackwell initially joined the Board as Chairman of Scottish Widows Group. He was previously Senior Independent Director and Chairman of the UK Board for Standard Life and Director of Group Development at NatWest Group. His past Board roles have included Chairman of Interserve plc, and Non-Executive Director of Halma plc, Dixons Group, SEGRO and Ofcom. He was Head of the Prime Minister's Policy Unit from 1995 to 1997 and was appointed a Life Peer in 1997. He has an MA in Natural Sciences from the University of Cambridge, a Ph.D in Finance and Economics and an MBA from the University of Pennsylvania.

External appointments: Governor of the Yehudi Menuhin School and a member of the Governing Body of the Royal Academy of Music.

2. Anita Frew Deputy Chairman and Senior Independent Director

Appointed: December 2010 (Board), May 2014 (Deputy Chairman), May 2017 (Senior Independent Director)

Skills and experience:

- Significant board, financial and general management experience
- Experience across a range of sectors, including banking, asset and investment management, manufacturing and utilities
- Extensive experience as chairman in a range of industries
- Strong board governance experience, including investor relations and remuneration

Anita was previously Chairman of Victrex plc, the Senior Independent Director of Aberdeen Asset Management and IMI plc, an Executive Director of Abbott Mead Vickers, a Non-Executive Director of Northumbrian Water and has held various investment and marketing roles at Scottish Provident and the Royal Bank of Scotland. She has a BA (Hons) in International Business from the University of Strathclyde, a MRes in Humanities and Philosophy from the University of London, an Honorary DSc for contribution to industry and finance from the University of Cranfield and an Honorary Doctorate in Management and Finance from the University of Aberdeen.

External appointments: Chairman of Croda International Plc and a Non-Executive Director of BHP Billiton.

3. Alan Dickinson Independent Director

Appointed: September 2014

Skills and experience:

- Highly regarded retail and commercial banker
- Strong strategic, risk and core banking experience
- Regulatory and public policy experience

Alan has 37 years' experience with the Royal Bank of Scotland, most notably as Chief Executive of RBS UK. More recently, Alan was a Non-Executive Director of Willis Limited and Chairman of its Risk Committee. He was formerly Chairman of Brown, Shipley & Co. Limited and a Non-Executive Director of Nationwide Building Society where he was Chairman of its Risk Committee. He is a Fellow of the Chartered Institute of Bankers and the Royal Statistical Society and has an MBA from the Manchester Business School and a BSc from the University of Birmingham.

External appointments: Chairman of Urban&Civic plc and a Governor of Motability.

4. Simon Henry Independent Director

Appointed: June 2014

Skills and experience:

- Deep international experience in board level strategy and execution
- Extensive knowledge of financial markets, treasury and risk management
- Qualification as an Audit Committee Financial Expert
- Strong board governance experience, including investor relations and remuneration

Until recently Simon was Chief Financial Officer and Executive Director of Royal Dutch Shell plc. He was previously Chair of the European Round Table CFO Taskforce and a Member of the Main Committee of the 100 Group of UK FTSE CFOs. He has a BA in Mathematics, an MA from the University of Cambridge and is a fellow of the Chartered Institute of Management Accountants (CIMA).

External appointments: Non-Executive Director of Rio Tinto plc and Rio Tinto Limited, Independent Director of PetroChina Company Limited, Member of the Defence Board and Chair of the Defence Audit Committee, UK Government, Member of the Advisory Panel of CIMA and of the Advisory Board of the Centre for European Reform.

5. Lord Lupton CBE Independent Director and Chairman of Lloyds Bank Corporate Markets plc

Appointed: June 2017

Skills and experience:

Extensive international corporate experience, especially in financial markets

Strong board governance experience, including investor relations and remuneration

Regulatory and public policy experience

Significant experience in strategic planning and implementation

Lord Lupton was Deputy Chairman of Baring Brothers, co-founded the London office of Greenhill & Co., and was Chairman of Greenhill Europe until May 2017. He was previously a Trustee of the British Museum, Governor of Downe House School and a member of the International Advisory Board of Global Leadership Foundation. He became a Life Peer in October 2015 and is a former Treasurer of the Conservative Party. He served on the House of Lords Select Committee on Charities. He read Jurisprudence at Lincoln College, Oxford and is a qualified solicitor.

External appointments: Senior Advisor to Greenhill Europe and Chairman of the Trustees of the Lovington Foundation.

6. Deborah McWhinney Independent Director

Appointed: December 2015

Skills and experience:

Extensive executive background in managing technology, operations and new digital innovations across banking, payments and institutional investment

International business and management experience

Experience in consumer analysis, marketing and distribution

Deborah is Chair of the Board Risk Committee's IT Resilience and Cyber Sub-Committee. She is a former Chief Executive Officer, Global Enterprise Payments and President, Personal Banking and Wealth Management at Citibank. Deborah was previously President of Institutional Services at Charles Schwab Corporation and held executive roles at Engage Media Services Group, Visa International and Bank of America, where she held senior roles in Consumer Banking. She holds a BSc in Communications from the University of Montana.

External appointments: Member of the Supervisory Board of Fresenius Medical Care AG & Co. KGaA, Independent Director of Fluor Corporation and IHS Markit Ltd, a Trustee of the California Institute of Technology and of the Institute for Defense Analyses.

7. Nick Prettejohn Independent Director and Chairman of Scottish Widows Group

Appointed: June 2014

Skills and experience:

Deep financial services experience, particularly in insurance

In-depth regulatory knowledge and experience

Governance experience and strong leadership qualities

Significant experience in strategic planning and implementation

Nick has served as Chief Executive of Lloyd's of London, Prudential UK and Europe and Chairman of Brit Insurance. He is a former Non-Executive Director of the Prudential Regulation Authority and of Legal & General Group Plc as well as Chairman of the Financial Services Practitioner Panel and the Financial Conduct Authority's Financial Advice Working Group. He was previously a Member of the BBC Trust and Chairman of the Britten-Pears Foundation. Nick has a First Class Degree in Philosophy, Politics and Economics from Balliol College, University of Oxford.

External appointments: Chairman of the Royal Northern College of Music and a member of the Board of Opera Ventures.

8. Stuart Sinclair Independent Director

Appointed: January 2016

Skills and experience:

Extensive experience in retail banking, insurance and consumer finance

Governance and regulatory experience

Significant experience in strategic planning and implementation

Experience in consumer analysis, marketing and distribution

Stuart is a former Non-Executive Director of TSB Banking Group plc, TSB Bank plc, LV Group, Virgin Direct and Vitality Health (formerly Prudential Health). He was also a Senior Independent Director of Swinton Group Limited. In his executive career, he was President and Chief Operating Officer of Aspen Insurance after spending nine years with General Electric, as Chief Executive Officer of the UK Consumer Finance business then President of GE Capital China. Before that he was Chief Executive Officer of Tesco Personal Finance and Director of UK Retail Banking at the Royal Bank of Scotland. He was a Council member of The Royal Institute for International Affairs (Chatham House). He has an MA in Economics from the University of Aberdeen and an MBA from the University of California.

External appointments: Interim Chairman of Provident Financial Plc with effect from 2 February 2018 (previously Senior Independent Director) and Chair of their Risk Advisory Committee, Senior Independent Director and Chair of Risk at QBE Insurance (Europe) Limited.

9. Sara Weller CBE Independent Director

Appointed: February 2012

Skills and experience:

Background in retail and associated sectors, including financial services

Strong board governance experience, including investor relations and remuneration

Passionate advocate of customers, the community, financial inclusion and the development of digital skills

Considerable experience of boards at both executive and non-executive level

Sara's previous appointments include Managing Director of Argos, various senior positions at J Sainsbury including Deputy Managing Director, Chairman of the Planning Inspectorate, Lead Non-Executive Director at the Department of Communities and Local Government, a Non-Executive Director of Mitchells & Butlers as well as a number of senior management roles for Abbey National and Mars Confectionery. She has an MA in Chemistry from Oxford University.

External appointments: Non-Executive Director of United Utilities Group and Chair of their Remuneration Committee and a member of their Nomination Committee, Lead Non-Executive Director at the Department for Work and Pensions, a Governing Council Member of Cambridge University, Board member at the Higher Education Funding Council and Trustee of Lloyds Bank Foundation for England and Wales, with effect from 1 February 2018.

10. António Horta-Osório Executive Director and Group Chief Executive

Appointed: January 2011 (Board), March 2011 (Group Chief Executive)

Skills and experience:

Extensive experience in, and understanding of, both retail and commercial banking built over a period of more than 30 years, working both internationally and in the UK

Drive, enthusiasm and commitment to customers

Proven ability to build and lead strong management teams

António previously worked for Citibank, Goldman Sachs and held various senior management positions at Grupo Santander before becoming its Executive Vice President and member of the Group's Management Committee. He was a Non-Executive Director of Santander UK and subsequently its Chief Executive. He is also a former Non-Executive Director of the Court of the Bank of England. António has a Degree in Management & Business Administration from the Universidade Católica Portuguesa, an MBA from INSEAD and has completed the Advanced Management Program at Harvard Business School.

External appointments: Non-Executive Director of EXOR N.V., Fundação Champalimaud and Sociedade Francisco Manuel dos Santos in Portugal, a member of the Board of Stichting INPAR and Chairman of the Wallace Collection.

11. George Culmer Executive Director and Chief Financial Officer

Appointed: May 2012 (Board)

Skills and experience:

Extensive operational and financial expertise including strategic and financial planning and control

Worked in financial services in the UK and overseas for over 25 years

George was an Executive Director and Chief Financial Officer of RSA Insurance Group, the former Head of Capital Management of Zurich Financial Services and Chief Financial Officer of its UK operations as well as holding various senior management positions at Prudential. He is a Non-Executive Director of Scottish Widows. George is a Chartered Accountant and has a history degree from the University of Cambridge.

External appointments: None.

12. Juan Colombás Executive Director and Chief Operating Officer

Appointed: November 2013 (Board), January 2011-September 2017 (Chief Risk Officer), September 2017 (Chief Operating Officer)

Skills and experience:

Significant banking and risk management experience

International business and management experience

Juan was appointed to the role of Chief Operating Officer in September 2017 and is responsible for leading a number of critical Group functions and driving the transformation activities across the Group in order to build the Bank of the Future. Prior to this he served as the Group's Chief Risk Officer and was responsible for developing the Group's risk framework, recommending the Group's risk appetite and ensuring that all risks generated by the business were measured, reviewed and monitored on an ongoing basis. He was previously the Chief Risk Officer and an Executive Director of Santander's UK business. Prior to this, he held a number of senior risk, control and business management roles across the Corporate, Investment, Retail and Risk Divisions of the Santander Group. Until September 2017 he was the Vice Chairman of the International Financial Risk Institute. Juan has a BSc in Industrial Chemical Engineering from the Universidad Politécnica de Madrid, a Financial Management degree from ICADE School of Business and Economics and an MBA from the Institute de Empresa Business School.

External appointments: None.

13. Malcolm Wood Company Secretary

Appointed: November 2014

Skills and experience:

Malcolm was previously General Counsel and Company Secretary of Standard Life after a career as a corporate lawyer in private practice in London and Edinburgh. He has a wealth of experience in governance, policy and regulation. He is a Fellow of the Institute of Chartered Secretaries and Administrators and a Member of the Corporate Governance Council and the GC100. Malcolm is an attendee of the Group Executive Committee.

Group Executive Committee

Delivering our vision and managing a more agile organisation

The depth of diverse experience and complementary skills in our management team strengthens our ability to adjust to changing market environments and deliver our strategy to become the best bank for customers, colleagues and shareholders.

Executive Director members

António Horta-Osório
Executive Director and Group Chief Executive

António joined the Board as an Executive Director in January 2011 and became Group Chief Executive in March 2011. Read his full biography on page 55.

George Culmer
Executive Director and Chief Financial Officer

George joined the Board as an Executive Director in May 2012. Read his full biography on page 55.

Juan Colombás
Executive Director and Chief Operating Officer

Juan joined the Group as Chief Risk Officer in January 2011 and joined the Board as an Executive Director in November 2013. He became Chief Operating Officer in September 2017. Read his full biography on page 55.

Other members and attendees

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1. Kate Cheetham
Group General Counsel (GEC attendee)

Kate was appointed Group General Counsel in January 2015. In this role she advises the Board and Senior Executives on legal matters, leads the Group's legal team and oversees management of the Group's external legal suppliers. Kate joined the Group in 2005 from Linklaters, where she was a corporate lawyer specialising in M&A transactions. Before her current role, Kate held a number of senior positions including Deputy Group General Counsel and General Counsel for Group Legal. Kate is co-chair of Breakthrough, LBG's women's network, a trustee of the Lloyds Bank Foundation for England and Wales and sponsor of 'Legal in the Community', the legal function's Responsible Business programme.

2. Karin Cook
Group Services Director

Karin is Group Services Director and is responsible for Global Payments, Customer Services, Property, Divestment and Development, the Chief Security Office, Credit Operations and Sourcing. Having worked in financial services for 27 years, prior to joining the Group as COO Commercial Banking in 2013, Karin led global operational, finance, and technology functions at HSBC, Morgan Stanley and Goldman Sachs. She is a Non-Executive Director of Scottish Widows and the Group's Executive Sponsor for Sexual Orientation and Gender Identity. She was named in the prestigious 2017 OUTstanding FT list as one of the Top 50 Allies globally, and is proud that the Group was also recognised as the 2017 Stonewall employer of the year. Karin holds a degree in Modern and Medieval Languages from Cambridge University.

3. Paul Day
Chief Internal Auditor (GEC attendee)

Paul joined the Group in June 2017 from Deloitte, where he was a partner in the UK Financial Services practice and led the UK Financial Services Internal Audit business. Paul has specialised in internal and external audit roles across financial services for over 20 years, including holding various leadership roles across Barclays Internal Audit. Paul studied at Cambridge University, holds an MBA from Manchester Business School and is a member of the Institute of Chartered Accountants and the UK Chartered Institute of Internal Auditors.

4. Antonio Lorenzo
Chief Executive, Scottish Widows and Group Director, Insurance and Wealth

Antonio joined the Group in 2011 as head of the Wealth and International division and Group Corporate Development, leading the Group's strategic review and subsequent programme of reducing non-core assets and exiting international locations. From 2013, he assumed the role of Group Director, Consumer Finance & Group Corporate Development, leading the division's growth strategy whilst completing the sale of TSB. At the end of 2015 he was appointed Chief Executive, Scottish Widows and Group Director, Insurance and during 2017 he also assumed responsibility for the Wealth Division. Antonio is also Group Executive Sponsor for Emerging Talent. Antonio joined the Group from Santander, where he had worked in a number of different leadership roles and jurisdictions since 1998. He was part of the management team that completed the take-over of Alliance & Leicester and Bradford & Bingley; and was Chief Financial Officer of Santander UK. Before Santander, Antonio spent over nine years at Arthur Andersen.

5. Vim Maru
Group Director, Retail

Vim was appointed Group Director, Retail in September 2017. He joined the Group in June 2011 as Managing Director, Customer Products and was appointed to the Group Executive Committee in August 2013. Vim is also a UK Finance Board member, leading on Retail Banking. Previously Vim worked for over 12 years at Santander, in a range of roles in Corporate Strategy, Mergers & Acquisitions, the Life Division and most recently held the position of Director, Retail Products. Vim holds an Economics degree from the London School of Economics and is a member of the Institute of Chartered Accountants.

6. Zaka Mian
Group Director, Transformation

Zak joined the Group in 1989 as a Business Analyst in IT and has carried out multiple roles involving Retail CIO, Head of IT Architecture and leading the Digital Transformation programme. He was appointed Group Director, Digital and Transformation in 2016 and his responsibilities increased in September 2017 as the Group Director, Transformation. He is responsible for the digital transformation of the Group, including all IT and business change, and ensuring we are ready to meet the future expectations of our customers. Zak has a Computer Science degree from York University.

7. David Oldfield
Group Director, Commercial Banking

David was appointed as Group Director for the Commercial Banking division in September 2017 responsible for supporting corporate clients from SMEs through Mid Markets to Global Corporates and Financial Institutions. David started his career with Lloyds Bank 31 years ago on the graduate entrant programme and has held a number of key leadership roles across all Divisions of the Group since that time. Immediately prior to his current role he was Group Director Retail and Consumer Finance, responsible for the Lloyds, Halifax, Bank of Scotland, Lex Autolease and Black Horse Brands including the retail branch networks, customer products and telephone banking, in addition to Retail Business Banking and UK Wealth businesses. David is a Fellow of the Chartered Institute of Bankers. He is also Group Executive Sponsor for Disability.

8. Jakob Pfaudler
Group Director, Community Banking (GEC attendee)

Jakob was appointed Group Director, Community Banking in September 2017. From 2015 to 2017 he was Chief Operating Officer for the Retail Bank and prior to this he was Managing Director of Asset Finance. Other previous roles include Chief Operating Officer for Wealth & International, Managing Director International Retail and International Banking and Wholesale Banking Operations Director. Jakob joined the Group in 2004 having spent six years with McKinsey & Co, in their London office. Prior to McKinsey, Jakob spent time with Goldman Sachs and Oliver Wyman. He has a PhD in Theoretical Physics from Oxford University.

9. Janet Pope
Chief of Staff and Group Director, Corporate Affairs, Responsible Business and Inclusion

Janet joined the Group in 2008 to run the Savings business. She was previously Chief Executive at Alliance Trust Savings, prior to which she was EVP Global Strategy at Visa International. Janet spent 10 years at Standard Chartered Bank where she held a variety of roles including Retail Banking MD for Africa and non-executive directorships at Standard Chartered Bank Zimbabwe, Kenya, Zambia and Botswana. Janet is Chairman of the Charities Aid Foundation Bank and a Non-Executive Director of the Banking Standards Board. Janet studied at the London School of Economics. She has a Master's degree in Economics and holds an MBA from Cass Business School. She is also the Group's Executive Sponsor for Inclusion and Diversity.

10. Stephen Shelley
Chief Risk Officer

Stephen was appointed Chief Risk Officer in September 2017. He joined the Group in May 2011 as Chief Credit Officer for Wholesale, Commercial and International. In October 2012 he became Risk Director, Commercial Banking Risk and was also a member of the Commercial Banking Management Group. Prior to joining the Group Stephen was Chief Risk Officer at Barclays Corporate and prior to that was Chief Credit Officer for the UK Retail and Corporate business in Barclays. In a 21-year career at Barclays, Stephen undertook a variety of roles in the front office and risk. He was also a member of the Group Risk Executive team and a Chair of Group Credit Committees. Stephen is also the Group's Executive Sponsor for Gender Diversity and Equality.

11. Jennifer Tippin
Group People and Productivity Director (GEC attendee)

Jen was appointed as Group People and Productivity Director in July 2017 and is responsible for leading the people function and managing the Group's cost base. Prior to her current role, Jen held the roles of Group Customer Services Director and Managing Director, Retail Business Banking. Graduating from Oxford University, Jen has enjoyed a career spanning multiple industries, including banking, engineering and the airline sector. Jen is a Non-Executive Director (Designate) on the Board of Lloyds Bank Corporate Markets and a Non-Executive Director of the Kent Community NHS Foundation Trust.

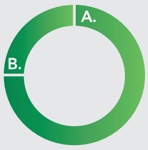
12. Malcolm Wood
Company Secretary (GEC attendee)

Malcolm joined the Group as Company Secretary in November 2014. Read his full biography on page 55.

Corporate governance report

Our Board in 2017
Diversity, skills and composition

Gender diversity

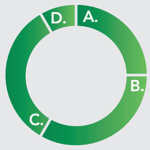


A. Male: 9
B. Female: 3

Skills and experience
(Non-Executive Directors only)

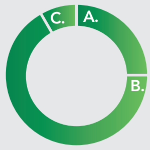
Retail/Commercial Banking	6 out of 9
Financial markets/wholesale banking/ corporate clients	8 out of 9
Insurance	3 out of 9
Prudential and conduct risk in financial institutions	8 out of 9
Core technology operations	4 out of 9
Government/regulatory	8 out of 9
Consumer/marketing/distribution	7 out of 9
Strategic thinking	9 out of 9

Board tenure



A. 0-2 years: 3
B. 3-4 years: 4
C. 5-6 years: 4
D. 7-8 years: 1

Age



A. 46-55: 3
B. 56-65: 8
C. 66-75: 1

Data as at 31 December 2017.

Board and Committee composition and attendance in 2017

Board member	Board meetings	Nomination and Governance Committee	Audit Committee	Board Risk Committee	Remuneration Committee	Responsible Business Committee
Lord Blackwell (C)	10/10	8/8 C	–	8/8	7/7	5/5
António Horta-Osório	10/10	–	–	–	–	–
Juan Colombás	10/10	–	–	–	–	–
George Culmer	10/10	–	–	–	–	–
Alan Dickinson	10/10	8/8	8/8	8/8 C	7/7	–
Anita Frew	10/10	8/8	8/8	8/8	7/7 C	3/5
Simon Henry	10/10	–	8/8 C [3]	8/8	–	–
Lord Lupton [1]	5/5	–	4/4	4/4	–	–
Nick Luff [2]	4/5	4/4	4/4 C [3]	3/4	–	–
Deborah McWhinney	9/10	–	8/8	8/8	–	–
Nick Prettejohn	8/10	–	7/8	8/8	–	–
Stuart Sinclair	10/10	–	–	8/8	7/7	4/4 [4]
Anthony Watson [2]	5/5	3/4	3/4	4/4	4/4	–
Sara Weller	10/10	4/4 [5]	–	8/8	7/7	5/5 C

1 Lord Lupton joined the Board and respective Committees on 1 June 2017.
2 Nick Luff and Anthony Watson retired from the Company on 10 May and 11 May respectively.
3 Simon Henry succeeded Nick Luff as Audit Committee Chairman with effect from 1 May 2017.
4 Stuart Sinclair was appointed to the Responsible Business Committee with effect from 1 April 2017.
5 Sara Weller joined the Nomination and Governance Committee on 11 May 2017.
C Chairman

Key focus areas

The Board sets the strategy, oversees its delivery and establishes the culture, values and standards of the Group. The Board ensures that the Group manages risk effectively, monitors financial performance and reporting and ensures that appropriate and effective succession planning arrangements and remuneration policies are in place. It provides and encourages entrepreneurial leadership across the Group within this framework.

Below are details of the main topics discussed by the Board during the year.

Discussions and decisions

Regular updates

- Group performance report
- Finance report, including budgets, forecasts and capital position
- Risk report
- Customer performance dashboard
- Chairman's report
- Reports from Committee Chairmen

Financial

- 2017 budget
- Dividend approval
- 5 year operating plan
- Draft results and presentations to analysts
- Funding and liquidity plans
- Capital plan
- Basel Pillar 3 disclosures
- Annual Report and Form 20-F

Strategy

- Two strategy away days to review progress in implementing the Group's strategy (see page 13 for further details)
- 'Deep Dives' on various elements of market development and business strategy (see below)
- MBNA integration
- Consideration and approval of large transactions
- Cloud strategy, which supports the transformation of the Group's IT architecture

Culture and values

- Helping Britain Prosper Plan
- Conduct, culture and values – Culture Dashboard
- Responsible business report

Governance and stakeholders

- Board effectiveness and Chairman's performance reviews
- AGM documentation approval and subsequent voting results briefing
- Review and approval of the Corporate Governance Framework
- Review and approval of various Group policies including the Code of Responsibilities, Signing Authorities, Group Statement on Modern Slavery, and Board and GEC Members' Dealing Policy
- Investor relations updates
- Committee and meeting simplification review

Regulatory

- Ring-fencing progress updates
- Whistleblowing updates
- Regulatory updates
- Senior Manager and Certification Regime
- FCA strategic review of retail banking business models

Risk management

- Approval of Group risk appetite
- Review of Group non-traded market risk plan
- Cyber security briefings
- Review of conduct risk
- Review and approval of PRA and EBA stress testing results
- Review and approval of the Risk Management Framework

'Deep dive' sessions

The Board regularly takes the opportunity to hold 'deep dive' sessions with senior management outside formal Board meetings. The purpose of the sessions is to provide the Board with deeper insight into key areas of strategic focus, whilst providing Directors with a greater understanding and appreciation for the subject matter to help drive better quality of debate and enhance knowledge. The sessions are structured to allow plenty of opportunity for discussion and include presentations and videos.

In 2017 'deep dive' sessions were held on the following topics:

- IT architecture strategy
- Customer journeys
- Interest only mortgages
- Consumer credit
- Open banking
- IFRS9 implementation
- Cloud strategy

Corporate governance report continued

Governance in action

Overseeing strategy development

The Board held two strategy offsite meetings during the year, giving the Directors the opportunity to focus solely on strategic issues. The first of these was held in June, and concentrated on the priorities of the business and the four strategic pillars which will help the Group progress towards the 'Bank of the Future'. During the second half of the year, the priorities agreed at the first meeting were developed and the second meeting held in November provided an opportunity to discuss these further, along with financial plans.

António Horta-Osório reflected on the offsite meetings:

> The Board offsite meetings are especially important in providing an opportunity to focus on strategic issues, taking a view of the longer-term outlook for the Group.

In June we debated the priorities of the business and the four strategic pillars which will help the Group progress towards the 'Bank of the Future'. It was extremely helpful to gain the input of our Board members, leveraging the broad range of experience and perspectives the Board has, resulting in a set of clear strategic priorities we will focus on.

In November the Board debated the detailed strategic priorities, associated delivery plans and financial projections. The collective experience and expertise of the Board was brought to life in challenging and scrutinising our plans ensuring we can further transform the Group and deliver sustainable value to our stakeholders over the course of the plan. The Board's focus on continuing to put the customer at the heart of everything we do, whilst recognising the increasing and critical role of technology, aligned well with the team's proposals and reinforced our aim to become the best bank for customers, colleagues and shareholders.

Integrating MBNA

In the immediate period following the Group's announcement of its milestone acquisition of MBNA in December 2016, work commenced to achieve regulatory approval from both the Competition & Markets Authority (CMA) and the Financial Conduct Authority (FCA), and also to prepare for the first day of legal ownership, known as 'Completion'. Unconditional CMA approval was achieved on 5 May 2017 and FCA approval of the Group's Change in Control application was received on 19 May 2017.

In readiness for Completion on 1 June 2017, many activities were completed to support a smooth transition of ownership from Bank of America, such as a review of some 470 IT applications to ensure services could continue, critical policy changes in MBNA to align to the Group and the introduction of a management structure and governance approach which was aligned to the Group's organisational design and risk management framework.

The 'Legal Day 1' Event completed seamlessly on 1 June 2017 with no operational issues. Since then, we have completed a detailed operating model review to identify how best we integrate the MBNA and existing Lloyds Banking Group Cards businesses to ensure we preserve and enhance areas of value creation and opportunities to improve the customer experience for all of our 8 million credit card customers.

The integration programme has moved into the delivery phase and has developed plans with Bank of America to complete the customer, systems and process integration by early 2019.

> There is a rigorous governance process to oversee design decision and integration execution, which ensures appropriate and timely updates and escalations up to Board level.

Lloyds Bank Corporate Markets

On 1 June, 2017, I was appointed a Non-Executive Director of Lloyds Banking Group and also as Chairman designate of the newly created 'non ring-fenced bank subsidiary', which is called Lloyds Bank Corporate Markets plc ('LBCM'), subject to regulatory consent. Since then, we have been engaged in a complex, intense and detailed programme to meet all the conditions which the PRA and FCA have set in order to enable them to give us full authorisation to conduct the non ring-fenced activities of the Group, which are required as part of the ring-fencing regulations for UK banks.

Our first, and surely the most important task, was to appoint a Board and senior management team to LBCM. The Board comprises eight Directors, three of whom are independent Non-Executive Directors recruited from outside the Group and all of whom have wide experience of banking, two Directors Designate (Group executives serving in a non-executive capacity and subject to regulatory approval), the Chief Executive, Chief Financial Officer, and myself as Chairman. This composition supports LBCM's legal and regulatory requirements for independent decision making within the overall framework of Group policies and controls. At the same time we have made good progress in appointing the rest of the senior management team of LBCM, such as the Chief Risk Officer, Chief Operating Officer, Chief Internal Auditor and Treasurer from both within and outside the Group. The bank received authorisation from the PRA and FCA in July 2017, subject to conditions. Our current plans are to operationalise the bank, and receive full authorisation for it to commence trading during 2018, leaving us good time to complete the process before the ring-fencing regulations come into force on 1 January 2019.

Since receiving the bank's conditional authorisation in July 2017, the Board has concentrated on creating a bespoke Governance Framework, including the vital Risk Management Framework, which is fit for purpose for LBCM, but also which is consistent and fits within the Group Governance Framework. In essence, LBCM must comply with each and every governance and risk requirement of the Group, but has the right and duty to manage the non ring-fenced bank within any narrower parameters set by the LBCM Board.

Lord Lupton
Chairman
Lloyds Bank Corporate Markets

Lord Lupton's induction

Induction pack prepared and sent to Lord Lupton prior to and on appointment

This contained key corporate documents, such as:

Role of Director

- Group policies such as anti-bribery, expenses, gifts and hospitality, and share dealing
- The role of a director and statutory duties, including Companies Act liabilities, Listing Rules, Disclosure Guidance and Transparency Rules and SEC Rules
- Directors' and officers' liability insurance

Board and its Committees

- Directors', Executive Management and Company Secretary biographies and contact details
- Schedule of Board Committee membership
- Schedule of Board and Committee meetings and Board calendar
- Last Board effectiveness review
- Minutes of the last 12 months' Board meetings
- Last three Board packs

Financial and strategic

- Latest Annual Report
- Corporate history, with a summary of significant events
- Group management structure chart and business unit details
- Key performance indicators, including KPIs on which incentive plans are measured
- Latest Strategic plan
- Guide to ring-fencing

Governance

- Corporate Governance Framework
- Articles of Association

Risk management

- Risk profile, appetite, risk management and internal control procedures

Shareholders

- Shareholder analysis/analyst reports
- Voting and shareholder feedback from the last AGM
- Notices of any general meetings held in the last three years

General

- Recent press cuttings, reports and articles concerning the Company
- Glossary of Company-specific jargon/acronyms

Training aspects

- The use of the electronic board portal
- The Senior Managers and Certification Regime

Meetings with senior management

Meetings were held during May and June with all the GEC to discuss aspects such as:

- Customer products and marketing
- Insurance risk
- Retail and consumer credit risk
- People, Legal and Strategy
- Retail and Consumer Finance
- Digital and transformation
- Group operations
- Commercial Banking
- Corporate affairs
- Treasury
- Scottish Widows and the Insurance Board

Meetings were also held specifically to deal with regulatory aspects, including:

- Ring-fencing
- Corporate governance and the Companies Act
- Whistleblowing
- Wholesale Banking conduct risk and remuneration rules

Ongoing programme of meetings, deep dives and training sessions developed in respect of the non ring-fenced bank, including:

- Commercial Banking
- Risk
- Markets
- Establishing the Board and governance procedures
- Financials (including meeting the internal and external auditors)
- Regulators
- Capital management and liquidity
- Culture
- Site visits to the New York, Jersey and Singapore offices
- Branch visits to Jersey
- Floor walks and informal engagement with colleagues

Corporate governance report continued

Engaging with our stakeholders

Shareholders

- Investor Relations has primary responsibility for managing and developing the Group's external relationships with existing and potential institutional equity investors and analysts. With support from senior management, they achieved this through a combination of more than 800 meetings and various presentations in 2017. The presentations were primarily aligned to results and included content on strategic progress and financial and operational performance. In addition to this direct shareholder engagement, Investor Relations provides regular reports to the executive team and Board on key market issues and shareholder concerns.
- The Company Secretary has a team dedicated to engaging with retail shareholders who, with support from the Company's registrar Equiniti Limited, deliver the Group's shareholder service strategy, including the AGM. Group Secretariat provide feedback to the Board and appropriate Committees to ensure the views of retail shareholders are received and considered. Important shareholder information, including details on the arrangements for the 2018 AGM, can be found on pages 263–264.
- The AGM is an opportunity for shareholders to hear directly from the Board on the Group's performance and strategic direction, and importantly, to ask questions.
  - over 200 shareholders represented
  - over 65 per cent of total voting rights voted
  - all resolutions voted on by way of a poll.
- The Board receives regular investor feedback and engages with shareholders, this includes:
  - meetings between the Chairman, Senior Independent Director and Chairman of the Remuneration Committee and institutional shareholders;
  - regular communications from the Group Chief Executive including correspondence with both retail and institutional shareholders;
  - investor meetings, roadshows and the AGM.

Customers

- The Group's aim is to become the best bank for customers, colleagues and shareholders. As part of this, the Board constantly reviews the strategy, receives updates on implementation and reviews progress as part of the governance process.
- One of the deep dives held by the Board during the year focused on the Customer Journey. This provided the Board with an update on the progress made on the Customer Journey transformation and gave the Board the opportunity to enhance their understanding and to consider and feedback on future plans.
- Further to the launch of mobile branches which serve local communities, an example was displayed at the 2017 AGM. More information regarding mobile branches can be found on page 23.
- The Board receives regular updates and reports detailing the findings of the ongoing customer surveys and feedback programme.
- Members of the Board have visited branches in various locations including Nottingham, Liverpool and Jersey during the year to help build understanding of the business and meet with colleagues.

Colleagues

- The Group intranet is used by the Directors to communicate with colleagues. During the year, this has included:
  - podcasts and videos detailing full year and half year results and details of the transformation within the Group and future plans;
  - Q&A sessions with the Group Chief Executive, where selected colleagues were given the opportunity to put questions directly to him; and
  - annual end of year message to all colleagues from the Chairman.
- Colleague feedback sessions are arranged on a regular basis where colleagues join the Chairman for informal discussion over lunch or dinner. These took place during the year in various locations, including Dunfermline, London, Bristol, Liverpool and Jersey.
- The Chairman hosts regular colleague breakfast meetings which are also attended by Non-Executive Directors.
- Helping Britain Prosper LIVE event was attended by 4,000 colleagues at the ExCel centre in London in March. This event provided everyone with more details about the future of the Group and the opportunity to see first-hand how we are helping Britain prosper every day. Speeches were given by the Group Chief Executive and Chief Financial Officer, which were broadcast live.
- The Chairman of the Remuneration Committee held a meeting during the year with the unions.
- Members of the Board have visited several Group offices and service centres during the year including Chester, Reading, Swindon and Edinburgh.

Regulators and government

- Members of the Board regularly meet with various organisations and institutions, including the Bank of England, the FCA, the PRA, CBI and accounting bodies.
- Members of the Board also participate in the Bank Governance Leadership Network, which addresses key issues facing global banks and provides opportunities for discussions between leading global banks, and other stakeholders across a range of activities throughout the year. Core themes include regulation and supervision of banks risk governance and oversight, the future of the banking industry, rebuilding trust and culture and changing business models and strategic challenges.
- Representatives of the regulator (both PRA and FCA) observed Board and Committee meetings in 2017.

Communities

- Members of the Board met with some of the organisations which are beneficiaries of the Group's independent charitable Lloyds Bank Foundation for England and Wales and Bank of Scotland Foundation.
- The Chairman also attended Lloyds Bank Foundation for England and Wales Westminster Parliamentary Reception in November, where more than 100 representatives of small and local charities were joined by MPs, government ministers and representatives from the Group. The reception highlighted the work of small and local charities tackling disadvantage across England.
- The Board engages with the work of the Foundations through the Responsible Business Committee. See page 80 for more information.
- Almost 260,000 hours of volunteering by colleagues were delivered in 2017, of which 44 per cent were skills-based volunteering. More than 5,000 colleagues took part in volunteering over the period of a week in the Group's Give & Gain volunteering campaign.

Whistleblowing

We encourage colleagues to speak up if they suspect wrongdoing or witness behaviours that do not meet the standards set out in our Codes of Responsibility or Group policies and procedures. This whistleblowing service is known internally as 'Speak Up' and it gives colleagues a way to raise concerns confidentially and without fear of reprisal.

The Group has an established Speak Up Champion (Anita Frew, Deputy Chairman and Senior Independent Director), a dedicated team to handle disclosures (the Colleague Conduct Management Team (CCMT)) and a third party supplier (Expolink) which colleagues can contact anonymously. There is a clear Speak Up Policy that sets out its commitment to listening to colleague concerns and protecting those who raise concerns from any detriment. The Policy provides information on how concerns can be raised and to whom. It also confirms that the Group has zero tolerance of retaliation and provides assurance around confidentiality and anonymity where required.

Whistleblowing continues to be a topic of public and regulatory concern; it is essential that colleagues feel confident reporting wrongdoing and are able to trust the process. A healthy culture encourages asking questions, raising concerns and admitting mistakes. This type of culture influences employee actions, decision-making and behaviour. In the reporting period, Speak Up has been embedded into Group culture through communication and awareness campaigns, training to all colleagues and the leadership team regularly considering speak up arrangements as part of its annual review of the system of internal control.

Lord Blackwell visits Liverpool

In July Lord Blackwell visited Liverpool, splitting his time between meeting colleagues and charities supported by the England and Wales Foundation.

Colleagues took the opportunity to present details of how they are implementing strategic priorities; an update on the apprenticeship training programme; how fraud is managed; and the impact on customers. Lord Blackwell also met representatives from the local PPI team, who discussed the end-to-end PPI complaint handling process, focusing on the key parts undertaken in Speke and Chester.

A networking lunch was held, with Lord Blackwell presenting a keynote speech to 50 colleagues. This was followed by a Q&A session at the Group's Speke office, after which he visited the Rotunda charity, an accredited training centre and community hub. The England and Wales Foundation has been supporting the charity since 2011. In 2017, Rotunda was awarded a further grant to support a pilot project which aims to demonstrate how a local community organisation can produce better services and outcomes for those with offender records and who are long term unemployed.

> As part of our Helping Britain Prosper Plan, we have committed to supporting the communities in which we serve and it is a matter of great personal pride that the Lloyds Bank Foundation is able to support this worthy cause.

Lord Blackwell
Chairman

How our Board works
Meetings, activities and processes

Board meetings

Start of the year

- A yearly planner is prepared by the Company Secretary to map out the flow of key items of business to the Board.
- Board venues are agreed and colleagues in the areas that the Board will visit are engaged at both senior management and operational level.

Agenda set

- The Chairman holds monthly meetings to review the draft agenda and planner with the Company Secretary and Chief of Staff, as well as quarterly meetings with a wider group of central functions, to identify emerging issues.
- The draft Board agenda is discussed between the Chairman and the Group Chief Executive and reviewed at GEC meetings.
- Matters may be added to agendas in response to external events, Non-Executive Director requests, regulatory initiatives and the quarterly Board topic review meetings.

Papers compiled and distributed

- Templates and guidelines are included within targeted training for authors of papers to ensure consistency and high quality of information.
- Meeting packs are uploaded and communicated to all Directors via a secure electronic board portal typically a week in advance of the meeting to ensure sufficient time to review the matters which are to be discussed and seek clarification or any additional information.

Before the meeting

- Executive meetings are held ahead of all Board and Committee meetings to ensure all matters being presented to the Board have been through a thorough discussion and escalation process.
- Committee meetings are held prior to Board meetings, with the Chairman of each Committee then reporting matters discussed to the Board.
- Non-Executive discussions and informal dinners are held prior to most Board meetings, some of which also include the Group Chief Executive.

Board meeting

- Board meetings have certain standing items, such as a report from the Group Chief Executive and Chief Financial Officer on Group performance, reports from Committee Chairmen and updates from GEC members.
- Topics for deep dives or additional items are discussed when required and include business, governance and regulatory updates.
- The Board makes full use of technology such as video conferencing, teleconferencing, a Board portal and tablets/devices in its meeting arrangements. This leads to greater flexibility, security and efficiency in Board paper distribution and meeting arrangements.

After the meeting

- The Board meetings offer the Board the chance to meet colleagues within the business, and if any additional meetings are required to provide more details, these are arranged.
- Minutes and matters arising from the meeting are produced and circulated to the Directors for review and feedback.
- Those responsible for matters arising are asked to provide updates to the next meeting by way of an update paper.

Beyond Board meetings

Non-Executive Directors see attendance at Board and Committee meetings as only one part of their role. In addition to the annual schedule of Board and Committee meetings, the Non-Executive Directors undertake a full programme of activities and engagement each year, as set out on page 62–63.

Non-Executive Directors regularly meet with senior management and spend time increasing their understanding of the business through site visits, formal briefing sessions or more informal events including breakfast meetings with senior staff. These informal meetings allow Directors greater time to discuss business in an informal setting, ensuring that there is sufficient time for the Board to discuss matters of a material nature at Board meetings.

Where further training or awareness is identified, such as new technology, regulations or sector advances, deep dives are held with the relevant field expert to provide overviews, chances to raise questions, and debate the impacts on business in an informal setting.

In April, the Board held a joint discussion with the Board of Scottish Widows Group Limited allowing in-depth focus on insurance matters.

The Executive Directors make decisions within clearly defined parameters which are documented within the Corporate Governance Framework, although where appropriate, any activities outside the ordinary course of business are brought to the full Board for their consideration, even if the matters fall within the agreed parameters. The Corporate Governance Framework helps to ensure that decisions are made by the management with the correct authority.

The right processes in place to deliver on our strategy

During the year, there were 10 scheduled Board meetings, with details of attendance shown on page 58. In addition to formal meetings, the Board meets as necessary to consider matters of a time-sensitive nature. The Chairman and the Chairmen of each Committee ensure Board and Committee meetings are structured to facilitate open discussion, debate and challenge. Through their opening remarks, the Chairmen set the focus of each meeting.

The Board is supported by its Committees which make recommendations on matters delegated to them under the Corporate Governance Framework, in particular in relation to internal control risk, financial reporting, governance and remuneration issues.

The management of all Committees is in keeping with the basis on which meetings of the Board are managed. Each of the Committee's structures facilitates open discussion and debate, with steps taken to ensure adequate time for members of the Committees to consider proposals which are put forward.

In the rare event of a Director being unable to attend a meeting, the Chairmen of the respective meetings discusses the matters proposed with the Director concerned, seeking their support and feedback accordingly. The Chairman subsequently represents those views at the meeting.

The Board recognises the need to be adaptable and flexible to respond to changing circumstances and emerging business priorities, whilst ensuring the continuing monitoring and oversight of core issues.

The Group has a comprehensive and continuous agenda setting and escalation process in place to ensure that the Board has the right information at the right time and in the right format to enable the Directors to make the right decisions. The Chairman leads the process, assisted by the Group Chief Executive and Company Secretary. The process ensures that sufficient time is being set aside for strategic discussions and business critical items.

The process of escalating issues and agenda setting is reviewed at least annually as part of the Board Effectiveness Review with enhancements made to the process, where necessary, to ensure it remains effective. Details of the meeting process are provided on page 64.

The Non-Executive Directors also receive regular updates from the Group Chief Executive's office including a weekly email which gives context to current issues. In-depth and background materials are regularly provided via a designated area on the Board portal.

A full schedule of matters reserved for the Board and Terms of Reference for each of the Committees can be found at www.lloydsbankinggroup.com

IT Resilience and cyber security

At the Board meeting in May 2017, the Board took part in an advanced scenario testing exercise to simulate real life cyber-attack scenarios. The purpose of this was to enhance the Board's understanding of the processes and controls in place, and to rehearse the actions required from the Board at the different stages of an incident if such an event should occur in reality.

IT resilience and the dynamic threat posed by cyber risk are recognised as key risks and are a central area of focus for the Board Risk Committee.

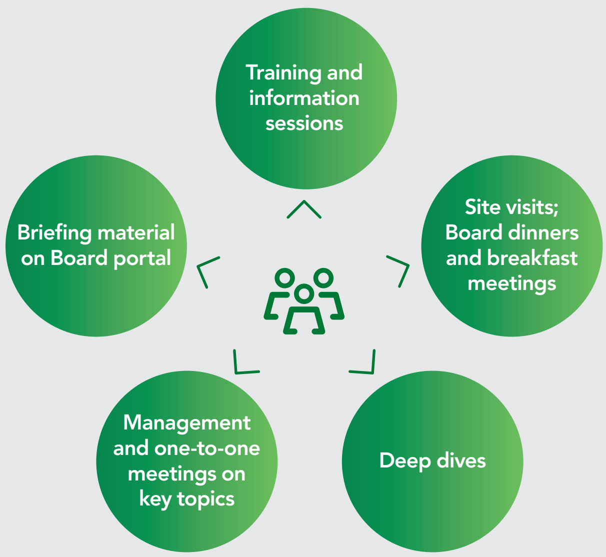
Important and/or material issues continue to be brought to the full Board Risk Committee for information, consideration and discussion as appropriate.

During the year, the sub-committee of the Board Risk Committee dedicated to IT resilience and cyber security considered a wide range of issues including:

- cyber and IT controls;
- technology resilience;
- cyber security; and
- roles and responsibilities of the Chief Security Officer.

See page 78 for more information.

Professional development and training programme at a glance



Assessing our effectiveness

How the Board performs and is evaluated

The Board is in the third year of its three year evaluation cycle. An external evaluation was conducted in 2015, facilitated by JCA Group[1], with an internal evaluation having been carried out in 2016 and this year. The annual evaluation is facilitated externally at least once every three years and an externally facilitated evaluation will be conducted in 2018. The Chairman of the Board leads the annual review of the Board's effectiveness and that of its Committees and individual Directors with the support of the Nomination and Governance Committee, which he also chairs. Performance evaluation of the Chairman is carried out by the Non-Executive Directors, led by the Senior Independent Director, taking into account the views of the Executive Directors.

2017 evaluation of the Board's performance

The 2017 evaluation was conducted internally between October 2017 and December 2017 by the Company Secretary, and was overseen by the Nomination and Governance Committee.

The 2017 review sought the Directors' views on a range of topics including: strategy; planning and performance; risk and control; Board composition and size; balance of skills and experience; diversity; culture and dynamics; the Board's calendar and agenda; the quality and timeliness of information; and support for Directors and Committees.

If Directors have concerns about the Company or a proposed action which cannot be resolved, it is recorded in the Board minutes. Also on resignation, Non-Executive Directors are encouraged to provide a written statement of any concerns to the Chairman, for circulation to the Board. No such concerns were raised in 2017 and up to the date of this report.

Internal evaluation process

OCTOBER 2017

- Questionnaires issued to all Directors by the Company Secretary for completion.

OCTOBER – DECEMBER 2017

- Individual meetings held between each Director and the Company Secretary to discuss responses and opportunity for Directors to raise any other matters concerning the Board or its Committees.

DECEMBER 2017 – JANUARY 2018

- Report prepared by the Company Secretary based on the questionnaire results and matters raised in individual meetings.

JANUARY 2018

- Draft report discussed by the Company Secretary with the Chairman.
- Final report discussed at a meeting of the Board. The Board discussion was subsequently considered by the Nomination and Governance Committee.

APRIL 2018

- Actions to be recommended to the Board by the Nomination and Governance Committee to reflect the Board discussion in January.
- Subsequently the Board will consider the recommendations and agree an action plan.

JULY 2018

- Update to be provided to both the Nomination and Governance Committee and the Board detailing progress against the agreed actions.

Highlights from the 2017 review

The reviews concluded that the performance of the Board, its Committees, the Chairman and each of the Directors continues to be effective. All Directors demonstrated commitment to their roles.

Having been Board members for more than six years, a particularly rigorous review of Anita Frew's and Sara Weller's independence was undertaken. The Nomination and Governance Committee concluded they were both still sufficiently independent.

Many Directors commented favourably on the performance of the Board as a whole, describing it as hardworking, conscientious, expert, questioning and highly engaged. Highlights mentioned by several Directors were the continued value of deep dives, the offsite strategy session (described by one Director as a 'model of open discussion'); the openness of Executives to interacting with the Board members and sharing issues, the discussion on executive succession; the process for keeping the Board aware of important issues which arise between meetings; the further development of Group Internal Audit; the usefulness of the Risk Sub-Committees and the Cyber Security Advisory Panel and the Non-Executive Director only discussions. Directors also spoke highly of the work done by the Chairman and the Chairmen of the Committees in structuring agendas and ensuring that business is covered at the meetings.

The actions from the 2016 Board Effectiveness Review have been recognised by Directors as helpful, particularly, the requirement that 'links to strategy' are identified in Board papers. Many think that more needs to be done to make Board papers more concise and focused and that less meeting time should be used for presentations.

Points raised in the 2017 Board effectiveness review

The review identified a number of areas for improvement in the Board's effectiveness.

Board papers and presentations to the Board
The most common observation by Directors concerned the volume and content of information contained within Board papers, which was also linked to observations in favour of reducing the amount of time spent on presentations in Board meetings. Directors would like to receive more concise reports, highlighting important points and avoiding unnecessary volume and repetition, along with having fewer and shorter presentations.

Stakeholder feedback
Directors believe that they receive good information on regulatory and customer feedback. Several Directors would like to receive more feedback from stakeholders other than regulators and customers, including shareholders and bond holders. The views of shareholders on remuneration matters are well represented at the Remuneration Committee.

Responsible Business Committee Terms of Reference
A number of Directors suggested that the Terms of Reference of the Responsible Business Committee be reconsidered, now that it has been in operation for a full year, in order to avoid duplication of effort in areas covered by other Committees.

Non-Executive Director recruitment
While there was general agreement that the balance of skills within the Board was good, a number of Directors asked that the following experience be borne in mind for future recruitment of Directors (to supplement the experience of the current Directors in these areas): major change management; finance; accounting and data.

Some Directors mentioned the importance of maintaining, and enhancing, gender diversity in the Board.

1 Aside from assisting with senior recruitment, benchmarking and succession planning, JCA Group has no other connection to the Company.

Progress against the 2016 internal Board effectiveness review

During the year, work focused particularly on the quality and quantity of papers and to the linkage of agenda items to the 'Bank of the Future' strategy. A summary of the Board's progress against the actions arising from the 2016 effectiveness review are set out below.

	Recommendations from the 2016 evaluation	Actions taken in 2017
Links to strategy	More frequent linkage to strategy in the regular business of the Board.	Two in-depth strategy away days held during the year; The programme of regular deep dives and discussion topics established in 2016 continues; All papers submitted to Board meetings include clear links to strategy.
Volume of Board/ Committee papers	Request from Directors to receive more concise reports with clearer signposting of the key issues.	Executive summaries have been shortened and a brief section on debate and challenge has been included; Revised Board template and clear guidance in place in respect of both papers submitted to meetings and presentations given during meetings.
Conduct of Board/ Committees	Review and continue to evolve the quality and content of Board papers to ensure effective use of meetings and improve discussions.	Continued progress on focusing material and presentations on key issues for the Board.

Internal control

Board responsibility

The Board is responsible for the Group's risk management and internal control systems, which are designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. The Directors and senior management are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. The Directors acknowledge their responsibilities in relation to the Group's risk management and internal control systems and for reviewing their effectiveness.

In establishing and reviewing the risk management and internal control systems, the Directors carried out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity, the likelihood of a risk event occurring and the costs of control. The process for identification, evaluation and management of the principal risks faced by the Group is integrated into the Group's overall framework for risk governance. The Group is forward-looking in its risk identification processes to ensure emerging risks are identified. The risk identification, evaluation and management process also identifies whether the controls in place result in an acceptable level of risk. At Group level, a consolidated risk report and risk appetite dashboard are reviewed and regularly debated by the Group Risk Committee, Board Risk Committee and the Board to ensure that they are satisfied with the overall risk profile, risk accountabilities and mitigating actions. The report and dashboard provide a monthly view of the Group's overall risk profile, key risks and management actions, together with performance against risk appetite and an assessment of emerging risks which could affect the Group's performance over the life of the operating plan. Information regarding the main features of the internal control and risk management systems in relation to the financial reporting process is provided within the risk management report on pages 107–156. The Board concluded that the Group's risk management arrangements are adequate to provide assurance that the risk management systems put in place are suitable with regard to the Group's profile and strategy.

Control effectiveness review

An annual control effectiveness review ('CER') is undertaken to evaluate the effectiveness of the Group's control framework with regard to its material risks, and to ensure management actions are in place to address key gaps or weaknesses in the control framework. Business areas and head office functions assess the controls in place to address all material risk exposures across all risk types. The CER considers all material controls, including financial, operational and compliance controls. Senior management approve the CER findings which are reviewed and independently challenged by the Risk Division and Group Internal Audit and reported to the Board. Action plans are implemented to address any control deficiencies.

Reviews by the Board

The effectiveness of the risk management and internal control systems is reviewed regularly by the Board and the Audit Committee, which also receives reports of reviews undertaken by the Risk Division and Group Internal Audit. The Audit Committee receives reports from the Company's auditor, PricewaterhouseCoopers LLP (which include details of significant internal control matters that they have identified), and has a discussion with the auditor at least once a year without executives present, to ensure that there are no unresolved issues of concern.

The Group's risk management and internal control systems are regularly reviewed by the Board and are consistent with the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting issued by the Financial Reporting Council and compliant with the requirements of CRD IV. They have been in place for the year under review and up to the date of the approval of the annual report. The Group has determined a pathway to compliance with BCBS 239 risk data aggregation and risk reporting requirements and continues to actively manage enhancements.

Continuous improvement

The Group's Controls Frameworks are continuously improved and enhanced, addressing known issues and keeping pace with the dynamic environment. Progress continues to be made in IT, Cyber and Conduct. The 2017 CER assessment provides reasonable assurance that the Group's controls are effective or that where control weaknesses are identified, they are subject to management oversight and action plans. The Audit Committee, in conjunction with the Board Risk Committee, concluded that the assessment process was effective and recommended them to the Board for approval.

Complying with the UK Corporate Governance Code 2016

The UK Corporate Governance Code 2016 (the 'Code') applied to the 2017 financial year. The Group confirms that it applied the main principles and complied with all the provisions of the Code throughout the year. The Code is publicly available at www.frc.org.uk.

The statement by the Chairman of the Remuneration Committee and the Annual report on remuneration are set out on pages 84 and 88.

The Group has adopted the UK Finance Code for Financial Reporting Disclosure and its 2017 financial statements have been prepared in compliance with its principles.

A. Leadership

A1. The Board's Role The Group is led by an effective, committed unitary Board, which is collectively responsible for the long-term success of the Company. The Group's Corporate Governance Framework, which is reviewed annually by the Board, sets out a number of key decisions and matters that are reserved for the Board's approval. Further details can be found online at www.lloydsbankinggroup.com and on page 64.

	Independent	Responsibilities
Chairman Lord Blackwell		Lord Blackwell leads the Board and promotes the highest standards of corporate governance. He sets the Board's agenda and builds an effective and complementary Board. The Chairman leads Board succession planning and ensures effective communication with shareholders.
Executive Directors **Group Chief Executive** António Horta-Osório		António Horta-Osório manages and leads the Group on a day-to-day basis and makes decisions on matters affecting the operation, performance and strategy of the Group's business. He delegates aspects of his own authority, as permitted under the Corporate Governance Framework, to other members of the Group Executive Committee. He provides leadership and direction to senior management and coordinates all activities to implement the strategy and for managing the business in accordance with the Group's risk appetite and business plan set by the Board.
Chief Financial Officer George Culmer		Under the leadership of the Group Chief Executive, George Culmer and Juan Colombás make and implement decisions in all matters affecting operations, performance and strategy. They provide specialist knowledge and experience to the Board. Together with António Horta-Osório, George Culmer and Juan Colombás design, develop and implement strategic plans and deal with day-to-day operations of the Group. During the year Juan Colombás was appointed to the role of Chief Operating Officer in September 2017. Prior to this he served as the Group's Chief Risk Officer.
Chief Operating Officer Juan Colombás		
Non-Executive Directors **Deputy Chairman and Senior Independent Director** Anita Frew	✓	As Deputy Chairman, Anita Frew would ensure continuity of chairmanship during any change of chairmanship. She supports the Chairman in representing the Board and acting as a spokesperson. She deputises for the Chairman and is available to the Board for consultation and advice. The Deputy Chairman represents the Group's interests to official enquiries and review bodies. As Senior Independent Director, Anita Frew is also a sounding board for the Chairman and Chief Executive. She acts as a conduit for the views of other Non-Executive Directors and conducts the Chairman's annual performance appraisal. She is available to help resolve shareholders' concerns and attend meetings with major shareholders and financial analysts to understand issues and concerns.
Alan Dickinson	✓	The Non-Executive Directors challenge constructively and help develop and set the Group's strategy. They actively participate in Board decision-making and scrutinise management performance. The Non-Executive Directors satisfy themselves on the integrity of financial information and review the Group's risk exposures and controls. The Non-Executive Directors, through the Remuneration Committee, determine the remuneration of Executive Directors.
Simon Henry	✓	
Nick Luff[1]	✓	
Lord Lupton[2]	✓	
Deborah McWhinney	✓	
Nick Prettejohn	✓	
Stuart Sinclair	✓	
Anthony Watson[1]	✓	
Sara Weller	✓	
Company Secretary Malcolm Wood		The Company Secretary advises the Board on matters such as governance and ensures good information flows and comprehensive practical support are provided to Directors. He maintains the Group's Corporate Governance Framework and organises Directors' induction and training. The Company Secretary communicates with shareholders as appropriate and ensures due regard is paid to their interests. Both the appointment and removal of the Company Secretary is a matter for the Board as a whole.

1 Nick Luff and Anthony Watson resigned from the board with effect from 10 May and 11 May 2017, respectively.

2 Lord Lupton joined the Board with effect from 1 June 2017.

A2. Division of responsibilities There is clear division of responsibility at the head of the Company, which is documented in the Group's Corporate Governance Framework.

A3. Role of the Chairman The Chairman has overall responsibility for the leadership of the Board and for ensuring its effectiveness.

Lord Blackwell was independent on appointment.

A4. Role of the Non-Executive Directors The Board has a Senior Independent Director ('SID'), Anita Frew, who acts as a sounding board to the Chairman and Group Chief Executive. She can be contacted by shareholders and other Directors as required. Anthony Watson served as SID until 11 May 2017.

The Non-Executive Directors challenge constructively and help develop and set the Group's strategy.

Meetings are held between the Non-Executive Directors in the absence of the Executive Directors, and at least once a year in the absence of the Chairman.

Further information on meeting arrangements and the responsibilities of the Directors are given on pages 64–65 and 68 respectively.

B. Effectiveness

B1. The Board's composition The balance of skills, experience, independence, and knowledge on the Board is the responsibility of the Nomination and Governance Committee, and is reviewed annually, or whenever appointments are considered.

The majority of the Board are independent Non-Executive Directors as shown on page 68.

B2. Board appointments The process for Board appointments is led by the Nomination and Governance Committee, which then makes a recommendation to the Board.

More details about succession planning can be found on page 72. More information about the work of the Nomination and Governance Committee can be found on pages 70–72.

B3. Time commitments The time commitments of the Directors are considered by the Board on appointment and annually.

The Chairman considers any new external appointments which may impact existing time commitments.

Non-Executive Directors are required to devote such time as is necessary for the effective discharge of their duties. The estimated minimum time commitment set out in the terms of appointment is 35-40 days per annum including attendance at Committee meetings. For Committee Chairmen and the SID, this increases to a minimum of 45 to 50 days. In reality, the time devoted on the Group's business by the Non-Executive Directors is considerably more than the minimum requirements.

Executive Directors are allowed to hold no more than one Non-Executive Director role in a FTSE 100 company and may not take on the Chairmanship of such a company.

The Chairman is committed to this being his primary role, limiting his other commitments to ensure he can spend as much time as the role requires.

There are no Directors whose time commitments are considered to be a matter for concern.

B4. Training and development The Chairman leads the learning and development of Directors and the Board generally and regularly reviews and agrees with each Director their individual and combined training and development needs.

Ample opportunities, support and resources for learning are provided through a comprehensive programme, which is in place throughout the year comprising both formal and informal training and information sessions.

The Chairman personally ensures that on appointment each Director receives a full, formal and tailored induction. The emphasis is on ensuring the induction brings the business and its issues alive for the new Director, taking account of the specific role they have been appointed to fulfil and the skills/experience of the Director to date. An outline of the induction programme for Lord Lupton can be found on page 61.

Directors who take on or change roles during the year attend induction meetings in respect of those new roles.

The Company Secretary maintains a training and development log for each Director.

B5. Provision of information and support The Chairman, supported by the Company Secretary, ensures that Board members receive appropriate and timely information.

The Group provides access, at its expense, to the services of independent professional advisers in order to assist Directors in the role.

Board Committees are also provided with sufficient resources to undertake their duties.

All Directors have access to the services of the Company Secretary in relation to the discharge of their duties.

B6. Board and Committee performance and evaluation An externally facilitated performance evaluation was completed in 2015, with internally facilitated evaluations having taken place in 2016 and 2017. More information can be found on pages 66–67, along with the findings, actions, and progress made during the year.

B7. Re-election of Directors At the 2017 AGM, all Directors were subject to re-election with the exception of Anthony Watson, who stepped down after the AGM and Nick Luff, who stepped down prior to the AGM. All Directors will be standing for re-election, and in the case of Lord Lupton, election by shareholders at the 2018 AGM.

C. Accountability

C1. Financial and business reporting The Directors' and Auditors' Statements of Responsibility can be found on pages 83 and 158 respectively.

Information on the Company's business model and strategy can be found on pages 1–37.

C2. Risk management and internal control systems See page 67 for more detail regarding internal control.

The Audit Committee is responsible for the effectiveness of internal controls and the Risk Management Framework. Further information can be found on pages 73–76.

The Board Risk Committee is responsible for the review of the risk culture of the Group, setting the tone from the top in respect of risk management. Further information can be found on pages 77–79.

The Directors' viability statement and confirmation that the business is a going concern can be found on page 82.

C3. Role and responsibilities of the Audit Committee The Audit Committee reports to the Board on how it discharges its responsibilities and makes recommendations to the Board. Full information on the Audit Committee can be found on pages 73–76.

D. Remuneration

D1. Level and elements of remuneration The Directors' Remuneration Report on pages 84–102 explains the work of the Remuneration Committee and provides full details regarding the remuneration of Directors. The Remuneration Policy can be found in the 2016 Annual Report and Accounts.

E. Relations with Shareholders

E1. Shareholder engagement Details of engagements with shareholders during the year can be found on page 62.

E2. Use of General Meetings The 2018 AGM will be held on 24 May 2018. The whole Board is expected to attend and will be available to answer shareholders' questions.

To facilitate shareholder participation, electronic proxy voting and voting through the CREST proxy appointment service are available. All votes are taken by way of a poll to include all shareholder votes cast.

A webcast of the AGM is carried out to allow shareholders who cannot attend in person to view the meeting live.

Nomination and Governance Committee report

> The Group aspires to the highest standards of corporate and internal governance in accordance with the expectations of the Board.

Dear Shareholder

The Nomination and Governance Committee (the 'Committee') continued to keep under review the structure, size and composition of the Board and its Committees. At the core of the process is an ongoing assessment led by me of the collective Board's technical and governance skill set. These assessments provide an essential analysis of the skills and experience of the Non-Executive Directors relative to the required and desirable Board competencies to help ensure that the Board continues to have an appropriate range and depth of Non-Executive skills.

As detailed in last year's annual report and following our announcement in February 2017, Nick Luff and Anthony Watson left the Board in May 2017. These departures resulted in the positions of Senior Independent Director and Audit Committee Chairman becoming vacant. The Committee reviewed both internal and external candidates for the position of Senior Independent Director. It was subsequently agreed that Anita Frew would become the Senior Independent Director and Simon Henry would become the Chairman of the Audit Committee. Further details in respect of both of these appointments are provided below.

In addition to these changes, a thorough recruitment process was initiated and overseen by the Committee to select suitable candidates for the roles of Non-Executive Director of the Company and Chairman of Lloyds Bank Corporate Markets plc, who would provide the required skill set, experience and knowledge whilst complementing the existing Board of Lloyds Banking Group plc. As a result of this Lord Lupton was appointed to the Board in June 2017. Lord Lupton was chosen for this role as he brings not just his experience of UK banking and capital markets, but also his extensive corporate advisory experience which will be of particular value to our overall Commercial Banking activities.

During the year, the Committee dedicated a substantial part of its time to Executive succession planning, building on the progress made over the previous years. The work undertaken included additional analysis and benchmarking, which led to the establishment of development plans for identified candidates (further details can be found opposite). These were important considerations in the executive reorganisation announced in the summer.

The Group aspires to the highest standards of corporate and internal governance in accordance with the expectations of the Board, ensuring that governance is in compliance with the latest regulation. As part of this, the Board's Diversity Policy was reviewed by the Committee during the year. The review included the consideration of aspects of new and emerging best practice and regulatory developments in the area of senior management and Board diversity. This led to amendments to the existing policy explicitly to broaden the range of diversity criteria which will be taken into consideration in future appointments. Specifically, the policy now includes race, age, gender, educational and professional background as attributes.

Lord Blackwell
Chairman, Nomination and Governance Committee

Committee purpose and responsibilities

The purpose of the Committee is to keep the Board's governance, composition, skills, experience, knowledge, independence and succession arrangements under review and to make appropriate recommendations to the Board to ensure the Company's arrangements are consistent with the highest corporate governance standards.

The Committee reports to the Board on how it discharges its responsibilities and makes recommendations to the Board, all of which have been accepted during the year. The Committee's terms of reference can be found at www.lloydsbankinggroup.com/our-group/corporate-governance

Committee composition, skills and experience

To ensure a broad representation of experienced and independent Directors, membership of the Committee comprises the Chairman, the Deputy Chairman, who is also the Chairman of the Remuneration Committee and the Senior Independent Director, the Chairman of the Board Risk Committee, and the Chairman of the Responsible Business Committee. The Group Chief Executive attends meetings as appropriate.

Details of Committee membership and meeting attendance can be found on page 58.

During the year the Committee considered a number of issues relating to the Group's governance arrangements, both internal and external. It assisted the Chairman in keeping the composition of the Board and its Committees under review and it leads the search process for nominations to the Board.

These issues are summarised on the next page.

Activities during the year

	KEY ISSUES	COMMITTEE REVIEW AND CONCLUSION
Board changes and Board composition	Change in Senior Independent Director and Audit Committee Chairman	Anita Frew as Senior Independent Director – The Committee considered a range of external and internal candidates for this position (the external candidates were sourced by JCA Group[1]), and agreed that Anita's significant board, financial and investment management experience, including as a Senior Independent Director, made her ideally suited to take on the role. Simon Henry as Audit Committee Chairman – Simon had been a member of the Audit Committee since June 2014, and the Committee agreed that his background and experience enable him to fulfil the role of Audit Committee Chairman and for SEC purposes the role of Audit Committee financial expert.
	New Non-Executive Director	The external search firm JCA Group provided an extensive list of candidates. The Committee selected and shortlisted candidates, interviews were carried out with various members of the Board, and the process resulted in the appointment of Lord Lupton to the Board in June. Details of Lord Lupton's induction are provided on page 61.
	Structure and composition of the Board	From the ongoing assessment of the Board members, the Chairman creates a skills matrix which the Committee uses to track the Board's strengths and identify gaps in the desired collective skills profile of Board members, giving due weight to diversity in its broadest sense. Recommendations are made to the Board as appropriate.
Succession planning	Developing the succession plans for senior management, and establishing and agreeing development plans.	During the year, the Committee, led by the Chairman, reviewed the succession plans for key senior management roles. Full details of the process are provided on the next page.
Lloyds Bank Corporate Markets plc	Formation of Lloyds Bank Corporate Markets plc, including the establishment of the Board and its governance structures.	In addition to the appointment of Lord Lupton as Chairman of the new bank, the Committee also oversaw the selection of the Board members. This involved shortlisting external candidates for the position of independent non-executive directors with the help of an external recruitment provider, Russell Reynolds[1], meeting with the candidates on a one-to-one basis and reviewing both the individuals and overall composition of the new board before making recommendations to the Group Board. In addition to the composition of the board, the Committee has also reviewed the governance framework, including the Terms of Reference of the preparatory board. The preparatory board preceded the formation of the operating board, and was established by the Group board to oversee the establishment of the company, board and structure.
Annual effectiveness review	Performance of the annual effectiveness review of the Board and its Committees.	During the year, the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review. Full details of the review can be found on pages 66–67.
Governance	The Committee oversees various aspects of corporate governance, and during the year, the key activities included the following:	Annual review of the Corporate Governance Framework Helping to establish governance for the non ring-fenced bank, including agreeing the Terms of Reference to the non ring-fenced bank preparatory board Annual review of the share dealing policy for Directors and GEC Received reports from the Chairman on communications with shareholders Approved the appointment of Trustees to the Bank's Foundations Reviewed and proposed a training schedule for Non-Executive Directors Received governance reports from the Company Secretary detailing updates and changes to regulation and best practice
Diversity	The Board Diversity Policy was reviewed by the Committee during the year.	In addition to the changes noted in the Chairman's letter on page 52, Board appointments must also take into account independence and knowledge in addition to specific skills and experience to ensure a diverse Board composition. The full Diversity Policy can be found at www.lloydsbankinggroup.com.
Independence and time commitments	A review as to whether Non-Executive Directors were demonstrably independent and free of relationships and other circumstances that could affect their judgement.	The Committee conducted a review of the role, including capabilities and time commitment of all the Directors of the Company. This review was undertaken with reference to the individual performance and conduct in reaching decisions. It also took account of any relationships that had been disclosed. Details of conflicts of interest can be found on page 81. Based on its assessment for 2017, the Committee is satisfied that, throughout the year, all Non-Executive Directors remained independent as to both character and judgement. All Directors were considered to have appropriate roles, including capabilities and time commitments.
Training	A review of the Group's approach to the training of Non-Executive Directors.	In addition to the existing methods of training for the Directors, the Board accepted a recommendation from the Committee that Non-Executive Directors should be provided with a mandatory training programme, ideally available online, based on relevant core modules which are part of the mandatory training programme undertaken by all colleagues. Members of the Committee are currently testing training modules and will feedback comments to the Committee in spring 2018 before it is considered for roll-out to the rest of the Board.

1 Aside from assisting with senior recruitment, benchmarking and succession planning, JCA Group, Russell Reynolds, Egon Zehnder and YSC Consulting have no other connection to the Company.

Corporate governance report continued

Succession planning in detail

Good succession planning contributes to the delivery of the Group's strategy by ensuring the desired mix of skills and experience of Board members now and in the future. The Board is also committed to recognising and nurturing talent within executive and management levels across the Group to ensure the Group creates opportunities to develop current and future leaders. The role of succession planning in promoting diversity is recognised and the Group has a range of policies which promote the engagement of under-represented groups within the business in order to build a diverse talent pipeline.

The Company continues to review and identify potential future executive talent and during the year the following activities were undertaken to develop the talent pipeline further:

- Assessment of potential candidates for senior management positions undertaken by the Group Chief Executive with the Chairman, using a range of criteria and benchmarking (facilitated by executive search and board consulting firm Egon Zehnder[1]). Details of assessment criteria are provided below. External candidates were identified by executive search firm, JCA Group to provide a reference benchmark and identify where recruitment might be required.
- Assessments were discussed by the Committee, also taking into consideration discussions with the Non-Executive Directors.
- Individual development plans established for each internal candidate, and validated with individuals.
- Development actions commenced.
- Evidenced progress against the development plans reported to the Committee and PRA in the third quarter.

Assessment of candidates

Each of the potential candidates for senior management positions was assessed by the Group Chief Executive and Chairman using the following criteria with input from Egon Zehnder by way of competency, psychometric and potential assessments and market benchmarking, and in the case of non-GEC members, also with further input from YSC Consulting[1] (a premier leadership consultancy), who use a biographical assessment methodology. The results were then discussed and reviewed by the Nomination and Governance Committee and subsequently in a meeting with all Non-Executive Directors.

Assessment criteria

Leadership:	Breadth of banking experience:
Strategy People Delivery Judgement/values	Retail Commercial Treasury/Capital Insurance Technology
Governance experience:	**Personal:**
Board Investor	Drive Resilience

Candidates were scored from 1 to 5 for each of the above categories, being 5 (very strong versus requirements), 3 (average – not a distinctive strength) and 1 (weakness/development needed).

Board Diversity Policy

The Board Diversity Policy sets out the Board of Lloyds Banking Group's approach to diversity and provides a high level indication of the Board's approach to diversity in senior management roles which is governed in greater detail through the Group's policies.

The Board places great emphasis on ensuring that its membership reflects diversity in its broadest sense. A combination of demographics, skills, experience, race, age, gender, educational and professional background and other relevant personal attributes on the Board is important in providing the range of perspectives, insights and challenge needed to support good decision making.

New appointments are made on merit, taking account of the specific skills and experience, independence and knowledge needed to ensure a rounded Board and the diversity benefits each candidate can bring to the overall Board composition.

Objectives for achieving Board diversity may be set on a regular basis. On gender diversity the Board has a specific target to maintain at least three female Board members and, recognising the emerging target for FTSE companies to move towards 33 per cent female representation, to take opportunities to increase the number of female Board members over time where that is consistent with other skills and diversity requirements.

The Board also places high emphasis on ensuring the development of diversity in the senior management roles within the Group and supports and oversees the Group's objective of achieving 40 per cent of senior roles held by female executives by 2020, along with other metrics which promote the engagement of other under-represented groups within the business. This is underpinned by a range of policies within the Group to help provide mentoring and development opportunities for female executives and to ensure unbiased career progression opportunities. Progress on this objective is monitored by the Board and built into its assessment of executive performance. You can read more on the Group's diversity programmes on page 21 of the strategic report.

A copy of the Board Diversity Policy is available on our website at www.lloydsbankinggroup.com/responsible-business and information on Board diversity can be found on page 58.

Female representation on the Board is currently 25 per cent (based on three female directors and nine male directors).

Audit Committee report

The Committee continues to deliver on its key responsibilities, ensuring focus is maintained on the Group's control environment.

Dear Shareholder

It was both an honour and a pleasure to take on the role as Chairman of the Audit Committee (the 'Committee') in May 2017, and I would like to record my thanks and recognition to Nick Luff for his excellent performance in this role in the preceding four years, on behalf of the Board and the Company.

2017 was a year of significant change and challenge for the Committee. In addition to welcoming Lord Lupton to the Committee we saw the establishment and embedding of new leadership in the internal audit function, and the first full calendar year of the new senior partner for external audit. The Committee oversaw the preparation for various new accounting standards and regulatory requirements, including IFRS 9 'Accounting for financial instruments', and the structural ring-fencing of relevant activities within the Bank.

Over half of the Committee's time is typically spent on financial reporting and integrity of information provided to external parties. In 2017 we focused on assessing judgements and outcomes relating to conduct issues, credit performance and various material accounting issues and changes. The latter included the completion and integration of the acquisition of the MBNA credit card business.

In particular we reviewed provisions for payment protection insurance (PPI), costs and provisions which had exceeded £18 billion by the end of the year. While PPI itself will be finalised as an issue by mid-2019, the Committee will continue to focus on both legacy and emerging conduct issues as a matter of priority.

The external environment for the Bank remains challenging from both a regulation and competition perspective. As a result the Bank is in the process of transforming its business model and ways of working, primarily through increasing digitisation of all its activities. This creates both risk and opportunity for financial reporting and internal controls, and the Committee has already spent significant time considering the implications of this significant level of change.

I am pleased to be able to report a successful conclusion to the planned transformation of the Group Internal Audit function, and during the year we carried out a thorough independent external quality assessment of the function. This review noted the scale and pace of improvement and also provided important recommendations on the application of best practice. These have been incorporated in the future audit plan and in providing a fit for purpose approach for audit in the rapidly changing environment.

This report covers in more detail how the Committee operates and the issues on which we focused. Noting the environment in which we operate I am pleased to be able to report that in the opinion of the Audit Committee, your Company has met its obligations for financial reporting and disclosure and that the internal control framework is both effectively designed and operated.

Simon Henry
Chairman, Audit Committee

Committee purpose and responsibilities

The purpose of the Committee is to monitor and review the Group's financial and narrative reporting arrangements, the effectiveness of the internal controls (including over financial reporting) and the risk management framework, whistleblowing arrangements and each of the internal and external audit processes, including the statutory audit of the consolidated financial statements and the independence of the statutory auditor.

The Committee reports to the Board on how it discharges its responsibilities and makes recommendations to the Board, all of which have been accepted during the year. A full list of responsibilities is detailed in the Committee's terms of reference, which can be found at www.lloydsbankinggroup.com/our-group/corporate-governance. In satisfying its purpose, the Committee undertakes the functions detailed within Disclosure and Transparency Rule 7.1.3R.

During the year the Committee considered a number of issues relating to the Group's financial reporting, these issues are summarised on the next page, including discussion of the conclusions the Committee reached, and the key factors considered by the Committee in reaching its conclusions.

In addition, the Committee considered a number of other significant issues not related directly to financial reporting, including internal controls, internal audit and external audit. These issues are also discussed in detail in the next section, including insight into the key factors considered by the Committee in reaching its conclusions.

Committee composition, skills and experience

The Committee acts independently of the executive to ensure that the interests of the shareholders are properly protected in relation to financial reporting and internal control.

All members of the Committee are independent Non-Executive Directors with competence in the financial sector and their biographies can be found on pages 54–55. With effect from 1 July 2017 the Committee welcomed Lord Lupton, who brings extensive financial experience. Simon Henry is a Chartered Global Management Accountant and has extensive knowledge of financial markets, treasury, risk management and international accounting standards. He is a member having recent and relevant financial experience for the purposes of the UK Corporate Governance Code and is the Audit Committee financial expert for SEC purposes. The members of the Committee keep their skills up to date with Board deep dives and scheduled Audit Committee training. The focus of specific Audit Committee training this year has been on IFRS 9.

During the course of the year, the Committee held separate sessions with the internal and external audit teams, without members of the executive management present. For details of how the Committee was run, see page 64.

Annually the Committee undertakes an effectiveness review. The review forms part of the Board evaluation process with Directors being asked to complete parts of the questionnaire relating to the Committees of which they were members. The findings of the review were considered by the Committee at its January meeting followed up with telephone calls from the Audit Committee chairman with each of the Committee members. On the basis of the evaluation the feedback was that the performance of the Committee continues to be effective.

Whilst the Committee's membership comprises the Non-Executive Directors noted on page 58, all Non-Executive Directors may attend meetings as agreed with the Chairman of the Committee. The Group Financial Controller, Chief Internal Auditor, the external auditor, the Group Chief Executive, the Chief Financial Officer, the Chief Risk Officer and the Chief Operating Officer also attend meetings of the Committee as appropriate. Details of Committee membership and meeting attendance can be found on page 58.

Corporate governance report continued

Financial reporting

During the year, the Committee considered the following issues in relation to the Group's financial statements and disclosures, with input from management, Group Internal Audit and the external auditor:

Activities for the year

	KEY ISSUES	COMMITTEE REVIEW AND CONCLUSION
Payment Protection Insurance (PPI)	In determining the adequacy of the provision for redress payments and administration costs in connection with the mis-selling of PPI the Group makes a number of assumptions based on management judgement. Such assumptions include the number of future complaints that will be received and the extent to which they will be upheld; average redress payments; and related administrative costs. During the year the Group provided a further £1,650 million to cover further operating costs and redress, including the impact of the August 2019 industry deadline. To 31 December 2017, the Group has provided a total of £18,675 million in respect of PPI mis-selling redress and administration costs.	The Committee continued to challenge the assumptions made by management to determine the provision for PPI redress and administration costs. The Committee oversaw continued use of sensitivities reflecting the uncertainty that remains around the ultimate cost of PPI redress. The Committee reviewed management's assessment of the potential impact of the Financial Conduct Authority's ('FCA') Policy Statement which confirmed a two month extension to the industry deadline (now August 2019) for consumers to make their PPI complaints, and on the potential impact of the Plevin case. In the second half of the year, consideration was given to the application for a Judicial Review in relation to the FCA's policy statement that introduced both the August 2019 industry deadline and the concept that an undisclosed commission in excess of 50 per cent of the premium would give rise to an unfair relationship under the Consumer Credit Act. The Committee also reviewed management's assessment of the start of the related FCA media campaign. The Committee concluded that the provision for PPI redress and the Group's external disclosures were appropriate. The disclosures relating to PPI are set out in note 37: 'Other provisions' on page 213 of the financial statements.
Other conduct provisions	The Group has also made provisions totalling £865 million in respect of other conduct matters, including £245 million for packaged bank accounts; £245 million for secured and unsecured arrears handling activities; and £100 million in respect of HBOS Reading, all largely reflecting issues caused prior to the implementation of the Group's Conduct Strategy in 2013.	For packaged bank accounts, the Committee has continued to monitor the utilisation of the provision and management's assessment of both the remaining exposure and the additional provisions required. This has included reviewing the expected level of complaints and the average redress payments. The Committee has understood the basis for determining the provision in respect of the Group's secured and unsecured arrears handling activities. The provision includes the cost of both identifying and rectifying the customers affected. The Committee has reviewed management's assessment of the compensation expected to be paid to a number of customers of the HBOS Impaired Assets Office based in Reading for economic losses, ex-gratia payments and distress and inconvenience following the conviction of two former HBOS employees. The Committee was satisfied that the provisions for other conduct matters were appropriate. The disclosures relating to other conduct provisions are set out in note 37: 'Other provisions' on page 213 of the financial statements.
Ring-fencing	The Committee discussed the accounting and control implications of the Government's structural reform programme ('ring-fencing').	The Committee discussed the accounting considerations for the planned transfer of assets and liabilities from Lloyds Bank plc and its subsidiaries to the Group's non ring-fenced bank. The issues considered included the effect of transactions between entities under common control, hedge accounting and the impact of applying the 'hold to collect' business model under IFRS 9. The Committee also considered specific financial control risks associated with the implementation of ring-fencing and the risk management framework being implemented to mitigate these risks.
Allowance for impairment losses on loans and advances	Determining the appropriateness of impairment losses requires the Group to make assumptions based on management judgement.	The Committee challenged the level of provisions made and the assumptions used to calculate the impairment provisions held by the Group. The Committee was satisfied that the impairment provisions were appropriate. The disclosures relating to impairment provisions are set out in note 51: 'Financial risk management' on page 240 of the financial statements. The allowance for impairment losses on loans and advances to customers at 31 December 2017 was £2,201 million (31 December 2016: £2,412 million).
Recoverability of the deferred tax asset	A deferred tax asset can be recognised only to the extent that it is recoverable. The recoverability of the deferred tax asset in respect of carry forward losses requires consideration of the future levels of taxable profit in the Group.	The Committee considered the recognition of deferred tax assets, in particular the forecast taxable profits based on the Group's operating plan, the split of these forecasts by legal entity and the Group's long-term financial and strategic plans. The assessment also included the impact of the changes in Group structure that will be made to comply with ring-fencing requirements. The Committee agreed with management's judgement that the deferred tax assets were appropriately supported by forecast taxable profits, taking into account the Group's long-term financial and strategic plans. The disclosures relating to deferred tax are set out in note 36: 'Deferred tax' on page 211 of the financial statements. The Group's deferred tax asset at 31 December 2017 was £2,284 million (31 December 2016: £2,706 million).
One-off transactions	Determining the appropriate accounting for certain one-off transactions requires management to assess the facts and circumstances specific to each transaction.	The sale of Vocalink was considered by the Committee during the year. The Committee reviewed the accounting proposed by management and was satisfied that it was appropriate.

	KEY ISSUES	COMMITTEE REVIEW AND CONCLUSION
Uncertain tax positions	The Group has open tax matters which require it to make judgements about the most likely outcome for the purposes of calculating its tax position.	The Committee took account of the respective views of both management and the relevant tax authorities when considering the uncertain tax positions of the Group. The Committee also understood the external advice obtained by management to support the views taken. The Committee was satisfied that the provisions and disclosures made in respect of uncertain tax positions were appropriate. The relevant disclosures are set out in note 47: 'Contingent liabilities and commitments' on page 224 of the financial statements.
Retirement benefit obligations	The Group must make both financial and demographic assumptions of a judgemental nature to determine the value of the defined benefit obligation.	The Committee considered the assumptions underlying the calculation of the defined benefit liabilities. The most critical assumptions reviewed were in respect of the mortality assumptions, inflation and the discount rate, which have been updated to reflect the Group's recent experience, the latest CMI mortality tables and the results of the latest full actuarial review of the Group's main schemes. The Committee was satisfied that the Group's quantitative and qualitative disclosures made in respect of retirement benefit obligations are appropriate. The relevant disclosures are set out in note 35: 'Retirement benefit obligations' on page 206 of the financial statements. The defined benefit obligation at 31 December 2017 was £44,384 million (31 December 2016: £45,822 million).
MBNA acquisition	The Group completed its acquisition of MBNA on 1 June 2017.	The Committee reviewed a summary of the key assumptions underlying the fair value adjustments made by management to the acquired MBNA assets and liabilities. The Committee was satisfied with the key assumptions made. The disclosures relating to the acquisition are set out in note 22: 'Acquisition of MBNA Limited' on page 197 of the financial statements.
Value-In-Force (VIF) asset and insurance liabilities	Determining the value of the VIF asset and insurance liabilities is judgemental and requires economic and non-economic actuarial assumptions.	The Committee challenged the economic and non-economic actuarial assumptions made by management which underpin the calculation of the VIF asset and the insurance liabilities. The most significant assumptions were in respect of annuitant mortality, workplace pension persistency and expenses. The annuitant mortality assumptions were updated to recognise recent experience and for the latest industry improvement model; the assumptions for workplace pension persistency were updated to reflect the introduction of new pension freedom; and the Group's expense assumption was updated to reflect new outsourcing arrangements. The Committee was satisfied that the value of the VIF asset and insurance liabilities were appropriate. The VIF asset at 31 December 2017 was £4,839 million (31 December 2016: £5,042 million). The disclosures are set out in note 24: 'Value of in-force business' on page 198 and note 31: 'Liabilities arising from insurance contracts and participating investment contracts' on page 202 of the financial statements. The liability arising from insurance contracts and participating investment contracts at 31 December 2017 was £103,413 million (2017: £94,390 million).
Viability statement	The Directors are required to confirm whether they have a reasonable expectation that the Company and the Group will be able to continue to operate and meet their liabilities as they fall due for a specified period. The viability statement must also disclose the basis for the Directors' conclusions and explain why the period chosen is appropriate.	The Committee assisted the Board in performing its assessment of the viability of the Company and the Group with input from management. The viability assessment, which was based on the Group's operating, capital and funding plans, included consideration of the principal and emerging risks which could impact the performance of the Group, and the liquidity and capital projections over the period. The Committee was satisfied that the viability statement could be provided and advised the Board that three years was a suitable period of review. The viability statement is disclosed on page 82 of the Directors' report.
IFRS 9	The Committee has devoted a substantial amount of time to understanding and challenging management on its IFRS 9 implementation programme. The Group adopted IFRS 9 on 1 January 2018.	The Committee has been briefed on the Group's IFRS 9 implementation programme throughout 2017 and in prior years and held a session dedicated to IFRS 9 in October 2017. IFRS 9 has three critical elements: classification and measurement, impairment, and hedging. The Group has not adopted the hedging rules within IFRS 9 at 1 January 2018 (a permitted option) and, accordingly, the Committee's focus has been on classification and measurement, and impairment. The Committee has received regular updates facilitating detailed discussion and challenge, including a dedicated extended session to review the key decisions taken by management to implement IFRS 9. During these updates, the Committee has discussed the Group's processes to assess the classification and impairment of its financial assets; the proxies and simplifications used in the data for the models, noting the Model Governance Committee's approval of the integrity, adequacy and methodology of the Group's critical models; the estimated financial and capital impact (including the Group's approach to the transitional arrangements); the industry-wide concerns raised by the PRA and the Group's response to these concerns; the key methodology decisions made by management; and the changes to the Group's key controls and governance.
Other accounting standards	The Committee has discussed the requirements of IFRS 15 (Revenue), which the Group adopted on 1 January 2018, and IFRS 16 (Leases), which the Group expects to adopt on 1 January 2019.	The Committee discussed the Group's approach to the new revenue standard (IFRS 15). The standard does not apply to transactions that are accounted for in accordance with IFRS 9 and, as a result, the impact on the Group is not significant. IFRS 16, the new leasing standard, is not effective until 1 January 2019. The main impact on the Group will be on its property leases which will move 'on-balance sheet'. The Group will recognise a right of use asset and a corresponding liability. The Committee has discussed the Group's progress on its implementation plans for the standard during 2017 and will continue to discuss the Group's plans and the impact of the standard on the Group during 2018.

Corporate governance report continued

Other significant issues

The following matters were also considered by the Committee during the year:

Risk management and internal control systems
Full details of the internal control and risk management systems in relation to the financial reporting process are given within the risk management section on pages 107–156. Specific matters that the Committee considered for the year included:

- the effectiveness of systems for internal control, financial reporting and risk management;
- the extent of the work undertaken by the Finance teams across the Group and consideration of the resources to ensure that the control environment continued to operate effectively; and
- the major findings of internal investigations into control weaknesses, fraud or misconduct and management's response along with any control deficiencies identified through the assessment of the effectiveness of the internal controls over financial reporting under the US Sarbanes-Oxley Act.

The Committee was satisfied that internal controls over financial reporting were appropriately designed and operating effectively.

Group Internal Audit
In monitoring the activity, role and effectiveness of the internal audit function and their audit programme the Committee:

- monitored the effectiveness of Group Internal Audit and their audit programme through quarterly reports on the activities undertaken and a report from the Quality Assurance function within Group Internal Audit;
- approved the annual audit plan and budget, including resource and reviewed progress against the plan through the year;
- oversaw the performance of an External Quality Assessment in line with CIIA standards and reviewed the findings and recommendations;
- oversaw the process for the appointment of the Chief Internal Auditor; and
- considered the major findings of significant internal audits, and management's response.

Speak Up (the Group's whistleblowing service)
The Committee received and considered reports from management on the Group's whistleblowing arrangements including summaries of cases and ongoing reviews of the Whistleblowing Governance Structure. On consideration of the reports submitted, the Committee was satisfied with the actions which had been taken, the reports first having been considered and approved by the Board's Whistleblowing Champion, Anita Frew.

Auditor independence and remuneration
Both the Board and the external auditor have safeguards in place to protect the independence and objectivity of the external auditor. The Committee continues to operate a policy approved during 2016, and amended in 2017 to regulate the use of the auditor for non-audit services to ensure compliance with the revised Ethical Standards for Auditors from the Financial Reporting Council (FRC).

In order to ensure the objectivity and independence of the external auditor, the policy sets a financial threshold above which all non-audit services provided by the external auditor must be approved in advance by the Committee, with additional provision made for the approval of non-material services which are below the threshold by certain members of senior management. The policy further formalises within the Group the restriction on the provision of non-audit services by the external auditor which the FRC considers to be prohibited.

The total amount of fees paid to the auditor for both audit and non-audit related services in 2017 is disclosed in note 11 to the financial statements on page 187.

External auditor
The Committee oversees the relationship with the external auditor. During the year, the Committee considered the auditor's terms of engagement (including remuneration), its independence and objectivity and approved the audit plan (including methodology and risk identification processes). Mark Hannam has been PwC's senior statutory audit partner for the Group and the Company since the beginning of 2016, and attends all meetings of the Committee.

The Committee also considered the effectiveness and performance of the auditor and the audit process.

The process was largely based on an assessment of responses received to a questionnaire from the Chairman of the Audit Committee and business areas as well as Finance, Risk, Legal and Group Internal Audit. The Committee considered also the FRC's Audit Quality Inspection Report published in June 2017. Following review of the feedback from the process the Committee concluded that it was satisfied with the auditor's performance and recommended to the Board a proposal for the re-appointment of the auditor, to be approved at the Company's AGM.

Statutory Audit Services compliance
The Company and the Group confirm compliance with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 for the year to 31 December 2017.

PwC has been auditor to the Company and the Group since 1995, having previously been auditor to certain of the Group's constituent companies. PwC was re-appointed as auditor with effect from 1 January 2016 following a tender process conducted in 2014 in respect of the audit contract for the 2016 financial year. There will be a mandatory rotation for the 2021 audit, and a competitive tender process will be conducted in advance of this time, if not earlier.

Board Risk Committee report

The Group's effective management of risk helps underpin its low risk and customer focused business model.

Dear Shareholder

I am pleased to report on how the Board Risk Committee (the 'Committee') has discharged its responsibilities throughout 2017.

The Committee has continued to give detailed consideration to existing and emerging risks, through a balanced agenda which ensures sufficient focus on standing areas of risk management, together with specific attention being given to those emerging risks which are considered to be of ongoing importance to the Group and its customers. During the year, the Committee continued to make use of dedicated sub-committees to focus on particular areas, such as IT resilience and cyber security, where the dynamic nature and significance of related risks and challenges continues to evolve.

Focus has also been given to the successful execution of a number of significant regulatory change programmes, proactive identification and resolution of conduct issues, and the challenges and opportunities arising from the introduction of open banking and the second Payment Services Directive. Increasing levels of UK consumer indebtedness were also reviewed, and whilst overall controls were found to be robust, with management actions being taken to increase risk mitigation and to minimise customer detriment; close monitoring will continue into 2018. Progress across each of these areas will be a key ongoing focus for the Committee during 2018.

The environment within which the Group operates continues to be subject to considerable change. Uncertainties, including the EU Exit and wider geo-political risks continue to provide challenges, and the Committee will continue to monitor developments and any associated impact on the Group's risk profile.

The Committee has concluded that the Group continues to have strong discipline in the management of both emerging and existing risks, and the Committee's work continues to help support the Group in achieving its core aim of operating as a safe, low risk bank.

Alan Dickinson
Chairman, Board Risk Committee

Committee purpose and responsibilities

The purpose of the Committee is to review the risk culture of the Group, setting the tone from the top in respect of risk management. The Committee is also responsible for ensuring the risk culture is fully embedded and supports at all times the Group's agreed risk appetite, covering the extent and categories of risk which the Board considers as acceptable for the Company.

In seeking to achieve this, the Committee assumes responsibility for monitoring the Group's Risk Management Framework, which embraces risk principles, policies, methodologies, systems, processes, procedures and people. It also includes the review of new, or material amendments to risk principles and policies, and overseeing any action resulting from material breaches of such policy.

More details on the Group's wider approach to risk management can be found in the risk management section on pages 107–156. Full details of the Committee's responsibilities are set out in its terms of reference, which can be found at www.lloydsbankinggroup.com/our-group/corporate-governance

Committee composition, skills, experience and operation

Alan Dickinson, Chairman of the Committee, is a highly regarded retail and commercial banker, having spent 37 years with the Royal Bank of Scotland, most notably as Chief Executive of RBS UK, overseeing the group's Retail and Commercial operations in the UK. The Committee is composed of independent Non-Executive Directors, who provide core banking and risk knowledge, together with breadth of experience which brings knowledge from other sectors, and a clear awareness of the importance of putting the customer at the centre of all that the Group does.

All Non-Executive Directors are members of the Board Risk Committee. The Chief Risk Officer has full access to the Committee and attends all meetings. The Chief Internal Auditor and members of the Executive also attend meetings, as appropriate.

During the year the Committee met its key objectives and carried out its responsibilities effectively. Details of Committee membership and meeting attendance can be found on page 58.

As the most senior risk committee in the Group, the Committee interacts with other related risk committees, including the Group Risk Committee. Such interaction assists with the agenda planning process, where in addition to annual agenda planning, matters considered by the Group Risk Committee are reviewed to ensure escalation of all relevant matters to the Board Risk Committee.

Matters considered by the Committee

Over the course of the year the Committee considered a wide range of risks facing the Group, both standing and emerging, across all key areas of risk management, in addition to risk culture and risk appetite, as noted above.

As part of this review, certain risks were identified which required further detailed consideration. Set out on the following pages is a summary of these risks, with an outline of the material factors considered by the Committee, and the conclusions which were ultimately reached.

During 2017, the Committee continued to utilise established sub-committees to provide additional focus on Financial Markets, IT Resilience & Cyber, and Stress Testing & Recovery Planning. These sub-committees enable members of the Committee to dedicate additional time and resource to achieving a more in-depth understanding of the topics covered, and enable further review and challenge of the associated risks.

Corporate governance report continued

Activities during the year

	KEY ISSUES	COMMITTEE REVIEW AND CONCLUSION
IT and cyber risk	A resilient IT environment is critical to providing reliable services to our customers and enabling sustainable growth. The dynamic cyber risk and the potential for external attacks threatens the confidentiality and integrity of electronic data or the availability of systems. These are key risks for the Group and a central area of focus for the Committee.	Given the dynamic nature and significance of IT and cyber risks, the Board Risk Committee sub-committee on IT resilience and cyber continues to enable more in depth consideration of these risks to the Group. During the year, the sub-committee gave consideration to a wide range of issues including enhanced assurance for cyber critical third parties, cyber and IT controls, Technology Resilience and Cyber Programme updates, Cyber Strategy, and roles and responsibilities of the Chief Security Officer. Alongside this an advisory panel comprised of external industry experts provides the sub-committee with an external view of current and evolving industry wide cyber security threats, challenges and developments. Conclusion: Whilst there have been significant improvements in cyber capability and the Group is within Board risk appetite in relation to its industry benchmark, the Committee will continue to challenge the Group to further improve its ability to mitigate and respond to cyber risk. Technology resilience will also remain a key focus for 2018 as the Group continues to invest in its infrastructure.
Strategy execution risk	The Committee recognises the risks associated with an extensive discretionary and regulatory change agenda. Assessments have been performed to establish achievability of its plans whilst new metrics will be introduced for ongoing risk monitoring and management.	In order to maintain and enhance the Group's strategic position, it continues to invest in new initiatives and programmes. The Group acknowledges the challenges faced with delivering this strategy alongside the extensive regulatory and legal change agenda whilst additionally enhancing systems and controls. In the development of the strategy, the Group considers these demands against the capacity of the organisation to ensure successful delivery for both customers and shareholders. Conclusion: Whilst initial planning has been undertaken to satisfy the Board that the Group can deliver against its planned change objectives, new metrics are being introduced to enable effective performance monitoring, risk management and the assessment of delivery challenges including subject matter capacity and capability. These risk metrics will be managed across the Group but reported to Board on a regular basis.
Regulatory and legal risk	Managing regulatory risk continues to be a key focus within the Group due to the significant amount of highly complex and interdependent regulatory reform that we have had to manage.	The Committee continues to focus on ensuring we have effective controls and oversight to comply with existing regulatory obligations. The Committee has also been focused on overseeing the successful execution of a number of significant, complex and interdependent regulatory change programmes including ring-fencing, EU General Data Protection Regulation, Payment Services Directive II (PSD2), Markets in Financial Instruments Directive II, and the Basel Committee on Banking Supervision (BCBS 239). Given the significance of ring-fencing, monthly programme reporting has been presented to Board and due consideration given to governance and compliance within the ring-fenced bank. Conclusion: The Group has placed significant focus on ensuring compliance with these complex regulatory changes. Regulatory risk will remain a key area of focus for the Committee in 2018 given the importance of complying with our regulatory obligations.
Operational risk	Managing operational risk continues to be a key focus within the Group due to the complexity and volume of change, the Group's IT infrastructure, cyber risk, and reliance on third party suppliers.	The Committee continues to focus on ensuring the Group has an effective framework for managing operational risk, including enhancing the use of key risk and control indicators and scenarios. The Committee has considered a number of reports in relation to the operational risk framework, cyber, IT resiliency, user access management and Cloud computing. Conclusion: The Group has made progress in enhancing its management of operational risk. The Group will continue to focus on enhancing the maturity of its operational risk framework to ensure it is proactive, forward looking and effective in managing the 21st century risks in a digital world, including execution, model, cyber/IT and third party risk.
Conduct risk	The Committee continues to focus closely on the Group's management of conduct risk.	Throughout 2017, the Committee has considered reports on the proactive identification and resolution of conduct issues which directly impact customers (customer conduct risks) and those which can undermine market integrity (market conduct risks). The pace and quality of remediation remained a focus, including root cause analysis to establish lessons learned and help prevent similar issues in the future. Consideration was also given to the conduct risks associated with the treatment of customers in vulnerable circumstances, with a particular focus on those in financial difficulties. In addition the Committee continues to consider developments in the Group's conduct culture as well as reports on rectification programmes, complaints and conduct risk appetite metric performance. Conclusion: Whilst good progress has been made in 2017, to continue embedding the Group's conduct strategy initiatives into business as usual, ongoing improvement in the Group's conduct risk profile will remain a priority for the Group in 2018 and will continue to be a subject of focus for the Committee.
Consumer lending indebtedness	The Committee reviewed key metrics for the motor finance, credit cards, personal loan and personal current account overdraft portfolios to understand the risks associated with persistent indebtedness.	The macroeconomic and market context was reviewed to ensure understanding of the key drivers of increased consumer lending; this included an examination of the overall market growth in consumer lending, changes in indebtedness, a comparison to pre-crisis levels and a review of the growth rate of each consumer credit product within the portfolio. The key macroeconomic drivers of credit losses including the specific impact of debt to income were also reviewed. Underwriting standards, credit quality and the programme of ongoing improvements to strengthen indebtedness and affordability controls were assessed to ensure that risk appetite for the consumer lending portfolios remains appropriate. Conclusion: Regular monitoring continues to assist the Committee in its assessment of indebtedness of the consumer lending portfolios, with management continuing to take action to mitigate potential risks associated with increased indebtedness and to continue to review the appropriate treatment of vulnerable customers.

	KEY ISSUES	COMMITTEE REVIEW AND CONCLUSION
Data risk	The Committee continues to focus on the Group's risks associated with data management, including governance, control and privacy.	Given the increase in data regulation, data remains a key risk for the Group and remains a critical area of focus for the Group's regulators. The Committee has monitored and reviewed the risks associated with the introduction of PSD2, including the need to ensure there is appropriate control and ownership of data as the use of Third Party Providers (TPPs) becomes more prevalent. With the introduction of GDPR, the Committee has overseen actions within the Group to ensure clear control and management of customer data, including assessing its accuracy and how it's used. It is increasingly important for the Committee to ensure the Group has effective controls in place to manage any potential data breaches, including a defined escalation route to the FCA and the ICO. Conclusion: The Group continues to enhance the controls required to manage the data environment effectively, whilst the Committee ensures the necessary risk oversight of the delivery of required regulatory changes relating to data.
UK Secured and buy-to-let	Reviews were undertaken of the risks associated with the UK residential interest only portfolio and the Group's participation in the buy-to-let segment.	In reviewing the UK Secured portfolio, specific consideration was given to the risks associated with maturing residential interest only mortgages. The Committee reviewed repayment rates, in-life and past-term customer engagement and treatment strategies, credit risk performance including debt-to-value ratios, and the Group's risk appetite for future originations. The Group's participation in the buy-to-let segment was also reviewed, including the design and implementation of underwriting changes in response to taxation changes and new supervisory standards for portfolio landlords. Conclusion: The Committee continues to monitor closely trends in the residential interest only portfolio and the progress of management's initiatives to further enhance customer treatment. The Committee was satisfied that additional underwriting controls within buy-to-let provided adequate safeguards to support continued participation in line with the Group's risk appetite limits.
Open banking and payments	Open banking and PSD2 present strategic and operational challenges as well as opportunities and is a central area of focus for the Group.	The UK payments landscape is experiencing a period of unprecedented change. Open banking, mandated by the Competition Markets Authority, will allow TPPs to offer new services through Application Process Interface technology, providing customers with alternative means of access to their bank accounts (governed by explicit customer consent). PSD2 classifies these TPPs as Account Information Service Providers and Payment Initiation Service Providers. The aim of these changes is to promote competition and enhance customer choice. The changes create a number of key risks including (but not limited to) security risk, data risk and fraud risk as sensitive and confidential customer information is shared more widely than current practice. The Group is alert to the potential new vectors for fraud and risks to consumers flowing from these channels, particularly in relation to data security. Additional controls and mitigations have been developed. The Committee received updates throughout 2017 through the consolidated risk report regarding the requirements of the legislation and how the Group is planning to achieve compliance. Conclusion: Initial legislative changes required compliance in January 2018 and further regulatory requirements will come into force by the third quarter of 2019 (when strong customer authentication becomes mandatory). The Committee will continue to review progress throughout 2018 as further developments are delivered by the Group-wide programme.
EU exit	Negotiations are on-going to determine the terms of the UK's exit from the EU. The uncertainty regarding the timing and the process itself could affect the outlook for both the UK and global economy.	The key risks for the Group include adverse movements and volatility in Financial Markets, impact on our customer credit profiles and the ability to operate cross border. When reviewing the possible impacts of the EU exit, the Committee has given consideration to the Group's strong UK focus and UK-centric strategy. The Committee continues to review the effectiveness of risk management across the Group and the actions taken to better understand the impact on our customers, as well as close monitoring of positions in Financial Markets. These actions not only include continued support to all our customers, but in addition the Group has ensured our Commercial Banking customers consider their relevant trading and financial impacts. Conclusion: The EU exit plans continue to be closely monitored by the Committee via a suite of early warning indicators and risk mitigation plans, including the possible loss of passporting arrangements into Europe.
Residual value risk in Motor Finance portfolio	Residual value risk of motor finance businesses was monitored over the year.	Consideration was given to new car registrations, used vehicle prices and provision adequacy in the context of Group exposure to residual value risk in the growing motor finance businesses. The Committee also monitored exposure to residual value risk via risk appetite. Conclusion: Residual value risk exposure continues to perform in line with appetite and the Committee will continue to closely monitor trends in the used car market and automotive sector as a whole.
Model risk	The Committee recognises the importance of the Group Executive and the Board holding a strong understanding of the Group's models, their associated risks and performance.	The Committee discussed, during the year, the current model landscape, trends in performance and actions being taken to resolve material model issues. The Committee considered regulatory impacts and the action being taken by the Group as well as benchmarking the Group's approach to the industry. Conclusion: Whilst good progress was made in 2017, the demand for models and model related activity is expected to increase, with key drivers being the Group strategy and the need for increased automation and analytics as well as increasing regulatory demands. There will be an increased focus by the Committee in 2018 on model risk management to address these challenges.

Responsible Business Committee report

Doing business responsibly is at the heart of strengthening trust in our Group and the industry.

Dear Shareholders

I am pleased to report on the Responsible Business Committee's (RBC) second full year of operation in 2017.

Doing business responsibly is central to our purpose to Help Britain Prosper, and supports our strategy to be a low risk, customer focused bank.

At its meetings, the RBC oversaw a wide range of responsible business activities, which included our substantial investments to provide opportunities for those starting out, whether as first time home buyers, small business start-ups, social entrepreneurs or apprentices.

We also reviewed work being done to tackle disadvantage in communities across the UK, through our four Charitable Foundations, our partnership with Mental Health UK, and our support for vulnerable customers, including those struggling with low financial skills or illness.

To respond to a rapidly changing external environment, the RBC also reviewed emerging areas such as the impact of climate change on UK businesses, individuals and communities, and ways in which we can support enhanced UK productivity through the strengthening of digital skills, particularly for individuals, small businesses and charities.

Many of these activities are described in our 2018 Helping Britain Prosper Plan, which is developed annually with the RBC to reflect the ways in which Lloyds Banking Group, both directly (as the largest corporate tax payer and a substantial UK-wide employer) and indirectly, contributes to the wider economic and social health of Britain.

I would like to thank the many thousands of colleagues who have dedicated their time and energy to supporting these activities and I very much hope you enjoy and find it interesting to read about the Committee's work.

Sara Weller
Chairman, Responsible Business Committee

How the Committee spent its time in 2017

The Chairman of the Committee reviews the forward agenda regularly to ensure that the appropriate topics are considered and adequate time is allocated for members to provide input to proposals at meetings.

During the year, the Committee considered in detail the development of the Group's responsible business approach, including a sustainability strategy. Detailed discussions took place with colleagues from relevant business areas and external advisers at which proposals were considered and challenged leading to a change of focus on some areas of the approach. The Committee contributed to the plans for strengthening the Group's ongoing commitment to supporting basic, workplace and specialist digital skills in the UK during 2018 and provided perspectives on how this could best be achieved.

The Committee also considered the following topics:

- a regular progress report from the Chairman of the executive level Group Customer First Committee (see page 114) on the approach to customers, conduct and culture;
- a report from Group Sourcing on working in a responsible way with the Group's suppliers;
- an oversight of the processes which provide reassurance that customer rectifications are managed responsibly;
- the benchmarking of trust amongst stakeholders and customers against financial services companies and acknowledged leaders in other industries;
- the outputs from colleague surveys in relation to the Group's role as a responsible business; and
- the draft Modern Slavery Statement, before recommending to the Board for approval.

Committee purpose

The purpose of the Committee is to oversee the Group's strategy and plans for becoming a leader in responsible business as part of the objective to help Britain prosper; the activities which have an impact on the Group's behaviour and reputation as a trusted, responsible business; and the development of the Group's responsible business report and Helping Britain Prosper Plan, which the Committee recommends to the Board for approval.

Committee composition, attendance at meetings and effectiveness review

Alan Dickinson, Chairman of the Board Risk Committee, attended all meetings. Representatives from Group Internal Audit and the Chief Operating Office are invited to meetings as appropriate.

Representatives of the regulators attended meetings as observers in January (FCA) and July 2017 (PRA).

During the year, the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review. The Committee will consider the output from the 2017 effectiveness review and whether any changes need to be made to the way it works.

Details of the committee membership and meeting attendance can be found on page 58.

RBC Chairman's visit to Elizabeth Fry charity

In August 2017, Sara Weller visited the Elizabeth Fry Charity in Reading, which has received a grant of around £70,000 from the Lloyds Bank Foundation for England and Wales. The charity runs one of only six approved premises for women released from prison on bail, on license or as part of a community order. The charity supports residents to deal with some challenging issues, such as substance abuse or mental health problems and equips them with the skills to live (and hopefully work) more independently within 3-6 months. After the visit Sara Weller commented: 'my visit reinforced the message that the Foundations actively seek out and make a difference for the most disadvantaged people in our society. Supporting them is something in which we, as a Group, take great pride.'

Directors' report

Corporate governance statement

The Corporate Governance report found on pages 51–80 together with this Directors' report of which it forms part, fulfils the requirements of the Corporate Governance Statement for the purpose of the Financial Conduct Authority's Disclosure Guidance and Transparency Rules (DTR).

Profit and dividends

The consolidated income statement shows a statutory profit before tax for the year ended 31 December 2017 of £5,275 million (2016: £4,238 million). The Directors have recommended a final dividend, which is subject to approval by the shareholders at the AGM, of 2.05 pence per share (2016: 1.7 pence per share) totalling £1,475 million (2016: £1,212 million). The final dividend will be paid on 29 May 2018.

The final dividend in respect of 2016 of 1.7 pence per ordinary share was paid to shareholders on 16 May 2017, a special dividend in respect of 2016 of 0.5 pence per ordinary share was paid to shareholders on 16 May 2017 and an interim dividend for 2017 of 1 pence per ordinary share was paid on 27 September 2017; these dividends totalled £2,284 million, net of a credit in respect of unclaimed dividends written-back in accordance with the Company's Articles of Association. Further information on dividends is shown in note 44 on page 220 and is incorporated by reference.

The Board continues to give due consideration at each year end to the return of any surplus capital and for 2017, the Board intends to implement a share buyback of up to £1 billion, equivalent to up to 1.4 pence per share. This represents the return of capital over and above the Board's view of the current level of capital required to grow the business, meet regulatory requirements and cover uncertainties. The share buyback programme will commence in March 2018 and is expected to be completed during the next 12 months. Given the total ordinary dividend of 3.05 pence per share and the intended share buyback, equivalent to up to 1.4 pence per ordinary share, the total capital return for 2017 will be up to 4.45 pence per share, an increase of up to 46 per cent on the prior year, equivalent to up to £3.2 billion.

The Company intends to use the authority for the repurchase of ordinary shares granted to it at the 2017 AGM to implement the proposed share buyback. Details of this existing authority are set out under 'Power of Directors in relation to shares'.

Appointment and retirement of Directors

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

Lord Lupton has been appointed to the Board since the 2017 AGM and will therefore stand for election at the forthcoming AGM. In the interests of good governance and in accordance with the provisions of the UK Corporate Governance Code, all other Directors will retire, and those wishing to serve again will submit themselves for re-election at the forthcoming AGM.

Biographies of current Directors are set out on pages 54–55. Details of the Directors seeking election or re-election at the AGM are set out in the Notice of Meeting.

Board composition changes

Changes to the composition of the Board since 1 January 2017 up to the date of this report are shown in the table below:

	Joined the Board	Left the Board
Nicholas Luff		10 May 2017
Anthony Watson		11 May 2017
Lord Lupton	1 June 2017	

Directors' and Officers' liability insurance

Throughout 2017 the Group had appropriate insurance cover in place to protect Directors, including the Directors who retired or resigned during the year, from liabilities that may arise against them personally in connection with the performance of their role.

As well as insurance cover, the Group agrees to indemnify the Directors to the maximum extent permitted by law. Further information on the Group's indemnity arrangements is provided in the Directors' indemnities section.

Change of control

The Company is not party to any significant contracts that are subject to change of control provisions in the event of a takeover bid. There are no agreements between the Company and its Directors or employees providing compensation for loss of office or employment that occurs because of a takeover bid.

Directors' indemnities

The Directors of the Company, including the former Directors who retired during the year, have entered into individual deeds of indemnity with the Company which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds indemnify the Directors to the maximum extent permitted by law and remain in force. The deeds were in force during the whole of the financial year or from the date of appointment in respect of the Director appointed in 2017. In addition, the Group had appropriate Directors' and Officers' liability insurance cover in place throughout 2017.

Deeds for existing Directors are available for inspection at the Company's registered office.

The Company has also granted deeds of indemnity by deed poll and by way of entering into individual deeds, which constitute 'qualifying third party indemnity provisions' to the Directors of the Group's subsidiary companies, including to former Directors who retired during the year and since the year end. Such deeds were in force during the financial year ended 31 December 2017 and remain in force as at the date of this report.

Qualifying pension scheme indemnities have also been granted to the Trustees of the Group's Pension Schemes, which were in force for the whole of the financial year and remain in force as at the date of this report.

Power of Directors in relation to shares

The Board manages the business of the Company under the powers set out in the articles of association, which include the Directors' ability to issue or buy back shares. The Directors were granted authorities to issue and allot shares and to buy back shares at the 2017 AGM. Shareholders will be asked to renew these authorities at the 2018 AGM. The authority in respect of purchase of the Company's ordinary shares is limited to 7,154,088,636 ordinary shares, equivalent to 10 per cent of the issued ordinary share capital of the Company as at the latest practicable date prior to publication of the 2017 AGM circular.

The Company did not repurchase any of its shares during the year. (2016: none).

Conflicts of interest

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

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

Branches

The Group provides a wide range of banking and financial services through branches and offices in the UK and overseas.

Research and development activities

During the ordinary course of business the Group develops new products and services within the business units.

Directors' report continued

Information incorporated by reference

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

Content		Pages
Group results	Summary of Group results	39–42
Ordinary dividends	Dividends on ordinary shares	220
Directors' biographies	Board of Directors	54–55
Directors in 2017[1]	Board of Directors	54–55
Directors' emoluments	Directors' remuneration report	84–106
Internal control and financial risk management	Financial reporting risk Risk management and Financial instruments	109 108–156 and 226–237
Information included in the strategic report	Future developments Greenhouse gas emissions (additional information) Inclusion and diversity Engaging colleagues	2–37 27 21–22 22
Disclosures required under Listing Rule 9.8.4R	Significant contracts Dividend waivers	223–224 220
Principal risks and uncertainties	Funding and liquidity Capital position	36 and 144–150 137–144
Share capital and control	Share capital and restrictions on the transfer of shares or voting rights Special rights with regard to the control of the Company Employee share schemes – exercise of voting rights	216 216 216

1 Nick Luff and Anthony Watson also served as directors during the year, retiring from the Company on 10 May 2017 and 11 May 2017 respectively.

Substantial shareholders

Information provided to the Company by substantial shareholders pursuant to the DTR is published via a Regulatory Information Service.

As at 31 December 2017, the Company had been notified by its substantial shareholders under Rule 5 of the DTR of the following interests in the Company's shares:

	Interest in shares	% of issued share capital with rights to vote in all circumstances at general meetings[1]
BlackRock Inc.	3,668,756,765[2]	5.14%
Harris Associates L.P.	3,607,058,758[3]	5.01%

1 Percentage provided was correct at the date of notification.

2 The most recent notification provided by BlackRock Inc. under Rule 5 of the DTR identifies (i) an indirect holding of 3,599,451,380 shares in the Company representing 5.04 per cent of the voting rights in the Company, and (ii) a holding of 69,305,385 in other financial instruments in respect of the Company representing 0.09 per cent of the voting rights of the Company. BlackRock Inc.'s holding most recently notified to the Company under Rule 5 of the DTR varies from the holding disclosed in BlackRock Inc.'s Schedule 13-G filing with the US Securities and Exchange Commission dated 7 February 2018, which identifies beneficial ownership of 4,843,291,732 shares in the Company representing 6.7 per cent of the issued share capital in the Company. This variance is attributable to different notification and disclosure requirements between these regulatory regimes.

3 An indirect holding.

No further notifications have been received under Rule 5 of the DTR as at the date of this report.

Post balance sheet events

The Board has announced its intention to implement a share buyback programme, details of which are from a post balance sheet events perspective provided in note 53, 'Events since the balance sheet date', on page 252.

Going concern

The going concern of the Company 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 Company 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 risk management section under principal risks and uncertainties: funding and liquidity on page 36 and pages 144–149 and capital position on pages 137–144. Additionally, the Directors have considered the capital and funding projections of the Company and Group. Accordingly, the Directors conclude that the Company 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.

Viability statement

The Directors have an obligation under the UK Corporate Governance Code to state whether they believe the Company and the Group will be able to continue in operation and meet their liabilities as they fall due over a specified period determined by the Directors, taking account of the current position and the principal risks of the Company and the Group.

In making this assessment, the Directors have considered a wide range of information, including: the principal and emerging risks which could impact the performance of the Group; the 2017 Group Strategic Review, which sets out the Group's customer and business strategy for the three year period from 2018 to 2020; and the Group's five year operating plan which comprises detailed customer, financial, capital and funding projections together with an assessment of relevant risk factors. In particular in 2017, the assessment included consideration of the impact of Structural Reform (ring-fencing), the effects of the continuing low interest rate environment, the ongoing impact of the implementation of IFRS 9 'Financial Instruments' and the continuing uncertainty over the transitional arrangements to be agreed as part of the UK's exit from the EU.

Group, divisional and business unit operating plans covering a period of five years are produced and subject to rigorous stress testing on an annual basis. The planning process takes account of the Group's business objectives, the risks taken to seek to meet those objectives and the controls in place to mitigate those risks to remain within the Group's overall risk appetite.

The Group's annual planning process comprises the following key stages:

- The Board reviews and revises the Group's strategy, risk appetite and objectives in the context of the operating environment and external market commitments.
- The divisional teams develop their operating plans based on the Board's objectives ensuring that they are in line with the Group's strategy and risk appetite.
- The financial projections and the underlying assumptions in respect of expected market and business changes, and future expected legal, accounting and regulatory changes are subject to rigorous review and challenge from both divisional and Group executives.
- In addition, the Board obtains independent assurance from Risk Division over the alignment of the plan with Group strategy and the Board's risk appetite. This assessment performed by Risk Division also identifies the key risks to delivery of the Group's operating plan.
- The planning process is also underpinned by a robust capital and funding stress testing framework. This framework allows the Group to assess compliance of the operating plan with the Group's risk appetite. The scenarios used for stress testing are designed to be severe but plausible, and take account of the availability and likely effectiveness of mitigating actions that could be taken by management to avoid or reduce the impact or occurrence of the underlying risks. In considering the likely effectiveness of such actions, the conclusions of the Board's regular monitoring and review of risk and internal control systems, as discussed on page 67, is taken into account. Further information on stress testing and reverse stress testing is provided on page 111.
- The final five year operating plan, Risk Division assessment and the results of the stress testing are presented to the Board for approval. Once approved, the operating plan drives detailed divisional and Group targets for the following year.

The Directors have specifically assessed the prospects of the Company and the Group over the first three years of the current plan. The uncertain economic and political environment caused by the UK's plans to leave the EU and the pace of regulatory change mean that the assumptions supporting the fourth and fifth years of the operating plan are likely to be less reliable. As a result, the Board considers that a three year period continues to present a reasonable degree of confidence over expected events and macroeconomic assumptions, whilst still providing an appropriate longer-term outlook, although the remaining period of the operating plan contains no information which would cause different conclusions to be reached over the longer-term viability of the Company and Group.

Information relevant to the assessment can be found in the following sections of the annual report and accounts:

- The Group's principal activities, business and operating models and strategic direction are described in the strategic report on pages 1–37;
- Emerging risks are disclosed on page 110;
- The principal risks, including the Group's objectives, policies and processes for managing credit, capital, liquidity and funding, are provided in the risk management section on pages 116–156; and
- The Group's approach to stress testing and reverse stress testing, including both regulatory and internal stresses, is described on page 111.

Based upon this assessment, the Directors have a reasonable expectation that the Company and the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years to 31 December 2020.

Greenhouse gas emissions

The Group has voluntarily reported greenhouse gas emissions and environmental performance since 2009, and since 2013 this has been reported in line with the requirements of the Companies Act 2006. Our total emissions, in tonnes of CO2 equivalent, are reported in the strategic report on page 26.

Deloitte LLP has provided limited level ISAE 3000 (Revised) assurance over selected non-financial indicators as noted by ✓. Their full, independent assurance statement is available online at www.lloydsbankinggroup.com/rbdownloads

Methodology
The Group follows the principles of the Greenhouse Gas (GHG) Protocol Corporate Accounting and Reporting Standard to calculate our Scope 1, 2 and 3 emissions from our worldwide operations.

The reporting period is 1 October 2016 to 30 September 2017, which is different to that of our Directors' report (January 2017 – December 2017). This is in line with regulations in that the majority of the emissions reporting year falls within the period of the Directors' report. Emissions are reported based on an operational boundary. The scope of reporting is in line with the GHG Protocol and covers Scope 1, Scope 2 and Scope 3 emissions. Reported Scope 1 emissions cover emissions generated from gas and oil used in buildings, emissions from UK company-owned vehicles used for business travel and emissions from the use of air conditioning and chiller/refrigerant plant. Reported Scope 2 emissions cover emissions generated from the use of electricity, calculated using the location based methodology. Reported Scope 3 emissions relate to business travel undertaken by colleagues and emissions associated with the extraction and distribution of each of our energy sources – electricity, gas and oil. A detailed definition of these emissions can be found in our 2017 Reporting Criteria online at www.lloydsbankinggroup.com/rbdownloads

Intensity ratio
GHG emissions (CO_2e) per £m of underlying income

Oct 2016-Sept 2017	**15.8**
Oct 2015-Sept 2016	19.7
Oct 2014-Sept 2015	22.4

Omissions
Emissions associated with joint ventures and investments are not included in this disclosure as they fall outside the scope of our operational boundary. The Group does not have any emissions associated with heat, steam or cooling and is not aware of any other material sources of omissions from our reporting.

Independent auditor and audit information

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

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditor and authorising the Audit Committee to set its remuneration will be proposed at the AGM.

Statement of directors' responsibilities

The Directors are responsible for preparing the annual report, the Directors' remuneration report and the financial statements in accordance with applicable law and regulations. Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors have prepared the Group and parent Company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Company and Group for that period. In preparing these financial statements, the Directors are required to: select suitable accounting policies and then apply them consistently; make judgements and accounting estimates that are reasonable and prudent; and state whether applicable IFRSs as adopted by the European Union have been followed.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

A copy of the financial statements is placed on our website at www.lloydsbankinggroup.com. The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the current Directors who are in office as at the date of this report, and whose names and functions are listed on pages 54–55 of this annual report, confirm that, to the best of his or her knowledge:

- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and Group; and
- the management report contained in the strategic report and the Directors' report includes a fair review of the development and performance of the business and the position of the Company and Group, together with a description of the principal risks and uncertainties that they face.

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

On behalf of the Board

Malcolm Wood Company Secretary
20 February 2018
Lloyds Banking Group plc
Registered in Scotland
Company number SC95000

Directors' remuneration report

Remuneration Committee Chairman's statement

> Our remuneration policy ensures fair reward for all colleagues, with a focus on building a culture where colleagues have a long-term interest in the success of the Group, in line with shareholders.

Anita Frew
Chairman, Remuneration Committee

Dear Shareholder

On behalf of the Board and the Remuneration Committee (the 'Committee'), I have the pleasure of presenting the Directors' remuneration report for the year ended 31 December 2017. The Committee strongly believes that the Group's remuneration approach, guided by four key reward principles, contributes significantly to the delivery of the Group's strategic priorities.

I am very grateful for the continued support and engagement we have had with shareholders, their representative bodies and our wider stakeholder group. I believe this is reflected in the positive voting outcome we received at the AGM in 2017 for our new remuneration policy. No changes are proposed to that policy.

Simplification

We made changes in 2017 in a drive towards further simplification of remuneration structures, removing complexity, and ensuring a focus on rewarding longer-term, sustainable performance. The Group Performance Share plan was introduced in 2017. The plan outcome is determined on a 'top down' basis, as a percentage of the Group's underlying profit, replacing the previous complex bonus pool methodology driven by aggregated divisional and functional bonus outcomes. There are enhancements to the levels of disclosure within this report, with the aim to provide additional clarity and transparency, particularly relating to the performance assessments that underpin the Group Performance Share outcome both at Group level, and for individual Executive Directors.

From 2018, the Group no longer operates specific incentive arrangements for customer-facing colleagues. Instead, colleagues now participate only in the Group Performance Share plan. Approximately 28,000 customer-facing colleagues have transitioned plans during 2017.

In my last report, I announced that all colleagues in the Group had received an award of Colleague Group Ownership Shares, with the aim of achieving 100 per cent share ownership among colleagues and building a colleague-wide long-term ownership culture. I am pleased to confirm that this award will be repeated in 2018.

Taking into consideration stakeholders' views

The Committee remains acutely aware that the topic of remuneration, alongside corporate culture and working practices, continues to generate a high level of focus and that the role of the Committee is to ensure that the interests of colleagues, shareholders and other key stakeholders are considered fairly, and in the context of wider societal expectations.

I have set a broad agenda for the Committee in 2017, further details of which can be found on page 99. The Committee remit is dynamic and extends beyond executive remuneration, believing that all colleagues should be represented in its consideration. It is our aim to ensure that the remuneration policy framework and guiding principles can be applied consistently to all colleagues. This recognises the importance of colleagues working together, sharing collectively in the Group's success and building a culture of acting as stewards of the long-term interests of the Group.

The Committee remains mindful of the relationship between pay for Executive Directors and all other colleagues. To ensure that the Committee understands wider stakeholder views, I have engaged directly with the Group's recognised unions (Accord

Our key priorities

1. Simplifying the Group's remuneration policy and principles, with a focus on long-term share ownership
2. Ensuring remuneration outcomes are fair for all colleagues
3. Rewarding individual performance and collective success
4. Providing alignment to the Group's future strategic priorities
5. Enhancing levels of disclosure and corporate governance

Rewarding all colleagues fairly

Group Ownership Share awards

We aim to achieve 100 per cent share ownership among our colleagues.

Direct engagement with unions

Feedback is sought from Accord and Unite on specific matters.

Our balanced scorecard

Pay linked to performance on the basis of both 'what' was achieved and 'how' it was delivered.

A single pay budget with higher awards for more junior colleagues

Increases to base salary for Directors below the Group pay budget.

Contents

and Unite) who represent the interests of around 30,000 colleagues. Feedback from the unions is provided to the Committee on specific matters under consultation, for example, in setting the annual pay budget for colleagues and any changes to benefits arrangements. I have also actively engaged with the Group's customers, regulators and my other Board members (including directly with the Responsible Business Committee). In addition, our independent advisers have provided regular updates on market context and emerging topics in remuneration.

Rewarding all colleagues fairly

The Group is committed to offering all colleagues a reward package that is competitive, performance-driven and fair.

In discussions with the Group's recognised unions, a 2018 pay budget of 2.7 per cent was agreed, including additional funding to ensure a minimum pay award of £600 for eligible colleagues. Colleagues in lower pay ranges receive higher awards to support pay progression, together with colleagues who receive stronger performance ratings in recognition of their contribution to the Group. The majority of colleagues' pay is determined consistently using fixed pay matrices aligned to the external market and designed to help recruit and retain colleagues with the skills, behaviours and motivation to deliver the Group's strategic aims. This approach supports the Group's commitment to the Living Wage Foundation.

The Committee proposes salary increases for the Group Chief Executive and the Chief Financial Officer set below the budget for the wider colleague population, at 2 per cent. Juan Colombás took on a new role of Chief Operating Officer (COO) in September 2017 and accordingly it is proposed he receive a salary increase of 3.4 per cent to reflect the fact that the COO role is larger than his previous role as the Chief Risk Officer.

The Committee considers that pay ratios provide a useful reference point. However, there remains uncertainty and potential confusion how these should be calculated and disclosed. The Committee has therefore chosen not to publish the CEO to colleague pay ratio data alongside this report and will instead comply with the government proposals when these are finalised.

Summary of 2017 remuneration outcomes

The 'Remuneration at a glance' section on the following pages provides a summary of the remuneration outcomes for Executive Directors and the key measures against which the Committee determined these outcomes.

I should like to draw attention to the following key messages:

- Underlying profit increased to £8,493 million in 2017, exceeding budget by 8.2 per cent. Taking into consideration this financial performance, the Committee agreed an overall Group Performance Share of 5.1 per cent of underlying profit. This was adjusted both positively and negatively to reflect strong performance against stretching Group strategic objectives and conduct provisions impacting negatively on profitability and shareholder returns. In reaching its decision, the Committee considered the impact on customers, conduct and the Group's reputation. The overall outcome determined by the Committee was £414.7 million, approximately 5.5 per cent higher than the equivalent bonus outcome for 2016. The total overall outcome, following the adjustments applied above, is 4.7 per cent of underlying profit before tax which remains significantly lower than the funding limit of 10 per cent. Further detail is provided on page 89, including the detailed metrics in the Group's balanced scorecard.
- The approach to determining individual Group Performance Share awards for Executive Directors is consistent with other colleagues. The Committee determined that awards of between 77 per cent and 80 per cent of maximum should be made to the Executive Directors. These awards reflect individual performance assessed on the basis of whole job contribution, both what was achieved and how it was delivered. The average annual Group Performance Share award for colleagues increased by 9.3 per cent relative to 2016, which compares favourably to the average increase in individual awards for Executive Directors of 4 per cent, excluding the Group Chief Executive. The award for the Group Chief Executive increased by 8.4 per cent relative to 2016, reflecting the increase in the base salary against which the award level is determined. The 2017 award is the same percentage of salary as 2016.
- The Long-Term Incentive Plan (LTIP) awards made in 2015 are vesting at 66.3 per cent, reflecting the Group's strong performance since 2015, balanced against uncertainty in the economic and political environment. In particular, this has impacted negatively on absolute share price performance, resulting in no vesting for the Total Shareholder Return component.
- In line with shareholder views, changes to the measures in the 2018 Group Ownership Share awards have been minimised to provide consistency with the 2017 plan, while aligning to the key strategic priorities as set out in the third Group Strategic Review. Further detail is provided on page 97.

2018 Annual General Meeting

I look forward to welcoming you to the 2018 AGM and hope you will support the resolution relating to remuneration.

Anita Frew
Chairman, Remuneration Committee

Directors' remuneration report continued

Remuneration at a glance
How we performed, and our policy

How Executive Directors' remuneration works

Fixed remuneration	Base salary	See page 100
	Fixed share award	See page 100
	Pension	See page 100
	Benefits	See page 100
Variable remuneration	Short-term plan	See page 101
	Long-term plan	See page 101

Group Performance Share (GPS) plan

The Committee determined that the GPS outcome would be **£414.7 million**, based on the following performance outcomes.

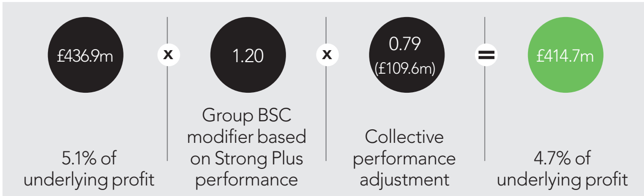
Underlying profit £m

1 Excludes MBNA.
2 The underlying profit of £8,493 million has been adjusted by the £74 million incremental difference between the Prudential Value Adjustment (PVA) at year-end 2016 to year-end 2017, in line with regulatory requirements.
3 The underlying profit of £7,867 million has been adjusted (reduced) by the £126 million incremental difference between the PVA at year-end 2015 to year-end 2016.

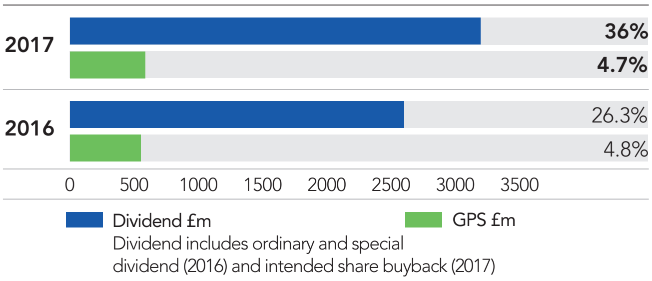
Group Balanced Scorecard (BSC) performance

BSC category	Rating
Customer	Strong+
People	Strong+
Control environment	Strong+
Building the business	Strong
Finance	Strong

Collective performance adjustment
The Committee considered the conduct-related provisions, including an additional PPI provision. This led to a downward adjustment of £109.6 million, or 21 per cent.



GPS award versus shareholder returns (% of underlying profit)



The total GPS award as a percentage of underlying profit before tax and GPS allocation decreased from 4.8 per cent in 2016 to 4.7 per cent in 2017. This compares favourably to shareholder return from dividend payments and share buyback over the same period which increased to 36 per cent of underlying profit. The GPS allocation for 2017 remains significantly lower than the Group's funding limit of 10 per cent of underlying profit.

Long-term incentive plan

LTIP awards made in 2015 are vesting at 66.3 per cent, as detailed in the table below. This reflects the Group's strong performance over the three financial years ended 31 December 2017, balanced against uncertainty in the economic and political environment. In particular, this has impacted negatively on absolute share price performance, resulting in no vesting for the Total Shareholder Return component. Executive Directors are required to retain any vested shares for a further two years after vesting.

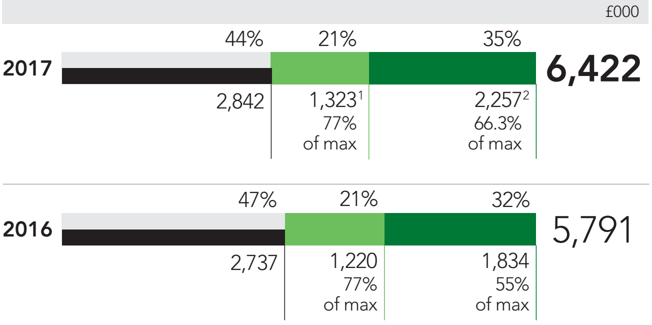
Weighting	Measure	Threshold	Maximum	Actual	Vesting
30%	Absolute total shareholder return (TSR)	8% p.a.	16% p.a.	**(1.7%)**	**0%**
25%	Economic profit	£2,870m	£3,587m	**£3,987m**	**25%**
10%	Cost:income ratio[1]	45.6%	44.5%	**44.9%**	**6.3%**
10%	Customer complaint handling[2] (FCA reportable complaints / FOS uphold rate)	0.79 =<32%	0.73 =<28%	**0.53** **15%**	**10%**
10%	Net promoter score	3rd	1st	**1st**	**10%**
7.5%	Digital active customer base	12.7m	13.3m	**13.4m**	**7.5%**
7.5%	Colleague engagement score	62	70	**76**	**7.5%**
				LTIP (% maximum) vesting	**66.3%**

1 Adjusted total costs.
2 The FCA changed the approach to complaint classification and reporting from 30 June 2016. The Committee determined that the original target should be translated on a like-for-like basis into the new reporting requirement. The Committee was satisfied that the revised targets, set on a mechanical basis, were no less stretching.

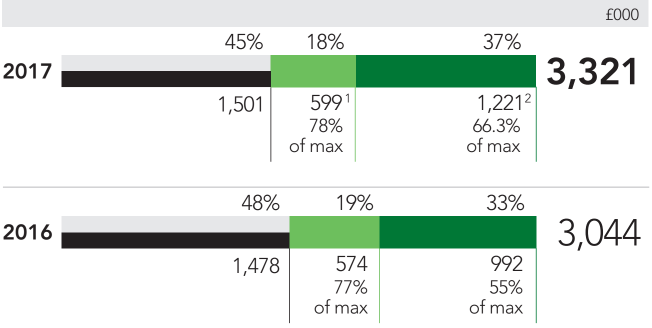
Single total figure of remuneration

The charts below summarise the Executive Directors' remuneration for the 2016 and 2017 performance years.

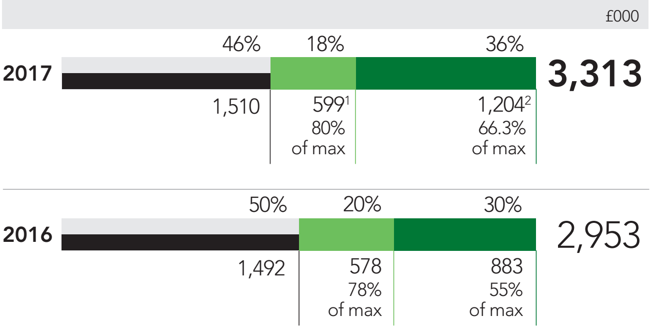
António Horta-Osório Group Chief Executive



George Culmer Chief Financial Officer



Juan Colombás Chief Operating Officer (formerly Chief Risk Officer)[3]



1 2017 Group Performance Share, awarded in March 2018.

2 The LTIP vesting and dividend equivalents awarded in shares were confirmed by the Remuneration Committee at its meeting on 19 February 2018. The average share price between 1 October 2017 and 31 December 2017 (66.75 pence) has been used to indicate the value. The shares were awarded in 2015 based on a share price of 79.93 pence.

3 Juan Colombás took up the role of Chief Operating Officer on 4 September 2017.

2018 policy implementation overview

The detailed policy implementation table containing all elements of remuneration can be found on page 96.

Base salary	The Group has applied a total pay budget of 2.7 per cent for the wider colleague population. Salary increases for the Group Chief Executive (GCE) and the Chief Financial Officer (CFO) are set below this budget, at 2 per cent. Juan Colombás took on a new role of Chief Operating Officer (COO) in September 2017 and accordingly it is proposed he receive a salary increase of 3.4 per cent to reflect the fact that the COO role is larger than his previous role as the Chief Risk Officer. Salaries will be as follows, effective dates shown below:
	GCE: £1,244,400 (1 January 2018)
	CFO: £779,351 (1 April 2018)
	COO: £779,351 (1 January 2018)
Fixed share award	The levels of award set for 2018 remain unchanged and are as follows:
	GCE: £900,000
	CFO: £504,000
	COO: £497,000
Group Performance Share plan	The maximum Group Performance Share opportunity is 140 per cent of base salary for the GCE and 100 per cent of base salary for other Executive Directors (no change). Malus/clawback provisions and holding period apply in line with regulatory requirements.
Group Ownership Share plan	The maximum annual Group Ownership Share award for Executive Directors is 300 per cent of salary (no change). Awards in 2018, based on individual performance in 2017, are made as follows:
	GCE: 300 per cent of base salary
	CFO: 275 per cent of base salary
	COO: 275 per cent of base salary
	Malus/clawback provisions and holding period apply in line with regulatory requirements and market practice.

Directors' remuneration report continued

Annual report on remuneration

Single total figure of remuneration (audited)

The following table summarises the total remuneration delivered during 2017 in relation to service as an Executive Director.

	António Horta-Osório		George Culmer		Juan Colombás		Totals	
£000	2017	2016	2017	2016	2017	2016	2017	2016
Base salary	1,220	1,125	760	745	753	739	2,733	2,609
Fixed share award	900	900	504	504	497	497	1,901	1,901
Benefits	156	143	46	42	71	70	273	255
Group Performance Share	1,323	1,220	599	574	599	578	2,521	2,372
Long-term incentive (LTIP)[1]	2,257	1,834	1,221	992	1,204	883	4,682	3,709
Pension allowance	565	568	190	186	188	185	943	939
Other remuneration[2]	1	1	1	1	1	1	3	3
Total remuneration	**6,422**	5,791	**3,321**	3,044	**3,313**	2,953	**13,056**	11,788

1 The LTIP vesting at 66.3 per cent and dividend equivalents awarded in shares were confirmed by the Remuneration Committee at its meeting on 19 February 2018. The total number of shares vesting were 3,035,880 and 346,087 shares delivered in respect of dividend equivalents for António Horta-Osório, 1,642,361 shares vesting and 187,227 shares delivered in respect of dividend equivalents for George Culmer and 1,619,551 shares vesting and 184,627 shares delivered in respect of dividend equivalents for Juan Colombás. The average share price between 1 October 2017 and 31 December 2017 (66.75 pence) has been used to indicate the value. The shares were awarded in 2015 based on a share price of 79.93 pence. LTIP and dividend equivalent figures for 2016 have been adjusted to reflect the share price on the date of vesting (67.51 pence) instead of the average price (58.30 pence) reported in the 2016 report.

2 Other remuneration payments comprise income from all employee share plans, which arises through employer matching or discounting of employee purchases.

Pension and benefits (audited)

Pension/Benefits £	António Horta-Osório	George Culmer	Juan Colombás
Cash allowance in lieu of pension contribution	565,000	190,081	188,364
Car or car allowance	12,000	15,313	12,000
Flexible benefits payments	45,000	29,964	29,547
Private medical insurance	35,167	760	15,985
Tax preparation	24,000	–	10,680
Transportation	39,389	–	2,649

Defined benefit pension arrangements (audited)

António Horta-Osório has a conditional unfunded pension commitment, subject to share price performance. This was a partial buy-out of a pension forfeited on joining from Santander Group. It is an Employer-Financed Retirement Benefits Scheme (EFRBS). The EFRBS provides benefits on a defined benefit basis at a normal retirement age of 65. The benefit in the EFRBS accrued during the six years following commencement of employment, therefore ceasing to accrue as of 31 December 2016.

The EFRBS was subject to performance conditions. It provides a percentage of the GCE's base salary or reference salary in the 12 months before retirement or leaving. No additional benefit is due in the event of early retirement. The rate of pension accrued in each year depended on share price conditions being met and the total pension due is 6 per cent of the reference salary of £1,220,000 or £73,200.

There are no other Executive Directors with defined benefit pension entitlements.

Under terms agreed when joining the Group, Juan Colombás is entitled to a conditional lump sum benefit of £718,996 either (i) on reaching normal retirement age of 65 unless he voluntarily resigns or is dismissed for cause, or (ii) on leaving due to long-term sickness or death.

Executive Directors' Group Performance Share outcome for 2017 (audited)

The annual Group Performance Share (GPS) outcome is based on a percentage of the Group's underlying profit, adjusted by a strategic modifier based on the Group's Balanced Scorecard (BSC) metrics and collective and discretionary adjustments to reflect risk matters and other factors.

£436.9m	x	1.20	x	0.79 (£109.6m)	=	£414.7m
5.1% of underlying profit		Group BSC modifier		Collective performance adjustment		4.7% of underlying profit

The Committee determined that the GPS outcome would be £414.7 million, based on the following performance outcomes.

Underlying profit £m

2017	Budget[1]	**£7,846**
	Actual[2]	**£8,567**
2016	Budget	£7,572
	Actual[3]	£7,741

1 Excludes MBNA.
2 The underlying profit of £8,493 million has been adjusted by the £74 million incremental difference between the Prudential Value Adjustment (PVA) at year-end 2016 to year-end 2017, in line with regulatory requirements.
3 The underlying profit of £7,867 million has been adjusted (reduced) by the £126 million incremental difference between the PVA at year-end 2015 to year-end 2016.

The Committee determined that the share of underlying profit should be 5.1 per cent. In reaching this decision, the Committee took into account the Group's actual performance against budget where outperformance was 8.2 per cent and distributions to shareholders which have increased by 46.9 per cent. Due consideration was also given to market levels of variable remuneration on both an individual basis and for the total GPS outcome overall.

Group Balanced Scorecard modifier

A balanced scorecard approach with clearly identified performance descriptors is used to assess Group performance in key areas. Stretching objectives for each division and function were approved by the Committee around the start of the performance year. The objectives are aligned to the Group's strategy and split across five categories: customer, people, control environment, building the business and finance.

The Balanced Scorecard (BSC) is not intended to be a purely mechanical approach to performance assessment, but designed to support the Committee in exercising judgement. It was noted that while there were a diverse range of outcomes, on balance despite challenging economic and external market conditions, the Group had delivered outperformance against 10 of the 20 BSC metrics, with only two falling below the target level; the progress on the creation of the non ring-fenced bank and return on required equity. The Committee discussed a number of key performance factors, noting in particular the Group's outperformance in customer complaints management, colleague engagement despite the significant structural changes during 2017, and strong balance sheet management and capital generation.

The Committee approved the final Group BSC performance outcome at Strong Plus (as detailed in table 'Group Balanced Scorecard performance' on page 90), with the view that while the mechanical BSC assessment was marginal in some areas, on balance there were other qualitative factors that provided the Committee with assurance that the recommendation was fair and justified. A full summary of the Group's performance is provided in the Group Chief Executive's statement on page 4, however the key factors were: the Group's return to full private ownership; significant additional cost reductions; the completion of the successful acquisition of MBNA; and continued focus on commitments to the UK economy through the Helping Britain Prosper strategy.

Under	Developing	Good	Strong	Strong Plus	Top
0	0.55	1.00	1.15	1.20	1.30

Collective performance adjustment

Consideration was given to items not factored into the Group underlying profit or the Group BSC. The Committee considered adjustments reflecting 2017 conduct-related provisions, including the additional PPI provision of £1.65 billion and other non-PPI provisions of £865 million. In arriving at the adjustment, the Committee considered factors such as customer impact and reputation.

As a result of these items, the Committee approved an overall collective adjustment of £109.6 million (or approximately 21 per cent of the modified GPS outcome) which reduced the total GPS outcome.

Directors' remuneration report continued

Group Balanced Scorecard performance

	Objective	Measure	Outcome	Performance range/outcome[2] Under	Performance range/outcome[2] Top	Rating
Customer	Creating the best customer experience	Customer dashboard		The Group has performed below expectations in terms of customer perception of brand, service, products and complaints.	The Group has exceeded expectations in terms of customer perception of brand, service, products and complaints.	Strong+
		Best customer experience: end-to-end customer journeys		The Group has not improved the operation and/or service of its key customer journeys.	The Group has significantly improved the operation or service of its key customer journeys.	
		Reportable complaints – Total FCA complaints per '000	3.24	> 4.95	≤ 3.09	
		Reportable complaints – Formally closed FCA complaints per '000	0.52	> 0.71	≤ 0.50	
		FOS uphold rate (ex PPI)	15%	> 30%	≤ 25%	
People	Best team: engaged and customer focused colleagues	Culture – Best Bank for Customers Index scores	80	≤ 68	≥ 84	Strong+
		People colleague engagement – EEI	76	≤ 57	≥ 73	
		People colleague engagement – PEI	83	≤ 60	≥ 81	
		Inclusion & Diversity – F+ Females	34	< 32.4%	> 34.3%	
Control environment	Maintain a strong control, governance and compliance structure in line with the Risk Management Framework	Board risk appetite		The Group has not managed its key risk measures to ensure the safe guarding of the Group.	The Group has strongly managed its key risk measures to ensure the safe guarding of the Group.	Strong+
		Regulatory management		The regulatory bodies (FCA and PRA) are concerned about the Group's approach to regulatory matters.	The regulatory bodies (FCA and PRA) are comfortable with the Group's approach to regulatory matters and recognise this as an area of strength.	
Building the business	Actively manage key stakeholders	Simpler and more efficient: Simplification savings		The Group has not managed to improve its operational and strategic processes through simplification initiatives and delivered below target savings.	The Group has successfully managed to improve its operations and strategic processes through simplification initiatives and delivered above target savings.	Strong
		Best customer experience: Digital active customer growth	13.44m	< 13.26m	≥ 13.38m	
		Reputation with external stakeholders – composite (excluding regulators)		Poor relationships with key external stakeholders.	Strong relationships with key external stakeholders.	
		Deliver Helping Britain Prosper Plan targets (Group)		< 50% of Helping Britain Prosper Plan metrics are Green	90%+ of Helping Britain Prosper Plan metrics are Green and none of the Helping Britain Prosper metrics are Red.	
		Establishment of the non ring-fenced bank		Key mobilisation milestones are not on track for the separation of the commercial and personal banking customers in line with the regulatory non ring-fenced Bank requirements.	Key mobilisation milestones are ahead of schedule and comfortably on track for the separation of the commercial and personal banking customers in line with the regulatory non ring-fenced Bank requirements.	
Finance	Maintain prudent reserves to withstand unexpected shocks	Cost:income ratio (Group)[1]	47.3%	> 49.8%	< 47.3%	Strong
		Underlying profit before tax (Group)[1]	8,298m	< 7,061m	> 8,238m	
		Total return on required equity (Group)	8.1%	< 7.0%	> 10.5%	
		Underlying Common Equity Tier 1 generation (Group)	245bps	< 140bps	> 200bps	
		PRA stress test (Group)		Failed the annual Prudential Regulation Authority (PRA) stress test due to the Group's capital position and negative feedback on quality of submissions and ranked significantly below peers.	Passed the annual Prudential Regulation Authority (PRA) stress test with a strong capital position and very positive feedback on quality of submissions and ranked highly against peers.	

1 Excludes MBNA.

2 Where the performance assessment is qualitative the position against threshold and maximum (Under and Top) is shown. Where internal dashboards are used in reaching the assessment of performance, the Committee is provided with underlying data points and additional commentary to inform its judgement.

The individual GPS awards for Executive Directors are determined in the same way as for colleagues across the Group, based on individual performance and the level of GPS outcome determined by the Committee following consideration of the factors set out on pages 89–90. Individual performance is assessed on the basis of 'whole job' contribution, both 'what' has been achieved against BSC objectives, role requirements and personal objectives and 'how' it has been delivered. Judgement is applied in reaching the overall assessment. Awards are approved by the Committee, which has discretion to adjust outcomes for any reason.

In reaching their decision on individual awards for Executive Directors, the Committee considered formulaic payout ranges set around the expected outcome for each performance rating, based on a percentage of base salary (see graphs below for each Executive Director). The percentage of base salary applied within the relevant range was determined by reference to the individual performance rating for each Executive Director.

António Horta-Osório Group Chief Executive (GCE)

The GCE's individual performance assessment for 2017 reflected the Group's objectives, assessed as Strong Plus as outlined on page 90 and a number of other considerations, including:

- Successful delivery of the second Group Strategic Review, with improved customer service, market leading digital proposition, targeted lending growth and simplification savings ahead of target. Completed acquisition of MBNA's prime credit card business.
- Next phase of strategy defined to further transform the business for success in a digital world and deliver additional sources of competitive advantage, positioning the Group well to meet changing customer needs.
- Restructured the business and reorganised the team ready for the next stage of the Group's strategic journey.
- Continued strong underlying financial performance with continued improvement in profit (£8.5 billion, up 8 per cent) and returns (RoTE of 15.6 per cent). Market leading cost:income ratio improving to 46.8 per cent.
- Credit and asset quality remain strong. CET1 ratio of 15.5 per cent pre capital return comfortably above requirements. Moody's upgraded Lloyds Bank's credit rating to Aa3 and S&P improved outlook to 'positive'.
- Increase in ordinary dividend to 3.05 pence per share (2016: 2.55 pence plus special dividend 0.5 pence per share), in line with the Group's progressive and sustainable dividend policy, with a share buyback of up to £1 billion.
- Employee engagement survey results further strengthened, exceeding UK high-performing benchmarks.
- Expansion of enhancement to key customer journeys leading to improved customer feedback and trust scores. Total complaints reduced by 18 per cent.
- Largest digital bank in the UK, with over 13.4 million digitally active customers, providing best-in-class customer experience (number 1 rated mobile app since 2015).
- Significant progress made against Helping Britain Prosper targets with more than £47 billion of lending to first-time buyers since 2014, and 15 per cent increase in lending to SMEs since 2014 (versus market increasing by only 1 per cent). Over 700,000 individuals, businesses and charities trained in digital skills.
- Successful return of the Group to full private ownership, repaying the taxpayer £20.3 billion plus an additional £900 million.

BSC category	Rating
Customer	Strong+
People	Strong+
Control environment	Strong+
Building the business	Strong
Finance	Strong

The individual rating of Strong Plus results in a GPS award of £1,322,520 (108 per cent of salary and 77 per cent of maximum).

George Culmer Chief Financial Officer (CFO)

The CFO's individual performance assessment for 2017 reflected the Finance division's objectives. During 2017, the Group undertook a significant structural change with the responsibility for Legal and Strategy transferring to the CFO from September 2017. The individual performance assessment of the CFO was Strong Plus for full year 2017, informed by the rating for the Finance, Legal and Strategy division at Q4 2017 and a number of other considerations, including:

- Strong financial performance delivered in challenging environment with low interest rates and Brexit uncertainty creating downward pressure on the UK economy. Improvements in profit and returns.
- Continued improvement in the Group's market leading cost:income ratio to 46.8 per cent (2016: 48.7 per cent).
- CET1 capital generation of 245 basis points, with CET1 ratio of 15.5 per cent pre capital return, 14.4 per cent pre-buyback, comfortably above requirements.
- Continued to build strong relationships with key external stakeholders, including debt and equity investors, regulators, and credit rating agencies.
- Effectively managed development of the next phase of the Group's strategy whilst successfully completing delivery of the second Group Strategic Review.
- Established the new Finance, Legal and Strategy division effectively, with excellent employee engagement scores and retention of talent.

BSC category	Rating
Customer	Strong+
People	Strong
Control environment	Strong+
Building the business	Strong–
Finance	Strong–

The individual rating of Strong Plus results in a GPS award of £599,000 (78 per cent of maximum).

Directors' remuneration report continued

Juan Colombás Chief Operating Officer (COO) (formerly Chief Risk Officer)

The COO's individual performance assessment for 2017 reflected the Risk division's objectives and the newly created Chief Operating Office from September 2017. The individual performance assessment of the COO was Strong Plus for full year 2017, informed by the rating for the Risk division at Q3 2017 and a number of other considerations, including:

- The Group continues to remain comfortably within the risk appetite set by the Board. Continued to drive a prudent risk culture and control framework to ensure low risk model maintained, positioning the Group well for market developments and uncertainties. Moody's upgraded Lloyds Bank's credit rating to Aa3 and S&P improved outlook to 'positive'.
- Further strengthening of operational risk management through enhanced reporting framework. Material reductions in operational losses and events.
- Support to the business in development of frameworks and controls to mitigate emerging and evolving risks, such as cyber risks.
- Development and maintenance of a high cadre of risk professionals, with employee engagement scores above the high performing norms and strong retention of talent.
- Fully supported successful transition to revised Group organisation structure and mobilisation of the new Chief Operating Office function.
- Effective implementation of the supporting infrastructure required to drive the transformation activities across the Group to build Bank of the Future.

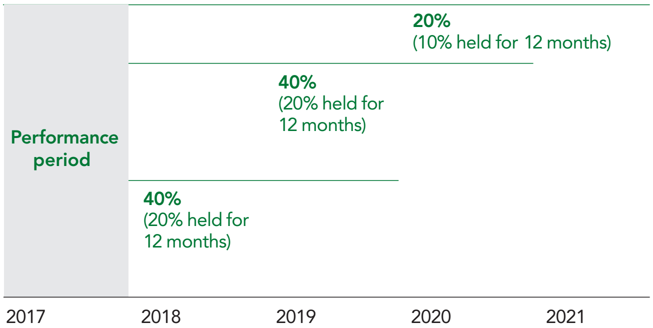
BSC category	Rating
Customer	Good
People	Strong-
Control environment	Strong+
Building the business	Good+
Finance	Top

The individual rating of Strong Plus results in a GPS award of £599,000 (80 per cent of maximum).

Deferral

The 2017 GPS for all Executive Directors is awarded in a combination of cash and shares. 40 per cent of the GPS will be released in 2018 (£2,000 cash in March, the remainder in shares), 40 per cent will be released in 2019 and the remaining 20 per cent will be released in 2020, subject to remaining in the Group's employment. Any shares released are subject to a further holding period in line with regulatory requirements.

The Group's malus and clawback provisions cover all material risk takers, in line with regulatory requirements. Vested variable remuneration can be recovered from employees for a period of up to seven years after the date of award which may be extended to 10 years where there is an ongoing internal or regulatory investigation. The Committee reserves the right to exercise its discretion in reducing any payment to be made, if it deems appropriate as a result of a risk matter coming to light before vesting.



2015 LTIP vesting (audited)

Awards in the form of conditional rights to free shares in 2015 were made over shares with a value of 300 per cent of reference salary for the GCE and 275 per cent of salary for the CFO and CRO (now COO). These LTIP awards are vesting at 66.3 per cent, as detailed in the table below. This reflects the Group's strong performance over the three financial years ended 31 December 2017, balanced against uncertainty in the economic and political environment. In particular, this has impacted negatively on absolute share price performance, resulting in no vesting for the Total Shareholder Return component. Executive Directors are required to retain any vested shares for a further two years after vesting.

Weighting	Measure	Threshold	Maximum	Actual	Vesting
30%	Absolute total shareholder return (TSR)	8% p.a.	16% p.a.	**(1.7%)**	**0%**
25%	Economic profit	£2,870m	£3,587m	**£3,987m**	**25%**
10%	Cost:income ratio[1]	45.6%	44.5%	**44.9%**	**6.3%**
10%	Customer complaint handling[2] (FCA reportable complaints/FOS uphold rate)	0.79	0.73	**0.53**	**10%**
		=<32%	=<28%	**15%**	
10%	Net promoter score	3rd	1st	**1st**	**10%**
7.5%	Digital active customer base	12.7m	13.3m	**13.4m**	**7.5%**
7.5%	Colleague engagement score	62	70	**76**	**7.5%**
				LTIP (% maximum) vesting	**66.3%**

1 Adjusted total costs.

2 The FCA changed the approach to complaint classification and reporting from 30 June 2016. The Committee determined that the original target should be translated on a like-for-like basis into the new reporting requirement. The Committee was satisfied that the revised targets, set on a mechanical basis, were no less stretching.

Percentage change in remuneration levels

Figures for 'All employees' are calculated using figures for UK-based colleagues subject to the GPS plan. This population is considered to be the most appropriate group of employees for these purposes because its remuneration structure is consistent with that of the GCE. For 2017, 45,696 colleagues were included in this category.

	% change in base salary (2016 – 2017)	% change in GPS (2016 – 2017)	% change in benefits (2016 – 2017)
GCE (salary increase effective 1 January 2018)	2	8.4[1]	8.7
All employees	2.7[2]	2[2,3]	2.7[2]

1 Reflects the increase in base salary from 1 January 2017 against which the award is determined.

2 Adjusted for movements in staff numbers and other impacts to ensure a like-for-like comparison. Salary increases effective 1 April 2018.

3 Average awards for colleagues participating in the Group annual GPS increased by 9.3 per cent.

Relative importance of spend on pay (£m)

The graphs illustrate the total remuneration of all Group employees compared with distributions to shareholders in the form of dividends and share buyback.

Dividend and share buyback[1] £m

1 2017: Ordinary dividend in respect of the financial year ended 31 December 2017, partly paid in 2017 and partly to be paid in 2018 and intended share buyback. 2016: Ordinary and special dividend in respect of the financial year ended 31 December 2016, partly paid in 2016 and partly paid in 2017.

Salaries and performance-based compensation[2] £m

2 In addition to the annual bonus of £414.7 million awarded in respect of 2017 performance, the Group made Group Ownership Share awards of £46.7 million and paid approximately £64.1 million under variable pay arrangements used to incentivise customer-facing colleagues, primarily in the Community Banking and Commercial Banking divisions.

Loss of office payments and payments within the reporting year to past Directors (audited)

There were no payments for the loss of office or any other payments made to former Directors during 2017.

External appointments

António Horta-Osório – During the year ended 31 December 2017, the GCE served as a Non-Executive Director of Exor, Fundação Champalimaud, Stichting INPAR and Sociedade Francisco Manuel dos Santos for which he received fees of £323,688 in total.

Chairman and Non-Executive Directors (audited)

	Fees £000		Total £000	
	2017	2016	**2017**	2016
Chairman and current Non-Executive Directors				
Lord Blackwell[1]	**728**	714	**740**	726
Alan Dickinson	**248**	195	**248**	195
Anita Frew	**364**	295	**364**	295
Simon Henry	**166**	135	**166**	135
Lord Lupton	**161**	–	**161**	–
Deborah McWhinney	**142**	135	**142**	135
Nick Prettejohn	**441**	412	**441**	412
Stuart Sinclair	**152**	135	**152**	135
Sara Weller	**190**	171	**190**	171
Former Non-Executive Directors				
Dyfrig John (retired May 2016)	**–**	49	**–**	49
Anthony Watson (retired May 2017)	**91**	230	**91**	230
Nick Luff (retired May 2017)	**69**	165	**69**	165
Total	**2,752**	2,636	**2,764**	2,648

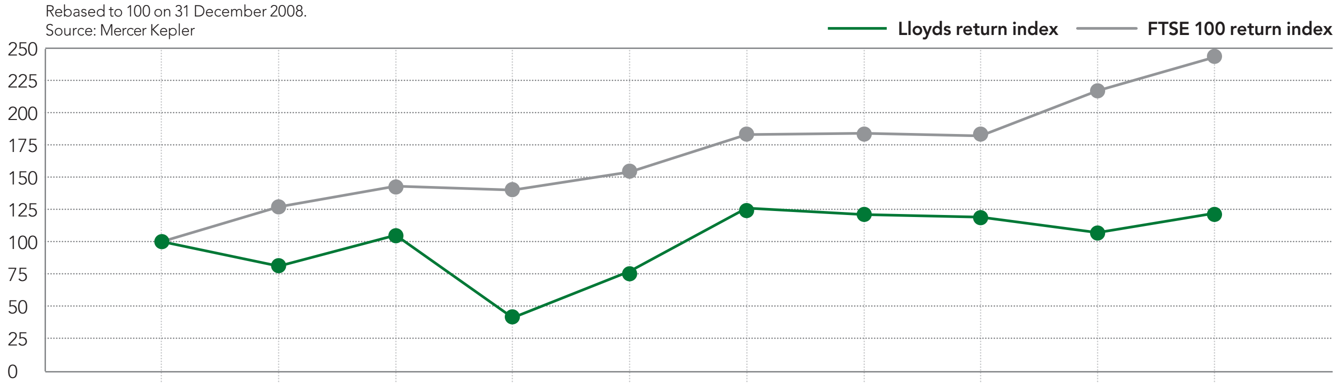
1 Benefits: car allowance (£12,000).

Directors' remuneration report continued

Comparison of returns to shareholders and GCE total remuneration

The chart below shows the historical total shareholder return (TSR) of Lloyds Banking Group plc compared with the FTSE 100 as required by the regulations. The FTSE 100 index has been chosen as it is a widely recognised equity index of which Lloyds Banking Group plc has been a constituent throughout this period.

TSR indices – Lloyds Banking Group and FTSE 100



GCE	Dec 2008	Dec 2009	Dec 2010	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015	Dec 2016	Dec 2017
GCE single figure of remuneration £000										
J E Daniels	1,121	2,572	855	–	–	–	–	–	–	–
António Horta-Osório	–	–	1,765	3,398	7,475	11,540	8,704	5,791	6,422	
Annual bonus/GPS payout (% of maximum opportunity)										
J E Daniels	Waived	62%	0%	–	–	–	–	–	–	–
António Horta-Osório	–	–	Waived	62%	71%	54%	57%	77%	77%	
Long-term incentive vesting (% of maximum opportunity)										
J E Daniels	0%	0%	0%	–	–	–	–	–	–	–
António Horta-Osório	–	–	0%	0%	54%	97%	94.18%	55%	66.3%	

Notes: J E Daniels served as GCE until 28 February 2011; António Horta-Osório was appointed GCE from 1 March 2011. J E Daniels declined to take a bonus in 2009 and António Horta-Osório declined to take a bonus in 2011.

Directors' share interests and share awards

Directors' interests (audited)

	Number of shares			Number of options		Total shareholding[1]		Value
	Owned outright	Unvested subject to continued employment	Unvested subject to performance	Unvested subject to continued employment	Vested unexercised	Totals at 31 December 2017	Totals at 20 February 2018	Expected value at 31 December 2017 (£000s)[2]
Executive Directors								
António Horta-Osório	21,611,593	3,228,463	14,912,901	51,277	–	39,804,234	39,804,808[6]	22,015
George Culmer	12,620,524	1,133,621	8,238,141	29,549	–	22,021,835	22,022,336[6]	12,184
Juan Colombás	7,937,630	1,127,750	8,123,722	29,109	–	17,218,211	17,218,711[6]	8,954
Non-Executive Directors								
Lord Blackwell	100,000	–	–	–	–	100,000	n/a[6]	n/a
Alan Dickinson	200,000	–	–	–	–	200,000	n/a[6]	n/a
Anita Frew	450,000	–	–	–	–	450,000	n/a[6]	n/a
Simon Henry	200,000	–	–	–	–	200,000	n/a[6]	n/a
Nick Luff[4]	400,000	–	–	–	–	400,000	n/a[6]	n/a
Lord Lupton	550,000	–	–	–	–	550,000	n/a[6]	n/a
Deborah McWhinney[3]	250,000	–	–	–	–	250,000	n/a[6]	n/a
Nick Prettejohn[5]	69,280	–	–	–	–	69,280	n/a[6]	n/a
Stuart Sinclair	–	–	–	–	–	–	n/a[6]	n/a
Anthony Watson[4]	576,357	–	–	–	–	576,357	n/a[6]	n/a
Sara Weller	340,000	–	–	–	–	340,000	n/a[6]	n/a

1 Including holdings of connected persons.

2 Awards subject to performance under the LTIP had an expected value of 50 per cent of face value at grant (in line with the Remuneration Policy). Values are based on the 31 December 2017 closing price of 68.06 pence. Full face value of awards are £27,090,761 for António Horta-Osório, £14,988,060 for George Culmer and £11,718,714 for Juan Colombás.

3 Shareholdings held by Deborah McWhinney are either wholly or partially in the form of ADRs.

4 Shares held as at date of resignation/retirement.

5 In addition, Nick Prettejohn held 400 6.475% preference shares at 1 January 2017 and 31 December 2017.

6 The changes in beneficial interests for António Horta-Osório (574 shares), George Culmer (501 shares) and Juan Colombás (500 shares) relate to 'partnership' and 'matching' shares acquired under the Lloyds Banking Group Share Incentive Plan between 31 December 2017 and 20 February 2018. There have been no other changes up to 20 February 2018.

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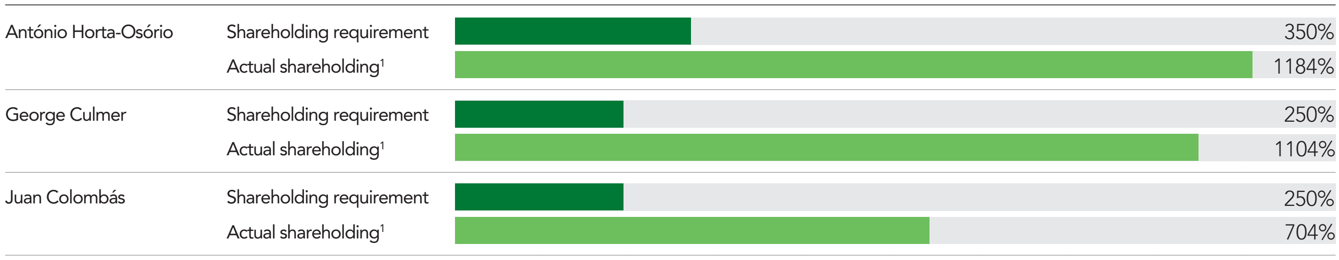
Shareholding requirement (audited)

From 1 January 2017 the shareholding requirement has been focused on base salary only (previously: base salary plus fixed share award) to provide greater transparency in the measurement of the shareholding requirements. This resulted in an increase in the percentage required as a multiple of salary. The new requirements are 350 per cent of base salary for the GCE and 250 per cent of base salary for the other Executive Directors.

In addition to the Group's shareholding requirements, shares vesting are subject to holding periods, in line with regulatory requirements.



1 Calculated using the average share price for the period 1 January 2017 to 31 December 2017 (66.85 pence). Includes shares owned outright reduced by forfeitable 'matching' shares under the Share Incentive Plan.

None of those who were Directors at the end of the year had any other interest in the capital of Lloyds Banking Group plc or its subsidiaries.

Outstanding share plan interests (audited)

	At 1 January 2017	Granted/ awarded	Dividends awarded	Vested / released / exercised	Lapsed	At 31 December 2017	Exercise price	Exercise periods From	Exercise periods To	Notes
António Horta-Osório										
LTIP 2014-2016	**4,640,077**	–	164,563	2,552,042	2,088,035	**–**				1, 2, 3
LTIP 2015-2017	**4,579,006**	–	–	–	–	**4,579,006**				3
LTIP 2016-2018	**5,015,210**	–	–	–	–	**5,015,210**				3
GOS 2017-2019		5,318,685	–	–	–	**5,318,685**				3, 4
Deferred GPS awarded in 2017		1,417,778	–	354,443	–	**1,063,335**				5
2014 Sharesave	**14,995**	–	–	–	–	**14,995**	60.02p	01/01/2018	30/06/2018	
2016 Sharesave	**14,554**	–	–	–	–	**14,554**	47.49p	01/01/2020	30/06/2020	
2017 Sharesave		21,728	–	–	–	**21,728**	51.03p	01/01/2021	30/06/2021	6
George Culmer										
LTIP 2014-2016	**2,510,205**	–	89,026	1,380,612	1,129,593	**–**				1, 2, 3
LTIP 2015-2017	**2,477,167**	–	–	–	–	**2,477,167**				3
LTIP 2016-2018	**2,767,409**	–	–	–	–	**2,767,409**				3
GOS 2017-2019		2,993,565	–	–	–	**2,993,565**				3, 4
Deferred GPS awarded in 2017		667,685	–	166,920	–	**500,765**				5
2014 Sharesave	**14,995**	–	–	–	–	**14,995**	60.02p	01/01/2018	30/06/2018	
2016 Sharesave	**14,554**	–	–	–	–	**14,554**	47.49p	01/01/2020	30/06/2020	
Juan Colombás										
LTIP 2014-2016	**2,234,780**	–	79,257	1,229,129	1,005,651	**–**				1, 2, 3
LTIP 2015-2017	**2,442,762**	–	–	–	–	**2,442,762**				3
LTIP 2016-2018	**2,728,973**	–	–	–	–	**2,728,973**				3
GOS 2017-2019		2,951,987	–	–	–	**2,951,987**				3, 4
Deferred GPS awarded in 2017		671,579	–	167,894	–	**503,685**				5
2016 Sharesave	**29,109**	–	–	–	–	**29,109**	47.49p	01/01/2020	30/06/2020	

1 The shares awarded in March 2014 vested on 6 March 2017. The closing market price of the Group's ordinary shares on that date was 67.51 pence. Shares vested are subject to a further two-year holding period.

2 2014 LTIP award was eligible to receive an amount equal in value to any dividends paid during the performance period. Dividend equivalents have been paid based on the number of shares vested and have been paid in shares. The dividend equivalent shares were paid on 6 March 2017. The closing market price of the Group's ordinary shares on that date was 67.51 pence. The dividend equivalent shares are not subject to any holding period.

3 All LTIPs have performance periods ending 31 December at the end of the three-year period. Awards were made in the form of conditional rights to free shares.

4 Awards (in the form of conditional rights to free shares) in 2017 were made over shares with a value of 300 per cent of reference salary for António Horta-Osório (5,318,685 shares with a face value of £3,660,000); 275 per cent for George Culmer (2,993,565 shares with a face value of £2,059,992); and 275 per cent for Juan Colombás (2,951,987 shares with a face value of £2,031,381). The share price used to calculate face value is the average price over the five days prior to grant (27 February to 3 March 2017), which was 68.814 pence. This was the average share price used to determine the number of shares awarded. Performance conditions for this award are set out in the table below.

5 GPS is deferred into shares. The face value of the share awards in respect of GPS granted in March 2017 was £975,630 (1,417,778 shares) for António Horta-Osório; £459,461 (667,685 shares) for George Culmer; and £462,141 (671,579 shares) for Juan Colombás. The share price used to calculate the face value is the average price over the five days prior to grant (27 February to 3 March 2017), which was 68.814 pence.

6 Sharesave options granted on 29 September 2017.

Directors' remuneration report continued

2017 GOS performance measures

Strategic priorities	Measure	Basis of payout range	Metric	Weighting
Creating the best customer experience	FCA total reportable complaints and Financial Ombudsman Service (FOS) uphold rate (excluding PPI)	Set relative to 2019 targets	Threshold: 3.52 complaints per 1,000 accounts Maximum: 3.18 complaints per 1,000 accounts	10%
		Average rate over 2019	Threshold: =<29% Maximum: =<25%	
	Net promoter score	Major Group average ranking over 2019	Threshold: 3rd Maximum: 1st	10%
	Digital active customer base	Set relative to 2019 targets	Threshold: 14.3m Maximum: 14.9m	7.5%
Becoming simpler and more efficient	Economic profit[1]	Set relative to 2019 targets	Threshold: £3,074m Maximum: £3,769m	25%
	Cost:income ratio	Set relative to 2019 targets	Threshold: 47.2% Maximum: 45.7%	10%
Delivering sustainable growth	Absolute total shareholder return (TSR)	Growth in share price including dividends over 3-year period	Threshold: 8% p.a. Maximum: 16% p.a.	30%
Building the best team	Employee engagement index	Set relative to 2019 targets	Threshold: 67 Maximum: 73	7.5%

1 A measure of profit taking into account Expected Losses, tax and a charge for equity utilisation.

None of the other Directors at 31 December 2017 had options to acquire shares in Lloyds Banking Group plc or its subsidiaries.

Implementation of the policy in 2018

It is proposed to operate the policy in the following way in 2018:

Base salary

The Group has applied a total pay budget of 2.7 per cent including additional funding to ensure a minimum pay award of £600 for eligible colleagues. Salary increases for the Group Chief Executive (GCE) and the Chief Financial Officer (CFO) are set below the budget for the wider colleague population, at 2 per cent. Juan Colombás took on a new role of Chief Operating Officer (COO) in September 2017 and accordingly it is proposed he receive a salary increase of 3.4 per cent to reflect the fact that the COO role is larger than his previous role as the Chief Risk Officer.

Salaries will therefore be as follows:

GCE: £1,244,400 (1 January 2018)
CFO: £779,351 (1 April 2018)
COO: £779,351 (1 January 2018)

Fixed share award

The levels of the 2018 award are unchanged from 2017:

GCE: £900,000
CFO: £504,000
COO: £497,000

Shares will be released in equal tranches over a five year period.

Pension

The level of pension allowances is unchanged from 2017:

GCE: 50 per cent of base salary less flexible benefits allowance
CFO: 25 per cent of base salary
COO: 25 per cent of base salary

Benefits

For 2018, the benefits provided to Executive Directors include a car allowance, transportation, private medical insurance, life assurance and other benefits selected through the flexible benefits allowance which is currently capped at 4 per cent of base salary (unchanged from 2017).

Group Performance Share plan

The maximum Group Performance Share opportunity will be unchanged from 2017 at 140 per cent of base salary for the GCE and 100 per cent of base salary for other Executive Directors. The threshold is set at 20 per cent below the Group's underlying profit target.

For 2018, the Group Performance Share will be based on a percentage of the Group's underlying profit, adjusted by a strategic modifier of up to 130 per cent based on the Group's Balanced Scorecard (BSC) metrics and collective and discretionary adjustments to reflect risk matters and other factors. At least 75 per cent of performance is weighted towards a financial measure.

Individual awards will be adjusted to reflect a balanced scorecard approach with clearly identified performance metrics used to assess Group performance in key areas. Stretching objectives for the Group are approved around the start of the performance year. The objectives are aligned to the Group's strategy and split across five categories: Customer, People, Control environment, Building the business and Finance. Each measure in the Group BSC is assigned targets aligned to a five-point rating scale. BSC ratings are based on a scale ranging from 'Under' (at the lowest level), through 'Developing', 'Good', 'Strong' and up to 'Top'. Each of these ratings may be further differentiated by the addition of 'minus' or 'plus'.

The Committee considers the targets that apply to these measures to be commercially sensitive but will provide information on the level of payout relative to the performance achieved in next year's annual report on remuneration.

The Committee applies its judgement to determine the payout level commensurate with Group, business and/or individual performance.

For the 2018 performance year, the Group Performance Share opportunity will be awarded in March 2019 in a combination of cash (up to 50 per cent) and shares. 40 per cent will be released in the first year following award, 40 per cent will be released in the second year and the remaining 20 per cent will be released in the third year. Any shares released are subject to a further 12-month holding period in line with regulatory requirements.

The Committee may consider the application of malus and clawback as outlined in the performance adjustment section below.

Group Ownership Share plan

The maximum Group Ownership Share award for Executive Directors is 300 per cent of salary (unchanged from 2017).

Awards in 2018 are being made as follows:

GCE: 300 per cent of base salary
CFO: 275 per cent of base salary
COO: 275 per cent of base salary

As regulations prohibit the payment of dividend equivalents on awards in 2018 and subsequent years, the number of shares subject to the award has been determined by applying a discount factor to the share price on grant, as previously disclosed. The Committee approved an adjustment of 25 per cent for colleagues who are senior managers, including the Executive Directors.

Awards will be subject to a three-year performance period with vesting between the third and seventh anniversary of award, on a pro-rata basis. Any shares released are subject to a further holding period in line with regulatory requirements and market practice.

Awards made in 2018 will vest based on the Group's performance against the financial and strategic measures, set out in the table below. In line with the Directors' remuneration policy, the Committee has full discretion to amend payout levels should the award not reflect business and/or individual performance. Business performance includes, but is not limited to, consideration of returns to shareholders.

In line with shareholder views, changes to strategic measures have been minimised to provide consistency with the 2017 plan, while aligning to the key strategic priorities as set out in the third Group Strategic Review. A new measure is proposed for the 2018 plan. The new measure will be Digital Net Promoter Score, to ensure that there is focus on maintaining customer satisfaction and quality of service. To provide alignment to the 2016 and 2017 plans, the Committee will also take into account other factors, for example the number of digitally active customers, when making its overall assessment of performance. Economic profit has been based on statutory profit after tax, not underlying profit, to align more closely with shareholder experience, while maintaining focus on capital efficiency. The targets for this revised measure are considered stretching. For reference, the equivalent outcome in 2017 would be £798 million (including PPI), compared to the 2020 threshold of £2.3 billion. The cost: income ratio measure is inclusive of conduct-related provisions (excluding PPI). The Committee believes that these measures appropriately capture risk management and long-term sustainable growth, aligning management and shareholder interests.

The Committee may consider the application of malus and clawback as outlined in the performance adjustment section below.

Strategic priorities	Measure	Basis of payout range	Metric	Weighting
Creating the best customer experience	Customer satisfaction	Major Group average ranking over 2020	Threshold: 3rd Maximum: 1st	10%
	Digital net promoter score	Set relative to 2020 targets	Threshold: 64 Maximum: 67	7.5%
	FCA total reportable complaints and Financial Ombudsman Service (FOS) uphold rate	Set relative to 2020 targets Average rates over 2020	Threshold: 2.97 Maximum: 2.69 Threshold: =<29% Maximum: =<25%	10%
Becoming simpler and more efficient	Statutory economic profit	Set relative to 2020 targets	Threshold: £2,300m Maximum: £3,451m	25%
	Cost:income ratio	Set relative to 2020 targets	Threshold: 46.4% Maximum: 43.9%	10%
Delivering sustainable growth	Absolute total shareholder return (TSR)	Growth in share price including dividends over 3-year period	Threshold: 8% p.a. Maximum: 16% p.a.	30%
Building the best team	Employee engagement index	Set relative to 2020 markets norms	Threshold: +5% vs UK Norm Maximum: +2% vs UK High Performing Norm	7.5%

Performance adjustment

Performance adjustment is determined by the Remuneration Committee and/or Board Risk Committee and may result in a reduction of up to 100 per cent of the GPS and/or GOS opportunity for the relevant period. It can be applied on a collective or individual basis. When considering collective adjustment, the Senior Independent Performance Adjustment and Conduct Committee (SIPACC) submits a report to the Remuneration Committee and Board Risk Committee regarding any adjustments required to BSCs or the overall GPS and/or GOS outcome to reflect in-year or prior year risk matters.

The application of malus will generally be considered when:

– there is reasonable evidence of employee misbehaviour or material error or that they participated in conduct which resulted in losses for the Group or failed to meet appropriate standards of fitness and propriety;

– there is material failure of risk management at a Group, business area, division and/or business unit level;

– the Committee determines that the financial results for a given year do not support the level of variable remuneration awarded; and/or

– any other circumstances where the Committee consider adjustments should be made.

Judgement on individual performance adjustment is informed by taking into account the severity of the issue, the individual's proximity to the issue and the individual's behaviour in relation to the issue. Individual adjustment may be applied through adjustments to BSC assessments and/or through reducing the GPS and/or GOS outcome.

Awards are subject to clawback for a period of up to seven years after the date of award which may be extended to 10 years where there is an ongoing internal or regulatory investigation.

The application of clawback will generally be considered when:

– there is reasonable evidence of employee misbehaviour or material error; or

– there is material failure of risk management at a Group, business area, division and/or business unit level.

Directors' remuneration report continued

Chairman and Non-Executive Director fees in 2018

The annual fee for the Chairman was increased by 2 per cent to £742,845, in line with the overall salary budget for the executive population.

The annual Non-Executive Director fees were increased by 2 per cent, in line with the base salary increase awarded to the senior management of the Group. These changes took effect from 1 January 2018.

	2018	2017
Basic Non-Executive Director fee	£78,000	£76,500
Deputy Chairman	£102,000	£100,000
Senior Independent Director	£61,200	£60,000
Audit Committee Chairmanship	£71,400	£70,000
Remuneration Committee Chairmanship	£71,400	£70,000
Board Risk Committee Chairmanship	£71,400	£70,000
Responsible Business Committee Chairmanship	£40,800	£40,000
Audit Committee membership	£32,650	£32,000
Remuneration Committee membership	£32,650	£32,000
Board Risk Committee membership	£32,650	£32,000
Responsible Business Committee membership[1]	£15,300	£15,000
Nomination and Governance Committee membership[2]	£15,300	£15,000

1 New members only.
2 Including payments to Chairmen of other Committees who are members.

Non-Executive Directors may receive more than one of the above fees.

Additional disclosures

Total remuneration of the eight highest paid senior executives[1]

The following table sets out the total remuneration of the eight highest paid senior executives (excluding Executive Directors) in respect of the 2017 performance year.

	Executive							
	8 £000	7 £000	6 £000	5 £000	4 £000	3 £000	2 £000	1 £000
Fixed								
Cash-based	601	498	569	617	635	490	709	815
Share-based	406	100	162	422	422	810	466	500
Total fixed	1,007	598	731	1,039	1,057	1,300	1,175	1,315
Variable								
Upfront cash	2	2	2	2	2	2	2	2
Deferred cash	0	0	0	0	0	0	0	0
Upfront shares	128	604	204	275	200	642	221	202
Deferred shares	195	172	309	416	303	276	335	305
Long-term incentive plan	185	247	401	157	404	524	984	1,113
Total variable pay	510	1,025	916	850	909	1,444	1,542	1,622
Pension cost[2]	160	100	125	154	167	98	177	196
Total remuneration	1,677	1,723	1,772	2,043	2,133	2,842	2,894	3,133

1 Includes members of the Group Executive Committee and Senior Executive level colleagues, employed by the Group as at 31 December 2017 (excluding colleagues on garden leave or subject to notice of termination).
2 Pension costs based on a percentage of salary according to level.

Total remuneration of employees across the Group

Total remuneration[1]	Number of employees
£0 to £100,000	68,299
£100,001 to £500,000	4,762
£500,001 to £1,000,000	102
Above £1,000,000	24

1 Total remuneration of UK-based colleagues. Includes base salary, bonus awards for the 2017 performance year, the estimated values of LTIP, pension and benefits.

Remuneration Committee

Committee composition and purpose

The Committee comprises Non-Executive Directors from a wide background to provide a balanced and independent view on remuneration matters. Anthony Watson retired as an independent Non-Executive Director and as a member of the Committee on 11 May 2017. For details of full membership and attendance at meetings, please see page 58.

The purpose of the Committee is to set the remuneration for all Executive Directors and the Chairman, including pension rights and any compensation payments. It recommends and monitors the level and structure of remuneration for senior management and material risk takers. It also considers, agrees and recommends to the Board an overall remuneration policy and philosophy for the Group that is aligned with its long-term business strategy, its business objectives, its risk appetite, values and the long-term interests of the Group that recognises the interests of relevant stakeholders.

Annual effectiveness review

During 2017, the Committee met its key objectives and carried out its responsibilities effectively, as confirmed by the annual effectiveness review.

How the Remuneration Committee spent its time in 2017

The Committee had eight scheduled meetings during 2017 to consider the following principal matters.

Committee:

– Review of committee composition
– Approval of terms of reference
– Results of the effectiveness review and suggestions for improvement

Remuneration approach and awards:

– Determination of 2016 bonus outcome
– Approval of the 2014 LTIP vesting
– Approval of the 2017 Group Performance Share plan design, methodology and performance measures
– Colleague 2017 Group Ownership Share
– Approval of the 2017 and 2018 Group Ownership Shares plan performance measures
– Incentive Plan review

Senior Executives:

– Review of performance and remuneration arrangements for Executive Directors and key senior managers
– Review and approval of material risk taker identification
– Approval of LBCM Non-Executive Fees
– Review of shareholding policy

Stakeholders:

– Feedback from the Chairman on her meeting with the PRA and shareholders
– Consideration of the BEIS Corporate Governance Report and PRA Policy and supervisory statements

Other remuneration matters:

– Approval of the 2016 Directors' Remuneration Report for publication within the annual report and Form 20-F
– Approval of the 2016 Remuneration Policy Statement
– Review of the Reward Governance Framework
– Gender pay reporting review
– Approval of the annual procedural review
– MBNA integration impacts and awards

Mercer (part of the MMC group of companies) is the appointed advisor to the Remuneration Committee. Mercer is a founding member and signatory of the Code of Conduct for Remuneration Consultants. For more detail, please refer to the website www.remunerationconsultantsgroup.com. Mercer was appointed by the Committee in 2016 following a competitive tender process and was retained during the year. The Committee is of the view that Mercer provides independent remuneration advice to the Committee and does not have any connections with the Group that may impair its independence, and, other than advice on remuneration, no other services were provided to the Company. The broader Mercer company provides unrelated advice on accounting.

During the year, Mercer attended Committee meetings upon invitation and provided advice and support in areas such as market and best practice, regulatory and governance developments, drafting the remuneration report, and relevant comparator groups for pay and performance.

Fees payable for the provision of Remuneration Committee services in 2017 were £98,020, based on time and materials.

António Horta-Osório (Group Chief Executive), Simon Davies (Chief People, Legal and Strategy Officer) until July 2017 and Jen Tippin (Group People and Productivity Director) thereafter, Paul Hucknall (People Director, Centres of Excellence), Matt Sinnott (Group Reward Director), Chris Evans (Director, Reward Policy and Partnering), Stuart Woodward (Head of Reward Regulation and Governance) and Letitia Smith (Group Director, Conduct, Compliance & Operational Risk) provided guidance to the Committee (other than for their own remuneration).

Juan Colombás (Chief Operating Officer from September 2017 and formerly the Chief Risk Officer) and George Culmer (Chief Financial Officer) also attended the Committee to advise as and when necessary on risk, financial and operational matters.

Statement of voting at Annual General Meeting

The table below sets out the voting outcome at the Annual General Meeting in May 2017.

	Votes cast in favour		Votes cast against		Votes withheld
	Number of shares (millions)	Percentage of votes cast	Number of shares (millions)	Percentage of votes cast	Number of shares (millions)
Directors' remuneration policy (binding vote)	**47,673**	**98.03%**	**959**	**1.97%**	**535**
2016 annual report on remuneration (advisory vote)	**48,113**	**97.92%**	**1,023**	**2.08%**	**31**

Directors' remuneration policy

The Group's remuneration policy was approved at the AGM on 11 May 2017 and took effect from that date. It is intended that approval of the remuneration policy will be sought at three-year intervals, unless amendments to the policy are required, in which case further shareholder approval will be sought; no changes are proposed for 2018. The full policy is set out in the 2016 annual report and accounts (pages 90–98) which is available at: www.lloydsbankinggroup.com/globalassets/documents/investors/2016/2016_lbg_annual_report_v2.pdf

The tables in this section provide a summary of the Directors' remuneration policy. There is no significant difference between the policy for Executive Directors and that for other colleagues. Further information about the remuneration policy for other colleagues is set out in section 'Other remuneration disclosures'.

Remuneration policy table for Executive Directors

Base salary

Purpose and link to strategy
To support the recruitment and retention of Executive Directors of the calibre required to develop and deliver the Group's strategic priorities. Base salary reflects the role of the individual, taking account of market competitiveness, responsibilities and experience, and pay in the Group as a whole.

Operation
Base salaries are typically reviewed annually with any increases normally taking effect from 1 January. When determining and reviewing base salary levels, the Committee takes into account base salary increases for employees throughout the Group and ensures that decisions are made within the following two parameters:

- An objective assessment of the individual's responsibilities and the size and scope of their role, using objective job-sizing methodologies.
- Pay for comparable roles in comparable publicly listed financial services groups of a similar size.

Salary may be paid in sterling or other currency and at an exchange rate determined by the Committee.

Maximum potential
The Committee will make no increase which it believes is inconsistent with the two parameters above. Increases will normally be in line with the increase awarded to the overall employee population. However, a greater salary increase may be appropriate in certain circumstances, such as a new appointment made on a salary below a market competitive level, where phased increases are planned, or where there has been an increase in the responsibilities of an individual. Where increases are awarded in excess of the wider employee population, the Committee will provide an explanation in the relevant annual report on remuneration.

Performance measures
N/A

Fixed share award

Purpose and link to strategy
To ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for Executive Directors with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements.

Operation
The fixed share award will initially be delivered entirely in Lloyds Banking Group shares, released over five years with 20 per cent being released each year following the year of award. The Committee can, however, decide to deliver some or all of it in the form of cash.

Maximum potential
The maximum award is 100 per cent of base salary.

Performance measures
N/A

Pension

Purpose and link to strategy
To provide cost effective and market competitive retirement benefits, supporting Executive Directors in building long-term retirement savings.

Operation
Executive Directors are entitled to participate in the Group's defined contribution scheme with company contributions set as a percentage of salary.

An individual may elect to receive some or all of their pension allowance as cash in lieu of pension contribution.

Maximum potential
The maximum allowance for the GCE is 50 per cent of base salary less any flexible benefits allowance.

The maximum allowance for other Executive Directors is 25 per cent of base salary.

All future appointments as Executive Directors will attract a maximum allowance of 25 per cent of base salary.

Performance measures
N/A

Benefits

Purpose and link to strategy
To provide flexible benefits as part of a competitive remuneration package.

Operation
Benefits may include those currently provided and disclosed in the annual report on remuneration.

Core benefits include a company car or car allowance, private medical insurance, life insurance and other benefits that may be selected through the Group's flexible benefits plan.

Additional benefits may be provided to individuals in certain circumstances such as relocation. This may include benefits such as accommodation, relocation, and travel. The Committee retains the right to provide additional benefits depending on individual circumstances.

When determining and reviewing the level of benefits provided, the Committee ensures that decisions are made within the following two parameters:

- An objective assessment of the individual's responsibilities and the size and scope of their role, using objective job-sizing methodologies.
- Benefits for comparable roles in comparable publicly listed financial services groups of a similar size.

Maximum potential
The Committee will make only increases in the benefits currently provided which it believes are consistent with the two parameters above. Executive Directors receive a flexible benefits allowance, in line with all other employees. The flexible benefits allowance does not currently exceed 4 per cent of base salary.

Performance measures
N/A

All-employee plans

Purpose and link to strategy
Executive Directors are eligible to participate in HMRC-approved share plans which promote share ownership by giving employees an opportunity to invest in Group shares.

Operation
Executive Directors may participate in these plans in line with HMRC guidelines currently prevailing (where relevant), on the same basis as other eligible employees.

Maximum potential
Participation levels may be increased up to HMRC limits as amended from time to time. The monthly savings limits for Save As You Earn (SAYE) is currently £500. The maximum value of shares that may be purchased under the Share Incentive Plan (SIP) in any year is currently £1,800 with a two-for-one match. Currently a three-for-two match is operated up to a maximum employee investment of £30 per month.

The maximum value of free shares that may be awarded in any year is £3,600.

Performance measures
N/A

Group Performance Share plan

Purpose and link to strategy
To incentivise and reward the achievement of the Group's annual financial and strategic targets whilst supporting the delivery of long-term superior and sustainable returns.

Operation
Measures and targets are set annually and awards are determined by the Committee after the year end based on performance against the targets set. The Group Performance Share may be delivered partly in cash, shares, notes or other debt instruments including contingent convertible bonds. Where all or part of any award is deferred, the Committee may adjust these deferred awards in the event of any variation of share capital, demerger, special dividend or distribution or amend the terms of the plan in accordance with the plan rules.

Where an award or a deferred award is in shares or other share-linked instrument, the number of shares to be awarded may be calculated using a fair value or based on discount to market value, as appropriate.

The Committee applies its judgement to determine the payout level commensurate with business and/or individual performance. The Committee may reduce the level of award (including to zero), apply additional conditions to the vesting, or delay the vesting of deferred awards to a specified date or until conditions set by the Committee are satisfied, where it considers it appropriate as a result of a risk matter coming to light before vesting. Awards may be subject to malus and clawback for a period of up to seven years after the date of award which may be extended to 10 years where there is an ongoing internal or regulatory investigation.

Maximum potential
The maximum Group Performance Share opportunities are 140 per cent of base salary for the GCE and 100 per cent of base salary for other Executive Directors.

Performance measures
Measures and targets are set annually by the Committee in line with the Group's strategic business plan and further details are set out in the annual report on remuneration for the relevant year.

Measures consist of both financial and non-financial measures and the weighting of these measures will be determined annually by the Committee. The weightings of the performance measures for the 2018 financial year are set out on page 96. All assessments of performance are ultimately subject to the Committee's judgement, but no award will be made if threshold performance (as determined by the Committee) is not met for financial measures or the individual is rated 'Developing performer' or below. The expected value of the Group Performance Share is 30 per cent of maximum opportunity.

The Committee is committed to providing transparency in its decision making in respect of Group Performance Share awards and will disclose historic measures and target information together with information relating to how the Group has performed against those targets in the annual report on remuneration for the relevant year except to the extent that this information is deemed to be commercially sensitive, in which case it will be disclosed once it is deemed not to be sensitive.

Group Ownership Share plan

Purpose and link to strategy
To incentivise and reward Executive Directors and senior management to deliver against strategic objectives designed to support the long-term success of the Group and encourage working as a team. It ensures executives build an ownership interest in the Group and are motivated by delivering long-term superior and sustainable returns for shareholders.

Operation
Awards are granted under the rules of the 2016 Long-Term Incentive Plan approved at the AGM on 12 May 2016. Awards are made in the form of conditional shares or nil cost options. Award levels are set at the time of grant, in compliance with regulatory requirements, and may be subject to a discount in determining total variable remuneration under the rules set by the European Banking Authority.

The number of shares to be awarded may be calculated using a fair value or based on a discount to market value, as appropriate.

Vesting will be subject to the achievement of performance conditions measured over a period of three years, or such longer period, as determined by the Committee.

The Committee retains full discretion to amend the payout levels should the award not reflect business and/or individual performance. The Committee may reduce (including to zero) the level of the award, apply additional conditions to the vesting, or delay the vesting of awards to a specified date or until conditions set by the Committee are satisfied, where it considers it appropriate as a result of a risk matter coming to light before vesting. Awards may be subject to malus and clawback for a period of up to seven years after the date of award which may be extended to 10 years where there is an ongoing internal or regulatory investigation.

Maximum potential
The maximum annual award for Executive Directors will normally be 300 per cent of salary. Under the plan rules, awards can be made up to 400 per cent of salary in exceptional circumstances.

Directors' remuneration report continued

Performance measures
Measures and targets are set by the Committee annually and are set out in the annual report on remuneration each year.

At least 60 per cent of awards are weighted towards typical market (e.g. Total Shareholder Return) and/or financial measures (e.g. economic profit), with the balance on strategic measures.

25 per cent will vest for threshold performance, 50 per cent for on-target performance and 100 per cent for maximum performance.

The measures are chosen to support the best bank for customers strategy and to align management and shareholder interests. Targets are set by the Committee to be stretching within the context of the strategic business plan. Measures are selected to balance profitability, achievement of strategic goals and to ensure the incentive does not encourage inappropriate risk-taking.

Following the end of the relevant performance period, the Committee will disclose in the annual report on remuneration for the relevant year historic measure and target information, together with how the Group has performed against those targets, unless this information is deemed to be commercially sensitive, in which case it will be disclosed once it is deemed not to be sensitive.

Deferral of variable remuneration and holding periods

Operation
The Group Performance Share and Group Ownership Share plans are both considered variable remuneration for the purpose of regulatory payment and deferral requirements. The payment of variable remuneration and deferral levels are determined at the time of award and in compliance with regulatory requirements (which currently require that at least 60 per cent of total variable remuneration is deferred for seven years with pro rata vesting between the third and seventh year, and at least 50 per cent of total variable remuneration is paid in shares or other equity linked instruments subject to a holding period in line with current regulatory requirements).

A proportion of the aggregate variable remuneration may vest immediately on award. The remaining proportion of the variable remuneration is then deferred in line with regulatory requirements.

Further information on which performance measures were chosen and how performance targets are set are disclosed in the relevant sections throughout the report.

Remuneration policy table for Chairman and Non-Executive Directors

Chairman and Non-Executive Director fees

Purpose and link to strategy
To provide an appropriate reward to attract and retain a high-calibre individual with the relevant skills, knowledge and experience.

Operation
The Committee is responsible for evaluating and making recommendations to the Board with regards to the Chairman's fees. The Chairman does not participate in these discussions.

The GCE and the Chairman are responsible for evaluating and making recommendations to the Board in relation to the fees of the NEDs.

When determining and reviewing fee and benefit levels, the Committee ensures that decisions are made within the following parameters:

– The individual's skills and experience.
– An objective assessment of the individual's responsibilities and the size and scope of their role, using objective sizing methodologies.
– Fees and benefits for comparable roles in comparable publicly listed financial services groups of a similar size.

The Chairman receives an all-inclusive fee, which is reviewed periodically plus benefits including life insurance, car allowance, medical insurance and transportation. The Committee retains the right to provide additional benefits depending on individual circumstances. NEDs are paid a basic fee plus additional fees for the chairmanship/membership of committees and for membership of Group companies/boards/non-board level committees.

Additional fees are also paid to the senior independent director and to the deputy chairman to reflect additional responsibilities.

Any increases normally take effect from 1 January of a given year.

The Chairman and the NEDs are not entitled to receive any payment for loss of office (other than in the case of the Chairman's fees for the six month notice period) and are not entitled to participate in the Group's bonus, share plan or pension arrangements.

NEDs are reimbursed for expenses incurred in the course of their duties, such as travel and accommodation expenses, on a grossed-up basis (where applicable).

Maximum potential
The Committee will make no increase in fees or benefits currently provided which it believes is inconsistent with the parameters above.

Performance metrics
N/A

Service agreements
The service contracts of all current Executive Directors are terminable on 12 months' notice from the Group and six months' notice from the individual. The Chairman also has a letter of appointment. His engagement may be terminated on six months' notice by either the Group or him.

Letters of appointment
The Non-Executive Directors all have letters of appointment and are appointed for an initial term of three years after which their appointment may continue subject to an annual review. Non-Executive Directors may have their appointment terminated, in accordance with statute and the articles of association, at any time with immediate effect and without compensation.

All Directors are subject to annual re-election by shareholders.

The service contracts and letters of appointments are available for inspection at the Company's registered office.

On behalf of the Board

Anita Frew
Chairman, Remuneration Committee

Other remuneration disclosures

This section discloses the remuneration awards made by the Group to Material Risk Takers (MRTs) in respect of the 2017 performance year. Additional information summarising the Group's remuneration policies, structure and governance is also provided. These disclosures should be read in conjunction with the disclosures for Executive Directors contained in the Directors' Remuneration Report (DRR) on pages 84–102, and together comply with the requirements of Article 450 of the Capital Requirements Regulation (EU) No. 575/2013 (CRR). The remuneration principles and practices detailed in the DRR apply to MRTs and non-MRTs in the same way as to Executive Directors (other than where stated in this disclosure).

The Group has applied the EBA Delegated Regulation (EU) No 604/2014 to determine which colleagues should be identified as MRTs. MRTs are colleagues who are considered to have a material impact on the Group's risk profile, and include, but are not limited to:

- Senior management, Executive Directors, members and attendees of the Group Executive Committee (GEC) and their respective executive level direct reports;
- Non-Executive Directors;
- Approved persons performing significant influence functions (SIFs) and/or all colleagues performing a senior management function; and
- Other highly remunerated individuals whose activities could have a material impact on the Group's risk profile.

Decision making process for remuneration policy

The Group has a strong belief in aligning the remuneration delivered to the Group's executives with the successful performance of the business and, through this, the delivery of long-term, superior and sustainable returns to shareholders. It has continued to seek the views of shareholders and other key stakeholders with regard to remuneration policy and seeks to motivate, incentivise and retain talent while being mindful of the economic outlook. An essential component of the Group's approach to remuneration is the governance process that underpins it. This ensures that the policy is robustly applied and risk is managed appropriately.

The overarching purpose of the Remuneration Committee is to consider, agree and recommend to the Board an overall remuneration policy and philosophy for the Group that is defined by, supports and is closely aligned to its long-term business strategy, business objectives, risk appetite and values and recognises the interests of relevant stakeholders. The remuneration policy governs all aspects of remuneration and applies in its entirety to all divisions, business units and companies in the Group, including wholly-owned overseas businesses and all colleagues, contractors and temporary staff. The Committee reviews the policy annually. In 2017, it was updated to reflect changes to the Reward Principles and new reward supporting policies. The Committee pays particular attention to the top management population, including the highest paid colleagues in each division, those colleagues who perform senior management functions for the Group and MRTs. Further details on the operation of the Remuneration Committee can be found on page 99 of the DRR.

The Group has a robust governance framework, with the Remuneration Committee reviewing all compensation decisions for Executive Directors, senior management, senior risk and compliance officers, high earners and any other MRTs. This approach to governance is cascaded through the Group with the Executive Compensation Committee having oversight for all other colleagues and divisional Remuneration Committees providing oversight for specific business areas.

Governance and risk management

An essential component of the approach to remuneration is the governance process that underpins it. This ensures that the policy is robustly applied and risk is managed appropriately.

In addition to setting the overall remuneration policy and philosophy for the Group, the Remuneration Committee ensures that colleagues who could have a material impact on the Group's risk profile are provided with appropriate incentives and reward to encourage them to enhance the performance of the Group and that they are recognised for their individual contribution to the success of the organisation, whilst ensuring that there is no reward for excessive risk taking. The Remuneration Committee works closely with the Risk Committee in ensuring the Group Performance Share (GPS) plan outcome is moderated. The two Committees determine whether the proposed GPS outcome and performance assessments adequately reflect the risk appetite and framework of the Group; whether it took account of current and future risks; and whether any further adjustment is required or merited. The Group and the Remuneration Committee are determined to ensure that the aggregate of the variable remuneration for all colleagues is appropriate and balanced with the interests of shareholders and all other stakeholders.

The Remuneration Committee's terms of reference are available from the Company Secretary and are displayed on the Group's website, www.lloydsbankinggroup.com. These terms are reviewed each year to ensure compliance with the remuneration regulations and were last updated in November 2017.

Link between pay and performance

The Group's approach to reward is intended to provide a clear link between remuneration and delivery of its key strategic objectives, supporting the aim of becoming the best bank for customers, and through that, for shareholders. To this end, the performance management process has been developed, with the close participation of the Group's Risk team, to embed performance measures across the Group's reward structure which are challenging and reflect Group and divisional achievement in addition to personal contribution.

The use of a balanced scorecard approach to measure performance enables the Remuneration Committee to assess the performance of the Group and its senior executives in a consistent and performance-driven way. The Group's remuneration policy supports the business values and strategy, based on building long-term relationships with customers and colleagues and managing the financial consequences of business decisions across the entire economic cycle.

Further detail can be found in the DRR. In particular, see pages 89–90, 92, 96–97 and 101–102 of the DRR.

Design and structure of remuneration

When establishing the remuneration policy and associated frameworks, the Group is required to take into account its size, organisation and the nature, scope and complexity of its activities. For the purpose of remuneration regulation, Lloyds Bank plc is treated as a proportionality level I firm and therefore subject to the more onerous remuneration rules.

Remuneration is delivered via a combination of fixed and variable remuneration. Fixed remuneration reflects the role, responsibility and experience of a colleague. Variable remuneration is based on an assessment of individual, business area and Group performance. The mix of variable and fixed remuneration is driven by seniority, grade and role. Taking into account the expected value of awards, the performance-related elements of pay make up a considerable proportion of the total remuneration package for MRTs, whilst maintaining an appropriate balance between the fixed and variable elements. The maximum ratio of fixed to variable remuneration for MRTs is 200 per cent, which has been approved by shareholders (98.77 per cent of votes cast) at the AGM on 15 May 2014.

Remuneration for control functions is set in relation to benchmark market data to ensure that it is possible to attract and retain staff with the appropriate knowledge, experience and skills. An appropriate balance between fixed and variable compensation supports this approach. Generally, control function staff receive a higher proportion of fixed remuneration than other colleagues and the aggregate ratio of fixed to variable remuneration for all control function staff does not exceed 100 per cent. Particular attention is paid to ensure remuneration for control function staff is linked to the performance of their function and independent from the business areas they control.

Other remuneration disclosures continued

The table below summarises the different remuneration elements for MRTs (this includes control function staff) and non-MRTs.

Base salary

Base salaries are reviewed annually, taking into account individual performance and market information. Further information on base salaries can be found on page 100 of the DRR.

Applies to:
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function
- Other MRTs
- Non-MRTs

Fees

Non-Executive Director fees are reviewed periodically by the Board. Further information on fees can be found on page 102 of the DRR.

Applies to:
- Non-Executive Directors (NEDs)

Fixed share award

The fixed share award, made annually, delivers Lloyds Banking Group shares over a period of five years. Its purpose is to ensure that total fixed remuneration is commensurate with the role, responsibilities and experience of the individual; provides a competitive reward package; and is appropriately balanced with variable remuneration, in line with regulatory requirements. The fixed share award can be amended or withdrawn in the following circumstances:

– to reflect a change in role;
– to reflect a Group leave policy (e.g. parental leave or sickness absence);
– termination of employment with the Group;
– if the award would be inconsistent with any applicable legal, regulatory or tax requirements or market practice.

Further information on fixed share awards can be found on page 100 of the DRR.

Applies to:
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function*
- Other MRTs*
- Non-MRTs*

Benefits and all-employee share plans

Core benefits for UK-based colleagues include pension, private medical insurance, life insurance, car or car allowance (eligibility dependent on grade) and other benefits that may be selected through the Group's flexible benefits plan. Further information on benefits and all-employee share plans can be found on pages 100–101 of the DRR. Benefits can be amended or withdrawn in the following circumstances:

– to reflect a change to colleague contractual terms;
– to reflect a change of grade;
– termination of employment with the Group;
– to reflect a change of Reward Strategy/benefit provision;
– if the award would be inconsistent with any statutory or tax requirements.

Details of NEDs' benefits are set out on page 102 of the DRR.

Applies to:
- Non-Executive Directors (NEDs)
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function
- Other MRTs
- Non-MRTs

Short-term variable remuneration arrangements

The Group Performance Share (GPS) plan is an annual discretionary bonus plan. The plan is designed to reflect specific goals linked to the performance of the Group. The majority of colleagues and all MRTs participate in the GPS plan.

Individual GPS awards are based upon individual contribution, overall Group financial results and Balanced Scorecard ratings over the past financial year. The Group's total risk-adjusted GPS outcome is determined by the Remuneration Committee annually as a percentage of the Group's underlying profit, modified for:

– Group Balanced Scorecard performance
– Collective and discretionary adjustments to reflect risk matters and/or other factors.

For the 2017 performance year, approximately one third of colleagues are eligible to participate in variable pay arrangements other than GPS. These are used to incentivise customer-facing colleagues, primarily in the Community Banking division. In structure these are substantively similar to GPS and the majority of colleagues will move across to GPS for the 2018 performance year.

The Group applies deferral arrangements to GPS and variable pay awards made to colleagues. GPS awards for MRTs are subject to deferral and a holding period in line with regulatory requirements and market practice.

Further information on the GPS plan can be found on pages 96–97 and 101–102 of the DRR.

Applies to:
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function
- Other MRTs
- Non-MRTs

Group Ownership Share plan

The Group Ownership Share (GOS) plan is a core part of the reward strategy and an important tool for aligning the Group's reward strategy to the long-term performance of the business. Through the application of carefully considered, stretching target measures, the Group can ensure that awards are forfeited or restricted where performance does not meet the desired level.

The GOS pays out in shares based on performance against Group financial and other non-financial strategic targets measured over a three-year period. Shares are released over a minimum three to five-year period and are then subject to a holding period (MRTs only) in line with regulatory requirements and market practice.

Further information on the GOS plan can be found on pages 97 and 101–102 of the DRR.

Applies to:
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function*
- Other MRTs*
- Non-MRTs*

Deferral, vesting and performance adjustment

At least 40 per cent of MRTs' variable remuneration above certain thresholds is deferred into Lloyds Banking Group Shares. For all MRTs, GPS is deferred in line with the regulatory requirements for three, five or seven years, (depending on MRT category) and subject to a six-month or 12-month retention period.

For all colleagues, any deferred variable remuneration amount is subject to performance adjustment (malus) in accordance with the Group's Deferral and Performance Adjustment Policy.

MRTs' vested variable remuneration (including variable remuneration subject to a holding period) can be recovered from colleagues up to seven years after the date of award in the case of a material or severe risk event (clawback). This period may be extended to ten years where there is an ongoing internal or regulatory investigation. Clawback is used alongside other performance adjustment processes.

Further information on deferral, vesting and performance adjustment can be found in the DRR on pages 92, 97 and 102.

Guaranteed variable remuneration

Guarantees, such as sign-on awards, may only be offered in exceptional circumstances to new hires for the first year of service and in accordance with regulatory requirements.

Any awards made to new hires to compensate them for unvested variable remuneration they forfeit on leaving their previous employment ('buy-out awards') will be subject to appropriate retention, deferral, performance and clawback arrangements in accordance with applicable regulatory requirements.

Retention awards may be made to existing colleagues in limited circumstances and are subject to prior regulatory approval in line with applicable regulatory requirements.

Applies to:
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function
- Other MRTs
- Non-MRTs

Shareholding requirement

Executive Directors: see DRR page 95.

All other MRTs and non-MRTs: 25 per cent - 100 per cent of the aggregate of base salary and fixed share award depending on grade.

Applies to:
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function**
- Other MRTs**
- Non-MRTs**

Termination payments

Executive Directors and GEC members: see page 96 of the 2016 DRR.

All other termination payments comply with the Group's contractual, legal and regulatory requirements and are made in such a way as to ensure they do not reward failure or misconduct and reflect performance over time.

Applies to:
- Senior Management, Executive Directors, members/attendees of the GEC and their respective direct reports
- Approved Persons performing SIFs and/or all colleagues performing a Senior Management Function
- Other MRTs
- Non-MRTs

* Eligibility based on seniority, grade and role

** Requirement based on seniority and grade

Table 1 Analysis of high earners by band

Number of Material Risk Takers paid €1 million[1,2] or more	2017 Material Risk Takers[3]	2016 Material Risk Takers
€1.0m - €1.5m	36	31
€1.5m - €2.0m	10	8
€2.0m - €2.5m	2	4
€2.5m - €3.0m	1	3
€3.0m - €3.5m	5	3
€3.5m - €4.0m	2	3
€4.0m - €4.5m	–	–
€4.5m - €5.0m	–	–
€5.0m - €6.0m	–	–
€6.0m - €7.0m	1	1

1 Converted to Euros using the exchange rate €1 = £0.88293 (average exchange rate 1 December 2017 – 31 December 2017 based on the European Commission Budget exchange rates). The exchange rate used for 2016 was €1 = £0.84815.

2 Values for LTIP awards based on an expected value of 50 per cent of maximum value.

3 Total number of Material Risk Takers earning more than €1m has increased from 53 in 2016 to 57 in 2017.

Table 2 Aggregate remuneration expenditure (Material Risk Takers)

Analysis of aggregate remuneration expenditure by division[1]

	Retail[2] £m	Commercial Banking £m	Insurance & Wealth £m	Group Functions & Services[3] £m	Total £m
Aggregate remuneration expenditure	19.3	54.5	8.2	90.5	172.5

1 The Group undertook a reorganisation during 2017. As a result, a number of reporting lines have changed.

2 Comprises previous Customer Products & Marketing and Consumer Finance divisions, and includes the 'Community Banking' division

3 Comprises Global Payments, Group Services, Group Sourcing, Group Property, Group & Cyber Security, Group Transformation and all supporting functions (Risk, Finance, People, Legal, Group Corporate Affairs, Group Internal Audit, Company Secretariat)

Other remuneration disclosures continued

Table 3 Fixed and variable remuneration (Material Risk Takers)

Analysis of remuneration between fixed and variable amounts

	Remuneration £m	Management body: Executive Directors	Management body: Non-Executive Directors	Awarded in relation to the 2017 performance year: Senior Management[2]	Other MRTs	2017 Total
Fixed Remuneration £m	Number of employees	3	11	139	131	284
	Total fixed remuneration	4.6	–	49.1	32.7	86.4
	Of which: Cash based	2.7	–	41.0	30.1	73.8
	Of which: Shares[1]	1.9	–	8.1	2.6	12.6
Variable Remuneration £m	Total variable remuneration	6.5	–	48.8	30.7	86.0
	Of which: Upfront cash based	–	–	0.3	0.2	0.5
	Of which: Share based[3]	6.5	–	48.5	30.5	85.5
	Of which: Deferred					
	Vested	1.0	–	19.2	16.8	37.0
	Unvested	5.5	–	29.3	13.7	48.5
	Total remuneration	11.1	–	97.9	63.4	172.4

1 Released over a five-year period.

2 Senior Management are defined as Group Executive Committee (GEC) members/attendees (excluding Group Executive Directors and Non-Executive Directors) and their direct reports (excluding those direct reports who do not materially influence the risk profile of any in-scope group firm).

3 Based on fair value at grant.

Table 4 Total outstanding deferred variable remuneration

	Remuneration £m	Management body: Executive Directors	Management body: Non-Executive Directors	Total outstanding deferred variable remuneration at 31 December 2017: Senior Management	Other MRTs	2017 Total
Variable Remuneration £m	Number of employees	3.0	11.0	139	131	284
	Total outstanding deferred variable remuneration	27.8	–	115.9	46.7	190.4
	Of which: Vested	2.7	–	10.6	0.8	14.1
	Of which: Unvested	25.1	–	105.3	45.9	176.3

Table 5 Other payments awarded in relation to the 2017 performance year

	Guaranteed bonuses: Number of awards made	Guaranteed bonuses: Total £m	Sign-on awards: Number of awards made	Sign-on awards: Total £m	Severance payments: Number of awards made	Severance payments: Total £m
Management body	–	–	–	–	–	–
Senior management	3	0.2	–	–	–	–
Other Material Risk Takers	1	0.2	–	–	–	–

Table 6 Deferred remuneration

Analysis of deferred remuneration at 31 December 2017

Remuneration £m	Total amount of outstanding deferred[1] and retained[2] remuneration	Of which: Total amount of outstanding remuneration exposed to ex-post explicit and/or implicit adjustment	Total amount of amendment during the year due to ex-post explicit adjustments	Total amount of deferred remuneration paid out in the performance year
Management body[3]	27.8	27.8	–[4]	3.7
Senior management	115.9	115.9	–	31.6
Other Material Risk Takers	46.7	46.7	–	36.0

1 Deferred in this context refers only to any unvested remuneration.

2 Retained refers to any variable remuneration for which the deferral period has ended but which is still subject to a holding period before release.

3 Reference to the 'Management Body' relates to Executive Directors only. Non-Executive Directors are not eligible to receive variable remuneration.

4 Actual amount £12,500.

RISK MANAGEMENT

All narrative and quantitative tables are unaudited unless otherwise stated. The audited information is required to comply with the requirements of relevant International Financial Reporting Standards.

Further information on risk management can be found:

The Group supports the recommendations made in the report 'Enhancing the Risk Disclosures of Banks' issued by the Enhanced Disclosure Task Force of the Financial Stability Board in October 2012.

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We've committed to help 1.8 million individuals improve their digital skills by 2020. Those we've already helped include Betty from Airdrie who is now banking online for the first time, thanks to free training provided at one of our Bank of Scotland branch Digizones.

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individuals, small businesses and charities helped to improve their digital skills in 2017

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Risk management

Risk management is at the heart of our strategy to become the best bank for customers.

Our mission is to support the business in delivering sustainable growth in targeted segments. This is achieved through informed risk decision making and superior risk and capital management, supported by a consistent risk-focused culture.

The risk overview (pages 32–37) provides a summary of risk management within the Group. It highlights the important role of risk as a strategic differentiator, along with a brief overview of the Group's Risk Management Framework, the potential risks and impacts arising from the external environment, and the principal risks faced by the Group and key mitigating actions.

This full risk management section provides a more in-depth picture of how risk is managed within the Group, detailing the Group's emerging risks, approach to stress testing, risk governance, committee structure, appetite for risk (pages 108–115) and a full analysis of the primary risk categories (pages 115–156) – the framework by which risks are identified, managed, mitigated and monitored.

Each risk category is described and managed using the following standard headings: definition, exposures, measurement, mitigation and monitoring.

The Group's approach to risk

The Group operates a prudent approach to risk with rigorous management controls to support sustainable business growth and minimise losses. Through a strong and independent risk function (Risk division) a robust control framework is maintained to identify and escalate current and emerging risks to support sustainable business growth within Group risk appetite and through good risk reward decision making.

Risk culture

The Board ensures that senior management implements risk policies and risk appetite that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the Group's risk profile.

As part of a conservative business model that embodies a risk culture founded on a prudent approach to managing risk, the Group reviewed its code of responsibility in 2017, reinforcing its approach under which colleagues are accountable for the risks they take and for prioritising their customers' needs.

The focus remains on building and sustaining long-term relationships with customers cognisant of the economic climate.

Risk appetite

Risk appetite is defined as 'the amount and type of risk that the Group is prepared to seek, accept or tolerate.'

Risk appetite is documented in a Group risk appetite statement which is reviewed by the Board Risk Committee and approved annually by the Board. The Group level metrics are supported by more detailed sub Board functional and divisional risk appetite metrics.

As a key component of the Risk Management Framework, Group risk appetite is embedded within principles, policies, authorities and limits across the Group and continues to evolve to reflect external market developments and composition of the Group.

The Group's strategy operates in tandem with the Group risk appetite and business planning is undertaken with a view to meeting the requirements of the Group risk appetite. Performance is optimised by allowing business units to operate within approved risk appetite and limits.

The Board Risk Committee is responsible for overseeing the development, implementation and maintenance of the Group's overall Risk Management Framework including its risk appetite, to ensure these are in line with emerging regulatory, corporate governance and industry best practice.

Group risk appetite includes the following areas:

Credit – the Group has a conservative and well balanced credit portfolio through the economic cycle, generating an appropriate return on equity, in line with the Group's target return on equity in aggregate.

Conduct – the Group's product design and sales practices ensure that products are transparent and meet customer needs.

Market – the Group has robust controls in place to manage the Group's inherent market risk and does not engage in any proprietary trading, reflecting the customer focused nature of the Group's activities.

Operational – the Group has robust controls in place to manage operational losses, reputational events and regulatory breaches.

Funding and liquidity – the Group maintains a prudent liquidity profile and a balance sheet structure that limits its reliance on potentially volatile sources of funding.

Capital – the Group maintains capital levels commensurate with a prudent level of solvency, and aims to deliver consistent and high quality earnings.

Regulatory and legal – the Group complies with all relevant regulation and all applicable laws (including codes of practice which have legal implications) and/or legal obligations.

People – the Group leads responsibly and proficiently, manages its people resource effectively, supports and develops colleague talent, and meets legal and regulatory obligations related to its people.

Governance – the Group has governance arrangements that support the effective long-term operation of the business, maximise shareholder value and meet regulatory and societal expectations.

Model – the Group has embedded a framework for the management of model risk to ensure effective control and oversight, compliance with all regulatory rules and standards, and to facilitate appropriate customer outcomes.

Financial reporting – the Group meets regulatory reporting and tax requirements in jurisdictions where it operates.

As separate regulated entities with their own Boards, the Insurance business and Lloyds Bank Corporate Markets each maintain their own risk appetite and framework, which are aligned to the Group risk appetite framework.

Governance and control

The Group's approach to risk is founded on a robust control framework and a strong risk management culture which are the foundation for the delivery of effective risk management and guide the way all employees approach their work, behave and make decisions.

Governance is maintained through delegation of authority from the Board down to individuals through the management hierarchy. Senior executives are supported by a committee based structure which is designed to ensure open challenge and support effective decision making.

The Group's risk appetite, principles, policies, procedures, controls and reporting are regularly reviewed and updated where needed to ensure they remain fully in line with regulations, law, corporate governance and industry good-practice.

The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by both the Board and senior management.

Board-level engagement, coupled with the direct involvement of senior management in Group-wide risk issues at Group Executive Committee level, ensures that escalated issues are promptly addressed and remediation plans are initiated where required.

Line managers are directly accountable for identifying and managing risks in their individual businesses, ensuring that business decisions strike an appropriate balance between risk and reward and are consistent with the Group's risk appetite.

Clear responsibilities and accountabilities for risk are defined across the Group through a three lines of defence model which ensures effective independent oversight and assurance in respect of key decisions.

Financial reporting risk management systems and internal controls

The Group maintains risk management systems and internal controls relating to the financial reporting process, which are designed to:

- ensure that accounting policies are consistently applied, transactions are recorded and undertaken in accordance with delegated authorities, that assets are safeguarded and liabilities are properly recorded;
- enable the calculation, preparation and reporting of financial, prudential regulatory and tax outcomes in accordance with applicable International Financial Reporting Standards, statutory and regulatory requirements;
- ensure that disclosures are made on a timely basis in accordance with statutory and regulatory requirements and as far as possible are consistent with best practice and in compliance with the UK Finance Code for Financial Reporting Disclosure.

The financial reporting process is actively monitored at business unit and Group levels. There are specific programmes of work undertaken across the Group to support:

- annual assessments of (i) the effectiveness of internal controls over financial reporting; and (ii) the effectiveness of the Group's disclosure controls and procedures, both in accordance with the requirements of the US Sarbanes Oxley Act; and
- annual certifications by the Senior Accounting Officer with respect to the maintenance of appropriate tax accounting arrangements, in accordance with the requirements of the 2009 Finance Act.

The Group also has in place an assurance process to support its prudential regulatory reporting and monitoring activities designed to identify and review tax exposures on a regular basis. There is ongoing monitoring to assess the impact of emerging regulation and legislation on financial, prudential regulatory and tax reporting.

The Group has a Disclosure Committee which assists the Group Chief Executive and Chief Financial Officer in fulfilling their disclosure responsibilities under relevant listing and other regulatory and legal requirements. In addition, the Audit Committee reviews the quality and acceptability of the Group's financial disclosures. For further information on the Audit Committee's responsibilities relating to financial reporting see pages 73–76.

Risk decision making and reporting

Taking risks which are well understood, consistent with strategy and with appropriate return is a key driver of shareholder value.

Risk analysis and reporting supports the identification of opportunities as well as risks.

An aggregate view of the Group's overall risk profile, key risks and management actions, and performance against risk appetite, is reported to and discussed monthly at the Group Risk Committee (and a subset at the Group Asset and Liability Committee), with regular reporting to the Board Risk Committee and the Board.

Rigorous stress testing exercises are carried out to assess the impact of a range of adverse scenarios with different probabilities and severities to inform strategic planning.

The Chief Risk Officer regularly informs the Board Risk Committee of the aggregate risk profile and has direct access to the Chairman and members of Board Risk Committee.

Table 1.1: Exposure to risk arising from the business activities of the Group

The table below provides a high level guide to how the Group's business activities are reflected through its risk-weighted assets. Details of the business activities for each division are provided in the Divisional overview on pages 28–31.

	Retail £bn	Commercial Banking £bn	Insurance & Wealth[1] £bn	Run-off £bn	Central items[2] £bn	Group £bn
Risk-weighted assets (RWAs)						
– Credit risk	71.1	71.2	0.6	7.1	14.5	164.5
– Counterparty credit risk[3]	–	7.1	–	–	0.8	7.9
– Market risk	–	3.0	–	–	0.1	3.1
– Operational risk	19.7	4.3	0.7	0.2	0.4	25.3
Total (excluding threshold)	90.8	85.6	1.3	7.3	15.8	200.8
– Threshold[4]					10.1	10.1
Total	90.8	85.6	1.3	7.3	25.9	210.9

1 As a separate regulated business, Insurance (excluding Wealth) maintains its own regulatory solvency requirements, including appropriate management buffers, and reports directly to the Insurance Board. Insurance does not hold any RWAs, as its assets are removed from the Banking Group's regulatory capital calculations. However, in accordance with Capital Requirements Directive and Regulation (CRD IV) rules, part of the Group's investment in Insurance is included in the calculation of threshold RWAs, while the remainder is taken as a capital deduction.

2 Central items include assets held outside the main operating divisions, including assets relating to Group Corporate Treasury which holds the Group's liquidity portfolio, and Group Operations.

3 Exposures relating to the default fund of a central counterparty and credit valuation adjustment risk are included in counterparty credit risk.

4 Threshold is presented on a fully loaded CRD IV basis. Threshold risk-weighted assets reflect the proportion of significant investments and deferred tax assets that are permitted to be risk-weighted instead of deducted from common equity tier 1 (CET1) capital. Significant investments primarily arise from the investment in the Group's Insurance business.

Principal risks

The Group's principal risks are shown in the risk overview (pages 34–37). The Group's emerging risks are shown overleaf. Full analysis of the Group's risk categories is on pages 115–156.

Risk management continued

Emerging risks

The Group considers the following to be risks that have the potential to increase in significance and affect the performance of the Group. These risks are considered alongside the Group's operating plan.

Risk	Key mitigating actions
Regulatory and legal: The industry continues to witness increased government and regulatory intervention in the financial sector with increasing regulatory rules and laws from both the UK and overseas affecting the Group's operation. There remains uncertainty as to the impact of EU exit on the regulatory and legal landscape; for example, the ability that the UK can continue to share data under the new data protection regime (both with other European countries and internationally) after EU exit.	– We continue to embed the regulatory and legal agenda across all areas of the Group ensuring that the customer is at the heart of our business planning. – We work closely with regulatory authorities and industry bodies to ensure that the Group can identify and respond to the evolving regulatory and legal landscape. – We actively implement programmes to deliver regulatory and legal change requirements.
Macroeconomic headwinds and political uncertainties: Uncertainty over the UK's eventual relationship with the EU, and the implications of a minority UK government, create a more uncertain outlook for the UK economy. A rise in global protectionism led by the US, fuelled by growing income inequality and an accompanying rise in political populism, and the recent indecisive German election, generate heightened risks to the global political and macroeconomic environment. Further, high levels of credit market liquidity have reduced spreads and weakened terms in some sectors, creating a potential under-pricing of risk.	– Internal contingency plans recalibrated and regularly reviewed for potential strategic, operational and reputational impacts, with a plan specifically for working through the potential impacts of the EU exit on the Group. – Engagement with politicians, officials, media, trade and other bodies to reassure our commitment to helping Britain prosper. – Wide array of risks considered in setting strategic plans. – Capital and liquidity is reviewed regularly through committees, ensuring compliance with risk appetite and regulatory requirements.
IT resilience and cyber: Increasing digitisation places greater reliance on the provision of resilient and secure services to customers. Continued increase in the volume and sophistication of cyber-attacks could disrupt service for customers, causing financial loss/reputational damage.	– Continued investment in IT and to improve the effectiveness of the Group's IT resilience. – Continued investment in the Group's Cyber Programme to ensure confidentiality and integrity of data and availability of key systems. – Collaboration with regulators and law enforcement agencies.
Response to market changes (agility): As technology and customer needs change, the typical banking model is evolving and as such, operational complexity has the potential to restrict our speed of response.	– The Group is transforming the business to improve customer experience by digitising customer journeys and leveraging branches for complex needs, in response to customers' evolving needs and expectations. – The Group will deepen insight into customer segments, their perception of brands and what they value. – Agility will be increased by consolidating platforms and building new architecture aligned with customer journeys.
Strategic use of customer data: The implementation of open banking introduces data sharing with third parties, potentially increasing the risks of fraud and data loss. There is a continued need to defend against dynamic external challengers and meet consumer expectations. Failure to address growth in data movement or understand the supply chain/third party controls may increase exposure to cyber and fraud leading to conduct and reputational issues.	– The Group has implemented open banking and is actively monitoring the implications for our customers, including protecting them from fraud. – The Group is making a significant investment to improve data privacy, including the security of data and oversight of third parties. – The Group's strategy is to introduce advanced data management practices, based on Group-wide standards, data-first culture and modern enterprise data platforms, supported by a simplified modern IT architecture.
Geopolitical shocks: Current uncertainties could further impede the global economic recovery. Events in North Korea, Russia, the Middle-East, as well as terrorist activity, have the potential to trigger changes in the economic outlook, market risk pricing and funding conditions.	– Risk appetite criteria limits single counterparty bank and non-bank exposures complemented by a UK-focused strategy. – The Chief Security Office develops and maintains the Stability Response Plan with the Financial Stability Response Team acting as a rapid reaction group, should an external crisis occur. – The Chief Security Office also maintains the operational resilience framework to embed resilience activities across the Group and limit the impact of internal or external events.

Capital stress testing

Overview

Stress testing is recognised as a key risk management tool within the Group by the Board, senior management, the businesses and the Risk and Finance functions. It is fully embedded in the planning process of the Group as a key activity in medium term planning, and senior management is actively involved in stress testing activities via a strict governance process.

The Group uses scenario stress testing for:

Risk identification:

- To understand key vulnerabilities of the Group under adverse economic conditions.

Risk appetite:

- Assess the results of the stress test against the Group's risk appetite to ensure the Group is managed within its risk parameters.
- Inform the setting of risk appetite by assessing the underlying risks under stress conditions.

Strategic and capital planning:

- Allow senior management and the Board to adjust strategies if the plan does not meet risk appetite in a stressed scenario.
- Support the Internal Capital Adequacy Assessment Process (ICAAP) by demonstrating capital adequacy, and meet the requirements of regulatory stress tests that are used to inform the setting of the Group's Prudential Regulation Authority (PRA) and management buffers (see capital risk on pages 137–144).

Risk mitigation:

- Drive the development of potential actions and contingency plans to mitigate the impact of adverse scenarios. Stress testing also links directly to the Group's recovery planning process.

Regulatory stress tests

The concurrent UK stress test run by the Bank of England was also undertaken in 2017. As announced in November, despite the severity of the stress scenario, the Group exceeded the capital and leverage thresholds set out for the purpose of the stress test and was not required to take any capital action as a result.

Internal stress tests

On at least an annual basis, the Group conducts macroeconomic stress tests of the operating plan, which are supplemented with higher-level refreshes if necessary. The exercise aims to highlight the key vulnerabilities of the Group's business plan to adverse changes in the economic environment, and to ensure that there are adequate financial resources in the event of a downturn.

Reverse stress testing

Reverse stress testing is used to explore the vulnerabilities of the Group's strategies and plans to extreme adverse events that would cause the business to fail, in order to facilitate contingency planning. The scenarios used are those that would cause the Group to be unable to carry on its business activities. Where reverse stress testing reveals plausible scenarios with an unacceptably high risk when considered against the Group's risk appetite, the Group will adopt measures to prevent or mitigate that risk, which are then reflected in strategic plans.

Other stress testing activity

The Group's stress testing programme also involves undertaking assessment of liquidity scenarios, market risk sensitivities and scenarios, and business specific scenarios (see the primary risk categories on pages 115–156 for further information on risk specific stress testing). If required, ad hoc stress testing exercises are also undertaken to assess emerging risks, as well as in response to regulatory requests. This wide ranging programme provides a comprehensive view of the potential impacts arising from the risks to which the Group is exposed and reflects the nature, scale and complexity of the Group.

Methodology

The stress tests at all levels must comply with all regulatory requirements, achieved through comprehensive construction of macroeconomic scenarios and a rigorous divisional, functional, risk and executive review and challenge process, supported by analysis and insight into impacts on customers and business drivers.

The engagement of all required business, Risk and Finance areas is built into the preparation process, so that the appropriate analysis of each risk category's impact upon the business plans is understood and documented. The methodologies and modelling approach used for stress testing ensure that a clear link is shown between the macroeconomic scenarios, the business drivers for each area and the resultant stress testing outputs. All material assumptions used in modelling are documented and justified, with a clearly communicated review and sign-off process. Modelling is supported by expert judgement and is subject to the Group Model Governance Policy.

Governance

Clear accountabilities and responsibilities for stress testing are assigned to senior management and the Risk and Finance functions throughout the Group. This is formalised through the Group Business Planning and Stress Testing Policy and Procedure, which are reviewed at least annually.

The Group Financial Risk Committee (GFRC), chaired by the Chief Risk Officer and attended by the Chief Financial Officer and other senior Risk and Finance colleagues, is the Committee that has primary responsibility for overseeing the development and execution of the Group's stress tests.

The review and challenge of the detailed stress forecasts, the key assumptions behind these, and the methodology used to translate the economic assumptions into stressed outputs conclude with the divisional Finance Directors', appropriate Risk Directors' and Managing Directors' sign-off. The outputs are then presented to GFRC, Group Asset and Liability Committee/Group Risk Committee/Group Executive Committee and Board Risk Committee for Group level executive and non-executive review and challenge, before being approved by the Board.

How risk is managed in Lloyds Banking Group

The Group's Risk Management Framework (RMF) (see risk overview, page 32), is structured around the following components which meet and align with the industry-accepted internal control framework issued by the Committee of Sponsoring Organisations of the Treadway Commission.

The RMF applies to every area of the business and covers all types of risk. It is reviewed, updated and approved by the Board at least annually to reflect any changes in the nature of our business and external regulations, law, corporate governance and industry best practice. In 2017 the annual update was also informed by the findings of an independent external review. The RMF provides the Group with an effective mechanism for developing and embedding risk policies and risk management strategies which are aligned with the risks faced by its businesses. It also seeks to facilitate effective communication on these matters across the Group.

Role of the Board and senior management

Key responsibilities of the Board and senior management include:

- setting risk appetite and approval of the RMF;
- approval of Group-wide risk principles and policies;
- the cascade of delegated authority (for example to Board sub-committees and the Group Chief Executive); and
- effective oversight of risk management consistent with risk appetite.

Risk appetite

Risk appetite is defined within the Group as 'the amount and type of risk that the Group is prepared to seek, accept or tolerate' (see the Group's approach to risk', pages 108–109).

Governance frameworks

The policy framework is founded on Board-approved key principles for the overall management of risk in the organisation, which are aligned with Group strategy and risk appetite and based on a current and comprehensive risk profile that identifies all material risks to the organisation. The principles are underpinned by a hierarchy of policies which define mandatory requirements for risk management and control which are consistently implemented across the Group.

Regular policy framework assessments are undertaken in all business areas, driving Board-level risk appetite metrics which monitor the operating effectiveness of policy controls and overall policy implementation. Robust processes and controls to identify and report policy breaches include clear materiality criteria and escalation procedures which ensure an appropriate level of visibility and prioritisation of remedial actions.

The risk committee governance framework is outlined on page 113.

Risk management continued

Three Lines of Defence model

The RMF is implemented through a 'three lines of defence' model which defines clear responsibilities and accountabilities and ensures effective independent oversight and assurance activities take place covering key decisions.

Business lines (first line) have primary responsibility for risk decisions, identifying, measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective governance and control frameworks for their business to be compliant with Group policy requirements, to maintain appropriate risk management skills, mechanisms and toolkits, and to act within Group risk appetite parameters set and approved by the Board.

Risk division (second line) is a centralised function headed by the Chief Risk Officer and consisting of eight Risk Directors and their specialist teams. The role of Chief Risk Officer was held by Juan Colombás until 4 September 2017 when he was succeeded by Stephen Shelley, previously Commercial Banking Risk Director. Within Risk division the Compliance function has been headed throughout 2017 by Letitia Smith, Group Director, Conduct, Compliance and Operational Risk.

Risk division provides oversight and independent constructive challenge to the effectiveness of risk decisions taken by business management, providing proactive advice and guidance, reviewing, challenging and reporting on the risk profile of the Group and ensuring that mitigating actions are appropriate.

It also has a key role in promoting the implementation of a strategic approach to risk management reflecting the risk appetite and RMF agreed by the Board that encompasses:

- embedded effective risk management processes;
- transparent, focused risk monitoring and reporting;
- provision of expert and high quality advice and guidance to the Board, executives and management on strategic issues and horizon scanning, including pending regulatory changes; and
- a constructive dialogue with the first line through provision of advice, development of common methodologies, understanding, education, training, and development of new tools.

The Chief Risk Officer is accountable for developing and leading an industry-wide recognised Risk function that adds value to the Group by:

- providing a regular comprehensive view of the Group's risk profile, both current and emerging key risks, and management actions;
- (with input from the business areas and Risk division) proposing Group risk appetite to the Board for approval, and overseeing performance of the Group against risk appetite;
- developing an effective RMF which meets regulatory requirements for approval by the Board, and overseeing execution and compliance; and
- challenging management on emerging risks and providing expert risk and control advice to help management maintain an effective risk and control framework.

The Risk Directors:

- provide independent advice, oversight and challenge to the business;
- design, develop and maintain policies, specific functional risk type frameworks and guidance to ensure alignment with business imperatives and regulatory requirements;
- establish and maintain appropriate governance structures, culture, oversight and monitoring arrangements which ensure robust and efficient compliance with relevant risk type risk appetites and policies;
- lead regulatory liaison on behalf of the Group including horizon scanning and regulatory development for their risk type; and
- recommend risk appetite and oversight of the associated risk profile across the Group.

Group Internal Audit (third line) provides independent and objective assurance designed to add value and improve the organisation's operations. Group Internal Audit has been headed throughout 2017 by Paul Day, Chief Internal Auditor, on an interim secondment basis from 1 January to 31 May, and on a permanent basis thereafter. It helps the Group accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes. Group Internal Audit provides independent assurance to the Audit Committee and the Board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group Internal Audit is fully independent of the business and the Risk division, and seeks to ensure objective challenge to the effectiveness of the risk governance framework.

Risk and control cycle from identification to reporting

To allow senior management to make informed risk decisions, the business follows a continuous risk management approach which includes producing appropriate, accurate and focused risk reporting and risk management. The risk and control cycle sets out how this should be approached and produced with the appropriate controls and processes in place. This cycle, from identification to reporting, ensures consistency and is intended to manage and mitigate the risks impacting the Group.

The process for risk identification, measurement and control is integrated into the overall framework for risk governance. Risk identification processes are forward looking to ensure emerging risks are identified. Risks are captured and measured using robust and consistent quantification methodologies. The measurement of risks includes the application of stress testing and scenario analysis, and considers whether relevant controls are in place before risks are incurred.

Identified risks are reported on a monthly basis or as frequently as necessary to the appropriate committee. The extent of the risk is compared to the overall risk appetite as well as specific limits or triggers. When thresholds are breached, committee minutes are clear on the actions and timeframes required to resolve the breach and bring risk within given tolerances. There is a clear process for escalation of risks and risk events.

All business areas complete a Control Effectiveness Review (CER) annually, reviewing the effectiveness of their internal controls and putting in place a programme of enhancements where appropriate. The CER reports are approved at divisional risk committees or directly by the relevant member of the Group Executive Committee to confirm the accuracy of the assessment. This key process is overseen and independently challenged by Risk division, reviewed by Group Internal Audit against the findings of its assurance activities, and reported to the Board.

Risk culture

Supporting the formal frameworks of the RMF is the underlying culture, or shared behaviours and values, which sets out in clear terms what constitutes good behaviour and good practice. In order to effectively manage risk across the organisation, the functions encompassed within the three lines of defence have a clear understanding of risk appetite, business strategy and an understanding of (and commitment to) the role they play in delivering it. A number of levers are used to reinforce the risk culture, including tone from the top, clear accountabilities, effective communication and challenge and an appropriately aligned performance incentive and structure.

Risk resources and capabilities

Appropriate mechanisms are in place to avoid over-reliance on key personnel or system/technical expertise within the Group. Adequate resources are in place to serve customers both under normal working conditions and in times of stress, and monitoring procedures are in place to ensure that the level of available resource can be increased if required. Colleagues undertake appropriate training to ensure they have the skills and knowledge necessary to enable them to deliver fair outcomes for customers, being mindful of the Group's strategic conduct agenda, customer treatment policy/standards and Financial Conduct Authority requirements.

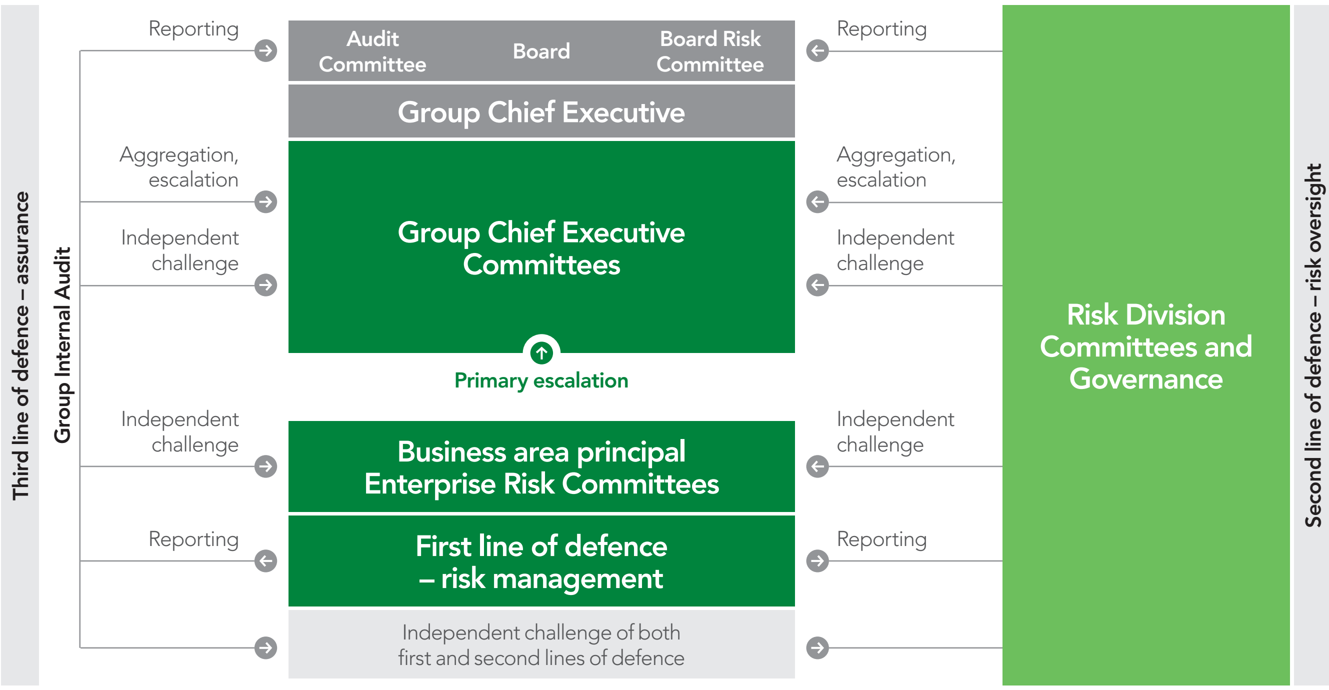
There is ongoing investment in risk systems and models alongside the Group's investment in customer and product systems and processes. This drives improvements in risk data quality, aggregation and reporting leading to effective and efficient risk decisions.

Risk governance

The risk governance structure below is integral to effective risk management across the Group. Risk division is appropriately represented on key committees to ensure that risk management is discussed in these meetings. This structure outlines the flow and escalation of risk information and reporting from business areas and Risk division to Group Executive Committee and Board. Conversely, strategic direction and guidance is cascaded down from the Board and Group Executive Committee.

Company Secretariat support senior and Board level committees, and support the Chairs in agenda planning. This gives a further line of escalation outside the three lines of defence.

Table 1.2: **Risk governance structure**



Group Chief Executive Committees

- Group Executive Committee (GEC)
- Group Risk Committee (GRC)
- Group Asset and Liability Committee (GALCO)
- Group Customer First Committee
- Group Cost Management Committee
- Conduct Review Committee
- Group People Committee
- Responsible Business Management Committee
- Senior Independent Performance Adjustment and Conduct Committee

Business area principal Enterprise Risk Committees

- Commercial Banking Risk Committee
- Retail Risk Committee
- Insurance and Wealth Risk Committee
- Community Banking Risk Committee
- Group Services Risk Committee
- Transformation Risk Committee
- Finance Risk Committee
- People and Productivity Risk Committee
- Group Corporate Affairs Risk Committee

Risk Division Committees and Governance

Credit risk
– Executive Credit Approval Committee
– Commercial Banking Credit Risk Committees
– Retail Credit Risk Committees

Market risk
– Group Market Risk Committee

Conduct, compliance and operational risk
– Group Conduct, Compliance and Operational Risk Committee

Fraud and financial crime risk
– Group Fraud and Financial Crime Prevention Committee

Financial risk
– Group Financial Risk Committee

Capital risk
– Group Capital Risk Committee

Model risk
– Group Model Governance Committee

Insurance underwriting risk through the governance arrangements for Insurance Group (Insurance Group is a separate regulated entity with its own Board, governance structure and Chief Risk Officer)

Risk management continued

Board, Executive and Risk Committees

The Group's risk governance structure (see table 1.2) strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

Assisted by the Board Risk and Audit Committees, the Board approves the Group's overall governance, risk and control frameworks and risk appetite. Refer to the Corporate Governance section on pages 58–80, for further information on Board committees.

The divisional and functional risk committees review and recommend divisional and functional risk appetite and monitor local risk profile and adherence to appetite.

Insurance, which is subject to separate regulation, has its own Board and governance structure. The Insurance Board, assisted by a Risk Oversight Committee and Audit Committee, approves the governance, risk and control frameworks for the Insurance business and the Insurance business risk appetite, ensuring it aligns with the Group's framework and risk appetite.

Table 1.3: Executive and Risk Committees

The Group Chief Executive is supported by the following:

Committees	Risk focus
Group Executive Committee (GEC)	Supports the Group Chief Executive in exercising his authority in relation to material matters having strategic, cross-business area or Group-wide implications.
Group Risk Committee (GRC)	Reviews and recommends the Group's risk appetite and governance, risk and control frameworks, and material Group policies. The committee also regularly reviews risk exposures and risk/reward returns and approves models that are material at Group level.
Group Asset and Liability Committee (GALCO)	Responsible for the strategic management of the Group's assets and liabilities and the profit and loss implications of balance sheet management actions. It is also responsible for the risk management framework for market risk, liquidity risk, capital risk and earnings volatility.
Group Customer First Committee	Provides a Group-wide perspective on the progress of Group's, divisions' and functions' implementation of initiatives which enhance the delivery of customer outcomes and customer trust, and sets and promotes the appropriate tone from the top to fulfil the Group's vision to become the best bank for customers and help Britain prosper.
Group Cost Management Committee	Leads and shapes the Group's approach to cost management, ensuring appropriate governance and process over Group-wide cost management activities and effective control of the Group's cost base.
Conduct Review Committee	Provides oversight and challenge in connection with the Group's engagement with conduct review matters as agreed with the Group Chief Executive.
Group People Committee	Oversees the Group's colleague policy, remuneration policy and Group-wide remuneration matters, oversees compliance with Senior Manager and Certification Regime (SM&CR) and other regulatory requirements, monitors colleague engagement surveys and ensures that colleague-related issues are managed fairly, effectively and compliantly.
Responsible Business Management Committee	Recommends and implements the strategy and plans to deliver the Group's aspiration to be a leader in responsible business as part of the objective of helping Britain prosper.
Senior Independent Performance Adjustment and Conduct Committee	Responsible for providing recommendations regarding performance adjustment, including the individual risk adjustment process and risk adjusted performance assessment, and making final decisions on behalf of the Group on the appropriate course of action relating to conduct breaches, under the formal scope of the SM&CR.

The Group Risk Committee is supported through escalation and ongoing reporting by business area risk committees, cross-divisional committees addressing specific matters of Group-wide significance and the following second line of defence Risk committees which ensure effective oversight of risk management:

Credit Risk Committees	Responsible for the development and effectiveness of the relevant credit risk management framework, clear description of the Group's credit risk appetite, setting of credit policy, and compliance with regulatory credit requirements.
Group Market Risk Committee	Monitors and reviews the Group's aggregate market risk exposures and concentrations and provides a proactive and robust challenge around business activities giving rise to market risks.
Group Conduct, Compliance and Operational Risk Committee	Responsible for monitoring breaches, material events and risk issues, and conducting deep dive assessments on specific conduct, compliance or operational risk subjects to inform corrective action along with the sharing of information and best practice.
Group Fraud and Financial Crime Prevention Committee	Reviews and challenges the management of fraud and financial crime risk including overall strategy and performance, Group-level risk appetite and broader corporate responsibilities, and engagement with relevant authorities and other external parties. The committee is accountable for ensuring that, at Group level, current and emerging fraud and financial crime risks are effectively identified and managed within appetite, and that strategies and investments to improve fraud and financial crime prevention are co-ordinated and implemented in relevant business areas.

Committees	Risk focus
Group Financial Risk Committee	Responsible for reviewing, challenging and recommending to GEC, GRC and GALCO, the Group Individual Liquidity Adequacy Assessment (ILAAP) and Internal Capital Adequacy Assessment Process (ICAAP) submissions, Pillar 3 Disclosures, the Group recovery and resolution plans, and the annual stress testing of the Group's operating plan, Prudential Regulation Authority (PRA) and European Banking Authority (EBA) stress tests, and any other analysis as required.
Group Capital Risk Committee	Responsible for providing oversight of all relevant capital matters within the Group including the Group's capital position, Pillar 2 requirements, regulatory reform and accounting developments specific to capital, as well as other areas such as stress testing and modelling activity. It also reviews regulatory submissions including the ICAAP and recovery plan prior to submission to Group Financial Risk Committee.
Group Model Governance Committee	Responsible for setting the framework and standards for model governance across the Group, including establishing appropriate levels of delegated authority and principles underlying the Group's modelling framework, specifically regarding consistency of approach across business units and risk types. It approves banking models other than those material at Group level, which are approved by GRC, and meets the PRA requirements regarding the governance and approval for Internal Ratings Based (IRB) methodologies. An equivalent committee exists in the Insurance division for approval of insurance models.

Full analysis of risk categories

The Group's risk framework covers all types of risk which affect the Group and could impact on the achievement of its strategic objectives. A detailed description of each category is provided on pages 116–156.

Following a review of the Group's risk categories in 2017, model risk is now a primary risk category, and is described in detail on page 156. Financial reporting risk, previously a primary risk category, is now considered as a secondary risk category of operational risk (see pages 135–136; additionally the main features of the Group's internal control system in relation to the financial reporting process are described on page 109).

Primary risk categories	Secondary risk categories		
Credit risk Page 116	– Retail credit	– Commercial credit	
Regulatory and legal risk Page 133	– Regulatory compliance	– Legal	
Conduct risk Page 134	– Conduct		
Operational risk Page 135	– Business process – Change – Cyber and information security – Data management – Sourcing	– External service provision – Financial crime – Financial reporting – Fraud	– Internal service provision – IT systems – Operational resilience – Physical security/health and safety
People risk Page 136	– People		
Insurance underwriting risk Page 137	– Insurance underwriting		
Capital risk Page 137	– Capital		
Funding and liquidity risk Page 144	– Funding and liquidity		
Governance risk Page 150	– Governance		
Market risk Page 151	– Trading book – Banking book	– Pensions – Insurance	
Model risk Page 156	– Model		

The Group considers both reputational and financial impact in the course of managing all its risks and therefore does not classify reputational impact as a separate risk category.

Risk management continued

Credit risk

Definition

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

Exposures

The principal sources of credit risk within the Group arise from loans and advances, contingent liabilities, commitments, debt securities and derivatives to customers, financial institutions and sovereigns. The credit risk exposures of the Group are set out in note 51 on page 240. Credit risk exposures are categorised as 'retail', arising primarily in the Retail and Run-off divisions, and some small and medium sized enterprises (SMEs) and 'corporate' (including larger SMEs, corporates, banks, financial institutions and sovereigns) arising primarily in the Commercial Banking, Run-off and Insurance and Wealth divisions and Group Corporate Treasury (GCT).

In terms of loans and advances, (for example loans and overdrafts) and contingent liabilities (for example credit instruments such as guarantees and standby, documentary and commercial letters of credit), credit risk arises both from amounts advanced and commitments to extend credit to a customer or bank. With respect to commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most retail commitments to extend credit may be cancelled and the creditworthiness of customers is monitored regularly. Most commercial term commitments to extend credit are contingent upon customers maintaining specific credit standards, which together with the creditworthiness of customers are monitored regularly.

Credit risk also arises from debt securities and derivatives. The total notional principal amount of interest rate, exchange rate, credit derivative and other contracts outstanding at 31 December 2017 is shown on page 122. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. Such amounts are reflected in note 51 on page 240.

Additionally, credit risk arises from leasing arrangements where the Group is the lessor. Note 2(J) on page 177 provides details on the Group's approach to the treatment of leases.

Credit risk exposures in the Insurance and Wealth division largely result from holding bond and loan assets, together with some related swaps, in the shareholder funds (including the annuity portfolio) and from exposure to reinsurers.

The investments held in the Group's defined benefit pension schemes also expose the Group to credit risk. Note 35 on page 206 provides further information on the defined benefit pension schemes' assets and liabilities.

Loans and advances, contingent liabilities, commitments, debt securities and derivatives also expose the Group to refinance risk. Refinance risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. If the Group does not wish to refinance the exposure then there is refinance risk if the obligor is unable to repay by securing alternative finance. This may be because the borrower is in financial difficulty, because the terms required to refinance are outside acceptable appetite at the time or the customer is unable to refinance externally, due to a lack of market liquidity. Refinance risk exposures are managed in accordance with the Group's existing credit risk policies, processes and controls, and are not considered to be material given the Group's prudent and through the cycle credit risk appetite. Where heightened refinance risk exists (such as in Commercial Banking's Business Support Unit (BSU) or the run-off book) exposures are minimised through intensive account management and are impaired and identified as forborne where appropriate.

Measurement

In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Group reflects three components:

(i) the 'probability of default' (PD) by the counterparty on its contractual obligations; (ii) current exposures to the counterparty and their likely future development, from which the Group derives the 'exposure at default'; and (iii) the likely loss ratio on the defaulted obligations (the 'loss given default').

Assessment of obligor quality for both retail and commercial counterparties is largely based on the outcomes of credit risk PD rating models. The Group operates a number of different regulatory rating models, typically developed internally using statistical analysis and management judgement – retail models rely more on the former, commercial models include more of the latter, especially in the larger corporate and more specialised lending portfolios. Internal data is supplemented with external data, where appropriate.

The models vary, inter alia, in the extent to which they are 'point in time' versus 'through the cycle'. The models are subject to rigorous validation and oversight and governance including, where appropriate, benchmarking to external information.

In the principal retail portfolios, exposure at default and loss given default models are in use. For regulatory reporting purposes, counterparties are segmented into a number of rating grades, each representing a defined range of default probabilities and exposures migrate between rating grades if the assessment of the counterparty PD changes. The retail master scale comprises 13 non-default ratings and one default rating.

In commercial portfolios the PD models also segment counterparties into a number of rating grades, with each grade representing a defined range of default probabilities. Counterparties migrate between rating grades if the assessment of the PD changes. The corporate (non-retail) master scale comprises of 19 non-default ratings and 4 default rating grades, and forms the basis on which internal reporting is completed.

Use of internally modelled outputs in the regulatory capital process is specific to the calculation approach being used. Under the Retail Internal Ratings Based (IRB) approach the rating system PD assessment is used alongside calculated exposure at default and loss given default values in order to derive risk-weighted assets (RWAs) and regulatory Expected Loss (EL). The Foundation IRB approach requires the use of the rating system PD alongside regulatory prescribed exposure at default and loss given default values. Slotting portfolios do not use loss given default whilst Standardised requires the use of regulatory refined exposure at default in a defined RWA calculation.

Impairment allowances are recognised for financial reporting purposes only for loss events that have occurred at the balance sheet date, based on objective evidence of impairment. Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the regulatory EL models. Note 2(H) on page 176 provides details of the Group's approach to the impairment of financial assets.

Mitigation

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

Prudent, through the cycle credit principles, risk policies and appetite statements: The independent Risk division sets out the credit principles, credit risk policies and credit risk appetite statements. Principles and policies are reviewed regularly, and any changes are subject to an approval process. Policies and risk appetite statements, where appropriate, are supported by procedures, which provide a disciplined and focused benchmark for credit decisions. Risk oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes, and test the adequacy of credit risk infrastructure and governance processes throughout the Group, which includes tracking portfolio performance against an agreed set of credit risk appetite tolerances. Oversight and reviews are also undertaken by independent credit risk oversight functions and Group Internal Audit.

Strong models and controls: The independent Risk division has established a set of model risk management principles, designed to ensure models and associated rating systems are developed consistently and are of sufficient quality to support business decisions and meet regulatory requirements. Internal rating models are developed and owned by the Risk division. The designated model owner takes responsibility for ensuring the fitness for purpose of the rating systems, supported and challenged by the independent specialist Group function.

Limitations on concentration risk: There are portfolio controls on certain industries, sectors and product lines to reflect risk appetite as well as individual, customer and bank limit guidelines. Credit policies and appetite statements are aligned to the Group's risk appetite and restrict exposure to higher risk countries and potentially vulnerable sectors and asset classes. Note 17 on page 193 provides an analysis of loans and advances to customers by industry (for commercial customers) and product (for retail customers). Exposures are monitored to prevent both an excessive concentration of risk and single name concentrations. These concentration risk controls are not necessarily in the form of a maximum limit on exposure, but may instead require new business in concentrated sectors to fulfil additional minimum policy and/or guideline requirements. The Group's largest exposures are regularly reported to the Board Risk Committee and reported in accordance with regulatory reporting requirements.

Robust country risk management: The Board sets a broad maximum country risk appetite. Within this, the Executive Credit Approval Committee approves the Group country risk framework and sovereign limits on an annual basis. Risk based country appetite for all countries is set within the independent Risk division, taking into account economic, financial, political and social factors as well as the approved business and strategic plans of the Group.

Specialist expertise: Credit quality is managed and controlled by a number of specialist units within the business and Risk division providing, for example: intensive management and control (see overleaf for Intensive care of customers in financial difficulty); security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector specific expertise; and legal services applicable to the particular market place and product range offered by the business.

Stress testing and scenario analysis: The Group's credit portfolios are also subjected to regular stress testing, with stress scenario assessments run at various levels of the organisation. Exercises focused on individual divisions and portfolios are performed in addition to the Group led and regulatory stress tests. For further information on stress testing process, methodology and governance, see page 111.

Frequent and robust credit risk oversight and assurance: Undertaken by independent credit risk oversight functions operating within Retail Credit Risk and Commercial Banking Risk which are part of the Group's second line of defence. Their primary objective is to provide reasonable and independent oversight that credit risk is being managed with appropriate and effective controls.

Group Internal Audit provides assurance to the Board Audit Committee on the effectiveness of credit risk management controls across the Group's activities. The team carries out independent risk based control audits across the full credit lifecycle.

Additional mitigation for Retail customers

The Group uses a variety of lending criteria when assessing applications for mortgages and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using internal data and information held by Credit Reference Agencies (CRA).

The Group also assesses the affordability and sustainability of lending for each borrower; for secured lending this includes use of an appropriate stressed interest rate scenario. Affordability assessments are compliant with relevant regulatory conduct guidelines. The Group takes reasonable steps to validate information used in the assessment of a customer's income and expenditure.

In addition, the Group has in place quantitative limits such as product maximum limits, the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are policy limits above which the Group will reject borrowing applications. The Group also applies certain criteria that are applicable to specific products such as for applications for a mortgage on a property that is to be let by the applicant.

For UK Secured, the Group's policy permits owner occupier applications with a loan to value (LTV) maximum of 95 per cent. Applications with an LTV above 90 per cent are subject to enhanced underwriting criteria, including higher scorecard cut-offs.

Buy-to-let mortgages are limited to a maximum loan size of £1,000,000 and 75 per cent LTV. Buy-to-let applications must pass a minimum rental cover ratio of 125 per cent under stressed interest rates, after applicable tax liabilities. Since September 2017, Portfolio Landlords (customers with four or more mortgaged buy-to-let properties) have been subject to additional controls including evaluation of overall portfolio resilience.

The Group's policy is to reject any application for a lending product where a customer is registered as bankrupt or insolvent, or has a recent County Court Judgment or financial default registered at a CRA used by the Group above de minimis thresholds. In addition, the Group rejects applicants where total unsecured debt, debt-to-income ratios, or other indicators of financial difficulty exceed policy limits.

Where credit acceptance scorecards are used, new models, model changes and monitoring of model effectiveness are independently reviewed and approved in accordance with the governance framework set by the Group Model Governance Committee.

Additional mitigation for Commercial customers

Individual credit assessment and independent sanction of customer and bank limits: With the exception of small exposures to SME customers where relationship managers have limited delegated sanctioning authority, credit risk in commercial customer portfolios is subject to sanction by the independent Risk division, which considers the strengths and weaknesses of individual transactions, the balance of risk and reward, and how credit risk aligns to the Group's risk appetite. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities and limit guidelines. Approval requirements for each decision are based on a number of factors including, but not limited to, the transaction amount, the customer's aggregate facilities, credit policy, risk appetite, credit risk ratings and the nature and term of the risk. The Group's credit risk appetite criteria for counterparty and customer underwriting is generally the same as that for assets intended to be held to maturity. All hard underwriting must be sanctioned via credit limits and a pre-approved credit matrix may be used for 'best efforts' underwriting.

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

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

Collateral

The principal collateral types acceptable for loans and advances, contingent liabilities and derivatives with commercial and bank counterparties and customers are:

- residential and commercial properties;
- charges over business assets such as premises, inventory and accounts receivable;
- financial instruments such as debt securities;
- vehicles;
- cash; and
- guarantees received from third parties.

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

Collateral held as security for financial assets other than loans and advances is determined by the nature of the underlying exposure. Debt securities, including treasury and other bills, are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, however securities are held as part of reverse repurchase or securities borrowing transactions or where a collateral agreement has been entered into under a master netting agreement. Derivative transactions with financial counterparties are typically collateralised under a Credit Support Annex (CSA) in conjunction with the International Swaps and Derivatives Association (ISDA) Master Agreement. Derivative transactions with non-financial customers are not usually supported by a CSA.

No collateral is held in respect of retail credit card or unsecured personal lending. For non-mortgage retail lending to small businesses, collateral may include second charges over residential property and the assignment of life cover.

Commercial lending decisions must be based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. The requirement for collateral and the type to be taken at origination will be based upon the nature of the transaction and the credit quality, size and structure of the borrower. For non-retail exposures, the Group will often require the collateral to include a first charge over land and buildings owned and occupied by the business, a

Risk management continued

debenture over one or more of the assets of a company or limited liability partnership, personal guarantees, limited in amount, from the directors of a company or limited liability partnership and key man insurance. The Group maintains policies setting out acceptable collateral bases for valuation, maximum LTV ratios and other criteria to be considered when reviewing an application. Other than for project finance, object finance and income producing real estate where charges over the subject assets are required, the provision of collateral will not determine the outcome of an application. Notwithstanding this, the fundamental business proposition must evidence the ability of the business to generate funds from normal business sources to repay a customer or counterparty's financial commitment.

The extent to which collateral values are actively managed will depend on the credit quality and other circumstances of the obligor and type of underlying transaction. Although lending decisions are based on expected cash flows, any collateral provided may impact the pricing and other terms of a loan or facility granted. This will have a financial impact on the amount of net interest income recognised and on internal loss given default estimates that contribute to the determination of asset quality and returns.

Collateral values are assessed at the time of loan origination. The Group requires collateral to be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. In certain circumstances, for Retail residential mortgages this may include the use of automated valuation models based on market data, subject to accuracy criteria and LTV limits. Collateral values are reviewed on a regular basis which will vary according to the type of lending, collateral involved and account performance. Such reviews are undertaken to confirm that the value recorded in the Bank's systems remains appropriate and whether revaluation is required, considering for example, account performance, market conditions and any information available that may indicate that the value of the collateral has materially declined. In such instances, the Group may seek additional collateral. For Retail, the Group adjusts open market values to take account of the costs of realisation and any discount associated with the realisation of the collateral when estimating credit losses.

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

The Group seeks to avoid correlation or wrong way risk where possible. Under repurchase (repo) policy, the issuer of the collateral and the repo counterparty should be neither the same nor connected. The same rule applies for derivatives. The Risk division has the necessary discretion to extend this rule to other cases where there is significant correlation. Countries with a rating equivalent to AA- and above may be considered to have no adverse correlation between the counterparty domiciled in the country and that country of risk (issuer of securities).

Refer to note 51 on page 240 for further information on collateral.

Master netting agreements

It is credit policy that a Group approved master netting agreement must be used for all derivative and traded property transactions and must be in place prior to trading. Any exceptions must be approved by the credit sanctioner. Although master netting agreements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis, within relevant jurisdictions and for appropriate counterparty types they do reduce the credit risk to the extent that, if an event of default occurs, all trades with the counterparty may be terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting agreements can change substantially within a short period, since this is the net position of all trades under the master netting agreement.

Other credit risk transfers

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

Monitoring

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

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

Intensive care of customers in financial difficulty

The Group operates a number of solutions to assist borrowers who are experiencing financial stress. The material elements of these solutions through which the Group has granted a concession, whether temporarily or permanently, are set out below.

Retail customers

The Group's aim in offering forbearance and other assistance to customers in financial distress is to benefit both the customer and the Group by discharging the Group's regulatory and social responsibilities to support its customers and act in their best long-term interests and by bringing customer facilities back into a sustainable position which, for owner occupier mortgages, also means keeping customers in their homes. The Group offers a range of tools and assistance to support customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer. Operationally, the provision and review of such assistance is controlled through the application of an appropriate policy framework, controls around the execution of policy, regular review of the different treatments to confirm that they remain appropriate, monitoring of customers' performance and the level of payments received, and management visibility of the nature and extent of assistance provided and the associated risk.

Assistance is provided through trained colleagues in branches and dedicated telephony units, and via online guidance material. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies when they have multiple credit facilities, including those at other lenders that require restructuring. Within the collections and recoveries functions, the sharing of best practice and alignment of policies across the Group has helped to drive more effective customer outcomes and achieve operational efficiencies.

The specific tools available to assist customers vary by product and the customer's status. In defining the treatments offered to customers who have experienced financial distress, the Group distinguishes between the following categories:

– Reduced payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example short-term arrangements to pay.
– Term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment.
– Repair: a permanent account change used to repair a customer's position when they have emerged from financial difficulty, for example capitalisation of arrears.

Forbearance identification, classification and measurement

The Group classifies Retail accounts as forborne at the time a customer in financial difficulty is granted a concession. Accounts are classified as forborne only for the period of time which the exposure is known to be, or may still be, in financial difficulty. Where temporary forbearance is granted, exit criteria are applied to include accounts until they are known to no longer be in financial difficulty. Where the treatment involves a permanent change to the contractual basis of the customer's account such as a capitalisation of arrears or term extension, the Group may classify the balance as forborne for a period of 24 months, after which no distinction is made between these accounts and others where no change has been made.

Those forborne loans which fall below individual assessment limits for impairment are grouped with other assets of similar characteristics and assessed collectively in accordance with the Group impairment policy detailed in note 2(H) on page 176. The Group's approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the underlying loss risk of exposures. The performance and output of models are monitored and challenged on an ongoing basis, in line with the Group's model governance policies.

The Group measures the success of a forbearance scheme for secured customers based upon the proportion of customers performing (less than or equal to three months in arrears) over the 24 months following the exit from a forbearance treatment. For temporary treatments, 80.7 per cent of customers accepting reduced payment arrangements are performing. For permanent treatments, 83.4 per cent of customers who have accepted capitalisations of arrears and 84.3 per cent of customers who have accepted term extensions are performing.

Customers receiving support from UK government sponsored programmes

To assist customers in financial distress, the Group also participates in UK government sponsored programmes for households the most significant of which is the Income Support for Mortgage Interest (SMI) which provides certain defined categories of customers access to a benefit scheme, paid for by the government, which covers all or part of the interest on the mortgage. There are two primary categories:

– Customers claiming Jobseeker's Allowance, Income Support, Universal Credit or Employment and Support Allowance benefits: Qualifying customers are able to claim for mortgage interest at 2.61 per cent on up to £200,000 of the mortgage. There is a two year time limit on Jobseeker's Allowance claims that started getting SMI benefit after 5 January 2009. There is no time limit for Income Support, Universal Credit or Employment and Support Allowance customer claims.
– Pension Credit customers: Qualifying customers are able to claim for mortgage interest at 2.61 per cent on up to £100,000 of the mortgage and there is no time limit as to how long they can claim.

For both categories, all decisions regarding an individual's eligibility and any amounts payable under the scheme rest solely with the government. Payments are made directly to the Group by the Department of Work and Pensions. The Group estimates that customers representing approximately £1.6 billion of its mortgage exposures are receiving this benefit, including those who are also receiving other treatments for financial difficulty.

Commercial customers

Early identification, control and monitoring are key to supporting the customer and protecting the Group. With the exception of small exposures in SME all non-retail exposures in the Commercial Banking and Run-off divisions are reviewed at least annually (and more frequently where required) by the independent Risk division. As part of the Group's established credit risk classification system, every exposure in the good book is categorised as either 'good' or 'watchlist'. The term 'watchlist' refers to cases which require closer monitoring on the good book and are split between 'special mention' and 'special review' (the latter being the more serious of the two). This complements the Group's risk rating tools and is designed to identify and highlight portfolio levels of asset quality as well as individual problem credits. All watchlist names are reviewed by the business and Risk division regularly, and the classification is updated if required. This process seeks to ensure that relationship managers act promptly to identify, and highlight to senior management, those customers who have greater potential to become higher risk in the future.

Those customers deemed higher risk where there is cause for concern over future repayment capability or where there is a risk of the asset becoming impaired will be transferred to the BSU at an early stage. The decision to transfer rests with the Credit teams and not the relationship team. On transfer, the BSU will take over the 'credit' responsibility for the customer relationship whilst the 'servicing' responsibility remains with the original relationship manager. The over-arching aim of the BSU is to provide support and work consensually with each customer to try and resolve the issues, restore the business to a financially viable position and thereby bring about a business turnaround. This may involve a combination of restructuring, work out strategies and other types of forbearance.

With the exception of small exposures (<£50,000) in SME, BSU case officers manage stressed and doubtful assets in Commercial Banking and are part of the independent Risk division. They are highly experienced and operate in a closely controlled and monitored environment, including regular oversight and close scrutiny by senior management. Distressed run-off assets are managed to the same standards by Client Asset Management (CAM).

A detailed assessment is undertaken for cases in BSU to assist in reducing and minimising risk exposure and to also highlight potential strategic options. A range of information is required to fully appraise and understand the customer's business and cashflow (and therefore debt serviceability).

This may involve the Group, in addition to using its own internal sector experts, engaging professional advisers to perform asset valuations, strategic reviews and where applicable, independent business reviews. The assessment may also involve:

– critically assessing a customer's ability to effectively manage the business in a distressed situation where a turnaround needs to be delivered;
– analysis of market sector factors, i.e. products, customers, suppliers, pricing and margin issues;
– performance review of operational areas that should be considered in terms of current effectiveness and efficiency and scope for improvements;
– financial analysis to model plans and factor in potential sensitivities, vulnerabilities and upsides; and
– determining the most appropriate corporate and capital structure suitable for the work out strategy concerned.

The above assessment, monitoring and control processes continue throughout the period the case is managed within the BSU. All the analysis performed around cash flows is used to determine appropriate impairment provisions.

The level of Commercial Banking BSU gross loans and advances to customers reduced from £3.4 billion to £2.6 billion between 31 December 2016 and 31 December 2017. The net reduction of £0.8 billion in BSU managed lending in Commercial Banking was driven by returns to mainstream, disposals, write-offs and repayments.

The Group's treatment of loan renegotiations is included in the impairment policy in note 2(H) on page 176 Income statement information set out in the credit risk tables is on an underlying basis (see page 43).

Forbearance

A key factor in determining whether the Group treats a commercial customer as forborne is the granting of a concession which is outside the Group's current risk appetite to a borrower who experiences, or is believed to be about to experience, financial difficulty. Where a concession is granted to a customer that is not in financial difficulty or the risk profile is considered within the Group's current risk appetite, the concession would not be considered to be an act of forbearance. The Group does not believe forbearance reporting is appropriate for derivatives, available for sale assets and the trading book where assets are marked to market daily.

The Group recognises that forbearance alone is not necessarily an indicator of impaired status, but it is a trigger for the review of the customer's credit profile. If there is any concern over the future cash flows and/or the Group incurring a loss, then forborne loans will be classified as impaired in accordance with the Group's impairment policy. All impaired loans, including recoveries portfolios, are currently reported as forborne.

Recovery can sometimes be through improvement in market or economic conditions, or the customer may benefit from access to alternative sources of liquidity, such as an equity injection. These can be especially relevant in real estate or other asset backed transactions where a fire sale of assets in a weak market may be unattractive.

Depending on circumstances and when operated within robust parameters and controls, the Group believes forbearance can help support the customer in the short to medium-term. The Group expects to have unimpaired forborne assets within its portfolios, where default has been avoided, or when no longer considered impaired, although the majority of these cases will be managed in the BSU, where more intensive management and monitoring is available.

Unimpaired forborne assets are included in calculating the overall collective unidentified impairment provision, which uses the historical observed default rate and loss emergence period of the relevant portfolio as a whole as part of its calculation.

Whilst the material portfolios have been reviewed for forbearance, some non-retail loans and advances in the Commercial Banking and Run-off divisions have not been reviewed on the basis that the level of unimpaired forbearance is relatively immaterial, or because the concept of forbearance is not relevant. These include, but are not limited to, Lloyds Bank Commercial Finance Ltd and The Agricultural Mortgage Corporation Plc.

Risk management continued

Types of forbearance

The Group's strategy and offer of forbearance is largely dependent on each customer's individual situation. Early identification, control and monitoring are key to supporting the customer and protecting the Group. Concessions are often provided to help the customer with their day-to-day liquidity and working capital. A number of options are available to the Group where a customer is facing financial difficulty and each case is treated depending on its own specific circumstances.

For commercial customers, the Group currently looks at forbearance concessions including changes to:

- Contractual payment terms (for example loan maturity extensions, or changes to capital and/or interest servicing arrangements, including capital repayment holidays or conversion to interest only terms); and
- Non-payment contractual terms (for example covenant amendments or waivers) where the concession enables default to be avoided.

The main types of forbearance concessions to commercial customers in or facing financial difficulty are set out below:

- Covenants: This includes temporary and permanent waivers, amendment or resetting of non-payment contractual covenants (including LTV and interest cover). The granting of this type of concession in itself would not result in the loan being classified as impaired and the customer is kept under review in the event that further forbearance is necessary;
- Extensions and alterations: This includes extension and/or alteration of repayment terms to a level outside of market or the Group's risk appetite due to the customer's inability to make existing contractual repayment terms; amendments to an interest rate to a level considered outside of market or the Group's risk appetite, or other amendments such as changes to capital and/or interest servicing arrangements including capital repayment holidays or conversion to interest only terms; and
- Multiple type of forbearance (a combination of the above two).

Forbearance identification, classification and measurement

All non-retail loans and advances on the watchlist are further categorised depending on the current and expected credit risk attaching to the customer and the transaction. All watchlist names are reviewed by the business and independent Risk function regularly and the classification is updated if required.

Any event that causes concern over future payments is likely to result in the customer being assessed for impairment and, if required, an impairment allowance recognised. If impairment is identified, the customer is immediately transferred to BSU (if not already managed there) and the lending will be treated as impaired.

All of a customer's impaired loans are treated as forborne as they are considered to have been (or will be) granted some form of forbearance. Most impaired loans and advances exist only in the BSU within Commercial Banking and Run-off divisions.

A portfolio approach is taken for SME customers with exposures below £1 million managed in BSU. All customers with exposures below £1 million are reported as forborne whilst they are managed by SME BSU (whether impaired or unimpaired).

All reviews performed in the good book, BSU within Commercial Banking or in the Run-off division include analysis of latest financial information, a consideration of the market and sector the customer operates in, performance against plan and revised terms and conditions granted as part of any forbearance concession that may have been provided.

Exit from forbearance

Where forbearance has been granted a customer will remain treated and recorded as forborne until the customer evidences acceptable performance over a period of time. This period will depend on a number of factors such as whether the customer is trading in line with its revised plan, it is operating within the new terms and conditions (including observation to revised covenants and contractual payments), its financial performance is stable or improving and there are no undue concerns over its future performance. As a minimum, this cure period is currently expected to be at least 12 months following a forbearance event. Customers curing are managed according to their overriding credit risk classification categorisation; this could be in BSU, Run-off or in the mainstream good book.

The exception to this 12 month minimum period is where a permanent structural cure is made (for example, an injection of new collateral security or a partial repayment of debt to restore an LTV to within a covenant). In this case, the customer may exit forbearance once the permanent cure has been made.

Notwithstanding this, the overriding requirement for exit from forbearance in all cases is that the customer is not impaired and the reason for the forbearance event is no longer present.

Upon exit from forbearance the customer may be returned to the mainstream good classification. It is important to note that such a decision can be made only by the independent Risk division.

The Group credit risk portfolio in 2017

Overview

- Asset quality remains strong with portfolios continuing to benefit from the Group's proactive approach to risk management, continued low interest rates and a resilient UK economic environment.
- Gross impairment charges remain broadly flat, including the acquisition of MBNA.
- Gross asset quality ratio (excluding releases and write-backs) was stable at 28 basis points.
- The net impairment charge increased to £795 million in 2017 compared to £645 million in 2016, reflecting expected lower provision releases and write-backs and the acquisition of MBNA (£118 million). The net asset quality ratio for 2017 was 18 basis points (2016: 15 basis points).
- The Group expects an asset quality ratio of around 35 basis points through the cycle and less than 30 basis points through the plan period and in 2018.
- Impaired loans as a percentage of closing loans and advances reduced to 1.6 per cent (31 December 2016: 1.8 per cent) with impaired loans down £0.7 billion to £7.8 billion (31 December 2016: £8.5 billion), with reductions across Retail, Commercial Banking and Run-off divisions. As at 31 December Retail impaired loans were £104 million lower at £4,951 million, despite including £151 million relating to the acquisition of MBNA. Commercial Banking impaired loans reduced by £270 million to £1,927 million, driven by impaired loan repayments and reductions, partly offset by a large newly impaired loan.

Low risk culture and prudent risk appetite

- The Group continues to take a prudent approach to credit risk, with robust credit quality and affordability controls at origination and a prudent through the cycle credit risk appetite. The Group's portfolios are well positioned against an uncertain economic outlook and potential market volatility.
- The Group continues to grow lending to key segments while maintaining prudent credit criteria.
- The Group's effective risk management ensures early identification and management of customers and counterparties who may be showing signs of distress.
- Sector concentrations within the lending portfolios are closely monitored and controlled, with mitigating actions taken where appropriate. Sector and product caps limit exposure to certain higher risk and vulnerable sectors and asset classes. In particular:
  - The average indexed LTV of the UK Retail mortgage portfolio improved to 43.6 per cent (31 December 2016: 44.0 per cent) and the percentage of Secured loans and advances with an indexed LTV greater than 100 per cent was 0.6 per cent (31 December 2016: 0.7 per cent). The average LTV for new UK Retail mortgages written in 2017 was 63.0 per cent (31 December 2016: 64.4 per cent).
  - The value of UK Retail mortgage lending with an indexed LTV of greater than 80 per cent fell to £30,680 million (31 December 2016: £32,395 million).
  - Total UK Direct Real Estate gross lending across the Group was £17.9 billion at 31 December 2017 (31 December 2016: £19.9 billion) and includes Commercial Banking lending of £17.3 billion, and £0.2 billion within Retail Business Banking (within Retail). The Group's legacy run-off direct real estate portfolio has continued to fall and was £0.4 billion at 31 December 2017.
- Run-off net external assets stood at £9.1 billion at 31 December 2017, down from £11.3 billion at 31 December 2016. The portfolio represents only 1.8 per cent of the overall Group's loans and advances (31 December 2016: 2.1 per cent).

Table 1.4: Group impairment charge

2017	Loans and advances to customers £m	Debt securities classified as loans and receivables £m	Available -for-sale financial assets £m	Other credit risk provisions £m	Total £m	2016[1] £m
Retail	717	–	–	–	717	654
Commercial Banking	117	–	3	(5)	115	17
Insurance and Wealth	–	–	–	–	–	–
Run-off	(31)	(6)	–	(4)	(41)	(26)
Central items	1	–	3	–	4	–
Total impairment charge	804	(6)	6	(9)	795	645
Asset quality ratio					0.18%	0.15%
Gross asset quality ratio					0.28%	0.28%

1 Restated. See page 181.

Table 1.5: Movement in gross impaired loans

	2017					
	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Run-off £m	Total £m	2016 Total £m
At 1 January[1]	5,055	2,197	26	1,217	8,495	9,590
Classified as impaired during the year	2,342	637	9	101	3,089	3,154
Transferred to not impaired during the year	(783)	(132)	(8)	(67)	(990)	(1,047)
Repayments	(711)	(601)	(2)	(163)	(1,477)	(1,327)
Amounts written off	(1,073)	(136)	2	(133)	(1,340)	(1,472)
Impact of disposal of business and asset sales	(8)	–	–	(20)	(28)	(492)
Impact of acquisition of businesses	138	–	–	–	138	–
Exchange and other movements	(9)	(38)	1	–	(46)	89
At 31 December	4,951	1,927	28	935	7,841	8,495

1 Restated. See page 181.

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Table 1.6: Group impaired loans and provisions

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans[2] %
At 31 December 2017					
Retail	**341,705**	**4,951**	**1.4**	**2,147**	**46.1**
Commercial Banking	**100,812**	**1,927**	**1.9**	**830**	**43.1**
Insurance and Wealth	**818**	**28**	**3.4**	**9**	**32.1**
Run-off	**8,533**	**935**	**11.0**	**456**	**48.8**
Reverse repos and other items[3]	**23,886**				
Total gross lending	**475,754**	**7,841**	**1.6**	**3,442**	**45.6**
Impairment provisions	**(3,442)**				
Fair value adjustments[4]	**186**				
Total Group	**472,498**				
At 31 December 2016[5]					
Retail	332,953	5,055	1.5	2,011	42.9
Commercial Banking	102,398	2,197	2.1	828	37.7
Insurance and Wealth	812	26	3.2	11	42.3
Run-off	10,259	1,217	11.9	682	56.0
Reverse repos and other items[3]	15,249				
Total gross lending	461,671	8,495	1.8	3,532	43.4
Impairment provisions	(3,532)				
Fair value adjustments[4]	(181)				
Total Group	457,958				

1 Impairment provisions include collective unidentified impairment provisions.

2 Impairment provisions as a percentage of impaired loans are calculated excluding loans in recoveries in Retail (31 December 2017: £291 million; 31 December 2016: £365 million).

3 Includes £6.9 billion (December 2016: £6.7 billion) of lower risk loans sold by Commercial Banking and Retail to Insurance and Wealth to back annuitant liabilities.

4 The Group made adjustments to reflect the HBOS and MBNA loans and advances at fair value on acquisition. At 31 December 2017, the remaining fair value adjustment was £186 million comprising a positive adjustment of £270 million in respect of the MBNA assets and a negative adjustment of £84 million in respect of the HBOS assets. The fair value unwind in respect of impairment losses incurred was £85 million for the year ended 31 December 2017 (31 December 2016: £70 million). The fair value adjustment in respect of loans and advances is expected to continue to decrease in future years and will reduce to zero over time.

5 Restated. See page 181.

Table 1.7: Derivative credit risk exposures

	2017	2017 Traded over the counter			2016	2016 Traded over the counter		
	Traded on recognised exchanges £m	Settled by central counterparties £m	Not settled by central counterparties £m	Total £m	Traded on recognised exchanges £m	Settled by central counterparties £m	Not settled by central counterparties £m	Total £m
Notional balances								
Foreign exchange	**–**	**19**	**278,833**	**278,852**	–	254	369,368	369,622
Interest rate	**109,492**	**2,903,481**	**324,834**	**3,337,807**	167,399	3,023,742	423,709	3,614,850
Equity and other	**15,455**	**–**	**9,695**	**25,150**	32,172	–	11,046	43,218
Credit	**–**	**–**	**4,568**	**4,568**	–	–	8,098	8,098
Total	**124,947**	**2,903,500**	**617,930**	**3,646,377**	199,571	3,023,996	812,221	4,035,788
Fair values								
Assets		**280**	**25,155**			262	35,563	
Liabilities		**(592)**	**(25,454)**			(1)	(34,506)	
Net asset		**(312)**	**(299)**			261	1,057	

The total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2017 and 31 December 2016 is shown in the table above. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. Such amounts are reflected in note 51 on page 240.

Retail

– Asset quality remains strong across all portfolios, with stable new business quality and flow of loans entering arrears.

– The impairment charge increased by £63 million to £717 million. Excluding MBNA, impairments were £55 million lower driven by a net release on the Secured portfolio, due to reduced impaired loans and rising house prices, which was offset by higher impairment charges on the Loans and UK Motor Finance portfolios.

– Impairment provisions as a percentage of impaired loans increased to 46.1 per cent from 42.9 per cent at the end of 2016.

Table 1.8: Retail impairment charge

	2017 £m	2016[1] £m	Change %
Secured	(15)	104	
Credit cards	254	136	(87)
Loans	111	70	(59)
Overdrafts	227	241	6
UK Motor Finance	111	75	(48)
Retail Business Banking	27	27	–
Europe	2	1	
Total impairment charge	717	654	(10)
Asset quality ratio	0.21%	0.20%	1bp

1 Restated. See page 181.

Table 1.9: Retail impaired loans and provisions

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans[2] %
At 31 December 2017					
Secured	292,187	3,886	1.3	1,443	37.1
Credit cards	18,134	413	2.3	267	82.9
Loans	8,010	254	3.2	107	79.9
Overdrafts	1,595	197	12.4	113	86.3
UK Motor Finance	13,738	134	1.0	171	127.6
Retail Business Banking	928	24	2.6	23	230.0
Europe	7,113	43	0.6	23	53.5
Total gross lending	341,705	4,951	1.4	2,147	46.1
Impairment provisions	(2,147)				
Fair value adjustments	186				
Total	339,744				
At 31 December 2016[3]					
Secured	294,503	4,104	1.4	1,503	36.6
Credit cards	9,843	307	3.1	157	81.8
Loans	7,767	277	3.6	92	81.4
Overdrafts	1,952	179	9.2	90	82.6
UK Motor Finance	11,555	120	1.0	127	105.8
Retail Business Banking	1,004	27	2.7	22	200.0
Europe	6,329	41	0.6	20	48.8
Total gross lending	332,953	5,055	1.5	2,011	42.9
Impairment provisions	(2,011)				
Fair value adjustments	(181)				
Total	330,761				

1 Impairment provisions include collective unidentified impairment provisions.

2 Impairment provisions as a percentage of impaired loans are calculated excluding loans in recoveries for Credit cards (31 December 2017: £91 million; 31 December 2016: £115 million), Loans (31 December 2017: £120 million; 31 December 2016: £164 million), Overdrafts (31 December 2017: £66 million; 31 December 2016: £70 million) and Retail Business Banking (31 December 2017: £14 million; 31 December 2016: £16 million).

3 Restated. See page 181.

Risk management continued

Secured

- Total loans and advances reduced by 0.8 per cent to £292,187 million (31 December 2016: £294,503 million). The closed Specialist portfolio has continued to run-off, reducing by 10.9 per cent to £15,668 million.
- New business quality remained stable and early arrears have continued to reduce.
- The value of mortgages greater than three months in arrears (excluding repossessions) reduced to £5,437 million at 31 December 2017 (31 December 2016: £6,033 million).
- Impaired loans decreased by £218 million to £3,886 million (31 December 2016: £4,104 million), and impaired loans as a percentage of closing advances reduced to 1.3 per cent (31 December 2016: 1.4 per cent).
- UK house prices increased by 2.7 per cent over 2017 (on a quarterly non-seasonally adjusted basis).
  - The average indexed LTV of the portfolio improved to 43.6 per cent (31 December 2016: 44.0 per cent).
  - The value of lending with an indexed LTV of greater than 80 per cent fell to £30,680 million (31 December 2016: £32,395 million).
  - The percentage of loans and advances with an indexed LTV in excess of 100 per cent fell to 0.6 per cent (31 December 2016: 0.7 per cent).
  - The average LTV for new mortgages written in 2017 was 63.0 per cent (31 December 2016: 64.4 per cent).
- Net impairment release of £15 million in 2017 (2016: £104 million charge) reflects an improvement in the level of impaired loans in the portfolio.
- Impairment provisions as a percentage of impaired loans increased to 37.1 per cent (31 December 2016: 36.6 per cent), reflecting the continued prudent approach to provisioning.

Table 1.10: Retail secured loans and advances to customers

	At 31 Dec 2017 £m	At 31 Dec 2016 £m
Mainstream	**223,322**	222,450
Buy-to-let	**53,197**	54,460
Specialist	**15,668**	17,593
Total secured	**292,187**	294,503

Table 1.11: Mortgages greater than three months in arrears (excluding repossessions)

	Number of cases		Total mortgage accounts %		Value of loans[1]		Total mortgage balances %	
at 31 Dec	2017 Cases	2016 Cases	2017 %	2016 %	2017 £m	2016 £m	2017 %	2016 %
Mainstream	**32,383**	35,254	**1.6**	1.7	**3,502**	3,865	**1.6**	1.7
Buy-to-let	**4,710**	5,324	**1.0**	1.1	**581**	660	**1.1**	1.2
Specialist	**8,313**	9,078	**7.3**	7.2	**1,354**	1,508	**8.7**	8.6
Total	**45,406**	49,656	**1.7**	1.8	**5,437**	6,033	**1.9**	2.0

1 Value of loans represents total gross book value of mortgages more than three months in arrears.

The stock of repossessions increased to 777 cases at 31 December 2017 compared to 678 cases at 31 December 2016.

Table 1.12: **Period end and average LTVs across the Retail mortgage portfolios**

	Mainstream %	Buy-to-let %	Specialist %	Total %	Unimpaired %	Impaired %
At 31 December 2017						
Less than 60%	**57.1**	**53.9**	**57.6**	**56.4**	**56.7**	**41.7**
60% to 70%	**16.9**	**25.0**	**18.4**	**18.5**	**18.5**	**18.6**
70% to 80%	**14.5**	**15.7**	**12.8**	**14.6**	**14.6**	**14.6**
80% to 90%	**9.0**	**4.1**	**6.4**	**8.0**	**7.9**	**10.5**
90% to 100%	**2.1**	**0.7**	**1.6**	**1.9**	**1.8**	**5.3**
Greater than 100%	**0.4**	**0.6**	**3.2**	**0.6**	**0.5**	**9.3**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Outstanding loan value (£m)	**223,322**	**53,197**	**15,668**	**292,187**	**288,301**	**3,886**
Average loan to value[1]:						
Stock of residential mortgages	**41.7**	**53.0**	**47.4**	**43.6**		
New residential lending	**63.7**	**59.1**	**n/a**	**63.0**		
Impaired mortgages	**50.0**	**68.3**	**60.4**	**54.1**		
At 31 December 2016						
Less than 60%	56.8	52.0	53.8	55.8	56.0	38.3
60% to 70%	17.8	25.4	17.8	19.2	19.3	18.4
70% to 80%	14.0	14.4	13.6	14.0	14.0	15.3
80% to 90%	8.4	6.1	8.6	8.0	7.9	11.9
90% to 100%	2.4	1.5	3.1	2.3	2.2	6.8
Greater than 100%	0.6	0.6	3.1	0.7	0.6	9.3
Total	100.0	100.0	100.0	100.0	100.0	100.0
Outstanding loan value (£m)	222,450	54,460	17,593	294,503	290,399	4,104
Average loan to value[1]:						
Stock of residential mortgages	41.8	53.7	49.2	44.0		
New residential lending	65.0	61.9	n/a	64.4		
Impaired mortgages	51.8	69.0	61.9	55.8		

1 Average loan to value is calculated as total loans and advances as a percentage of the total indexed collateral of these loans and advances.

Interest only mortgages

The Group provides interest only mortgages to owner occupier mortgage customers whereby only payments of interest are made for the term of the mortgage with the customer responsible for repaying the principal outstanding at the end of the loan term. At 31 December 2017, owner occupier interest only balances as a proportion of total owner occupier balances had reduced to 29.2 per cent (31 December 2016: 31.8 per cent). The average indexed loan to value improved to 41.7 per cent (31 December 2016: 42.6 per cent).

For existing interest only mortgages, a contact strategy is in place throughout the term of the mortgage to ensure that customers are aware of their obligations to repay the principal upon maturity of the loan.

Treatment strategies are in place to help customers anticipate and plan for repayment of capital at maturity and support those who may have difficulty in repaying the principal amount. A dedicated specialist team supports customers who have passed their contractual maturity date and are unable to fully repay the principal. A range of treatments are offered such as full (or part) conversion to capital repayment, and extension of term to match the maturity dates of any associated repayment vehicles.

Risk management continued

Table 1.13: **Analysis of owner occupier interest only mortgages**

	2017	2016[1]
Interest only balances (£m)	**69,703**	76,229
Of which, impaired (%)	**3.0**	3.0
Average loan to value (%)	**41.7**	42.6
Maturity profile (£m):		
Due	**1,093**	1,028
1 year	**2,672**	2,499
2-5 years	**10,227**	10,287
6-10 years	**18,026**	17,368
>11 years	**37,685**	45,047
Past term interest only balances (£m)[2]	**1,553**	1,365
Of which, impaired (%)	**13.1**	11.7
Average loan to value (%)	**33.4**	31.5
Negative equity (%)	**2.1**	1.6

1 2016 values have been restated to include Scottish Widows Bank Mortgages and certain other interest only balances of £3,578 million.

2 Balances where all interest only elements have moved past term. Some may subsequently have had a term extension, so are no longer classed as due.

Credit cards

- Loans and advances increased by 84.2 per cent to £18,134 million (31 December 2016: £9,843 million), of which £8,003 million relates to MBNA. The MBNA portfolio is performing broadly in line with both the Group's expectations and the existing credit card portfolio.
- Impaired loans increased by £106 million to £413 million (31 December 2016: £307 million), of which £151 million related to MBNA. Impaired loans as a percentage of closing loans and advances improved to 2.3 per cent (31 December 2016: 3.1 per cent), reflecting good credit performance and the continued sale of debt in recoveries.
- The impairment charge increased to £254 million (2016: £136 million), driven by the acquisition of MBNA (£118 million).

Loans

- Loans and advances increased by 3.1 per cent to £8,010 million (31 December 2016: £7,767 million).
- Impaired loans decreased by £23 million to £254 million (31 December 2016: £277 million), largely due to the sale of debt in recoveries. Impaired loans as a percentage of closing loans and advances improved to 3.2 per cent (31 December 2016: 3.6 per cent).
- The impairment charge increased to £111 million (2016: £70 million), reflecting a one-off change relating to policy alignment across brands for franchised customers, and reducing cash flows due to previous sales of debt in recoveries.

Overdrafts

- Loans and advances decreased to £1,595 million (31 December 2016: £1,952 million).
- Impaired loans increased by £18 million to £197 million (31 December 2016: £179 million), and impaired loans as a percentage of closing advances increased to 12.4 per cent (31 December 2016: 9.2 per cent), reflecting a one-off impact relating to changes in overdraft fees and charges.
- The impairment charge decreased by 5.8 per cent to £227 million (2016: £241 million), largely due to increased sale of debt in recoveries and improved underlying performance.

UK Motor Finance

- Loans and advances increased by £2,183 million to £13,738 million (31 December 2016: £11,555 million), with 49.7 per cent of growth from Jaguar Land Rover business. The book continues to benefit from conservative residual values and prudent provisioning with stable credit quality and flows into arrears.
- Impaired loans increased by £14 million to £134 million (31 December 2016: £120 million), reflecting growth in the portfolio. Impaired loans as a percentage of closing loans and advances were stable at 1.0 per cent.
- The impairment charge increased by £36 million to £111 million (2016: £75 million), driven by portfolio growth and increased provisions for residual value risks reflecting a more conservative outlook on used car prices.

Forborne loans

Forborne loans and advances on the principal Retail portfolios reduced by £601 million in 2017 to £1,951 million, driven by improvements on the Secured portfolio. As a percentage of loans and advances, forborne loans and advances on these portfolios improved to 0.6 per cent (31 December 2016: 0.8 per cent).

Impairment provisions as a percentage of loans and advances that are forborne increased to 13.0 per cent (31 December 2016: 9.6 per cent).

Secured forborne loans and advances reduced by £668 million in 2017 to £1,428 million, primarily due to a reduction in recapitalisations (with historically higher levels of cases exiting the two year probation period) and a reduction in the level of reduced payment arrangements.

Within the other portfolios, movements were seen in the level of forborne loans and advances in relation to one off changes for 2017. This included the acquisition of MBNA in the Credit cards portfolio (with forborne loans and advances of £112 million and impaired forborne loans and advances of £90 million), and improved customer views and the reclassification of some treatments across the Loans and UK Motor Finance portfolios.

Table 1.14: **UK Retail forborne loans and advances (audited)**[1]

	Total loans and advances which are forborne		Total forborne loans and advances which are impaired		Impairment provisions as a % of loans and advances which are forborne	
	At Dec 2017 £m	At Dec 2016 £m	**At Dec 2017 £m**	At Dec 2016 £m	**At Dec 2017 %**	At Dec 2016 %
Temporary reduced payment arrangements	**249**	428	**76**	101	**5.7**	4.9
Permanent term extensions and repair	**1,179**	1,668	**61**	116	**4.0**	4.7
Secured	**1,428**	2,096	**137**	217	**4.3**	4.7
Credit cards	**295**	212	**190**	119	**36.0**	29.0
Loans[2]	**86**	49	**45**	46	**27.9**	44.4
Overdrafts	**108**	78	**94**	61	**47.0**	38.0
UK Motor Finance[2]	**34**	117	**19**	62	**36.6**	27.0
Total	**1,951**	2,552	**485**	505	**13.0**	9.6

1 Includes temporary treatments where the customer is currently benefiting from the change or the treatment has ended within the last three months for Secured, and six months for other portfolios. Permanent changes, such as refinancing or recapitalisation which commenced during the last 24 months, are also included.

2 Figures for 2017 include improved customer views and the reclassification of some treatments.

The movements in Retail forborne loans and advances during the year are as follows:

Table 1.15: **Movement in UK Retail forborne loans and advances (audited)**

	2017					
	Secured £m	**Credit cards £m**	**Loans £m**	**Overdrafts £m**	**UK Motor Finance £m**	**Total £m**
At 1 January	**2,096**	**212**	**49**	**78**	**117**	**2,552**
Classified as forborne during the year	**744**	**159**	**44**	**85**	**24**	**1,056**
Written-off/sold	**(13)**	**(100)**	**(18)**	**(32)**	**(20)**	**(183)**
Exit from forbearance	**(1,217)**	**(41)**	**(3)**	**(19)**	**(15)**	**(1,295)**
Redeemed or repaid	**(162)**	**(15)**	**(6)**	**–**	**(8)**	**(191)**
Exchange and other movements[1]	**(20)**	**80**	**20**	**(4)**	**(64)**	**12**
At 31 December	**1,428**	**295**	**86**	**108**	**34**	**1,951**

	2016					
	Secured £m	Credit cards £m	Loans £m	Overdrafts £m	UK Motor Finance £m	Total £m
At 1 January	3,102	225	60	87	100	3,574
Classified as forborne during the year	975	110	34	50	82	1,251
Written-off/sold	(12)	(46)	(24)	(31)	(16)	(129)
Exit from forbearance	(1,741)	(43)	(4)	(24)	(22)	(1,834)
Redeemed or repaid	(200)	(9)	(6)	–	(16)	(231)
Exchange and other movements	(28)	(25)	(11)	(4)	(11)	(79)
At 31 December	2,096	212	49	78	117	2,552

1 Exchange and other movements for 2017 reflects the acquisition of MBNA within Credit cards, and improved customer views and the reclassification of some treatments across the Loans and UK Motor Finance portfolios.

Risk management continued

Commercial Banking

- Net impairment charge was £115 million in 2017 (2016: £17 million) with the increase due to a lower level of write-backs and provision releases rather than a deterioration in the underlying portfolio.
- Both 2016 and 2017 included material charges against a single customer (2016: oil & gas sector, 2017: construction sector), but otherwise gross charges have remained relatively low.
- The portfolio continues to benefit from effective risk management, a resilient economic environment and continued low interest rates.
- Credit quality of the portfolio and new business remains generally good and the Group is not relaxing risk appetite despite a more competitive market.
- Impaired loans reduced by 12 per cent to £1,927 million at 31 December 2017 compared with £2,197 million at 31 December 2016, driven by impaired loan repayments and reductions, partly offset by a large newly impaired loan. Impaired loans as a percentage of closing loans and advances reduced to 1.9 per cent from 2.1 per cent at 31 December 2016.
- Impairment provisions were broadly flat at £830 million at 31 December 2017 (31 December 2016: £828 million) and includes collective unidentified impairment provisions of £183 million (31 December 2016: £183 million). Provisions as a percentage of impaired loans increased from 37.7 per cent to 43.1 per cent during 2017, driven by a number of isolated cases.
- An uncertain UK and global economic outlook and uncertainty relating to EU exit negotiations have the ability to impact the Commercial Banking portfolios.
- Internal and external key performance indicators continue to be monitored closely to help identify early signs of any deterioration and portfolios remain subject to ongoing risk mitigation actions as appropriate.
- Despite the uncertain economic outlook, the portfolios are well positioned and the Group's through the cycle risk appetite approach is unchanged. Monitoring indicates no material deterioration in the credit quality of our portfolios. Notwithstanding this, impairments are likely to increase from their historic low levels, driven mainly by lower levels of releases and write-backs and an element of credit normalisation.

Table 1.16: Commercial Banking impairment charge

	2017 £m	2016[1] £m	Change %
SME	**7**	(7)	
Other	**108**	24	
Total impairment charge	**115**	17	
Asset quality ratio[2]	**0.12%**	0.02%	10bp

1 Restated. See page 181.

2 In respect of loans and advances to customers.

Table 1.17: Commercial Banking impaired loans and provisions

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
At 31 December 2017					
SME	**30,480**	**821**	**2.7**	**151**	**18.4**
Other	**70,332**	**1,106**	**1.6**	**679**	**61.4**
Total gross lending	**100,812**	**1,927**	**1.9**	**830**	**43.1**
Impairment provisions	**(830)**				
Total	**99,982**				
At 31 December 2016[2]					
SME	29,959	923	3.1	173	18.7
Other	72,439	1,274	1.8	655	51.4
Total gross lending	102,398	2,197	2.1	828	37.7
Impairment provisions	(828)				
Total	101,570				

1 Impairment provisions include collective unidentified impairment provisions.

2 Restated. See page 181.

Portfolios

- The SME Banking portfolio continues to grow within prudent credit risk appetite parameters. As a result of the Group's customer driven relationship management, net lending has increased 2 per cent in 2017. Portfolio credit quality has remained stable or improved across the majority of key risk metrics.
- The Mid Markets portfolio is domestically focused and reflects the underlying performance of the UK economy and our prudent credit risk appetite. Credit quality has been stable with levels of financial stress and impairment remaining low.
- The Global Corporates business continues to have a predominance of investment grade clients, primarily UK based. The portfolio remains of good quality despite the current global economic uncertainty particularly relating to the EU Exit and a softer outlook in a number of sectors, including construction and retail.
- The commercial real estate business within the Group's Mid Markets and Global Corporate portfolio is focused on clients operating in the UK commercial property market ranging in size from medium-sized private real estate entities up to publicly listed property companies. The market for UK real estate has continued to be resilient, with appetite from a range of investors. UK real estate continues to offer attractive yields compared to other asset classes and the fall in Sterling has boosted the attractiveness to foreign investors. Credit quality remains good with minimal impairments/stressed loans. Recognising this is a cyclical sector, appropriate caps are in place to control exposure and business propositions continue to be written in line with a prudent, through the cycle risk appetite with conservative LTVs, strong quality of income and proven management teams.
- Through clearly defined sector strategies Financial Institutions serves predominantly investment grade counterparties with whom relationships are either client focused or held to support the Group's funding,

liquidity or general hedging requirements. The portfolio continues to be prudently managed within the Group's conservative risk appetite and clearly defined sector strategies.

– The Group continues to adopt a conservative stance across the Eurozone maintaining close portfolio scrutiny and oversight particularly given the current macro environment and horizon risks.

Commercial Banking UK Direct Real Estate LTV analysis

– The Group classifies Direct Real Estate as exposure which is directly supported by cash flows from property activities (as opposed to trading activities, such as hotels, care homes and housebuilders).

– Focus remains on the UK market, on good quality customers, with a proven track record in Real Estate and where cash flows are robust.

– Commercial Banking UK Direct Real Estate gross lending stood at £17.3 billion at 31 December 2017.

– Approximately 70 per cent of loans and advances to UK Direct Real Estate relate to commercial real estate with the remainder relating to residential real estate. The portfolio continues to be heavily weighted towards investment real estate (c.90 per cent) over development.

– The LTV profile of the UK Direct Real Estate portfolio in Commercial Banking continues to improve.

Table 1.18: **LTV – UK Direct Real Estate**

	At 31 December 2017[1]				At 31 December 2016[1]			
	Unimpaired £m	Impaired £m	Total £m	%	Unimpaired £m	Impaired £m	Total £m	%
UK Exposures > £5m								
Less than 60%	5,567	–	5,567	77.8	5,721	14	5,735	67.2
60% to 70%	855	–	855	12.0	1,470	–	1,470	17.2
70% to 80%	183	25	208	2.9	506	9	515	6.1
80% to 100%	14	54	68	1.0	20	6	26	0.3
100% to 120%	–	–	–	–	–	–	–	–
120% to 140%	–	–	–	–	–	–	–	–
Greater than 140%	–	49	49	0.7	–	68	68	0.8
Unsecured[2]	404	–	404	5.6	689	26	715	8.4
	7,023	128	7,151	100.0	8,406	123	8,529	100.0
UK Exposures <£5m[3]	9,443	305	9,748		9,563	429	9,992	
Total	16,466	433	16,899		17,969	552	18,521	

1 Excludes Islands Commercial UK Direct Real Estate of £0.4 billion (31 December 2016: £0.5 billion).

2 Predominantly investment grade corporate CRE lending where the Group is relying on the corporate covenant.

3 December 2017 <£5m exposures include £9.2 billion within SME which has an LTV profile broadly similar to the >£5m exposures.

Forborne loans

Commercial Banking forbearance

At 31 December 2017, £2,374 million (31 December 2016: £2,663 million) of total loans and advances were forborne of which £1,927 million (31 December 2016: £2,197 million) were impaired. Impairment provisions as a percentage of forborne loans and advances increased from 31.1 per cent at 31 December 2016 to 35.0 per cent at 31 December 2017.

Table 1.19: **Commercial Banking forborne loans and advances (audited)**

	Total loans and advances which are forborne		Impairment provisions as a % of loans and advances which are forborne	
	2017 £m	2016[1] £m	2017 %	2016[1] %
Impaired	1,927	2,197	43.1	37.7
Unimpaired	447	466	–	–
Total	2,374	2,663	35.0	31.1

1 Restated. See page 181.

All Commercial Banking impaired assets are considered forborne.

Risk management continued

Impaired loans and advances

The movements in Commercial Banking impaired forborne loans and advances were as follows:

Table 1.20: Movement in Commercial Banking impaired forborne loans and advances (audited)

	2017 £m	2016[1] £m
At 1 January	2,197	2,543
Classified as impaired during the year		
Exposures >£5m	518	547
Exposures <£5m	119	124
	637	671
Transferred to unimpaired		
Exposures >£5m but still reported as forborne	–	–
Exposures >£5m no longer reported as forborne	(51)	(31)
Exposures <£5m	(81)	(81)
	(132)	(112)
Written-off	(136)	(311)
Asset disposals/sales of impaired assets	–	(33)
Drawdowns/repayments	(601)	(595)
Exchange and other movements	(38)	34
At 31 December	**1,927**	**2,197**

1 Restated. See page 181.

Unimpaired loans and advances

Unimpaired forborne loans and advances were £447 million at 31 December 2017 (31 December 2016: £466 million).

The table below sets out the largest unimpaired forborne loans and advances to Commercial Banking customers (exposures over £5 million) as at 31 December 2017 by type of forbearance:

Table 1.21: Commercial Banking unimpaired forborne loans and advances[1] (audited)

	31 Dec 2017 £m	31 Dec 2016 £m
Type of unimpaired forbearance		
Exposures >£5m		
Covenants	157	153
Extensions/alterations	–	7
Multiple	–	21
	157	181
Exposures <£5m	290	285
Total	**447**	**466**

1 Material portfolios only.

Table 1.22: Movement in Commercial Banking unimpaired forborne loans and advances >£5m[1] (audited)

	2017 £m	2016 £m
At 1 January	181	669
Classified as impaired during the year	(34)	(63)
Cured no longer forborne	(50)	(413)
Classified as forborne during the tear	90	88
Transferred from impaired but still reported as forborne	–	–
Asset disposal/sales	–	–
Net drawdowns/repayments	(25)	(100)
Exchange and other movements	(5)	–
At 31 December	**157**	**181**

1 Balances exclude intra-year movements.

Run-off

Table 1.23: **Run-off impairment charge**

	2017 £m	2016 £m	Change %
Ireland	(9)	(14)	36
Corporate real estate and other corporate	(13)	1	
Specialist finance	(15)	(2)	
Other	(4)	(11)	64
Total	**(41)**	(26)	(58)
Asset quality ratio[1]	(0.32%)	(0.15%)	(17)bp

1 In respect of loans and advances to customers.

Table 1.24: **Run-off impaired loans and provisions**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions £m	Impairment provisions as a % of impaired loans %
At 31 December 2017					
Ireland	4,391	136	3.1	115	84.6
Corporate real estate and other corporate	815	692	84.9	287	41.5
Specialist finance	2,327	23	1.0	29	126.1
Other	1,000	84	8.4	25	29.8
Total gross lending	**8,533**	**935**	**11.0**	**456**	**48.8**
Impairment provisions	(456)				
Total	**8,077**				
At 31 December 2016					
Ireland	4,498	139	3.1	133	95.7
Corporate real estate and other corporate	1,190	896	75.3	399	44.5
Specialist finance	3,374	99	2.9	111	112.1
Other	1,197	83	6.9	39	47.0
Total gross lending	10,259	1,217	11.9	682	56.0
Impairment provisions	(682)				
Total	9,577				

Eurozone exposures

The following section summarises the Group's direct exposure to Eurozone countries at 31 December 2017. The exposures comprise on balance sheet exposures based on their balance sheet carrying values net of provisions and off-balance sheet exposures, and are based on the country of domicile of the counterparty unless otherwise indicated.

The Group manages its exposures to individual countries through authorised country limits which take into account economic, financial, political and social factors. In addition, the Group manages its direct risks to the selected countries by establishing and monitoring risk limits for individual banks, financial institutions, corporates and individuals.

Identified indirect exposure information, where available, is also taken into account when setting limits and determining credit risk appetite for individual counterparties. This forms part of the Group's credit analysis undertaken at least annually for counterparty and sector reviews, with interim updates performed as necessary. Interim updates would usually be triggered by specific credit events such as rating downgrades, sovereign events or other developments such as spread widening. Examples of indirect risk which have been identified, where information is available, are: European banking groups with lending and other exposures to certain Eurozone countries; corporate customers with operations or significant trade in certain European jurisdictions; major travel operators known to operate in certain Eurozone countries; and international banks with custodian operations based in certain European locations.

The Chief Security Office (formerly the Group Financial Stability Forum) monitors developments within the Eurozone, carries out stress testing through detailed scenario analysis and completes appropriate due diligence on the Group's exposures. The Group has pre-determined action plans that would be executed in certain scenarios which set out governance requirements and responsibilities for the key actions which would be carried out and cover risk areas such as payments, liquidity and capital, communications, suppliers and systems, legal, credit, delivery channels and products, employees and the impact on customers.

Derivative balances are included within exposures to financial institutions or corporates, as appropriate, at fair value adjusted for master netting agreements at obligor level and net of cash collateral in line with legal agreements. Exposures in respect of reverse repurchase agreements are included on a gross International Financial Reporting Standards (IFRS) basis and are disclosed based on the counterparty rather than the collateral (repos and stock lending are excluded); reverse repurchase exposures are not, therefore, reduced as a result of collateral held. Exposures to central clearing counterparties are shown net.

For multi-country asset backed securities exposures, the Group has reported exposures based on the largest country exposure. The country of exposure for asset backed securities is based on the location of the underlying assets which are predominantly residential mortgages not on the domicile of the issuer.

For Insurance, the Group has reported shareholder exposures i.e. where the Group is directly exposed to risk of loss. These shareholder exposures relate to direct investments where the issuer is resident in the named Eurozone country and the credit rating is consistent with the tight credit criteria defined under the appropriate investment mandate. Insurance also has interests in funds domiciled in Ireland and Luxembourg where, in line with the investment mandates, cash is invested in short term financial instruments. The exposure is analysed on a look through basis to the country of risk of the obligors of the underlying assets rather than treating as exposure to country of domicile of the fund.

Risk management continued

Exposures to selected Eurozone countries

The Group continues to have minimal exposure, in aggregate, which could be considered to be direct recourse to the sovereign risk of the selected countries.

Table 1.25: **Selected Eurozone exposures**

	Sovereign debt		Financial Institutions						
	Direct Sovereign Expenses £m	Cash at Central Banks £m	Banks £m	Other[1] £m	Asset backed securities £m	Corporate £m	Personal £m	Insurance Assets[1] £m	Total £m
At 31 December 2017									
Ireland	**–**	**–**	**177**	**300**	**100**	**749**	**4,276**	**–**	**5,602**
Spain	**–**	**–**	**103**	**4**	**–**	**591**	**51**	**68**	**817**
Portugal	**–**	**–**	**5**	**–**	**–**	**9**	**7**	**–**	**21**
Italy	**–**	**–**	**33**	**–**	**–**	**78**	**–**	**99**	**210**
Greece	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
	–	**–**	**318**	**304**	**100**	**1,427**	**4,334**	**167**	**6,650**
At 31 December 2016									
Ireland	–	–	215	512	91	929	4,363	–	6,110
Spain	23	–	76	126	–	630	41	19	915
Portugal	–	–	7	–	–	22	7	–	36
Italy	–	–	38	–	–	59	–	67	164
Greece	–	–	–	–	–	–	–	–	–
	23	–	336	638	91	1,640	4,411	86	7,225

1 Excludes reverse repurchase exposure to Institutional funds domiciled in Ireland secured by UK gilts of £16,323 million (2016: £14,506 million) on a gross basis.

In addition to the exposures detailed above, the Group has exposures in the following Eurozone countries:

Table 1.26: **Other Eurozone exposures**

	Sovereign debt		Financial Institutions						
	Direct Sovereign Expenses £m	Cash at Central Banks £m	Banks £m	Other[1] £m	Asset backed securities £m	Corporate £m	Personal £m	Insurance Assets £m	Total £m
At 31 December 2017									
Netherlands	**38**	**12,182**	**269**	**303**	**29**	**1,678**	**6,673**	**433**	**21,605**
France	**205**	**–**	**1,059**	**128**	**–**	**2,040**	**91**	**1,142**	**4,665**
Germany	**2,008**	**68**	**325**	**–**	**261**	**1,581**	**575**	**473**	**5,291**
Luxembourg	**22**	**–**	**306**	**702**	**629**	**1,130**	**–**	**4**	**2,793**
Belgium	**22**	**–**	**142**	**7**	**–**	**110**	**–**	**113**	**394**
All other Eurozone countries	**80**	**–**	**22**	**–**	**–**	**423**	**–**	**58**	**583**
	2,375	**12,250**	**2,123**	**1,140**	**919**	**6,962**	**7,339**	**2,223**	**35,331**
At 31 December 2016									
Netherlands	–	8,795	343	324	50	1,610	6,315	423	17,860
France	–	–	1,907	620	41	2,648	96	851	6,163
Germany	1,543	93	538	31	224	1,598	443	477	4,947
Luxembourg	7	–	306	1,484	619	923	–	–	3,339
Belgium	35	–	1,009	300	–	114	–	49	1,507
All other Eurozone countries	38	–	95	–	–	354	–	62	549
	1,623	8,888	4,198	2,759	934	7,247	6,854	1,862	34,365

1 Excludes reverse repurchase exposure to Institutional funds secured by UK gilts of £2,644 million (2016: £2,679 million) on a gross basis.

Environmental risk management

The Group ensures appropriate management of the environmental impact, including climate change, of its lending activities. The Group-wide credit risk principles require all credit risk to be incurred with due regard to environmental legislation and the Group's code of responsibility.

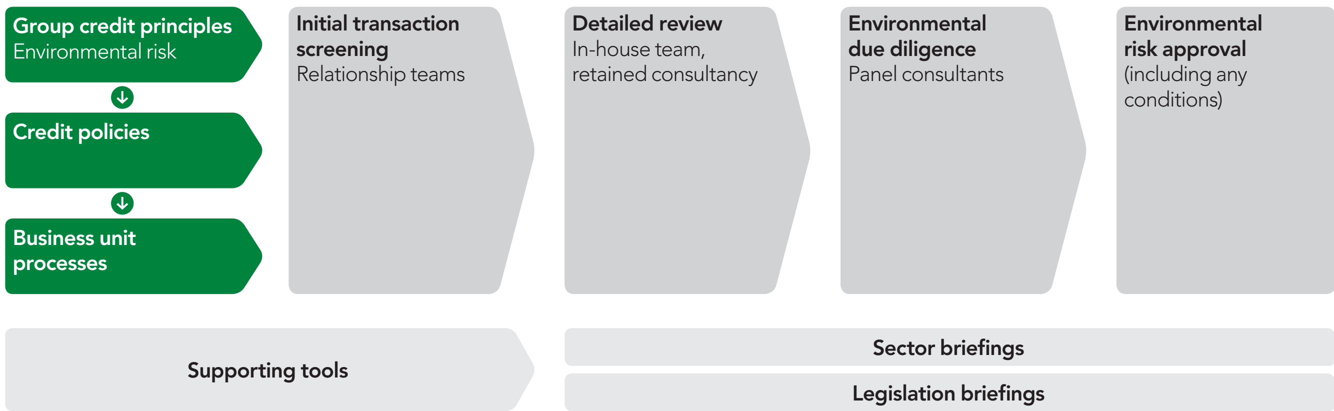
The Group's divisions are each exposed to different types and levels of climate-related risk in their operations. For example, the general insurance division regularly uses weather, climate and environmental models and data to assess its insurance risk from covered perils such as windstorm and flood. A team of specialist scientists are employed within underwriting to do this work and they also regularly monitor the state of climate science to assess the need to include its potential impacts within pricing and solvency. In response to the Task Force on Climate-related Financial Disclosure recommendations, in 2018 we will commence a systematic review of climate-related risks and opportunities across the Group's core divisions.

The Group has been a signatory to the Equator Principles since 2008 and has adopted and applied the expanded scope of Equator Principles III. The Equator Principles support the Group's approach to assessing and managing environmental and social issues in Project Finance, Project-Related Corporate loans and Bridge loans. The Group has also been a signatory to the UN Principles for Responsible Investment (UNPRI) since 2012, which incorporate ESG (environmental, social and governance risk) considerations in asset management. Scottish Widows is responsible for the annual UNPRI reporting process.

Within Commercial Banking, an electronic Environmental Risk Screening Tool is the primary mechanism for assessing environmental risk for lending transactions. This system provides screening of location specific and sector based risks that may be present in a transaction. Where a risk is identified, the transaction is referred to the Group's expert in-house environmental risk team for further review and assessment, as outlined below. Where required, the Group's panel of environmental consultants provide additional expert support.

We provide colleague training on environmental risk management as part of the standard suite of Commercial Banking credit risk courses. To support this training, a range of online resource is available to colleagues and includes environmental risk theory, procedural guidance, and information on environmental legislation and sector-specific environmental impacts.

Table 1.27: **Environmental risk management approach**



Regulatory and legal risk

Definition

Regulatory and legal risk is defined as the risk that the Group is exposed to fines, censure, or legal or enforcement action; or to civil or criminal proceedings in the courts (or equivalent) and/or the Group is unable to enforce its rights due to failing to comply with applicable laws (including codes of practice which could have legal implications), regulations, codes of conduct or legal obligations.

Exposures

Whilst the Group has a zero risk appetite for material regulatory breaches or material legal incidents, the Group remains exposed to material regulatory breaches and material legal incidents outside of its risk appetite. Exposure is driven by significant ongoing and new legislation, regulation and court proceedings in the UK and overseas which in each case needs to be interpreted, implemented and embedded into day-to-day operational and business practices across the Group.

Measurement

Regulatory and legal risks are measured against a set of risk appetite metrics, with appropriate thresholds, which are approved annually by the Board and which are regularly reviewed and monitored. Metrics include assessments of control and material regulatory rule breaches.

Mitigation

We have taken a number of steps and have outlined below the following key components:

- The Board establishes a Group-wide risk appetite and metrics for regulatory and legal risk;
- Group policies and procedures set out the principles and key controls that should apply across the business which are aligned to the Group risk appetite. Mandated policies and processes require appropriate control frameworks, management information, standards and colleague training to be implemented to identify and manage regulatory and legal risk;
- Business units assess and implement policy and regulatory requirements and establish local control, processes and procedures to ensure governance and compliance;
- Material risks and issues are escalated to divisional and then Group-level bodies which challenge and support the business on its management of them;
- Business units regularly produce management information to assist in the identification of issues and test management controls are working effectively;
- Risk division and Legal provide oversight and proactive support and constructive challenge to the business in identifying and managing regulatory and legal issues;
- Risk division will conduct thematic reviews of regulatory compliance across businesses and divisions where appropriate; and
- Business units with the support of divisional and Group-level bodies conduct ongoing horizon scanning to identify and address changes in regulatory and legal requirements.

Monitoring

Business unit risk exposure is reported to Risk division where it is aggregated at Group level and a report prepared. The report forms the basis of challenge to the business at the monthly Group Conduct, Compliance and Operational Risk Committee. This committee may escalate matters to the Chief Risk Officer, or higher committees. The report also forms the basis of the regulatory and legal sections in the Group's consolidated risk reporting.

Risk management continued

Conduct risk

Definition

The risk of customer detriment due to poor design, distribution and execution of products and services or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure and financial and reputational loss.

Exposures

The Group faces significant conduct risks, which affect all aspects of the Group's operations and all types of customers.

Conduct risks can impact directly or indirectly on our customers and can materialise from a number of areas across the Group, including: sales processes resulting in poor customer outcomes; products and services not meeting the customers' needs; failing to deal with customers' complaints effectively; failing to promote effective competition in the interest of customers and failing to identify and report behaviour which could undermine the integrity of the market.

There is an ongoing high level of scrutiny regarding financial institutions' treatment of customers, including those in vulnerable circumstances, from regulatory bodies, the media, politicians and consumer groups. There is also a significant regulatory focus on market misconduct, resulting from previous issues which include London Interbank Offered Rate (LIBOR) and Foreign Exchange (FX).

As a result, there is a risk that certain aspects of the Group's current or legacy business may be determined by the Financial Conduct Authority, other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or in a manner that fails to deliver fair and reasonable customer treatment.

The Group may also be liable for damages to third parties harmed by the conduct of its business.

Measurement

To articulate its conduct risk appetite, the Group has sought more granularity through the use of suitable conduct risk metrics and tolerances that indicate where it may potentially be operating outside its conduct appetite.

Conduct risk appetite metrics (CRAMs) have been designed for all product families offered by the Group; a set of common metrics supports a consistent approach across products and services. These contain a range of product design, sales and service metrics (such as sales volume, usage and customer outcome testing) to provide a more holistic view of conduct risks; each product also has additional bespoke metrics.

Each of the tolerances for the metrics are agreed for the individual product or service and are tracked monthly. At a consolidated level these metrics are part of the Board approved risk appetite. The Group is also evolving its approach to measurements supporting customer vulnerability and customer journeys.

Measurements in relation to market integrity continued to evolve in 2017, including additional business unit level risk control metrics to enhance the established suite of metrics (which already cover key topics such as the management of conflicts of interest and the handling of market sensitive information).

Mitigation

The Group takes a range of mitigating actions with respect to conduct risk. The Group's ongoing commitment to good customer outcomes sets the tone from the top and supports the development of the right customer centric culture – strengthening links between actions to support conduct, culture and customer and enabling more effective control management. Actions to enable good conduct include:

- Conduct risk appetite established at Group and business area level, with metrics included in the Group risk appetite to ensure ongoing focus;
- Customer needs explicitly considered within business and product level planning and strategy, through divisional customer and culture plans, with integral conduct lens, reviewed and challenged by Group Customer First Committee (GCFC);
- Cultural transformation, supported by strong direction and tone from senior executives and the Board. This is underpinned by the Group's values and codes of responsibility, to deliver the best bank for customers;
- Further embedding of the customer vulnerability framework. The Customer Vulnerability Cross Divisional Committee operates at a senior level to prioritise change, drive implementation and ensure consistency across the Group. Significant partnership established with Macmillan to support customers with cancer;
- Embedding and evolving the Group's customer journey strategy and framework to support our focus on conduct from an end-to-end customer perspective;
- Enhanced product governance framework to ensure products continue to offer customers fair value, and consistently meet their needs throughout their product life cycle;
- Enhanced complaints management through effectively responding to, and learning from, root causes to reduce complaint volumes and the Financial Ombudsman Service change rate;
- Enhanced recruitment and training, with a focus on how the Group manages colleagues' performance with clearer customer accountabilities; and
- Ongoing focus on the strategic conduct agenda in our interactions with third parties involved in serving the Group's customers to ensure consistent delivery.

The Group continues to prioritise activity designed to reinforce good conduct in its engagement with the markets in which it operates, with the Market Conduct Steering Committee leading read-across activity of industry issues for LBG consideration. Further training has been delivered for colleagues, and the focus on enhanced procedures, and the enhancement of preventative and detective controls continues – including the Group's trade surveillance and continuous surveillance capability.

The Group's leadership team, through GCFC, support the development of the conduct agenda and priorities. The Board and Group Risk Committee receive regular qualitative and quantitative reports to track progress on how the Group is meeting customer needs and minimising conduct risk across all areas of the business.

The Group actively engages with regulatory bodies and other stakeholders in developing its understanding of concerns related to customer treatment, effective competition and market integrity, to ensure that the Group's strategic conduct focus continues to meet evolving stakeholder expectations.

Monitoring

Monitoring and reporting is undertaken at Board, Group and business area committees. As part of the reporting of CRAMs, a robust outcomes testing regime for both sales and complaints processes is in place to test performance of customer critical activities.

GCFC has responsibility for monitoring and reviewing integrated measurement of enhanced outcomes and customer views, including challenging divisions to make changes based on key learnings to support the delivery of the Group's vision and foster a customer centric culture.

Operational risk

Definition

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, which can lead to adverse customer impact, reputational damage or financial loss.

Exposures

The principal operational risks to the Group are:

– A cyber-attack could result in customer detriment, financial loss, disruption and/or reputational damage;
– Failure in IT systems, due to volume of change, and/or aged infrastructure, could result in unfair customer outcomes, financial loss and/or reputational damage;
– Failure to protect and manage customers' data could result in customer detriment, financial loss, disruption and/or reputational damage;
– Internal and/or external fraud or financial crime could result in customer detriment, financial loss, disruption and/or reputational damage;
– Failure to ensure compliance with increasingly complex and detailed anti-money laundering, anti-terrorism, sanctions and prohibitions laws and regulations, as such a failure would adversely impact the Group's reputation and potentially incur fines and other legal enforcements; and
– Terrorist acts, other acts of war or hostility, geopolitical, pandemic or other such events.

A number of these risks could increase where there is a reliance on third party suppliers to provide services to the Group or its customers.

Measurement

Operational risk is managed across the Group through an operational risk framework and operational risk policies. The operational risk framework includes a risk control self-assessment process, risk impact likelihood matrix, key risk and control indicators, risk appetite, a robust operational event management and escalation process, scenario analysis and operational losses process.

Table 1.28 below shows high level loss and event trends for the Group using Basel II categories. Based on data captured on the Group's Operational Risk System, in 2017 the highest frequency of events occurred in external fraud (64.37 per cent) and execution, delivery and process management (22.69 per cent). Clients, products and business practices accounted for 72.74 per cent of losses by value, driven by legacy issues where impacts materialised in 2017 (excluding PPI).

Table 1.28: **Operational risk events by risk category (losses greater than or equal to £10,000), excluding PPI**

	% of total volume		% of total losses	
	2017	2016	**2017**	2016
Business disruption and system failures	**1.35**	1.01	**0.92**	0.55
Clients, products and business practices	**10.12**	11.31	**72.74**	77.62
Damage to physical assets	**1.10**	1.05	**0.07**	0.27
Employee practices and workplace safety	**–**	0.04	**–**	–
Execution, delivery and process management	**22.69**	24.80	**22.80**	19.23
External fraud	**64.37**	61.58	**3.50**	2.31
Internal fraud	**0.37**	0.21	**(0.03)**	0.02
Total	**100.00**	100.00	**100.00**	100.00

Operational risk losses and scenario analysis is used to inform the Internal Capital Adequacy Assessment Process (ICAAP). The Group calculates its minimum (Pillar I) operational risk capital requirements using The Standardised Approach (TSA). Pillar II is calculated using Internal and External loss data and extreme but plausible scenarios that may occur in the next 12 months.

Mitigation

The Group's strategic review considers the changing risk management requirements, adapting the change delivery model to be more agile and develop the people skills and capabilities needed to be the 'Bank of the Future'. The Group continues to review and invest in its control environment to ensure it addresses the inherent risks faced. Risks are reported and discussed at local governance forums and escalated to executive management and Board as appropriate to ensure the correct level of visibility and engagement. The Group employs a range of risk management strategies, including: avoidance, mitigation, transfer (including insurance) and acceptance. Where there is a reliance on third party suppliers to provide services, the Group's sourcing policy ensures that outsourcing initiatives follow a defined process including due diligence, risk evaluation and ongoing assurance.

Mitigating actions to the principal operational risks are:

– The threat landscape associated with cyber risk continues to evolve and there is significant regulatory attention on this subject. The Board has defined a cyber risk appetite and has completed a three year programme to deliver capability to meet that risk appetite. Given the nature of the threat, the Group continues to invest heavily in protecting against malicious cyber-attacks and is commencing further investment in enhancing the protection of its customers and their data, improving capability to detect and respond to attacks and protecting its most critical systems.
– The Group continues to optimise its approach to IT and operational resilience by investing in technology improvements and enhancing the resilience of systems that support the Group's critical business processes, primarily through the Technology Resilience Programme, with independent verification of progress on an annual basis. The Board recognises the role that resilient technology plays in achieving the Group's strategy of becoming the best bank for customers and in maintaining banking services across the wider industry. As such, the Board dedicates considerable time and focus to this subject at both the Board and the Board Risk Committee, and continues to sponsor key investment programmes that enhance resilience.
– The Group is making a significant investment to improve data privacy, including the security of data and oversight of third parties. The Group's strategy is to introduce advanced data management practices, based on Group-wide standards, data-first culture and modern enterprise data platforms, supported by a simplified modern IT architecture.
– The Group adopts a risk based approach to mitigate the internal and external fraud risks it faces, reflecting the current and emerging fraud risks within the market. Fraud risk appetite metrics have been defined, holistically covering the impacts of fraud in terms of losses to the Group, costs of fraud systems and operations, and customer experience of actual and attempted fraud. Oversight of the appropriateness and performance of these metrics is undertaken regularly through business area and Group-level committees. This approach drives a continual programme of prioritised enhancements to the Group's technology, process and people related controls, with an emphasis on preventative controls supported by real time detective controls wherever feasible. Group-wide policies and operational control frameworks are maintained and designed to provide customer confidence, protect the Group's commercial interests and reputation, comply with legal requirements and meet regulatory expectations. The Group's fraud awareness programme remains a key component of its fraud control environment, and awareness of fraud risk is supported by mandatory training for all

Risk management continued

colleagues. The Group also plays an active role with other financial institutions, industry bodies, and enforcement agencies in identifying and combatting fraud.

- The Group has adopted policies and procedures designed to detect and prevent the use of its banking network for money laundering, terrorist financing, bribery, tax evasion, human trafficking, and modern-day slavery, and activities prohibited by legal and regulatory sanctions. Against a background of increasingly complex and detailed laws and regulations, and of increased criminal and terrorist activity, the Group regularly reviews and assesses its policies, procedures and organisational arrangements to keep them current, effective and consistent across markets and jurisdictions. The Group requires mandatory training on these topics for all employees. Specifically, the anti-money laundering procedures include 'know-your-customer' requirements, transaction monitoring technologies, reporting of suspicions of money laundering or terrorist financing to the applicable regulatory authorities, and interaction between the Group's Financial Intelligence Unit and external agencies and other financial institutions. The Anti-Bribery Policy prohibits the payment, offer, acceptance or request of a bribe, including 'facilitation payments' by any employee or agent and provides a confidential reporting service for anonymous reporting for suspected or actual bribery activity. The Sanctions and Related Prohibitions Policy sets out a framework of controls for compliance with legal and regulatory sanctions.
- Operational resilience measures and recovery planning defined in the Group's Resilience and Continuity (including Incident Management) Policy ensure an appropriate and consistent approach to the management of continuity risks, including potential interruptions from a range of internal and external incidents or threats including environmental and climatic issues, terrorism, cyber, economic instability, pandemic planning and operational incidents. The Group considers its operational resilience across five key pillars; cyber, third parties, IT, people and property.

Monitoring

Monitoring and reporting of operational risk is undertaken at Board, Group and divisional risk committees. Each committee monitors key risks, control effectiveness, key risk and control indicators, events, operational losses, risk appetite metrics and the results of independent testing conducted by Risk and/or Group Internal Audit.

The Group maintains a formal approach to operational risk event escalation, whereby material events are identified, captured and escalated. Root causes of events are determined, where possible, and action plans put in place to ensure an optimum level of control to keep customers and the business safe, reduce costs, and improve efficiency.

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

People risk

Definition

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

Exposures

The Group's management of material people risks is critical to its capacity to deliver against its strategic objectives and to be the best bank for customers. Over the coming year the Group anticipates the following key people risk exposures:

- Maintaining organisational skills, capability, resilience and capacity levels in response to increasing volumes of organisational, political and external market change;
- Senior Managers and Certification Regime (SM&CR) and additional regulatory constraints on remuneration structures may impact the Group's ability to attract and retain talent;
- The increasing digitisation of the business is changing the capability mix required and may impact our ability to attract and retain talent; and
- Colleague engagement may continue to be challenged by ongoing media attention on banking sector culture, sales practices and ethical conduct.

Measurement

People risk is measured through a series of quantitative and qualitative indicators, aligned to key sources of people risk for the Group such as succession, retention, colleague engagement and performance management. In addition to risk appetite measures and limits, people risks and controls are monitored on a monthly basis via the Group's risk governance framework and reporting structures.

Mitigation

The 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 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 through divisional people strategies to ensure there are 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 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; and
- Ongoing consultation with the Group's recognised unions on changes which impact their members.

Monitoring

People risks from across the Group are monitored and reported through Board and Group Governance Committees in accordance with the Group's Risk Management Framework and people risk sub-framework. Risk exposures are discussed monthly via the Group People Risk Committee with upwards reporting to Group Risk and Executive Committees. In addition, oversight, challenge and reporting is completed at Risk division level and, combined with risk assurance, Risk division reviews and assesses the effectiveness of controls, recommending follow up remedial action if relevant. All material people risk events are escalated in accordance with the formal Group Operational Risk Policy and People Policies to the respective divisional Managing Directors and the Group Director, Conduct, Compliance and Operational Risk.

Insurance underwriting risk

Definition

Insurance underwriting risk is defined as the risk of adverse developments in longevity, mortality, persistency, General Insurance underwriting and policyholder behaviour, leading to reductions in earnings and/or value.

Exposures

The major source of insurance underwriting risk within the Group is the Insurance business.

Longevity and persistency are key risks within the life and pensions business. Longevity risk arises from the annuity portfolios where policyholders' future cashflows are guaranteed at retirement and increases in life expectancy, beyond current assumptions, will increase the cost of annuities. Longevity risk exposures are expected to increase with the Insurance business growth in the bulk annuity market. Persistency assumptions are set to give a best estimate, however customer behaviour may result in increased cancellations or cessation of contributions.

Property insurance risk is a key risk within the General Insurance business, through Home Insurance. Exposures can arise, for example, in extreme weather conditions, such as flooding, when property damage claims are higher than expected.

The Group's defined benefit pension schemes also expose the Group to longevity risk. For further information please refer to the defined benefit pension schemes component of the market risk section and note 35 to the financial statements.

Measurement

Insurance underwriting risks are measured using a variety of techniques including stress, reverse stress and scenario testing, as well as stochastic modelling. Current and potential future insurance underwriting risk exposures are assessed and aggregated on a range of stresses including risk measures based on 1-in-200 year stresses for Insurance's regulatory capital assessments and other supporting measures where appropriate, including those set out in note 32 to the financial statements.

Mitigation

Insurance underwriting risk in the Insurance business is mitigated in a number of ways:

- General Insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements broadly spread over different reinsurers. Detailed modelling, including that of the potential losses under various catastrophe scenarios, supports the choice of reinsurance arrangements;
- Insurance processes on underwriting, claims management, pricing and product design;
- Longevity risk transfer and hedging solutions are considered on a regular basis and in 2017 we reinsured £1.3 billion of annuitant longevity. A team of longevity and bulk pricing experts has been built to support the new bulk annuity proposition; and
- Exposure limits by risk type are assessed through the business planning process and used as a control mechanism to ensure risks are taken within risk appetite.

Monitoring

Insurance underwriting risks in the Insurance business are monitored by Insurance senior executive committees and ultimately the Insurance Board. Significant risks from the Insurance business and the defined benefit pension schemes are reviewed by the Group Executive and Group Risk Committees and/or Board.

Insurance underwriting risk exposures within the Insurance business are monitored against risk appetite. The Insurance business monitors experiences against expectations, for example business volumes and mix, claims and persistency experience. The effectiveness of controls put in place to manage insurance underwriting risk is evaluated and significant divergences from experience or movements in risk exposures are investigated and remedial action taken.

Capital risk

Definition

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

Exposures

A capital risk exposure arises when the Group has insufficient capital resources to support its strategic objectives and plans, and to meet external stakeholder requirements and expectations. This could arise due to a depletion of the Group's capital resources as a result of the crystallisation of any of the risks to which it is exposed. Alternatively a shortage of capital could arise from an increase in the amount of capital that needs to be held. The Group's capital management approach is focused on maintaining sufficient capital resources to prevent such exposures while optimising value for shareholders.

Measurement

The Group measures the amount of capital it requires and holds through applying the regulatory framework defined by the Capital Requirements Directive and Regulation (CRD IV) as implemented in the UK by the Prudential Regulation Authority (PRA) and supplemented through additional regulation under the PRA Rulebook. Full details of the Group's regulatory capital and leverage frameworks, including the means by which its capital and leverage requirements and capital resources are calculated, will be provided in the Group's Pillar 3 Report.

The minimum amount of total capital, under Pillar 1 of the regulatory framework, is determined as 8 per cent of aggregate 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 to be referred to as the Group's Total Capital Requirement (TCR) from 1 January 2018, and a number of regulatory capital buffers as described below.

Additional minimum requirements under Pillar 2A are currently set by the PRA through the issuance of bank specific Individual Capital Guidance (ICG). This reflects a point in time estimate by the PRA, which may change over time, of the minimum amount of capital that is needed by the bank to cover risks that are not fully covered by Pillar 1, such as credit concentration and operational risk, and those risks not covered at all by Pillar 1, such as pensions and interest rate risk in the banking book (IRRBB). From 1 January 2018, Pillar 2A will be set as a firm specific capital requirement (Pillar 2R) rather than as individual capital guidance.

The Group is also required to maintain a number of regulatory capital buffers, which are required to be met with CET1 capital.

Systemic buffers are designed to hold systemically important banks to higher capital standards, so that they can withstand a greater level of stress before requiring resolution.

- Although the Group is not currently classified as a global systemically important institution (G-SII) under the Capital Requirements Directive, it has been classified as an 'other' systemically important institution (O-SII) by the PRA. The O-SII buffer is set to zero in the UK.
- The Systemic Risk Buffer (SRB) will be applied to UK ring-fenced banks from early 2019. The size of buffer applied to the Group's ring-fenced bank (RFB) sub-group in 2019 will be dependent upon the total assets of the sub-group. The FPC anticipates applying a buffer of 2.5 per cent to the largest ring-fenced institutions. Although the SRB will apply at a sub consolidated level within the Group's structure, the PRA have indicated that they will include in the Group's PRA Buffer an amount equivalent to the RFB's Systemic Risk Buffer. The amount included in the PRA Buffer is expected to be lower as a percentage of Group risk-weighted assets reflecting the assets of the Group that will not be held in the RFB sub-group and for which the SRB will not apply to.

The capital conservation buffer (CCB) is a standard buffer of 2.5 per cent of risk-weighted assets designed to provide for losses in the event of stress and is being phased in over the period from 1 January 2016 to 1 January 2019. During 2017 it was 1.25 per cent and during 2018 it will increase to 1.875 per cent.

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The countercyclical capital buffer (CCyB) is time-varying and is designed to require banks to hold additional capital to remove or reduce the build-up of systemic risk in times of credit boom, providing additional loss absorbing capacity and acting as an incentive for banks to constrain further credit growth. The amount of the buffer is determined by reference to buffer rates set by the (FPC) for the individual countries where the Group has relevant credit risk exposures. The CCyB rate for the UK is currently set at zero but will increase to 0.5 per cent on 27 June 2018 and to 1.0 per cent on 28 November 2018. The FPC will reconsider the adequacy of a 1.0 per cent UK CCyB rate during the first half of 2018 in light of the evolution of the overall risk environment. Non-zero buffer rates currently apply for Norway, Sweden, Hong Kong, Iceland, Slovakia and the Czech Republic. Given that the Group has minimal exposures to these jurisdictions, the overall countercyclical capital buffer requirement at 31 December 2017 is considered to be negligible.

As part of the capital planning process, forecast capital positions are subjected to extensive stress analyses to determine the adequacy of the Group's capital resources against the minimum requirements, including the ICG. The PRA uses the outputs from some of these stress analyses as one of the inputs that inform the setting of a bank-specific capital buffer for the Group, known as the PRA Buffer. The PRA Buffer also takes into account the CCB and CCyB. The PRA requires the PRA Buffer to remain confidential between the Group and the PRA.

All buffers are required to be met with CET1 capital. A breach of the PRA buffer would trigger a dialogue between the Group and the PRA to agree what action is required whereas a breach of the CRD IV combined buffer (all regulatory buffers excluding the PRA buffer) would give rise to automatic constraints upon any discretionary capital distributions by the Group.

In addition to the risk-based capital framework outlined above, the Group is also subject to minimum capital requirements under the UK Leverage Ratio Framework. The leverage ratio is calculated by dividing fully loaded tier 1 capital resources by a defined measure of on-balance sheet assets and off-balance sheet items.

The minimum leverage ratio requirement under the UK Leverage Ratio Framework is 3.25 per cent. In addition the framework requires two buffers to be maintained: an Additional Leverage Ratio Buffer (ALRB), which is calculated as 35 per cent of the Systemic Risk Buffer (applicable from 2019) and a time-varying Countercyclical Leverage Buffer (CCLB) which is calculated as 35 per cent of the countercyclical capital buffer rate (currently set at 0 per cent). At least 75 per cent of the minimum 3.25 per cent requirement and the entirety of any buffers that may apply must be met by CET1 capital.

The leverage ratio framework does not currently give rise to higher capital requirements for the Group than the risk-based capital framework.

Mitigation

The Group has a capital management framework including policies and procedures that are designed to ensure that it operates within its risk appetite, uses its capital resources efficiently and continues to comply with regulatory requirements.

The Group is able to accumulate additional capital through the retention of profits over time, which can be enhanced through cutting costs and reducing or cancelling dividend payments, by raising new equity via, for example, a rights issue or debt exchange and by raising additional tier 1 or tier 2 capital through issuing tier 1 instruments or subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time. The Group is also able to manage the demand for capital through management actions including adjusting its lending strategy, risk hedging strategies and through business disposals.

Additional measures to manage the Group's capital position include seeking to optimise the generation of capital demand within the Group's businesses to strike an appropriate balance of capital held within the Group's Insurance and banking subsidiaries and through improving the quality of its capital through liability management exercises.

Monitoring

Capital is actively managed and monitoring capital ratios is a key factor in the Group's planning processes and stress analyses. Multi-year forecasts of the Group's capital position, based upon the Group's operating plan, are produced at least annually to inform the Group's capital plan whilst shorter term forecasts are more frequently undertaken to understand and respond to variations of the Group's actual performance against the plan. The capital plans are tested for capital adequacy using a range of stress scenarios covering adverse economic conditions as well as other adverse factors that could impact the Group and the Group maintains a recovery plan which sets out a range of potential mitigating actions that could be taken in response to a stress.

Regular reporting of actual and projected ratios, including those in stressed scenarios, is undertaken, including submissions to the Group Capital Risk Committee (GCRC), Group Financial Risk Committee (GFRC), Group Asset and Liability Committee (GALCO), Group Risk Committee (GRC), Board Risk Committee (BRC) and the Board. Capital policies and procedures are subject to independent oversight.

The regulatory framework within which the Group operates continues to evolve and further detail on this will be provided in the Group's Pillar 3 report. The Group continues to monitor these developments very closely, analysing the potential capital impacts to ensure that, through organic capital generation, the Group continues to maintain a strong capital position that exceeds both minimum regulatory requirements and the Group's risk appetite and is consistent with market expectations.

Target capital ratios

The Board's view of the level of CET1 capital required is c.13 per cent plus a management buffer of around 1 per cent.

This takes into account, amongst other things:

- the Pillar 2A ICG set by the PRA, reflecting their point in time estimate, which may change over time, of the amount of capital that is needed in relation to risks not covered by Pillar 1. During the year the PRA updated the Group's ICG representing an increase from 4.5 per cent to 5.4 per cent of risk-weighted assets at 31 December 2017, of which 3.0 per cent has to be met by CET1 capital.
- the PRA Buffer, which they set taking into account the results of the PRA stress tests and other information, as well as outputs from the Group's internal stress tests. The PRA requires the PRA Buffer itself to remain confidential between the Group and the PRA.
- future regulatory developments, including the introduction of the Systemic Risk Buffer in early 2019 and the CCyB on UK exposures during the course of 2018.

Dividend policy

The Group intends to maintain an ordinary dividend policy that is both progressive and sustainable. The rate of growth of the ordinary dividend will be decided by the Board in light of the circumstances at the time.

The Board also gives due consideration to the distribution of surplus capital through the use of special dividends or share buybacks. Surplus capital represents the return of capital over and above the Board's view of the current level of capital required to grow the business, meet regulatory requirements and cover uncertainties. The amount of required capital may vary from time to time depending on circumstances and by its nature there can be no guarantee that any surplus capital distribution will be appropriate in future years.

The ability of the Group to pay a dividend is also subject to constraints including the availability of distributable reserves, legal and regulatory restrictions and the financial and operating performance of the entity.

Distributable reserves are determined as required by the Companies Act 2006 by reference to a company's individual financial statements. At 31 December 2017 Lloyds Banking Group plc ('the Company') had accumulated distributable reserves of approximately £8.5 billion. Substantially all of the Company's merger reserve is available for distribution under UK company law as a result of transactions undertaken to recapitalise the Company in 2009.

Lloyds Banking Group plc acts as a holding company which also issues capital and other securities to capitalise and fund the activities of the Group. The profitability of the holding company, and consequently its ability to sustain dividend payments, is therefore dependent upon the continued receipt of dividends from its subsidiaries (representing both banking and insurance). A number of Group subsidiaries, principally those with banking and insurance activities, are also subject to regulatory capital requirements. These require entities to maintain minimum amounts of capital related to their size and risk. The principal operating subsidiary is Lloyds Bank plc which, at 31 December 2017, had a consolidated CET1 capital ratio of 15.8 per cent (31 December 2016: 15.1 per cent). The Group actively manages the capital of its subsidiaries, which includes monitoring the regulatory capital ratios for its banking and insurance subsidiaries against approved risk appetite limits. It operates a formal capital management policy which requires all subsidiary entities to remit any surplus capital to their parent companies.

Analysis of capital position

Excluding the capital impact of the acquisition of MBNA on 1 June 2017, the Group generated 2.45 per cent of CET1 capital on a pro forma basis before ordinary dividends and allowing for the share buyback, primarily as a result of:

- Strong underlying capital generation of 2.5 per cent, largely driven by underlying profits (2.2 per cent) and the dividend paid by the Insurance business in February 2018 in relation to 2017 earnings (0.3 per cent);
- A reduction in risk-weighted assets (prior to the impact of the acquisition of MBNA) resulting in an increase of 0.8 per cent, primarily reflecting updates made to both mortgage and unsecured retail IRB models, continued active portfolio management, foreign exchange movements, disposals and capital efficient securitisation activity, partly offset through targeted growth in key customer segments;
- The impact of market and other movements, generating an increase of 0.4 per cent, partially reflecting positive movements in available-for-sale assets and the defined benefit pension schemes;
- Offset by a reduction of (1.2) per cent for conduct provisions.

In addition, the Group utilised the 0.8 per cent of CET1 capital retained at 31 December 2016 to cover the acquisition of MBNA.

Overall the Group's CET1 ratio has strengthened to 15.5 per cent on a pro forma basis before ordinary dividends and the share buyback. After ordinary dividends the Group's CET1 ratio was 14.4 per cent on a pro forma basis. In addition the Board intends to implement a share buyback programme of up to £1 billion, equivalent to up to 1.4 pence per share. The buyback will impact the Group's capital position in 2018 and is expected to reduce CET1 capital by c.50 basis points. Allowing for this at 31 December 2017 the pro forma CET1 ratio would be 13.9 per cent (31 December 2016: 13.0 per cent pro forma after dividends and adjusting for MBNA).

The accrual for foreseeable dividends reflects the recommended final ordinary dividend of 2.05 pence per share.

The transitional total capital ratio, after ordinary dividends reduced by 0.2 per cent to 21.2 per cent, largely reflecting amortisation on dated tier 2 instruments and foreign exchange movements on tier 1 and tier 2 instruments, offset by the increase in CET1 capital and the reduction in risk-weighted assets.

Applying the Bank of England's Minimum Requirement for Own Funds and Eligible Liabilities (MREL) policy to current capital requirements, the Group's indicative MREL requirement, excluding regulatory capital buffers, is as follows:

- From 2020, 2 times Pillar 1 plus Pillar 2A, equivalent to 21.4 per cent of risk-weighted assets
- From 2022, 2 times Pillar 1 plus 2 times Pillar 2A, equivalent to 26.8 per cent of risk-weighted assets

The Bank of England will review the calibration of MREL in 2020 before setting final end-state requirements to be met from 2022. This review will take into consideration any changes to the capital framework, including the finalisation of Basel III.

During 2017, the Group issued £8.5 billion (sterling equivalent as at 31 December 2017) of senior unsecured securities from Lloyds Banking Group plc which, while not included in total capital, are eligible to meet MREL. Combined with previous issuances made during 2016 the Group remains comfortably positioned to meet MREL requirements from 2020 and, as at 31 December 2017, had a transitional MREL ratio of 25.7 per cent of risk-weighted assets.

The UK leverage ratio, after ordinary dividends, increased from 5.3 per cent on a pro forma basis to 5.4 per cent on a pro forma basis, largely reflecting the increase in fully loaded tier 1 capital and the underlying reduction in balance sheet assets, net of qualifying central bank claims and deconsolidation adjustments.

An analysis of the Group's capital position as at 31 December 2017 is presented in the following section on both a CRD IV transitional arrangements basis and a CRD IV fully loaded basis.

Risk management continued

The table below summarises the consolidated capital position of the Group. The Group's Pillar 3 report will provide a comprehensive analysis of the own funds of the Group.

Table 1.29: **Capital resources (audited)**

	Transitional		Fully loaded	
	At 31 Dec 2017 £m	At 31 Dec 2016 £m	**At 31 Dec 2017 £m**	At 31 Dec 2016 £m
Common equity tier 1				
Shareholders' equity per balance sheet	**43,551**	43,020	**43,551**	43,020
Adjustment to retained earnings for foreseeable dividends	**(1,475)**	(1,568)	**(1,475)**	(1,568)
Deconsolidation adjustments[1]	**1,301**	1,342	**1,301**	1,342
Adjustment for own credit	**109**	87	**109**	87
Cash flow hedging reserve	**(1,405)**	(2,136)	**(1,405)**	(2,136)
Other adjustments	**(177)**	(276)	**(177)**	(276)
	41,904	40,469	**41,904**	40,469
less: deductions from common equity tier 1				
Goodwill and other intangible assets	**(2,966)**	(1,623)	**(2,966)**	(1,623)
Prudent valuation adjustment	**(556)**	(630)	**(556)**	(630)
Excess of expected losses over impairment provisions and value adjustments	**(498)**	(602)	**(498)**	(602)
Removal of defined benefit pension surplus	**(541)**	(267)	**(541)**	(267)
Securitisation deductions	**(191)**	(217)	**(191)**	(217)
Significant investments[1]	**(4,250)**	(4,282)	**(4,250)**	(4,282)
Deferred tax assets	**(3,255)**	(3,564)	**(3,255)**	(3,564)
Common equity tier 1 capital	**29,647**	29,284	**29,647**	29,284
Additional tier 1				
Other equity instruments	**5,330**	5,320	**5,330**	5,320
Preference shares and preferred securities[2]	**4,503**	4,998	**–**	–
Transitional limit and other adjustments	**(1,748)**	(1,692)	**–**	–
	8,085	8,626	**5,330**	5,320
less: deductions from tier 1				
Significant investments[1]	**(1,403)**	(1,329)	**–**	–
Total tier 1 capital	**36,329**	36,581	**34,977**	34,604
Tier 2				
Other subordinated liabilities[2]	**13,419**	14,833	**13,419**	14,833
Deconsolidation of instruments issued by insurance entities[1]	**(1,786)**	(1,810)	**(1,786)**	(1,810)
Adjustments for transitional limit and non-eligible instruments	**1,617**	1,351	**(1,252)**	(1,694)
Amortisation and other adjustments	**(3,524)**	(3,447)	**(3,565)**	(3,597)
	9,726	10,927	**6,816**	7,732
Eligible provisions	**120**	186	**120**	186
less: deductions from tier 2				
Significant investments[1]	**(1,516)**	(1,571)	**(2,919)**	(2,900)
Total capital resources	**44,659**	46,123	**38,994**	39,622
Risk-weighted assets	**210,919**	215,534	**210,919**	215,534
Common equity tier 1 capital ratio[3]	**14.1%**	13.6%	**14.1%**	13.6%
Tier 1 capital ratio	**17.2%**	17.0%	**16.6%**	16.1%
Total capital ratio	**21.2%**	21.4%	**18.5%**	18.4%

1 For regulatory capital purposes, the Group's Insurance business is deconsolidated and replaced by the amount of the Group's investment in the business. A part of this amount is deducted from capital (shown as 'significant investments' in the table above) and the remaining amount is risk-weighted, forming part of threshold risk-weighted assets.

2 Preference shares, preferred securities and other subordinated liabilities are categorised as subordinated liabilities in the balance sheet.

3 The common equity tier 1 ratio is 14.4 per cent on a pro forma basis upon recognition of the dividend paid by the Insurance business in February 2018 in relation to its 2017 earnings (31 December 2016: 13.8 per cent pro forma).

The key difference between the transitional capital calculation as at 31 December 2017 and the fully loaded equivalent is primarily related to capital securities that previously qualified as tier 1 or tier 2 capital, but that do not fully qualify under CRD IV, which can be included in additional tier 1 (AT1) or tier 2 capital (as applicable) up to specified limits which reduce by 10 per cent per annum until 2022.

The movements in the transitional CET1, AT1, tier 2 and total capital positions in the period are provided below.

Table 1.30: **Movements in capital resources**

	Common Equity tier 1 £m	Additional Tier 1 £m	Tier 2 £m	Total capital £m
At 31 December 2016	29,284	7,297	9,542	46,123
Profit attributable to ordinary shareholders[1]	**2,514**	**–**	**–**	**2,514**
Movement in foreseeable dividends[2]	**93**	**–**	**–**	**93**
Dividends paid out on ordinary shares during the year	**(2,284)**	**–**	**–**	**(2,284)**
Dividends in respect of 2016 earnings and 2017 interim earnings received from the Insurance business[1]	**575**	**–**	**–**	**575**
Movement in treasury shares and employee share schemes	**3**	**–**	**–**	**3**
Pension movements:				
Removal of defined benefit pension surplus	**(274)**	**–**	**–**	**(274)**
Movement through other comprehensive income	**428**	**–**	**–**	**428**
Available-for-sale reserve	**(74)**	**–**	**–**	**(74)**
Prudent valuation adjustment	**74**	**–**	**–**	**74**
Deferred tax asset	**309**	**–**	**–**	**309**
Goodwill and other intangible assets	**(1,343)**	**–**	**–**	**(1,343)**
Excess of expected losses over impairment provisions and value adjustments	**104**	**–**	**–**	**104**
Significant investments	**32**	**(74)**	**55**	**13**
Eligible provisions	**–**	**–**	**(66)**	**(66)**
Movements in subordinated debt:				
Repurchases, redemptions and other	**–**	**(541)**	**(1,201)**	**(1,742)**
Other movements	**206**	**–**	**–**	**206**
At 31 December 2017	**29,647**	**6,682**	**8,330**	**44,659**

1 Under the regulatory framework, profits made by Insurance are removed from CET1 capital. However, when dividends are paid to the Group by Insurance these are recognised through CET1 capital.

2 Includes the accrual for the 2017 full year ordinary dividend and the reversal of the accrual for the 2016 full year ordinary and special dividends which were paid during the year.

CET1 capital resources have increased by £363 million in the year, primarily reflecting a combination of profit generation, dividends received from the Insurance business during the year, movements in the defined benefit pension schemes and a reduction in the deferred tax asset deducted from capital, partially offset by the payment of the 2017 interim dividend, the accrual of the full year ordinary dividend and an increase in the deduction for goodwill and other intangible assets, largely in relation to the acquisition of MBNA.

AT1 capital resources have reduced by £615 million in the year, primarily reflecting the annual reduction in the transitional limit applied to grandfathered AT1 capital instruments and foreign exchange movements.

Tier 2 capital resources have reduced by £1,212 million in the year largely reflecting the amortisation of dated tier 2 instruments and foreign exchange movements on subordinated debt, partly offset by the transitioning of grandfathered AT1 instruments to tier 2.

Risk management continued

Table 1.31: Risk-weighted assets

	At 31 Dec 2017 £m	At 31 Dec 2016 £m
Foundation Internal Ratings Based (IRB) Approach	**60,207**	64,907
Retail IRB Approach	**61,588**	64,970
Other IRB Approach	**17,191**	17,788
IRB Approach	**138,986**	147,665
Standardised (STA) Approach	**25,503**	18,956
Credit risk	**164,489**	166,621
Counterparty credit risk	**6,055**	8,419
Contributions to the default fund of a central counterparty	**428**	340
Credit valuation adjustment risk	**1,402**	864
Operational risk	**25,326**	25,292
Market risk	**3,051**	3,147
Underlying risk-weighted assets	**200,751**	204,683
Threshold risk-weighted assets[1]	**10,168**	10,851
Total risk-weighted assets	**210,919**	215,534

1 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of being deducted from CET1 capital. Significant investments primarily arise from investment in the Group's Insurance business.

Table 1.32: Risk-weighted assets movement by key driver

	Credit risk IRB £m	Credit risk STA £m	Credit risk[1] £m	Counterparty credit risk[2] £m	Market risk £m	Operational risk £m	Total £m
Total risk-weighted assets as at 31 December 2016							215,534
Less total threshold risk-weighted assets[3]							(10,851)
Risk-weighted assets as at 31 December 2016	147,665	18,956	166,621	9,623	3,147	25,292	204,683
Asset size	**(2,465)**	**100**	**(2,365)**	**(403)**	–	–	**(2,768)**
Asset quality	**322**	**(112)**	**210**	**(222)**	–	–	**(12)**
Model updates	**(4,399)**	–	**(4,399)**	–	**349**	–	**(4,050)**
Methodology and policy	**(789)**	**434**	**(355)**	**(431)**	–	–	**(786)**
Acquisitions and disposals	**(606)**	**6,237**	**5,631**	**(26)**	–	**930**	**6,535**
Movements in risk levels (market risk only)	–	–	–	–	**(445)**	–	**(445)**
Foreign exchange	**(742)**	**(112)**	**(854)**	**(656)**	–	–	**(1,510)**
Other	–	–	–	–	–	**(896)**	**(896)**
Risk-weighted assets as at 31 December 2017	**138,986**	**25,503**	**164,489**	**7,885**	**3,051**	**25,326**	**200,751**
Threshold risk-weighted assets[3]							**10,168**
Total risk-weighted assets as at 31 December 2017							**210,919**

1 Credit risk includes securitisation risk-weighted assets.

2 Counterparty credit risk includes movements in contributions to the default fund of central counterparties and movements in credit valuation adjustment risk.

3 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of being deducted from CET1 capital. Significant investments primarily arise from investment in the Group's Insurance business.

The risk-weighted assets movement tables provide analyses of the movement in risk-weighted assets in the period by risk type and an insight into the key drivers of the movements. The key driver analysis is compiled on a monthly basis through the identification and categorisation of risk-weighted asset movements and is subject to management judgment.

Credit risk-weighted assets reductions of £2.1 billion were driven by the following key movements:

- Asset size saw a reduction of £2.4 billion due to continued active portfolio management, partly offset by targeted growth in key customer segments.
- Model update reductions of £4.4 billion were mainly due to PRA approved model changes within the mortgage and unsecured retail portfolios.
- Methodology and policy reductions of £0.4 billion were principally the result of further capital efficient securitisation activity.
- Acquisitions and disposals increased by £5.6 billion and were primarily driven by the acquisition of MBNA, partly offset by the disposal of the Group's interest in a strategic equity investment.
- Sterling foreign exchange movements, principally with the Euro and US Dollar, contributed to an overall reduction in credit risk-weighted assets of £0.9 billion.

Counterparty credit risk and CVA risk-weighted assets reductions of £1.7 billion were mainly driven by foreign exchange movements, reductions in position levels, updates to the calculation methodology following clarification of the regulatory approach and other movements.

Market risk, risk-weighted assets reduced by £0.1 billion largely due to a decrease in interest rate risk exposure, offset by an increase in the VaR multiplier, an increase in exposure to corporate bonds and refinements to internal models.

Operational risk, risk-weighted assets are broadly in line with the prior year, with the increase following the acquisition of MBNA mostly offset by the annual update of the income based Standardised Approach operational risk calculation.

Stress testing

The Group undertakes a wide ranging programme of stress testing providing a comprehensive view of the potential impacts arising from the risks to which the Group is exposed. One of the most important uses of stress testing is to assess the resilience of the operational and strategic plans of the Group to adverse economic conditions and other key vulnerabilities. As part of this programme, and in line with previous years, the Group conducted macroeconomic stress tests of the operating plan.

The concurrent UK stress test run by the Bank of England was also undertaken in 2017. As announced in November, despite the severity of the stress scenario, the Group exceeded the capital and leverage thresholds set out for the purpose of the stress test and was not required to take any capital action as a result.

Leverage ratio

The table below summarises the component parts of the Group's leverage ratio. Further analysis will be provided in the Group's Pillar 3 Report.

Table 1.33: **Leverage ratio**

	Fully loaded	
Leverage ratio	At 31 Dec 2017 £m	At 31 Dec 2016 £m
Total tier 1 capital for leverage ratio		
Common equity tier 1 capital	29,647	29,284
Additional tier 1 capital	5,330	5,320
Total tier 1 capital	34,977	34,604
Exposure measure		
Statutory balance sheet assets		
Derivative financial instruments	25,834	36,138
Securities financing transactions	49,193	42,285
Loans and advances and other assets	737,082	739,370
Total assets	812,109	817,793
Qualifying central bank claims	(53,842)	(41,510)
Deconsolidation adjustments[1]		
Derivative financial instruments	(2,043)	(2,403)
Securities financing transactions	(85)	112
Loans and advances and other assets	(140,387)	(142,955)
Total deconsolidation adjustments	(142,515)	(145,246)
Derivatives adjustments		
Adjustments for regulatory netting	(13,031)	(20,490)
Adjustments for cash collateral	(7,380)	(8,432)
Net written credit protection	881	699
Regulatory potential future exposure	12,335	13,188
Total derivatives adjustments	(7,195)	(15,035)
Securities financing transactions adjustments	(2,022)	39
Off-balance sheet items	58,357	58,685
Regulatory deductions and other adjustments	(7,658)	(9,128)
Total exposure measure[2]	657,234	665,598
Average exposure measure[4]	660,557	
UK Leverage ratio[2,3,6]	5.3%	5.2%
Average UK leverage ratio[4]	5.4%	
CRD IV exposure measure[5]	711,076	707,108
CRD IV leverage ratio[5]	4.9%	4.9%

1 Deconsolidation adjustments relate to the deconsolidation of certain Group entities that fall outside the scope of the Group's regulatory capital consolidation, being primarily the Group's Insurance business.

2 Calculated in accordance with the UK Leverage Ratio Framework which requires qualifying central bank claims to be excluded from the leverage exposure measure.

3 The countercyclical leverage ratio buffer is currently nil.

4 The average UK leverage ratio is based on the average of the month end tier 1 capital and exposure measures over the quarter (1 October 2017 to 31 December 2017). The average of 5.4 per cent compares to 5.4 per cent at the start and 5.3 per cent at the end of the quarter.

5 Calculated in accordance with CRD IV rules which include central bank claims within the leverage exposure measure.

6 The UK leverage ratio is 5.4 per cent on a pro forma basis upon recognition of the dividend paid by the Insurance business in February 2018 in relation to its 2017 earnings (31 December 2016: 5.3 per cent pro forma).

Risk management continued

Key movements

The Group's fully loaded UK leverage ratio increased by 0.1 per cent to 5.3 per cent reflecting the impact of both the increase in tier 1 capital and the £8.4 billion reduction in the exposure measure, the latter largely reflecting the underlying reduction in balance sheet assets (net of qualifying central bank claims and deconsolidation adjustments) driven by the reductions in both available-for-sale financial assets and derivatives assets, partially offset by the increase in loans and advances following the acquisition of MBNA and an increase in securities financing transactions (SFT) activity.

The derivatives exposure measure, representing derivative financial instruments per the balance sheet net of deconsolidation and derivatives adjustments, reduced by £2.1 billion during the year, primarily driven by market movements and a reduction in position levels.

The £4.7 billion increase in the SFT exposure measure during the year, representing SFT assets per the balance sheet net of deconsolidation and other SFT adjustments, reflected an increase in customer volumes, partially offset by reduced trading volumes and an increase in eligible netting adjustments.

Off-balance sheet items reduced by £0.3 billion during the year, primarily reflecting a net reduction in securitisation financing facility commitments together with corporate facility drawdowns, reductions and exits, largely offset by an increase in unconditionally cancellable credit card commitments following the acquisition of MBNA and new residential mortgage offers placed.

The average UK leverage ratio of 5.4 per cent over the quarter reflected a strengthening tier 1 capital position prior to the accrual for the announced full year ordinary dividend and further conduct provisions, and the reduction in underlying balance sheet assets during the quarter, net of qualifying central bank claims.

G-SIB indicators

Although the Group is not currently classified as a Global Systemically Important Bank (G-SIB), by virtue of the Group's leverage exposure measure exceeding €200 billion the Group is required to report G-SIB indicator metrics to the PRA. The Group's indicator metrics used within the 2017 Basel G-SIBs annual exercise will be disclosed in April 2018 and the results are expected to be made available by the Basel Committee later this year.

Insurance businesses

The business transacted by the insurance companies within the Group comprises both life insurance business and General Insurance business. Life insurance business comprises unit-linked business, non-profit business and with-profits business.

Scottish Widows Limited (SW Ltd) holds the only with-profit funds managed by the Group. Each insurance company within the Group is regulated by the PRA.

The Solvency II regime for insurers and insurance groups came into force from 1 January 2016. The insurance businesses are required to calculate solvency capital requirements and available capital on a risk-based approach. The Insurance business of the Group calculates regulatory capital on the basis of an internal model, which was approved by the PRA on 5 December 2015.

The minimum required capital must be maintained at all times throughout the year. These capital requirements and the capital available to meet them are regularly estimated in order to ensure that capital maintenance requirements are being met.

All minimum regulatory requirements of the insurance companies have been met during the year.

Funding and liquidity risk

Definition

Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding. Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due.

Exposure

Liquidity exposure represents the potential stressed outflows in any future period less expected inflows. The Group considers liquidity from both an internal and a regulatory perspective.

Measurement

Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturities with behavioural overlays as appropriate. Note 51 on page 240 sets out an analysis of assets and liabilities by relevant maturity grouping. Additionally the Group undertakes quantitative and qualitative analysis of behavioural aspects of its assets and liabilities in order to reflect their expected behaviour.

Mitigation

Group Corporate Treasury (GCT) is responsible for managing and monitoring liquidity risks on behalf of the Group and ensuring that liquidity risk management systems and arrangements are adequate with regard to the internal risk appetite and Group strategy. Liquidity policies and procedures are subject to independent internal oversight by Risk. Overseas branches and subsidiaries of the Group may also be required to meet the liquidity requirements of the entity's domestic country. Management of liquidity requirements is performed by the overseas branch or subsidiary and overseen by GCT. Liquidity risk of the Insurance business is actively managed and monitored within the Insurance business. The Group plans funding requirements over the life of the funding plan, combining business as usual and stressed conditions. The Group manages its risk appetite and liquidity position with regard to its internal risk appetite and the Liquidity Coverage Ratio (LCR) required by the PRA and Capital Requirements Directive and Regulation (CRD IV) liquidity requirements.

The Group's funding and liquidity position is underpinned by its significant customer deposit base, and is supported by strong relationships across customer segments. The Group has consistently observed that in aggregate the retail deposit base provides a stable source of funding. Funding concentration by counterparty, currency and tenor is monitored on an ongoing basis and where concentrations do exist, these are managed as part of the planning process and limited by internal risk appetite, with analysis regularly provided to senior management.

To assist in managing the balance sheet the Group operates a Liquidity Transfer Pricing (LTP) process which: allocates relevant interest expenses from the centre to the Group's banking businesses within the internal management accounts; helps drive the correct inputs to customer pricing; and is consistent with regulatory requirements. LTP makes extensive use of behavioural maturity profiles, taking account of expected customer loan prepayments and stability of customer deposits, modelled on historic data.

The Group can monetise liquid assets quickly, either through the repurchase agreements (repo) market or through outright sale. In addition, the Group has pre-positioned a substantial amount of assets at the Bank of England's Discount Window Facility which can be used to access additional liquidity in a time of stress. The Group considers diversification across geography, currency, markets and tenor when assessing appropriate holdings of liquid assets. The liquid asset buffer is managed under the control of Group Corporate Treasury and is available for deployment at immediate notice, subject to complying with regulatory requirements.

Liquidity risk within the Insurance business may result from: the inability to sell financial assets quickly at their fair values; an insurance liability falling due for payment earlier than expected; the inability to generate cash inflows as anticipated; an unexpected large operational event; or from a general insurance catastrophe e.g. a significant weather event. Following the implementation of Solvency II, the annuity portfolio is ring-fenced and assets held to match annuity liability cashflows are excluded from shareholder liquidity. In the event a liquidity shortfall arises on the annuity portfolio, shareholder liquidity will be required to support this. As a result, the shareholder's exposure to liquidity risk is through Insurance's non-annuity and surplus assets, any shortfall arising in the annuity portfolio and the investment portfolios within the general Insurance business. Liquidity risk is actively managed and monitored within the Insurance business to ensure that, even under stress conditions, there is sufficient liquidity to meet obligations and remain within approved risk appetite.

Monitoring

Daily monitoring and control processes are in place to address internal and regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group. This captures regulatory metrics as well as metrics the Group considers relevant for its liquidity profile. These are a mixture of quantitative and qualitative measures, including: daily variation of customer balances; changes in maturity profiles; cash outflows; funding concentration; changes in LCR eligible liquidity portfolio; credit default swap (CDS) spreads; and changing funding costs.

The Group carries out internal stress testing of its liquidity and potential cash flow mismatch position over both short (up to one month) and longer term horizons against a range of scenarios forming an important part of the internal risk appetite. The scenarios and assumptions are reviewed at least annually to ensure that they continue to be relevant to the nature of the business including reflecting emerging horizon risks to the Group, such as the UK exit from the EU. For further information on the Group's 2017 liquidity stress testing results refer to page 148 .

The Group maintains a Contingency Funding Plan which is designed to identify emerging liquidity concerns at an early stage, so that mitigating actions can be taken to avoid a more serious crisis developing. Contingency Funding Plan invocation and escalation processes are based on analysis of five major quantitative and qualitative components, comprising assessment of: early warning indicators; prudential and regulatory liquidity risk limits and triggers; stress testing results; event and systemic indicators; and market intelligence.

Funding and liquidity management in 2017

The Group has maintained its strong funding and liquidity position with a loan to deposit ratio of 110 per cent at 31 December 2017 (109 per cent as at 31 December 2016).

During 2017, the Group drew down a further £15.4 billion under the Bank of England's Term Funding Scheme (TFS), now fully utilised at £20 billion as at 31 December 2017. The amount outstanding under the Bank of England's Funding for Lending Scheme (FLS) is £25.1 billion as at 31 December 2017 (£30.1 billion as at 31 December 2016).

As a result, wholesale funding has decreased by £9.7 billion to £101.1 billion as at 31 December 2017, with the amount maturing in less than one year falling to £28.5 billion as at 31 December 2017 (£35.1 billion as at 31 December 2016). In 2017, the Group issued term funding of £10.2 billion and following the full utilisation of the TFS, would expect term issuance volumes in 2018 to return to a steady-state requirement of between £15 billion and £20 billion per annum.

The Group's strong balance sheet and funding and liquidity position has been reflected in positive movements in the Group's credit ratings in 2017. During the second half of the year, Moody's upgraded Lloyds Bank plc's long-term rating by one notch to 'Aa3'. In addition, S&P improved Lloyds Bank plc's outlook to 'positive' to reflect the Group's improved bail-in capital position following recent Lloyds Banking Group plc issuance.

The Group's liquidity surplus continues to exceed the regulatory minimum and internal risk appetite, with a Liquidity Coverage Ratio of 127 per cent as at 31 December 2017 based on the EU Delegated Act.

Table 1.34: **Summary funding and liquidity metrics**

	At 31 Dec 2017 £bn	At 31 Dec 2016 £bn	Change (%)
LCR eligible assets	**120.9**	120.8	–
Loan to deposit ratio (%)	**109.7**	108.9	1
LCR eligible liquid assets/money market funding less than one year maturity (x)[1]	**8.3**	8.8	(6)

1 Excludes balances relating to margins of £2.1 billion (31 December 2016: £3.2 billion) and settlement accounts of £1.5 billion (31 December 2016: £1.8 billion).

Risk management continued

Table 1.35: Group funding position

	At 31 Dec 2017 £bn	At 31 Dec 2016 £bn	Change %
Funding requirement			
Loans and advances to customers[1]	455.7	449.7	1
Loans and advances to banks[2]	4.1	5.1	(20)
Debt securities	3.6	3.4	6
Reverse repurchase agreements	0.7	0.5	40
Available-for-sale financial assets – non-LCR eligible[3]	0.9	1.9	(53)
Cash and balances at central bank – non-LCR eligible[4]	4.8	4.8	–
Funded assets	469.8	465.4	1
Other assets[5]	234.7	249.9	(6)
	704.5	715.3	(2)
On balance sheet LCR eligible liquid assets			
Reverse repurchase agreements	16.9	8.7	94
Cash and balances at central banks[4]	53.7	42.7	26
Available-for-sale financial assets	41.2	54.6	(25)
Trading and fair value through profit and loss	1.7	1.8	(6)
Repurchase agreements	(5.9)	(5.3)	11
	107.6	102.5	5
Total Group assets	812.1	817.8	(1)
Less: other liabilities[5]	(226.5)	(240.7)	(6)
Funding requirement	585.6	577.1	1
Funded by			
Customer deposits	415.5	413.0	1
Wholesale funding[6]	101.1	110.8	(9)
	516.6	523.8	(1)
Term funding scheme	19.9	4.5	
Total equity	49.1	48.8	1
Total funding	585.6	577.1	1

1 Excludes £16.8 billion (31 December 2016: £8.3 billion) of reverse repurchase agreements.

2 Excludes £1.7 billion (31 December 2016: £20.9 billion) of loans and advances to banks within the Insurance business and £0.8 billion (31 December 2016: £0.9 billion) of reverse repurchase agreements.

3 Non-LCR eligible liquid assets comprise a diversified pool of highly rated unencumbered collateral (including retained issuance).

4 Cash and balances at central banks are combined in the Group's balance sheet.

5 Other assets and other liabilities primarily include balances in the Group's Insurance business and the fair value of derivative assets and liabilities.

6 The Group's definition of wholesale funding aligns with that used by other international market participants, including interbank deposits, debt securities in issue and subordinated liabilities.

Table 1.36: Reconciliation of Group funding to the balance sheet (audited)

	At 31 December 2017				At 31 December 2016			
	Included in funding analysis £bn	Repos and cash collateral received by Insurance £bn	Fair value and other accounting methods £bn	Balance sheet £bn	Included in funding analysis £bn	Repos and cash collateral received by Insurance £bn	Fair value and other accounting methods £bn	Balance sheet £bn
Deposits from banks	5.1	24.1	0.6	29.8	8.1	8.0	0.3	16.4
Debt securities in issue	78.1	–	(5.6)	72.5	83.0	–	(6.7)	76.3
Subordinated liabilities	17.9	–	–	17.9	19.7	–	0.1	19.8
Total wholesale funding	101.1	24.1			110.8	8.0		
Customer deposits	415.5	2.6	–	418.1	413.0	2.5	–	415.5
Total	516.6	26.7			523.8	10.5		

Table 1.37: **Analysis of 2017 total wholesale funding by residual maturity**

	Less than one month £bn	One to three months £bn	Three to six months £bn	Six to nine months £bn	Nine months to one year £bn	One to two years £bn	Two to five years £bn	More than five years £bn	Total at 31 Dec 2017 £bn	Total at 31 Dec 2016 £bn
Deposit from banks	3.7	1.0	0.3	0.1	–	–	–	–	5.1	8.1
Debt securities in issue:										
Certificates of deposit	1.3	2.1	3.2	2.5	0.9	–	–	–	10.0	7.5
Commercial paper	0.4	2.8	–	–	–	–	–	–	3.2	3.2
Medium-term notes[1]	0.7	0.6	0.5	0.9	2.3	3.0	12.1	17.3	37.4	36.9
Covered bonds	1.5	–	0.7	0.1	–	2.8	12.3	7.3	24.7	29.1
Securitisation	–	0.4	–	0.1	0.1	0.6	1.3	0.3	2.8	6.3
	3.9	5.9	4.4	3.6	3.3	6.4	25.7	24.9	78.1	83.0
Subordinated liabilities	–	0.2	1.5	–	0.6	0.5	3.2	11.9	17.9	19.7
Total wholesale funding[2]	7.6	7.1	6.2	3.7	3.9	6.9	28.9	36.8	101.1	110.8
Of which issued by Lloyds Banking Group plc[3]	–	–	–	–	–	–	4.4	11.0	15.4	7.4

1 Medium-term notes include funding from the National Loan Guarantee Scheme (31 December 2016: £1.4 billion), which matured during 2017.

2 The Group's definition of wholesale funding aligns with that used by other international market participants; including interbank deposits, debt securities in issue and subordinated liabilities.

3 Consists of medium-term notes only.

Table 1.38: **Total wholesale funding by currency (audited)**

	Sterling £bn	US Dollar £bn	Euro £bn	Other currencies £bn	Total £bn
At 31 December 2017	25.8	32.1	37.0	6.2	101.1
At 31 December 2016	30.6	33.0	41.4	5.8	110.8

Table 1.39: **Analysis of 2017 term issuance (audited)**

	Sterling £bn	US Dollar £bn	Euro £bn	Other currencies £bn	Total £bn
Securitisation	–	–	–	–	–
Medium-term notes	1.0	5.2	1.6	1.0	8.8
Covered bonds	1.0	–	–	–	1.0
Private placements[1]	0.1	0.3	–	–	0.4
Subordinated liabilities	–	–	–	–	–
Total issuance	2.1	5.5	1.6	1.0	10.2
Of which issued by Lloyds Banking Group plc[2]	1.0	5.2	1.6	1.0	8.8

1 Private placements include structured bonds and term repurchase agreements (repos).

2 Consists of medium-term notes only.

The Group continues to maintain a diversified approach to funding markets with trades in public and private format, secured and unsecured products and a wide range of currencies and markets. For 2018, the Group will continue to maintain this diversified approach to funding, including capital and funding from the holding company, Lloyds Banking Group plc, as needed to transition towards final UK Minimum Requirements for Own Funds and Eligible Liabilities (MREL). The contractual maturities for the FLS and TFS are fully factored into the Group's funding plan.

Risk management continued

Liquidity portfolio

At 31 December 2017, the banking business had £120.9 billion of highly liquid unencumbered LCR eligible assets (31 December 2016: £120.8 billion), of which £120.2 billion is LCR level 1 eligible (31 December 2016: £120.3 billion) and £0.7 billion is LCR level 2 eligible (31 December 2016: £0.5 billion). These assets are available to meet cash and collateral outflows and PRA regulatory requirements. A separate liquidity portfolio to mitigate any insurance liquidity risk is managed within the Insurance business. LCR eligible liquid assets represent over eight times the Group's money market funding less than one year to maturity (excluding derivative collateral margins and settlement accounts) and exceed total wholesale funding, and thus provide a substantial buffer in the event of market dislocation. As previously communicated, given the economic climate, the Group does not expect to hold gilts to maturity. The Group has therefore continued to reduce the size of its gilts portfolio owned outright.

Table 1.40: **LCR eligible assets**

	At 31 Dec 2017 £bn	At 31 Dec 2016 £bn	Change %	Unweighted average 2017 £bn	Unweighted average 2016 £bn
Level 1					
Cash and central bank reserves	**53.7**	42.7	26	**51.0**	53.7
High quality government/MDB/agency bonds[1]	**65.8**	75.3	(13)	**72.0**	72.4
High quality covered bonds	**0.7**	2.3	(70)	**1.1**	2.4
Total	**120.2**	120.3	–	**124.1**	128.5
Level 2[2]	**0.7**	0.5	40	**0.6**	0.5
Total LCR eligible assets	**120.9**	120.8	–	**124.7**	129.0

1 Designated multilateral development bank (MDB).

2 Includes Level 2A and Level 2B.

Table 1.41: **LCR eligible assets by currency**

	Sterling £bn	US Dollar £bn	Euro £bn	Other currencies £bn	Total £bn
At 31 December 2017					
Level 1	**90.8**	**16.3**	**13.1**	**–**	**120.2**
Level 2	**0.2**	**0.5**	**–**	**–**	**0.7**
Total	**91.0**	**16.8**	**13.1**	**–**	**120.9**
At 31 December 2016					
Level 1	96.0	12.5	11.8	–	120.3
Level 2	0.2	0.3	–	–	0.5
Total	96.2	12.8	11.8	–	120.8

The banking business also has a significant amount of non-LCR eligible assets which are eligible for use in a range of central bank or similar facilities. Future use of such facilities will be based on prudent liquidity management and economic considerations, having regard for external market conditions.

Stress testing results

Internal stress testing results at 31 December 2017 showed that the banking business had liquidity resources representing 142 per cent of modelled outflows from all wholesale funding sources, retail and corporate deposits, intraday requirements and rating dependent contracts under the Group's most severe liquidity stress scenario.

A hypothetical idiosyncratic two notch downgrade of the Group's current long-term debt rating and accompanying short-term downgrade implemented instantaneously by all major rating agencies, could result in a contractual outflow of £1.1 billion of cash over a period of up to one year, £2.0 billion of collateral posting related to customer financial contracts and £5.9 billion of collateral posting associated with secured funding.

Encumbered assets

This disclosure provides further detail on the availability of assets that could be used to support potential future funding requirements of the Group. The disclosure is not designed to identify assets that would be available in the event of a resolution or bankruptcy.

The Board and the Group Asset and Liability Committee (GALCO) monitor and manage total balance sheet encumbrance via a number of risk appetite metrics. At 31 December 2017, the Group had £64.6 billion (31 December 2016: £83.5 billion) of externally encumbered on balance sheet assets with counterparties other than central banks. The decrease in encumbered assets was primarily driven by maturities of covered bond and securitisation issuances. The Group also had £587.5 billion (31 December 2016: £580.9 billion) of unencumbered on balance sheet assets, and £160.1 billion (31 December 2016: £153.5 billion) of pre-positioned and encumbered assets held with central banks. Primarily the Group encumbers mortgages, unsecured lending and credit card receivables through the issuance programmes and tradable securities through securities financing activity. The Group mainly positions mortgage assets at central banks.

Table 1.42: On balance sheet encumbered and unencumbered assets

	Encumbered with counterparties other than central banks				Pre-positioned and encumbered assets held with central banks	Unencumbered assets not pre-positioned with central banks				
	Securitisations £m	Covered bond £m	Other £m	Total £m	£m	Readily realisable[1] £m	Other realisable assets[2] £m	Cannot be used[3] £m	Total £m	Total £m
At 31 December 2017										
Cash and balances at central banks	–	–	–	–	–	53,887	–	4,634	58,521	58,521
Trading and other financial assets at fair value through profit or loss	–	–	4,642	4,642	–	7,378	–	150,858	158,236	162,878
Derivative financial instruments	–	–	–	–	–	–	–	25,834	25,834	25,834
Loans and receivables:										
Loans and advances to banks	–	–	–	–	–	213	1,417	4,981	6,611	6,611
Loans and advances to customers	5,023	26,414	6,610	38,047	160,060	13,927	170,771	89,693	274,391	472,498
Debt securities	–	–	2,374	2,374	–	919	4	346	1,269	3,643
	5,023	26,414	8,984	40,421	160,060	15,059	172,192	95,020	282,271	482,752
Available-for-sale financial assets	–	–	19,526	19,526	–	21,514	–	1,058	22,572	42,098
Other[4]	–	–	–	–	–	16	1,175	38,835	40,026	40,026
Total assets	5,023	26,414	33,152	64,589	160,060	97,854	173,367	316,239	587,460	812,109
At 31 December 2016										
Cash and balances at central banks	–	–	–	–	–	42,998	–	4,454	47,452	47,452
Trading and other financial assets at fair value through profit or loss	–	–	4,806	4,806	–	9,175	22	137,171	146,368	151,174
Derivative financial instruments	–	–	–	–	–	–	–	36,138	36,138	36,138
Loans and receivables:										
Loans and advances to banks	–	–	32	32	–	528	1,825	24,517	26,870	26,902
Loans and advances to customers	14,542	30,883	7,305	52,730	153,482	7,032	152,997	91,717	251,746	457,958
Debt securities	–	–	904	904	–	2,344	5	144	2,493	3,397
	14,542	30,883	8,241	53,666	153,482	9,904	154,827	116,378	281,109	488,257
Available-for-sale financial assets	154	–	24,824	24,978	–	31,017	31	498	31,546	56,524
Other[4]	–	–	–	–	–	34	1,737	36,477	38,248	38,248
Total assets	14,696	30,883	37,871	83,450	153,482	93,128	156,617	331,116	580,861	817,793

1 Assets regarded by the Group to be readily realisable in the normal course of business, to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements, and are not subject to any restrictions on their use for these purposes.

2 Assets where there are no restrictions on their use to secure funding, meet collateral needs, or be sold to reduce potential future funding requirements, but are not readily realisable in the normal course of business in their current form.

3 The following assets are classified as unencumbered – cannot be used: assets held within the Group's Insurance businesses which are generally held to either back liabilities to policyholders or to support the solvency of the Insurance subsidiaries; assets held within consolidated limited liability partnerships which provide security for the Group's obligations to its pension schemes; assets pledged to facilitate the use of intra-day payment and settlement systems; and reverse repos and derivatives balance sheet ledger items.

4 Other comprises: items in the course of collection from banks; investment properties; goodwill; value in-force business; other intangible assets; tangible fixed assets; current tax recoverable; deferred tax assets; retirement benefit assets; and other assets.

The above table sets out the carrying value of the Group's encumbered and unencumbered assets, separately identifying those that are available to support the Group's funding needs. The table does not include collateral received by the Group (i.e. from reverse repos) that is not recognised on its balance sheet, the vast majority of which the Group is permitted to repledge.

Risk management continued

Governance risk

Definition

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

Exposures

The internal and corporate governance arrangements of major financial institutions continue to be subject to a high level of regulatory and public scrutiny. The Group's exposure to governance risk is also reflective of the significant volume of existing and proposed legislation and regulation, both within the UK and across the multiple jurisdictions within which it operates, with which it must comply. Risk governance and risk culture are mutually reinforcing.

Measurement

The Group's governance arrangements are assessed against new or proposed legislation and regulation and best practice among peer organisations in order to identify any areas of enhancement required.

Mitigation

The Group's Risk Management Framework (RMF) 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;
- Outlining governance arrangements which articulate the enterprise-wide approach to risk management; and
- Supporting a consistent approach to Group-wide behaviour and risk decision making through a Group policy framework which helps everyone understand their responsibilities by clearly articulating and communicating rules, standards, boundaries and risk appetite measures which can be controlled, enforced and monitored.

Under the banner of the RMF, training modules are in place to support all colleagues in understanding and fulfilling their risk responsibilities.

The Ethics and Responsible Business Policy and supporting code of responsibility embody the Group's values and reflect its commitment to operating responsibly and ethically both at a business and an individual level. All colleagues are required to adhere to the code in all aspects of their roles.

Effective implementation of the RMF 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.

Monitoring

A review of the Group's RMF, which includes the status of the Group's principles and policy framework, and the design and operational effectiveness of key governance committees, is undertaken on an annual basis and the findings are reported to the Group Risk Committee, Board Risk Committee and the Board.

This includes a review of the Group's current approach to governance and ongoing initiatives in light of the latest regulatory guidance, including in 2017 the continued enhancement of frameworks to address Senior Managers and Certification Regime (SM&CR) requirements and prepare for the requirement to ring-fence retail banking activities with effect from January 2019.

For further information on Corporate Governance see pages 58–80.

Market risk

Definition

Market risk is defined as the risk that unfavourable market moves (including changes in and increased volatility of interest rates, market-implied inflation rates, credit spreads and prices for bonds, foreign exchange rates, equity, property and commodity prices and other instruments) lead to reductions in earnings and/or value.

Balance sheet linkages

The information provided in table 1.43 aims to facilitate the understanding of linkages between banking, trading, and insurance balance sheet items and the positions disclosed in the Group's market risk disclosures.

Table 1.43: **Market risk linkage to the balance sheet**

		Banking			
2017	Total £m	Trading book only £m	Non-trading £m	Insurance £m	Primary market risk factor
Assets					
Cash and balances at central banks	58,521	–	58,521	–	Interest rate
Trading and other financial assets at fair value through profit or loss	162,878	42,230	3,325	117,323	Interest rate, foreign exchange, credit spread
Derivative financial instruments	25,834	21,605	1,881	2,348	Interest rate, foreign exchange, credit spread
Loans and receivables					
Loans and advances to banks	6,611	–	4,274	2,337	Interest rate
Loans and advances to customers[1]	472,498	–	472,498	–	Interest rate
Debt securities	3,643	–	3,643	–	Interest rate, credit spread
	482,752	–	480,415	2,337	
Available-for-sale financial assets	42,098	–	42,098	–	Interest rate, foreign exchange, credit spread
Value of in-force business	4,839	–	–	4,839	Equity
Other assets	35,187	–	18,303	16,884	Interest rate
Total assets	812,109	63,835	604,543	143,731	
Liabilities					
Deposit from banks	29,804	–	29,804	–	Interest rate
Customer deposits	418,124	–	418,124	–	Interest rate
Trading and other financial liabilities at fair value through profit or loss	50,877	43,062	7,815	–	Interest rate, foreign exchange
Derivative financial instruments	26,124	21,699	1,613	2,812	Interest rate, foreign exchange, credit spread
Debt securities in issue	72,450	–	72,450	–	Interest rate, credit spread
Liabilities arising from insurance and investment contracts	118,860	–	–	118,860	Credit spread
Subordinated liabilities	17,922	–	16,131	1,791	Interest rate, foreign exchange
Other liabilities	28,805	–	8,345	20,460	Interest rate
Total liabilities	762,966	64,761	554,282	143,923	

1 Includes £6.9 billion of lower risk loans within the banking book sold by Commercial Banking and Retail to Insurance to manage market risk arising from annuitant liabilities within the Insurance business.

The defined benefit pension schemes' assets and liabilities are included under Other assets and Other liabilities in this table and note 35 on page 206 provides further information.

The Group's trading book assets and liabilities are originated by Commercial Banking (CB) Markets within the Commercial Banking division. Within the Group's balance sheet these fall under the trading assets and liabilities and derivative financial instruments. The assets and liabilities are classified as trading books if they have been acquired or incurred for the purpose of selling or repurchasing in the near future. These consist of government, corporate and financial institution bonds and loans/deposits and repos. Further information on these activities can be found under the Trading portfolios section on page 155.

Derivative assets and liabilities are held by the Group for three main purposes; to provide risk management solutions for clients, to manage portfolio risks arising from client business and to manage and hedge the Group's own risks. The majority of derivatives exposure arises within CB Markets. Insurance business assets and liabilities relate to policyholder funds, as well as shareholder invested assets, including annuity funds. The Group recognises the value of in-force business in respect of Insurance's long-term life assurance contracts as an asset in the balance sheet (see note 24, page 198).

The Group ensures that it has adequate cash and balances at central banks and stocks of high quality liquid assets (e.g. gilts or US Treasury securities) that can be converted easily into cash to meet liquidity requirements. The majority of these assets are held as available-for-sale with the remainder held as financial assets at fair value through profit and loss. Further information on these balances can be found under Funding and liquidity risk on page 146. Interest rate risk in the asset portfolios is swapped into a floating rate.

The majority of debt issuance originates from the issuance, capital vehicles and medium term notes desks and the interest rate risk of the debt issued is hedged by swapping them into a floating rate.

The non-trading book primarily consists of customer on balance sheet activities and the Group's capital and funding activities, which expose it to the risk of adverse movements in market prices, predominantly interest rates, credit spreads, exchange rates and equity prices, as described in further detail within the Banking activities section (page 152).

Risk management continued

Table 1.44 below shows the key material market risks for the Group's banking, defined benefit pension schemes, insurance and trading activities.

Table 1.44: **Key material market risks for the Group by individual business activity (profit before tax impact measured against Group single stress scenarios)**

	Risk Type					
2017	**Interest rate**	**Basis risk**	**FX**	**Credit spread**	**Equity**	**Inflation**
Banking activities[1]	●	–	–	●	●	–
Defined benefit pension schemes[1]	●	–	–	■	●	–
Insurance portfolios[1]	■	–	–	●	●	–
Trading portfolios[2]	–	–	–	–	–	–

Profit before tax	**Loss**	**Gain**
> £500m	●	■
£250m – £500m	●	■
£50m – <£250m	●	■
Immaterial/zero	–	–

1 Banking activities, Pensions and Insurance stresses; Interest rate -100 bps, Basis Risk 3 month London Interbank Offered Rate (LIBOR) +100bps/bank base rate -25bps, Foreign Exchange (FX) -15 per cent GBP, Credit Spread +100 per cent, Equity -30 per cent, Inflation +50 bps

2 Trading Portfolios; Interest rate +30bps, FX +5 per cent GBP, Credit Spread +20 per cent, Inflation +50bps.

Measurement

In addition to measuring single factors, Group risk appetite is calibrated primarily to five multi-risk Group economic scenarios, and is supplemented with sensitivity based measures. The scenarios assess the impact of unlikely, but plausible adverse stresses on income, with the worst case for banking activities, defined benefit pensions, insurance and trading portfolios reported against independently, and across the Group as a whole.

The Group risk appetite is cascaded first to the Group Asset and Liability Committee (GALCO), chaired by the Chief Financial Officer, where risk appetite is approved and monitored by risk type, and then to Group Market Risk Committee (GMRC) where risk appetite is sub allocated by division. These metrics are reviewed regularly by senior management to inform effective decision making.

Mitigation

GALCO is responsible for approving and monitoring Group market risks, management techniques, market risk measures, behavioural assumptions, and the market risk policy. Various mitigation activities are assessed and undertaken across the Group to manage portfolios and seek to ensure they remain within approved limits. The mitigation actions will vary dependent on exposure, but will, in general, look to reduce risk in a cost effective manner, by offsetting balance sheet exposures and externalising through to the financial markets dependent on market liquidity. The market risk policy is owned by Group Corporate Treasury (GCT) and refreshed annually. The policy is underpinned by supplementary market risk procedures, which define specific market risk management and oversight requirements.

Monitoring

GALCO and the GMRC regularly review high level market risk exposure, as part of the wider risk management framework. They also make recommendations to the Group Chief Executive concerning overall market risk appetite and Group Market Risk Policy. Exposures at lower levels of delegation are monitored at various intervals according to their volatility, from daily in the case of trading portfolios to monthly or quarterly in the case of less volatile portfolios. Levels of exposures compared to approved limits and triggers are monitored by Risk and where appropriate, escalation procedures are in place.

How market risks arise and are managed across the Group's activities is considered in more detail below.

Banking activities

Exposures

The Group's banking activities expose it to the risk of adverse movements in market prices, predominantly interest rates, credit spreads, exchange rates and equity prices. The volatility of market values can be affected by both the transparency of prices and the amount of liquidity in the market for the relevant asset or liability.

Interest rate risk

Yield curve risk in the Group's divisional portfolios, and in the Group's capital and funding activities arises from the different repricing characteristics of the Group's non-trading assets, liabilities (see loans and advances to customers and customer deposits in table 1.43) and off balance sheet positions.

Basis risk arises from the possible changes in spreads, for example where the bank lends with reference to a central bank rate but funds with reference to LIBOR, and the spread between these two rates widens or tightens.

Optionality risk arises predominantly from embedded optionality within assets, liabilities or off-balance sheet items where either the Group or the customer can affect the size or timing of cash flows. One example of this risk is pipeline mortgage risk where the customer owns an option on a mortgage rate and changes in market rates can impact the take up of the committed offer. Mortgage prepayment risk is another example where the customer owns an option allowing them to prepay when it is economical to do so. This can result in customer balances amortising more quickly or slowly than anticipated due to economic conditions or customers' response to changes in economic conditions.

Foreign exchange risk

Economic foreign exchange exposure arises from the Group's investment in its overseas operations (net investment exposures are disclosed in note 51 on page 240). In addition, the Group incurs foreign exchange risk through non-functional currency flows from services provided by customer facing divisions and the Group's debt and capital management programmes.

Equity risk

Equity risk arises primarily from three different sources: (i) the Group's strategic equity holdings in Banco Sabadell, Aberdeen Asset Management, and Visa Europe; (ii) exposure to Lloyds Banking Group share price through deferred shares and deferred options granted to employees as part of their benefits package; and (iii) the Group's private equity investments held by Lloyds Development Capital.

Credit spread risk

Credit spread risk arises largely from: (i) the liquid asset portfolio held in the management of Group liquidity, comprising of government, supranational, and other eligible assets; (ii) the Credit Valuation Adjustment (CVA) and Debit Valuation Adjustment (DVA) sensitivity to credit spreads; and (iii) a number of the Group's structured medium term notes where we have elected to fair value the notes through the profit and loss account.

Measurement

Interest rate risk exposure is monitored monthly using, primarily:

(i) Market value sensitivity: this methodology considers all repricing mismatches (behaviourally adjusted where appropriate) in the current balance sheet and calculates the change in market value that would result from an instantaneous 25, 100 and 200 basis points parallel rise or fall in the yield curve (subject to an appropriate floor). The market value sensitivities are calculated on a static balance sheet using principal cash flows excluding commercial margins and other spread components and are therefore discounted at the risk free zero-coupon rate.

(ii) Interest income sensitivity: this measures the 12 month impact on future net interest income arising from various economic scenarios. These include instantaneous 25, 100 and 200 basis point parallel shifts in all yield curves and the five Group economic scenarios (subject to an appropriate floor). These scenarios are reviewed every year and are designed to replicate severe but plausible economic events, capturing risks that would not be evident through the use of parallel shocks alone such as basis risk and steepening or flattening of the yield curve. An additional negative rates scenario is also used for information purposes where all floors are removed; however this is not measured against the limit framework.

Unlike the market value sensitivities, the interest income sensitivities incorporate additional behavioural assumptions as to how and when individual products would reprice in response to changing rates. In addition a dynamic balance sheet is used which includes the run-off of current assets and liabilities and the addition of planned new business.

Reported sensitivities are not necessarily predictive of future performance as they do not capture additional management actions that would likely be taken in response to an immediate, large, movement in interest rates. The actions could reduce the net interest income sensitivity and help mitigate any adverse impacts or they may result in changes to total income that are not captured in the net interest income.

(iii) Market value limit: this caps the amount of conventional and inflation-linked government bonds held by the Group for liquidity purposes.

(iv) Structural hedge limits: these metrics enhance understanding of assumption and duration risk taken within the behaviouralisation of this portfolio.

The Group has an integrated Asset and Liability Management (ALM) system which supports non traded asset and liability management of the Group. This provides a single consolidated tool to measure and manage interest rate repricing profiles (including behavioural assumptions), perform stress testing and produce forecast outputs. The Group is aware that any assumptions based model is open to challenge. A full behavioural review is performed annually, or in response to changing market conditions, to ensure the assumptions remain appropriate and the model itself is subject to annual re-validation, as required under the Group Model Governance Policy. The key behavioural assumptions are: (i) embedded optionality within products; (ii) the duration of balances that are contractually repayable on demand, such as current accounts and overdrafts, together with net free reserves of the Group; and (iii) the re-pricing behaviour of managed rate liabilities namely variable rate savings.

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

Table 1.45 below shows, split by material currency, the Group's market value sensitivities to an instantaneous parallel up and down 25 and 100 basis points change to all interest rates.

Table 1.45: **Banking activities: market value sensitivity**

	2017				2016			
	Up 25bps £m	**Down 25bps £m**	**Up 100bps £m**	**Down 100bps £m**	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m
Sterling	**(9.9)**	**10.1**	**(38.7)**	**22.1**	(11.4)	11.5	(45.1)	31.6
US Dollar	**(3.6)**	**3.7**	**(14.2)**	**15.3**	3.2	(3.2)	12.6	(13.7)
Euro	**2.2**	**(0.7)**	**8.9**	**0.9**	(6.0)	(3.7)	(23.2)	(12.1)
Other	**(0.1)**	**0.2**	**(0.5)**	**0.6**	(0.2)	0.2	(0.9)	0.6
Total	**(11.4)**	**13.3**	**(44.5)**	**38.9**	(14.4)	4.8	(56.6)	6.4

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

The market value sensitivity is driven by temporary customer flow positions not yet hedged plus other positions occasionally held, within limits, by the Group's wholesale funding desks in order to minimise overall funding and hedging costs. The level of risk is low relative to the size of the total balance sheet.

Table 1.46 below shows supplementary value sensitivity to a steepening and flattening (c. 100 basis points around the 3 year point) in the yield curve. This ensures there are no unintended consequences to managing risk to parallel shifts in rates.

Table 1.46: **Banking activities: market value sensitivity to a steepening and flattening of the yield curve**

	2017		2016	
	Steepener £m	**Flattener £m**	Steepener £m	Flattener £m
Sterling	**(1.1)**	**(16.5)**	(5.8)	(13.2)
US Dollar	**7.1**	**(8.9)**	0.7	(1.3)
Euro	**(3.8)**	**7.9**	(15.3)	(12.8)
Other	**(0.2)**	**0.2**	(0.2)	0.2
Total	**2.0**	**(17.3)**	(20.6)	(27.1)

Risk management continued

The table below shows the banking book income sensitivity to an instantaneous parallel up and down 25 and 100 basis points change to all interest rates.

Table 1.47: Banking activities: net interest income sensitivity

	2017				2016			
	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m	Up 25bps £m	Down 25bps £m	Up 100bps £m	Down 100bps £m
Client facing activity and associated hedges	**86.1**	**(54.0)**	**370.5**	**(186.9)**	176.8	(286.1)	724.9	(408.0)

Income sensitivity is measured over a rolling 12 month basis.

The reduction in the net interest income sensitivity reflects the growth in the structural hedge throughout 2017 and the accompanying reduction in income volatility in future years.

Basis risk, foreign exchange, equity, and credit spread risks are measured primarily through scenario analysis by assessing the impact on profit before tax over a 12 month horizon arising from a change in market rates, and reported within the Board risk appetite on a monthly basis. Supplementary measures such as sensitivity and exposure limits are applied where they provide greater insight into risk positions. Frequency of reporting supplementary measures varies from daily to quarterly appropriate to each risk type.

Mitigation

The Group's policy is to optimise reward whilst managing its market risk exposures within the risk appetite defined by the Board. The Group Market Risk Policy and procedures outlines the hedging process, and the centralisation of risk from divisions into GCT, e.g. via the transfer pricing framework. GCT is responsible for managing the centralised risk and does this through natural offsets of matching assets and liabilities, and appropriate hedging activity of the residual exposures, subject to the authorisation and mandate of GALCO within the Board risk appetite. Derivative desks in CB Markets will then externalise the hedges to the market. The Group has hedge accounting solutions in place, which reduce the accounting volatility arising from the Group's economic hedging activities by utilising both LIBOR based and bank base rate assets.

The largest residual risk exposure arises from balances that are deemed to be insensitive to changes in market rates (including current accounts, a portion of variable rate deposits and investable equity), and is managed through the Group's structural hedge. Consistent with the Group's strategy to deliver stable returns, GALCO seeks to minimise large reinvestment risk, and to smooth earnings over a range of investment tenors. 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 GALCO.

Whilst the bank faces margin compression in the current low rate environment, its exposure to pipeline and prepayment risk are not considered material, and are hedged in line with expected customer behaviour. These are appropriately monitored and controlled through divisional Asset and Liability Committees (ALCOs).

Net investment foreign exchange exposures are managed centrally by GCT, by hedging non-sterling asset values with currency borrowing. In the first half of 2017, the Group unwound the economic hedges against these positions in order to create additional offset to common equity tier 1 (CET1) movements arising from revaluation of foreign currency risk-weighted assets (see note 51 on page 240). Economic foreign exchange exposures arising from non-functional currency flows are identified by divisions and transferred and managed centrally. The Group also has a policy of forward hedging its forecasted currency profit and loss to year end.

Monitoring

The appropriate limits and triggers are monitored by senior executive committees within the banking divisions. Banking assets, liabilities and associated hedging are actively monitored and if necessary rebalanced to be within agreed tolerances.

Defined benefit pension schemes

Exposures

The Group's defined benefit pension schemes are exposed to significant risks from their assets and liabilities. The liability discount rate provides exposure to interest rate risk and credit spread risk, which are partially offset by fixed interest assets (such as gilts and corporate bonds) and swaps. Equity and alternative asset risk arises from direct asset holdings. Scheme membership provides exposure to longevity risk.

For further information on defined benefit pension scheme assets and liabilities please refer to note 35 on page 206.

Measurement

Management of the schemes' assets is the responsibility of the Trustees of the schemes who are responsible for setting the investment strategy and for agreeing funding requirements with the Group. Should a funding deficit arise, the Group will be liable for meeting it, and as part of a triennial valuation process will agree with the Trustees a funding strategy to eliminate the deficit over an appropriate period.

Longevity risk is measured using both 1-in-20 year stresses (risk appetite) and 1-in-200 year stresses (regulatory capital).

Mitigation

The Group takes an active involvement in agreeing mitigation strategies with the schemes' Trustees. An interest rate and inflation hedging programme is in place to reduce liability risk. The schemes have also reduced equity allocation and invested the proceeds in credit assets as part of a programme to de-risk the portfolio. The merits of longevity risk transfer and hedging solutions are regularly reviewed.

Monitoring

In addition to the wider risk management framework, governance of the schemes includes two specialist pensions committees.

The surplus or deficit in the schemes is tracked on a monthly basis along with various single factor and scenario stresses which consider the assets and liabilities holistically. Key metrics are monitored monthly including the Group's capital resources of the scheme, the performance against risk appetite triggers, and the performance of the hedged asset and liability matching positions.

Insurance portfolios

Exposures

The main elements of market risk to which the Group is exposed through the Insurance business are equity, credit spread, interest rate and inflation.

- Equity risk arises indirectly through the value of future management charges on policyholder funds. These management charges form part of the value of in-force business (see note 24 on page 198). Equity risk also arises in the with-profits funds but is less material.
- Credit spread risk mainly arises from annuities where policyholders' future cashflows are guaranteed at retirement. Exposure arises if the market value of the assets which are held to back these liabilities, mainly corporate bonds and loans, do not perform in line with expectations. Within the Group accounts a large amount of the exposure to market value movements, but not actual default losses, is removed as accounting rules require that assets which the Insurance division has acquired from Group are maintained at the original amortised book value.
- Interest rate risk arises through holding credit and interest assets mainly in the annuity book and also to cover general insurance liabilities, capital requirements and risk appetite.
- Inflation exposure arises from a combination of inflation linked policyholder benefits and inflation assumptions used to project future expenses.

Measurement

Current and potential future market risk exposures within Insurance are assessed using a range of stress testing exercises and scenario analyses.

Risk measures include 1-in-200 year stresses used for regulatory capital assessments and single factor stresses for profit before tax.

Table 1.48 demonstrates the impact of the Group's Eurozone Credit Crunch scenario on Insurance's porfolio (with no diversification benefit, but after the impact of Group consolidation on interest rate and spread widening). This is the most onerous scenario for Insurance out of the Group scenarios. The amounts include movements in assets, liabilities and the value of in-force business in respect of insurance contracts and participating investment contracts.

Table 1.48: **Insurance business: profit before tax sensitivities**

	Increase (reduction) in profit before tax	
	2017 £m	2016[1] £m
Interest rates – decrease 100 basis points	**(202)**	(387)
Inflation – increase 50 basis points	**24**	(34)
Credit spreads – 100% widening	**140**	369
Equity – 30% fall	**(1,001)**	(681)
Property – 25% fall	**(67)**	(58)

1 Restated. The most onerous scenario has changed to Eurozone Credit Crunch from UK Recession.

Further stresses that show the effect of reasonably possible changes in key assumptions, including the risk-free rate, equity investment volatility, widening of credit default spreads on corporate bonds and an increase in illiquidity premia, as applied to profit before tax are set out in note 32.

Mitigation

Equity and credit spread risks are closely monitored and, where appropriate, asset liability matching is undertaken to mitigate risk. A hedging strategy is in place to reduce exposure from the with-profit funds.

Interest rate risk in the annuity book is mitigated by investing in assets whose cash flows closely match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result, the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch.

Other market risks (e.g. interest rate exposure outside the annuity book and inflation) are also closely monitored and where considered appropriate, hedges are put in place to reduce exposure.

Monitoring

Market risks in the Insurance business are monitored by Insurance senior executive committees and ultimately the Insurance Board. Monitoring includes the progression of market risk capital against risk appetite limits, as well as the sensitivity of profit before tax to combined market risk stress scenarios and in year market movements. Asset and liability matching positions and hedges in place are actively monitored and if necessary rebalanced to be within agreed tolerances. In addition market risk is controlled via approved investment policies and mandates.

Trading portfolios

Exposures

The Group's trading activity is small relative to its peers and does not engage in any proprietary trading activities. The Group's trading activity is undertaken solely to meet the financial requirements of commercial and retail customers for foreign exchange, credit and interest rate products. These activities support customer flow and market making activities.

All trading activities are performed within the Commercial Banking division. While the trading positions taken are generally small, any extreme moves in the main risk factors and other related risk factors could cause significant losses in the trading book depending on the positions at the time. The average 95 per cent 1-day trading VaR (Value at Risk: diversified across risk factors) was £0.6 million for 31 December 2017 compared to £1.3 million for 31 December 2016. The decrease in exposure was mainly due to high VaR during the first half of 2016 caused by overstatement of the interest rate risk by the VaR model. Improvements to more accurately reflect the risk were implemented in June 2016 which reduced the VaR significantly over the second half of 2016 and over 2017.

Trading market risk measures are applied to all of the Group's regulatory trading books and they include daily VaR (table 1.49), sensitivity based measures, and stress testing calculations.

Measurement

The Group internally uses VaR as the primary risk measure for all trading book positions.

Table 1.49 shows some relevant statistics for the Group's 1-day 95 per cent confidence level VaR that are based on 300 historical consecutive business days to year end 2017 and year end 2016.

The risk of loss measured by the VaR model is the minimum expected loss in earnings given the 95 per cent confidence. The total and average trading VaR numbers reported below have been obtained after the application of the diversification benefits across the five risk types. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported at Group level.

Table 1.49: **Trading portfolios: VaR (1-day 95 per cent confidence level) (audited)**

	At 31 December 2017				At 31 December 2016			
	Close £m	Average £m	Maximum £m	Minimum £m	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	**0.5**	**0.6**	**2.1**	**0.2**	0.7	1.3	7.7	0.5
Foreign exchange risk	**0.1**	**0.1**	**0.4**	**0.0**	0.1	0.3	0.8	0.1
Equity risk	**–**	**–**	**–**	**–**	–	–	–	–
Credit spread risk	**0.3**	**0.3**	**0.5**	**0.2**	0.2	0.2	0.4	0.1
Inflation risk	**0.2**	**0.3**	**0.9**	**0.2**	0.2	0.3	5.9	0.1
All risk factors before diversification	**1.1**	**1.3**	**2.9**	**0.9**	1.2	2.1	14.3	1.1
Portfolio diversification	**(0.4)**	**(0.7)**			(0.5)	(0.8)		
Total VaR	**0.7**	**0.6**	**2.2**	**0.3**	0.7	1.3	5.7	0.6

Risk management continued

The market risk for the trading book continues to be low with respect to the size of the Group and compared to our peers. This reflects the fact that the Group's trading operations are customer-centric and focused on hedging and recycling client risks.

Although it is an important market standard measure of risk, VaR has limitations. One of them is the use of limited historical data sample which influences the output by the implicit assumption that future market behaviour will not differ greatly from the historically observed period. Another known limitation is the use of defined holding periods which assumes that the risk can be liquidated or hedged within that holding period. Also calculating the VaR at the chosen confidence interval does not give enough information about potential losses which may occur if this level is exceeded. The Group fully recognises these limitations and supplements the use of VaR with a variety of other measurements which reflect the nature of the business activity. These include detailed sensitivity analysis, position reporting and a stress testing programme.

Trading book VaR (1-day 99 per cent) is compared daily against both hypothetical and clean profit and loss. 1-day 99 per cent VaR charts for Lloyds Bank, HBOS and Lloyds Banking Group models can be found in the Group's Pillar 3 Report.

Mitigation

The level of exposure is controlled by establishing and communicating the approved risk limits and controls through policies and procedures that define the responsibility and authority for risk taking. Market risk limits are clearly and consistently communicated to the business. Any new or emerging risks are brought within risk reporting and defined limits.

Monitoring

Trading risk appetite is monitored daily with 1-day 95 per cent VaR and stress testing limits. These limits are complemented with position level action triggers and profit and loss referrals. Risk and position limits are set and managed at both desk and overall trading book levels. They are reviewed at least annually and can be changed as required within the overall Group risk appetite framework.

Model risk

Definition

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

Models are defined as quantitative methods that process input data into quantitative outputs, or qualitative outputs (including ordinal letter output) which have a quantitative measure associated with them. Model Governance Policy is restricted to specific categories of application of models, principally financial risk, treasury and valuation, with certain exclusions, such as prescribed calculations and project appraisal calculations.

Exposures

There are over 300 models in the Group performing a variety of functions including:

- capital calculation;
- credit decisioning, including fraud;
- pricing models;
- impairment calculation;
- stress testing and forecasting; and
- market risk measurement.

As a result of the wide scope and breadth of coverage, there is exposure to model risk across a number of the Group's primary risk categories.

Measurement

The Group risk appetite framework is the key component for measuring the Group's model risk. Reported monthly to the Group Risk Committee and Board, focus is placed on the performance of the Group's most material models.

Mitigation

The model risk management framework, established by and with continued oversight from an independent team in the Risk division, provides the foundation for managing and mitigating Model Risk within the Group. Accountability is cascaded from the Board and senior management via the Group Risk Management Framework.

This provides the basis for the Group Model Governance Policy, which defines the mandatory requirements for models across the Group, including:

- the scope of models covered by the policy;
- model materiality;
- roles and responsibilities, including ownership, independent oversight and approval; and
- key principles and controls regarding data integrity, development, validation, implementation, ongoing maintenance and validation, monitoring, and the process for non-compliance.

The above ensures models, including those involved in regulatory capital calculation, are developed consistently and are of sufficient quality to support business decisions and meet regulatory requirements.

Monitoring

The Group Model Governance Committee is the primary body for overseeing model risk. Policy requires that Key Performance Indicators are monitored for every model and all issues are escalated appropriately. Material model issues are reported to Group and Board Risk Committees monthly with more detailed papers as necessary to focus on key issues.

FINANCIAL STATEMENTS

Independent auditors' report to the members of Lloyds Banking Group plc

Report on the financial statements

Opinion

In our opinion, Lloyds Banking Group plc's consolidated financial statements and parent company financial statements (the 'financial statements'):

– give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2017 and of the Group's profit and the Group's and the parent company's cash flows for the year then ended;

– have been properly prepared in accordance with IFRSs as adopted by the European Union and, as regards the parent company's financial statements, as applied in accordance with the provisions of the Companies Act 2006; and

– have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the 'Annual Report'), which comprise: the consolidated and parent company balance sheets as at 31 December 2017; the consolidated income statement and the consolidated statement of comprehensive income for the year then ended; the consolidated and parent company statements of changes in equity for the year then ended; and the consolidated and parent company cash flow statements for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

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

Basis for opinion

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

Independence

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

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

Other than those disclosed in note 11 to the financial statements, we have provided no non-audit services to the Group or the parent company in the period from 1 January 2017 to 31 December 2017.

Our audit approach

Overview

– Overall Group materiality: £350 million (2016: £325 million), based on 5 per cent of the 3 year average of adjusted profit before tax. Statutory profits were adjusted to remove the effects of certain items which are exceptional and/or one-off in nature.

– Overall parent company materiality: £350 million (2016: £325 million), based on 1 per cent of total assets.

– The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).

– We performed audit procedures over components considered financially significant in the context of the Group (full scope audit) or in the context of individual primary statement account balances (audit of specific account balances). We performed other procedures including testing entity level controls, information technology general controls and analytical review procedures to mitigate the risk of material misstatement in the residual components.

The areas of focus for our audit which involved the greatest allocation of our resources and effort were:

– Loan loss impairment provisions (Group)

– Conduct risk and provisions (Group)

– Insurance actuarial assumptions (Group)

– Defined benefit obligation (Group)

– Hedge accounting (Group and parent)

– Significant transactions (Group and parent)

– Privileged access to IT systems (Group and parent)

– Disclosure of the impact of IFRS 9 (Group)

These items were discussed with the Audit Committee as part of our audit plan communicated in April 2017 and updated in October 2017. These were the key audit matters for discussion at the conclusion of our audit.

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.

The scope of our audit

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

We gained an understanding of the legal and regulatory framework applicable to the Group and the industries in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that 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. We focused on laws and regulations that could give rise to a material misstatement in the Group and parent financial statements, including but not limited to, the Companies Act 2006, the Listing Rules, the Prudential Regulation Authority's regulations, the Pensions Regulator legislation, the UK tax legislation. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, enquiries of management, review of significant components auditors' work and review of internal audit reports in so far as they related to the financial statements.

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.

We found conduct risks and provisions to be a key audit matter, and this is discussed further below. As in all of our audits, we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

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 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	Parent company financial statements
Overall materiality	£350 million (2016: £325 million).	£350 million (2016: £325 million).
How we determined it	5 per cent of the 3 year average of adjusted profit before tax. Profit was adjusted to remove the effects of certain items which are exceptional and/or one off in nature.	1 per cent of total assets.
Rationale for benchmark applied	We have used a 3 year average of adjusted profit before tax in order to reduce the potential for volatility and large changes in materiality year-on-year. This is a generally accepted auditing practice. Statutory profits before tax for 2015, 2016 and 2017 were adjusted to remove the disproportionate impact of several items which are considered exceptional and/or one-off in nature. These adjustments included charges related to PPI and other conduct provisions, charges relating to redemptions of enhanced capital notes and the credit in relation to the Group's disposal of its stake in Visa Europe Ltd.	We have selected total assets as an appropriate benchmark for parent company materiality. Profit based benchmarks are not considered appropriate for parent company materiality as the Group is not required to disclose a parent company income statement. Parent company overall materiality calculated based on the total assets benchmark exceeds the Group overall materiality level. Therefore parent company overall materiality is restricted to equal the Group overall materiality level (£350m).

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 £60 million and £120 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £20 million for the Group and parent company audits (2016: £20 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Audit scope

We tailored the scope of our audit to ensure that we performed sufficient work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the Group and the parent company, the accounting processes and controls, and the industry in which the Group operates.

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

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

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

Any components which were considered individually financially significant in the context of the Group's consolidated financial statements (defined as components which 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 of more account balances was subject to specific audit procedures over those account balances. Inconsequential components (defined as components which did not represent a reasonable possibility of a risk of material misstatement either individually or in aggregate) were eliminated from further consideration for specific audit procedures although they were subject to Group level analytical review procedures. All remaining components which were neither inconsequential nor

Independent auditors' report to the members of Lloyds Banking Group plc continued

individually financially significant were within our audit scope, with the risk of material misstatement mitigated through audit procedures including testing of entity level controls, information technology general controls and Group and component level analytical review procedures.

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

Components within the scope of our audit contributed 99 per cent of Group total assets and 94 per cent of profit after tax.

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

Loan loss impairment provisions

Group

Refer to page 73 (Audit Committee Report), page 173 (Accounting Policies) and page 195 (Note 20 and Critical Accounting Estimates and Judgements).

The determination of impairment provisions is complex, and significant judgements are required around both the timing of recognition of impairment provisions and estimation of the amount of provisions required in relation to loss events which have occurred at the balance sheet date.

Impairment provisions relating to loans and advances in the Retail division are determined on a collective basis, with the use of impairment models. These models are used to calculate impairment provisions based on key assumptions for example loss emergence period, probability of default, loss given default (including possession propensity and forced sale discounts for mortgages) and valuation of recoveries. These are estimated based on historical experience and other data as available at the reporting date. Management also applies overlays where they believe the calculated assumptions based on historical experience are not appropriate, either due to emerging trends or the models not capturing the risks in the loan portfolio. An example of this is an overlay to the impairment model output for the UK mortgage portfolio relating to the current low interest rate environment. These overlays require significant judgement and are therefore a main area of focus.

Impairment provisions relating to loans and advances in the Commercial Banking division are primarily determined on an individual basis. Judgement is required to determine when a loan is considered impaired, and then to estimate the expected future cash flows related to that loan. A collective provision is also calculated to cover unidentified impairment (i.e. losses which have been incurred but not yet identified). Management apply overlays to the modelled output to address risks not captured by the model.

How our audit addressed the key audit matter

We understood management's process and tested key controls around the determination of impairment provision, including:

- the identification of impairment events;
- the governance over the impairment processes, including controls over unauthorised modifications to the models and the re-assessment by management that impairment models are still calibrated in a way which is appropriate for the impairment risks in the Group's loan portfolios;
- the transfer of data between underlying source systems and the impairment models that the Group operates; and
- the review, challenge and approval processes that are in place to assess the outputs of the Group's impairment models, and the overlays that are applied.

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

In addition we have performed the following substantive procedures:

Retail

We understood and critically assessed the appropriateness of models used. This included challenging whether the portfolios were appropriately segmented and whether historical experience was representative of current circumstances. We also performed testing over the completeness and accuracy of data from underlying systems, assessed whether customer forbearance plans had been appropriately reflected in the impairment models and performed testing to obtain evidence over the existence and valuation of collateral.

We critically assessed the completeness of overlays proposed by management, including challenging whether risk concentrations (e.g. past-term interest only loans, forborne loans, personal contract purchase loans) have been appropriately provided for. We also performed testing over the measurement of the overlays in place, including challenging the appropriateness of the calculation, the reasonableness of the assumptions used and the reliability of the underlying data.

Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models and overlays to modelled outputs to be appropriate.

Commercial Banking

We critically assessed the criteria for determining whether an impairment event had occurred and therefore whether there was a requirement to calculate an individual impairment provision. We tested a sample of performing loans with characteristics that might imply an impairment indicator existed (e.g. a customer experiencing financial difficulty or in breach of covenant) as well as an additional haphazardly selected sample of performing loans to assess whether these loans had any impairment indicators that management had not identified.

For a sample of individually impaired loans, we understood the latest developments in relation to each case and the basis of measuring the impairment provisions and considered whether key judgments were appropriate given the borrower's circumstances. We also re-performed management's impairment calculation, testing key inputs including the expected future cash flows, discount rates and the valuation of collateral held. Our testing of collateral valuation specifically considered whether valuations were up to date, consistent with the strategy being followed in respect of the particular borrower and assessed the appropriateness and sensitivities of key assumptions. We back-tested previous provisions by comparing them to the gains or losses crystallised when impaired loans were sold or exited.

For the collective unidentified impaired provision, we tested the completeness and accuracy of the underlying loan information used in the impairment models by agreeing details to the Group's source systems as well as re-performing the calculation of the modelled provision. For the key inputs and assumptions in the model, we obtained and tested objective evidence that supported their appropriateness. For overlays to the modelled output, we challenged management to provide objective evidence that the overlays were appropriate.

We also considered whether certain recent events and macro-economic factors (e.g. continued volatility and uncertainty around commodity prices, sterling exchange rate movements and low interest rates) had been appropriately considered and captured.

Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models and overlays to modelled outputs are appropriate.

Key audit matter	How our audit addressed the key audit matter
Conduct risk and provisions *Group* *Refer to page 73 (Audit Committee Report), page 173 (Accounting Policies) and page 213 (Note 37 and Critical Accounting Estimates and Judgements).* Provisions reflecting the Group's best estimate of present obligations relating to anticipated customer redress payments, operational costs and regulatory fines as a result of past events, practices and conduct continue to be significant and therefore represent a key audit matter. The most significant provisions relate to past sales of payment protection insurance (PPI) policies, arrears handling activities, packaged bank accounts and insurance products of the German branch of Clerical Medical Investment Group Ltd (now Scottish Widows Ltd). For the known issues that have been provided for, we focused on the use of several management assumptions including volume of future complaints and related redress costs that are key judgmental inputs into the measurement of provisions. Given the number and volume of products sold by the Group historically, and the continued regulatory and public focus on the banking industry, there is a continuing risk that new conduct issues will emerge. Therefore, there is a financial reporting risk that such emerging risks and exposures are not appropriately identified, for which financial statement disclosure and, or, provision may be required.	We understood and tested the key controls and management's processes around: – identifying emerging conduct risk exposures and assessing whether provisions or disclosures were necessary; and – calculating and reviewing conduct provisions, including governance processes, challenge of key assumptions and approval of provisions. We found these controls were designed, implemented and operated effectively and therefore we determined that we could place reliance on these controls for the purposes of our audit. We performed the following procedures around the measurement of provisions recognised: The majority of our detailed audit work was on the significant conduct provisions in relation to past sales of PPI policies, arrears handling activities, packaged bank accounts and insurance products in the German branch of Clerical Medical Investment Group Ltd (now Scottish Widows Ltd). We also examined other conduct provisions which are individually less material. For significant provisions made, we understood and challenged the provisioning methodologies and underlying assumptions used by management. For example, we challenged the basis that management used for forecasting the number of PPI complaints that will be received in the future. We considered regulatory developments and management's interactions with regulators. For those assumptions based on historic information, we challenged whether this was appropriate for future experience and challenged the appropriateness of any adjustments made by management. We independently performed sensitivity analysis on the key assumptions. Given the inherent uncertainty in the calculation of conduct provisions and their judgemental nature, we evaluated the disclosures made in the financial statements. In particular, we focused on challenging management around whether the disclosures were sufficiently clear in highlighting the exposures that remain, significant uncertainties that exist in respect of the provisions and the sensitivity of the provisions to changes in the underlying assumptions. Based on the procedures performed and evidence obtained, we found management's assumptions to be appropriate. We performed the following procedures around the completeness of provisions recognised: We met with Divisional and Group management to understand the emerging and potential issues that they had identified. We independently assessed emerging and potential areas where exposures might have arisen based upon our knowledge and experience of emerging industry issues and the regulatory environment. We used this to challenge the completeness of the issues identified by management and whether a provision was required. We understood the nature of customer complaints received, and assessed the trends. We used this analysis to understand whether there were indicators of more systemic issues being present for which provisions or disclosures may have needed to be made in the financial statements. We reviewed the Group's litigation reports, to identify potentially material cases which may require provision. We also communicated with the Group's external legal representatives to confirm our understanding of significant cases. We reviewed the Group's correspondence with the Financial Conduct Authority and Prudential Regulation Authority, discussing the content of any correspondence considered to be pertinent to our audit with management. We met on a trilateral basis with the Prudential Regulation Authority and the Chair of the Audit Committee. We also met on a bilateral basis with each regulator. We read the minutes of key governance meetings including those of the Board, and of various management committees, as well as attending all Audit Committee and Board Risk Committee meetings. No additional material conduct issues that would require financial statement disclosure or provision were identified as a result of the audit work performed.

Independent auditors' report to the members of Lloyds Banking Group plc continued

Key audit matter	How our audit addressed the key audit matter
Insurance actuarial assumptions *Group* *Refer to page 73 (Audit Committee Report), page 173 (Accounting Policies) and pages 198, 202 and 205 (Notes 24, 31, 32 and Critical Accounting Estimates and Judgements).* A number of subjective assumptions about future experience contribute as key inputs into the valuation of the Group's insurance contracts. Some of the economic and non-economic actuarial assumptions used in valuing insurance contracts are highly judgemental in nature, in particular persistency (the retention of policies over time), longevity (the expectation of how long an annuity policyholder will live and how that might change over time), maintenance expenses (future expenses incurred to maintain existing policies to maturity), credit default and illiquidity premium (adjustments made to the discount rate for the IFRS value of in-force business asset. In line with the Group's accounting policy, the discount rate applied to cash flows is consistent with that applied to such cash flows in the capital markets. Management currently uses the actual asset mix as a proxy for deriving a market consistent view of the illiquidity adjustment to the discount rate.	We understood and tested key controls and governance around the processes for setting economic and non-economic assumptions. We found that the key controls for the setting of assumptions, including those operating over the experience analysis data where applicable, were designed and operated effectively. Therefore we are able to place reliance on these controls for the purposes of our financial statement audit. We engaged our actuarial specialists to assess the reasonableness of the actuarial assumptions, including the consideration and challenge of management's rationale for the judgements applied and any reliance placed on industry information. The assessment includes reference to our benchmarking data which considers each of these principal areas. For persistency, we considered the appropriateness of assumptions set by management in light of regulatory changes. In particular, we considered how the assumptions reflect expected persistency improvements from the removal of commission for qualifying pension schemes and greater outflows of funds expected as a result of increased options available to pension policyholders (Finance Act 2014). For longevity, we have assessed the appropriateness of how own experience and industry data are used in setting future assumptions around longevity experience and future longevity trends and compared resulting life expectancies to benchmarking data. For maintenance expenses, we assessed the appropriateness of the judgements around costs deemed to be non-attributable to insurance business and the resulting per-policy costs assumptions. We have reviewed the adjustments required reflecting the impact of the Group's outsourcing agreement in this area. For credit default and illiquidity premium we assessed the appropriateness of the methodology, including modifications made, against our knowledge and experience of the regulatory requirements and of the industry. We assessed the methodology with reference to wider market practice and prevailing economic conditions. We challenged whether the actual asset mix used in the illiquidity premium calculation remained an appropriate proxy to a market consistent portfolio by comparing the proportion of illiquid assets held to those held by other similar companies based on our understanding of the market and the most recent public information for other similar companies. Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models and overlays to modelled outputs are appropriate.
Defined benefit obligation *Group* *Refer to page 73 (Audit Committee Report), page 173 (Accounting Policies) and page 206 (Note 35 and Critical Accounting Estimates and Judgements).* The retirement benefit schemes in the Group are calculated and valued with reference to a number of actuarial assumptions including discount rate, rate of inflation and mortality rates. As a result of the size of these schemes, small changes in these assumptions can have a significant impact on the financial statements.	We understood and tested key controls over the completeness and accuracy of data extracted and supplied to the Group's actuary, which is used in the valuation of the Group's defined benefit obligations. We tested the controls for determining the actuarial assumptions and the approval of those assumptions by senior management. We found the key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We engaged our actuarial experts and met with management and their actuary to understand the judgements made in determining key economic assumptions used in the calculation of the liability. We assessed the reasonableness of those assumptions by comparing to our own independently determined benchmarks and concluded that the assumptions used by management were appropriate. We tested the consensus and employee data used in calculating the obligation. Where material, we also considered the treatment of curtailments, settlements, past service costs and measurements, contributions and benefits paid, and any other amendments made to obligations during the year. Based on the evidence obtained, we found that the data and assumptions used by management in the actuarial valuations for pension obligations are within a range we consider to be reasonable. We read and assessed the disclosures made in the financial statements, including disclosures of the assumptions, and found them to be appropriate.
Hedge accounting *Group and parent* *Refer to page 73 (Audit Committee Report), page 173 (Accounting Policies), and page 240 (Note 51).* The Group enters into derivative contracts in order to manage and hedge risks such as interest rate and foreign exchange rate risk. These arrangements create accounting mismatches which are addressed through hedge accounting, predominantly fair value hedge or cash flow hedges. The application of hedge accounting and ensuring hedge effectiveness can be highly judgemental and operationally cumbersome, and requires close monitoring from management.	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 controls around the preparation and review of hedging strategy and related documentation prior to the implementation of new hedges. We found the key controls were designed, implemented and operated effectively, and therefore we determined that we could place reliance on these controls for the purposes of our audit. We examined hedge documentation to assess whether the documentation complied with all IAS 39 requirements. We tested key year-end reconciliations between underlying source systems and spreadsheets used to manage hedging models, including testing of hedging capacity after considering the impact of structural reform, designation of hedges and the measurement and recording of hedge effectiveness adjustments. In monitoring hedging effectiveness against stresses, we noted that despite significant market uncertainty and volatility during the year, all significant hedge accounting relationships continued to be effective. We tested a sample of manual adjustments posted to hedge reserves relating to hedge ineffectiveness arising in cash flow hedging models. We found that hedge accounting methodology was appropriately applied.

Strategic report
Financial results
Governance
Risk management
Financial statements
Other information

Key audit matter	How our audit addressed the key audit matter
Significant transactions *Group and parent* *Refer to page 73 (Audit Committee Report).* During the year, the Group has entered into significant one-off transactions that inherently have a high level of complexity and/or judgment in its determination of accounting treatment (e.g. acquisition of MBNA). This judgment increases the risk of management bias being introduced into the transactions. Due to the nature of significant one-off transactions, the accounting often falls outside of the business as usual process level controls and requires manual calculations to be performed. The design of the initial accounting treatment may form the basis for subsequent periods for long dated transactions.	We understood and tested key controls which require that one-off transactions are referred to Group Financial Reporting and that an accounting paper is produced outlining the treatment of the transaction in the financial statements. Further to this, we ensured that the accounting paper is appropriately reviewed and approved. We found the key controls were designed, implemented and operated effectively. We understood the nature of the significant transactions and reviewed the accounting papers produced in the year including any transaction documents or contracts to evaluate and assess the impact of the transaction on the Group. We made our own assessment as to the most appropriate accounting treatment, using this as a basis to challenge the key judgements made by management, including the assessment of any potential management bias. We assessed whether the extent of the disclosures made, in relation to significant transactions was appropriate. Based on the results of the evidence obtained, we found the accounting treatments applied to significant transactions were supported by the evidence obtained.
Privileged access to IT systems *Group and parent* *Refer to page 73 (Audit Committee Report).* The Group's financial reporting processes are reliant on automated processes and controls performed by IT systems. Further, the group-wide IT estate is complex in terms of the scale and nature of IT systems relied upon. The risks associated with IT are also impacted by the threat profile of IT within the banking environment, which is subject to a number of internal and external risks relating to cyber security and the resilience of IT systems. As part of the audit, we validate the design and operating effectiveness of in-scope automated and IT dependent controls over financial reporting at a point in time as well as review the supporting IT General Computer Controls (ITGCs) that provide assurance over the continued integrity of these controls for the full financial reporting period. As part of our audit work in prior periods, we identified recurring control matters in relation to the management of IT privileged access to IT systems and therefore have relied on compensating controls and performed additional procedures. While there is an ongoing programme of activities to address such control matters, the fact that these were open control matters during the period meant there was an increased risk that the data and reports from the affected systems were not reliable.	We understood and tested key controls surrounding Group IT's central process for the periodic recertification of user access entitlements across in-scope systems as well as reviewed the processes for managing privileged access to IT systems. We have obtained an understanding of management's remediation programme and observed progress in terms of their remediation of a number of the control matters. However, several of the controls continued to be ineffective for the full financial reporting period. Where these control matters affected applications and supporting IT systems within the scope of our audit, we performed a combination of additional controls testing, including compensating controls where relevant and substantive audit procedures. On the basis of our additional audit testing, we were able to place reliance on the data and reports from in-scope applications.
Disclosure of the impact of IFRS 9 *Group* *Refer to page 73 (Audit Committee Report) and page 253 (Note 54).* On 1 January 2018, the Group transitioned to financial instruments accounting standard IFRS 9 which replaced IAS 39. The estimated transition impact is disclosed in Note 54 to the Financial Statements in accordance with IAS 8. Disclosures in 2017 are intended to provide users with an understanding of the estimated impact of the new standard, and as a result are more limited than the disclosure to be included in the 2018 financial statements. We have deemed the disclosure of the impact of IFRS 9 for impairment an area of focus because of the significant changes introduced by the standard. Under the new impairment model, losses are recognised on an expected credit loss basis. Expected credit losses ('ECLs') are required to incorporate forward-looking information, reflecting management's view of potential future economic environments. The complexity involved requires management to develop new methodologies involving the use of significant judgements. Separately, the standard introduces new requirements around the classification and measurement of financial instruments, potentially resulting in fair value differences. In order to meet the requirements of the new standard, significant changes have also been made to systems, processes and controls with effect from 1 January 2018.	We understood and tested key controls supporting management's estimate of the transition adjustment focusing on: – model development, validation and approval to ensure compliance with IFRS 9 requirements; – review and approval of key assumptions, judgements and forward looking information prior to use in the models; – the integrity of data used as input to the models including the transfer of data between source systems and the impairment models; – review and approval of post model adjustments recorded by management; and – review and approval of the output of IFRS 9 models and related transition impacts. We noted the controls were designed and operated effectively, in all material respects. We understood and critically assessed classification and measurement decisions and the ECL models developed by the Group. This included using our credit modelling experts in our assessment of judgements and assumptions supporting the ECL requirements of the standard. We re-performed certain model calculations to confirm the risk parameter outputs and the results were appropriate. We assessed the reasonableness of forward looking information incorporated into the impairment calculations by using our experts and specialists to challenge the multiple economic scenarios chosen and the weighting applied to capture non-linear losses. We considered post-model adjustments in the context of key model and data limitations identified by management, challenged their rationale and recalculated where necessary. We tested the underlying disclosures related to the transition impact and reconciled the disclosed impact to underlying accounting records. Based on the evidence obtained, we found that the methodologies, modelled assumptions, data used within the models, resulting outputs and overlays to modelled outputs are appropriate.

Independent auditors' report to the members of Lloyds Banking Group plc continued

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and the parent company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and parent company's ability to continue as a going concern.
We are required to report if the directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

As noted in the directors' statement, the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. In drawing this conclusion the directors have considered:

– the regulatory capital position of the Group which is critical to the market maintaining confidence in the Group's ability to absorb losses that it may incur in a market stress; and

– the funding and liquidity position of the Group to be able to meet its liabilities as they fall due, including in a market stress.

As part of our audit we have concluded that the directors' use of the going concern basis is appropriate. In drawing our conclusion, we critically assessed the going concern assessment undertaken by management and approved by the Board of Directors. As part of our assessment we have:

– evaluated the appropriateness of the stress scenarios used and their impact on the Group's and parent company's capital and liquidity positions;

– evaluated the key economic and other assumptions used in both the capital and liquidity plans and the Group's operating plan; and

– substantiated the Group's and parent company's access to unencumbered collateral placed with, and liquidity facilities available from, the central bank.

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 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, the Companies Act 2006, (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

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 2017 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. *(CA06)*

In light of the knowledge and understanding of the Group and parent company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' report. *(CA06)*

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

– The directors' confirmation on page 83 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.

– The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.

– The directors' explanation on page 82 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the 'Code'); and considering whether the statements are consistent with the knowledge and understanding of the Group and parent company and their environment obtained in the course of the audit.

Other code provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the directors, on page 83, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and parent company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and parent company obtained in the course of performing our audit.
- The section of the Annual Report on page 73 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The directors' statement relating to the parent company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' remuneration

In our opinion, the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006. *(CA06)*

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 83, 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 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 parent company'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 parent company or to cease operations, or have no realistic alternative but to do so.

Use of this report

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

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 parent company, 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 parent company financial statements and the part of the Directors' remuneration report to be audited 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 21 December 1995 to audit the financial statements for the year ended 31 December 1995 and subsequent financial periods. The period of total uninterrupted engagement is 23 years, covering the years ended 31 December 1995 to 31 December 2017. The audit was tendered in 2014 and we were re-appointed with effect from 1 January 2016. There will be a mandatory rotation for the 2021 audit.

Mark Hannam (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
20 February 2018

Consolidated income statement

for the year ended 31 December

	Note	2017 £ million	2016 £ million	2015 £ million
Interest and similar income		**16,006**	16,620	17,615
Interest and similar expense		**(5,094)**	(7,346)	(6,297)
Net interest income	5	**10,912**	9,274	11,318
Fee and commission income		**2,965**	3,045	3,252
Fee and commission expense		**(1,382)**	(1,356)	(1,442)
Net fee and commission income	6	**1,583**	1,689	1,810
Net trading income	7	**11,817**	18,545	3,714
Insurance premium income	8	**7,930**	8,068	4,792
Other operating income	9	**1,995**	2,035	1,516
Other income		**23,325**	30,337	11,832
Total income		**34,237**	39,611	23,150
Insurance claims	10	**(15,578)**	(22,344)	(5,729)
Total income, net of insurance claims		**18,659**	17,267	17,421
Regulatory provisions		**(2,515)**	(2,024)	(4,837)
Other operating expenses		**(10,181)**	(10,253)	(10,550)
Total operating expenses	11	**(12,696)**	(12,277)	(15,387)
Trading surplus		**5,963**	4,990	2,034
Impairment	12	**(688)**	(752)	(390)
Profit before tax		**5,275**	4,238	1,644
Tax expense	13	**(1,728)**	(1,724)	(688)
Profit for the year		**3,547**	2,514	956

Profit attributable to ordinary shareholders		**3,042**	2,001	466
Profit attributable to other equity holders[1]		**415**	412	394
Profit attributable to equity holders		**3,457**	2,413	860
Profit attributable to non-controlling interests		**90**	101	96
Profit for the year		**3,547**	2,514	956

Basic earnings per share	14	**4.4p**	2.9p	0.8p
Diluted earnings per share	14	**4.3p**	2.9p	0.8p

1 The profit after tax attributable to other equity holders of £415 million (2016: £412 million; 2015: £394 million) is partly offset in reserves by a tax credit attributable to ordinary shareholders of £102 million (2016: £91 million; 2015: £80 million).

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

Consolidated statement of comprehensive income

for the year ended 31 December

	2017 £ million	2016 £ million	2015 £ million
Profit for the year	**3,547**	2,514	956
Other comprehensive income			
Items that will not subsequently be reclassified to profit or loss:			
Post-retirement defined benefit scheme remeasurements:			
Remeasurements before tax	**628**	(1,348)	(274)
Tax	**(146)**	320	59
	482	(1,028)	(215)
Gains and losses attributable to own credit risk:			
Gains (losses) before tax	**(55)**	–	–
Tax	**15**	–	–
	(40)	–	–
Items that may subsequently be reclassified to profit or loss:			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Adjustment on transfer from held-to-maturity portfolio	**–**	1,544	–
Change in fair value	**303**	356	(318)
Income statement transfers in respect of disposals	**(446)**	(575)	(51)
Income statement transfers in respect of impairment	**6**	173	4
Tax	**63**	(301)	(6)
	(74)	1,197	(371)
Movement in cash flow hedging reserve:			
Effective portion of changes in fair value taken to other comprehensive income	**(363)**	2,432	537
Net income statement transfers	**(651)**	(557)	(956)
Tax	**283**	(466)	7
	(731)	1,409	(412)
Currency translation differences (tax: nil)	**(32)**	(4)	(42)
Other comprehensive income for the year, net of tax	**(395)**	1,574	(1,040)
Total comprehensive income for the year	**3,152**	4,088	(84)
Total comprehensive income attributable to ordinary shareholders	**2,647**	3,575	(574)
Total comprehensive income attributable to other equity holders	**415**	412	394
Total comprehensive income attributable to equity holders	**3,062**	3,987	(180)
Total comprehensive income attributable to non-controlling interests	**90**	101	96
Total comprehensive income for the year	**3,152**	4,088	(84)

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

Consolidated balance sheet

at 31 December

	Note	2017 £ million	2016 £ million
Assets			
Cash and balances at central banks		58,521	47,452
Items in the course of collection from banks		755	706
Trading and other financial assets at fair value through profit or loss	15	162,878	151,174
Derivative financial instruments	16	25,834	36,138
Loans and receivables:			
Loans and advances to banks		6,611	26,902
Loans and advances to customers	17	472,498	457,958
Debt securities		3,643	3,397
		482,752	488,257
Available-for-sale financial assets	21	42,098	56,524
Goodwill	23	2,310	2,016
Value of in-force business	24	4,839	5,042
Other intangible assets	25	2,835	1,681
Property, plant and equipment	26	12,727	12,972
Current tax recoverable		16	28
Deferred tax assets	36	2,284	2,706
Retirement benefit assets	35	723	342
Other assets	27	13,537	12,755
Total assets		812,109	817,793

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

Equity and liabilities	Note	**2017 £ million**	2016 £ million
Liabilities			
Deposits from banks		**29,804**	16,384
Customer deposits	28	**418,124**	415,460
Items in course of transmission to banks		**584**	548
Trading and other financial liabilities at fair value through profit or loss	29	**50,877**	54,504
Derivative financial instruments	16	**26,124**	34,924
Notes in circulation		**1,313**	1,402
Debt securities in issue	30	**72,450**	76,314
Liabilities arising from insurance contracts and participating investment contracts	31	**103,413**	94,390
Liabilities arising from non-participating investment contracts	33	**15,447**	20,112
Other liabilities	34	**20,730**	29,193
Retirement benefit obligations	35	**358**	822
Current tax liabilities		**274**	226
Deferred tax liabilities	36	**–**	–
Other provisions	37	**5,546**	4,868
Subordinated liabilities	38	**17,922**	19,831
Total liabilities		**762,966**	768,978
Equity			
Share capital	39	**7,197**	7,146
Share premium account	40	**17,634**	17,622
Other reserves	41	**13,815**	14,652
Retained profits	42	**4,905**	3,600
Shareholders' equity		**43,551**	43,020
Other equity instruments	43	**5,355**	5,355
Total equity excluding non-controlling interests		**48,906**	48,375
Non-controlling interests		**237**	440
Total equity		**49,143**	48,815
Total equity and liabilities		**812,109**	817,793

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

The directors approved the consolidated financial statements on 20 February 2018.

Lord Blackwell
Chairman

António Horta-Osório
Group Chief Executive

George Culmer
Chief Financial Officer

Consolidated statement of changes in equity

for the year ended 31 December

	Attributable to equity shareholders						
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2017	24,768	14,652	3,600	43,020	5,355	440	48,815
Comprehensive income							
Profit for the year	–	–	3,457	3,457	–	90	3,547
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	482	482	–	–	482
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(74)	–	(74)	–	–	(74)
Gains and losses attributable to own credit risk, net of tax		–	(40)	(40)	–	–	(40)
Movements in cash flow hedging reserve, net of tax	–	(731)	–	(731)	–	–	(731)
Currency translation differences (tax: £nil)	–	(32)	–	(32)	–	–	(32)
Total other comprehensive income	–	(837)	442	(395)	–	–	(395)
Total comprehensive income	–	(837)	3,899	3,062	–	90	3,152
Transactions with owners							
Dividends	–	–	(2,284)	(2,284)	–	(51)	(2,335)
Distributions on other equity instruments, net of tax	–	–	(313)	(313)	–	–	(313)
Issue of ordinary shares	63	–	–	63	–	–	63
Movement in treasury shares	–	–	(411)	(411)	–	–	(411)
Value of employee services:							
Share option schemes	–	–	82	82	–	–	82
Other employee award schemes	–	–	332	332	–	–	332
Changes in non-controlling interests	–	–	–	–	–	(242)	(242)
Total transactions with owners	63	–	(2,594)	(2,531)	–	(293)	(2,824)
At 31 December 2017	24,831	13,815	4,905	43,551	5,355	237	49,143

Further details of movements in the Group's share capital, reserves and other equity instruments are provided in notes 39, 40, 41, 42 and 43.

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

	Attributable to equity shareholders						
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2015	24,427	13,216	5,692	43,335	5,355	1,213	49,903
Comprehensive income							
Profit for the year	–	–	860	860	–	96	956
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(215)	(215)	–	–	(215)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(371)	–	(371)	–	–	(371)
Movements in cash flow hedging reserve, net of tax	–	(412)	–	(412)	–	–	(412)
Currency translation differences (tax: £nil)	–	(42)	–	(42)	–	–	(42)
Total other comprehensive income	–	(825)	(215)	(1,040)	–	–	(1,040)
Total comprehensive income	–	(825)	645	(180)	–	96	(84)
Transactions with owners							
Dividends	–	–	(1,070)	(1,070)	–	(52)	(1,122)
Distributions on other equity instruments, net of tax	–	–	(314)	(314)	–	–	(314)
Redemption of preference shares	131	(131)	–	–	–	–	–
Movement in treasury shares	–	–	(816)	(816)	–	–	(816)
Value of employee services:							
Share option schemes	–	–	107	107	–	–	107
Other employee award schemes	–	–	172	172	–	–	172
Adjustment on sale of interest in TSB Banking Group plc	–	–	–	–	–	(825)	(825)
Other changes in non-controlling interests	–	–	–	–	–	(41)	(41)
Total transactions with owners	131	(131)	(1,921)	(1,921)	–	(918)	(2,839)
Balance at 31 December 2015	24,558	12,260	4,416	41,234	5,355	391	46,980
Comprehensive income							
Profit for the year	–	–	2,413	2,413	–	101	2,514
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(1,028)	(1,028)	–	–	(1,028)
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	1,197	–	1,197	–	–	1,197
Movements in cash flow hedging reserve, net of tax	–	1,409	–	1,409	–	–	1,409
Currency translation differences (tax: £nil)	–	(4)	–	(4)	–	–	(4)
Total other comprehensive income	–	2,602	(1,028)	1,574	–	–	1,574
Total comprehensive income	–	2,602	1,385	3,987	–	101	4,088
Transactions with owners							
Dividends	–	–	(2,014)	(2,014)	–	(29)	(2,043)
Distributions on other equity instruments, net of tax	–	–	(321)	(321)	–	–	(321)
Redemption of preference shares	210	(210)	–	–	–	–	–
Movement in treasury shares	–	–	(175)	(175)	–	–	(175)
Value of employee services:							
Share option schemes	–	–	141	141	–	–	141
Other employee award schemes	–	–	168	168	–	–	168
Changes in non-controlling interests	–	–	–	–	–	(23)	(23)
Total transactions with owners	210	(210)	(2,201)	(2,201)	–	(52)	(2,253)
Balance at 31 December 2016	24,768	14,652	3,600	43,020	5,355	440	48,815

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

Consolidated cash flow statement

for the year ended 31 December

	Note	2017 £ million	2016 £ million	2015 £ million
Profit before tax		**5,275**	4,238	1,644
Adjustments for:				
Change in operating assets	52(A)	**(15,492)**	(12,218)	34,700
Change in operating liabilities	52(B)	**(4,282)**	(2,659)	(11,985)
Non-cash and other items	52(C)	**12,332**	13,535	(7,808)
Tax paid		**(1,028)**	(822)	(179)
Net cash (used in) provided by operating activities		**(3,195)**	2,074	16,372
Cash flows from investing activities				
Purchase of financial assets		**(7,862)**	(4,930)	(19,354)
Proceeds from sale and maturity of financial assets		**18,675**	6,335	22,000
Purchase of fixed assets		**(3,655)**	(3,760)	(3,417)
Proceeds from sale of fixed assets		**1,444**	1,684	1,537
Acquisition of businesses, net of cash acquired	52(E)	**(1,923)**	(20)	(5)
Disposal of businesses, net of cash disposed	52(F)	**129**	5	(4,071)
Net cash provided by (used in) investing activities		**6,808**	(686)	(3,310)
Cash flows from financing activities				
Dividends paid to ordinary shareholders		**(2,284)**	(2,014)	(1,070)
Distributions on other equity instruments		**(415)**	(412)	(394)
Dividends paid to non-controlling interests		**(51)**	(29)	(52)
Interest paid on subordinated liabilities		**(1,275)**	(1,687)	(1,840)
Proceeds from issue of subordinated liabilities		**–**	1,061	338
Proceeds from issue of ordinary shares		**14**	–	–
Repayment of subordinated liabilities		**(1,008)**	(7,885)	(3,199)
Changes in non-controlling interests		**–**	(8)	(41)
Net cash used in financing activities		**(5,019)**	(10,974)	(6,258)
Effects of exchange rate changes on cash and cash equivalents		**–**	21	2
Change in cash and cash equivalents		**(1,406)**	(9,565)	6,806
Cash and cash equivalents at beginning of year		**62,388**	71,953	65,147
Cash and cash equivalents at end of year	52(D)	**60,982**	62,388	71,953

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

Notes to the consolidated financial statements

Note 1: Basis of preparation

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

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. As stated on page 82, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

With effect from 1 January 2017 the Group has elected to early adopt the provision in IFRS 9 for gains and losses attributable to changes in own credit risk on financial liabilities designated at fair value through profit or loss to be presented in other comprehensive income. The impact has been to increase profit after tax and reduce other comprehensive income by £40 million in the year ended 31 December 2017; there is no impact on total liabilities or shareholders' equity. Comparatives have not been restated.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2017 and which have not been applied in preparing these financial statements are given in note 54.

Note 2: Accounting policies

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

(A) Consolidation

The assets, liabilities and results of Group undertakings (including structured entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include subsidiaries, associates and joint ventures. Details of the Group's subsidiaries and related undertakings are given on pages 268–274.

(1) Subsidiaries

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

The Group consolidates collective investment vehicles if its beneficial ownership interests give it substantive rights to remove the external fund manager over the investment activities of the fund. Where a subsidiary of the Group is the fund manager of a collective investment vehicle, the Group considers a number of factors in determining whether it acts as principal, and therefore controls the collective investment vehicle, including: an assessment of the scope of the Group's decision making authority over the investment vehicle; the rights held by other parties including substantive removal rights without cause over the Group acting as fund manager; the remuneration to which the Group is entitled in its capacity as decision maker; and the Group's exposure to variable returns from the beneficial interest it holds in the investment vehicle. Consolidation may be appropriate in circumstances where the Group has less than a majority beneficial interest. Where a collective investment vehicle is consolidated the interests of parties other than the Group are reported in other liabilities and the movement in these interests in interest expense.

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.

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

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

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

(2) Joint ventures and associates

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

Notes to the consolidated financial statements continued

Note 2: Accounting policies continued

The Group utilises the venture capital exemption for investments where significant influence or joint control is present and the business unit operates as a venture capital business. These investments are designated at initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for by the equity method of accounting.

(B) Goodwill

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

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. At the date of disposal of a subsidiary, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal.

(C) Other intangible assets

Intangible assets which have been determined to have a finite useful life are amortised on a straight line basis over their estimated useful life as follows: up to 7 years for capitalised software; 10 to 15 years for brands and other intangibles.

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

(D) Revenue recognition

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 or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability, including early redemption fees, and related penalties; and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account.

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan once drawn. Where it is unlikely that loan commitments will be drawn, loan commitment fees are recognised over the life of the facility.

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

Revenue recognition policies specific to life insurance and general insurance business are detailed below (see (M) below); those relating to leases are set out in (J)(2) below.

(E) Financial assets and liabilities

On initial recognition, financial assets are classified into fair value through profit or loss, available-for-sale financial assets, held-to-maturity investments or loans and receivables. Financial liabilities are measured at amortised cost, except for trading liabilities and other financial liabilities designated at fair value through profit or loss on initial recognition which are held at fair value. The Group initially recognises loans and receivables, 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 they are extinguished (i.e. when the obligation is discharged), cancelled or expire.

(1) Financial instruments at fair value through profit or loss

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

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

Classified at fair value through profit and loss: Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur, except that gains and losses attributable to changes in own credit risk on financial liabilities held at fair value through profit or loss are taken directly to other comprehensive income (see note 1). Financial assets and liabilities are designated at fair value through profit or loss on acquisition in the following circumstances:

- it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on different bases. The main type of financial assets designated by the Group at fair value through profit or loss are assets backing insurance contracts and investment contracts issued by the Group's life insurance businesses. Fair value designation allows changes in the fair value of these assets to be recorded in the income statement along with the changes in the value of the associated liabilities, thereby significantly reducing the measurement inconsistency had the assets been classified as available-for-sale financial assets.
- the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, with management information also prepared on this basis.

Note 2: Accounting policies continued

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

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. Refer to note 48(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

(2) Available-for-sale financial assets

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

The Group is permitted to transfer a financial asset from the available-for-sale category to the loans and receivables category where that asset would otherwise have met the definition of loans and receivables at the time of reclassification and where there is both the intention and ability to hold that financial asset for the foreseeable future. Reclassification of a financial asset from the available-for-sale category to the held-to-maturity category is permitted when the Group has the ability and intent to hold that financial asset to maturity. Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable. Effective interest rates for financial assets reclassified to the loans and receivables and held-to-maturity categories are determined at the reclassification date. Any previous gain or loss on a transferred asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest method or until the asset becomes impaired. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest method.

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

(3) Loans and receivables

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

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

(4) 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 original carrying value of the liability and the fair value of the new equity is recognised in the 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 receivables or trading securities. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Securities 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 receivable or customer deposit.

(F) Derivative financial instruments and hedge accounting

Derivatives are classified as trading except those designated as effective hedging instruments which meet the criteria under IAS 39. 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 48(3) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

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

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

Notes to the consolidated financial statements continued

Note 2: Accounting policies continued

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

(1) Fair value hedges

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

(2) Cash flow hedges

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

(3) Net investment hedges

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

(G) Offset

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Cash collateral on exchange traded derivative transactions is presented gross unless the collateral cash flows are always settled net with the derivative cash flows. In certain situations, even though master netting agreements exist, the lack of management intention to settle on a net basis results in the financial assets and liabilities being reported gross on the balance sheet.

(H) Impairment of financial assets

(1) Assets accounted for at amortised cost

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

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

Subsequent to the recognition of an impairment loss on a financial asset or a group of financial assets, interest income continues to be recognised on an effective interest rate basis, on the asset's carrying value net of impairment provisions. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

Impairment allowances are assessed individually for financial assets that are individually significant. Impairment allowances for portfolios of smaller balance homogenous loans such as most residential mortgages, personal loans and credit card balances that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis.

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. Where the renegotiated payments of interest and principal will not recover the original carrying value of the asset, the asset continues to be reported as past due and is considered impaired. Where the renegotiated payments of interest and principal will recover the original carrying value of the asset, the loan is no longer reported as past due or impaired provided that payments are made in accordance with the revised terms. Renegotiation may lead to the loan and associated provision being derecognised and a new loan being recognised initially at fair value.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement. For both secured and unsecured retail balances, the write-off takes place only once an extensive set of collections processes has been completed, or the status of the account reaches a point where policy dictates that forbearance is no longer appropriate. For 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.

(2) Available-for-sale financial assets

The Group assesses, at each balance sheet date, whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for financial assets accounted for at amortised cost set out above, this assessment involves reviewing the current financial circumstances (including creditworthiness) and future prospects of the issuer, assessing the future cash flows expected to be realised and, in the case of equity shares, considering whether there has been a significant or prolonged decline in the fair value of the asset below its cost. If an impairment loss has been incurred, the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair

Note 2: Accounting policies continued

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

(I) Property, plant and equipment

Property, plant and equipment (other than investment property) is included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows: the shorter of 50 years and the remaining period of the lease for freehold/long and short leasehold premises; the shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease for leasehold improvements; 10 to 20 years for fixtures and furnishings; and 2 to 8 years for other equipment and motor vehicles.

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

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

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

(J) Leases

(1) As lessee

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

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

(2) As lessor

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

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

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

(K) Employee benefits

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

(1) Pension schemes

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

Scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. The Group's income statement charge includes the current service cost of providing pension benefits, past service costs, net interest expense (income), and plan administration costs that are not deducted from the return on plan assets. Past service costs, which represents the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment, are recognised when the plan amendment or curtailment occurs. Net interest expense (income) is calculated by applying the discount rate at the beginning of the period to the net defined benefit liability or asset.

Remeasurements, comprising actuarial gains and losses, the return on plan assets (excluding amounts included in net interest expense (income) and net of the cost of managing the plan assets), and the effect of changes to the asset ceiling (if applicable) are reflected immediately in the balance sheet with a charge or credit recognised in other comprehensive income in the period in which they occur. Remeasurements recognised in other comprehensive income are reflected immediately in retained profits and will not subsequently be reclassified to profit or loss.

The Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes. In assessing whether a surplus is recoverable, the Group considers its current right to obtain a refund or a reduction in future contributions and does not anticipate any future acts by other parties that could change the amount of the surplus that may ultimately be recovered.

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

Notes to the consolidated financial statements continued

Note 2: Accounting policies continued

(2) Share-based compensation

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

(L) Taxation

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it.

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

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

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

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

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

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

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

(M) Insurance

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

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

- Insurance contracts – these contracts transfer significant insurance risk and may also transfer financial risk. The Group defines significant insurance risk as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur. These contracts may or may not include discretionary participation features.
- Investment contracts containing a discretionary participation feature (participating investment contracts) – these contracts do not transfer significant insurance risk, but contain a contractual right which gives the holder the right to receive, in addition to the guaranteed benefits, further additional discretionary benefits or bonuses that are likely to be a significant proportion of the total contractual benefits and the amount and timing of which is at the discretion of the Group, within the constraints of the terms and conditions of the instrument and based upon the performance of specified assets.
- Non-participating investment contracts – these contracts do not transfer significant insurance risk or contain a discretionary participation feature.

The general insurance business issues only insurance contracts.

(1) Life insurance business

(i) Accounting for insurance and participating investment contracts

Premiums and claims

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

Liabilities

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

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

  Liabilities of the Group's with-profit funds, including guarantees and options embedded within products written by these funds, are stated at their realistic values in accordance with the Prudential Regulation Authority's realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in the unallocated surplus (see below).

Note 2: Accounting policies continued

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

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

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

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

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

Unallocated surplus

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

(ii) Accounting for non-participating investment contracts

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

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

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

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

(iii) Value of in-force business

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

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

(2) General insurance business

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included in insurance premium income, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred in the balance sheet within liabilities arising from insurance contracts and participating investment contracts on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of the contract and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

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

(3) Liability adequacy test

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

(4) Reinsurance

Contracts entered into by the Group with reinsurers under which the Group is compensated for benefits payable on one or more contracts issued by the Group are recognised as assets arising from reinsurance contracts held. Where the underlying contracts issued by the Group are classified as insurance contracts and the reinsurance contract transfers significant insurance risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as insurance contracts. Where the underlying contracts issued by the Group are classified as non-participating investment contracts and

Notes to the consolidated financial statements continued

Note 2: Accounting policies continued

the reinsurance contract transfers financial risk on those contracts to the reinsurer, the assets arising from reinsurance contracts held are classified as non-participating investment contracts.

Assets arising from reinsurance contracts held – Classified as insurance contracts

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured contracts and in accordance with the terms of each reinsurance contract and are regularly reviewed for impairment. Premiums payable for reinsurance contracts are recognised as an expense when due within insurance premium income. Changes in the reinsurance recoverable assets are recognised in the income statement through insurance claims.

Assets arising from reinsurance contracts held – Classified as non-participating investment contracts

These contracts are accounted for as financial assets whose value is contractually linked to the fair values of financial assets within the reinsurers' investment funds. Investment returns (including movements in fair value and investment income) allocated to these contracts are recognised in insurance claims. Deposits and withdrawals are not accounted for through the income statement but are accounted for directly in the balance sheet as adjustments to the assets arising from reinsurance contracts held.

(N) Foreign currency translation

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

The results and financial position of all group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows: the assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date; 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 (F)(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.

(O) 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 irrevocable undrawn loan commitments if it is probable that the facility will be drawn and result in the recognition of an asset at an amount less than the amount advanced.

(P) 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.

Where the Company or any member of the Group purchases the Company's share capital, the consideration paid is deducted from shareholders' equity as treasury shares until they are cancelled; if these shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

(Q) 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.

Note 3: Critical accounting estimates

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

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

– Allowance for impairment losses on loans and receivables (note 20);

– Valuation of assets and liabilities arising from insurance business (notes 24 and 31);

– Defined benefit pension scheme obligations (note 35);

– Recoverability of deferred tax assets (note 36);

– Payment protection insurance and other regulatory provisions (note 37); and

– Fair value of financial instruments (note 48).

Note 4: Segmental analysis

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

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

The segmental results and comparatives are presented on an underlying basis, the basis reviewed by the chief operating decision maker. The effects of the following are excluded in arriving at underlying profit:

– losses on redemption of the Enhanced Capital Notes and the volatility in the value of the embedded equity conversion feature;
– market volatility and asset sales, which includes the effects of certain asset sales, the volatility relating to the Group's own debt and hedging arrangements and that arising in the insurance businesses and insurance gross up;
– the unwind of acquisition-related fair value adjustments and the amortisation of purchased intangible assets;
– restructuring costs, comprising costs relating to the Simplification programme and the costs of implementing regulatory reform and ring-fencing, the rationalisation of the non-branch property portfolio and the integration of MBNA;
– TSB build and dual running costs and the loss relating to the TSB sale in 2015; and
– payment protection insurance and other conduct provisions.

For the purposes of the underlying income statement, operating lease depreciation (net of gains on disposal of operating lease assets) is shown as an adjustment to total income.

As part of a Group restructuring during 2017:

– the Consumer Finance division has now become part of Retail;
– the Group's UK wealth business, previously part of Retail, has been transferred to the Insurance division, now renamed Insurance and Wealth;
– the Group's International wealth business, previously part of Retail, has been transferred to the Commercial Banking division; and
– the Group's venture capital business, previously part of Commercial Banking, has been transferred to Other.

Comparatives have been restated accordingly. Following this restructuring, the Group's activities are now organised into three financial reporting segments: Retail; Commercial Banking; and Insurance and Wealth.

Retail offers a broad range of financial service products, including current accounts, savings, mortgages, motor finance and unsecured consumer lending to personal and small business customers.

Commercial Banking provides a range of products and services such as lending, transactional banking, working capital management, risk management and debt capital markets services to SMEs, corporates and financial institutions.

Insurance and Wealth offers insurance, investment and wealth management products and services.

Other includes certain assets previously reported as outside of the Group's risk appetite and income and expenditure not attributed to divisions, including the costs of certain central and head office functions and the Group's private equity business, Lloyds Development Capital.

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

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

	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Other £m	Underlying basis total £m
Year ended 31 December 2017					
Net interest income	8,706	3,086	133	395	12,320
Other income, net of insurance claims	2,217	1,761	1,846	381	6,205
Total underlying income, net of insurance claims	10,923	4,847	1,979	776	18,525
Operating lease depreciation[1]	(946)	(44)	–	(63)	(1,053)
Net income	9,977	4,803	1,979	713	17,472
Operating costs	(4,857)	(2,199)	(1,040)	(88)	(8,184)
Impairment (charge) credit	(717)	(115)	–	37	(795)
Underlying profit	4,403	2,489	939	662	8,493
External income	12,651	3,093	1,883	898	18,525
Inter-segment income	(1,728)	1,754	96	(122)	–
Segment underlying income, net of insurance claims	10,923	4,847	1,979	776	18,525
Segment external assets	349,116	174,081	151,986	136,926	812,109
Segment customer deposits	253,127	147,588	13,770	3,639	418,124
Segment external liabilities	258,423	223,543	157,824	123,176	762,966
Other segment items reflected in income statement above:					
Depreciation and amortisation	1,545	259	197	369	2,370
Increase in value of in-force business	–	–	(165)	–	(165)
Defined benefit scheme charges	137	48	25	149	359
Other segment items:					
Additions to fixed assets	2,431	107	274	843	3,655
Investments in joint ventures and associates at end of year	9	–	–	56	65

1 Net of profits on disposal of operating lease assets of £32 million.

Notes to the consolidated financial statements continued

Note 4: Segmental analysis continued

	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Other £m	Underlying basis total £m
Year ended 31 December 2016[1]					
Net interest income	8,073	2,934	80	348	11,435
Other income, net of insurance claims	2,162	1,756	1,939	208	6,065
Total underlying income, net of insurance claims	10,235	4,690	2,019	556	17,500
Operating lease depreciation[2]	(775)	(105)	–	(15)	(895)
Net income	9,460	4,585	2,019	541	16,605
Operating costs	(4,748)	(2,189)	(1,046)	(110)	(8,093)
Impairment (charge) credit	(654)	(17)	–	26	(645)
Underlying profit	4,058	2,379	973	457	7,867
External income	12,203	3,408	1,434	455	17,500
Inter-segment income	(1,968)	1,282	585	101	–
Segment underlying income, net of insurance claims	10,235	4,690	2,019	556	17,500
Segment external assets	338,939	187,405	154,782	136,667	817,793
Segment customer deposits	256,453	141,302	13,798	3,907	415,460
Segment external liabilities	264,915	230,030	160,815	113,218	768,978
Other segment items reflected in income statement above:					
Depreciation and amortisation	1,343	313	169	555	2,380
Decrease in value of in-force business	–	–	472	–	472
Defined benefit scheme charges	141	49	31	66	287
Other segment items:					
Additions to fixed assets	2,362	126	481	791	3,760
Investments in joint ventures and associates at end of year	6	–	–	53	59

1 Restated – see page 181.
2 Net of profits on disposal of operating lease assets of £58 million.

	Retail £m	Commercial Banking £m	Insurance and Wealth £m	Other £m	Underlying basis total £m
Year ended 31 December 2015[1]					
Net interest income	8,253	2,774	59	396	11,482
Other income, net of insurance claims	2,263	1,842	1,986	64	6,155
Total underlying income, net of insurance claims	10,516	4,616	2,045	460	17,637
Operating lease depreciation[2]	(720)	(30)	–	(14)	(764)
Net income	9,796	4,586	2,045	446	16,873
Operating costs	(4,958)	(2,225)	(954)	(174)	(8,311)
Impairment (charge) credit	(583)	22	(1)	(6)	(568)
TSB	–	–	–	118	118
Underlying profit	4,255	2,383	1,090	384	8,112
External income	12,217	3,364	2,155	(99)	17,637
Inter-segment income	(1,701)	1,252	(110)	559	–
Segment underlying income, net of insurance claims	10,516	4,616	2,045	460	17,637
Segment external assets	340,263	178,110	145,737	142,578	806,688
Segment customer deposits	261,646	140,675	14,477	1,528	418,326
Segment external liabilities	270,666	235,221	150,702	103,119	759,708
Other segment items reflected in income statement above:					
Depreciation and amortisation	1,247	203	124	538	2,112
Decrease in value of in-force business	–	–	(162)	–	(162)
Defined benefit scheme charges	124	32	17	142	315
Other segment items:					
Additions to fixed assets	2,133	155	343	786	3,417
Investments in joint ventures and associates at end of year	5	–	–	42	47

1 Restated – see page 181.
2 Net of profits on disposal of operating lease assets of £66 million.

Note 4: Segmental analysis continued

Reconciliation of underlying basis to statutory results

The underlying basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results. The table below reconciles the statutory results to the underlying basis.

	Lloyds Banking Group statutory £m	Removal of: Volatility and other items[1] £m	Insurance gross up[2] £m	PPI £m	Other conduct provisions £m	Underlying basis £m
Year ended 31 December 2017						
Net interest income	**10,912**	**228**	**1,180**	**–**	**–**	**12,320**
Other income, net of insurance claims	**7,747**	**(186)**	**(1,356)**	**–**	**–**	**6,205**
Total income, net of insurance claims	**18,659**	**42**	**(176)**	**–**	**–**	**18,525**
Operating lease depreciation[3]		**(1,053)**	**–**	**–**	**–**	**(1,053)**
Net income	**18,659**	**(1,011)**	**(176)**	**–**	**–**	**17,472**
Operating expenses	**(12,696)**	**1,821**	**176**	**1,650**	**865**	**(8,184)**
Impairment	**(688)**	**(107)**	**–**	**–**	**–**	**(795)**
Profit	**5,275**	**703**	**–**	**1,650**	**865**	**8,493**

	Lloyds Banking Group statutory £m	Removal of: Volatility and other items[4] £m	Insurance gross up[2] £m	PPI £m	Other conduct provisions £m	Underlying basis £m
Year ended 31 December 2016						
Net interest income	9,274	263	1,898	–	–	11,435
Other income, net of insurance claims	7,993	121	(2,110)	–	61	6,065
Total income, net of insurance claims	17,267	384	(212)	–	61	17,500
Operating lease depreciation[3]		(895)	–	–	–	(895)
Net income	17,267	(511)	(212)	–	61	16,605
Operating expenses	(12,277)	1,948	212	1,000	1,024	(8,093)
Impairment	(752)	107	–	–	–	(645)
Profit	4,238	1,544	–	1,000	1,085	7,867

	Lloyds Banking Group statutory £m	Removal of: Volatility and other items[5] £m	TSB[6] £m	Insurance gross up[2] £m	PPI £m	Other conduct provisions £m	Underlying basis £m
Year ended 31 December 2015							
Net interest income	11,318	318	(192)	38	–	–	11,482
Other income, net of insurance claims	6,103	209	(31)	(126)	–	–	6,155
Total income, net of insurance claims	17,421	527	(223)	(88)	–	–	17,637
Operating lease depreciation[3]		(764)	–	–	–	–	(764)
Net income	17,421	(237)	(223)	(88)	–	–	16,873
Operating expenses	(15,387)	2,065	86	88	4,000	837	(8,311)
Impairment	(390)	(197)	19	–	–	–	(568)
TSB	–	–	118	–	–	–	118
Profit	1,644	1,631	–	–	4,000	837	8,112

1 In the year ended 31 December 2017 this comprises the effects of asset sales (gain of £30 million); volatile items (gain of £263 million); liability management (loss of £14 million); the amortisation of purchased intangibles (£91 million); restructuring costs (£621 million, principally comprising costs relating to the Simplification programme; the rationalisation of the non-branch property portfolio, the work on implementing the ring-fencing requirements and the integration of MBNA); and the fair value unwind and other items (loss of £270 million).

2 The Group's insurance businesses' income statements include income and expenditure which are attributable to the policyholders of the Group's long-term assurance funds. These items have no impact in total upon the profit attributable to equity shareholders and, in order to provide a clearer representation of the underlying trends within the business, these items are shown net within the underlying results.

3 Net of profits on disposal of operating lease assets of £32 million (2016: £58 million; 2015: £66 million).

4 Comprises the write-off of the ECN embedded derivative and premium paid on redemption of the remaining notes in the first quarter (loss of £790 million); the effects of asset sales (gain of £217 million); volatile items (gain of £99 million); liability management (gain of £123 million); the amortisation of purchased intangibles (£340 million); restructuring costs (£622 million, principally comprising the severance related costs related to phase II of the Simplification programme); and the fair value unwind and other items (loss of £231 million).

5 Comprises market movements on the ECN embedded derivative (loss of £101 million); the effects of asset sales (gain of £54 million); volatile items (loss of £107 million); liability management (loss of £28 million); the amortisation of purchased intangibles (£342 million); restructuring costs (£170 million); TSB costs (£745 million); and the fair value unwind and other items (loss of £192 million).

6 Comprises the underlying results of TSB.

Geographical areas

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

Notes to the consolidated financial statements continued

Note 5: Net interest income

	Weighted average effective interest rate 2017 %	2016 %	2015 %	2017 £m	2016 £m	2015 £m
Interest and similar income:						
Loans and advances to customers	**3.16**	3.32	3.50	**14,712**	15,190	16,256
Loans and advances to banks	**0.40**	0.46	0.42	**271**	381	397
Debt securities held as loans and receivables	**1.29**	1.47	1.87	**43**	56	40
Interest receivable on loans and receivables	**2.81**	2.87	2.98	**15,026**	15,627	16,693
Available-for-sale financial assets	**1.96**	1.88	1.77	**980**	762	725
Held-to-maturity investments	**–**	1.44	1.49	**–**	231	197
Total interest and similar income[1]	**2.73**	2.77	2.86	**16,006**	16,620	17,615
Interest and similar expense:						
Deposits from banks, excluding liabilities under sale and repurchase transactions	**1.18**	0.65	0.41	**(80)**	(68)	(43)
Customer deposits, excluding liabilities under sale and repurchase transactions	**0.49**	0.69	0.87	**(1,722)**	(2,520)	(3,299)
Debt securities in issue[2]	**0.37**	0.94	0.69	**(266)**	(799)	(586)
Subordinated liabilities	**7.93**	8.35	8.37	**(1,481)**	(1,864)	(2,091)
Liabilities under sale and repurchase agreements	**0.58**	0.46	0.57	**(110)**	(38)	(34)
Interest payable on liabilities held at amortised cost	**0.79**	1.07	1.19	**(3,659)**	(5,289)	(6,053)
Amounts payable to unitholders in consolidated open-ended investment vehicles	**9.15**	10.85	1.16	**(1,435)**	(2,057)	(244)
Total interest and similar expense[3]	**1.06**	1.44	1.19	**(5,094)**	(7,346)	(6,297)
Net interest income				**10,912**	9,274	11,318

1 Includes £12 million (2016: £nil; 2015: £nil) of interest income on liabilities with negative interest rates.

2 The impact of the Group's hedging arrangements is included on this line; excluding this impact the weighted average effective interest rate in respect of debt securities in issue would be 2.43 per cent (2016: 2.70 per cent; 2015: 2.76 per cent).

3 Includes £50 million (2016: £51 million; 2015: £nil) of interest expense on assets with negative interest rates.

Included within interest and similar income is £179 million (2016: £205 million; 2015: £248 million) in respect of impaired financial assets. Net interest income also includes a credit of £651 million (2016: credit of £557 million; 2015: credit of £956 million) transferred from the cash flow hedging reserve (see note 41).

Note 6: Net fee and commission income

	2017 £m	2016 £m	2015 £m
Fee and commission income:			
Current accounts	**712**	752	804
Credit and debit card fees	**953**	875	918
Other	**1,300**	1,418	1,530
Total fee and commission income	**2,965**	3,045	3,252
Fee and commission expense	**(1,382)**	(1,356)	(1,442)
Net fee and commission income	**1,583**	1,689	1,810

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

Note 7: Net trading income

	2017 £m	2016 £m	2015 £m
Foreign exchange translation (losses) gains	(174)	1,363	(80)
Gains on foreign exchange trading transactions	517	542	335
Total foreign exchange	343	1,905	255
Investment property gains (losses) (note 26)	230	(83)	416
Securities and other gains (see below)	11,244	16,723	3,043
Net trading income	11,817	18,545	3,714

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

	2017 £m	2016 £m	2015 £m
Net income arising on assets held at fair value through profit or loss:			
Debt securities, loans and advances	1,122	4,771	451
Equity shares	9,862	12,534	2,384
Total net income arising on assets held at fair value through profit or loss	10,984	17,305	2,835
Net (expense) income arising on liabilities held at fair value through profit or loss – debt securities in issue	(144)	(154)	14
Total net gains arising on assets and liabilities held at fair value through profit or loss	10,840	17,151	2,849
Net gains (losses) on financial instruments held for trading	404	(428)	194
Securities and other gains	11,244	16,723	3,043

Note 8: Insurance premium income

	2017 £m	2016 £m	2015 £m
Life insurance			
Gross premiums:			
Life and pensions	6,273	5,613	3,613
Annuities	1,082	1,685	430
	7,355	7,298	4,043
Ceded reinsurance premiums	(168)	(88)	(122)
Net earned premiums	7,187	7,210	3,921
Non-life insurance			
Net earned premiums	743	858	871
Total net earned premiums	7,930	8,068	4,792

Premium income in 2015 was reduced by a charge of £1,959 million relating to the recapture by a third party insurer of a portfolio of policies previously reassured with the Group.

Note 9: Other operating income

	2017 £m	2016 £m	2015 £m
Operating lease rental income	1,344	1,225	1,165
Rental income from investment properties (note 26)	213	229	268
Gains less losses on disposal of available-for-sale financial assets (note 41)	446	575	51
Movement in value of in-force business (note 24)	(165)	472	(162)
Liability management	(14)	(598)	(28)
Share of results of joint ventures and associates	6	(1)	(3)
Other	165	133	225
Total other operating income	1,995	2,035	1,516

Notes to the consolidated financial statements continued

Note 10: Insurance claims

Insurance claims comprise:	2017 £m	2016 £m	2015 £m
Life insurance and participating investment contracts			
Claims and surrenders	**(8,898)**	(8,617)	(7,983)
Change in insurance and participating investment contracts (note 31)	**(9,067)**	(14,160)	2,898
Change in non-participating investment contracts	**2,836**	679	(438)
	(15,129)	(22,098)	(5,523)
Reinsurers' share	**35**	106	101
	(15,094)	(21,992)	(5,422)
Change in unallocated surplus	**(147)**	14	63
Total life insurance and participating investment contracts	**(15,241)**	(21,978)	(5,359)
Non-life insurance			
Total non-life insurance claims, net of reinsurance	**(337)**	(366)	(370)
Total insurance claims	**(15,578)**	(22,344)	(5,729)
Life insurance and participating investment contracts gross claims and surrenders can also be analysed as follows:			
Deaths	**(675)**	(635)	(631)
Maturities	**(1,280)**	(1,347)	(1,348)
Surrenders	**(5,674)**	(5,444)	(4,811)
Annuities	**(985)**	(949)	(902)
Other	**(284)**	(242)	(291)
Total life insurance gross claims and surrenders	**(8,898)**	(8,617)	(7,983)

Note 11: Operating expenses

	2017 £m	2016 £m	2015 £m
Staff costs:			
Salaries	**2,679**	2,750	2,808
Performance-based compensation	**473**	475	409
Social security costs	**361**	363	349
Pensions and other post-retirement benefit schemes (note 35)	**625**	555	548
Restructuring costs	**24**	241	104
Other staff costs	**448**	433	459
	4,610	4,817	4,677
Premises and equipment:			
Rent and rates	**365**	365	368
Repairs and maintenance	**231**	187	173
Other	**134**	120	174
	730	672	715
Other expenses:			
Communications and data processing	**882**	848	893
Advertising and promotion	**208**	198	253
Professional fees	**328**	265	262
UK bank levy	**231**	200	270
TSB disposal	**–**	–	665
Other	**814**	873	703
	2,463	2,384	3,046
Depreciation and amortisation:			
Depreciation of property, plant and equipment (note 26)	**1,944**	1,761	1,534
Amortisation of acquired value of in-force non-participating investment contracts (note 24)	**34**	37	41
Amortisation of other intangible assets (note 25)	**392**	582	537
	2,370	2,380	2,112
Goodwill impairment (note 23)	**8**	–	–
Total operating expenses, excluding regulatory provisions	**10,181**	10,253	10,550
Regulatory provisions:			
Payment protection insurance provision (note 37)	**1,650**	1,000	4,000
Other regulatory provisions[1] (note 37)	**865**	1,024	837
	2,515	2,024	4,837
Total operating expenses	**12,696**	12,277	15,387

1 In 2016, regulatory provisions of £61 million were charged against income.

Note 11: Operating expenses continued

Performance-based compensation

The table below analyses the Group's performance-based compensation costs between those relating to the current performance year and those relating to earlier years.

	2017 £m	2016 £m	2015 £m
Performance-based compensation expense comprises:			
Awards made in respect of the year ended 31 December	**334**	312	280
Awards made in respect of earlier years	**139**	163	129
	473	475	409
Performance-based compensation expense deferred until later years comprises:			
Awards made in respect of the year ended 31 December	**127**	123	114
Awards made in respect of earlier years	**35**	41	56
	162	164	170

Performance-based awards expensed in 2017 include cash awards amounting to £102 million (2016: £116 million; 2015: £96 million).

Average headcount

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

	2017	2016	2015
UK	**75,150**	79,606	84,922
Overseas	**794**	812	781
Total	**75,944**	80,418	85,703

Fees payable to the auditors

Fees payable to the Company's auditors by the Group are as follows:

	2017 £m	2016 £m	2015 £m
Fees payable for the audit of the Company's current year annual report	**1.5**	1.5	1.2
Fees payable for other services:			
Audit of the Company's subsidiaries pursuant to legislation	**18.6**	14.7	14.9
Other services supplied pursuant to legislation	**3.0**	3.1	2.2
Total audit fees	**23.1**	19.3	18.3
Other services – audit related fees	**1.2**	3.1	3.2
Total audit and audit related fees	**24.3**	22.4	21.5
Services relating to taxation:			
Taxation compliance services	**–**	0.2	0.2
All other taxation advisory services	**–**	0.1	0.1
	–	0.3	0.3
Other non-audit fees:			
Services relating to corporate finance transactions	**1.2**	0.1	0.2
Other services	**2.4**	1.5	2.3
Total other non-audit fees	**3.6**	1.6	2.5
Total fees payable to the Company's auditors by the Group	**27.9**	24.3	24.3

Notes to the consolidated financial statements continued

Note 11: Operating expenses continued

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

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings. Other services supplied pursuant to legislation relate primarily to the costs associated with the Sarbanes-Oxley Act audit requirements together with the cost of the audit of the Group's Form 20-F filing.

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

Services relating to taxation: Following a change in policy, the Group's auditors are not engaged to provide tax services except in exceptional circumstances and where permitted by applicable guidance.

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital transactions and other assurance and advisory services.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to assistance in transactions involving the acquisition and disposal of businesses and accounting advice.

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

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

	2017 £m	2016 £m	2015 £m
Audits of Group pension schemes	0.1	0.3	0.3
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	0.3	0.4	0.4
Reviews of the financial position of corporate and other borrowers	–	1.2	3.1
Acquisition due diligence and other work performed in respect of potential venture capital investments	0.1	1.0	1.2

Note 12: Impairment

	2017 £m	2016 £m	2015 £m
Impairment losses on loans and receivables:			
Loans and advances to customers	697	592	443
Debt securities classified as loans and receivables	(6)	–	(2)
Total impairment losses on loans and receivables (note 20)	691	592	441
Impairment of available-for-sale financial assets	6	173	4
Other credit risk provisions	(9)	(13)	(55)
Total impairment charged to the income statement	**688**	**752**	**390**

Note 13: Taxation

(A) Analysis of tax expense for the year

	2017 £m	2016 £m	2015 £m
UK corporation tax:			
Current tax on profit for the year	**(1,342)**	(1,010)	(485)
Adjustments in respect of prior years	**122**	156	(90)
	(1,220)	(854)	(575)
Foreign tax:			
Current tax on profit for the year	**(40)**	(20)	(24)
Adjustments in respect of prior years	**10**	2	27
	(30)	(18)	3
Current tax expense	**(1,250)**	(872)	(572)
Deferred tax:			
Current year	**(430)**	(758)	(212)
Adjustments in respect of prior years	**(48)**	(94)	96
Deferred tax expense	**(478)**	(852)	(116)
Tax expense	**(1,728)**	(1,724)	(688)

The income tax expense is made up as follows:

	2017 £m	2016 £m	2015 £m
Tax (expense) credit attributable to policyholders	**(82)**	(301)	3
Shareholder tax expense	**(1,646)**	(1,423)	(691)
Tax charge	**(1,728)**	(1,724)	(688)

(B) Factors affecting the tax expense for the year

The UK corporation tax rate for the year was 19.25 per cent (2016: 20 per cent; 2015: 20.25 per cent). An explanation of the relationship between tax expense and accounting profit is set out below:

	2017 £m	2016 £m	2015 £m
Profit before tax	**5,275**	4,238	1,644
UK corporation tax thereon	**(1,015)**	(848)	(333)
Impact of surcharge on banking profits	**(452)**	(266)	–
Non-deductible costs: conduct charges	**(352)**	(219)	(459)
Non-deductible costs: bank levy	**(44)**	(40)	(55)
Other non-deductible costs	**(59)**	(135)	(116)
Non-taxable income	**72**	75	162
Tax-exempt gains on disposals	**128**	19	67
Recognition of losses that arose in prior years	**–**	59	42
Remeasurement of deferred tax due to rate changes	**(9)**	(201)	(27)
Differences in overseas tax rates	**(15)**	10	(4)
Policyholder tax[1]	**(66)**	(241)	3
Adjustments in respect of prior years	**85**	64	33
Tax effect of share of results of joint ventures	**(1)**	(1)	(1)
Tax expense	**(1,728)**	(1,724)	(688)

1 In 2016 this included a £231 million write down of the deferred tax asset held within the life business, reflecting the Group's utilisation estimate which has been restricted by the current economic environment.

Notes to the consolidated financial statements continued

Note 14: Earnings per share

	2017 £m	2016 £m	2015 £m
Profit attributable to equity shareholders – basic and diluted	**3,042**	2,001	466
Tax credit on distributions to other equity holders	**102**	91	80
	3,144	2,092	546

	2017 million	2016 million	2015 million
Weighted average number of ordinary shares in issue – basic	**71,710**	71,234	71,272
Adjustment for share options and awards	**683**	790	1,068
Weighted average number of ordinary shares in issue – diluted	**72,393**	72,024	72,340
Basic earnings per share	**4.4p**	2.9p	0.8p
Diluted earnings per share	**4.3p**	2.9p	0.8p

Basic earnings per share are calculated by dividing the net profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the year, which has been calculated after deducting 57 million (2016: 140 million; 2015: 101 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares that arise in respect of share options and awards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted-average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

There were no anti-dilutive share options and awards excluded from the calculation of diluted earnings per share at 31 December 2017 (2016: weighted-average of 0.3 million; 2015: weighted-average of 1 million).

Note 15: Trading and other financial assets at fair value through profit or loss

These assets are comprised as follows:

	2017			2016		
	Trading assets £m	Other financial assets at fair value through profit or loss £m	Total £m	Trading assets £m	Other financial assets at fair value through profit or loss £m	Total £m
Loans and advances to customers	**29,976**	**–**	**29,976**	30,473	–	30,473
Loans and advances to banks	**1,614**	**–**	**1,614**	2,606	–	2,606
Debt securities:						
Government securities	**9,833**	**12,187**	**22,020**	11,828	14,904	26,732
Other public sector securities	**–**	**1,527**	**1,527**	–	1,325	1,325
Bank and building society certificates of deposit	**–**	**222**	**222**	–	244	244
Asset-backed securities:						
Mortgage-backed securities	**189**	**211**	**400**	47	660	707
Other asset-backed securities	**95**	**926**	**1,021**	69	1,469	1,538
Corporate and other debt securities	**523**	**19,467**	**19,990**	224	19,608	19,832
	10,640	**34,540**	**45,180**	12,168	38,210	50,378
Equity shares	**6**	**86,084**	**86,090**	6	67,691	67,697
Treasury and other bills	**–**	**18**	**18**	–	20	20
Total	**42,236**	**120,642**	**162,878**	45,253	105,921	151,174

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

(i) financial assets backing insurance contracts and investment contracts of £117,323 million (2016: £101,888 million) which are so designated because the related liabilities either have cash flows that are contractually based on the performance of the assets or are contracts whose measurement takes account of current market conditions and where significant measurement inconsistencies would otherwise arise. Included within these assets are investments in unconsolidated structured entities of £28,759 million (2016: £15,611 million), see note 19; and

(ii) private equity investments of £1,944 million (2016: £2,245 million) that are managed, and evaluated, on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

For amounts included above which are subject to repurchase and reverse repurchase agreements see note 51.

Note 16: Derivative financial instruments

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

	31 December 2017			31 December 2016		
	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading and other						
Exchange rate contracts:						
Spot, forwards and futures	31,716	1,023	789	38,072	1,149	1,383
Currency swaps	223,624	3,157	3,534	288,441	6,903	6,382
Options purchased	8,191	580	–	15,192	808	–
Options written	6,684	–	627	18,342	–	1,016
	270,215	4,760	4,950	360,047	8,860	8,781
Interest rate contracts:						
Interest rate swaps	2,264,834	15,791	15,364	2,160,535	19,780	18,862
Forward rate agreements	239,797	5	1	628,962	13	87
Options purchased	32,097	2,329	–	39,509	3,251	–
Options written	32,817	–	2,524	39,847	–	3,400
Futures	35,542	9	7	114,284	6	3
	2,605,087	18,134	17,896	2,983,137	23,050	22,352
Credit derivatives	4,568	77	423	8,098	381	659
Equity and other contracts	25,150	982	1,242	43,218	1,135	1,168
Total derivative assets/liabilities – trading and other	2,905,020	23,953	24,511	3,394,500	33,426	32,960
Hedging						
Derivatives designated as fair value hedges:						
Currency swaps	1,327	19	38	1,454	19	22
Interest rate swaps	109,670	1,145	407	194,416	1,462	737
	110,997	1,164	445	195,870	1,481	759
Derivatives designated as cash flow hedges:						
Interest rate swaps	549,099	597	1,053	384,182	814	1,166
Futures	73,951	–	1	53,115	–	3
Currency swaps	7,310	120	114	8,121	417	36
	630,360	717	1,168	445,418	1,231	1,205
Total derivative assets/liabilities – hedging	741,357	1,881	1,613	641,288	2,712	1,964
Total recognised derivative assets/liabilities	3,646,377	25,834	26,124	4,035,788	36,138	34,924

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 51 Credit risk.

The Group holds derivatives as part of the following strategies:

- Customer driven, where derivatives are held as part of the provision of risk management products to Group customers;
- To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value and cash flow hedge approaches as described in note 51; and
- Derivatives held in policyholder funds as permitted by the investment strategies of those funds.

Notes to the consolidated financial statements continued

Note 16: Derivative financial instruments continued

The principal derivatives used by the Group are as follows:

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

Hedged cash flows

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

2017	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**346**	**515**	**682**	**492**	**395**	**701**	**55**	**46**	**3,232**
Forecast payable cash flows	**(475)**	**(654)**	**(592)**	**(552)**	**(406)**	**(1,150)**	**(627)**	**(163)**	**(4,619)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**307**	**562**	**648**	**448**	**466**	**684**	**63**	**54**	**3,232**
Forecast payable cash flows	**(680)**	**(640)**	**(556)**	**(505)**	**(377)**	**(1,085)**	**(612)**	**(164)**	**(4,619)**

2016	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	172	198	415	372	391	1,215	102	45	2,910
Forecast payable cash flows	(565)	(722)	(692)	(599)	(429)	(1,541)	(806)	(262)	(5,616)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	211	223	418	363	472	1,070	99	54	2,910
Forecast payable cash flows	(777)	(713)	(671)	(521)	(415)	(1,477)	(787)	(255)	(5,616)

There were no transactions for which cash flow hedge accounting had to be ceased in 2016 or 2017 as a result of the highly probable cash flows no longer being expected to occur.

Note 17: Loans and advances to customers

	2017 £m	2016 £m
Agriculture, forestry and fishing	**7,461**	7,269
Energy and water supply	**1,609**	2,320
Manufacturing	**7,886**	7,285
Construction	**4,428**	4,535
Transport, distribution and hotels	**14,074**	13,320
Postal and telecommunications	**2,148**	2,564
Property companies	**30,980**	32,192
Financial, business and other services	**57,006**	49,197
Personal:		
Mortgages	**304,665**	306,682
Other	**28,757**	20,761
Lease financing	**2,094**	2,628
Hire purchase	**13,591**	11,617
Total loans and advances to customers before allowance for impairment losses	**474,699**	460,370
Allowance for impairment losses (note 20)	**(2,201)**	(2,412)
Total loans and advances to customers	**472,498**	457,958

For amounts included above which are subject to reverse repurchase agreements see note 51.

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

	2017 £m	2016 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**680**	551
Later than 1 year and not later than 5 years	**1,106**	1,618
Later than 5 years	**1,053**	1,561
	2,839	3,730
Unearned future finance income on finance leases	**(692)**	(1,038)
Rentals received in advance	**(53)**	(64)
Net investment in finance leases	**2,094**	2,628

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

	2017 £m	2016 £m
Not later than 1 year	**546**	361
Later than 1 year and not later than 5 years	**887**	1,282
Later than 5 years	**661**	985
Net investment in finance leases	**2,094**	2,628

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2016 and 2017 no contingent rentals in respect of finance leases were recognised in the income statement. There was no allowance for uncollectable finance lease receivables included in the allowance for impairment losses (2016: £nil).

Note 18: Securitisations and covered bonds

Securitisation programmes

Loans and advances to customers and debt securities classified as loans and receivables include loans securitised under the Group's securitisation programmes, the majority of which have been sold by subsidiary companies to bankruptcy remote structured entities. As the structured entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained by the subsidiary, the structured entities are consolidated fully and all of these loans are retained on the Group's balance sheet, with the related notes in issue included within debt securities in issue.

Covered bond programmes

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

The Group's principal securitisation and covered bond programmes, together with the balances of the advances subject to these arrangements and the carrying value of the notes in issue at 31 December, are listed below. The notes in issue are reported in note 30.

Notes to the consolidated financial statements continued

Note 18: Securitisations and covered bonds continued

	2017 Loans and advances securitised £m	2017 Notes in issue £m	2016 Loans and advances securitised £m	2016 Notes in issue £m
Securitisation programmes[1]				
UK residential mortgages	**21,158**	**14,105**	35,146	17,705
Commercial loans	**6,616**	**7,001**	7,395	8,179
Credit card receivables	**7,701**	**4,090**	7,610	5,723
Dutch residential mortgages	**–**	**–**	2,033	2,081
	35,475	**25,196**	52,184	33,688
Less held by the Group		**(21,536)**		(26,435)
Total securitisation programmes (note 30)		**3,660**		7,253
Covered bond programmes				
Residential mortgage-backed	**30,361**	**25,632**	33,881	30,021
Social housing loan-backed	**1,628**	**1,200**	2,087	1,200
	31,989	**26,832**	35,968	31,221
Less held by the Group		**(700)**		(700)
Total covered bond programmes (note 30)		**26,132**		30,521
Total securitisation and covered bond programmes		**29,792**		37,774

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

Cash deposits of £3,507 million (2016: £9,018 million) which support the debt securities issued by the structured entities, the term advances related to covered bonds and other legal obligations are held by the Group. Additionally, the Group had certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2017 these obligations had not been triggered; the maximum exposure under these facilities was £95 million (2016: £373 million).

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

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

The Group has not voluntarily offered to repurchase assets from any of its public securitisation programmes during 2017 (2016: none).

Note 19: Structured entities

The Group's interests in structured entities are both consolidated and unconsolidated. Detail of the Group's interests in consolidated structured entities are set out in: note 18 for securitisations and covered bond vehicles, note 35 for structured entities associated with the Group's pension schemes, and below in part (A) and (B). Details of the Group's interests in unconsolidated structured entities are included below in part (C).

(A) Asset-backed conduits

In addition to the structured entities discussed in note 18, which are used for securitisation and covered bond programmes, the Group sponsors an active asset-backed conduit, Cancara, which invests in client receivables and debt securities. The total consolidated exposure of Cancara at 31 December 2017 was £6,049 million (2016: £6,840 million), comprising £5,939 million of loans and advances (2016: £6,684 million) and £110 million of debt securities (2016: £156 million).

All lending assets and debt securities held by the Group in Cancara are restricted in use, as they are held by the collateral agent for the benefit of the commercial paper investors and the liquidity providers only. The Group provides liquidity facilities to Cancara under terms that are usual and customary for standard lending activities in the normal course of the Group's banking activities. During 2017 there have continued to be planned drawdowns on certain liquidity facilities for balance sheet management purposes, supporting the programme to provide funding alongside the proceeds of the asset-backed commercial paper issuance. The Group could be asked to provide support under the contractual terms of these arrangements including, for example, if Cancara experienced a shortfall in external funding, which may occur in the event of market disruption.

The external assets in Cancara are consolidated in the Group's financial statements.

(B) Consolidated collective investment vehicles and limited partnerships

The assets of the Insurance business held in consolidated collective investment vehicles, such as Open-Ended Investment Companies and limited partnerships, are not directly available for use by the Group. However, the Group's investment in the majority of these collective investment vehicles is readily realisable. As at 31 December 2017, the total carrying value of these consolidated collective investment vehicle assets and liabilities held by the Group was £68,124 million (2016: £75,669 million).

The Group has no contractual arrangements (such as liquidity facilities) that would require it to provide financial or other support to the consolidated collective investment vehicles; the Group has not previously provided such support and has no current intentions to provide such support.

Note 19: Structured entities continued

(C) Unconsolidated collective investment vehicles and limited partnerships

The Group's direct interests in unconsolidated structured entities comprise investments in collective investment vehicles, such as Open-Ended Investment Companies, and limited partnerships with a total carrying value of £28,759 million at 31 December 2017 (2016: £15,611 million), included within financial assets designated at fair value through profit and loss (see note 15). These investments include both those entities managed by third parties and those managed by the Group. At 31 December 2017, the total asset value of these unconsolidated structured entities, including the portion in which the Group has no interest, was £2,338 billion (2016: £1,849 billion).

The Group's maximum exposure to loss is equal to the carrying value of the investment. However, the Group's investments in these entities are primarily held to match policyholder liabilities in the Insurance division and the majority of the risk from a change in the value of the Group's investment is matched by a change in policyholder liabilities. The collective investment vehicles are primarily financed by investments from investors in the vehicles.

During the year the Group has not provided any non-contractual financial or other support to these entities and has no current intention of providing any financial or other support. There were no transfers from/to these unconsolidated collective investment vehicles and limited partnerships.

The Group considers itself the sponsor of a structured entity where it is primarily involved in the design and establishment of the structured entity; and further where the Group transfers assets to the structured entity; market products associated with the structured entity in its own name and/or provide guarantees regarding the structured entity's performance.

The Group sponsors a range of diverse investment funds and limited partnerships where it acts as the fund manager or equivalent decision maker and markets the funds under one of the Group's brands.

The Group earns fees from managing the investments of these funds. The investment management fees that the Group earned from these entities, including those in which the Group held no ownership interest at 31 December 2017, are reported in note 6.

Note 20: Allowance for impairment losses on loans and receivables

Critical accounting estimates and judgements

The allowance for impairment losses on loans and receivables is management's best estimate of losses incurred in the portfolio at the balance sheet date. In determining the required level of impairment provisions, the Group uses the output from various statistical models. Management judgement is required to assess the robustness of the outputs from these models and, where necessary, make appropriate adjustments. Impairment allowances are made up of two components, those determined individually and those determined collectively.

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

For such individually identified financial assets, a review is undertaken of the expected future cash flows which requires significant management judgement as to the amount and timing of such cash flows. Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of costs to realise, whether or not foreclosure or realisation of the collateral is probable. The determination of individual impairment allowances requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer, and the value of the security held, for which there may not be a readily accessible market. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

Collective impairment allowances are generally established for smaller balance homogenous portfolios such as the retail portfolios. For these portfolios the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. Segmentation takes into account factors such as the type of asset, industry sector, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

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

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

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics set out above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience. The collective impairment allowance is also subject to estimation uncertainty and in particular is sensitive to changes in economic and credit conditions, including the interdependency of house prices, unemployment rates, interest rates, borrowers' behaviour, and consumer bankruptcy trends. It is, however, inherently difficult to estimate how changes in one or more of these factors might impact the collective impairment allowance.

Notes to the consolidated financial statements continued

Note 20: Allowance for impairment losses on loans and receivables continued

The value of collateral supporting the Group's UK mortgage portfolio is estimated by applying changes in the house price indices to the original assessed value of the property. Given the relative size of the portfolio, this is a key variable in determining the Group's impairment charge for loans and receivables. If average house prices were ten per cent lower than those estimated at 31 December 2017, the impairment charge would increase by approximately £200 million in respect of UK mortgages.

In addition, the collective provision also includes provision for losses that have been incurred but have not been separately identified at the balance sheet date. The loans that are not currently recognised as impaired are grouped into homogenous portfolios by key risk drivers. Risk drivers for secured retail lending include the current indexed loan-to-value, previous mortgage arrears, internal cross-product delinquency data and external credit bureau data; for unsecured retail lending they include whether the account is up-to-date and, if not, the number of payments that have been missed; and for commercial lending they include factors such as observed default rates and loss given default. An assessment is made of the likelihood of assets being impaired at the balance sheet date and being identified subsequently; the length of time taken to identify that an impairment event has occurred is known as the loss emergence period. The loss emergence period is determined by local management for each portfolio and the Group has a range of loss emergence periods which are dependent upon the characteristics of the portfolios. Loss emergence periods are reviewed regularly and updated when appropriate. In general the periods used across the Group vary between one month and 12 months based on historical experience. Unsecured portfolios tend to have shorter loss emergence periods than secured portfolios. This provision is sensitive to changes in the loss emergence period. Management use a significant level of judgement when determining the collective unidentified impairment provision, including the assessment of the level of overall risk existing within particular sectors and the impact of the low interest rate environment on loss emergence periods. In the Commercial Banking division, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unidentified impairment provisions would result in an increase in the collective unidentified impairment provision of approximately £25 million (2016: £33 million).

	2017			2016		
	Loans and advances to customers £m	Debt securities £m	Total £m	Loans and advances to customers £m	Debt securities £m	Total £m
At 1 January	2,412	76	2,488	3,033	97	3,130
Exchange and other adjustments	132	–	132	69	–	69
Advances written off	(1,499)	(44)	(1,543)	(2,111)	(22)	(2,133)
Recoveries of advances written off in previous years	482	–	482	861	1	862
Unwinding of discount	(23)	–	(23)	(32)	–	(32)
Charge (release) to the income statement (note 12)	697	(6)	691	592	–	592
At 31 December	2,201	26	2,227	2,412	76	2,488

Of the total allowance in respect of loans and advances to customers, £1,772 million (2016: £1,876 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the total allowance in respect of loans and advances to customers, £1,201 million (2016: £1,208 million) was assessed on a collective basis.

Note 21: Available-for-sale financial assets

	2017 £m	2016 £m
Debt securities:		
Government securities	34,708	48,714
Bank and building society certificates of deposit	167	142
Asset-backed securities:		
Mortgage-backed securities	1,156	108
Other asset-backed securities	255	317
Corporate and other debt securities	4,615	6,030
	40,901	55,311
Equity shares	1,197	1,213
Total available-for-sale financial assets	42,098	56,524

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in note 2(H).

Note 22: Acquisition of MBNA Limited

On 1 June 2017, following the receipt of competition and regulatory approval, the Group acquired 100 per cent of the ordinary share capital of MBNA Limited (MBNA), which together with its subsidiaries undertakes a UK consumer credit card business, from FIA Jersey Holdings Limited, a wholly-owned subsidiary of Bank of America. The acquisition will enable the Group to enhance its position and offering within the UK prime credit card market. The total fair value of the purchase consideration was £2,016 million, settled in cash. The acquisition is expected to result in a significant opportunity for cost synergies and goodwill of £302 million has been recognised on the transaction. None of the goodwill recognised is deductible for tax purposes.

The table below sets out the fair value of the identifiable assets and liabilities acquired. The Group has finalised the acquisition accounting in the second half of 2017 and this has resulted in a reduction in other assets of £23 million, an increase in deferred tax assets of £4 million and an increase in goodwill of £19 million compared to the provisional amounts previously reported.

	Book value as at 1 June 2017 £m	Fair value adjustments £m	Fair value as at 1 June 2017 £m
Assets			
Loans and advances to customers	7,466	345	7,811
Available-for-sale financial assets	16	–	16
Purchased credit card relationships	–	702	702
Deferred tax assets	27	4	31
Other assets	190	322	512
Total assets	7,699	1,373	9,072
Liabilities			
Deposits from banks[1]	6,431	–	6,431
Deferred tax liabilities	3	184	187
Other liabilities	112	–	112
Other provisions	233	395	628
Total liabilities	6,779	579	7,358
Fair value of net assets acquired	920	794	1,714
Goodwill arising on acquisition			302
Total consideration			2,016

1 Upon acquisition, the funding of MBNA was assumed by Lloyds Bank plc.

At acquisition date, the contractual amount of loans and advances receivable from customers was £7,628 million. The amount expected to be collected is not materially different from the book value recognised by MBNA at 1 June 2017 (£7,466 million).

As a result of an indemnity guaranteed by Bank of America, N.A., the Group's exposure to MBNA's PPI liability is capped at £240 million. Acquisition-related costs of £21 million have been included in operating expenses for the year ended 31 December 2017.

The post-acquisition total income of MBNA, which is included in the Group statutory consolidated income statement for the year ended 31 December 2017, is £436 million. MBNA also contributed profit before tax of £146 million for the same period.

Had the acquisition date of MBNA been 1 January 2017, the Group's consolidated total income would have been £329 million higher at £34,566 million and the Group's consolidated profit before tax would have been £112 million higher at £5,387 million.

Note 23: Goodwill

	2017 £m	2016 £m
At 1 January	2,016	2,016
Acquisition of businesses (note 22)	302	–
Impairment charged to the income statement (note 11)	(8)	–
At 31 December	2,310	2,016
Cost[1]	2,664	2,362
Accumulated impairment losses	(354)	(346)
At 31 December	2,310	2,016

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

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,310 million (2016: £2,016 million), £1,836 million, or 79 per cent of the total (2016: £1,836 million, 91 per cent of the total) has been allocated to Scottish Widows in the Group's Insurance and Wealth division; £302 million, or 13 per cent of the total (2016: £nil) relates to the acquisition of MBNA (note 22) and has been allocated to Cards in the Group's Retail division; and £170 million, or 7 per cent of the total (2016: £170 million, 8 per cent of the total) to Motor Finance in the Group's Retail division.

The recoverable amount of the goodwill relating to Scottish Widows has been based on a value-in-use calculation. The calculation uses pre-tax projections of future cash flows based upon budgets and plans approved by management covering a five-year period, the related run-off of existing business in force and a discount rate of 9 per cent. The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. New business cash flows beyond the five-year period have been extrapolated using a steady 2 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

Notes to the consolidated financial statements continued

Note 23: Goodwill continued

The recoverable amount of the goodwill relating to Motor Finance has also been based on a value-in-use calculation using pre-tax cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 14 per cent. The cash flows beyond the five-year period are extrapolated using a growth rate of 0.5 per cent which does not exceed the long-term average growth rates for the markets in which Motor Finance participates. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of Motor Finance to fall below the balance sheet carrying value.

The goodwill relating to the acquisition of MBNA has been allocated to the Group's Cards business as the Cards business is expected to benefit from the synergies of the acquisition. The recoverable amount of this goodwill has been based on a value-in-use calculation using pre-tax cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 14 per cent. The cash flows beyond the five year period are extrapolated using a growth rate of 0.5 per cent which does not exceed the long-term average growth rates for the markets in which Cards participates. Management believes that any reasonably possible change in the key assumptions above would not cause the recoverable amount of the Cards business to fall below the balance sheet carrying value.

Note 24: Value of in-force business

Critical accounting estimates and judgements

The value of in-force business asset represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. The valuation of this asset requires assumptions to be made about future economic and operating conditions which are inherently uncertain and changes could significantly affect the value attributed to this asset. The methodology used to value this asset and the key assumptions that have been made in determining the carrying value of the value of in-force business asset at 31 December 2017 are set out below.

Key assumptions

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

Economic assumptions

Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. In practice, to achieve the same result, where the cash flows are either independent of or move linearly with market movements, a method has been applied known as the 'certainty equivalent' approach whereby it is assumed that all assets earn a risk-free rate and all cash flows are discounted at a risk-free rate. The certainty equivalent approach covers all investment assets relating to insurance and participating investment contracts, other than the annuity business (where an illiquidity premium is included, see below).

A market-consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date. Further information on options and guarantees can be found in note 31.

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds and illiquid loan assets. The value of the in-force business asset for UK annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of corporate bond holdings and relevant illiquid loan assets. In determining the market premium for illiquidity, a range of inputs are considered which reflect actual asset allocation and relevant observable market data. The illiquidity premium is estimated to be 114 basis points at 31 December 2017 (2016: 138 basis points).

The risk-free rate is derived from the relevant swap curve with a deduction for credit risk.

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

	2017 %	2016 %
Risk-free rate (value of in-force non-annuity business)[1]	**0.00 to 4.20**	0.00 to 4.20
Risk-free rate (value of in-force annuity business)[1]	**1.14 to 5.34**	1.38 to 5.58
Risk-free rate (financial options and guarantees)[1]	**0.00 to 4.20**	0.00 to 4.20
Retail price inflation	**3.43**	3.50
Expense inflation	**3.67**	3.73

1 All risk-free rates are quoted as the range of rates implied by the relevant forward swap curve.

Non-market risk

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

Non-economic assumptions

Future mortality, morbidity, expenses, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. Further information on these assumptions is given in note 31 and the effect of changes in key assumptions is given in note 32.

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

	2017 £m	2016 £m
Acquired value of in-force non-participating investment contracts	**306**	340
Value of in-force insurance and participating investment contracts	**4,533**	4,702
Total value of in-force business	**4,839**	5,042

Note 24: Value of in-force business continued

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

	2017 £m	2016 £m
At 1 January	340	377
Amortisation taken to income statement (note 11)	(34)	(37)
At 31 December	**306**	340

The acquired value of in-force non-participating investment contracts includes £185 million (2016: £206 million) in relation to OEIC business.

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

	2017 £m	2016 £m
At 1 January	4,702	4,219
Exchange and other adjustments	(4)	11
Movements in the year:		
New business	348	428
Existing business:		
Expected return	(318)	(210)
Experience variances	(226)	(137)
Assumption changes	(238)	127
Economic variance	269	264
Movement in the value of in-force business taken to income statement (note 9)	(165)	472
At 31 December	**4,533**	4,702

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

Note 25: Other intangible assets

	Brands £m	Core deposit intangible £m	Purchased credit card relationships £m	Customer-related intangibles £m	Capitalised software enhancements £m	Total £m
Cost:						
At 1 January 2016	596	2,770	315	538	1,814	6,033
Additions	–	–	–	–	463	463
Disposals	–	–	–	–	(110)	(110)
At 31 December 2016	596	2,770	315	538	2,167	6,386
Acquisition of businesses (note 22)	–	–	702	–	–	702
Additions	–	–	–	–	850	850
Disposals	–	–	–	–	(77)	(77)
At 31 December 2017	**596**	**2,770**	**1,017**	**538**	**2,940**	**7,861**
Accumulated amortisation:						
At 1 January 2016	149	2,460	309	472	805	4,195
Charge for the year	22	297	2	27	234	582
Disposals	–	–	–	–	(72)	(72)
At 31 December 2016	171	2,757	311	499	967	4,705
Charge for the year	22	13	44	20	293	392
Disposals	–	–	–	–	(71)	(71)
At 31 December 2017	**193**	**2,770**	**355**	**519**	**1,189**	**5,026**
Balance sheet amount at 31 December 2017	**403**	**–**	**662**	**19**	**1,751**	**2,835**
Balance sheet amount at 31 December 2016	425	13	4	39	1,200	1,681

Included within brands above are assets of £380 million (31 December 2016: £380 million) that have been determined to have indefinite useful lives and are not amortised. These brands use the Bank of Scotland name which has been in existence for over 300 years. These brands are well established financial services brands and there are no indications that they should not have an indefinite useful life.

The additional £702 million of purchased credit card relationships in the year ended 31 December 2017 have arisen from the acquisition of MBNA (see note 22) and represent the benefit of recurring income generated from the portfolio of credit cards purchased.

Notes to the consolidated financial statements continued

Note 26: Property, plant and equipment

	Investment properties £m	Premises £m	Equipment £m	Operating lease assets £m	Total £m
Cost or valuation:					
At 1 January 2016	4,361	2,589	5,266	5,023	17,239
Exchange and other adjustments	13	2	6	112	133
Additions	–	59	806	2,088	2,953
Expenditure on investment properties (see below)	344	–	–	–	344
Change in fair value of investment properties (note 7)	(83)	–	–	–	(83)
Disposals	(871)	(100)	(113)	(1,017)	(2,101)
At 31 December 2016	3,764	2,550	5,965	6,206	18,485
Exchange and other adjustments	**–**	**(37)**	**–**	**(44)**	**(81)**
Acquisition of businesses (note 22)	**–**	**3**	**3**	**–**	**6**
Additions	**–**	**70**	**382**	**2,262**	**2,714**
Expenditure on investment properties (see below)	**209**	**–**	**–**	**–**	**209**
Change in fair value of investment properties (note 7)	**230**	**–**	**–**	**–**	**230**
Disposals	**(504)**	**(795)**	**(1,282)**	**(1,896)**	**(4,477)**
At 31 December 2017	**3,699**	**1,791**	**5,068**	**6,528**	**17,086**
Accumulated depreciation and impairment:					
At 1 January 2016	–	1,247	2,096	917	4,260
Exchange and other adjustments	–	(1)	(8)	49	40
Depreciation charge for the year	–	136	672	953	1,761
Disposals	–	(49)	(89)	(410)	(548)
At 31 December 2016	–	1,333	2,671	1,509	5,513
Exchange and other adjustments	**–**	**(8)**	**(9)**	**(34)**	**(51)**
Depreciation charge for the year	**–**	**125**	**734**	**1,085**	**1,944**
Disposals	**–**	**(722)**	**(1,271)**	**(1,054)**	**(3,047)**
At 31 December 2017	**–**	**728**	**2,125**	**1,506**	**4,359**
Balance sheet amount at 31 December 2017	**3,699**	**1,063**	**2,943**	**5,022**	**12,727**
Balance sheet amount at 31 December 2016	3,764	1,217	3,294	4,697	12,972

Expenditure on investment properties is comprised as follows:

	2017 £m	2016 £m
Acquisitions of new properties	**82**	251
Additional expenditure on existing properties	**127**	93
	209	344

Rental income of £213 million (2016: £229 million) and direct operating expenses arising from properties that generate rental income of £24 million (2016: £26 million) have been recognised in the income statement.

Capital expenditure in respect of investment properties which had been contracted for but not recognised in the financial statements was £21 million (2016: £65 million).

The table above analyses movements in investment properties, all of which are categorised as level 3. See note 48 for details of levels in the fair value hierarchy.

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

	2017 £m	2016 £m
Receivable within 1 year	**1,301**	1,120
1 to 5 years	**1,419**	1,373
Over 5 years	**128**	347
Total future minimum rentals receivable	**2,848**	2,840

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2016 and 2017 no contingent rentals in respect of operating leases were recognised in the income statement.

Total future minimum sub-lease income of £71 million at 31 December 2017 (£109 million at 31 December 2016) is expected to be received under non-cancellable sub-leases of the Group's premises.

Note 27: Other assets

	2017 £m	2016 £m
Assets arising from reinsurance contracts held (notes 31 and 33)	**602**	714
Deferred acquisition and origination costs	**104**	81
Settlement balances	**720**	700
Corporate pension asset	**7,786**	6,645
Investments in joint ventures and associates	**65**	59
Other assets and prepayments	**4,260**	4,556
Total other assets	**13,537**	12,755

Note 28: Customer deposits

	2017 £m	2016 £m
Non-interest bearing current accounts	**70,444**	61,804
Interest bearing current accounts	**95,889**	90,978
Savings and investment accounts	**196,966**	208,227
Liabilities in respect of securities sold under repurchase agreements	**2,638**	2,462
Other customer deposits	**52,187**	51,989
Customer deposits	**418,124**	415,460

For amounts included above which are subject to repurchase agreements, see note 51.

Included in the amounts reported above are deposits of £220,855 million (2016: £219,106 million) which are protected under the UK Financial Services Compensation Scheme.

Note 29: Trading and other financial liabilities at fair value through profit or loss

	2017 £m	2016 £m
Liabilities held at fair value through profit or loss	**7,815**	9,425
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	**41,378**	42,067
Other deposits	**381**	530
Short positions in securities	**1,303**	2,482
	43,062	45,079
Trading and other financial liabilities at fair value through profit or loss	**50,877**	54,504

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

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2017 was £14,224 million, which was £6,412 million higher than the balance sheet carrying value (2016: £16,079 million, which was £6,656 million higher than the balance sheet carrying value). At 31 December 2017 there was a cumulative £147 million increase in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of Lloyds Bank plc, the issuing entity within the Group. Of the cumulative amount an increase of £52 million arose in 2017 and an increase of £28 million arose in 2016.

For the fair value of collateral pledged in respect of repurchase agreements see note 51.

Note 30: Debt securities in issue

	2017 £m	2016 £m
Medium-term notes issued	**29,418**	27,182
Covered bonds (note 18)	**26,132**	30,521
Certificates of deposit issued	**9,999**	8,077
Securitisation notes (note 18)	**3,660**	7,253
Commercial paper	**3,241**	3,281
Total debt securities in issue	**72,450**	76,314

Notes to the consolidated financial statements continued

Note 31: Liabilities arising from insurance contracts and participating investment contracts

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

	2017			2016		
	Gross £m	Reinsurance[1] £m	Net £m	Gross £m	Reinsurance[1] £m	Net £m
Life insurance (see (1) below):						
Insurance contracts	89,157	(563)	88,594	79,793	(671)	79,122
Participating investment contracts	13,673	–	13,673	13,984	–	13,984
	102,830	(563)	102,267	93,777	(671)	93,106
Non-life insurance contracts (see (2) below):						
Unearned premiums	358	(13)	345	404	(14)	390
Claims outstanding	225	–	225	209	–	209
	583	(13)	570	613	(14)	599
Total	103,413	(576)	102,837	94,390	(685)	93,705

1 Reinsurance balances are reported within other assets (note 27).

(1) Life insurance

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

	Insurance contracts £m	Participating investment contracts £m	Gross £m	Reinsurance £m	Net £m
At 1 January 2016	66,122	13,460	79,582	(629)	78,953
New business	4,422	28	4,450	(5)	4,445
Changes in existing business	9,214	496	9,710	(37)	9,673
Change in liabilities charged to the income statement (note 10)	13,636	524	14,160	(42)	14,118
Exchange and other adjustments	35	–	35	–	35
At 31 December 2016	79,793	13,984	93,777	(671)	93,106
New business	4,154	43	4,197	(21)	4,176
Changes in existing business	5,224	(354)	4,870	129	4,999
Change in liabilities charged to the income statement (note 10)	9,378	(311)	9,067	108	9,175
Exchange and other adjustments	(14)	–	(14)	–	(14)
At 31 December 2017	89,157	13,673	102,830	(563)	102,267

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

	2017			2016		
	With-profit fund £m	Non-profit fund £m	Total £m	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	8,946	80,211	89,157	9,147	70,646	79,793
Participating investment contracts	8,481	5,192	13,673	8,860	5,124	13,984
Total	17,427	85,403	102,830	18,007	75,770	93,777

With-profit fund realistic liabilities

(i) Business description

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

(ii) Method of calculation of liabilities

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

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

Note 31: Liabilities arising from insurance contracts and participating investment contracts continued

(iii) Assumptions

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

Investment returns and discount rates

With-profit fund liabilities are valued on a market-consistent basis, achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The with-profit fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as the spot yield derived from the relevant swap curve, adjusted for credit risk. Further information on significant options and guarantees is given below.

Guaranteed annuity option take-up rates

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

Investment volatility

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

Mortality

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

Lapse rates (persistency)

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

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

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

(iv) Options and guarantees within the With-Profit Funds

The most significant options and guarantees provided from within the With-Profit Funds are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies.

For those policies written in Scottish Widows pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up, within the With-Profit Fund originally held in Scottish Widows plc and subsequently transferred into Scottish Widows Limited, called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2017 of £2.8 billion (2016: £2.7 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

As noted above, the liabilities of the With-Profit Funds are valued using a market-consistent stochastic simulation model which places a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are risk-free yield and investment volatility.

Non-profit fund liabilities

(i) Business description

The Group principally writes the following types of life insurance contracts within its non-profit funds. Shareholder profits on these types of business arise from management fees and other policy charges.

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

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

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

(ii) Method of calculation of liabilities

The non-profit fund liabilities are determined on the basis of recognised actuarial methods and involve estimating future policy cash flows over the duration of the in-force book of policies, and discounting the cash flows back to the valuation date allowing for probabilities of occurrence.

(iii) Assumptions

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

Notes to the consolidated financial statements continued

Note 31: Liabilities arising from insurance contracts and participating investment contracts continued

Interest rates

The rates of interest used are determined by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

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

Mortality and morbidity

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

Lapse rates (persistency)

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

Maintenance expenses

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

Key changes in assumptions

A detailed review of the Group's assumptions in 2017 resulted in the following key impacts on profit before tax:

- Change in persistency assumptions (£237 million decrease).
- Change in the assumption in respect of current and future mortality and morbidity rates (£289 million increase).
- Change in expenses assumptions (£142 million decrease).

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

(iv) Options and guarantees outside the With-Profit Funds

A number of typical guarantees are provided outside the With-Profit Funds such as guaranteed payments on death (e.g. term assurance) or guaranteed income for life (e.g. annuities). In addition, certain personal pension policyholders in Scottish Widows, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £35 million (2016: £82 million) in respect of those guarantees.

(2) Non-life insurance

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

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

	2017 £m	2016 £m
Provisions for unearned premiums		
Gross provision at 1 January	404	461
Increase in the year	724	827
Release in the year	(770)	(884)
Change in provision for unearned premiums charged to income statement	(46)	(57)
Gross provision at 31 December	358	404
Reinsurers' share	(13)	(14)
Net provision at 31 December	345	390

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

	2017 £m	2016 £m
Claims outstanding		
Gross claims outstanding at 1 January	209	251
Cash paid for claims settled in the year	(321)	(408)
Increase/(decrease) in liabilities charged to the income statement [1]	337	366
	16	(42)
Gross claims outstanding at 31 December	225	209
Reinsurers' share	–	–
Net claims outstanding at 31 December	225	209
Notified claims	174	122
Incurred but not reported	51	87
Net claims outstanding at 31 December	225	209

1 Of which an increase of £350 million (2016: £363 million) was in respect of current year claims and a decrease of £13 million (2016: an increase of £3 million) was in respect of prior year claims.

Note 32: Life insurance sensitivity analysis

Critical accounting estimates and judgements

Elements of the valuations of liabilities arising from insurance contracts and participating investment contracts require assumptions to be made about future investment returns, future mortality rates and future policyholder behaviour and are subject to significant management judgement and estimation uncertainty. The methodology used to value these liabilities and the key assumptions that have been made in determining their carrying value are set out in note 31.

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

		2017		2016	
	Change in variable	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
Non-annuitant mortality and morbidity[1]	5% reduction	23	19	25	21
Annuitant mortality[2]	5% reduction	(221)	(184)	(287)	(238)
Lapse rates[3]	10% reduction	75	62	48	40
Future maintenance and investment expenses[4]	10% reduction	289	240	318	264
Risk-free rate[5]	0.25% reduction	(40)	(33)	(74)	(62)
Guaranteed annuity option take up[6]	5% addition	(6)	(5)	(12)	(10)
Equity investment volatility[7]	1% addition	(7)	(6)	(10)	(8)
Widening of credit default spreads on corporate bonds[8]	0.25% addition	(235)	(195)	(200)	(166)
Increase in illiquidity premia[9]	0.10% addition	145	120	152	126

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

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

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

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

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

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

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

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

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

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

Note 33: Liabilities arising from non-participating investment contracts

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

	2017 £m	2016 £m
At 1 January	20,112	22,777
New business	608	560
Changes in existing business	(5,273)	(3,225)
At 31 December	**15,447**	**20,112**

The balances above are shown gross of reinsurance. As at 31 December 2017, related reinsurance balances were £26 million (2016: £29 million); reinsurance balances are reported within other assets (note 27). Liabilities arising from non-participating investment contracts are categorised as level 2. See note 48 for details of levels in the fair value hierarchy.

Note 34: Other liabilities

	2017 £m	2016 £m
Settlement balances	501	706
Unitholders' interest in Open Ended Investment Companies	14,480	22,947
Unallocated surplus within insurance businesses	390	243
Other creditors and accruals	5,359	5,297
Total other liabilities	**20,730**	**29,193**

Notes to the consolidated financial statements continued

Note 35: Retirement benefit obligations

	2017 £m	2016 £m	2015 £m
Charge to the income statement			
Defined benefit pension schemes	362	279	307
Other post-retirement benefit schemes	7	8	8
Total defined benefit schemes	369	287	315
Defined contribution pension schemes	256	268	233
Total charge to the income statement (note 11)	625	555	548

	2017 £m	2016 £m
Amounts recognised in the balance sheet		
Retirement benefit assets	723	342
Retirement benefit obligations	(358)	(822)
Total amounts recognised in the balance sheet	365	(480)

The total amount recognised in the balance sheet relates to:

	2017 £m	2016 £m
Defined benefit pension schemes	509	(244)
Other post-retirement benefit schemes	(144)	(236)
Total amounts recognised in the balance sheet	365	(480)

Pension schemes

Defined benefit schemes

Critical accounting estimates and judgements

The accounting valuation of the Group's defined benefit pension schemes' liabilities requires management to make a number of assumptions. The key areas of estimation uncertainty are the discount rate applied to future cash flows and the expected lifetime of the schemes' members. The discount rate is required to be set with reference to market yields at the end of the reporting period on high quality corporate bonds in the currency and with a term consistent with the defined benefit pension schemes' obligations. The average duration of the schemes' obligations is approximately 19 years. The market for bonds with a similar duration is illiquid and, as a result, significant management judgement is required to determine an appropriate yield curve on which to base the discount rate. The cost of the benefits payable by the schemes will also depend upon the life expectancy of the members. The Group considers latest market practice and actual experience in determining the appropriate assumptions for both current mortality expectations and the rate of future mortality improvement. It is uncertain whether this rate of improvement will be sustained going forward and, as a result, actual experience may differ from current expectations. The effect on the net accounting surplus or deficit and on the pension charge in the Group's income statement of changes to the principal actuarial assumptions is set out in (iii) below.

(i) Characteristics of and risks associated with the Group's schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas. All significant schemes are based in the UK, with the three most significant being the defined benefit sections of the Lloyds Bank Pension Schemes No's 1 and 2 and the HBOS Final Salary Pension Scheme. At 31 December 2017, these schemes represented 95 per cent of the Group's total gross defined benefit pension assets (2016: 94 per cent). These schemes provide retirement benefits calculated as a percentage of final pensionable salary depending upon the length of service; the minimum retirement age under the rules of the schemes at 31 December 2017 is generally 55 although certain categories of member are deemed to have a contractual right to retire at 50.

The Group operates a number of funded and unfunded pension arrangements, the majority, including the three most significant schemes, are funded schemes in the UK. All these schemes are operated as separate legal entities under trust law by the trustees and are in compliance with the Pensions Act 2004. The responsibility for the governance of the Group's funded defined benefit pension schemes lies with the Pension Trustees. All of the Group's funded UK defined benefit pension schemes are managed by a Trustee Board (the Trustee) whose role is to ensure that their Scheme is administered in accordance with the Scheme rules and relevant legislation, and to safeguard the assets in the best interests of all members and beneficiaries. The Trustee is solely responsible for setting investment policy and for agreeing funding requirements with the employer through the funding valuation process. The Board of Trustees must be composed of representatives of the Company and plan participants in accordance with the Scheme's regulations.

A valuation to determine the funding status of each scheme is carried out at least every three years, whereby scheme assets are measured at market value and liabilities (technical provisions) are measured using prudent assumptions. If a deficit is identified a recovery plan is agreed between the Group and the scheme Trustee and sent to the Pensions Regulator for review. The Group has not provided for these deficit contributions as the future economic benefits arising from these contributions are expected to be available to the Group. The Group's overseas defined benefit pension schemes are subject to local regulatory arrangements.

The most recent triennial funding valuation of the Group's three main schemes, based on the position as at 31 December 2016, is substantially complete and the terms have been agreed in principle with the trustees. The valuation shows an aggregate funding deficit of £7.3 billion (a funding level of 85.6 per cent) compared to a £5.2 billion deficit (a funding level of 85.9 per cent) for the previous valuation as at 30 June 2014. In the light of this funding deficit, and in contemplation of the changes the Group expects to make as a result of its Structural Reform Programme, the Group has agreed in principle a recovery plan with the trustees. Under the plan, deficit contributions of £412 million are payable during 2018, rising to £618 million in 2019, £798 million in 2020, £1,287 million in 2021 and £1,305 million per annum from 2022 to 2024. Contributions in the later years will be subject to review and renegotiation at subsequent funding valuations. The next funding valuation is due to be completed by March 2021 with an effective date of 31 December 2019. The deficit contributions are in addition to the regular contributions to meet of benefits accruing over the year. The Group currently expects to pay contributions of approximately £750 million to its defined benefit schemes in 2018.

During 2009, the Group made one-off contributions to the Lloyds Bank Pension Scheme No 1 and Lloyds Bank Pension Scheme No 2 in the form of interests in limited liability partnerships for each of the two schemes which hold assets to provide security for the Group's obligations to the two schemes. At 31 December 2017, the limited liability partnerships held assets of approximately £5.5 billion. The limited liability partnerships are consolidated fully in the Group's balance sheet.

Note 35: Retirement benefit obligations continued

The Group has also established three private limited companies which hold assets to provide security for the Group's obligations to the HBOS Final Salary Pension Scheme, a section of the Lloyds Bank Pension Scheme No 1 and the Lloyds Bank Offshore Pension Scheme. At 31 December 2017 these held assets of approximately £4.8 billion in aggregate. The private limited companies are consolidated fully in the Group's balance sheet. The terms of these arrangements require the Group to maintain assets in these vehicles to agreed minimum values in order to secure obligations owed to the relevant Group pension schemes. The Group has satisfied this requirement during 2017.

The last funding valuations of other Group schemes were carried out on a number of different dates. In order to report the position under IAS 19 as at 31 December 2017 the most recent valuation results for all schemes have been updated by qualified independent actuaries. The main differences between the funding and IAS 19 valuations are different and more prudent approach to setting the discount rate and more conservative longevity assumptions used in the funding valuations.

(ii) Amounts in the financial statements

	2017 £m	2016 £m
Amount included in the balance sheet		
Present value of funded obligations	**(44,384)**	(45,822)
Fair value of scheme assets	**44,893**	45,578
Net amount recognised in the balance sheet	**509**	(244)

	2017 £m	2016 £m
Net amount recognised in the balance sheet		
At 1 January	**(244)**	736
Net defined benefit pension charge	**(362)**	(279)
Actuarial (losses) gains on defined benefit obligation	**(731)**	(8,770)
Return on plan assets	**1,267**	7,455
Employer contributions	**580**	623
Exchange and other adjustments	**(1)**	(9)
At 31 December	**509**	(244)

	2017 £m	2016 £m
Movements in the defined benefit obligation		
At 1 January	**(45,822)**	(36,903)
Current service cost	**(295)**	(257)
Interest expense	**(1,241)**	(1,401)
Remeasurements:		
Actuarial gains – experience	**(347)**	535
Actuarial gains (losses) – demographic assumptions	**1,084**	195
Actuarial (losses) gains – financial assumptions	**(1,468)**	(9,500)
Benefits paid	**3,714**	1,580
Past service cost	**(14)**	(20)
Curtailments	**(10)**	–
Settlements	**15**	12
Exchange and other adjustments	**–**	(63)
At 31 December	**(44,384)**	(45,822)

	2017 £m	2016 £m
Analysis of the defined benefit obligation:		
Active members	**(7,947)**	(9,903)
Deferred members	**(15,823)**	(16,934)
Pensioners	**(19,014)**	(17,476)
Dependants	**(1,600)**	(1,509)
	(44,384)	(45,822)

Notes to the consolidated financial statements continued

Note 35: Retirement benefit obligations continued

	2017 £m	2016 £m
Changes in the fair value of scheme assets		
At 1 January	**45,578**	37,639
Return on plan assets excluding amounts included in interest income	**1,267**	7,455
Interest income	**1,242**	1,441
Employer contributions	**580**	623
Benefits paid	**(3,714)**	(1,580)
Settlements	**(18)**	(18)
Administrative costs paid	**(41)**	(36)
Exchange and other adjustments	**(1)**	54
At 31 December	**44,893**	45,578

Composition of scheme assets:

	2017			2016		
	Quoted £m	Unquoted £m	Total £m	Quoted £m	Unquoted £m	Total £m
Equity instruments	**846**	**5**	**851**	1,114	–	1,114
Debt instruments[1]:						
Fixed interest government bonds	**5,344**	**–**	**5,344**	5,797	–	5,797
Index-linked government bonds	**17,439**	**–**	**17,439**	14,359	–	14,359
Corporate and other debt securities	**6,903**	**–**	**6,903**	7,464	–	7,464
Asset-backed securities	**121**	**–**	**121**	99	–	99
	29,807	**–**	**29,807**	27,719	–	27,719
Property	**–**	**544**	**544**	–	497	497
Pooled investment vehicles	**3,937**	**13,443**	**17,380**	3,577	12,845	16,422
Money market instruments, cash, derivatives and other assets and liabilities	**1,501**	**(5,190)**	**(3,689)**	1,462	(1,636)	(174)
At 31 December	**36,091**	**8,802**	**44,893**	33,872	11,706	45,578

1 Of the total debt instruments, £27,732 million (31 December 2016: £25,219 million) were investment grade (credit ratings equal to or better than 'BBB').

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

The pension schemes' pooled investment vehicles comprise:

	2017 £m	2016 £m
Equity funds	**2,669**	2,883
Hedge and mutual funds	**2,377**	2,350
Liquidity funds	**2,877**	484
Bond and debt funds	**1,830**	3,383
Other	**7,627**	7,322
At 31 December	**17,380**	16,422

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

	2017 £m	2016 £m	2015 £m
Current service cost	**295**	257	302
Net interest amount	**(1)**	(40)	(43)
Past service credits and curtailments	**10**	–	–
Settlements	**3**	6	6
Past service cost – plan amendments	**14**	20	12
Plan administration costs incurred during the year	**41**	36	30
Total defined benefit pension expense	**362**	279	307

Note 35: Retirement benefit obligations continued

Assumptions

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

	2017 %	2016 %
Discount rate	**2.59**	2.76
Rate of inflation:		
Retail Prices Index	**3.20**	3.23
Consumer Price Index	**2.15**	2.18
Rate of salary increases	**0.00**	0.00
Weighted-average rate of increase for pensions in payment	**2.73**	2.74
	2017 Years	2016 Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.9**	28.1
Women	**29.5**	30.3
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.9**	29.3
Women	**30.7**	31.7

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 at 31 December 2017 is assumed to live for, on average, 27.9 years for a male and 29.5 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years' time at age 60.

(iii) Amount timing and uncertainty of future cash flows

Risk exposure of the defined benefit schemes

Whilst the Group is not exposed to any unusual, entity specific or scheme specific risks in its defined benefit pension schemes, it is exposed to a number of significant risks, detailed below:

Inflation rate risk: the majority of the plans' benefit obligations are linked to inflation both in deferment and once in payment. Higher inflation will lead to higher liabilities although this will be partially offset by holdings of inflation-linked gilts and, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation.

Interest rate risk: The defined benefit obligation is determined using a discount rate derived from yields on AA-rated corporate bonds. A decrease in corporate bond yields will increase plan liabilities although this will be partially offset by an increase in the value of bond holdings.

Longevity risk: The majority of the schemes obligations are to provide benefits for the life of the members so increases in life expectancy will result in an increase in the plans' liabilities.

Investment risk: Scheme assets are invested in a diversified portfolio of debt securities, equities and other return-seeking assets. If the assets underperform the discount rate used to calculate the defined benefit obligation, it will reduce the surplus or increase the deficit. Volatility in asset values and the discount rate will lead to volatility in the net pension liability on the Group's balance sheet and in other comprehensive income. To a lesser extent this will also lead to volatility in the pension expense in the Group's income statement.

The ultimate cost of the defined benefit obligations to the Group will depend upon actual future events rather than the assumptions made. The assumptions made are unlikely to be borne out in practice and as such the cost may be higher or lower than expected.

Sensitivity analysis

The effect of reasonably possible changes in key assumptions on the value of scheme liabilities and the resulting pension charge in the Group's income statement and on the net defined benefit pension scheme liability, for the Group's three most significant schemes, is set out below. The sensitivities provided assume that all other assumptions and the value of the schemes' assets remain unchanged, and are not intended to represent changes that are at the extremes of possibility. The calculations are approximate in nature and full detailed calculations could lead to a different result. It is unlikely that isolated changes to individual assumptions will be experienced in practice. Due to the correlation of assumptions, aggregating the effects of these isolated changes may not be a reasonable estimate of the actual effect of simultaneous changes in multiple assumptions.

Notes to the consolidated financial statements continued

Note 35: Retirement benefit obligations continued

	Effect of reasonably possible alternative assumptions			
	Increase (decrease) in the income statement charge		Increase (decrease) in the net defined benefit pension scheme liability	
	2017 £m	2016 £m	2017 £m	2016 £m
Inflation (including pension increases):[1]				
Increase of 0.1 per cent	**16**	19	**472**	491
Decrease of 0.1 per cent	**(15)**	(14)	**(453)**	(458)
Discount rate:[2]				
Increase of 0.1 per cent	**(28)**	(30)	**(773)**	(821)
Decrease of 0.1 per cent	**26**	30	**794**	847
Expected life expectancy of members:				
Increase of one year	**44**	42	**1,404**	1,213
Decrease of one year	**(41)**	(37)	**(1,357)**	(1,178)

1 At 31 December 2017, the assumed rate of RPI inflation is 3.20 per cent and CPI inflation 2.15 per cent (2016: RPI 3.23 per cent and CPI 2.18 per cent).

2 At 31 December 2017, the assumed discount rate is 2.59 per cent (2016: 2.76 per cent).

Sensitivity analysis method and assumptions

The sensitivity analysis above reflects the impact on the Group's three most significant schemes which account for over 90 per cent of the Group's defined benefit obligations. Whilst differences in the underlying liability profiles for the remainder of the Group's pension arrangements mean they may exhibit slightly different sensitivities to variations in these assumptions, the sensitivities provided above are indicative of the impact across the Group as a whole.

The inflation assumption sensitivity applies to both the assumed rate of increase in the Consumer Prices Index (CPI) and the Retail Prices Index (RPI), and include the impact on the rate of increases to pensions, both before and after retirement. These pension increases are linked to inflation (either CPI or RPI) subject to certain minimum and maximum limits.

The sensitivity analysis (including the inflation sensitivity) does not include the impact of any change in the rate of salary increases as pensionable salaries have been frozen since 2 April 2014.

The life expectancy assumption has been applied by allowing for an increase/decrease in life expectation from age 60 of one year, based upon the approximate weighted average age for each scheme. Whilst this is an approximate approach and will not give the same result as a one year increase in life expectancy at every age, it provides an appropriate indication of the potential impact on the schemes from changes in life expectancy.

There was no change in the methods and assumptions used in preparing the sensitivity analysis from the prior year.

Asset-liability matching strategies

The main schemes' assets are invested in a diversified portfolio, consisting primarily of debt securities. The investment strategy is not static and will evolve to reflect the structure of liabilities within the schemes. Specific asset-liability matching strategies for each pension plan are independently determined by the responsible governance body for each scheme and in consultation with the employer.

A significant goal of the asset-liability matching strategies adopted by Group schemes is to reduce volatility caused by changes in market expectations of interest rates and inflation. In the main schemes, this is achieved by investing scheme assets in bonds, primarily fixed interest gilts and index linked gilts, and by entering into interest rate and inflation swap arrangements. These investments are structured to take into account the profile of scheme liabilities, and actively managed to reflect both changing market conditions and changes to the liability profile.

At 31 December 2017 the asset-liability matching strategy mitigated 98 per cent of the liability sensitivity to interest rate movements and 102 per cent of the liability sensitivity to inflation movements. Much of the residual interest rate sensitivity is mitigated through holdings of corporate and other debt securities.

Maturity profile of defined benefit obligation

The following table provides information on the weighted average duration of the defined benefit pension obligations and the distribution and timing of benefit payments:

	2017 Years	2016 Years
Duration of the defined benefit obligation	**19**	20
	2017 £m	2016 £m
Maturity analysis of benefits expected to be paid		
Benefits expected to be paid within 12 months	**1,174**	1,639
Benefits expected to be paid between 1 and 2 years	**1,235**	1,180
Benefits expected to be paid between 2 and 5 years	**4,089**	3,971
Benefits expected to be paid between 5 and 10 years	**8,082**	8,030
Benefits expected to be paid between 10 and 15 years	**9,360**	9,453
Benefits expected to be paid between 15 and 25 years	**19,044**	20,268
Benefits expected to be paid between 25 and 35 years	**16,735**	18,831
Benefits expected to be paid between 35 and 45 years	**11,156**	13,589
Benefits expected to be paid in more than 45 years	**5,219**	7,809

Note 35: Retirement benefit obligations continued

Maturity analysis method and assumptions

The projected benefit payments are based on the assumptions underlying the assessment of the obligations, including allowance for expected future inflation. They are shown in their undiscounted form and therefore appear large relative to the discounted assessment of the defined benefit obligations recognised in the Group's balance sheet. They are in respect of benefits that have been accrued prior to the respective year-end date only and make no allowance for any benefits that may have been accrued subsequently.

Defined contribution schemes

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally Your Tomorrow and the defined contribution sections of the Lloyds Bank Pension Scheme No. 1.

During the year ended 31 December 2017 the charge to the income statement in respect of defined contribution schemes was £256 million (2016: £268 million; 2015: £233 million), representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

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

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2017 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.81 per cent (2016: 6.84 per cent).

Movements in the other post-retirement benefits obligation:

	2017 £m	2016 £m
At 1 January	**(236)**	(200)
Actuarial (loss) gain	**92**	(33)
Insurance premiums paid	**7**	7
Charge for the year	**(7)**	(8)
Exchange and other adjustments	**–**	(2)
At 31 December	**(144)**	(236)

Note 36: Deferred tax

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

Statutory position	**2017 £m**	2016 £m
Deferred tax assets	**2,284**	2,706
Deferred tax liabilities	**–**	–
Asset at 31 December	**2,284**	2,706

Tax disclosure	**2017 £m**	2016 £m
Deferred tax assets	**4,989**	5,634
Deferred tax liabilities	**(2,705)**	(2,928)
Asset at 31 December	**2,284**	2,706

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

The UK corporation tax rate will reduce from 19 per cent to 17 per cent on 1 April 2020. The Group measures its deferred tax assets and liabilities at the value expected to be recoverable or payable in future periods, and re-measures them at each reporting date based on the most recent estimates of utilisation or settlement, including the impact of bank surcharge where appropriate. The deferred tax impact of this re-measurement in 2017 is a charge of £9 million in the income statement and a credit of £22 million in other comprehensive income.

Notes to the consolidated financial statements continued

Note 36: Deferred tax continued

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

Deferred tax assets	Tax losses £m	Property, plant and equipment £m	Pension liabilities £m	Provisions £m	Share-based payments £m	Other temporary differences £m	Total £m
At 1 January 2016	4,890	1,089	102	28	91	395	6,595
(Charge) credit to the income statement	(592)	(120)	(1,981)	12	(17)	(357)	(3,055)
(Charge) credit to other comprehensive income	–	–	2,107	–	–	–	2,107
Other (charge) credit to equity	–	–	–	–	(13)	–	(13)
At 31 December 2016	4,298	969	228	40	61	38	5,634
(Charge) credit to the income statement	**(264)**	**(226)**	**(287)**	**(7)**	**7**	**(28)**	**(805)**
(Charge) credit to other comprehensive income	**–**	**–**	**149**	**25**	**–**	**–**	**174**
Other (charge) credit to equity	**–**	**–**	**–**	**–**	**(17)**	**–**	**(17)**
Impact of acquisitions and disposals	**–**	**–**	**–**	**–**	**–**	**3**	**3**
At 31 December 2017	**4,034**	**743**	**90**	**58**	**51**	**13**	**4,989**

Deferred tax liabilities	Long-term assurance business £m	Acquisition fair value £m	Pension assets £m	Derivatives £m	Available-for-sale asset revaluation £m	Other temporary differences £m	Total £m
At 1 January 2016	(641)	(891)	(174)	(395)	(11)	(506)	(2,618)
(Charge) credit to the income statement	(273)	93	1,876	232	23	252	2,203
(Charge) credit to other comprehensive income	–	–	(1,787)	(466)	(246)	–	(2,499)
Exchange and other adjustments	–	–	–	(14)	–	–	(14)
At 31 December 2016	(914)	(798)	(85)	(643)	(234)	(254)	(2,928)
(Charge) credit to the income statement	**115**	**76**	**199**	**(139)**	**(40)**	**116**	**327**
(Charge) credit to other comprehensive income	**–**	**–**	**(295)**	**283**	**67**	**–**	**55**
Impact of acquisitions and disposals	**–**	**(157)**	**–**	**–**	**–**	**(2)**	**(159)**
At 31 December 2017	**(799)**	**(879)**	**(181)**	**(499)**	**(207)**	**(140)**	**(2,705)**

Critical accounting estimates and judgments

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

The Group has recognised a deferred tax asset of £4,034 million (2016: £4,298 million) in respect of UK trading losses carried forward. Substantially all of these losses have arisen in Bank of Scotland plc and Lloyds Bank plc, and they will be utilised as taxable profits arise in those legal entities in future periods.

The Group's expectations as to the level of future taxable profits take into account the Group's long-term financial and strategic plans, and anticipated future tax-adjusting items. In making this assessment, account is taken of business plans, the Board-approved operating plan and the expected future economic outlook as set out in the strategic report, as well as the risks associated with future regulatory change.

Under current law there is no expiry date for UK trading losses not yet utilised, although (since Finance Act 2016) banking losses that arose before 1 April 2015 can only be used against 25 per cent of taxable profits arising after 1 April 2016, and they cannot be used to reduce the surcharge on banking profits. This restriction in utilisation means that the value of the deferred tax asset is only expected to be fully recovered by 2034.

Note 36: Deferred tax continued

Deferred tax not recognised

No deferred tax has been recognised in respect of the future tax benefit of expenses of the life assurance business carried forward. The deferred tax asset not recognised in respect of these expenses is approximately £470 million (2016: £636 million). These expenses can be carried forward indefinitely.

Deferred tax assets of approximately £76 million (2016: £92 million) have not been recognised in respect of £404 million of UK tax losses and other temporary differences which can only be used to offset future capital gains. UK capital losses can be carried forward indefinitely.

In addition, no deferred tax asset is recognised in respect of unrelieved foreign tax credits of £46 million (2016: £46 million), as there are no expected future taxable profits against which the credits can be utilised. These credits can be carried forward indefinitely.

No deferred tax has been recognised in respect of foreign trade losses where it is not more likely than not that we will be able to utilise them in future periods. Of the asset not recognised, £35 million (2016: £63 million) relates to losses that will expire if not used within 20 years, and £56 million (2016: £56 million) relates to losses with no expiry date.

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

Note 37: Other provisions

Critical accounting estimates and judgements

At 31 December 2017, the Group carried provisions of £4,070 million (2016: £3,597 million) against the cost of making redress payments to customers and the related administration costs in connection with historical regulatory breaches, principally the mis-selling of payment protection insurance (2017: £2,778 million; 2016: £2,258 million).

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

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

	Provisions for commitments £m	Payment protection insurance £m	Other regulatory provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2017	56	2,258	1,339	51	1,164	4,868
Exchange and other adjustments	(26)	–	16	9	139	138
Acquisition of businesses (note 22)	9	527	–	–	92	628
Provisions applied	–	(1,657)	(928)	(23)	(252)	(2,860)
Charge for the year	(9)	1,650	865	19	247	2,772
At 31 December 2017	**30**	**2,778**	**1,292**	**56**	**1,390**	**5,546**

Provisions for commitments

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

Payment protection insurance (excluding MBNA)

The Group increased the provision for PPI costs by a further £1,650 million in 2017, of which £600 million was in the fourth quarter, bringing the total amount provided to £18,675 million. The remaining provision is consistent with an average of 11,000 complaints per week (previously 9,000) through to the industry deadline of August 2019, in line with the average experience over the last nine months.

The higher volume of complaints received has been driven by increased claims management company (CMC) marketing activity and the Financial Conduct Authority (FCA) advertising campaign.

At 31 December 2017, a provision of £2,438 million remained unutilised relating to complaints and associated administration costs. Total cash payments were £1,470 million during the year to 31 December 2017.

Sensitivities

The Group estimates that it has sold approximately 16 million PPI policies since 2000. These include policies that were not mis-sold and those that have been successfully claimed upon. Since the commencement of the PPI redress programme in 2011 the Group estimates that it has contacted, settled or provided for approximately 53 per cent of the policies sold since 2000.

The total amount provided for PPI represents the Group's best estimate of the likely future cost. However a number of risks and uncertainties remain in particular with respect to future volumes. The cost could differ from the Group's estimates and the assumptions underpinning them, and could result in a further provision being required. There is significant uncertainty around the impact of the regulatory changes, FCA media campaign and Claims Management Company and customer activity.

For every additional 1,000 reactive complaints per week above 11,000 on average through to the industry deadline of August 2019, the Group would expect an additional charge of £200 million.

Notes to the consolidated financial statements continued

Note 37: Other provisions continued

Payment protection insurance (MBNA)

With regard to MBNA, as announced in December 2016, the Group's exposure is capped at £240 million already provided for, through an indemnity received from Bank of America.

Other provisions for legal actions and regulatory matters

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Group also receives complaints in connection with its past conduct and claims brought by or on behalf of current and former employees, customers, investors and other third parties and is subject to legal proceedings and other legal actions. Where significant, provisions are held against the costs expected to be incurred in relation to these matters and matters arising from related internal reviews. During the year ended 31 December 2017 the Group charged a further £865 million in respect of legal actions and other regulatory matters, the unutilised balance at 31 December 2017 was £1,292 million (31 December 2016: £1,339 million). The most significant items are as follows.

Arrears handling related activities

The Group has provided an additional £245 million (bringing the total provided to date to £642 million), for the costs of identifying and rectifying certain arrears management fees and activities. Following a review of the Group's arrears handling activities, the Group has put in place a number of actions to improve further its handling of customers in these areas and has made good progress in reimbursing mortgage arrears fees to the 590,000 impacted customers.

Packaged bank accounts

In 2017 the Group provided an additional £245 million in respect of complaints relating to alleged mis-selling of packaged bank accounts raising the total amount provided to £750 million. A number of risks and uncertainties remain in particular with respect to future volumes.

Customer claims in relation to insurance branch business in Germany

The Group continues to receive claims in Germany from customers relating to policies issued by Clerical Medical Investment Group Limited (subsequently renamed Scottish Widows Limited). The German industry-wide issue regarding notification of contractual 'cooling off' periods continued to lead to an increasing number of claims in 2016 and 2017. Up to 31 December 2016 the Group had provided a total of £639 million and no further amounts have been provided to 31 December 2017. The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will be known only once all relevant claims have been resolved.

HBOS Reading – customer review

The Group is undertaking a review into a number of customer cases from the former HBOS Impaired Assets Office based in Reading. This review follows the conclusion of a criminal trial in which a number of individuals, including two former HBOS employees, were convicted of conspiracy to corrupt, fraudulent trading and associated money laundering offences which occurred prior to the acquisition of HBOS by the Group in 2009. The Group has provided £100 million in the year to 31 December 2017 and is in the process of paying compensation to the victims of the fraud for economic losses as well as ex-gratia payments and awards for distress and inconvenience. The review is ongoing and at 12 February 2018, the Group had made offers to 57 customers, which represents more than 80 per cent of the customers in review.

Vacant leasehold property

Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income, compared to the head rent, and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on a biannual basis and will normally run off over the period of under-recovery of the leases concerned, currently averaging 5 years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Other

Following the sale of TSB Banking Group plc in 2015, the Group raised a provision of £665 million in relation to the Transitional Service Agreement entered into between Lloyds Bank plc and TSB and the contribution to be provided to TSB in moving to alternative IT provision; £622 million of this provision remained unutilised at 31 December 2017.

Provisions are made for staff and other costs related to Group restructuring initiatives at the point at which the Group becomes irrevocably committed to the expenditure. At 31 December 2017 provisions of £104 million (31 December 2016: £239 million) were held.

Other provisions also includes those arising in the normal course of business, whether from certain customer rectifications or provisions for dilapidation and refurbishment of properties. Provisions also include a matter arising out of the insolvency of a third party insurer, which remains exposed to asbestos and pollution claims in the US. The ultimate cost and timing of payments are uncertain. The provision held of £32 million at 31 December 2017 represents management's current best estimate of the cost after having regard to actuarial estimates of future losses.

Note 38: Subordinated liabilities

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

	Preference shares £m	Preferred securities £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2017	**864**	**4,134**	**599**	**14,234**	**19,831**
Issued during the year	–	–	–	–	–
Repurchases and redemptions during the year[1]	–	(237)	–	(771)	(1,008)
Foreign exchange movements	(43)	(221)	(34)	(487)	(785)
Other movements (all non-cash)	(8)	14	–	(122)	(116)
At 31 December 2017	**813**	**3,690**	**565**	**12,854**	**17,922**

1 The repurchases and redemptions resulted in cash outflows of £1,008 million.

Repurchases and redemptions during the year	
Preferred securities	**£m**
7.627% Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities	**163**
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	**74**
	237
Dated subordinated liabilities	**£m**
Subordinated Callable Notes 2017	**771**
	771

There were no repurchases of preference shares or undated subordinated liabilities during the year.

	Preference shares £m	Preferred securities £m	Undated subordinated liabilities £m	Enhanced capital notes £m	Dated subordinated liabilities £m	Total £m
At 1 January 2016	980	3,748	965	3,610	14,009	23,312
Issued during the year[1]	–	–	–	–	1,061	1,061
Tender offers and redemptions[2]	–	–	–	(3,568)	–	(3,568)
Other repurchases and redemptions during the year[2]	(319)	(182)	(475)	–	(3,070)	(4,046)
Foreign exchange movements	127	511	166	93	1,854	2,751
Other movements (all non-cash)	76	57	(57)	(135)	380	321
At 31 December 2016	864	4,134	599	–	14,234	19,831

Other repurchases and redemptions	
Preference shares	£m
6.267% Non-Cumulative Callable Fixed to Floating Rate Preference shares callable 2016	319
Preferred securities	£m
4.939% Non-voting Non-cumulative Perpetual Preferred Securities	32
7.286% Perpetual Regulatory Tier One Securities (Series A)	150
	182
Undated subordinated liabilities	£m
7.5% Undated Subordinated Step-up Notes	5
4.25% Subordinated Undated Instruments	7
Floating Rate Primary Capital Notes	108
Primary Capital Undated Floating Rate Notes[3]	353
5.125% Undated subordinated Step-up Notes callable 2016	2
	475
Dated subordinated liabilities	£m
Subordinated Fixed to Fixed Rate Notes 2021 callable 2016[4]	2,359
Callable Floating Rate Subordinated Notes 2016	329
Subordinated Callable Notes 2016	382
	3,070

1 4.65% Subordinated Fixed Rate Notes 2026 (US$1,500 million).

2 In total, the tender offers, repurchases and redemptions resulted from cash outflows of £7,885 million.

3 Comprising Series 1 (£101 million), Series 2 (£142 million), Series 3 (£110 million).

4 Comprising notes with the following coupon rates: 13% (£244 million), 10.125% (£233 million), 11.875% (£960 million), 10.75% (£466 million), 9.875% (£456 million).

Notes to the consolidated financial statements continued

Note 38: Subordinated liabilities continued

These securities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preference shares and preferred securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of holders of the dated subordinated liabilities. The subordination of the dated Enhanced Capital Notes (ECNs) ranked equally with that of the dated subordinated liabilities. The Group has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2017 (2016: none).

Note 39: Share capital

(1) Authorised share capital

As permitted by the Companies Act 2006, the Company removed references to authorised share capital from its articles of association at the annual general meeting on 5 June 2009. This change took effect from 1 October 2009.

(2) Issued and fully paid share capital

	2017 Number of shares	2016 Number of shares	2015 Number of shares	2017 £m	2016 £m	2015 £m
Ordinary shares of 10p (formerly 25p) each						
At 1 January	**71,373,735,357**	71,373,735,357	71,373,735,357	**7,138**	7,138	7,138
Issued under employee share schemes	**518,293,181**	–	–	**51**	–	–
Redesignation of limited voting ordinary shares (see below)	**80,921,051**	–	–	**8**	–	–
At 31 December	**71,972,949,589**	71,373,735,357	71,373,735,357	**7,197**	7,138	7,138
Limited voting ordinary shares of 10p (formerly 25p) each						
At 1 January	**80,921,051**	80,921,051	80,921,051	**8**	8	8
Redesignation to ordinary shares (see below)	**(80,921,051)**	–	–	**(8)**	–	–
At 31 December	**–**	80,921,051	80,921,051	**–**	8	8
Total issued share capital				**7,197**	7,146	7,146

Share issuances

No shares were issued in 2015 or 2016; in 2017, 518 million shares were issued in respect of employee share schemes.

(3) Share capital and control

There are no restrictions on the transfer of shares in the Company 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);

– where directors and certain employees of the Company require the approval of the Company to deal in the Company's shares; and

– pursuant to the rules of some of the Company's employee share plans where certain restrictions may apply while the shares are subject to the plans.

Where, under an employee share plan operated by the Company, participants are the beneficial owners of shares but not the registered owners, the voting rights are normally exercised by the registered owner at the direction of the participant. Outstanding awards and options would normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions at that time.

In addition, the Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

Information regarding significant direct or indirect holdings of shares in the Company can be found on page 82.

The directors have authority to allot and issue ordinary and preference shares and to make market purchases of ordinary and preference shares as granted at the annual general meeting on 11 May 2017. The authority to issue shares and the authority to make market purchases of shares will expire at the next annual general meeting. Shareholders will be asked, at the annual general meeting, to give similar authorities.

Subject to any rights or restrictions attached to any shares, on a show of hands at a general meeting of the Company every holder of shares present in person or by proxy and entitled to vote has one vote and on a poll every member present and entitled to vote has one vote for every share held.

Further details regarding voting at the annual general meeting can be found in the notes to the notice of the annual general meeting.

Ordinary shares

The holders of ordinary shares, who held 100 per cent of the total ordinary share capital at 31 December 2017, are entitled to receive the Company'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 Company's articles of association) and on a winding up may share in the assets of the Company.

Limited voting ordinary shares

At the annual general meeting on 11 May 2017, the Company's shareholders approved the redesignation of the 80,921,051 limited voting ordinary shares held by the Lloyds Bank Foundations as ordinary shares of 10 pence each. The redesignation took effect on 1 July 2017 and the redesignated shares now rank equally with the existing issued ordinary shares of the Company.

The Company has entered into deeds of covenant with the Foundations under the terms of which the Company makes annual donations. The deeds of covenant in effect as at 31 December 2017 provide that such annual donations will cease in certain circumstances, including the Company providing nine years' notice. Such notice has been given to the Lloyds TSB Foundation for Scotland.

Preference shares

The Company has in issue various classes of preference shares which are all classified as liabilities under IFRS which are included in note 38.

Note 40: Share premium account

	2017 £m	2016 £m	2015 £m
At 1 January	**17,622**	17,412	17,281
Issued under employee share schemes	**12**	–	–
Redemption of preference shares[1]	**–**	210	131
At 31 December	**17,634**	17,622	17,412

1 During the year ended 31 December 2016, the Company redeemed all of its outstanding 6.267% Non-cumulative Fixed to Floating Rate Callable US Dollar Preference Shares at their combined sterling equivalent par value of £210 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £210 million was transferred from the distributable merger reserve to the share premium account (2015: £131 million in respect of the redemption of the outstanding 6.0884% Non-cumulative Fixed to Floating Rate Preference Shares and 5.92% Non-cumulative Fixed to Floating Rate Preference Shares).

Note 41: Other reserves

	2017 £m	2016 £m	2015 £m
Other reserves comprise:			
Merger reserve	**7,766**	7,766	7,976
Capital redemption reserve	**4,115**	4,115	4,115
Revaluation reserve in respect of available-for-sale financial assets	**685**	759	(438)
Cash flow hedging reserve	**1,405**	2,136	727
Foreign currency translation reserve	**(156)**	(124)	(120)
At 31 December	**13,815**	14,652	12,260

The merger reserve primarily comprises the premium on shares issued on 13 January 2009 under the placing and open offer and shares issued on 16 January 2009 on the acquisition of HBOS plc.

The capital redemption reserve represents transfers from distributable reserve in accordance with companies' legislation upon the redemption of ordinary and preference share capital.

The revaluation reserve in respect of available-for-sale financial assets represents the cumulative after tax unrealised change in the fair value of financial assets classified as available-for-sale since initial recognition; in the case of available-for-sale financial assets obtained on acquisitions of businesses, since the date of acquisition; and in the case of transferred assets that were previously held at amortised cost, by reference to that amortised cost.

The cash flow hedging reserve represents the cumulative after tax gains and losses on effective cash flow hedging instruments that will be reclassified to the income statement in the periods in which the hedged item affects profit or loss.

The foreign currency translation reserve represents the cumulative after-tax gains and losses on the translation of foreign operations and exchange differences arising on financial instruments designated as hedges of the Group's net investment in foreign operations.

	2017 £m	2016 £m	2015 £m
Merger reserve			
At 1 January	**7,766**	7,976	8,107
Redemption of preference shares (note 40)	**–**	(210)	(131)
At 31 December	**7,766**	7,766	7,976

Notes to the consolidated financial statements continued

Note 41: Other reserves continued

Movements in other reserves were as follows:

	2017 £m	2016 £m	2015 £m
Revaluation reserve in respect of available-for-sale financial assets			
At 1 January	**759**	(438)	(67)
Adjustment on transfer from held-to-maturity portfolio	**–**	1,544	–
Deferred tax	**–**	(417)	–
	–	1,127	–
Change in fair value of available-for-sale financial assets	**303**	356	(318)
Deferred tax	**(26)**	(25)	(18)
Current tax	**(4)**	(3)	2
	273	328	(334)
Income statement transfers:			
Disposals (note 9)	**(446)**	(575)	(51)
Deferred tax	**93**	196	3
Current tax	**–**	(52)	(1)
	(353)	(431)	(49)
Impairment	**6**	173	4
Deferred tax	**–**	–	8
	6	173	12
At 31 December	**685**	759	(438)

	2017 £m	2016 £m	2015 £m
Cash flow hedging reserve			
At 1 January	**2,136**	727	1,139
Change in fair value of hedging derivatives	**(363)**	2,432	537
Deferred tax	**121**	(610)	(186)
	(242)	1,822	351
Income statement transfers (note 5)	**(651)**	(557)	(956)
Deferred tax	**162**	144	193
	(489)	(413)	(763)
At 31 December	**1,405**	2,136	727

	2017 £m	2016 £m	2015 £m
Foreign currency translation reserve			
At 1 January	**(124)**	(120)	(78)
Currency translation differences arising in the year	**(21)**	(110)	(59)
Foreign currency gains on net investment hedges (tax: £nil)	**(11)**	106	17
At 31 December	**(156)**	(124)	(120)

Note 42: Retained profits

	2017 £m	2016 £m	2015 £m
At 1 January	3,600	4,416	5,692
Profit for the year	3,457	2,413	860
Dividends paid[1]	(2,284)	(2,014)	(1,070)
Distributions on other equity instruments (net of tax)	(313)	(321)	(314)
Post-retirement defined benefit scheme remeasurements	482	(1,028)	(215)
Gains and losses attributable to own credit risk (net of tax)[2]	(40)	–	–
Movement in treasury shares	(411)	(175)	(816)
Value of employee services:			
Share option schemes	82	141	107
Other employee award schemes	332	168	172
At 31 December	4,905	3,600	4,416

1 Net of a credit in respect of unclaimed dividends written-back in accordance with the Company's Articles of Association.

2 During 2017 the Group derecognised, on redemption, financial liabilities on which cumulative fair value movements relating to own credit of £3 million (net of tax) had been recognised directly in retained profits.

Retained profits are stated after deducting £611 million (2016: £495 million; 2015: £740 million) representing 861 million (2016: 730 million; 2015: 943 million) treasury shares held.

The payment of dividends by subsidiaries and the ability of members of the Group to lend money to other members of the Group may be subject to regulatory or legal restrictions, the availability of reserves and the financial and operating performance of the entity. Details of such restrictions and the methods adopted by the Group to manage the capital of its subsidiaries are provided under Capital Risk on page 139.

Note 43: Other equity instruments

	2017 £m	2016 £m	2015 £m
At 1 January and 31 December	5,355	5,355	5,355

The AT1 securities are Fixed Rate Resetting Perpetual Subordinated Contingent Convertible 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 Lloyds Banking Group plc of (a) unsubordinated creditors, (b) claims which are, or are expressed to be, subordinated to the claims of unsubordinated creditors of Lloyds Banking Group plc but not further or otherwise or (c) whose claims are, or are expressed to be, junior to the claims of other creditors of Lloyds Banking Group, whether subordinated or unsubordinated, other than those whose claims rank, or are expressed to rank, pari passu with, or junior to, the claims of the holders of the AT1 Securities in a winding-up occurring prior to the Conversion Trigger.

– The securities bear a fixed rate of interest until the first call date. After the initial call date, in the event that they are not redeemed, the AT1 securities will bear interest at rates fixed periodically in advance for five year periods based on market rates.

– Interest on the securities will be due and payable only at the sole discretion of Lloyds Banking Group plc, and Lloyds Banking Group plc 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 Lloyds Banking Group plc, in whole at the first call date, or on any fifth anniversary after the first call date. In addition, the AT1 securities are repayable, at the option of Lloyds Banking Group plc, in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the PRA.

– The securities convert into ordinary shares of Lloyds Banking Group plc, at a pre-determined price, should the fully loaded Common Equity Tier 1 ratio of the Group fall below 7.0 per cent.

Notes to the consolidated financial statements continued

Note 44: Dividends on ordinary shares

The directors have recommended a final dividend, which is subject to approval by the shareholders at the Annual General Meeting, of 2.05 pence per share (2016: 1.7 pence per share; 2015: 1.5 pence per share) representing a total dividend of £1,475 million (2016: £1,212 million; 2015: £1,070 million), which will be paid on 29 May 2018. At 31 December 2016 the directors also recommended a special dividend of 0.5 pence per share (2015: 0.5 pence per share) representing a total dividend of £356 million (2015: £357 million). The financial statements do not reflect recommended dividends.

Dividends paid during the year were as follows:

	2017 pence per share	2016 pence per share	2015 pence per share	2017 £m	2016 £m	2015 £m
Recommended by directors at previous year end:						
Final dividend	**1.70**	1.50	0.75	**1,212**	1,070	535
Special dividend	**0.50**	0.50	–	**356**	357	–
Interim dividend paid in the year	**1.00**	0.85	0.75	**720**	607	535
	3.20	2.85	1.50	**2,288**	2,034	1,070

The cash cost of the dividends paid in the year was £2,284 million (2016: £2,014 million; 2015: £1,070 million), net of a credit in respect of unclaimed dividends written-back in accordance with the Company's Articles of Association.

The trustees of the following holdings of Lloyds Banking Group plc shares in relation to employee share schemes retain the right to receive dividends but have chosen to waive their entitlement to the dividends on those shares as indicated: the Lloyds Banking Group Share Incentive Plan (holding at 31 December 2017: 12,414,401 shares, 31 December 2016: 27,898,019 shares, waived rights to all dividends), the HBOS Share Incentive Plan Trust (holding at 31 December 2017: 445,625 shares, 31 December 2016: 445,625 shares, waived rights to all dividends), the Lloyds Banking Group Employee Share Ownership Trust (holding at 31 December 2017: 13,346,132 shares, 31 December 2016: 10,699,978 shares, on which it waived rights to all dividends) and Lloyds Group Holdings (Jersey) Limited (holding at 31 December 2017: 42,846 shares, 31 December 2016: 42,846 shares, waived rights to all but a nominal amount of one penny in total).

Note 45: Share-based payments

Charge to the income statement

The charge to the income statement is set out below:

	2017 £m	2016 £m	2015 £m
Deferred bonus plan	**313**	266	255
Executive and SAYE plans:			
Options granted in the year	**17**	16	12
Options granted in prior years	**81**	138	99
	98	154	111
Share plans:			
Shares granted in the year	**17**	15	15
Shares granted in prior years	**9**	7	6
	26	22	21
Total charge to the income statement	**437**	442	387

During the year ended 31 December 2017 the Group operated the following share-based payment schemes, all of which are equity settled.

Deferred bonus plans

The Group operates a number of deferred bonus plans that are equity settled. Bonuses in respect of employee performance in 2017 have been recognised in the charge in line with the proportion of the deferral period completed.

Note 45: Share-based payments continued

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn schemes to save up to £500 per month and, at the expiry of a fixed term of three or five years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Group at a discounted price of no less than 80 per cent of the market price at the start of the invitation.

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

	2017		2016	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**678,692,896**	**51.76**	850,146,220	50.99
Granted	**268,653,890**	**51.03**	454,667,560	47.49
Exercised	**(13,119,229)**	**55.58**	(401,286,043)	40.74
Forfeited	**(18,545,569)**	**51.70**	(10,590,490)	56.02
Cancelled	**(41,211,075)**	**52.77**	(204,238,535)	60.23
Expired	**(13,603,825)**	**56.98**	(10,005,816)	57.08
Outstanding at 31 December	**860,867,088**	**51.34**	678,692,896	51.76
Exercisable at 31 December	**–**	**–**	–	–

The weighted average share price at the time that the options were exercised during 2017 was £0.67 (2016: £0.67). The weighted average remaining contractual life of options outstanding at the end of the year was 1.4 years (2016: 2.9 years).

The weighted average fair value of SAYE options granted during 2017 was £0.15 (2016: £0.13). The fair values of the SAYE options have been determined using a standard Black-Scholes model.

Other share option plans

Lloyds Banking Group Executive Share Plan 2003

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

Options granted on 27 March 2014 under the Commercial Banking Transformation Plan (CBTP), became exercisable in March 2017 and vested at a factor of 2.1 from the original 'on-target' award, due to the degree to which the performance conditions were exceeded. The award was based upon the underlying profit and return on risk-weighted assets ('RoRWA') of Commercial Banking as at 31 December 2016.

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

	2017		2016	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**218,962,281**	**Nil**	221,397,597	Nil
Granted	**5,466,405**	**Nil**	4,298,701	Nil
Exercised	**(104,967,667)**	**Nil**	(2,700,679)	Nil
Forfeited	**(81,883)**	**Nil**	(3,863,477)	Nil
Lapsed	**(104,855,147)**	**Nil**	(169,861)	Nil
Outstanding at 31 December	**14,523,989**	**Nil**	218,962,281	Nil
Exercisable at 31 December	**7,729,919**	**Nil**	4,504,392	Nil

The weighted average fair value of options granted in the year was £0.62 (2016: £0.68). The fair values of options granted have been determined using a standard Black-Scholes model. The weighted average share price at the time that the options were exercised during 2017 was £0.69 (2016: £0.64). The weighted average remaining contractual life of options outstanding at the end of the year was 4.9 years (2016: 5.1 years).

Notes to the consolidated financial statements continued

Note 45: Share-based payments continued

Other share plans

Lloyds Banking Group Long-Term Incentive Plan

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

For the 2015 and 2016 LTIPs participants may be entitled to any dividends paid during the vesting period if the performance conditions are met. An amount equal in value to any dividends paid between the award date and the date the Remuneration Committee determine that the performance conditions were met may be paid, based on the number of shares that vest. The Remuneration Committee will determine if any dividends are to be paid in cash or in shares. Details of the performance conditions for the plan are provided in the Directors' remuneration report.

At the end of the performance period for the 2014 grant, the targets had not been fully met and therefore these awards vested in 2017 at a rate of 55 per cent.

	2017 Number of shares	2016 Number of shares
Outstanding at 1 January	358,228,028	398,066,746
Granted	139,812,788	132,194,032
Vested	(57,406,864)	(140,879,465)
Forfeited	(73,268,966)	(33,713,900)
Dividend award	3,439,929	2,560,615
Outstanding at 31 December	370,804,915	358,228,028

Awards in respect of the 2015 grant will vest in 2018 at a rate of 66.3 per cent.

The weighted average fair value of awards granted in the year was £0.57 (2016: £0.64).

The fair value calculations at 31 December 2017 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	Save-As-You-Earn	Executive Share Plan 2003	LTIP
Weighted average risk-free interest rate	0.59%	0.18%	0.22%
Weighted average expected life	3.3 years	1.9 years	3.6 years
Weighted average expected volatility	29%	30%	31%
Weighted average expected dividend yield	4.0%	4.0%	0.0%
Weighted average share price	£0.68	£0.67	£0.68
Weighted average exercise price	£0.51	nil	nil

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

Share Incentive Plan

Free Shares

An award of shares may be made annually to employees up to a maximum of £3,000. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition. If an employee leaves the Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited.

On 10 May 2017, the Group made an award of £200 of shares to all eligible employees. The number of shares awarded was 21,566,047, with an average fair value of 0.69 based on the market price at the date of award.

Matching shares

The Group undertakes to match shares purchased by employees up to the value of £45 per month; these matching shares are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited. Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

The number of shares awarded relating to matching shares in 2017 was 32,025,497 (2016: 35,956,224), with an average fair value of £0.67 (2016: £0.61), based on market prices at the date of award.

Fixed share awards

Fixed share awards were introduced in 2014 in order to ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for certain Lloyds Banking Group employees, with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements. The fixed share awards are delivered in Lloyds Banking Group shares, released over five years with 20 per cent being released each year following the year of award. The number of shares purchased in 2017 was 9,313,314 (2016: 10,031,272).

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

Note 46: Related party transactions

Key management personnel

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

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

	2017 £m	2016 £m	2015 £m
Compensation			
Salaries and other short-term benefits	13	17	14
Post-employment benefits	–	–	–
Share-based payments	22	23	18
Total compensation	35	40	32

Aggregate contributions in respect of key management personnel to defined contribution pension schemes were £0.05 million (2016: £0.1 million; 2015: £0.1 million).

	2017 million	2016 million	2015 million
Share option plans			
At 1 January	3	9	13
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	–	3	3
Exercised/lapsed (includes entitlements of former key management personnel)	(2)	(9)	(7)
At 31 December	1	3	9

	2017 million	2016 million	2015 million
Share plans			
At 1 January	65	82	102
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	37	29	37
Exercised/lapsed (includes entitlements of former key management personnel)	(20)	(46)	(57)
At 31 December	82	65	82

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

	2017 £m	2016 £m	2015 £m
Loans			
At 1 January	4	5	3
Advanced (includes loans of appointed key management personnel)	1	3	4
Repayments (includes loans of former key management personnel)	(3)	(4)	(2)
At 31 December	2	4	5

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 6.45 per cent and 23.95 per cent in 2017 (2016: 2.49 per cent and 23.95 per cent; 2015: 3.99 per cent and 23.95 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2016 and 2015: £nil).

	2017 £m	2016 £m	2015 £m
Deposits			
At 1 January	12	13	16
Placed (includes deposits of appointed key management personnel)	41	41	58
Withdrawn (includes deposits of former key management personnel)	(33)	(42)	(61)
At 31 December	20	12	13

Deposits placed by key management personnel attracted interest rates of up to 4.0 per cent (2016: 4.0 per cent; 2015: 4.7 per cent).

At 31 December 2017, the Group did not provide any guarantees in respect of key management personnel (2016 and 2015: none).

At 31 December 2017, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £0.01 million with three directors and two connected persons (2016: £0.4 million with five directors and two connected persons; 2015: £1 million with four directors and six connected persons).

Notes to the consolidated financial statements continued

Note 46: Related party transactions continued

Subsidiaries

Details of the Group's subsidiaries and related undertakings are provided on pages 268–274. In accordance with IFRS 10 Consolidated financial statements, transactions and balances with subsidiaries have been eliminated on consolidation.

Pension funds

The Group provides banking and some investment management services to certain of its pension funds. At 31 December 2017, customer deposits of £337 million (2016: £171 million) and investment and insurance contract liabilities of £307 million (2016: £406 million) related to the Group's pension funds.

Collective investment vehicles

The Group manages 134 (2016: 139) collective investment vehicles, such as Open Ended Investment Companies (OEICs) and of these 83 (2016: 83) are consolidated. The Group invested £418 million (2016: £265 million) and redeemed £616 million (2016: £826 million) in the unconsolidated collective investment vehicles during the year and had investments, at fair value, of £2,328 million (2016: £2,405 million) at 31 December. The Group earned fees of £133 million from the unconsolidated collective investment vehicles during 2017 (2016: £192 million).

Joint ventures and associates

At 31 December 2017 there were loans and advances to customers of £123 million (2016: £173 million) outstanding and balances within customer deposits of £9 million (2016: £15 million) relating to joint ventures and associates.

In addition to the above balances, the Group has a number of other associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2017, these companies had total assets of approximately £4,661 million (2016: £4,712 million), total liabilities of approximately £5,228 million (2016: £5,033 million) and for the year ended 31 December 2017 had turnover of approximately £4,601 million (2016: £4,401 million) and made a loss of approximately £87 million (2016: net loss of £27 million). In addition, the Group has provided £1,226 million (2016: £1,550 million) of financing to these companies on which it received £81 million (2016: £127 million) of interest income in the year.

Note 47: Contingent liabilities and commitments

Interchange fees

With respect to multi-lateral interchange fees (MIFs), the Group is not directly involved in the ongoing investigations and litigation (as described below) which involve card schemes such as Visa and MasterCard. However, the Group is a member of Visa and MasterCard and other card schemes.

- The European Commission continues to pursue competition investigations against MasterCard and Visa probing, amongst other things, MIFs paid in respect of cards issued outside the EEA.
- Litigation brought by retailers continues in the English Courts against both Visa and MasterCard.
- Any ultimate impact on the Group of the above investigations and litigation against Visa and MasterCard remains uncertain at this time.

Visa Inc completed its acquisition of Visa Europe on 21 June 2016. As part of this transaction, the Group and certain other UK banks also entered into a Loss Sharing Agreement (LSA) with Visa Inc, which clarifies the allocation of liabilities between the parties should the litigation referred to above result in Visa Inc being liable for damages payable by Visa Europe. The maximum amount of liability to which the Group may be subject under the LSA is capped at the cash consideration which was received by the Group at completion. Visa Inc may also have recourse to a general indemnity, previously in place under Visa Europe's Operating Regulations, for damages claims concerning inter or intra-regional MIF setting activities.

LIBOR and other trading rates

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

Certain Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar, Japanese Yen and Sterling LIBOR and the Australian BBSW Reference Rate. Certain of the plaintiffs' claims, including those in connection with USD and JPY LIBOR, have been dismissed by the US Federal Court for Southern District of New York, and decisions are awaited on the Group's motions to dismiss the Sterling LIBOR and BBSW claims. The decisions leading to the Group's dismissal from the USD LIBOR claims are subject to two appeals; the first took place on 25 September 2017 and a decision is expected in the first quarter of 2018, and the second is expected to take place in the first half of 2018. The decisions leading to the Group's dismissal from the JPY LIBOR claims are not presently subject to appeal.

Certain Group companies are also named as defendants in: (i) UK based claims; and (ii) in a Dutch class action, each raising LIBOR manipulation allegations. A number of the claims against the Group in relation to the alleged mis-sale of Interest Rate Hedging Products also include allegations of LIBOR manipulation.

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

UK shareholder litigation

In August 2014, the Group and a number of former directors were named as defendants in a claim by a number of claimants who held shares in Lloyds TSB Group plc (LTSB) prior to the acquisition of HBOS plc, alleging breaches of duties in relation to information provided to shareholders in connection with the acquisition and the recapitalisation of LTSB. The defendants refute all claims made. A trial commenced in the English High Court on 18 October 2017 and is scheduled to conclude in the first quarter of 2018 with judgment to follow. It is currently not possible to determine the ultimate impact on the Group (if any).

Note 47: Contingent liabilities and commitments continued

Financial Services Compensation Scheme

Following the default of a number of deposit takers in 2008, the Financial Services Compensation Scheme (FSCS) borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. In June 2017, the FSCS announced that following the sale of certain Bradford & Bingley mortgage assets, the principal balance outstanding on the HM Treasury loan was £4,678 million (31 December 2016: £15,655 million). Although it is anticipated that the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants, including the Group, of the FSCS. The amount of future levies payable by the Group depends on a number of factors, principally, the amounts recovered by the FSCS from asset sales.

Tax authorities

The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Group that their interpretation of the UK rules which allow the offset of such losses denies the claim. If HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities of approximately £650 million (including interest) and a reduction in the Group's deferred tax asset of approximately £350 million. The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due. There are a number of other open matters on which the Group is in discussion with HMRC (including the tax treatment of certain costs arising from the divestment of TSB Banking Group plc), none of which is expected to have a material impact on the financial position of the Group.

Residential mortgage repossessions

In August 2014, the Northern Ireland High Court handed down judgment in favour of the borrowers in relation to three residential mortgage test cases concerning certain aspects of the Group's practice with respect to the recalculation of contractual monthly instalments of customers in arrears. The FCA is actively engaged with the industry in relation to these considerations and has published Guidance on the treatment of customers with mortgage payment shortfalls. The Guidance covers remediation for mortgage customers who may have been affected by the way firms calculate these customers' monthly mortgage instalments. The Group is now determining its detailed approach to implementation of the Guidance and will contact affected customers during 2018.

Mortgage arrears handling activities

On 26 May 2016, the Group was informed that an enforcement team at the FCA had commenced an investigation in connection with the Group's mortgage arrears handling activities. This investigation is ongoing and it is currently not possible to make a reliable assessment of the liability, if any, that may result from the investigation.

Other legal actions and regulatory matters

In addition, during the ordinary course of business the Group is subject to other complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to such matters. In these circumstances, specific disclosure in relation to a contingent liability will be made where material. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

	2017 £m	2016 £m
Contingent liabilities		
Acceptances and endorsements	71	21
Other:		
Other items serving as direct credit substitutes	740	779
Performance bonds and other transaction-related contingencies	2,300	2,237
	3,040	3,016
Total contingent liabilities	3,111	3,037

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.

	2017 £m	2016 £m
Commitments		
Forward asset purchases and forward deposits placed	384	648
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	11,156	10,749
Other commitments	81,883	62,697
	93,039	73,446
1 year or over original maturity	36,386	40,074
Total commitments	129,809	114,168

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £60,126 million (2016: £63,203 million) was irrevocable.

Notes to the consolidated financial statements continued

Note 47: Contingent liabilities and commitments continued

Operating lease commitments

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

	2017 £m	2016 £m
Not later than 1 year	**275**	264
Later than 1 year and not later than 5 years	**845**	855
Later than 5 years	**934**	944
Total operating lease commitments	**2,054**	2,063

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

Capital commitments

Excluding commitments in respect of investment property (note 26), capital expenditure contracted but not provided for at 31 December 2017 amounted to £444 million (2016: £543 million). Of this amount, £440 million (2016: £541 million) related to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

Note 48: Financial instruments

(1) Measurement basis of financial assets and liabilities

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

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
At 31 December 2017								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	58,521	–	58,521
Items in the course of collection from banks	–	–	–	–	–	755	–	755
Trading and other financial assets at fair value through profit or loss	–	42,236	120,642	–	–	–	–	162,878
Derivative financial instruments	1,881	23,953	–	–	–	–	–	25,834
Loans and receivables:								
Loans and advances to banks	–	–	–	–	6,611	–	–	6,611
Loans and advances to customers	–	–	–	–	472,498	–	–	472,498
Debt securities	–	–	–	–	3,643	–	–	3,643
	–	–	–	–	482,752	–	–	482,752
Available-for-sale financial assets	–	–	–	42,098	–	–	–	42,098
Total financial assets	1,881	66,189	120,642	42,098	482,752	59,276	–	772,838
Financial liabilities								
Deposits from banks	–	–	–	–	–	29,804	–	29,804
Customer deposits	–	–	–	–	–	418,124	–	418,124
Items in course of transmission to banks	–	–	–	–	–	584	–	584
Trading and other financial liabilities at fair value through profit or loss	–	43,062	7,815	–	–	–	–	50,877
Derivative financial instruments	1,613	24,511	–	–	–	–	–	26,124
Notes in circulation	–	–	–	–	–	1,313	–	1,313
Debt securities in issue	–	–	–	–	–	72,450	–	72,450
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	103,413	103,413
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	15,447	15,447
Unallocated surplus within insurance businesses	–	–	–	–	–	–	390	390
Subordinated liabilities	–	–	–	–	–	17,922	–	17,922
Total financial liabilities	1,613	67,573	7,815	–	–	540,197	119,250	736,448

Note 48: Financial instruments continued

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
At 31 December 2016								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	47,452	–	47,452
Items in the course of collection from banks	–	–	–	–	–	706	–	706
Trading and other financial assets at fair value through profit or loss	–	45,253	105,921	–	–	–	–	151,174
Derivative financial instruments	2,712	33,426	–	–	–	–	–	36,138
Loans and receivables:								
Loans and advances to banks	–	–	–	–	26,902	–	–	26,902
Loans and advances to customers	–	–	–	–	457,958	–	–	457,958
Debt securities	–	–	–	–	3,397	–	–	3,397
	–	–	–	–	488,257	–	–	488,257
Available-for-sale financial assets	–	–	–	56,524	–	–	–	56,524
Total financial assets	2,712	78,679	105,921	56,524	488,257	48,158	–	780,251
Financial liabilities								
Deposits from banks	–	–	–	–	–	16,384	–	16,384
Customer deposits	–	–	–	–	–	415,460	–	415,460
Items in course of transmission to banks	–	–	–	–	–	548	–	548
Trading and other financial liabilities at fair value through profit or loss	–	45,079	9,425	–	–	–	–	54,504
Derivative financial instruments	1,964	32,960	–	–	–	–	–	34,924
Notes in circulation	–	–	–	–	–	1,402	–	1,402
Debt securities in issue	–	–	–	–	–	76,314	–	76,314
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	94,390	94,390
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	20,112	20,112
Unallocated surplus within insurance businesses	–	–	–	–	–	–	243	243
Subordinated liabilities	–	–	–	–	–	19,831	–	19,831
Total financial liabilities	1,964	78,039	9,425	–	–	529,939	114,745	734,112

(2) Fair value measurement

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

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted market prices are not available, or are unreliable because of poor liquidity, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

The Group manages valuation adjustments for its derivative exposures on a net basis; the Group determines their fair values on the basis of their net exposures. In all other cases, fair values of financial assets and liabilities measured at fair value are determined on the basis of their gross exposures.

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

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.

Notes to the consolidated financial statements continued

Note 48: Financial instruments continued

Valuation control framework

The key elements of the control framework for the valuation of financial instruments include model validation, product implementation review and independent price verification. These functions are carried out by appropriately skilled risk and finance teams, independent of the business area responsible for the products.

Model validation covers both qualitative and quantitative elements relating to new models. In respect of new products, a product implementation review is conducted pre- and post-trading. Pre-trade testing ensures that the new model is integrated into the Group's systems and that the profit and loss and risk reporting are consistent throughout the trade life cycle. Post-trade testing examines the explanatory power of the implemented model, actively monitoring model parameters and comparing in-house pricing to external sources. Independent price verification procedures cover financial instruments carried at fair value. The frequency of the review is matched to the availability of independent data, monthly being the minimum. Valuation differences in breach of established thresholds are escalated to senior management. The results from independent pricing and valuation reserves are reviewed monthly by senior management.

Formal committees, consisting of senior risk, finance and business management, meet at least quarterly to discuss and approve valuations in more judgemental areas, in particular for unquoted equities, structured credit, over-the-counter options and the Credit Valuation Adjustment (CVA) reserve.

Valuation of financial assets and liabilities

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

Level 1

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

Level 2

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

Level 3

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

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

Note 48: Financial instruments continued

(3) Financial assets and liabilities carried at fair value

Critical accounting estimates and judgements

The valuation techniques for level 2 and, particularly, level 3 financial instruments involve management judgement and estimates the extent of which depends on the complexity of the instrument and the availability of market observable information. In addition, in line with market practice, the Group applies credit, debit and funding valuation adjustments in determining the fair value of its uncollateralised derivative positions. A description of these adjustments is set out in this note on page 233. Further details of the Group's level 3 financial instruments and the sensitivity of their valuation including the effect of applying reasonably possible alternative assumptions in determining their fair value are set out below. Details about sensitivities to market risk arising from trading assets and other treasury positions can be found in the risk management section on page 151.

(A) Financial assets, excluding derivatives

Valuation hierarchy

At 31 December 2017, the Group's financial assets carried at fair value, excluding derivatives, totalled £204,976 million (31 December 2016: £207,698 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 228). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

Valuation hierarchy

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2017				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	29,976	–	29,976
Loans and advances to banks	–	1,614	–	1,614
Debt securities:				
Government securities	20,268	1,729	23	22,020
Other public sector securities	–	1,526	1	1,527
Bank and building society certificates of deposit	–	222	–	222
Asset-backed securities:				
Mortgage-backed securities	3	348	49	400
Other asset-backed securities	5	229	787	1,021
Corporate and other debt securities	–	18,542	1,448	19,990
	20,276	22,596	2,308	45,180
Equity shares	84,694	18	1,378	86,090
Treasury and other bills	18	–	–	18
Total trading and other financial assets at fair value through profit or loss	104,988	54,204	3,686	162,878
Available-for-sale financial assets				
Debt securities:				
Government securities	34,534	174	–	34,708
Bank and building society certificates of deposit	–	167	–	167
Asset-backed securities:				
Mortgage-backed securities	–	1,156	–	1,156
Other asset-backed securities	–	163	92	255
Corporate and other debt securities	229	4,386	–	4,615
	34,763	6,046	92	40,901
Equity shares	555	38	604	1,197
Total available-for-sale financial assets	35,318	6,084	696	42,098
Total financial assets carried at fair value, excluding derivatives	140,306	60,288	4,382	204,976

Notes to the consolidated financial statements continued

Note 48: Financial instruments continued

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2016				
Trading and other financial assets at fair value through profit or loss				
Loans and advances to customers	–	30,473	–	30,473
Loans and advances to banks	–	2,606	–	2,606
Debt securities:				
Government securities	24,959	1,773	–	26,732
Other public sector securities	–	1,279	46	1,325
Bank and building society certificates of deposit	–	244	–	244
Asset-backed securities:				
Mortgage-backed securities	–	654	53	707
Other asset-backed securities	4	1,092	442	1,538
Corporate and other debt securities	112	17,968	1,752	19,832
	25,075	23,010	2,293	50,378
Equity shares	66,147	37	1,513	67,697
Treasury and other bills	20	–	–	20
Total trading and other financial assets at fair value through profit or loss	91,242	56,126	3,806	151,174
Available-for-sale financial assets				
Debt securities:				
Government securities	48,542	172	–	48,714
Bank and building society certificates of deposit	–	142	–	142
Asset-backed securities:				
Mortgage-backed securities	–	108	–	108
Other asset-backed securities	–	184	133	317
Corporate and other debt securities	107	5,923	–	6,030
	48,649	6,529	133	55,311
Equity shares	435	17	761	1,213
Total available-for-sale financial assets	49,084	6,546	894	56,524
Total financial assets carried at fair value, excluding derivatives	140,326	62,672	4,700	207,698

Movements in Level 3 portfolio

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

	2017			2016		
	Trading and other financial assets at fair value through profit or loss £m	**Available-for-sale £m**	**Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m**	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Total level 3 assets carried at fair value, excluding derivatives (recurring basis) £m
At 1 January	**3,806**	**894**	**4,700**	5,116	684	5,800
Exchange and other adjustments	**(1)**	**(24)**	**(25)**	8	12	20
Gains recognised in the income statement within other income	**202**	**–**	**202**	437	–	437
(Losses) gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	**–**	**(117)**	**(117)**	–	312	312
Purchases	**774**	**41**	**815**	833	258	1,091
Sales	**(1,005)**	**(61)**	**(1,066)**	(2,597)	(527)	(3,124)
Transfers into the level 3 portfolio	**152**	**2**	**154**	186	155	341
Transfers out of the level 3 portfolio	**(242)**	**(39)**	**(281)**	(177)	–	(177)
At 31 December	**3,686**	**696**	**4,382**	3,806	894	4,700
Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**125**	**–**	**125**	642	–	642

Note 48: 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.

Equity investments

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

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

- A number of earnings multiples are used in valuing the portfolio including price earnings, earnings before interest and tax and earnings before interest, tax, depreciation and amortisation. The particular multiple selected being appropriate for the type of business being valued and is derived by reference to the current market-based multiple. Consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple.
- Discounted cash flow valuations use estimated future cash flows, usually based on management forecasts, with the application of appropriate exit yields or terminal multiples and discounted using rates appropriate to the specific investment, business sector or recent economic rates of return. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple.
- For fund investments the most recent capital account value calculated by the fund manager is used as the basis for the valuation and adjusted, if necessary, to align valuation techniques with the Group's valuation policy.

Unlisted equity investments and investments in property partnerships held in the life assurance funds are valued using third party valuations. Management take account of any pertinent information, such as recent transactions and information received on particular investments, to adjust the third party valuations where necessary.

(B) Financial liabilities, excluding derivatives

Valuation hierarchy

At 31 December 2017, the Group's financial liabilities carried at fair value, excluding derivatives, comprised its trading and other financial liabilities at fair value through profit or loss and totalled £50,877 million (31 December 2016: £54,504 million). (Financial guarantees are also recognised at fair value, on initial recognition, and are classified as level 3; but the balance is not material). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on page 228). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2017				
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	**3**	**7,812**	**–**	**7,815**
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	**–**	**41,378**	**–**	**41,378**
Other deposits	**–**	**381**	**–**	**381**
Short positions in securities	**1,106**	**197**	**–**	**1,303**
	1,106	**41,956**	**–**	**43,062**
Total financial liabilities carried at fair value, excluding derivatives	**1,109**	**49,768**	**–**	**50,877**
At 31 December 2016				
Trading and other financial liabilities at fair value through profit or loss				
Liabilities held at fair value through profit or loss	–	9,423	2	9,425
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	42,067	–	42,067
Other deposits	–	530	–	530
Short positions in securities	2,417	65	–	2,482
	2,417	42,662	–	45,079
Total financial liabilities carried at fair value, excluding derivatives	2,417	52,085	2	54,504

Notes to the consolidated financial statements continued

Note 48: Financial instruments continued

The table below analyses movements in the level 3 financial liabilities portfolio, excluding derivatives. There were no transfers into or out of level 3 during 2016 or 2017.

	2017 £m	2016 £m
At 1 January	2	1
Losses (gains) recognised in the income statement within other income	(2)	1
Redemptions	–	–
At 31 December	–	2
Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December	–	1

Valuation methodology for financial liabilities, excluding derivatives

Liabilities held at fair value through profit or loss

These principally comprise debt securities in issue which are classified as level 2 and their fair value is determined using techniques whose inputs are based on observable market data. The carrying amount of the securities is adjusted to reflect the effect of changes in own credit spreads. From 1 January 2017, the resulting gain or loss is recognised in other comprehensive income (see note 1).

At 31 December 2017, the own credit adjustment arising from the fair valuation of £7,812 million (2016: £9,423 million) of the Group's debt securities in issue designated at fair value through profit or loss resulted in a loss of £55 million, recognised in other comprehensive income (2016: loss of £28 million, recognised in the income statement).

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.

(C) Derivatives

All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2017, such assets totalled £25,834 million (31 December 2016: £36,138 million) and liabilities totalled £26,124 million (31 December 2016: £34,924 million). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on page 228). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and level 2 during the year.

	2017				2016			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	246	24,532	1,056	25,834	270	34,469	1,399	36,138
Derivative liabilities	(587)	(24,733)	(804)	(26,124)	(358)	(33,606)	(960)	(34,924)

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 are used to calculate CVA, FVA, and own credit adjustments, but are not considered significant in determining the classification of the derivative and debt portfolios. Consequently, those inputs do not form part of the Level 3 sensitivities presented.

Note 48: Financial instruments continued

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

	2017		2016	
	Derivative assets £m	**Derivative liabilities £m**	Derivative assets £m	Derivative liabilities £m
At 1 January	**1,399**	**(960)**	1,469	(723)
Exchange and other adjustments	**24**	**(20)**	74	(53)
Losses (gains) recognised in the income statement within other income	**(208)**	**215**	220	(299)
Purchases (additions)	**103**	**(18)**	24	(13)
(Sales) redemptions	**(79)**	**53**	(91)	128
Derecognised pursuant to tender offers and redemptions in respect of Enhanced Capital Notes	**–**	**–**	(476)	–
Transfers into the level 3 portfolio	**33**	**(74)**	216	–
Transfers out of the level 3 portfolio	**(216)**	**–**	(37)	–
At 31 December	**1,056**	**(804)**	1,399	(960)
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December	**(208)**	**213**	284	(262)

Derivative valuation adjustments

Derivative financial instruments which are carried in the balance sheet at fair value are adjusted where appropriate to reflect credit risk, market liquidity and other risks.

(i) Uncollateralised derivative valuation adjustments, excluding monoline counterparties

The following table summarises the movement on this valuation adjustment account during 2016 and 2017:

	2017 £m	2016 £m
At 1 January	**744**	598
Income statement charge (credit)	**(260)**	163
Transfers	**37**	(17)
At 31 December	**521**	744

Represented by:

	2017 £m	2016 £m
Credit Valuation Adjustment	**408**	685
Debit Valuation Adjustment	**(37)**	(123)
Funding Valuation Adjustment	**150**	182
	521	744

Credit and Debit Valuation Adjustments (CVA and DVA) are applied to the Group's over-the-counter derivative exposures with counterparties that are not subject to standard interbank collateral arrangements. These exposures largely relate to the provision of risk management solutions for corporate customers within the Commercial Banking division.

A CVA is taken where the Group has a positive future uncollateralised exposure (asset). A DVA is taken where the Group has a negative future uncollateralised exposure (liability). These adjustments reflect interest rates and expectations of counterparty creditworthiness and the Group's own credit spread respectively.

The CVA is sensitive to:

- the current size of the mark-to-market position on the uncollateralised asset;
- expectations of future market volatility of the underlying asset; and
- expectations of counterparty creditworthiness.

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

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

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 £82 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 (although no such adjustment was required at 31 December 2017).

The DVA is sensitive to:

- the current size of the mark-to-market position on the uncollateralised liability;
- expectations of future market volatility of the underlying liability; and
- the Group's own CDS spread.

Notes to the consolidated financial statements continued

Note 48: Financial instruments continued

A one per cent rise in the CDS spread would lead to an increase in the DVA of £96 million to £133 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates. Due to the nature of the Group's business the CVA/DVA exposures tend to be on average the same way around such that the valuation adjustments fall when interest rates rise. A one per cent rise in interest rates would lead to a £186 million fall in the overall valuation adjustment to £185 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 £26 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 2017, the Group's derivative trading business held mid to bid-offer valuation adjustments of £74 million (2016: £96 million).

(D) Sensitivity of level 3 valuations

			At 31 December 2017			At 31 December 2016		
				Effect of reasonably possible alternative assumptions[2]			Effect of reasonably possible alternative assumptions[2]	
	Valuation techniques	Significant unobservable inputs[1]	Carrying value £m	Favourable changes £m	Unfavourable changes £m	Carrying value £m	Favourable changes £m	Unfavourable changes £m
Trading and other financial assets at fair value through profit or loss								
Debt securities	Discounted cash flows	Credit spreads (bps) (1bps/2bps)	11	–	–	29	5	(5)
Asset-backed securities	Lead manager or broker quote	n/a	–	–	–	59	–	–
Equity and venture capital investments	Market approach	Earnings multiple (0.9/14.4)	1,879	65	(65)	2,163	63	(68)
	Underlying asset/net asset value (incl. property prices)[3]	n/a	50	5	(5)	54	2	(3)
Unlisted equities, debt securities and property partnerships in the life funds	Underlying asset/net asset value (incl. property prices), broker quotes or discounted cash flows[3]	n/a	1,746	26	(76)	1,501	–	(32)
			3,686			3,806		
Available-for-sale financial assets								
Asset-backed securities	Lead manager or broker quote/consensus pricing	n/a	92	–	(4)	133	–	–
Equity and venture capital investments	Underlying asset/net asset value (incl. property prices)[3]	n/a	604	83	(42)	761	48	(53)
Other	Various	n/a				–	–	–
			696			894		
Derivative financial assets								
Interest rate derivatives	Option pricing model	Interest rate volatility (9%/94%)	1,056	11	(3)	1,399	(3)	(19)
			1,056			1,399		
Level 3 financial assets carried at fair value			5,438			6,099		
Trading and other financial liabilities at fair value through profit or loss			–	–	–	2	–	–
Derivative financial liabilities								
Interest rate derivatives	Option pricing model	Interest rate volatility (9%/94%)	804	–	–	960	–	–
			804			960		
Level 3 financial liabilities carried at fair value			804			962		

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

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

3 Underlying asset/net asset values represent fair value.

Note 48: Financial instruments continued

Unobservable inputs

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

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

Reasonably possible alternative assumptions

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

Debt securities

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

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 9 per cent to 94 per cent (2016: nil per cent to 115 per cent).

Unlisted equity, venture capital investments and investments in property partnerships

The valuation techniques used for unlisted equity and venture capital investments vary depending on the nature of the investment. Reasonably possible alternative valuations for these investments have been calculated by reference to the approach taken, as appropriate to the business sector and investment circumstances and as such the following inputs have been considered:

- for valuations derived from earnings multiples, consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple;
- the discount rates used in discounted cash flow valuations; and
- in line with International Private Equity and Venture Capital Guidelines, the values of underlying investments in fund investments portfolios.

(4) Financial assets and liabilities carried at amortised cost

(A) Financial assets

Valuation hierarchy

The table below analyses the fair values of the financial assets of the Group which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on page 228). Loans and receivables are mainly classified as level 3 due to significant unobservable inputs used in the valuation models. Where inputs are observable, debt securities are classified as level 1 or 2.

			Valuation hierarchy		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2017					
Loans and receivables:					
Loans and advances to customers: unimpaired	**467,670**	**467,276**	**–**	**16,832**	**450,444**
Loans and advances to customers: impaired	**4,828**	**4,809**	**–**	**–**	**4,809**
Loans and advances to customers	**472,498**	**472,085**	**–**	**16,832**	**455,253**
Loans and advances to banks	**6,611**	**6,564**	**–**	**771**	**5,793**
Debt securities	**3,643**	**3,586**	**–**	**3,571**	**15**
Reverse repos included in above amounts:					
Loans and advances to customers	**16,832**	**16,832**	**–**	**16,832**	**–**
Loans and advances to banks	**771**	**771**	**–**	**771**	**–**
At 31 December 2016					
Loans and receivables:					
Loans and advances to customers: unimpaired	451,339	450,986	–	–	450,986
Loans and advances to customers: impaired	6,619	6,475	–	–	6,475
Loans and advances to customers	457,958	457,461	–	–	457,461
Loans and advances to banks	26,902	26,812	–	–	26,812
Debt securities	3,397	3,303	–	3,288	15
Reverse repos included in above amounts:					
Loans and advances to customers	8,304	8,304	–	–	8,304
Loans and advances to banks	902	902	–	–	902

Notes to the consolidated financial statements continued

Note 48: Financial instruments continued

Valuation methodology

Loans and advances to customers

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

To determine the fair value of loans and advances to customers, loans are segregated into portfolios of similar characteristics. A number of techniques are used to estimate the fair value of fixed rate lending; these take account of expected credit losses based on historic trends, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is usually estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair value of commercial loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. No adjustment is made to put it in place by the Group to manage its interest rate exposure.

Loans and advances to banks

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

Debt securities

The fair values of debt securities, which were previously within assets held for trading and were reclassified to loans and receivables, are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

Reverse repurchase agreements

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

(B) Financial liabilities

Valuation hierarchy

The table below analyses the 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 228).

			Valuation hierarchy		
	Carrying value £m	Fair value £m	Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2017					
Deposits from banks	**29,804**	**29,798**	**–**	**29,798**	**–**
Customer deposits	**418,124**	**418,441**	**–**	**411,591**	**6,850**
Debt securities in issue	**72,450**	**75,756**	**–**	**75,756**	**–**
Subordinated liabilities	**17,922**	**21,398**	**–**	**21,398**	**–**
Repos included in above amounts:					
Deposits from banks	**23,175**	**23,175**	**–**	**23,175**	**–**
Customer deposits	**2,638**	**2,638**	**–**	**2,638**	**–**
At 31 December 2016					
Deposits from banks	16,384	16,395	–	16,395	–
Customer deposits	415,460	416,490	–	408,571	7,919
Debt securities in issue	76,314	79,650	–	79,434	216
Subordinated liabilities	19,831	22,395	–	22,395	–
Repos included in above amounts:					
Deposits from banks	7,279	7,279	–	7,279	–
Customer deposits	2,462	2,462	–	2,462	–

Valuation methodology

Deposits from banks and customer deposits

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

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

Debt securities in issue

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

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.

Note 48: Financial instruments continued

(5) Reclassifications of financial assets

There have been no reclassifications of financial assets in 2017.

During 2016, the Group reassessed its holding of government securities classified as held-to-maturity in light of the low interest rate environment at that time and they were reclassified as available-for-sale; this resulted in a credit of £1,544 million to the available-for-sale revaluation reserve (£1,127 million after tax).

Note 49: Transfers of financial assets

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

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

As set out in note 18, included within loans and receivables are loans transferred under the Group's securitisation and covered bond programmes. As the Group retains all of a majority of the risks and rewards associated with these loans, including credit, interest rate, prepayment and liquidity risk, they remain on the Group's balance sheet. Assets transferred into the Group's securitisation and covered bond programmes are not available to be used by the Group whilst the assets are within the programmes. However, the Group retains the right to remove loans from the covered bond programmes where they are in excess of the programme's requirements. In addition, where the Group has retained some of the notes issued by securitisation and covered bond programmes, the Group has the ability to sell or pledge these retained notes.

The table below sets out the carrying values of the transferred assets and the associated liabilities. For repurchase and securities lending transactions, the associated liabilities represent the Group's obligation to repurchase the transferred assets. For securitisation programmes, the associated liabilities represent the external notes in issue (note 30). Except as otherwise noted below, none of the liabilities shown in the table below have recourse only to the transferred assets.

	2017		2016	
	Carrying value of transferred assets £m	Carrying value of associated liabilities £m	Carrying value of transferred assets £m	Carrying value of associated liabilities £m
Repurchase and securities lending transactions				
Trading and other financial assets at fair value through profit or loss	9,946	3,257	10,256	3,380
Available-for-sale financial assets	19,359	16,753	24,681	21,809
Loans and receivables:				
Loans and advances to customers	–	–	583	–
Securitisation programmes				
Loans and receivables:				
Loans and advances to customers[1]	35,475	3,660	52,184	7,253

1 The carrying value of associated liabilities excludes securitisation notes held by the Group of £21,582 million (31 December 2016: £26,435 million).

Notes to the consolidated financial statements continued

Note 50: 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.

At 31 December 2017	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]: Cash collateral received/ pledged £m	Related amounts where set off in the balance sheet not permitted[3]: Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Trading and other financial assets at fair value through profit or loss:						
Excluding reverse repos	131,288	–	131,288	–	(3,322)	127,966
Reverse repos	38,882	(7,292)	31,590	–	(31,590)	–
	170,170	(7,292)	162,878	–	(34,912)	127,966
Derivative financial instruments	72,869	(47,035)	25,834	(5,419)	(13,807)	6,608
Loans and advances to banks:						
Excluding reverse repos	5,840	–	5,840	(2,293)	–	3,547
Reverse repos	771	–	771	(646)	(125)	–
	6,611	–	6,611	(2,939)	(125)	3,547
Loans and advances to customers:						
Excluding reverse repos	457,382	(1,716)	455,666	(1,656)	(7,030)	446,980
Reverse repos	16,832	–	16,832	–	(16,832)	–
	474,214	(1,716)	472,498	(1,656)	(23,862)	446,980
Debt securities	3,643	–	3,643	–		3,643
Available-for-sale financial assets	42,098	–	42,098	–	(16,751)	25,347
Financial liabilities						
Deposits from banks:						
Excluding repos	6,629	–	6,629	(4,860)	–	1,769
Repos	23,175	–	23,175	–	(23,175)	–
	29,804	–	29,804	(4,860)	(23,175)	1,769
Customer deposits:						
Excluding repos	417,009	(1,523)	415,486	(1,205)	(7,030)	407,251
Repos	2,638	–	2,638	–	(2,638)	–
	419,647	(1,523)	418,124	(1,205)	(9,668)	407,251
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	9,499	–	9,499	–	–	9,499
Repos	48,670	(7,292)	41,378	–	(41,378)	–
	58,169	(7,292)	50,877	–	(41,378)	9,499
Derivative financial instruments	73,352	(47,228)	26,124	(3,949)	(17,459)	4,716

Note 50: Offsetting of financial assets and liabilities continued

At 31 December 2016	Gross amounts of assets and liabilities[1] £m	Amounts offset in the balance sheet[2] £m	Net amounts presented in the balance sheet £m	Related amounts where set off in the balance sheet not permitted[3]: Cash collateral received/ pledged £m	Related amounts where set off in the balance sheet not permitted[3]: Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
Financial assets						
Trading and other financial assets at fair value through profit or loss:						
Excluding reverse repos	118,095	–	118,095	–	(3,265)	114,830
Reverse repos	35,298	(2,219)	33,079	–	(33,079)	–
	153,393	(2,219)	151,174	–	(36,344)	114,830
Derivative financial instruments	92,390	(56,252)	36,138	(6,472)	(19,906)	9,760
Loans and advances to banks:						
Excluding reverse repos	26,000	–	26,000	(2,826)	–	23,174
Reverse repos	902	–	902	–	(902)	–
	26,902	–	26,902	(2,826)	(902)	23,174
Loans and advances to customers:						
Excluding reverse repos	451,290	(1,636)	449,654	(1,793)	(6,331)	441,530
Reverse repos	8,304	–	8,304	–	(8,304)	–
	459,594	(1,636)	457,958	(1,793)	(14,635)	441,530
Debt securities	3,397	–	3,397	–	–	3,397
Available-for-sale financial assets	56,524	–	56,524	–	(21,475)	35,049
Financial liabilities						
Deposits from banks:						
Excluding repos	9,105	–	9,105	(5,080)	(695)	3,330
Repos	7,279	–	7,279	–	(7,279)	–
	16,384	–	16,384	(5,080)	(7,974)	3,330
Customer deposits:						
Excluding repos	415,153	(2,155)	412,998	(1,391)	(6,331)	405,276
Repos	2,462	–	2,462	–	(2,462)	–
	417,615	(2,155)	415,460	(1,391)	(8,793)	405,276
Trading and other financial liabilities at fair value through profit or loss:						
Excluding repos	12,437	–	12,437	–	–	12,437
Repos	44,286	(2,219)	42,067	–	(42,067)	–
	56,723	(2,219)	54,504	–	(42,067)	12,437
Derivative financial instruments	90,657	(55,733)	34,924	(4,620)	(24,820)	5,484

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.

Notes to the consolidated financial statements continued

Note 51: Financial risk management

As a bancassurer, 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 foreign exchange risk; liquidity risk; capital risk; and insurance risk. Information about the Group's exposure to each of the above risks and capital can be found on pages 107–156. The following additional disclosures, which provide quantitative information about the risks within financial instruments held or issued by the Group, should be read in conjunction with that earlier information.

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 establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt.

At 31 December 2017 the aggregate notional principal of interest rate swaps designated as fair value hedges was £109,670 million (2016: £194,416 million) with a net fair value asset of £738 million (2016: asset of £725 million) (note 16). The losses on the hedging instruments were £420 million (2016: losses of £1,946 million). The gains on the hedged items attributable to the hedged risk were £484 million (2016: gains of £2,017 million).

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. Note 16 shows when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2017 was £549,099 million (2016: £384,182 million) with a net fair value liability of £456 million (2016: liability of £352 million) (note 16). In 2017, ineffectiveness recognised in the income statement that arises from cash flow hedges was a loss of £21 million (2016: gain of £24 million).

Currency risk

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to the market and liquidity risk function in London. Associated VaR and the closing, average, maximum and minimum are disclosed on page 155.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group hedges part of the currency translation risk of the net investment in certain foreign operations using currency borrowings. At 31 December 2017 the aggregate principal of these currency borrowings was £41 million (2016: £695 million). In 2017, an ineffectiveness loss of £11 million before tax and £8 million after tax (2016: ineffectiveness loss of £2 million before tax and £1 million after tax) was recognised in the income statement arising from net investment hedges.

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

Functional currency of Group operations

	2017			2016		
	Euro £m	US Dollar £m	Other non-sterling £m	Euro £m	US Dollar £m	Other non-sterling £m
Gross exposure	73	374	32	247	479	36
Net investment hedges	(41)	–	–	(216)	(479)	–
Total structural foreign currency exposures, after net investment hedges	32	374	32	31	–	36

Note 51: Financial risk management continued

Credit risk

The Group's credit risk exposure arises in respect of the instruments below and predominantly in the United Kingdom. Information about the Group's exposure to credit risk, credit risk management, measurement and mitigation can be found on pages 107–156.

A. Maximum credit exposure

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

	At 31 December 2017			At 31 December 2016		
	Maximum exposure £m	Offset[2] £m	Net exposure £m	Maximum exposure £m	Offset[2] £m	Net exposure £m
Loans and receivables:						
Loans and advances to banks, net[1]	6,611	–	6,611	26,902	–	26,902
Loans and advances to customers, net[1]	472,498	(7,030)	465,468	457,958	(6,331)	451,627
Debt securities, net[1]	3,643	–	3,643	3,397	–	3,397
	482,752	(7,030)	475,722	488,257	(6,331)	481,926
Available-for-sale financial assets[3]	40,901	–	40,901	55,311	–	55,311
Trading and other financial assets at fair value through profit or loss:[3,4]						
Loans and advances	31,590	–	31,590	33,079	–	33,079
Debt securities, treasury and other bills	45,198	–	45,198	50,398	–	50,398
	76,788	–	76,788	83,477	–	83,477
Derivative assets	25,834	(13,049)	12,785	36,138	(18,539)	17,599
Assets arising from reinsurance contracts held	602	–	602	714	–	714
Financial guarantees	5,820	–	5,820	6,883	–	6,883
Off-balance sheet items:						
Acceptances and endorsements	71	–	71	21	–	21
Other items serving as direct credit substitutes	740	–	740	779	–	779
Performance bonds and other transaction-related contingencies	2,300	–	2,300	2,237	–	2,237
Irrevocable commitments	60,126	–	60,126	63,203	–	63,203
	63,237	–	63,237	66,240	–	66,240
	695,934	(20,079)	675,855	737,020	(24,870)	712,150

1 Amounts shown net of related impairment allowances.

2 Offset items comprise deposit amounts available for offset, and amounts available for offset under master netting arrangements, that do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

3 Excluding equity shares.

4 Includes assets within the Group's unit-linked funds for which credit risk is borne by the policyholders and assets within the Group's With-Profits funds for which credit risk is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back related contract liabilities.

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. Further information on the Group's management of this risk is included within Credit risk mitigation, Risk management on page 116.

At 31 December 2017 the most significant concentrations of exposure were in mortgages (comprising 64 per cent of total loans and advances to customers) and to financial, business and other services (comprising 12 per cent of the total). For further information on concentrations of the Group's loans, refer to note 17.

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

Notes to the consolidated financial statements continued

Note 51: Financial risk management continued
C. Credit quality of assets

Loans and receivables

The disclosures in the table below and those on page 243 are produced under the underlying basis used for the Group's segmental reporting. The Group believes that, for reporting periods following a significant acquisition this underlying basis, which includes the allowance for loan losses at the acquisition date on a gross basis, more fairly reflects the underlying provisioning status of the loans. The remaining acquisition-related fair value adjustments in respect of this lending are therefore identified separately in this table.

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

Loans and advances

		Loans and advances to customers				
	Loans and advances to banks £m	Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
At 31 December 2017						
Neither past due nor impaired	**6,577**	**295,765**	**48,897**	**116,396**	**461,058**	**31,590**
Past due but not impaired	**6**	**5,934**	**585**	**336**	**6,855**	**–**
Impaired – no provision required	**28**	**640**	**306**	**700**	**1,646**	**–**
– provision held	**–**	**3,529**	**1,053**	**1,613**	**6,195**	**–**
Gross	**6,611**	**305,868**	**50,841**	**119,045**	**475,754**	**31,590**
Allowance for impairment losses	**–**	**(1,604)**	**(655)**	**(1,183)**	**(3,442)**	**–**
Fair value adjustments	**–**				**186**	**–**
Net balance sheet carrying value	**6,611**				**472,498**	**31,590**
At 31 December 2016						
Neither past due nor impaired	26,888	296,303	39,478	109,364	445,145	33,079
Past due but not impaired	14	7,340	386	305	8,031	–
Impaired – no provision required	–	784	392	689	1,865	–
– provision held	–	3,536	1,038	2,056	6,630	–
Gross	26,902	307,963	41,294	112,414	461,671	33,079
Allowance for impairment losses	–	(1,696)	(458)	(1,378)	(3,532)	–
Fair value adjustments	–				(181)	–
Net balance sheet carrying value	26,902				457,958	33,079

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(H). Included in loans and receivables are advances which are individually determined to be impaired with a gross amount before impairment allowances of £2,465 million (31 December 2016: £2,870 million).

The table below sets out the reconciliation of the allowance for impairment losses of £2,201 million (2016: £2,412 million) shown in note 20 to the allowance for impairment losses on an underlying basis of £3,442 million (2016: £3,532 million) shown above:

	2017 £m	2016 £m
Allowance for impairment losses on loans and advances to customers	**2,201**	2,412
Impairment allowance of HBOS and MBNA at acquisition[1]	**11,309**	11,147
Impairment charge covered by fair value adjustments	**12,321**	12,236
Amounts subsequently written off, net of foreign exchange and other movements	**(22,389)**	(22,263)
Allowance for impairment losses on loans and advances to customers on an underlying basis	**3,442**	3,532

1 Comprises an allowance in respect of HBOS (£11,147 million) and, in 2017, MBNA (£162 million). These amounts impact the impairment allowance on an underlying basis but not on a statutory basis.

Note 51: Financial risk management continued

Loans and advances which are neither past due nor impaired

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
At 31 December 2017						
Good quality	**6,351**	**294,748**	**43,145**	**81,121**		**31,548**
Satisfactory quality	**198**	**790**	**4,770**	**30,154**		**42**
Lower quality	**28**	**32**	**286**	**4,807**		**–**
Below standard, but not impaired	**–**	**195**	**696**	**314**		**–**
Total loans and advances which are neither past due nor impaired	**6,577**	**295,765**	**48,897**	**116,396**	**461,058**	**31,590**
At 31 December 2016						
Good quality	26,745	295,286	34,195	72,083		33,049
Satisfactory quality	87	814	4,479	30,433		30
Lower quality	3	39	387	6,433		–
Below standard, but not impaired	53	164	417	415		–
Total loans and advances which are neither past due nor impaired	26,888	296,303	39,478	109,364	445,145	33,079

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and commercial are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Commercial lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models. Further information about the Group's internal probabilities of default rating models can be found on page 116.

Loans and advances which are past due but not impaired

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	
At 31 December 2017						
0-30 days	**6**	**3,057**	**458**	**246**	**3,761**	**–**
30-60 days	**–**	**1,115**	**111**	**10**	**1,236**	**–**
60-90 days	**–**	**785**	**3**	**13**	**801**	**–**
90-180 days	**–**	**977**	**3**	**8**	**988**	**–**
Over 180 days	**–**	**–**	**10**	**59**	**69**	**–**
Total loans and advances which are past due but not impaired	**6**	**5,934**	**585**	**336**	**6,855**	**–**
At 31 December 2016						
0-30 days	14	3,547	285	157	3,989	–
30-60 days	–	1,573	75	37	1,685	–
60-90 days	–	985	2	74	1,061	–
90-180 days	–	1,235	6	14	1,255	–
Over 180 days	–	–	18	23	41	–
Total loans and advances which are past due but not impaired	14	7,340	386	305	8,031	–

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

Notes to the consolidated financial statements continued

Note 51: Financial risk management continued

Debt securities classified as loans and receivables

An analysis by credit rating of the Group's debt securities classified as loans and receivables is provided below:

	2017			2016		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Asset-backed securities:						
Mortgage-backed securities	2,366	–	2,366	2,089	–	2,089
Other asset-backed securities	1,164	96	1,260	1,192	98	1,290
	3,530	96	3,626	3,281	98	3,379
Corporate and other debt securities	27	16	43	29	65	94
Gross exposure	3,557	112	3,669	3,310	163	3,473
Allowance for impairment losses			(26)			(76)
Total debt securities classified as loans and receivables			3,643			3,397

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

2 Other comprises sub-investment grade (2017: £89 million; 2016: £91 million) and not rated (2017: £23 million; 2016: £72 million).

Available-for-sale financial assets (excluding equity shares)

An analysis of the Group's available-for-sale financial assets is included in note 21. The credit quality of the Group's available-for-sale financial assets (excluding equity shares) is set out below:

	2017			2016		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Debt securities:						
Government securities	34,708	–	34,708	48,714	–	48,714
Bank and building society certificates of deposit	167	–	167	142	–	142
Asset-backed securities:						
Mortgage-backed securities	1,156	–	1,156	108	–	108
Other asset-backed securities	235	20	255	312	5	317
	1,391	20	1,411	420	5	425
Corporate and other debt securities	4,250	365	4,615	6,030	–	6,030
Total held as available-for-sale financial assets	40,516	385	40,901	55,306	5	55,311

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

2 Other comprises sub-investment grade (2017: £9 million; 2016: £5 million) and not rated (2017: £376 million; 2016: £nil).

Note 51: Financial risk management continued

Debt securities, treasury and other bills held at fair value through profit or loss

An analysis of the Group's trading and other financial assets at fair value through profit or loss is included in note 15. The credit quality of the Group's debt securities, treasury and other bills held at fair value through profit or loss is set out below:

	2017			2016		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Debt securities, treasury and other bills held at fair value through profit or loss						
Trading assets:						
Government securities	9,833	–	9,833	11,828	–	11,828
Asset-backed securities:						
Mortgage-backed securities	84	105	189	47	–	47
Other asset-backed securities	95	–	95	69	–	69
	179	105	284	116	–	116
Corporate and other debt securities	469	54	523	221	3	224
Total held as trading assets	10,481	159	10,640	12,165	3	12,168
Other assets held at fair value through profit or loss:						
Government securities	12,180	7	12,187	14,904	–	14,904
Other public sector securities	1,519	8	1,527	1,318	7	1,325
Bank and building society certificates of deposit	222	–	222	244	–	244
Asset-backed securities:						
Mortgage-backed securities	208	3	211	633	27	660
Other asset-backed securities	924	2	926	1,178	291	1,469
	1,132	5	1,137	1,811	318	2,129
Corporate and other debt securities	17,343	2,124	19,467	17,445	2,163	19,608
Total debt securities held at fair value through profit or loss	32,396	2,144	34,540	35,722	2,488	38,210
Treasury bills and other bills	18	–	18	20	–	20
Total other assets held at fair value through profit or loss	32,414	2,144	34,558	35,742	2,488	38,230
Total held at fair value through profit or loss	42,895	2,303	45,198	47,907	2,491	50,398

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

2 Other comprises sub-investment grade (2017: £331 million; 2016: £485 million) and not rated (2017: £1,972 million; 2016: £2,006 million).

Credit risk in respect of trading and other financial assets at fair value through profit or loss held within the Group's unit-linked funds is borne by the policyholders and credit risk in respect of with-profits funds is largely borne by the policyholders. Consequently, the Group has no significant exposure to credit risk for such assets which back those contract liabilities.

Derivative assets

An analysis of derivative assets is given in note 16. The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the Group's net credit risk relating to derivative assets of £12,785 million (2016: £17,599 million), cash collateral of £5,419 million (2016: £6,472 million) was held and a further £275 million was due from OECD banks (2016: £613 million).

	2017			2016		
	Investment grade[1] £m	Other[2] £m	Total £m	Investment grade[1] £m	Other[2] £m	Total £m
Trading and other	21,742	2,211	23,953	31,373	2,053	33,426
Hedging	1,874	7	1,881	2,664	48	2,712
Total derivative financial instruments	23,616	2,218	25,834	34,037	2,101	36,138

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

2 Other comprises sub-investment grade (2017: £1,878 million; 2016: £1,830 million) and not rated (2017: £340 million; 2016: £271 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

A general description of collateral held as security in respect of financial instruments is provided on page 117. The Group holds collateral against loans and receivables and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for trading and other financial assets at fair value through profit or loss and for derivative assets is also shown below.

Notes to the consolidated financial statements continued

Note 51: Financial risk management continued

Loans and receivables

The disclosures below are produced under the underlying basis used for the Group's segmental reporting. The Group believes that, for reporting periods following a significant acquisition, such as the acquisition of HBOS in 2009, this underlying basis, which includes the allowance for loan losses at the acquisition on a gross basis, more fairly reflects the underlying provisioning status of the loans.

The Group holds collateral in respect of loans and advances to banks and customers as set out below. The Group does not hold collateral against debt securities, comprising asset-backed securities and corporate and other debt securities, which are classified as loans and receivables.

Loans and advances to banks

There were reverse repurchase agreements which are accounted for as collateralised loans within loans and advances to banks with a carrying value of £771 million (2016: £902 million), against which the Group held collateral with a fair value of £796 million (2016: £785 million).

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

Loans and advances to customers

Retail lending

Mortgages

An analysis by loan-to-value ratio of the Group's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations.

	2017				2016			
	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m	Neither past due nor impaired £m	Past due but not impaired £m	Impaired £m	Gross £m
Less than 70 per cent	217,070	4,309	2,443	223,822	220,497	5,288	2,334	228,119
70 per cent to 80 per cent	43,045	787	595	44,427	39,789	1,004	648	41,441
80 per cent to 90 per cent	25,497	500	436	26,433	23,589	621	495	24,705
90 per cent to 100 per cent	7,085	177	245	7,507	7,983	223	355	8,561
Greater than 100 per cent	3,068	161	450	3,679	4,445	204	488	5,137
Total	295,765	5,934	4,169	305,868	296,303	7,340	4,320	307,963

Other

The majority of non-mortgage retail lending is unsecured. At 31 December 2017, impaired non-mortgage lending amounted to £817 million, net of an impairment allowance of £542 million (2016: £972 million, net of an impairment allowance of £458 million). The fair value of the collateral held in respect of this lending was £154 million (2016: £139 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation and the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Unimpaired non-mortgage retail lending amounted to £49,482 million (2016: £39,864 million). Lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values are rigorously assessed at the time of loan origination and are thereafter monitored in accordance with business unit credit policy.

The Group credit risk disclosures for unimpaired non-mortgage retail lending report assets gross of collateral and therefore disclose the maximum loss exposure. The Group believes that this approach is appropriate. The value of collateral is reassessed if there is observable evidence of distress of the borrower. Unimpaired non-mortgage retail lending, including any associated collateral, is managed on a customer-by-customer basis rather than a portfolio basis. No aggregated collateral information for the entire unimpaired non-mortgage retail lending portfolio is provided to key management personnel.

Commercial lending

Reverse repurchase transactions

At 31 December 2017 there were reverse repurchase agreements which were accounted for as collateralised loans with a carrying value of £16,832 million (2016: £8,304 million), against which the Group held collateral with a fair value of £17,122 million (2016: £7,490 million), all of which the Group was able to repledge. Included in these amounts were collateral balances in the form of cash provided in respect of reverse repurchase agreements of £nil (2016: £8 million). These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Impaired secured lending

The value of collateral is re-evaluated and its legal soundness re-assessed if there is observable evidence of distress of the borrower; this evaluation is used to determine potential loss allowances and management's strategy to try to either repair the business or recover the debt.

At 31 December 2017, impaired secured commercial lending amounted to £698 million, net of an impairment allowance of £242 million (2016: £204 million, net of an impairment allowance of £401 million). The fair value of the collateral held in respect of impaired secured commercial lending was £797 million (2016: £1,160 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured commercial lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Impaired secured commercial lending and associated collateral relates to lending to property companies and to customers in the financial, business and other services; transport, distribution and hotels; and construction industries.

Unimpaired secured lending

Unimpaired secured commercial lending amounted to £48,120 million (2016: £36,275 million).

Note 51: Financial risk management continued

For unimpaired secured commercial lending, the Group reports assets gross of collateral and therefore discloses the maximum loss exposure. The Group believes that this approach is appropriate as collateral values at origination and during a period of good performance may not be representative of the value of collateral if the obligor enters a distressed state.

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

Trading and other financial assets at fair value through profit or loss (excluding equity shares)

Included in trading and other financial assets at fair value through profit or loss are reverse repurchase agreements treated as collateralised loans with a carrying value of £31,590 million (2016: £33,079 million). Collateral is held with a fair value of £39,099 million (2016: £30,850 million), all of which the Group is able to repledge. At 31 December 2017, £31,281 million had been repledged (2016: £27,303 million).

In addition, securities held as collateral in the form of stock borrowed amounted to £61,469 million (2016: £47,816 million). Of this amount, £44,432 million (2016: £16,204 million) had been resold or repledged as collateral for the Group's own transactions.

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

Derivative assets, after offsetting of amounts under master netting arrangements

The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net derivative assets after offsetting of amounts under master netting arrangements of £12,785 million (2016: £17,599 million), cash collateral of £5,419 million (2016: £6,472 million) was held.

Irrevocable loan commitments and other credit-related contingencies

At 31 December 2017, the Group held irrevocable loan commitments and other credit-related contingencies of £63,237 million (2016: £66,240 million). Collateral is held as security, in the event that lending is drawn down, on £10,956 million (2016: £10,053 million) of these balances.

Collateral repossessed

During the year, £297 million of collateral was repossessed (2016: £241 million), consisting primarily of residential property.

In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against commercial lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

E. Collateral pledged as security

The Group pledges assets primarily for repurchase agreements and securities lending transactions which are generally conducted under terms that are usual and customary for standard securitised borrowing contracts.

Repurchase transactions

Deposits from banks

Included in deposits from banks are balances arising from repurchase transactions of £23,175 million (2016: £7,279 million); the fair value of the collateral provided under these agreements at 31 December 2017 was £23,082 million (2016: £8,395 million).

Customer deposits

Included in customer deposits are balances arising from repurchase transactions of £2,638 million (2016: £2,462 million); the fair value of the collateral provided under these agreements at 31 December 2017 was £2,640 million (2016: £2,277 million).

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 £48,765 million (2016: £45,702 million).

Securities lending transactions

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

	2017 £m	2016 £m
Trading and other financial assets at fair value through profit or loss	**6,622**	6,991
Loans and advances to customers	**197**	583
Available-for-sale financial assets	**2,608**	3,206
	9,427	10,780

Securitisations and covered bonds

In addition to the assets detailed above, the Group also holds assets that are encumbered through the Group's asset-backed conduits and its securitisation and covered bond programmes. Further details of these assets are provided in notes 18 and 19.

Liquidity risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturity. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the PRA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

Notes to the consolidated financial statements continued

Note 51: Financial risk management continued

The table below analyses assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual 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.

Maturities of assets and liabilities

	Up to 1 month £m	1-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-2 years £m	2-5 years £m	Over 5 years £m	Total £m
At 31 December 2017									
Assets									
Cash and balances at central banks	**58,519**	**2**	**–**	**–**	**–**	**–**	**–**	**–**	**58,521**
Trading and other financial assets at fair value through profit or loss	**11,473**	**13,345**	**4,858**	**2,781**	**1,056**	**2,655**	**5,341**	**121,369**	**162,878**
Derivative financial instruments	**449**	**601**	**763**	**451**	**503**	**965**	**2,763**	**19,339**	**25,834**
Loans and advances to banks	**3,104**	**314**	**190**	**190**	**192**	**131**	**2,405**	**85**	**6,611**
Loans and advances to customers	**28,297**	**15,953**	**13,585**	**11,881**	**10,482**	**29,340**	**70,967**	**291,993**	**472,498**
Debt securities held as loans and receivables	**10**	**29**	**–**	**–**	**7**	**350**	**2,775**	**472**	**3,643**
Available-for-sale financial assets	**59**	**365**	**286**	**1,025**	**265**	**3,040**	**15,366**	**21,692**	**42,098**
Other assets	**3,807**	**897**	**414**	**1,170**	**854**	**725**	**5,618**	**26,541**	**40,026**
Total assets	**105,718**	**31,506**	**20,096**	**17,498**	**13,359**	**37,206**	**105,235**	**481,491**	**812,109**
Liabilities									
Deposits from banks	**2,810**	**2,318**	**1,885**	**87**	**28**	**–**	**22,378**	**298**	**29,804**
Customer deposits	**366,778**	**18,821**	**10,615**	**5,524**	**5,074**	**7,823**	**2,986**	**503**	**418,124**
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	**19,215**	**16,932**	**4,933**	**3,419**	**948**	**1,961**	**4,298**	**25,295**	**77,001**
Debt securities in issue	**3,248**	**6,014**	**4,431**	**3,506**	**2,902**	**6,333**	**25,669**	**20,347**	**72,450**
Liabilities arising from insurance and investment contracts	**1,898**	**2,003**	**2,484**	**2,466**	**2,425**	**8,532**	**21,842**	**77,210**	**118,860**
Other liabilities	**4,229**	**2,805**	**239**	**2,216**	**1,894**	**1,498**	**1,933**	**13,991**	**28,805**
Subordinated liabilities	**–**	**202**	**1,588**	**–**	**570**	**574**	**3,983**	**11,005**	**17,922**
Total liabilities	**398,178**	**49,095**	**26,175**	**17,218**	**13,841**	**26,721**	**83,089**	**148,649**	**762,966**
At 31 December 2016									
Assets									
Cash and balances at central banks	47,446	2	4	–	–	–	–	–	47,452
Trading and other financial assets at fair value through profit or loss	20,168	14,903	7,387	2,914	817	1,680	6,011	97,294	151,174
Derivative financial instruments	956	1,700	1,393	786	651	2,230	4,165	24,257	36,138
Loans and advances to banks	9,801	6,049	3,894	1,201	867	1,281	3,692	117	26,902
Loans and advances to customers	20,179	10,651	14,235	12,400	10,773	26,007	69,300	294,413	457,958
Debt securities held as loans and receivables	8	–	–	242	–	–	34	3,113	3,397
Available-for-sale financial assets	127	259	73	637	222	1,887	16,080	37,239	56,524
Other assets	5,025	583	584	1,560	1,059	1,846	4,808	22,783	38,248
Total assets	103,710	34,147	27,570	19,740	14,389	34,931	104,090	479,216	817,793
Liabilities									
Deposits from banks	3,772	2,779	1,062	503	13	43	7,859	353	16,384
Customer deposits	347,753	18,936	8,961	10,482	8,477	13,859	6,430	562	415,460
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	18,381	19,640	8,779	1,696	1,179	3,843	5,575	30,335	89,428
Debt securities in issue	4,065	8,328	6,433	4,158	1,224	6,939	25,020	20,147	76,314
Liabilities arising from insurance and investment contracts	1,583	2,190	2,737	2,463	2,377	8,588	19,971	74,593	114,502
Other liabilities	3,282	2,266	1,213	2,164	1,440	413	2,737	23,544	37,059
Subordinated liabilities	–	390	161	393	–	1,750	4,527	12,610	19,831
Total liabilities	378,836	54,529	29,346	21,859	14,710	35,435	72,119	162,144	768,978

The above tables are provided on a contractual basis. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms and readers are, therefore, advised to use caution when using this data to evaluate the Group's liquidity position. In particular, amounts in respect of customer deposits are usually contractually payable on demand or at short notice. However, in practice, these deposits are not usually withdrawn on their contractual maturity.

Note 51: Financial risk management continued

The table below analyses financial instrument liabilities of the Group, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2017						
Deposits from banks	**2,516**	**3,545**	**2,096**	**21,498**	**660**	**30,315**
Customer deposits	**367,103**	**18,854**	**21,308**	**11,198**	**2,375**	**420,838**
Trading and other financial liabilities at fair value through profit or loss	**21,286**	**14,424**	**6,499**	**4,251**	**13,044**	**59,504**
Debt securities in issue	**3,444**	**6,331**	**12,562**	**36,999**	**23,923**	**83,259**
Liabilities arising from non-participating investment contracts	**15,447**	**–**	**–**	**–**	**–**	**15,447**
Subordinated liabilities	**231**	**454**	**2,907**	**7,170**	**19,164**	**29,926**
Total non-derivative financial liabilities	**410,027**	**43,608**	**45,372**	**81,116**	**59,166**	**639,289**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**23,850**	**31,974**	**24,923**	**43,444**	**30,605**	**154,796**
Gross settled derivatives – inflows	**(23,028)**	**(30,972)**	**(23,886)**	**(43,523)**	**(32,065)**	**(153,474)**
Gross settled derivatives – net flows	**822**	**1,002**	**1,037**	**(79)**	**(1,460)**	**1,322**
Net settled derivatives liabilities	**17,425**	**128**	**776**	**974**	**2,795**	**22,098**
Total derivative financial liabilities	**18,247**	**1,130**	**1,813**	**895**	**1,335**	**23,420**
At 31 December 2016						
Deposits from banks	3,686	4,154	1,541	5,883	1,203	16,467
Customer deposits	347,573	19,151	28,248	20,789	1,294	417,055
Trading and other financial liabilities at fair value through profit or loss	14,390	19,718	11,845	1,938	13,513	61,404
Debt securities in issue	7,590	8,721	12,533	36,386	17,635	82,865
Liabilities arising from non-participating investment contracts	20,112	–	–	–	–	20,112
Subordinated liabilities	41	674	1,289	9,279	18,542	29,825
Total non-derivative financial liabilities	393,392	52,418	55,456	74,275	52,187	627,728
Derivative financial liabilities:						
Gross settled derivatives – outflows	33,128	24,088	25,366	52,925	36,462	171,969
Gross settled derivatives – inflows	(31,359)	(22,401)	(23,510)	(49,239)	(32,382)	(158,891)
Gross settled derivatives – net flows	1,769	1,687	1,856	3,686	4,080	13,078
Net settled derivatives liabilities	21,669	117	620	1,167	3,020	26,593
Total derivative financial liabilities	23,438	1,804	2,476	4,853	7,100	39,671

The Group's financial guarantee contracts are accounted for as financial instruments and measured at fair value, upon initial recognition, on the balance sheet. The majority of the Group's financial guarantee contracts are callable on demand, were the guaranteed party to fail to meet its obligations. It is, however, expected that most guarantees will expire unused. The contractual nominal amounts of these guarantees totalled £5,820 million at 31 December 2017 (2016: £6,883 million) with £3,132 million expiring within one year; £627 million between one and three years; £1,471 million between three and five years; and £590 million over five years (2016: £3,815 million expiring within one year; £667 million between one and three years; £1,334 million between three and five years; and £1,067 million over five years).

The majority of the Group's non-participating investment contract liabilities are unit-linked. These unit-linked products are invested in accordance with unit fund mandates. Clauses are included in policyholder contracts to permit the deferral of sales, where necessary, so that linked assets can be realised without being a forced seller.

The principal amount for undated subordinated liabilities with no redemption option is included within the over five years column; interest of approximately £24 million (2016: £23 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond five years.

Notes to the consolidated financial statements continued

Note 51: Financial risk management continued

Further information on the Group's liquidity exposures is provided on pages 144–148.

Liabilities arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2017	**1,708**	**1,747**	**6,467**	**26,479**	**67,012**	**103,413**
At 31 December 2016	1,283	1,836	6,266	23,425	61,580	94,390

For insurance and participating investment contracts which are neither unit-linked nor in the Group's with-profit funds, in particular annuity liabilities, the aim is to invest in assets such that the cash flows on investments match those on the projected future liabilities.

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

	Up to 1 month £m	1-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
At 31 December 2017									
Acceptances and endorsements	**12**	**51**	**4**	**–**	**–**	**4**	**–**	**–**	**71**
Other contingent liabilities	**392**	**669**	**210**	**131**	**205**	**506**	**271**	**656**	**3,040**
Total contingent liabilities	**404**	**720**	**214**	**131**	**205**	**510**	**271**	**656**	**3,111**
Lending commitments	**66,964**	**3,137**	**5,966**	**5,525**	**11,440**	**17,374**	**15,106**	**3,913**	**129,425**
Other commitments	**19**	**–**	**–**	**38**	**–**	**46**	**71**	**210**	**384**
Total commitments	**66,983**	**3,137**	**5,966**	**5,563**	**11,440**	**17,420**	**15,177**	**4,123**	**129,809**
Total contingents and commitments	**67,387**	**3,857**	**6,180**	**5,694**	**11,645**	**17,930**	**15,448**	**4,779**	**132,920**

	Up to 1 month £m	1-3 months £m	3-6 months £m	6-9 months £m	9-12 months £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
At 31 December 2016									
Acceptances and endorsements	13	6	–	–	1	1	–	–	21
Other contingent liabilities	427	782	163	153	122	466	280	623	3,016
Total contingent liabilities	440	788	163	153	123	467	280	623	3,037
Lending commitments	48,210	3,546	5,276	4,783	11,628	17,212	18,775	4,090	113,520
Other commitments	–	3	–	41	1	79	122	402	648
Total commitments	48,210	3,549	5,276	4,824	11,629	17,291	18,897	4,492	114,168
Total contingents and commitments	48,650	4,337	5,439	4,977	11,752	17,758	19,177	5,115	117,205

Note 52: Consolidated cash flow statement

(A) Change in operating assets

	2017 £m	2016 £m	2015 £m
Change in loans and receivables	**(24,747)**	710	6,081
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**9,916**	(13,889)	20,689
Change in other operating assets	**(661)**	961	7,930
Change in operating assets	**(15,492)**	(12,218)	34,700

(B) Change in operating liabilities

	2017 £m	2016 £m	2015 £m
Change in deposits from banks	**13,415**	(654)	6,107
Change in customer deposits	**2,913**	(3,690)	(4,252)
Change in debt securities in issue	**(3,600)**	(6,552)	5,657
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	**(12,481)**	11,265	(16,924)
Change in investment contract liabilities	**(4,665)**	(2,665)	(3,922)
Change in other operating liabilities	**136**	(363)	1,349
Change in operating liabilities	**(4,282)**	(2,659)	(11,985)

Note 52: Consolidated cash flow statement continued
(C) Non-cash and other items

	2017 £m	2016 £m	2015 £m
Depreciation and amortisation	**2,370**	2,380	2,112
Revaluation of investment properties	**(230)**	83	(416)
Allowance for loan losses	**691**	592	441
Write-off of allowance for loan losses, net of recoveries	**(1,061)**	(1,272)	(3,467)
Impairment of available-for-sale financial assets	**6**	173	4
Change in insurance contract liabilities	**9,168**	14,084	(2,856)
Payment protection insurance provision	**1,650**	1,000	4,000
Other regulatory provisions	**865**	1,085	837
Other provision movements	**(17)**	(40)	337
Net charge (credit) in respect of defined benefit schemes	**369**	287	315
Impact of consolidation and deconsolidation of OEICs[1]	**–**	(3,157)	(5,978)
Unwind of discount on impairment allowances	**(23)**	(32)	(56)
Foreign exchange impact on balance sheet[2]	**125**	(155)	507
Loss on ECN transactions	**–**	721	–
Interest expense on subordinated liabilities	**1,436**	1,864	1,970
Loss (profit) on disposal of businesses	**–**	–	46
Net gain on sale of available-for-sale financial assets	**(446)**	(575)	(51)
Hedging valuation adjustments on subordinated debt	**(327)**	153	(162)
Value of employee services	**414**	309	279
Transactions in own shares	**(411)**	(175)	(816)
Accretion of discounts and amortisation of premiums and issue costs	**1,701**	465	339
Share of post-tax results of associates and joint ventures	**(6)**	1	3
Transfers to income statement from reserves	**(650)**	(557)	(956)
Profit on disposal of tangible fixed assets	**(120)**	(93)	(51)
Other non-cash items	**–**	(17)	(11)
Total non-cash items	**15,504**	17,124	(3,630)
Contributions to defined benefit schemes	**(587)**	(630)	(433)
Payments in respect of payment protection insurance provision	**(1,657)**	(2,200)	(3,091)
Payments in respect of other regulatory provisions	**(928)**	(761)	(661)
Other	**–**	2	7
Total other items	**(3,172)**	(3,589)	(4,178)
Non-cash and other items	**12,332**	13,535	(7,808)

1 These OEICs (Open-ended investment companies) are mutual funds which are consolidated if the Group manages the funds and also has a sufficient beneficial interest. The population of OEICs to be consolidated varies at each reporting date as external investors acquire and divest holdings in the various funds. The consolidation of these funds is effected by the inclusion of the fund investments and a matching liability to the unitholders; and changes in funds consolidated represent a non-cash movement on the balance sheet.

2 When considering the movement on each line of the balance sheet, the impact of foreign exchange rate movements is removed in order to show the underlying cash impact.

(D) Analysis of cash and cash equivalents as shown in the balance sheet

	2017 £m	2016 £m	2015 £m
Cash and balances at central banks	**58,521**	47,452	58,417
Less: mandatory reserve deposits[1]	**(957)**	(914)	(941)
	57,564	46,538	57,476
Loans and advances to banks	**6,611**	26,902	25,117
Less: amounts with a maturity of three months or more	**(3,193)**	(11,052)	(10,640)
	3,418	15,850	14,477
Total cash and cash equivalents	**60,982**	62,388	71,953

1 Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents at 31 December 2017 is £2,322 million (2016: £14,475 million; 2015: £13,545 million) held within the Group's long-term insurance and investments businesses, which is not immediately available for use in the business.

Notes to the consolidated financial statements continued

Note 52: Consolidated cash flow statement continued
(E) Acquisition of group undertakings and businesses

	2017 £m	2016 £m	2015 £m
Net assets acquired:			
Cash and cash equivalents	123	–	–
Loans and receivables: Loans and advances to customers	7,811	–	–
Available-for-sale financial assets	16	–	–
Intangible assets	702	–	–
Property, plant and equipment	6	–	–
Other assets	414	–	–
Deposits from banks[1]	(6,431)	–	–
Other liabilities	(927)	–	–
Goodwill arising on acquisition	302	–	–
Cash consideration	2,016	–	–
Less: Cash and cash equivalents acquired	(123)	–	–
Net cash outflow arising from acquisition of MBNA	1,893	–	–
Acquisition of and additional investment in joint ventures	30	20	5
Net cash outflow from acquisitions in the year	1,923	20	5

1 Upon acquisition, the funding of MBNA was assumed by Lloyds Bank plc.

(F) Disposal and closure of group undertakings and businesses

	2017 £m	2016 £m	2015 £m
Trading and other assets at fair value through profit or loss	–	–	3,420
Loans and advances to customers	342	–	21,333
Loans and advances to banks	–	–	5,539
Available-for-sale financial assets	–	–	654
Value of in-force business	–	–	60
Property, plant and equipment	–	–	150
	342	–	31,156
Customer deposits	–	–	(24,613)
Debt securities in issue	–	–	(9)
Liabilities arising from insurance contracts and participating investment contracts	–	–	(3,828)
Liabilities arising from non-participating investment contracts	–	–	(549)
Non-controlling interests	(242)	–	(825)
Other net assets (liabilities)	29	5	(314)
	(213)	5	(30,138)
Net assets	129	5	1,018
Non-cash consideration received	–	–	–
(Loss) profit on sale	–	–	(46)
Cash consideration received on losing control of group undertakings and businesses	129	5	972
Cash and cash equivalents disposed	–	–	(5,043)
Net cash inflow (outflow)	129	5	(4,071)

Note 53: Events since the balance sheet date
The Group intends to implement a share buyback of up to £1 billion. This represents the return to shareholders of capital surplus to that required to provide capacity for growth, meet regulatory requirements and cover uncertainties. The share buyback programme will commence in March 2018 and is expected to be completed during the next 12 months.

Note 54: Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2017 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 IFRS 17 'Insurance Contracts', the amendment to IFRS 9 'Prepayment Features with Negative Compensation' and certain other minor amendments as at 20 February 2018 these pronouncements have been endorsed by the EU.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 'Financial Instruments: Recognition and Measurement' and is effective for annual periods beginning on or after 1 January 2018. The Group has chosen 1 January 2018 as its initial application date of IFRS 9 and has not restated comparative periods.

Classification and measurement

IFRS 9 requires financial assets to be classified into one of three measurement categories, fair value through profit or loss, fair value through other comprehensive income or amortised cost. Financial assets will be measured at amortised cost if they are held within a business model the objective of which is to hold financial assets in order to collect contractual cash flows, and their contractual cash flows represent solely payments of principal and interest. Financial assets will be measured at fair value through other comprehensive income if they are held within a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets and their contractual cash flows represent solely payments of principal and interest. Financial assets not meeting either of these two business models; and all equity instruments (unless designated at inception to fair value through other comprehensive income); and all derivatives are measured at fair value through profit or loss. An entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch.

In October 2017 the IASB issued an Amendment to IFRS 9, 'Prepayment Features with Negative Compensation' which has an effective date of 1 January 2019. This Amendment changes the requirements of IFRS 9 so that certain prepayment features meet the solely payments of principal and interest test. The Group has some loans in its Commercial Banking division that have these features and so the Group has decided to apply the Amendment in 2018 in order to avoid further changes to accounting for financial assets in 2019. The Amendment is still subject to EU endorsement and the Group assumes this will occur during 2018.

Impairment

The IFRS 9 impairment model will be applicable to all financial assets at amortised cost, debt instruments measured at fair value through other comprehensive income, lease receivables, loan commitments and financial guarantees not measured at fair value through profit or loss.

IFRS 9 replaces the existing 'incurred loss' impairment approach with an expected credit loss ('ECL') model resulting in earlier recognition of credit losses compared with IAS 39. Expected credit losses are the unbiased probability weighted average credit losses determined by evaluating a range of possible outcomes and future economic conditions.

The ECL model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance when there has been a significant increase in credit risk since initial recognition (stage 2). Stage 3 requires objective evidence that an asset is credit-impaired, which is similar to the guidance on incurred losses in IAS 39, and then a lifetime expected loss allowance is recognised.

IFRS 9 requires the use of more forward looking information including reasonable and supportable forecasts of future economic conditions. The need to consider a range of economic scenarios and how they could impact the loss allowance is a subjective feature of the IFRS 9 ECL model. The Group has developed the capability to model a number of economic scenarios and capture the impact on credit losses to ensure the overall ECL reflects an appropriate distribution of economic outcomes.

For all material portfolios, IFRS 9 ECL calculation will leverage the systems, data and methodology used to calculate regulatory 'expected losses'. The definition of default for IFRS 9 purposes will be aligned to the Basel definition of default to ensure consistency across the Group. IFRS 9 models will use three key input parameters for the computation of expected loss, being probability of default ('PD'), loss given default ('LGD') and exposure at default ('EAD'). However, given the conservatism inherent in the regulatory expected losses calculation and some differences in the period over which risk parameters are measured, some adjustments to these components have been made to ensure compliance with IFRS 9.

Impact on 31 December 2017 balance sheet

It is estimated that the new impairment methodology will result in higher impairment provisions of approximately £1.3 billion, predominantly for loans and advances to customers, recognised on the Group's balance sheet. The re-classification and measurement of assets under IFRS 9 also results in a reduction to the carrying value of financial assets of approximately £0.2 billion gross of tax, mainly as a result of transferring assets managed by the Insurance division to fair value through profit or loss. The total net of tax impact on shareholders' equity is a reduction of approximately £1.2 billion.

The ongoing impact on the financial results will only become clearer after running the IFRS 9 credit risk models over a period of time and under different economic environments, however, it could result in impairment charges being more volatile when compared to the current IAS 39 impairment model, due to the forward looking nature of expected credit losses.

Hedge accounting

The hedge accounting requirements of IFRS 9 are more closely aligned with risk management practices and follow a more principle-based approach than IAS 39. The standard does not address macro hedge accounting, which is being considered in a separate IASB project. There is an option to retain the existing IAS 39 hedge accounting requirements until the IASB completes its project on macro hedging. The Group expects to continue applying IAS 39 hedge accounting in accordance with this accounting policy choice.

Notes to the consolidated financial statements continued

Note 54: Future accounting developments continued

IFRS 15 Revenue from Contracts with Customers

IFRS 15 replaces IAS 18 'Revenue' and IAS 11 'Construction Contracts' and is effective for annual periods beginning on or after 1 January 2018.

The core principle of IFRS 15 is that revenue reflects the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled. The recognition of such revenue is in accordance with five steps to: identify the contract; identify the performance obligations; determine the transaction price; allocate the transaction price to the performance obligations; and recognise revenue when the performance obligations are satisfied.

In nearly all cases the Group's current accounting policy is consistent with the requirements of IFRS 15, however, certain income streams within the Group's car leasing business will be deferred with effect from 1 January 2018. This results in an additional £14 million being recognised as deferred income at 1 January 2018 and a corresponding debit of £11 million, net of tax, to shareholders' equity; as permitted by the transition options under IFRS 15 comparative figures for the prior year have not been restated.

IFRS 16 Leases

IFRS 16 replaces IAS 17 'Leases' and is effective for annual periods beginning on or after 1 January 2019.

IFRS 16 requires lessees to recognise a right of use asset and a liability for future payments arising from a lease contract. Lessees will recognise a finance charge on the liability and a depreciation charge on the asset which could affect the timing of the recognition of expenses on leased assets. This change will mainly impact the properties that the Group currently accounts for as operating leases. Finance systems will need to be changed to reflect the new accounting rules and disclosures. Lessor accounting requirements remain aligned to the current approach under IAS 17.

IFRS 17 Insurance Contracts

IFRS 17 replaces IFRS 4 'Insurance Contracts' and is effective for annual periods beginning on or after 1 January 2021.

IFRS 17 requires insurance contracts and participating investment contracts to be measured on the balance sheet as the total of the fulfilment cash flows and the contractual service margin. Changes to estimates of future cash flows from one reporting date to another are recognised either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it. The effects of some changes in discount rates can either be recognised in profit or loss or in other comprehensive income as an accounting policy choice. The risk adjustment is released to profit and loss as an insurer's risk reduces. Profits which are currently recognised through a Value in Force asset, will no longer be recognised at inception of an insurance contract. Instead, the expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided.

The standard will have a significant impact on the accounting for the insurance and participating investment contracts issued by the Group.

Minor amendments to other accounting standards

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2018 (including IFRS 2 Share-based Payment and IAS 40 Investment Property) and effective 1 January 2019 (including IAS 19 Employee Benefits, IAS 12 Income Taxes and IFRIC 23 Uncertainty over Income Tax Treatments). These revised requirements are not expected to have a significant impact on the Group.

Parent company balance sheet

at 31 December

	Note	2017 £ million	2016[1] £ million
Assets			
Non-current assets:			
Investment in subsidiaries	8	**44,863**	44,188
Loans to subsidiaries	8	**14,379**	6,912
Deferred tax asset		**22**	38
		59,264	51,138
Current assets:			
Derivative financial instruments		**265**	461
Other assets		**961**	959
Amounts due from subsidiaries	2	**47**	67
Cash and cash equivalents		**272**	42
Current tax recoverable		**724**	465
		2,269	1,994
Total assets		**61,533**	53,132
Equity and liabilities			
Capital and reserves:			
Share capital	3	**7,197**	7,146
Share premium account	3	**17,634**	17,622
Merger reserve	4	**7,423**	7,423
Capital redemption reserve	4	**4,115**	4,115
Retained profits[1]	5	**1,500**	1,584
Shareholders' equity		**37,869**	37,890
Other equity instruments	3	**5,355**	5,355
Total equity		**43,224**	43,245
Non-current liabilities:			
Debt securities in issue	6	**10,886**	2,455
Subordinated liabilities	7	**3,993**	4,329
		14,879	6,784
Current liabilities:			
Derivative financial instruments		**327**	–
Other liabilities		**3,103**	3,103
		3,430	3,103
Total liabilities		**18,309**	9,887
Total equity and liabilities		**61,533**	53,132

1 The parent company recorded a profit after tax for the year of £2,399 million (2016: £3,135 million).

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

The directors approved the parent company financial statements on 20 February 2018.

Lord Blackwell
Chairman

António Horta-Osório
Group Chief Executive

George Culmer
Chief Financial Officer

Parent company statement of changes in equity

for the year ended 31 December

	Share capital and premium £ million	Merger reserve £ million	Capital redemption reserve £ million	Retained profits[1] £ million	Total shareholders' equity £ million	Other equity instruments £ million	Total equity £ million
Balance at 1 January 2015	24,427	7,764	4,115	1,720	38,026	5,355	43,381
Total comprehensive income[1]	–	–	–	897	897	–	897
Dividends paid	–	–	–	(1,070)	(1,070)	–	(1,070)
Distributions on other equity instruments, net of tax	–	–	–	(314)	(314)	–	(314)
Redemption of preference shares	131	(131)	–	–	–	–	–
Movement in treasury shares	–	–	–	(753)	(753)	–	(753)
Value of employee services:							
Share option schemes, net of tax	–	–	–	133	133	–	133
Other employee award schemes	–	–	–	172	172	–	172
Balance at 31 December 2015	24,558	7,633	4,115	785	37,091	5,355	42,446
Total comprehensive income[1]	–	–	–	3,135	3,135	–	3,135
Dividends paid	–	–	–	(2,014)	(2,014)	–	(2,014)
Distributions on other equity instruments, net of tax	–	–	–	(330)	(330)	–	(330)
Redemption of preference shares	210	(210)	–	–	–	–	–
Movement in treasury shares	–	–	–	(301)	(301)	–	(301)
Value of employee services:							
Share option schemes, net of tax	–	–	–	141	141	–	141
Other employee award schemes	–	–	–	168	168	–	168
Balance at 31 December 2016	24,768	7,423	4,115	1,584	37,890	5,355	43,245
Total comprehensive income[1]	**–**	**–**	**–**	**2,399**	**2,399**	**–**	**2,399**
Dividends paid				**(2,284)**	**(2,284)**	**–**	**(2,284)**
Distributions on other equity instruments, net of tax	**–**	**–**	**–**	**(336)**	**(336)**	**–**	**(336)**
Issue of ordinary shares	**63**	**–**	**–**	**–**	**63**	**–**	**63**
Movement in treasury shares	**–**	**–**	**–**	**(277)**	**(277)**	**–**	**(277)**
Value of employee services:							
Share option schemes, net of tax	**–**	**–**	**–**	**82**	**82**	**–**	**82**
Other employee award schemes	**–**	**–**	**–**	**332**	**332**	**–**	**332**
Balance at 31 December 2017	**24,831**	**7,423**	**4,115**	**1,500**	**37,869**	**5,355**	**43,224**

1 Total comprehensive income comprises only the profit (loss) for the year; no statement of comprehensive income has been shown for the parent company, as permitted by section 408 of the Companies Act 2006.

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

Parent company cash flow statement

for the year ended 31 December

	2017 £ million	2016 £ million	2015 £ million
Profit before tax	2,416	3,463	969
Fair value and exchange adjustments and other non-cash items	495	1,986	(1,357)
Change in other assets	18	(50)	(566)
Change in other liabilities and other items	8,431	(8,392)	458
Dividends received	(2,650)	(3,759)	(1,080)
Distributions on other equity instruments received	(292)	(119)	–
Tax (paid) received	(197)	(679)	(142)
Net cash provided by (used in) operating activities	**8,221**	**(7,550)**	**(1,718)**
Cash flows from investing activities			
Return of capital contribution	77	441	600
Dividends received	2,650	3,759	1,080
Distributions on other equity instruments received	292	119	–
Capital injection to Lloyds Bank plc	–	(3,522)	–
Acquisition of subsidiaries	(320)	–	–
Amounts advanced to subsidiaries	(8,476)	(4,978)	(1,157)
Redemption of loans to subsidiaries	475	13,166	570
Interest received on loans to subsidiaries	244	496	763
Net cash (used in) provided by investing activities	**(5,058)**	**9,481**	**1,856**
Cash flows from financing activities			
Dividends paid to ordinary shareholders	(2,284)	(2,014)	(1,070)
Distributions on other equity instruments	(415)	(412)	(394)
Issue of subordinated liabilities	–	1,061	1,436
Interest paid on subordinated liabilities	(248)	(229)	(129)
Repayment of subordinated liabilities	–	(319)	(152)
Proceeds from issue of ordinary shares	14	–	–
Net cash used in financing activities	**(2,933)**	**(1,913)**	**(309)**
Change in cash and cash equivalents	230	18	(171)
Cash and cash equivalents at beginning of year	42	24	195
Cash and cash equivalents at end of year	**272**	**42**	**24**

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

Notes to the parent company financial statements

for the year ended 31 December

Note 1: Basis of preparation and accounting policies

The Company has applied International Financial Reporting Standards as adopted by the European Union in its financial statements for the year ended 31 December 2017. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the IFRS Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 Financial Instruments: Recognition and Measurement relaxes some of the hedge accounting requirements; the Company has not taken advantage of this relaxation, and therefore there is no difference in application to the Company 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 all derivative contracts.

The accounting policies of the Company are the same as those of the Group which are set out in note 2 to the consolidated financial statements, except that it has no policy in respect of consolidation and investments in subsidiaries are carried at historical cost, less any provisions for impairment.

Note 2: Amounts due from subsidiaries

These comprise short-term lending to subsidiaries, repayable on demand. The fair values of amounts owed by subsidiaries are equal to their carrying amounts. No provisions have been recognised in respect of amounts owed by subsidiaries.

Note 3: Share capital, share premium and other equity instruments

Details of the Company's share capital, share premium account and other equity instruments are as set out in notes 39, 40 and 43 to the consolidated financial statements.

Note 4: Other reserves

The merger reserve comprises the premium on shares issued on 13 January 2009 under the placing and open offer and shares issued on 16 January 2009 on the acquisition of HBOS plc, offset by adjustments on the redemption of preference shares. Substantially all of the Company's merger reserve is available for distribution.

Movements in the merger reserve were as follows:

	2017 £m	2016 £m	2015 £m
At 1 January	**7,423**	7,633	7,764
Redemption of preference shares[1]	**–**	(210)	(131)
At 31 December	**7,423**	7,423	7,633

1 During the year ended 31 December 2016, the Company redeemed all of its outstanding 6.267% Non-cumulative Fixed to Floating Rate Callable US Dollar Preference Shares at their combined sterling equivalent par value of £210 million. These preference shares had been accounted for as subordinated liabilities. On redemption an amount of £210 million was transferred from the distributable merger reserve to the share premium account (2015: £131 million in respect of the redemption of the outstanding 6.0884% Non-cumulative Fixed to Floating Rate Preference Shares and 5.92% Non-cumulative Fixed to Floating Rate Preference Shares).

The capital redemption reserve represents transfers from the merger reserve in accordance with companies' legislation and amounts transferred from share capital following the cancellation of the deferred shares.

There were no movements in the capital redemption reserve in 2015, 2016 or 2017.

Note 5: Retained profits

	2017 £m	2016 £m	2015 £m
At 1 January	**1,584**	785	1,720
Profit for the year	**2,399**	3,135	897
Dividends paid	**(2,284)**	(2,014)	(1,070)
Distributions on other equity instruments, net of tax	**(336)**	(330)	(314)
Movement in treasury shares	**(277)**	(301)	(753)
Value of employee services:			
Share option schemes	**82**	141	133
Other employee award schemes	**332**	168	172
At 31 December	**1,500**	1,584	785

Details of the Company's dividends are as set out in note 44 to the consolidated financial statements.

Note 6: Debt securities in issue

These comprise notes issued by the Company in a number of currencies, although predominantly Euros and US dollars, with maturity dates ranging up to 2028.

Note 7: Subordinated liabilities

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer. Any repayments of subordinated liabilities require the consent of the Prudential Regulation Authority.

	Preference shares £m	Undated subordinated liabilities £m	Dated subordinated liabilities £m	Total £m
At 1 January 2016	911	10	2,144	3,065
Issued during the year:				
4.65% Subordinated Fixed Rate Notes 2026 (US$1,500 million)	–	–	1,061	1,061
Repurchases and redemptions during the year:				
6.267% Non-Cumulative Fixed to Floating Rate Preference Shares callable 2016 (US$1,000 million)[1]	(319)	–	–	(319)
Foreign exchange and other movements	(24)	–	546	522
At 31 December 2016	568	10	3,751	4,329
Foreign exchange and other movements	**(2)**	**–**	**(334)**	**(336)**
At 31 December 2017	**566**	**10**	**3,417**	**3,993**

1 See note 4.

Note 8: Related party transactions

Key management personnel

The key management personnel of the Group and the Company are the same. The relevant disclosures are given in note 46 to the consolidated financial statements.

The Company has no employees (2016: nil).

As discussed in note 2 to the consolidated financial statements, the Group provides share-based compensation to employees through a number of schemes; these are all in relation to shares in the Company and the cost of providing those benefits is recharged to the employing companies in the Group.

Investment in subsidiaries

	2017 £m	2016 £m
At 1 January	**44,188**	40,785
Additions and capital injections	**320**	3,522
Capital contribution	**432**	322
Return of capital contribution	**(77)**	(441)
At 31 December	**44,863**	44,188

Details of the subsidiaries and related undertakings are given on pages 268 to 274 and are incorporated by reference.

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

Loans to subsidiaries

	2017 £m	2016 £m
At 1 January	**6,912**	14,548
Exchange and other adjustments	**(534)**	552
New issues	**8,476**	4,978
Redemptions	**(475)**	(13,166)
At 31 December	**14,379**	6,912

Notes to the parent company financial statements continued

Note 8: Related party transactions continued

In addition the Company carries out banking activities through its subsidiary, Lloyds Bank plc. At 31 December 2017, the Company held deposits of £272 million with Lloyds Bank plc (2016: £42 million). Given the volume of transactions flowing through the account, it is not meaningful to provide gross inflow and outflow information. Included within other liabilities is £2,168 million (2016: £2,690 million) due to subsidiary undertakings. In addition, at 31 December 2017 the Company had interest rate and currency swaps with Lloyds Bank plc with an aggregate notional principal amount of £8,068 million and a net negative fair value of £62 million (2016: notional principal amount of £2,905 million and a net positive fair value of £461 million). Of this amount an aggregate notional principal amount of £4,455 million and a net positive fair value of £246 million (2016: notional principal amount of £1,529 million and a net positive fair value of £307 million) were designated as fair value hedges to manage the Company's issuance of subordinated liabilities.

Guarantees

The Company guarantees certain of its subsidiaries' liabilities to the Bank of England.

Other related party transactions

Related party information in respect of other related party transactions is given in note 46 to the consolidated financial statements.

Note 9: Financial instruments

Measurement basis of financial assets and liabilities

The accounting policies in note 2 to the consolidated financial statements describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the Company's financial assets and liabilities by category and by balance sheet heading.

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Held for trading at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
At 31 December 2017					
Financial assets:					
Cash and cash equivalents	–	–	–	272	272
Derivative financial instruments	265	–	–	–	265
Loans to subsidiaries	–	–	14,379	–	14,379
Amounts due from subsidiaries	–	–	47	–	47
Total financial assets	**265**	**–**	**14,426**	**272**	**14,963**
Financial liabilities:					
Debt securities in issue	–	–	–	10,886	10,886
Subordinated liabilities	–	–	–	3,993	3,993
Derivative financial instruments	19	308	–	–	327
Total financial liabilities	**19**	**308**	**–**	**14,879**	**15,206**
At 31 December 2016					
Financial assets:					
Cash and cash equivalents	–	–	–	42	42
Derivative financial instruments	307	154	–	–	461
Loans to subsidiaries	–	–	6,912	–	6,912
Amounts due from subsidiaries	–	–	67	–	67
Total financial assets	307	154	6,979	42	7,482
Financial liabilities:					
Debt securities in issue	–	–	–	2,455	2,455
Subordinated liabilities	–	–	–	4,329	4,329
Total financial liabilities	–	–	–	6,784	6,784

Note 48 to the consolidated financial statements outlines the valuation hierarchy into which financial instruments measured at fair value are categorised.

The derivative assets designated as hedging instruments represent level 2 portfolios.

The following reconciliation shows the movements in derivative financial instrument assets within level 3 portfolios:

	2017 £m	2016 £m
At 1 January	–	545
Derecognised following completion of the Group's ECN tender offers and redemptions	–	(476)
Losses recognised in the income statement	–	(69)
At 31 December	**–**	–

Note 9: Financial instruments continued

Interest rate risk and currency risk

The Company is exposed to interest rate risk and currency risk on its debt securities in issue and its subordinated debt.

As discussed in note 8, the Company has entered into interest rate and currency swaps with its subsidiary, Lloyds Bank plc, to manage these risks.

Credit risk

The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiary, Lloyds Bank plc, and subsidiaries of that company.

Liquidity risk

The table below analyses financial instrument liabilities of the Company, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
At 31 December 2017						
Debt securities in issue	**46**	**6**	**218**	**5,437**	**7,133**	**12,840**
Subordinated liabilities	**–**	**28**	**213**	**962**	**7,062**	**8,265**
Total financial instrument liabilities	**46**	**34**	**431**	**6,399**	**14,195**	**21,105**
At 31 December 2016						
Debt securities in issue	13	–	27	1,809	820	2,669
Subordinated liabilities	–	30	229	1,043	7,893	9,195
Total financial instrument liabilities	13	30	256	2,852	8,713	11,864

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £1 million (2016: £1 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

Fair values of financial assets and liabilities

The valuation techniques for the Company's financial instruments are as discussed in note 48 to the consolidated financial statements.

Valuation hierarchy

The table below analyses the assets and liabilities of the Company. With the exception of derivatives all assets and liabilities are held at amortised cost. They are categorised into levels 1 to 3 based on the degree to which their fair value is observable. No assets or liabilities were categorised as level 1 (2016: nil).

Fair value of financial assets and liabilities

	2017				2016			
			Valuation hierarchy				Valuation hierarchy	
	Carrying value £m	Fair value £m	Level 2 £m	Level 3 £m	Carrying value £m	Fair value £m	Level 2 £m	Level 3 £m
Derivative financial instruments	**265**	**265**	**265**	**–**	461	461	461	–
Loans to subsidiaries	**14,379**	**14,379**	**14,379**	**–**	6,912	6,912	6,912	–
Amounts due from subsidiaries	**47**	**47**	**47**	**–**	67	67	67	–
Total financial assets	**14,691**	**14,691**	**14,691**	**–**	7,440	7,440	7,440	–
Derivative financial instruments	**327**	**327**	**327**	**–**	–	–	–	–
Debt securities in issue	**10,886**	**10,966**	**10,966**	**–**	2,455	2,452	2,452	–
Subordinated liabilities	**3,993**	**5,160**	**5,160**	**–**	4,329	5,111	5,111	–
Total financial liabilities	**15,206**	**16,453**	**16,453**	**–**	6,784	7,563	7,563	–

The carrying amount of cash and cash equivalents (2017: £272 million; 2016: £42 million) is a reasonable approximation of fair value.

Note 10: Other information

Lloyds Banking Group plc was incorporated as a public limited company and registered in Scotland under the UK Companies Act 1985 on 21 October 1985 with the registered number 95000. Lloyds Banking Group plc's registered office is The Mound, Edinburgh EH1 1YZ, Scotland, and its principal executive offices in the UK are located at 25 Gresham Street, London EC2V 7HN.

OTHER INFORMATION

TACKLING DISADVANTAGE ACROSS BRITAIN

We're helping thousands of disadvantaged people across Britain through our independent charitable Foundations. In Edinburgh, the Thistle Centre of Wellbeing has received a £70,000 grant from the Bank of Scotland Foundation to help them support people with long term health conditions. They will use the grant to finance around 320 personal consultations for the next two years. This face-to-face support allows people to stay connected and manage their health condition thanks to a range of activities including tai chi sessions led by local volunteers.

>£20m

given to our independent charitable Foundations in 2017

Visit www.lloydsbankinggroup.com/prosperplan

Shareholder information

Annual general meeting (AGM)

The AGM will be held at the Edinburgh International Conference Centre, The Exchange, Edinburgh EH3 8EE on Thursday 24 May 2018 at 11am. Further details about the meeting, including the proposed resolutions and where shareholders can stream the meeting live, can be found in our Notice of AGM which will be available shortly on our website at www.lloydsbankinggroup.com

Reports and communications

The Group issues regulatory announcements through the Regulatory News Service (RNS); shareholders can subscribe for free via the 'Investors & Performance' section of our website at www.lloydsbankinggroup.com, where our statutory reports and shareholder communications are available. A summary of the scheduled reports and communications to be issued in 2018 is set out below:

		Available format			
Report/Communication	Month	Online	Email	RNS	Paper
Preliminary results and publication of Annual Report and Accounts	Feb	✔	✔	✔	
Pillar 3 report	Mar/Aug	✔			
Group Chief Executive update to shareholders	Mar	✔	✔		✔
Mailing of Annual Report and Accounts, Annual Review or Performance Summary	Mar	✔	✔		✔
Notice of AGM and voting materials	Mar	✔	✔		✔
Q1 interim management statement[1]	Apr	✔	✔	✔	
Country analysis[2]	Jun/Jul	✔			
Interim results	Jul	✔	✔	✔	
Group Chief Executive update to shareholders	Aug	✔	✔		✔
Q3 interim management statement[1]	Oct	✔	✔	✔	

1 There is no longer a requirement to issue interim management statements and though we will continue to issue them going forward they will be much shorter.

2 To be published on the Group's website by 1 July 2018 in accordance with the Capital Requirements (country analysis) Regulations 2013.

Share dealing facilities

We offer a choice of three share dealing services for our UK shareholders and customers. To see the full range of services available for each, please use the contact details below:

Service Provider	Telephone Dealing	Internet Dealing
Bank of Scotland Share Dealing	0345 606 1188	www.bankofscotland.co.uk/sharedealing
Halifax Share Dealing	03457 22 55 25	www.halifax.co.uk/sharedealing
Lloyds Bank Direct Investments	0345 60 60 560	www.lloydsbank.com/share-dealing.asp

Note:

All internet services are available 24/7. Telephone dealing services are available between 8.00 am and 9.15 pm, Monday to Friday and 9.00 am to 1.00 pm on Saturday. To open a share dealing account with any of these services, you must be 18 years of age or over and be resident in the UK, Jersey, Guernsey or the Isle of Man.

Share dealing for the Lloyds Banking Group Shareholder Account

Share dealing services for the Lloyds Banking Group Shareholder Account are provided by Equiniti Shareview Dealing, operated by Equiniti Financial Services Limited. Details of the services provided can be found either on the Shareholder Information page of our website at www.lloydsbankinggroup.com or by contacting Equiniti using the contact details provided on the next page.

Share price information

Shareholders can access both the latest and historical share prices via our website at www.lloydsbankinggroup.com as well as listings in most national newspapers. For a real time buying or selling price, you will need to contact a stockbroker, or you can contact the share dealing providers detailed above.

Individual Savings Accounts (ISAs)

There are a number of options for investing in Lloyds Banking Group shares through an ISA. For details of services and products provided by the Group please contact Bank of Scotland Share Dealing, Halifax Share Dealing or Lloyds Bank Direct Investments using the contact details above.

Shareholder information continued

American Depositary Receipts (ADRs)

Our shares are traded in the USA through a New York Stock Exchange-listed sponsored ADR facility with The Bank of New York Mellon as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4.

For details contact: BNY Mellon Shareowner Services, 462 South 4th Street, Suite 1600, Louisville KY 40202. Telephone: 1-866-259-0336 (US toll free), international callers: +1 201-680-6825. Alternatively visit www.adrbnymellon.com or email shrrelations@cpushareownerservices.com

Analysis of shareholders

At 31 December 2017	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 999	1,994,288	81.41	599.8	0.83
1,000 – 9,999	390,857	15.95	1,041.9	1.45
10,000 – 99,999	60,662	2.48	1,502.2	2.09
100,000 – 999,999	2,745	0.11	670.3	0.93
1,000,000 – 4,999,999	598	0.02	1,386.5	1.93
5,000,000 – 9,999,999	182	0.01	1,301.4	1.81
10,000,000 – 49,999,999	293	0.01	6,592.1	9.16
50,000,000 – 99,999,999	66	–	4,722.0	6.56
100,000,000 – 499,999,999	78	–	18,240.3	25.34
500,000,000 – 999,999,999	10	–	6,889.5	9.57
1,000,000,000 and over	13	–	29,026.9	40.33
	2,449,792	100.00	71,972.9	100.00

Security – share fraud and scams

Shareholders should exercise caution when unsolicited callers offer the chance to buy or sell shares with promises of huge returns. If it sounds too good to be true, it usually is and we would ask that shareholders take steps to protect themselves. We strongly recommend seeking advice from an independent financial adviser authorised by the Financial Conduct Authority (FCA). Shareholders can verify whether a firm is authorised via the Financial Services Register which is available at www.fca.org.uk

If a shareholder is concerned that they may have been targeted by such a scheme, please contact the FCA Consumer Helpline on 0800 111 6768 or use the online 'Share Fraud Reporting Form' available from their website (see above). We would also recommend contacting the Police through Action Fraud on 0300 123 2040 or visiting www.actionfraud.org.uk for further information.

Important shareholder and registrar information

Company website
www.lloydsbankinggroup.com

Shareholder information
help.shareview.co.uk
(from here you will be able to email your query securely)

Registrar
Equiniti Limited
Aspect House, Spencer Road, Lancing
West Sussex BN99 6DA

Shareholder helpline
0371 384 2990* from within the UK
+44 121 415 7066 from outside the UK

*Lines are open from 8.30 am to 5.30 pm Monday to Friday, excluding English and Welsh public holidays.

The company registrar is Equiniti Limited. They provide a shareholder service, including a telephone helpline and shareview which is a free secure portfolio service.

Register today to manage your shareholding online

Get online in just three easy steps:

step 1
Register at www.shareview.co.uk/info/register

step 2
Receive activation code in post

step 3
Log on

Scan me
to register

Five year financial summary

The financial statements (statutory basis) for each of the years presented have been audited by PricewaterhouseCoopers LLP, independent auditors.

	2017	2016	2015	2014	2013
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**18,659**	17,267	17,421	16,399	18,478
Operating expenses	**(12,696)**	(12,277)	(15,387)	(13,885)	(15,322)
Trading surplus	**5,963**	4,990	2,034	2,514	3,156
Impairment	**(688)**	(752)	(390)	(752)	(2,741)
Profit before tax	**5,275**	4,238	1,644	1,762	415
Profit (loss) after tax for the year	**3,547**	2,514	956	1,499	(802)
Profit (loss) for the year attributable to ordinary shareholders	**3,042**	2,001	466	1,125	(838)

	31 December 2017	31 December 2016	31 December 2015	31 December 2014	31 December 2013
Balance sheet data (£m)					
Share capital	**7,197**	7,146	7,146	7,146	7,145
Shareholders' equity	**43,551**	43,020	41,234	43,335	38,989
Other equity instruments	**5,355**	5,355	5,355	5,355	–
Net asset value per ordinary share	**60.5p**	60.2p	57.9p	60.7p	54.6p
Customer deposits	**418,124**	415,460	418,326	447,067	439,467
Subordinated liabilities	**17,922**	19,831	23,312	26,042	32,312
Loans and advances to customers	**472,498**	457,958	455,175	482,704	492,952
Total assets	**812,109**	817,793	806,688	854,896	842,380

	2017	2016	2015	2014	2013
Share information					
Basic earnings (loss) per ordinary share	**4.4p**	2.9p	0.8p	1.7p	(1.2) p
Diluted earnings (loss) per ordinary share	**4.3p**	2.9p	0.8p	1.6p	(1.2) p
Dividends per ordinary share[1,2]	**3.05p**	3.05p	2.75p	0.75p	–
Market price (year end)	**68.1p**	62.5p	73.1p	75.8p	78.9p
Number of shareholders (thousands)	**2,450**	2,510	2,563	2,626	2,681
Number of ordinary shares in issue (millions)[3]	**71,973**	71,374	71,374	71,374	71,368

	2017	2016	2015	2014	2013
Financial ratios (%)[4]					
Dividend payout ratio[5]	**69.8**	104.0	359.3	45.1	–
Post-tax return on average shareholders' equity	**7.2**	4.9	1.3	2.9	(2.0)
Post-tax return on average assets	**0.43**	0.30	0.11	0.17	(0.09)
Cost:income ratio[6]	**68.0**	71.1	88.3	84.7	82.9

	31 December 2017	31 December 2016	31 December 2015	31 December 2014	31 December 2013
Capital ratios (%)[7, 8]					
Total capital	**21.2**	21.4	21.5	22.0	20.8
Tier 1 capital	**17.2**	17.0	16.4	16.5	14.5
Common equity tier 1 capital/Core tier 1 capital	**14.1**	13.6	12.8	12.8	14.0

1 Annual dividends comprise both interim and final dividend payments. Under IFRS, the total dividend for the year represents the interim dividend paid during the year and the final dividend which will be paid and accounted for during the following year.

2 Dividends per ordinary share in 2016 include a recommended special dividend of 0.5 pence (2015: 0.5 pence).

3 For 2016 and previous years, this figure excluded the limited voting ordinary shares owned by the Lloyds Bank Foundations. The limited voting ordinary shares were redesignated as ordinary shares on 1 July 2017

4 Averages are calculated on a monthly basis from the consolidated financial data of Lloyds Banking Group.

5 Total dividend for the year divided by earnings attributable to ordinary shareholders adjusted for tax relief on distributions to other equity holders.

6 The cost:income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims).

7 Capital ratios for 2013 are in accordance with the modified Basel II framework as implemented by the PRA.

8 Capital ratios for 2014 and later years are in accordance with the CRD IV rules implemented by the PRA on 1 January 2014.

Forward looking statements

This Annual Report contains certain forward looking statements with respect to the business, strategy, plans and/or results of Lloyds Banking Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds Banking Group'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. 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.

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 Lloyds Banking 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.

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; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, instability as a result of the exit by the UK from the European Union (EU) 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; 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 Group's control; 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; changes in laws, regulations, 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 Group's control; 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 on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors 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 Annual Report are made as of the date hereof, and Lloyds Banking Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this Annual Report to reflect any change in Lloyds Banking Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

The information, statements and opinions contained in this Annual Report 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.

Abbreviations

ADRs	American Depositary Receipts
BSU	Business Support Unit
CDS	Credit Default Swap
CET1	Common Equity Tier 1
CRD IV	Capital Requirements Directive IV
CUIP	Collective unidentified impairment provision
CVA	Credit Valuation Adjustment
DVA	Debit Valuation Adjustment
EBA	European Banking Authority
ECNs	Enhanced Capital Notes
EP	Economic Profit
EPS	Earnings Per Share
FCA	Financial Conduct Authority
FLS	Funding for Lending Scheme
FRC	Financial Reporting Council
HMRC	Her Majesty's Revenue & Customs
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICG	Individual Capital Guidance
IFRS	International Financial Reporting Standards
LCR	Liquidity Coverage Ratio
LIBOR	London Inter-Bank Offered Rate
LTIP	Long-Term Incentive Plan
OEICs	Open Ended Investment Companies
PFI	Private Finance Initiative
PPI	Payment Protection Insurance
PPP	Public Private Partnership
PRA	Prudential Regulation Authority
PVNBP	Present Value of New Business Premiums
SEC	Securities and Exchange Commission
TSR	Total Shareholder Return
VaR	Value-at-Risk

Alternative performance measures

As described on page 43, the Group analyses its performance on an underlying basis. The Group also calculates a number of metrics that are used throughout the banking and insurance industries on an underlying basis as these provide management with a relevant and consistent view of these measures from period to period. A description of the Group's alternative performance measures and their calculation is set out below.

Asset quality ratio	The underlying impairment charge for the period (on an annualised basis) in respect of loans and advances to customers after releases and write-backs, expressed as a percentage of average gross loans and advances to customers for the period.
Banking net interest margin	Banking net interest income on customer and product balances in the banking businesses as a percentage of average banking gross interest-earning assets for the period.
Cost:income ratio	Operating costs as a percentage of net income calculated on an underlying basis.
Gross asset quality ratio	The underlying impairment charge for the period (on an annualised basis) in respect of loans and advances to customers before releases and write-backs, expressed as a percentage of average gross loans and advances to customers for the period.
Impaired loans as a percentage of closing advances	Impaired loans and advances to customers adjusted to exclude Retail and Consumer Finance loans in recoveries, expressed as a percentage of closing gross loans and advances to customers.
Loan to deposit ratio	Loans and advances to customers net of allowance for impairment losses and excluding reverse repurchase agreements divided by customer deposits excluding repurchase agreements.
Operating jaws	The difference between the period on period percentage change in net income and the period on period change in operating costs calculated on an underlying basis.
Present value of new business premium	The total single premium sales received in the period (on an annualised basis) plus the discounted value of premiums expected to be received over the term of the new regular premium contracts.
Return on risk-weighted assets	Underlying profit before tax divided by average risk-weighted assets.
Return on tangible equity	Statutory profit after tax adjusted to add back amortisation of intangible assets, and to deduct profit attributable to non-controlling interests and other equity holders, divided by average tangible net assets.
Tangible net assets per share	Net assets excluding intangible assets such as goodwill and acquisition-related intangibles divided by the weighted average number of ordinary shares in issue.
Underlying profit	Statutory profit adjusted for certain items as detailed on page 40.
Underlying return on tangible equity	Underlying profit after tax at the standard UK corporation tax rate adjusted to add back amortisation of intangible assets and to deduct profit attributable to non-controlling interests and other equity holders, divided by average tangible net assets.

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 Group, as at 31 December 2017. 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.

Subsidiary undertakings

The Group directly or indirectly holds 100% of the share class and a majority of voting rights (including where the undertaking does not have share capital as indicated) in the following undertakings.

Name of undertaking	Notes
A G Finance Ltd	7 ii #
A.C.L. Ltd	1
ACL Autolease Holdings Ltd	1
ADF No.1 Pty Ltd	8
Alex Lawrie Factors Ltd	9
Alex. Lawrie Receivables Financing Ltd	9
Alexanderplatz 2017 GmbH	92
Amberdate Ltd	1 iv
AN Vehicle Finance Ltd (In liquidation)	13
Anglo Scottish Utilities Partnership 1	+ *
Aquilus Ltd	1
Automobile Association Personal Finance Ltd	4
Bank of Scotland (B G S) London Nominees Ltd	5 *
Bank of Scotland (Stanlife) London Nominees Ltd	5 *
Bank of Scotland Branch Nominees Ltd	5
Bank of Scotland Capital Funding (Jersey) Ltd	10
Bank of Scotland Central Nominees Ltd	5 *
Bank of Scotland Edinburgh Nominees Ltd	5 *
Bank of Scotland Equipment Finance Ltd	2
Bank of Scotland Hong Kong Nominees Ltd	11 *
Bank of Scotland Insurance Services Ltd (In liquidation)	88
Bank of Scotland Leasing Ltd	2
Bank of Scotland LNG Leasing (No 1) Ltd (In liquidation)	13
Bank of Scotland London Nominees Ltd	5 *
Bank of Scotland Nominees (Unit Trusts) Ltd	5 *
Bank of Scotland P.E.P. Nominees Ltd	5 *
Bank of Scotland plc	5 iv
Bank of Scotland Structured Asset Finance Ltd	1
Bank of Scotland Transport Finance 1 Ltd (In liquidation)	2
Bank of Wales Ltd	2
Barents Leasing Ltd	1
Barnwood Mortgages Ltd	12
Bedfont Lakes Business Park (No.2) LP	20
Birchcrown Finance Ltd	1 iv vi
Birmingham Midshires Asset Management Ltd (In liquidation)	4
Birmingham Midshires Financial Services Ltd	4
Birmingham Midshires Land Development Ltd	4
Birmingham Midshires Mortgage Services Ltd	4
Black Horse (TRF) Ltd	1
Black Horse Executive Mortgages Ltd	1
Black Horse Finance Holdings Ltd	1 i ii
Black Horse Finance Management Ltd	1
Black Horse Group Ltd	1 iv
Black Horse Ltd	1
Black Horse Offshore Ltd	6
Black Horse Property Services Ltd	1
Boltro Nominees Ltd	1
BOS (Ireland) Property Services 2 Ltd	16
BOS (Ireland) Property Services Ltd	16
BOS (Shared Appreciation Mortgages (Scotland) No. 2) Ltd	4
BOS (Shared Appreciation Mortgages (Scotland) No. 3) Ltd	4
BOS (Shared Appreciation Mortgages (Scotland) Ltd	4
BOS (Shared Appreciation Mortgages) No. 1 plc	4 #
BOS (Shared Appreciation Mortgages) No. 2 plc	4 #
BOS (Shared Appreciation Mortgages) No. 3 plc	4 #
BOS (Shared Appreciation Mortgages) No. 4 plc	4 #
BOS (Shared Appreciation Mortgages) No. 5 plc	4
BOS (Shared Appreciation Mortgages) No. 6 plc	4
BOS (USA) Fund Investments Inc.	14 xiii
BOS (USA) Inc.	14
BOS Edinburgh No 1 Ltd	5
BOS Mistral Ltd	2
BOSIC Inc.	18
BOSSAF Rail Ltd	1
Britannia Personal Lending Ltd	4 i #
British Linen Leasing (London) Ltd	5
British Linen Leasing Ltd	5
British Linen Shipping Ltd	5
C & G Homes Ltd (In liquidation)	12
C&G Estate Agents Ltd	12
C.T.S.B. Leasing Ltd (In liquidation)	13
Capital 1945 Ltd	2
Capital Bank Insurance Services Ltd (In liquidation)	13
Capital Bank Leasing 1 Ltd	2
Capital Bank Leasing 2 Ltd	2
Capital Bank Leasing 3 Ltd	2
Capital Bank Leasing 4 Ltd	2
Capital Bank Leasing 5 Ltd	2
Capital Bank Leasing 6 Ltd	2
Capital Bank Leasing 7 Ltd	2
Capital Bank Leasing 8 Ltd	17
Capital Bank Leasing 9 Ltd	2
Capital Bank Leasing 10 Ltd	2
Capital Bank Leasing 11 Ltd	2
Capital Bank Leasing 12 Ltd	5
Capital Bank Property Investments (3) Ltd	2
Capital Bank Vehicle Management Ltd	2
Capital Leasing (Edinburgh) Ltd	17
Capital Leasing Ltd (In liquidation)	88
Capital Personal Finance Ltd	4
Car Ownership Finance Ltd (In liquidation)	13
Cardnet Merchant Services Ltd	1 ii, # iii ^
Carlease Ltd	1
Cartwright Finance Ltd	2 viii vii #
Cashfriday Ltd	9
Cashpoint Ltd	1
Caveminster Ltd	1
CBRail S.A.R.L.	19
Cedar Holdings Ltd	1
Central Mortgage Finance Ltd	12
CF Asset Finance Ltd	2
Chariot Finance Ltd (In liquidation)	13
Chartered Trust (Nominees) Ltd	1
Charterhall (No. 1) Ltd (In liquidation)	13
Charterhall (No. 2) Ltd (In liquidation)	13
Cheltenham & Gloucester plc	12
Chiswell Stockbrokers Ltd	1
Clerical Medical (Dartford Number 2) Ltd	20
Clerical Medical (Dartford Number 3) Ltd	20
Clerical Medical Finance plc	20
Clerical Medical Financial Services Ltd	20
Clerical Medical Forestry Ltd	20
Clerical Medical International Holdings B.V.	21
Clerical Medical Investment Fund Managers Ltd	4
Clerical Medical Managed Funds Ltd	20
Clerical Medical Non Sterling Property Company SARL	22
Clerical Medical Properties Ltd	20
Cloak Lane Funding Ltd	6 iv
Cloak Lane Investments Ltd	6
CM Venture Investments Ltd	23 iv
CMI Insurance (Luxembourg) S.A. (In liquidation)	24
Conquest Securities Ltd	1 iv vi
Corbiere Asset Investments Ltd	1 i ii
Create Services Ltd	1
Dalkeith Corporation	25
Delancey Rolls UK Ltd (In liquidation)	26 i
Direct LB Ltd (In liquidation)	13
Dunstan Investments (UK) Ltd	1
Enterprise Car Finance Ltd	7 ii #
Eurolead Services Holdings Ltd	9
Exclusive Finance No. 1 Ltd (In liquidation)	13 i
Financial Consultants LB Ltd	1
First Retail Finance (Chester) Ltd	4
Flexifly Ltd (In liquidation)	88
Fontview Ltd	20
Forthright Finance Ltd	2
France Industrial Premises Holding Company	28
Freeway Ltd (In liquidation)	2
General Leasing (No. 4) Ltd	1
General Leasing (No. 12) Ltd	1
General Reversionary and Investment Company	20
Glosstrips Ltd (In liquidation)	88
Godfrey Davis (Contract Hire) Ltd	2
Gresham Nominee 1 Ltd	1
Gresham Nominee 2 Ltd	1
Halifax Credit Card Ltd	4 i ii vii
Halifax Equitable Ltd	4
Halifax Financial Brokers Ltd	4
Halifax Financial Services (Holdings) Ltd	4
Halifax Financial Services Ltd	4
Halifax General Insurance Services Ltd	4
Halifax Group Ltd	4
Halifax Investment Services Ltd	4
Halifax Leasing (June) Ltd	1
Halifax Leasing (March No.2) Ltd	1
Halifax Leasing (September) Ltd	1
Halifax Life Ltd	4
Halifax Ltd	4
Halifax Loans Ltd	4
Halifax Mortgage Services (Holdings) Ltd	4
Halifax Mortgage Services Ltd	4
Halifax Nominees Ltd	4
Halifax Pension Nominees Ltd	29
Halifax Premises Ltd	1
Halifax Share Dealing Ltd	4
Halifax Vehicle Leasing (1998) Ltd	4
HBOS Canada Inc.	18
HBOS Capital Funding (Jersey) Ltd	10
HBOS Covered Bonds LLP	4 *
HBOS Directors Ltd (In liquidation)	13
HBOS Final Salary Trust Ltd	5
HBOS Financial Services Ltd	20
HBOS Insurance & Investment Group Ltd	20
HBOS International Financial Services Holdings Ltd	20
HBOS Investment Fund Managers Ltd	4
HBOS Management (Jersey) Ltd	10
HBOS plc	5 iv vi
HBOS Social Housing Covered Bonds LLP	2 *
HBOS Treasury Services Ltd (In liquidation)	13
HBOS UK Ltd	5
Heidi Finance Holdings (UK) Ltd	1
Hill Samuel (USA), Inc.	14
Hill Samuel Bank Ltd	1
Hill Samuel Finance Ltd	1 iv xi
Hill Samuel Leasing (No 2) Ltd (In liquidation)	13
Hill Samuel Leasing Co. Ltd	1
Hill Samuel Nominees Asia Private Ltd	31
HL Group (Holdings) Ltd (In liquidation)	13
Home Shopping Personal Finance Ltd	4
Horizon Capital 2000 Ltd	5
Horizon Capital Ltd (In liquidation)	88
Horizon Resources Ltd (In liquidation)	88
Horsham Investments Ltd	6
Housing Growth Partnership GP LLP	1 *
Housing Growth Partnership LP	1 * #
Housing Growth Partnership Ltd	1 i ii
Housing Growth Partnership Manager Ltd	1
HSDL Nominees Ltd	4
HVF Ltd	2
Hyundai Car Finance Ltd	7 i ii
IAI International Ltd (In liquidation)	1
IBOS Finance Ltd	2
ICC Enterprise Partners Ltd (In liquidation)	32
ICC Equity Partners Ltd (In liquidation)	32
ICC ESOP Trustee Ltd (In liquidation)	33
ICC Holdings Unlimited Company	16
ICC Software Partners Ltd (In liquidation)	32
IF Covered Bonds Limited Liability Partnership (In liquidation)	70 *
Inchcape Financial Services Ltd	2 i #
Industrial Real Estate LP	34
Industrial Real Estate (General Partner) Ltd	34
Industrial Real Estate (Nominee) Ltd	34
Intelligent Finance Financial Services Ltd	4
Intelligent Finance Software Ltd	4
International Motors Finance Ltd	2 i #
Kanaalstraat Funding C.V.	35 *
Kanto Leasing Ltd (In liquidation)	13
Katrine Leasing Ltd	36
LB Comhold Ltd (In liquidation)	13
LB Healthcare Trustee Ltd	1
LB Leasing L.P	38 *
LB Motorent Ltd	1
LB Quest Ltd	1
LB Share Schemes Trustees Ltd	1
LBCF Ltd	9
LBG Brasil Administração LTDA	49
LBG Capital Holdings Ltd	1 ^
LBG Capital No. 2 Ltd (In liquidation)	13
LBG Capital No. 1 Ltd (In liquidation)	13
LBG Equity Investments Limited	1 ^
LBI Leasing Ltd	1
LBPB (21 Hill Street) Limited (In liquidation)	1
LDC (Asia) Ltd (In liquidation)	39
LDC (General Partner) Ltd	40
LDC (Managers) Ltd	40
LDC (Nominees) Ltd	40
LDC Carry VII LP	41*
LDC Equity VII LP	41*
LDC GP LLP	41 *

LDC I LP	41 *
LDC II LP	41 *
LDC III LP	41 *
LDC IV LP	41 *
LDC Parallel VII LP	41 *
LDC Parallel (Nominees) Ltd	40
LDC Ventures Carry Ltd (applied for strike off)	40
LDC Ventures Trustees Ltd (applied for strike off)	40
LDC V LP	41 *
LDC VI LP	41 *
LDC VII LP	41 *
Leasing (No. 2) Ltd (In liquidation)	13
Legacy Renewal Company Ltd	5
Lex Autolease (CH) Ltd	1
Lex Autolease (FMS) Ltd (In liquidation)	13
Lex Autolease (Shrewsbury) Ltd (In liquidation)	13
	iv
	v
Lex Autolease (VC) Ltd	1
Lex Autolease Carselect Ltd	1
Lex Autolease Ltd	1
Lex Vehicle Finance 2 Ltd	2
Lex Vehicle Finance 3 Ltd	2
Lex Vehicle Finance Ltd (In liquidation)	13
Lex Vehicle Leasing (Holdings) Ltd	2 i
	ii
	x
Lex Vehicle Leasing Ltd	2
Lex Vehicle Partners (1) Ltd (In liquidation)	13
Lex Vehicle Partners (2) Ltd (In liquidation)	13
Lex Vehicle Partners (3) Ltd (In liquidation)	13
Lex Vehicle Partners (4) Ltd (In liquidation)	13
Lex Vehicle Partners Ltd (In liquidation)	13
Lime Street (Funding) Ltd	1
Lloyds (FDC) Company (In liquidation)	13
Lloyds (General Partner) Ltd	6
Lloyds (Gresham) Ltd	1
	x
Lloyds (Gresham) No. 1 Ltd	1
Lloyds (Nimrod) Leasing Industries Ltd (In liquidation)	13
Lloyds (Nimrod) Specialist Finance Ltd	1
Lloyds America Securities Corporation	14
Lloyds Asset Leasing Ltd	1
Lloyds Bank (BLSA) (In liquidation)	13
Lloyds Bank (Branches) Nominees Ltd	1
Lloyds Bank (Colonial & Foreign) Nominees Ltd	1
Lloyds Bank (Fountainbridge 1) Ltd	5
Lloyds Bank (Fountainbridge 2) Ltd	5
Lloyds Bank (Gibraltar) Ltd	42
Lloyds Bank (I.D.) Nominees Ltd	1
Lloyds Bank (PEP Nominees) Ltd	1
Lloyds Bank (Stock Exchange Branch) Nominees Ltd	1
Lloyds Bank Asset Finance Ltd	1
Lloyds Bank Commercial Finance Ltd	9
Lloyds Bank Commercial Finance Scotland Ltd	43
Lloyds Bank Corporate Asset Finance (HP) Ltd	1
Lloyds Bank Corporate Asset Finance (No.1) Ltd	1
Lloyds Bank Corporate Asset Finance (No. 2) Ltd	1
Lloyds Bank Corporate Asset Finance (No.3) Ltd	1
Lloyds Bank Corporate Asset Finance (No.4) Ltd	1
Lloyds Bank Corporate Markets plc	1 ^
Lloyds Bank Covered Bonds LLP	44 *
Lloyds Bank Equipment Leasing (No. 1) Ltd	1
Lloyds Bank Equipment Leasing (No. 5) Ltd (In liquidation)	13
Lloyds Bank Equipment Leasing (No. 7) Ltd	1
Lloyds Bank Equipment Leasing (No. 9) Ltd	1
Lloyds Bank Equipment Leasing (No. 10) Ltd (In liquidation)	13
Lloyds Bank Equipment Leasing (No. 11) Ltd (In liquidation)	13
Lloyds Bank Financial Advisers Ltd	1 i
	ii
Lloyds Bank Financial Services (Holdings) Ltd	1
	iv
Lloyds Bank General Insurance Holdings Ltd	45
Lloyds Bank General Insurance Ltd	1
Lloyds Bank General Leasing (No. 1) Ltd (In liquidation)	13
Lloyds Bank General Leasing (No. 3) Ltd	1
Lloyds Bank General Leasing (No. 5) Ltd	1
Lloyds Bank General Leasing (No. 9) Ltd (In liquidation)	13
Lloyds Bank General Leasing (No. 11) Ltd	1
Lloyds Bank General Leasing (No. 17) Ltd	1
Lloyds Bank General Leasing (No. 18) Ltd (In liquidation)	13
Lloyds Bank General Leasing (No. 20) Ltd (In liquidation)	13
Lloyds Bank Hill Samuel Holding Company Ltd	1
Lloyds Bank Insurance Services (Direct) Ltd	1
Lloyds Bank Insurance Services Ltd	1
Lloyds Bank International Ltd	6
Lloyds Bank Leasing (No. 3) Ltd (In liquidation)	13
Lloyds Bank Leasing (No. 4) Ltd (In liquidation)	1
Lloyds Bank Leasing (No. 6) Ltd	1
Lloyds Bank Leasing (No. 7) Ltd (In liquidation)	13
Lloyds Bank Leasing (No. 8) Ltd	1
Lloyds Bank Leasing Ltd	1
Lloyds Bank Maritime Leasing (No. 2) Ltd (In liquidation)	13

Lloyds Bank Maritime Leasing (No. 8) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 10) Ltd	1
Lloyds Bank Maritime Leasing (No. 12) Ltd (In liquidation)	1
Lloyds Bank Maritime Leasing (No. 13) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 15) Ltd	1
Lloyds Bank Maritime Leasing (No.16) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing (No. 17) Ltd	1
Lloyds Bank Maritime Leasing (No. 18) Ltd (In liquidation)	13
Lloyds Bank Maritime Leasing Ltd (In liquidation)	13
Lloyds Bank MTCH Ltd	1
Lloyds Bank Nominees Ltd	1
Lloyds Bank Offshore Pension Trust Ltd	6
Lloyds Bank Pension ABCS (No. 1) LLP	1 *
Lloyds Bank Pension ABCS (No. 2) LLP	1 *
Lloyds Bank Pension Trust (No. 1) Ltd	1
Lloyds Bank Pension Trust (No. 2) Ltd	1
Lloyds Bank Pensions Property (Guernsey) Ltd	37 i
	ii
Lloyds Bank plc	1 ^
	^ x
Lloyds Bank Properties Ltd	1
Lloyds Bank Property Company Ltd	1
Lloyds Bank S.F. Nominees Ltd	1
Lloyds Bank Subsidiaries Ltd	1
Lloyds Bank Trust Company (International) Ltd	1
Lloyds Bank Trustee Services Ltd	1
Lloyds Banking Group Pensions Trustees Ltd	1
Lloyds Commercial Leasing Ltd (In liquidation)	13
Lloyds Commercial Properties Ltd	1
Lloyds Commercial Property Investments Ltd	1
Lloyds Corporate Services (Jersey) Ltd	6
Lloyds Development Capital (Holdings) Ltd	40
Lloyds Engine Capital (No.1) U.S LLC	14 *
Lloyds Far East Ltd	46
Lloyds Financial Leasing Ltd (In liquidation)	13
Lloyds General Leasing Ltd	1
Lloyds Group Holdings (Jersey) Ltd	47 i #
	ii
	vii
Lloyds Holdings (Jersey) Ltd	6
Lloyds Industrial Leasing Ltd	1
Lloyds International Pty Ltd	8
Lloyds Investment Bonds Ltd	1
Lloyds Investment Fund Managers Ltd	6
Lloyds Investment Securities No.5 Ltd	1
Lloyds Leasing (North Sea Transport) Ltd	1
Lloyds Leasing Developments Ltd	1
Lloyds Merchant Bank Asia Ltd	31
	iv
Lloyds Nominees (Guernsey) Ltd	37
Lloyds Offshore Global Services Private Ltd	48
Lloyds Plant Leasing Ltd	1
Lloyds Portfolio Leasing Ltd	1
Lloyds Premises Investments Ltd	1
Lloyds Project Leasing Ltd	1
Lloyds Property Investment Company No. 3 Ltd (In liquidation)	13
Lloyds Property Investment Company No. 4 Ltd	1
Lloyds Property Investment Company No.5 Ltd	1
Lloyds Secretaries Ltd	1
Lloyds Securities Inc.	14
Lloyds Trust Company (Gibraltar) Ltd	42
Lloyds TSB Pacific Ltd	51
Lloyds UDT Asset Leasing Ltd	1
Lloyds UDT Asset Rentals Ltd	1
Lloyds UDT Business Development Ltd	1
Lloyds UDT Business Equipment Ltd	1
Lloyds UDT Hiring Ltd	1
Lloyds UDT Leasing Ltd	1
Lloyds UDT Ltd	1
Lloyds UDT Rentals Ltd (In liquidation)	52
Lloyds Your Tomorrow Trustee Ltd	1
Loans.Co.UK Limited	82
London Taxi Finance Ltd	1 i
	ii
London Uberior (L.A.S. Group) Nominees Ltd	5 *
Lotus Finance Ltd	79 i #
LTGP Limited Partnership Incorporated	37 *
Mainsearch Company Limited	82
Maritime Leasing (No. 19) Ltd	1
MBNA Direct Limited	82
MBNA Europe Finance Limited	83
MBNA Europe Holdings Limited	82
MBNA Global Services Limited	82
MBNA Indian Services Private Limited	84
MBNA Limited	82
MBNA R & L S.A.R.L.	85
MBNA Receivables Limited	63
Meadowfield Investments Ltd (In liquidation)	88
Membership Services Finance Ltd	4
Mitre Street Funding Ltd	6
Moor Lane Holdings Ltd	6
Moray Investments Ltd (In liquidation)	13
Newfont Ltd	20
NFU Mutual Finance Ltd	2 i #
	vii
Nominees (Jersey) Ltd	6
Nordic Leasing Ltd	1
NWS Trust Ltd	5

Ocean Leasing (July) Ltd (In liquidation)	1
Ocean Leasing (No 1) Ltd (In liquidation)	13
Ocean Leasing (No 2) Ltd (In liquidation)	13
Oystercatcher LP	20
Oystercatcher Nominees Ltd	20
Oystercatcher Residential Ltd	20
Pacific Leasing Ltd	
Paneldeluxe Company Limited (In liquidation)	86
Pensions Management (S.W.F.) Ltd	54 *
Peony Eastern Leasing Ltd	1
Peony Leasing Ltd	1
Peony Western Leasing Ltd	1
Perry Nominees Ltd	1
PIPS Asset Investments Ltd	1 i
	ii
Portland Funding Ltd (In liquidation)	13
Prestonfield Investments Ltd	5
Prestonfield P1 Ltd (In liquidation)	88
Prestonfield P2 Ltd (In liquidation)	88
Prestonfield P3 Ltd (In liquidation)	88
Proton Finance Ltd	7 ii #
Quion 6 BV	55
R.F. Spencer And Company Ltd	2
Ranelagh Nominees Ltd	1
Retail Revival (Burgess Hill) Investments Ltd	1
Saint Michel Holding Company No1	28
Saint Michel Investment Property	28
Saint Witz 2 Holding Company No1	28
Saint Witz 2 Investment Property	28
Saleslease Purchase Ltd (In liquidation)	88
Sapphire Cards Limited (In liquidation)	86
Savban Leasing Ltd	1
Scotland International Finance B.V.	21
Scotmar Commercial Equipment Finance Ltd (In liquidation)	13 i #
Scottish Widows (Port Hamilton) Ltd	54
Scottish Widows Active Management Fund	3 *
Scottish Widows Administration Services Ltd	1
Scottish Widows Annuities Ltd	3
Scottish Widows Financial Services Holdings	3
Scottish Widows Fund and Life Assurance Society	54 *
Scottish Widows Fund Management Ltd	54
Scottish Widows Group Ltd	3 i
	ii
	iv
	x
Scottish Widows Industrial Properties Europe B.V.	56
Scottish Widows Ltd	1
Scottish Widows Pension Trustees Ltd	3
Scottish Widows Property Management Ltd	54
Scottish Widows Services Ltd	3
Scottish Widows Trustees Ltd	54
Scottish Widows Unit Funds Ltd	3
Scottish Widows Unit Trust Managers Ltd	45
Seabreeze Leasing Ltd	1
Seaforth Maritime (Highlander) Ltd (In liquidation)	88
Seaforth Maritime (Jarl) Ltd (In liquidation)	88
Seaspirit Leasing Ltd	1
Seaspray Leasing Ltd (In liquidation)	13
Services LB (No. 2) Ltd (In liquidation)	13
	iv
Share Dealing Nominees Ltd	4
Shogun Finance Ltd	7 ii #
Silentdale Ltd	1 iv
	vi
	vi
St Andrew's Group Ltd	20
St Andrew's Insurance plc	20
St Andrew's Life Assurance plc	20
St. Mary's Court Investments	1
Standard Property Investment (1987) Ltd	17 i
	ii
Standard Property Investment Ltd	57 #
Starfort Ltd	20
Sussex County Homes Ltd	4
Suzuki Financial Services Ltd	79 i #
SWB (67 Morrison Street) PLC	89
SW No.1 Ltd	3
SWAMF (GP) Ltd	20
SWAMF Nominee (1) Ltd	20
SWAMF Nominee (2) Ltd	20
SW Funding plc	3 #
Target Corporate Services Ltd	1
The Agricultural Mortgage Corporation plc	45
The British Linen Company Ltd	5
The Mortgage Business plc	4
Thistle Leasing	+ *
Three Copthall Avenue Ltd	1
Tower Hill Property Investments (7) Ltd	2 #
Tower Hill Property Investments (10) Ltd	2 #
Tranquility Leasing Ltd	1
Uberior (Moorfield) Limited	5
Uberior Canada LP Ltd	58
Uberior Co-Investments Ltd	5
Uberior ENA Ltd	17
Uberior Equity Ltd	5
Uberior Europe Ltd	5
Uberior Fund Investments Ltd	5
Uberior Infrastructure Investments Ltd	5
Uberior Infrastructure Investments (No.2) Ltd	1
Uberior Investments Ltd	5
Uberior ISAF CIP 2007 L.P	59 *
Uberior Nominees Ltd	5 *
Uberior Trading Ltd	5

Subsidiaries and related undertakings continued

Uberior Trustees Ltd	5 *
Uberior Ventures Australia Pty Ltd	8
Uberior Ventures Ltd	5
UDT Autolease Ltd	1
UDT Budget Leasing Ltd	1
UDT Ltd	1
UDT Sales Finance Ltd	1
United Dominions Leasing Ltd	1
United Dominions Trust Ltd	1
Universe, The CMI Global Network Fund	92 *
Upsaala Ltd	16
Vehicle Leasing (1) Ltd (In liquidation)	13
Vehicle Leasing (2) Ltd (In liquidation)	13
Vehicle Leasing (3) Ltd (In liquidation)	13
Vehicle Leasing (4) Ltd (In liquidation)	13
Ward Nominees (Abingdon) Ltd	1
Ward Nominees (Birmingham) Ltd	1
Ward Nominees (Bristol) Ltd	1
Ward Nominees Ltd	1
Warwick Leasing Ltd (In liquidation)	13
Waverley – Fund II Investor LLC	25
Waverley – Fund III Investor LLC	25
Waymark Asset Investments Ltd	1 i ii
WCS Ltd	60
West Craigs Ltd	5
Western Trust & Savings Holdings Ltd (In liquidation)	13
Western Trust Holdings Ltd (In liquidation)	13
Whitestar Securities Ltd (In liquidation)	13 ii xi
Wood Street Leasing Ltd	1

Subsidiary undertakings continued

The Group has determined that it has the power to exercise control over the following entities without having the majority of the voting rights of the undertakings. Unless otherwise stated, the undertakings do not have share capital or the Group does not hold any shares.

Name of undertaking	Notes
Addison Social Housing Holdings Ltd	61
ARKLE Finance Trustee Ltd	10
ARKLE Funding (No. 1) Ltd	62
ARKLE Holdings Ltd	62
ARKLE Master Issuer plc	62
ARKLE PECOH Holdings Ltd	62
ARKLE PECOH Ltd	62
Cancara Asset Securitisation Ltd	63
Candide Financing 2007 NHG BV	64
Candide Financing 2008-1 BV	64
Candide Financing 2008-2 BV	64
Candide Financing 2011-1 BV	64
Candide Financing 2012-1 BV	64
Cardiff Auto Receivables Securitisation 2018-1 Plc	44
Cardiff Auto Receivables Securitisation Holdings Limited	44
Celsius European Lux 2 SARL	91
Cheltenham Securities 2017 Limited	61
Chepstow Blue Holdings Ltd	44
Chepstow Blue plc	44
Chester Asset Options No.2 Limited	69
Chester Asset Options No.3 Limited	87
Chester Asset Receivables Dealings Issuer Limited	63
Chester Asset Securitisation Holdings Limited	69
Chester Asset Securitisation Holdings No.2 Limited	63
Clerical Medical Non Sterling Arts FSA	65
Clerical Medical Non Sterling Arts LSA	65
Clerical Medical Non Sterling Guadalix Hold Co BV	66
Clerical Medical Non Sterling Guadalix Spanish Prop Co SL	67
Clerical Medical Non Sterling Megapark Hold Co BV	68
Clerical Medical Non Sterling Megapark Prop Co SA	67
Credit Card Securitisation Europe Limited	63
Deva Financing Holdings Ltd	44
Deva Financing plc	44
Deva One Limited	63
Deva Three Limited	63
Deva Two Limited	63
Edgbaston RMBS 2010-1 plc	44
Edgbaston RMBS Holdings Ltd	44
Fontwell Securities 2016 Ltd	61
Gresham Receivables (No. 1) Ltd	63
Gresham Receivables (No. 3) Ltd	63
Gresham Receivables (No. 10) Ltd	63
Gresham Receivables (No.11) UK Ltd	69
Gresham Receivables (No. 12) Ltd	63
Gresham Receivables (No. 13) UK Ltd	69
Gresham Receivables (No. 14) UK Ltd	69
Gresham Receivables (No. 15) UK Ltd	69
Gresham Receivables (No. 16) UK Ltd	69
Gresham Receivables (No. 19) UK Ltd	69
Gresham Receivables (No. 20) Ltd	63
Gresham Receivables (No. 21) Ltd	63
Gresham Receivables (No. 22) Ltd	63
Gresham Receivables (No. 23) Ltd	63
Gresham Receivables (No. 24) Ltd	63
Gresham Receivables (No. 25) UK Ltd	69
Gresham Receivables (No. 26) UK Ltd	69
Gresham Receivables (No.27) UK Ltd	69
Gresham Receivables (No. 28) Ltd	63
Gresham Receivables (No. 29) Ltd	63
Gresham Receivables (No. 30) UK Ltd	69
Gresham Receivables (No. 31) UK Ltd	69
Gresham Receivables (No. 32) UK Ltd	69
Gresham Receivables (No. 33) UK Ltd	69
Gresham Receivables (No. 34) UK Ltd	69
Gresham Receivables (No. 35) Ltd	63
Gresham Receivables (No.36) UK Ltd	69
Gresham Receivables (No.37) UK Ltd	69
Gresham Receivables (No.38) UK Ltd	69
Gresham Receivables (No.39) UK Ltd	69
Gresham Receivables (No.40) UK Ltd	69
Gresham Receivables (No.41) UK Ltd	69
Gresham Receivables (No.42) Ltd	63
Gresham Receivables (No.44) UK Ltd	69
Gresham Receivables (No.45) UK Ltd	69
Gresham Receivables (No.46) UK Ltd	69
Gresham Receivables (No.47) UK Limited	69
Guildhall Asset Purchasing Company (No 3) Ltd	63
Guildhall Asset Purchasing Company (No.11) UK Ltd	69
Hart 2014-1 Ltd	61
Leicester Securities 2014 Ltd	71
Lingfield 2014 I Holdings Ltd	44
Lingfield 2014 I plc	44
Lloyds Bank Covered Bonds (Holdings) Ltd	44
Lloyds Bank Covered Bonds (LM) Ltd	44
Molineux RMBS 2016-1 plc	44
Molineux RMBS Holdings Ltd	44
Penarth Asset Securitisation Holdings Ltd	44
Penarth Funding 1 Ltd	61
Penarth Funding 2 Ltd	61
Penarth Master Issuer plc	44
Penarth Receivables Trustee Ltd	61
Permanent Funding (No. 1) Ltd	44
Permanent Funding (No. 2) Ltd	44
Permanent Holdings Ltd	44
Permanent Master Issuer plc	44
Permanent Mortgages Trustee Ltd	44
Permanent PECOH Holdings Ltd	44
Permanent PECOH Ltd	44
Salisbury Securities 2015 Ltd	61
Salisbury II Securities 2016 Ltd	61
Salisbury II-A Securities 2017 Limited	61
Sandown 2012-2 Holdings Ltd	44
Sandown 2012-2 plc	44
Sandown Gold 2011-1 Holdings Ltd	44
Sandown Gold 2011-1 plc (in liquidation)	70
Sandown Gold 2012-1 Holdings Ltd	44
Sandown Gold 2012-1 plc	44
SARL Coliseum	75
SARL Fonciere De Rives	75
SARL Hiram	75
SAS Compagnie Fonciere De France,	75
SCI Astoria Invest	75
SCI De L'Horloge	75
SCI Equinoxe	75
SCI Mercury Invest	75
SCI Millenium AP1	75
SCI Norli	75
SCI Rambuteau CFF	75
Stichting Candide Financing Holdings	64
Swan Funding 2 Ltd	61
Thistle Investments (AMC) Ltd	44
Thistle Investments (ERM) Ltd	44
Trinity Financing Holdings Ltd	44
Trinity Financing plc	44
Wetherby Securities 2017 Limited	61
Lloyds Bank Foundation for England & Wales •	77
The Halifax Foundation for Northern Ireland •	15
Lloyds Bank Foundation for the Channel Islands•	77
Lloyds TSB Foundation for Scotland •	78
Bank of Scotland Foundation •	5
MBNA General Foundation	82

• A charitable foundation funded but not owned by Lloyds Banking Group

Associated undertakings

The Group has a participating interest in the following undertakings.

Name of undertaking	% of share class held by immediate parent company (or by the Group where this varies)	Registered office address (UK unless stated otherwise)	Notes
Aceso Healthcare Group Holdings Ltd	89%	Sherwood House, Cartwright Way, Forest Business Park, Brandon Hill, Coalville, LE67 1UB	ii &
Addo Food Group (Holdings) Limited	76.85%	Queens Drive, Nottingham, NG2 1LU	i &
Addison Social Housing Ltd	20%	35 Great St Helen's, London, EC3A 6AP	
Adler & Allan Group Ltd	89%	80 Station Parade, Harrogate, HG1 1HQ	i &
ADP Primary Care Services Limited	54.54%	1 Park Row, Leeds, LS1 5AB	iii &
Aghoco 1472 Limited	89.25%	58 Evans Road, Liverpool, L24 9PB	i &
Aghoco 1476 Limited	89.25%	100-102 King Street, Knutsford, Cheshire, WA16 6HQ	i &
Agora Shopping Centres Ltd (In receivership)	50%	Hill House, 1 Little New Street, London, EC4A 3TR	ii &
Airline Services And Components Group Ltd	94.45%	Canberra House, Robeson Way, Sharston Green Business Park, Manchester, M22 4SX	i &
Allan Water Homes (Heartlands) Limited	50%	24B Kenilworth Road, Bridge Of Allan, Stirling, Scotland, FK9 4DU	
AMA (Slateford) Limited	50%	15 Coates Crescent, Edinburgh, EH3 7AF	i
AMA (Fusion) Limited	50%	15 Coates Crescent, Edinburgh, Midlothian, EH3 7AF	i
Angus International Safety Group Ltd	88.9%	Station Road, High Bentham, Near Lancaster, LA2 7NA	i &
Applied Composites Group Ltd	85.76%	Victoria Works, Thrumpton Lane, Retford, DN22 6HH	i &
Aqualisa Holdings (International) Ltd	89.25% 86.45%	Westerham Trade Centre, The Flyers Way, Westerham, TN16 1DE	i & i
Aspin Group Holdings Ltd	99%	Nexus House Boundary Way, Hemel Hempstead Industrial Estate, Hemel Hempstead, England, HP2 7SJ	i &
Aspire Oil Services Ltd	28.4%	Bishop's Court, 29 Albyn Place, Aberdeen, AB10 1YL, United Kingdom	&

Australand Apartments No.6 Pty Ltd	50%	Level 3, 1C Homebush Bay Drive, Rhodes NSW 2138, Australia	
Australand Residential Investments Pty Ltd	50%	Level 3, 1C Homebush Bay Drive, Rhodes NSW 2138, Australia	
Australand Residential Trust	50%	Level 3, 1C Homebush Bay Drive, Rhodes NSW 2138, Australia	
Autograph Homes (Hambrook) Ltd	50%	Meadows Causeway, Radipole, Weymouth, Dorset, United Kingdom, DT4 9RY	i
Bacchus Newco Ltd	89.25%	The Grange, Harnett Drive, Wolverton Mill, Milton Keynes, Buckinghamshire, MK12 5NE	i &
Backhouse (Castle Cary) JV Limited	25%	DAC Beachcroft LLP, Portwall Place, Portwall Lane, Bristol, BS1 9HS	i
Bergamot Ventures Ltd	50%	6th Floor 25 Farringdon Street, London, EC4A 4AB	ii
Big Society Capital Limited	25%	New Fetter Place, 8-10 New Fetter Lane, London, EC4A 1AZ	ii
Blue Bay Travel Group Limited	99%	A4 Bellringer Road, Trentham Business Quarter, Stoke-On-Trent, ST4 8GB	i &
Bluestone Consolidated Holdings Ltd	99%	Newnham Mill, Newnham Road, Cambridge, CB3 9EY	i &
	99%		iv
BoS Mezzanine Partners Fund LP	n/a	7 Melville Crescent, Edinburgh, EH3 7JA	*
Brington North Holdco Ltd	50%	25 Gresham Street, London, EC2V 7HN	&
Bybox Group Holdings Ltd	89.25%	1-2 Cherry Barn, High Street, Harwell, Oxford, OX11 0EY	i &
Caedmon Homes (St Johns Mews) Limited	24.50%	Alderside Thirsk Road, Easingwold, York, YO61 3HJ	
Canopy Holdco Limited	89.25%	Bath Yard Bath Yard, Moira, Swadlincote, Derbyshire, England, DE12 6BA	i &
	99.25%		iv
Cala Properties (Holdings) Limited	100%	Johnstone House, 52-54 Rose Street, Aberdeen, AB10 1HA	iv &
Capital Economics Research Ltd	99%	100 Victoria Street, London, England, SW1E 5JL	i &
Cardel Group Limited	89.25%	5 The Marquis Centre, Royston Road, Baldock, Hertfordshire, England, SG7 6XL	i &
Cary Towne Parke Holdings LLC	n/a	Jeffrey Cohen, 1066 Woodward Avenue, Detroit, MI 48226, United States	*
Cary Towne Parke LLC	n/a	100 Galleria Officentre, Suite 419, Southfield MI 48034, United States	*
Caedmon Homes Limited	24%	Alderside Thirsk Road, Easingwold, York, YO61 3HJ	
Chester Business Park Management Company Ltd	24%	Drake House, Gadbrook Park, Rudheath, Northwich, CW9 7TW, United Kingdom	
Chiron Topco Limited	22%	22 Grenville Street, St Helier, Jersey, Channel Islands, JE4 8PX	i
	74.84%		iv
CIPHR Group Ltd	89.25%	Abbey Place, 24-28 Easton Street, High Wycombe, HP11 1NT, United Kingdom	i &
City & General Securities Ltd	100%	10 Upper Berkeley Street, London, W1H 7PE	ii &
City Living (Midlands) Limited	50%	Old Banks Chambers, 582-586 Kingsbury Road, Erdington, Birmingham, B24 9ND	
Citysprint (UK) Holdings Ltd	82%	Ground Floor, Redcentral, 60 High Street, Redhill, RH1 1SH	i &
	91.22%		i
Cleanslate Ashford Limited	25%	Chobham Farm, Sandpit Hall Road, Chobham, Surrey, GU24 8 HA	
CMS Acquisitions Company Ltd	99%	Caisteal Road, Castlecary, Cumbernauld, Glasgow, G88 0FS	i &
Cobaco Holdings Ltd	90%	Cobaco House, North Florida Road, Haydock Industrial Estate, Merseyside, WA11 9TP	i &
Coln Signature Homes Limited	50%	2nd Floor 19 Apex Court Woodlands, Almondsbury Business Centre, Bristol, BS32 4JT	i
Connect Managed Holdings Ltd	89%	4th Floor, Chancellor House, 5 Thomas More Square, London, E1W 1YW, United Kingdom	i &
	89%		i
	27.75%		ii
Connery Ltd	20%	44 Esplanade St Helier Jersey JE4 9WG	&
Continental Shelf 225 Ltd (In liquidation)	100%	4 Mount Ephraim Road, Tunbridge Wells, Kent, TN1 1EE	i &
Continental Shelf 291 Ltd (In liquidation)	100%	4 Mount Ephraim Road, Tunbridge Wells, Kent, TN1 1EE	i &
Cruden Homes (Aberlady) Limited	50%	Baberton House, Juniper Green, Edinburgh, EH14 3HN, United Kingdom	
CTI Holdings Ltd	99%	7th Floor, 111 Piccadilly, Manchester, M1 2HY, United Kingdom	i &
Cuts Ice Holdings Ltd	99%	Level 1, Devonshire House, Mayfair Place, London, England, W1J 8AJ	i &
D.U.K.E Real Estate Ltd	50%	1st Floor, Exchange Place, 3 Semple Street, Edinburgh, EH3 8BL	ii
Dale Erskine Power Solutions Ltd	99%	Eastfield Industrial Estate, Salter Road, Scarborough, North Yorkshire, YO11 3DU	i &
Delancey Arnold UK Ltd (In liquidation)	50%	4th Floor, 4 Victoria Square, St Albans, AL1 3TF, United Kingdom	
Devonshire Homes (Cullompton) Ltd	50%	Devonshire House, Lowman Green, Tiverton, Devon, EX16 4LA	i
DHHG1 Limited	25%	220 West George Street, Glasgow, G2 2PG, United Kingdom	
Dino Newco Ltd	89.25%	Unit 2, Orchard Place, Nottingham Business Park, Nottingham, NG8 6PX	i &
Duchy Homes (Penistone) Ltd	50%	Middleton House, Westland Road, Leeds, West Yorkshire, LS11 5UH	
Duchy Homes (Scawthorpe) Ltd	50%	Middleton House, Westland Road, Leeds, West Yorkshire, LS11 5UH	
EDM Business Services Holdings Ltd	81.65%	Queens House, 8-9 Queen Street, London, EC4N 1SP	i &
Eley Group Ltd	85.85%	Selco Way, Off First Avenue, Minworth Industrial Estate, Minworth, Sutton Coldfield, B76 1BA	i &
Ellis Whittam (Holdings) Ltd	89.25%	Woodhouse, Aldford, Chester, CH3 6JD	i &
Ensco 997 Limited	32.74%	The Yard Dodd Lane, Westhoughton, Bolton, Bl5 3NU	iv &
Ensek Holdings Limited	99%	The Watercourt, 116-118 Canal Street, Nottingham, NG1 7HF	i &
Equiom Holdings Ltd	99%	Jubilee Buildings, Victoria Street, Douglas, Isle of Man, IM 1 2SH	i &
Europa Property Company (Northern) Ltd	100%	Europa House, 20 Esplanade, Scarborough, North Yorkshire, YO11 2AQ	vii &
European Property Fund (Holdings) Ltd SARL	24.9%	1 Allee Scheffer, Luxembourg, I-25250, Luxembourg	ii &
Everest Acquisition Company Limited	89.25%	1 Park Row, Leeds, LS1 5AB	i &
Express Engineering (Group) Ltd	26.98%	Kingsway North, Team Valley Trading Estate, Gateshead, NE11 0EG	i &
	99%		iii
FDL Salterns Ltd	50%	2 Poole Road, Bournemouth, BH2 5QY	i
Fern Bay Seaside Village Ltd (In liquidation)	34.48%	Septimus Roe Square, Level 8, 256 Adelaide Terrace, Perth, WA 6000, Australia	i &
FHR European Ventures LLP	n/a	CMS Cameron Mckenna LLP, 78 Cannon Street, London, EC4N 6AF	* &
Frontline Estates St Johns Walk Limited	25%	20-22 Wenlock Road, London, N1 7GU	
Georgian House Developments (Investments) Ltd	50%	35 St Leonards Road, Northampton, Northamptonshire, United Kingdom, NN4 8DL	i
Ginger Acquisition Company Limited	89.25%	Tudno Mill, Smith Street, Aston-Under-Lyne, Ol7 0DB, United Kingdom	i &
Guardian Holdings Limited	87.25%	Merlin House, Brunel Court Village Farm Industrial Estate, Pyle, Bridgend, CF33 6BL	i &
Great Wigmore Property Ltd	50%	33 Cavendish Square, London, W1G 0PW	&
Hamsard 3468 Limited	89.25%	Squire Patton Boggs (UK) LLP (Ref:CSU), Rutland House, 148 Edmund Street, Birmingham, B3 2JR	i &
Harrier Developments Limited	50%	4 Melbourne House Corbygate Business Park, Priors Haw Road, Corby, Northamptonshire, England, NN17 5JG	i
Heckfords Road Great Bentley Ltd	50%	Bonks Hill House, High Wych Road, Sawbridgeworth, United Kingdom, CM21 9HT	
Hedge End Place (Durkan) LLP	n/a	4 Elstree Gate, Elstree Way, Borehamwood, Hertfordshire, WD6 1JD	*
Hedge End Place Hold Co Ltd	50%	25 Gresham Street, London, EC2V 7HN	&
Helsinki Topco Ltd	99%	Granville House, Gatton Park Business Centre, Redhill, Surrey, RH1 3AS	i
Hillcrest Homes (Hurst Green) Limited	50%	Mynshulls House, 14 Cateaton Street, Manchester, M3 1SQ	i
HTF Finco Limited	33.3%	The Zenith Building, 26 Spring Gardens, Manchester, M2 1AB	&
Iglufastnet Ltd	89.25%	2nd Floor, 165 The Broadway, Wimbledon, London, SW19 1NE	i &
Ingleby (1884) Ltd	80.83%	Fontana House, Works Road, Letchworth Garden City, SG6 1LD	i &
	99%		i
Ingleby (2016) Ltd	89.25%	Unit 22, Lodge Way, Lodge Farm Industrial Estate, Northampton, NN5 7US	i &
Inprova Group Ltd	89%	Unit 2, Olympic Park, Woolston Grange Avenue, Warrington, Cheshire, WA2 0YL	i &
IP Solutions Holdings Limited	89.25%	Bury House, 31 Bury Street, London, EC3A 5AR	i &
Kenmore Capital 2 Ltd (In liquidation)	50%	Grant Thornton UK LLP, 110 Queen Street, Glasgow, G1 3BX	ii
Kenmore Capital 3 Ltd (In receivership)	50%	Grant Thornton UK LLP, 110 Queen Street, Glasgow, G1 3BX	ii
Kenmore Capital Ltd (In liquidation)	50%	Grant Thornton UK LLP, 110 Queen Street, Glasgow, G1 3BX	ii
Keoghs Topco Ltd	99%	2 The Parklands, Bolton, Lancashire, BL6 4SE	ii &
KHL 2017 Limited	84.4%	One Eleven, Edmund Street, Birmingham, England, B3 2HJ	i &
	84.4%		ii
KHL Newco Limited	89%	Barrington House, Heyes Lane, Alderley Edge, Cheshire, SK9 7LA	i
	99%		ii
	89%		vii
LCP Baby Investors LP (in process of disposal)	n/a	International Corporation Services Ltd, Harbour Place, 2nd Floor, 103 South Church Street, George Town, Grand Cayman, KY1106, Cayman Islands	*
Lidcombe Unincorporated JV	50%	Level 3, 1C Homebush Bay Drive, Rhodes NSW 2138, Australia	*
LKR Holdings Limited	89%	111-113 Great Portland Street, 3rd Floor, London, W1W 6QQ	xiv
London Topco Ltd	62.81%	Gloucester Road, Cheltenham, Gloucester, GL51 8NR	i &
Lothian Fifty (150) Ltd (In liquidation)	100%	55 Baker Street, London, W1U 7EU	i &
Magicard Holdings Ltd	89.25%	Waverley House, Hampshire Road, Granby Industrial Estate, Weymouth, DT4 9XD	i &
	89.25%		i
Marvel Newco Ltd	89%	1 Prince Of Wales Road, Norwich, England, NR1 1BD	i &
Mitrefinch Holdings Ltd	89.25%	Mitrefinch House, Green Lane Trading Estate, Clifton, York, North Yorkshire, YO30 5YY	i &

Subsidiaries and related undertakings continued

Morston Assets Ltd (In administration)	20.08%	KPMG LLP, Arlington Business Park, Theale, Reading, Berkshire, RG7 4SD	
Motability Operations Group plc	20% (40%)	City Gate House, 22 Southwark Bridge Road, London, SE1 9HB	i
	20% (40%)		iv
Mulberry Property Developments (HGP) Ltd	50%	Units 3-4 Twigden Barns Grooms Lane, Creaton, Northampton, England, NN6 8NN	i
My 360 Living Limited	50%	Strategic Business Centre, Blue Ridge Park, Thunderhead Ridge, Glasshoughton, West Yorkshire, WF10 4AU, United Kingdom	i
Nevada Topco Ltd	89.25%	National Exhibition Centre, Birmingham, B40 1NT	i &
	89.25%		i
Nexinto Ltd	65.3%	55 Baker Street, London, W1U 7EU	&
Northern Edge Ltd	39.4%	The Beacon, 176 St. Vincent Street, Glasgow, G2 5SG	ii &
Omnium Leasing Company	39%	N/A	+
Onapp (Topco) II Ltd	82.5%	3MC Middlemarch Business Park, Siskin Drive, Coventry, United Kingdom, CV3 4FJ	i &
	100%		iv
Onapp (Topco) Ltd	82.5%	3MC Middlemarch Business Park, Siskin Drive, Coventry, United Kingdom, CV3 4FJ	i &
	82.5%		i
Osprey Aviation Services (UK) Ltd	89.25%	Blackwood House, Union Grove Lane, Aberdeen, AB10 6XU	i &
	89.25%		i
Pacific Shelf 1809 Ltd	89.25%	Seabrook House, Duncombe Street, Bradford, West Yorkshire, BD8 9AJ	i &
	89.25%		i
Panther Partners Ltd	89%	16 Kirby Street, London, EC1N 8TS	i &
	89%		i
Paw Topco Ltd	89.25%	Birkbecks, Water Street, Skipton, North Yorkshire, BD23 1PB	i
	89.25%		i &
PEI Group Topco Ltd	89.25%	140 London Wall, London, EC2Y 5DN	i &
Personal Touch Holdings Ltd	100%	3 Trinity Park, Solihull, West Midlands, B37 7ES	xvi &
	100%		xvii
	100%		xviii
	100%		xix
Pertemps Network Group Ltd	96.28%	Meriden Hall, Main Road, Meriden, Coventry	ii &
PIHL Equity Administration Ltd	100%	Cavendish House, 18 Cavendish Square, London, W1G 0PJ	ii &
PIMCO (Holdings) Ltd	82.5%	Dearing House, 1 Young Street, Sheffield, S1 4UP	i &
	42.8%		ii
	30.58%		vii
Port Coogee Unincorporated JV	50%	Level 3, 1C Homebush Bay Drive, Rhodes NSW 2138, Australia	*
Potter Topco Limited	89.25%	Lakelovers House, Victoria Street, Windermere, Cumbria, United Kingdom, LA23 1AB	i &
Prestbury 1 Limited Partnership	n/a	Cavendish House, 18 Cavendish Square, London, W1G 0PJ	* &
Prestbury Hotel Holdings Ltd (In liquidation)	100%	15 Canada Square, London, E14 5GL	vii &
Project Polka Bidco Limited	89.25%	Roundhouse Road, Faverdale Industrial Estate, Darlington, County Durham, DL3 0UR, United Kingdom	ii &
Prism Medical Healthcare Ltd	89%	Unit 4, Jubilee Business Park, Jubilee Way, Grange Moor, West Yorkshire, WF4 4TD	i &
PW Growth Finance Limited	95.24%	140 Aldersgate Street, London, England, EC1A 4HY	vii
Quantel Holdings Ltd	100%	Turnpike Road, Newbury, Berkshire, RG14 2NX	i &
Quantum (Flimwell) Limited	24.57%	Kings Parade, Lower Coombe Street, Croydon, CR0 1AA	
Ramco Acquisition Ltd	89.45%	Blackwood House, Union Grove Lane, Aberdeen, AB10 6XU	i &
	89.45%		xix
	89.45%		xix
Rectory (Aston Clinton) Ltd	50%	Rectory House, Thame Road, Haddenham, Aylesbury, Buckinghamshire, HP17 8DA	i
Rolls Development UK Ltd (In Liquidation)	50%	4th Floor , 4 Victoria Square, St Ablans, Hertfordhsire, AL1 3TF, United Kingdom√	ii
Rush Hair Group Limited	89.25%	23 George Street, Croydon, Surrey, CR0 1LA	i &
Scenic Topco Limited	89.25%	One Central Square, Cardiff, CF10 1FS	i &
Seaspray Unincorporated JV	n/a	Level 3, 1C Homebush Bay Drive, Rhodes NSW 2138, Australia	*
SHOO 788AA Ltd	89.25%	21-22 Balena Close, Poole, Dorset, BH17 7DX	i &
SHOO 802AA Limited	89.25%	Burleighfield House, London Road, Loudwater, Buckinghamshire, HP10 9RF	i
Specialist People Services Group Ltd	82.5%	7 Bradford Business Park, Kingsgate, Bradford, BD1 4SJ	i &
	82.5%		iii
	82.5%		iv
SSP Topco Ltd	88.8%	2nd Floor, G Mill, Dean Clough, Halifax, HX3 5AX	i &
Stewart Milne (Glasgow) Ltd	100%	Level 1, Citymark, 150 Fountainbridge, Edinburgh, EH3 9PE	i
Stewart Milne (West) Ltd	100%	Level 1, Citymark, 150 Fountainbridge, Edinburgh, EH3 9PE	i
Stratus (Holdings) Ltd	82.5%	3MC Middlemarch Business Park, Siskin Drive, Coventry, West Midlands, England, CV3 4FJ	i &
	82.5%		i
Stroma Group Ltd	99%	Unit 4, Pioneer Way, Castleford, West Yorkshire, WF10 5QU	i &
Sunshine Unincorporated JV	n/a	Level 3, 1C Homebush Bay Drive, Rhodes NSW 2138, Australia	*
Tatton Hall Homes (Bradmore) Limited	50%	34 Waterloo Road, Wolverhampton, West Midlands, England, WV1 4DG	i
Team 17 Holdings Ltd	89.25%	Castleview House, Calder Island Way, Wakefield, West Yorkshire, WF2 7AW	i
	89.25%		xv &
Temple Topco Limited	89.25%	Market Place, Henley-On-Thames, Oxfordshire, RG9 2AD	i &
The Exceed Partnership LP	n/a	Cavendish House, 39-41 Waterloo Street, Birmingham, B2 5PP	*
The Great Wigmore Partnership (G.P.) Ltd	50%	33 Cavendish Square, London, W1G 0PW	
The Great Wigmore Partnership	n/a	33 Cavendish Square, London, W1G 0PW	*
The Pallet Network Group Limited	89.25%	Prologis Park, Midpoint Way, Minworth, Sutton Coldfield, West Midlands, B76 9EH	i
The Power Industrial Group Limited (In liquidation)	82.5%	Deloitte LLP, 1 City Square, Leeds, LS1 2AL	i &
	82.5%		i &
Thistlerow Ltd	25%	Radleigh House 1 Golf Road, Clarkston, Glasgow, G76 7HU	*
Thread Real Estate Cary Towne Park LLC	n/a	Corporation Trust Centre, 1209 Orange Street, Wilmington, DE 19801, United States	
Timec 1601 Limited	89.25%	Waterloo House, Thornton Street, Newcastle Upon Tyne, England, England, NE1 4AP	i &
Travellers Cheque Associates Ltd	36%	Belgrave House, 76 Buckingham Palace Road, London, SW1W 9AX	
United House Group Holdings Ltd	81.65%	26 Kings Hill Avenue, Kings Hill, West Malling, Kent, ME19 4AE	i &
United Living Group Ltd	100%	Media House, Azalea Drive, Swanley, Kent, BR8 8HU	i &
	98.55%		xvii
Velocity Holdco Limited	99%	Unit 1 22 Aspen Way, Paignton, Devon, United Kingdom, TQ4 7QR	i &
Vulcan Topco Ltd	89.25%	2 Mountview Court, 310 Friern Barnet Lane, Wheststone, London, N20 0YZ	i &
	89.25%		i
Whittington Facilities Limited	100%	Cannon Place, 78 Cannon Street, London, EC4N 6AF	v &
Willoughby (873) Ltd (In administration)	95.95%	Four, Brindley Place, Birmingham, West Midlands, B1 2HZ	i &
Willoughby (880) Ltd	89.25%	IMEX, 575-599 Maxted Road, Hemel Hempstead Industrial Estate, Hemel Hempstead, Herts, HP2 7DX	i &
Zog Brownfield Ventures Ltd (In administration)	50%	1 More London Place, London, SE1 2AF	

Collective Investment Vehicles

The following comprises a list of the Group's and other external collective investment vehicles (CIV), where the shareholding is greater than or equal to 20 per cent of the nominal value of any class of shares, or a book value greater than 20 per cent of the CIV's assets.

Name of undertaking	% of fund held by immediate parent (or by the Group where this varies	Notes
ABERDEEN INVESTMENT ICVC		8
Aberdeen European Property Share Fund	56.79%	
Aberdeen Sterling Bond Fund	77.36%	
Aberdeen European Global High Yield Bond Fund	24.25%	
Aberdeen Sterling Opportunistic Corporate Bond Fund	34.58%	
ABERDEEN INVESTMENTS ICVC II		8
Aberdeen Global Corporate Bond Tracker Fund	97.86%	
ABERDEEN INVESTMENT ICVC III		8
Aberdeen Global Emerging Markets Quantitative Equity Fund	70.62%	
ABERDEEN LIQUIDITY FUND (LUX)		7
Aberdeen Liquidity Fund (Lux) - Sterling Fund	52.49%	
Aberdeen Liquidity Fund (Lux) - Euro Fund	20.88%	
Aberdeen Liquidity Fund (Lux) - Ultra Short Duration Sterling Fund	61.20%	
ABERDEEN PRIVATE EQUITY FUND OF FUNDS (2007) PLC	96.08%	3
ACS POOLED PROPERTY		2
Scottish Widows Pooled Property ACS Fund	100%	
Scottish Widows Pooled Property ACS Fund2	100%	
BLACKROCK BALANCED GROWTH PORTFOLIO FUND	42.06%	9
BLACKROCK UK SMALLER COMPANIES FUND	23.09%	9
BNY MELLON INVESTMENTS FUNDS ICVC		10
Insight Global Multi-Strategy Fund	43.84%	
Insight Global Absolute Return Fund	73.62%	
Newton Multi-Asset Growth Fund	29.15%	
Newton UK Opportunities Fund	42.36%	
Newton UK Income Fund	27.38%	
HBOS ACTIVELY MANAGED PORTFOLIO FUNDS ICVC		1
Diversified Return Fund	94.47%	
Absolute Return Fund	92.49%	
Dynamic Return Fund	96.56%	
HBOS INTERNATIONAL INVESTMENT FUNDS ICVC		1
North American Fund	96.49%	
Far Eastern Fund	81.71%	
European Fund	94.19%	
International Growth Fund	53.63%	
Japanese Fund	95.80%	
HBOS SPECIALISED INVESTMENT FUNDS ICVC		1
Cautious Managed Fund	52.61%	
Ethical Fund	83.59%	
Fund of Investment Trusts	40.57%	
Smaller Companies Fund	66.86%	
Special Situations Fund	51.67%	
HBOS UK INVESTMENT FUNDS ICVC		1
UK Equity Income Fund	62.43%	
UK Growth Fund	62.36%	
UK FTSE All-Share Index Tracking Fund	58.47%	
HBOS PROPERTY INVESTMENT FUNDS ICVC		1
UK Property Fund	40.50%	
HLE Active Managed Portfolio Konservativ	32.65%	18
HLE Active Managed Portfolio Dynamisch	53.98%	18
HLE Active Managed Portfolio Ausgewogen	58.43%	18
INSIGHT INVESTMENT FUND OF FUNDS II ICVC		11
Absolute Insight Fund	61.29%	
INVESCO PERPETUAL FAR EASTERN INVESTMENT SERIES		12
Invesco Perpetual Asian Equity Income Fund	24.38%	
LDI SOLUTIONS PLUS PLC		19
IIFIG Government Liquidity Fund	21.81%	
MULTI MANAGER ICVC		2
Multi Manager UK Equity Growth Fund	82.23%	
Multi Manager UK Equity Income Fund	29.30%	
Multi Manager UK Equity Focus Fund	21.50%	
RUSSELL INVESTMENT COMPANY PLC		15
Russell Euro Fixed Income Fund	29.73%	
Russell Sterling Bond Fund	38.48%	
Russell U.S. Bond Fund	48.73%	
SCHRODER GILT AND FIXED INTEREST FUND	23.75%	16
SCOTTISH WIDOWS INCOME AND GROWTH FUNDS ICVC		2
UK Index Linked Gilt Fund	100%	
Corporate Bond PPF Fund	100%	
SW Corporate Bond Tracker	100%	
Scottish Widows GTAA 1	84.39%	
Corporate Bond 1 Fund	100%	
Balanced Growth Fund	27.17%	
Adventurous Growth Fund	71.69%	
SCOTTISH WIDOWS INVESTMENT SOLUTIONS FUNDS ICVC		2
Balanced Solution	45.76%	
Cautious Solution	37.40%	
Discovery Solution	45.42%	
Strategic Solution	55.13%	
Dynamic Solution	57.85%	
Defensive Solution	68.08%	
Adventurous Solution	76.79%	
European (ex UK) Equity Fund	96.77%	
Asia Pacific (ex Japan) Equity Fund	95.74%	
Japan Equities Fund	94.71%	
US Equities Fund	99.71%	
Fundamental Index UK Equity Fund	85.30%	
Fundamental Index Global Equity Fund	96.68%	
Fundamental Index Emerging Markets Equity Fund	95.50%	
Fundamental Low Volatility Index Global Equity	98.39%	
Fundamental Low Volatility Index Emerging Markets Equity	96.17%	
Fundamental Low Volatility Index UK Equity	91.85%	
SCOTTISH WIDOWS MANAGED INVESTMENT FUNDS ICVC		2
International Equity Tracker Fund	77.65%	
Balanced Portfolio Fund	82.19%	
Progressive Portfolio Fund	72.76%	
Cautious Portfolio Fund	60.17%	
Cash Fund	99.06%	
Opportunities Portfolio Fund	92.18%	
SCOTTISH WIDOWS OVERSEAS GROWTH INVESTMENT FUNDS ICVC		2
Global Growth Fund	54.22%	
European Growth Fund	90.07%	
American Growth Fund	87.81%	
Pacific Growth Fund	76.54%	
Japan Growth Fund	98.62%	
SCOTTISH WIDOWS TRACKER AND SPECIALIST INVESTMENT FUNDS ICVC		2
UK All Share Tracker Fund	92.70%	
International Bond Fund	32.96%	
UK Smaller Companies Fund	28.56 %	
UK Tracker Fund	47.44%	
UK Fixed Interest Tracker Fund	96.28%	
Emerging Markets Fund	89.40%	
UK Index-Linked Tracker Fund	50.89%	
Overseas Fixed Interest Tracker Fund	94.23%	
SCOTTISH WIDOWS UK AND INCOME INVESTMENT FUNDS ICVC		2
UK Corporate Bond Fund	62.79%	
UK Growth Fund	62.02%	
Gilt Fund	95.99%	
High Income Bond Fund	25.77%	
Strategic Income Fund	63.23%	
Environmental Investor Fund	69.89%	
Ethical Fund	73.65%	
SSGA ASIA PACIFIC TRACKER FUND	86.64%	4
SSGA EUROPE (EX UK)	96.10%	4
SSGA UK EQUITY TRACKER FUND	92.43%	4
SSGA NORTH AMERICAN EQUITY FUND	100%	4
SWIP EUROPEAN BALANED PROPERTY FUND	84.64%	5
UNIVERSE, THE CMI GLOBAL NETWORK		6
CMIG GA 70 Flexible	100%	
CMIG GA 80 Flexible	100%	
CMIG GA 90 Flexible	100%	
Euro Cautious	90.89%	
European Enhanced Equity	100%	
CMIG Access 80%	100%	
Continental Euro Equity	97.56%	
UK Equity	73.76%	
US Enhanced Equity	87.67%	
Japan Enhanced Equity	93.57%	
Pacific Enhanced Basin	78.82%	
Euro Bond	69.14%	
US Bond	93.52%	
US Currency Reserve	76.15%	
Euro Currency Reserve	98.70%	
CMIG Focus Euro Bond	99.96%	
INVESTMENT PORTFOLIO ICVC		2
IPS Growth	22.01%	
THE TM LEVITAS FUNDS		21
TM Levitas A Fund	21.56%	
TM Levitas B Fund	26.39%	
UBS INVESTMENT FUNDS ICVC		17
UBS Global Optimal Fund	25.42%	
UBS UK Opportunities Fund	44.79%	

Subsidiaries and related undertakings continued

Principal place of business for collective investment vehicles
(1) Trinity Road, Halifax West Yorkshire, HX1 2RG
(2) 15 Dalkeith Road Edinburgh EH16 5WL
(3) 39/40 Upper Mount Street, Dublin, Ireland
(4) 20 Churchill Place, Canary Wharf, London E14 5HJ
(5) 80 route d'Esch, L-1470 Luxembourg
(6) Lemanik Asset Management S.A 106 route d'Arlon, L-8210 Mamer Luxembourg
(7) 35a avenue John F. Kennedy, L-1855, Luxembourg
(8) ABERDEEN ASSET MANAGERS LTD, 1 BREAD STREET, BOW BELLS HOUSE, LONDON EC4M 9HH
(9) BlackRock Fund Managers Limited, 12 Throgmorton Avenue, London EC2N 2DL
(10) BNY MELLON INVESTMENT FUNDS, BNY MELLON CENTRE, 160 QUEEN VICTORIA STREET, LONDON EC4V 4LA
(11) INSIGHT INVESTMENT MGMT GLOBAL, 160 QUEEN VICTORIA STREET, LONDON EC4V 4LA
(12) Perpetual Park, Perpetual Park Drive, Henley-on-Thames, Oxfordshire, RG9 1HH
(13) JP Morgan Funds Limited, 3 Lochside View, Edinburgh Park, Edinburgh, EH12 9DH
(14) Nordea Investment Funds S.A., 562 rue de Neudorf, L-2220 Luxembourg
(15) 78 SIR JOHN ROGERSON'S QUAY, DUBLIN 2, IRELAND
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* The undertaking does not have share capital
+ The undertaking does not have a registered office
# In relation to Subsidiary Undertakings, an undertaking external to the Group holds shares
^ Shares held directly by Lloyds Banking Group plc
& The Group holds voting rights of between 20% and 49.9%

(i) A Ordinary shares
(ii) B Ordinary shares
(iii) Deferred shares
(iv) Preference shares
(v) Preferred ordinary shares
(vi) Non-voting shares
(vii) C Ordinary shares
(viii) N Ordinary shares
(ix) Callable preference shares
(x) Redeemable preference shares
(xi) Ordinary limited voting shares
(xii) Redeemable ordinary shares
(xiii) Common stock
(xiv) D Ordinary Shares
(xv) E Ordinary Shares
(xvi) W Ordinary Shares
(xvii) X Ordinary Shares
(xviii) Y Ordinary Shares
(xix) Z Ordinary Shares

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