Lloyds Banking Group plc
Form 20-F
May 13, 2010

As filed with the Securities and Exchange Commission on 13 May 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended 31 December 2009

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-15246

LLOYDS BANKING GROUP plc

(previously Lloyds TSB Group plc)
(Exact name of Registrant as Specified in Its Charter)

Scotland
(Jurisdiction of Incorporation or Organization)

25 Gresham Street
London EC2V 7HN
United Kingdom
(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary shares of nominal value 10 pence each, represented by American Depositary Shares.	The New York Stock Exchange.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

The number of outstanding shares of each of Lloyds Banking Group plc s classes of capital or common stock as of 31 December 2009 was:

Ordinary shares, nominal value 10 pence each	63,774,511,536
Limited voting shares, nominal value 10 pence each	80,921,051
Deferred shares, nominal value 15 pence each	27,242,603,417
Preference shares, nominal value 25 pence each	484,144,705
Preference shares, nominal value 25 cents each	3,038,001
Preference shares, nominal value 25 euro cents each	500,000

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes x No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Yes o No x

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-Accelerated filer o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements including in this filing:

U.S. GAAP o International Financial Reporting Standards as issued by the International Accounting Standards Board x Other o

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

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PRESENTATION OF INFORMATION

In this annual report, references to the Company are to Lloyds Banking Group plc; references to Lloyds Banking Group , Lloyds or the Group are to Lloyds Banking Group plc and its subsidiary and associated undertakings; references to Lloyds TSB Bank are to Lloyds TSB Bank plc; and references to the consolidated financial statements or financial statements are to Lloyds Banking Group s consolidated financial statements included in this annual report. References to the Financial Services Authority or FSA are to the United Kingdom (the UK) Financial Services Authority.

On 16 January 2009 the Company acquired 100 per cent of the ordinary share capital of HBOS plc and changed the Company s name to Lloyds Banking Group plc. Accordingly, where this annual report provides information for dates prior to 16 January 2009, unless otherwise indicated, such information relates to the Lloyds Banking Group prior to the acquisition of HBOS plc. References to HBOS or the HBOS Group are to HBOS plc and its subsidiary and associated undertakings.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

In this annual report, amounts described as statutory refer to amounts included within the Group s consolidated financial statements.

Lloyds Banking Group publishes its consolidated financial statements expressed in British pounds (pounds sterling , sterling or £), the lawful currency of the UK. In this annual report, references to pence and p are to one-hundredth of one pound sterling; references to US dollars , US$ or $ are to the lawful currency of the United States (the US); references to cent or c are to one-hundredth of one US dollar; references to euro or e are to the lawful currency of the member states of the European Union that have adopted a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty of European Union; references to euro cent are to one-hundredth of one euro; and references to Japanese yen , Japanese ¥ or ¥ are to the lawful currency of Japan. Solely for the convenience of the reader, this annual report contains translations of certain pounds sterling amounts into US dollars at specified rates. These translations should not be construed as representations by Lloyds Banking Group that the pounds sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or at any other rate. Unless otherwise stated, the translations of pounds sterling into US dollars have been made at the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) in effect on 31 December 2009, which was $1.6167 = £1.00. The Noon Buying Rate on 31 December 2009 differs from certain of the actual rates used in the preparation of the consolidated financial statements, which are expressed in pounds sterling, and therefore US dollar amounts appearing in this annual report may differ significantly from actual US dollar amounts which were translated into pounds sterling in the preparation of the consolidated financial statements in accordance with IFRS.

BUSINESS OVERVIEW

Lloyds Banking Group is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers. At 31 December 2009, total Lloyds Banking Group assets were £1,027,255 million and Lloyds Banking Group had some 107,000 employees (on a full-time equivalent basis). Lloyds Banking Group plc s market capitalisation at that date was some £32,327 million. The profit before tax for the 12 months to 31 December 2009 was £1,042 million and the capital ratios as at that date were 12.4 per cent for total capital, 9.6 per cent for tier 1 capital and 8.1 per cent for core tier 1 capital.

Set out below is the Group s summarised income statement for the last two years:

	2009 **£m**	2008[1] £m
Net interest income	**9,026**	7,718
Other income	**36,271**	(709)
Total income	**45,297**	7,009
Insurance claims	**(22,019)**	2,859
Total income, net of insurance claims	**23,278**	9,868
Operating expenses	**(15,984)**	(6,100)
Trading surplus	**7,294**	3,768
Impairment	**(16,673)**	(3,012)
Share of results of joint ventures and associates	**(752)**	4
Gain on acquisition	**11,173**	
Profit before tax	**1,042**	760

1 Restated for IFRS 2 (Revised).

Lloyds Banking Group was formed in January 2009 following the acquisition of HBOS and the Group s main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision. Services are offered through a number of well recognised brands including Lloyds TSB, Halifax, Bank of Scotland, Scottish Widows, Clerical Medical and Cheltenham & Gloucester, and via a distribution capability comprising the largest branch network in the UK and intermediary channels. The new Group also operates an international banking business with a global footprint in over 30 countries.

Since the acquisition of HBOS in January 2009 there have been four primary operating divisions, which constitute the Group s reporting segments: Retail, Wholesale, Wealth and International, and Insurance. Retail provides banking, mortgages and other financial services to personal customers in the UK. Wholesale provides banking and related services for major UK and multinational corporates and financial institutions, and small and medium-sized UK businesses. It also provides asset finance to personal and corporate customers and manages Lloyds Banking Group s activities in financial markets through its treasury function. Wealth and International provides private banking, wealth and asset management in the UK and overseas and corporate, commercial and retail banking services outside the UK. Insurance offers life assurance, pensions and investment products in the UK and Europe and provides general insurance to personal customers in the UK.

The acquisition of HBOS plc on 16 January 2009 has had a significant effect on the comparability of the Group s financial position and results with prior periods. Profit before tax is analysed further on pages 13 to 23 on a statutory basis and, in order to provide a more comparable representation of business performance of the Group s segments, on pages 25 to 40 on a combined businesses basis. The key principles adopted in the preparation of the combined businesses basis of reporting are described on page 25. The Group Executive Committee, which is the chief operating decision maker for the Group, reviews the Group s internal reporting based around these segments (which reflect the Group s organisational and management structures) in order to assess performance and allocate resources; this reporting is on a combined businesses basis, which the Group Executive Committee feel best represents the underlying performance of the Group. These combined businesses segmental results for 2009 and 2008 are therefore presented in compliance with IFRS 8 but the aggregated total of the combined businesses segmental results constitutes a non-GAAP measure as defined in the SEC s Regulation G and a reconciliation of this aggregated total to the statutory income statement is therefore provided on page 39. The following table shows the results of Lloyds Banking Group s Retail, Wholesale, Wealth and International, and Insurance segments and Central group items in the last two fiscal years, and their aggregation.

	2009	2008
	£m	£m
Retail	**1,382**	2,542
Wholesale	**(4,703)**	(10,479)
Wealth and International	**(2,356)**	277
Insurance	**975**	1,540
Group Operations and Central items:		
Group Operations	**(149)**	(76)
Central items	**(1,449)**	(517)
	(1,598)	(593)
Loss before tax Combined businesses basis	**(6,300)**	(6,713)

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, United Kingdom, telephone number + 44 (0) 20 7626 1500.

SELECTED CONSOLIDATED FINANCIAL DATA

The financial information set out in the tables below has been derived from the annual reports and accounts of Lloyds Banking Group plc for each of the past five years adjusted for subsequent changes in accounting policy and presentation. The financial statements for each of the years shown have been audited by PricewaterhouseCoopers LLP, independent accountants.

	2009	2008[1]	2007[1]	2006[1]	2005[1]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**23,278**	9,868	10,696	11,098	10,543
Operating expenses	**(15,984)**	(6,100)	(5,568)	(5,300)	(5,481)
Trading surplus	**7,294**	3,768	5,128	5,798	5,062
Impairment losses	**(16,673)**	(3,012)	(1,796)	(1,555)	(1,299)
Gain on acquisition	**11,173**				
Profit before tax	**1,042**	760	3,999	4,249	3,810
Profit for the year	**2,953**	798	3,320	2,908	2,545
Profit for the year attributable to equity shareholders	**2,827**	772	3,288	2,804	2,483
Total dividend for the year[2]		648	2,026	1,928	1,915
Balance sheet data at 31 December (£m)					
Share capital	**10,472**	1,513	1,432	1,429	1,420
Shareholders equity	**43,278**	9,393	12,141	11,155	10,195
Customer deposits	**406,741**	170,938	156,555	139,342	131,070
Subordinated liabilities	**34,727**	17,256	11,958	12,072	12,402
Loans and advances to customers	**626,969**	240,344	209,814	188,285	174,944
Total assets	**1,027,255**	436,033	353,346	343,598	309,754
Share information					
Basic earnings per ordinary share[3]	**7.5p**	6.7p	28.9p	24.8p	22.0p
Diluted earnings per ordinary share[3]	**7.5p**	6.6p	28.7p	24.5p	21.8p
Net asset value per ordinary share	**68p**	155p	212p	195p	180p
Total dividend per ordinary share[2]		11.4p	35.9p	34.2p	34.2p
Equivalent cents per share[2,4]		20.3c	71.0c	67.0c	62.2c
Market price per ordinary share (year end)	**50.7p**	126.0p	472.0p	571.5p	488.5p
Number of shareholders (thousands)	**2,834**	824	814	870	920
Number of ordinary shares in issue (millions)[5]	**63,775**	5,973	5,648	5,638	5,603
Financial ratios (%)[6]					
Dividend payout ratio		83.9	61.6	68.7	77.1
Post-tax return on average shareholders equity	**8.8**	7.0	28.1	26.6	25.5
Post-tax return on average assets	**0.28**	0.21	0.94	0.88	0.83
Average shareholders equity to average assets	**3.0**	2.9	3.3	3.2	3.2
Cost:income ratio[7]	**68.7**	61.8	52.1	47.8	52.0
Capital ratios (%)[8]					
Total capital	**12.4**	11.2	11.0	10.7	10.9
Tier 1 capital	**9.6**	8.0	8.1	8.2	7.9

1 Restated for IFRS 2 (Revised).

2 Annual dividends comprise both interim and final dividend payments. The total dividend for the year represents the interim dividend paid during the year and the final dividend, which is paid and accounted for in the following year.

[3] Earnings per share calculations for 2008 and earlier years have also been restated for the impact of the bonus element of the share issues in 2009.

[4] Translated into US dollars at the Noon Buying Rate on the date each payment was made.

[5] This figure excludes the limited voting ordinary shares owned by the Lloyds TSB Foundations.

[6] Averages are calculated on a monthly basis from the consolidated financial data of Lloyds Banking Group.

[7] The cost: income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims).

[8] Capital ratios for 2008 and later years are in accordance with Basel II requirements; ratios for 2007 and earlier years reflect Basel I.

EXCHANGE RATES

In this annual report, unless otherwise indicated, all amounts are expressed in pounds sterling. For the months shown the US dollar high and low Noon Buying Rates per pound sterling were:

	2010 April	2010 March	2010 February	2010 January	2009 December	2009 November
US dollars per pound sterling:						
High	**1.55**	**1.53**	**1.60**	**1.64**	**1.66**	**1.68**
Low	**1.52**	**1.49**	**1.52**	**1.59**	**1.59**	**1.64**

For each of the years shown, the average of the US dollar Noon Buying Rates per pound sterling on the last day of each month was:

	2009	2008	2007	2006	2005
US dollars per pound sterling:					
Average	**1.57**	1.84	2.01	1.86	1.81

On 30 April 2010, the latest practicable date, the US dollar Noon Buying Rate was $1.5308 = £1.00. Lloyds Banking Group makes no representation that amounts in pounds sterling have been, could have been or could be converted into US dollars at that rate or at any of the above rates.

BUSINESS

HISTORY AND DEVELOPMENT OF LLOYDS BANKING GROUP

The history of the Group can be traced back to the 18th century when the banking partnership of Taylors and Lloyds was established in Birmingham, England. Lloyds Bank Plc was incorporated in 1865 and during the late 19th and early 20th centuries entered into a number of acquisitions and mergers, significantly increasing the number of banking offices in the UK. In 1995, it continued to expand with the acquisition of the Cheltenham and Gloucester Building Society (C&G).

TSB Group plc became operational in 1986 when, following UK Government legislation, the operations of four Trustee Savings Banks and other related companies were transferred to TSB Group plc and its new banking subsidiaries. By 1995, the TSB Group had, either through organic growth or acquisition, developed life and general insurance operations, investment management activities, and a motor vehicle hire purchase and leasing operation to supplement its retail banking activities.

In 1995, TSB Group plc merged with Lloyds Bank Plc. Under the terms of the merger, the TSB and Lloyds Bank groups were combined under TSB Group plc, which was re-named Lloyds TSB Group plc with Lloyds Bank Plc, which was subsequently re-named Lloyds TSB Bank plc, the principal subsidiary. In 1999, the businesses, assets and liabilities of TSB Bank plc, the principal banking subsidiary of the TSB Group prior to the merger, and its subsidiary Hill Samuel Bank Limited were vested in Lloyds TSB Bank plc, and in 2000, Lloyds TSB Group acquired Scottish Widows. In addition to already being one of the leading providers of banking services in the UK, this transaction also positioned Lloyds TSB Group as one of the leading suppliers of long-term savings and protection products in the UK.

On 18 September 2008, with the support of the UK Government, the boards of Lloyds TSB Group plc and HBOS plc announced that they had reached agreement on the terms of a recommended acquisition by Lloyds TSB Group plc of HBOS plc. The shareholders of Lloyds TSB Group plc approved the acquisition at the company s general meeting on 19 November 2008. On 16 January 2009, the acquisition was completed and Lloyds TSB Group plc changed its name to Lloyds Banking Group plc.

Pursuant to two placing and open offers which were completed by the Company in January and June 2009 and the Rights Issue completed in December 2009, the UK Government acquired 43.4 per cent of the Company s issued ordinary share capital. Following the issue of ordinary shares in February 2010 pursuant to the Group s capital raising announced in November 2009, the UK Government s holding was reduced to approximately 41.3 per cent.

STRATEGY OF LLOYDS BANKING GROUP

The Group s corporate strategy supports its vision of being recognised as the best financial services company in the UK by customers, colleagues and shareholders. The strategy is focused on being a conservative, through the cycle relationship-based business.

The main focus for the Group remains the financial services markets in the UK and the Group s strategic position was strengthened through the acquisition of HBOS in January 2009. The Group is a well diversified UK financial services group and the largest retail financial services provider in the UK. The Group has leading positions in many of the markets in which it participates, a market leading distribution capability, well recognised brands and a large customer base. The scale of the organisation provides the opportunity to further invest in products and services, systems and training that combined will offer improved choice and service to the Group s customers. The effective integration of the two businesses will be a significant challenge over the next few years, but comprehensive plans are in place and progress is already being made.

The Group s corporate strategy is focused on:

DEVELOPING STRONG CUSTOMER FRANCHISES THAT ARE BASED ON DEEP CUSTOMER RELATIONSHIPS

The Group s businesses are focused on extending the reach and depth of its customer relationships, whilst enhancing product capabilities to build competitive advantage. Striving to understand and effectively meet the needs of the Group s customers from core banking products to the more specialist services such as insurance, wealth management or corporate banking is at the heart of the Group s business and is fundamental to ensuring that the Group is developing long-lasting customer relationships.

BUILDING A HIGH PERFORMANCE ORGANISATION

In building a high performance organisation the Group is focused on improving its cost efficiency and utilising its capital more effectively whilst maintaining a prudent approach to risk.

BUSINESS

The Group aspires to have one of the lowest cost: income ratios amongst UK financial institutions and further improving the Group s processing efficiency and effectiveness will remain a priority. The anticipated synergies arising from the acquisition will be key to further improving the Group s efficiency.

Utilising capital more effectively is increasingly important in the current environment and capital will be rigorously allocated across the Group s portfolio of businesses to support business growth.

The prudent Lloyds TSB through the cycle approach to risk has been applied to the enlarged Group. The Group s conservative and prudent approach to risk is core to the business model and the through the cycle approach means that the Group will continue to support its customers throughout the economic cycle. The risk structures and frameworks that have been implemented are the foundation for good business management.

MANAGING THE GROUP S MOST VALUABLE RESOURCE, PEOPLE

Executing the Group s strategy effectively will only be possible if the Group ensures that deliverables are effectively aligned with its corporate strategy and it manages its most valuable resource, people, well. In driving performance it is important to encourage, manage and develop staff whilst creating a great place to work.

SUMMARY

The Group believes that the successful execution of its strategy to focus on core markets, customer and cost leadership, capital efficiency, a prudent risk appetite and the effective management of its most valuable resource, its people, will bring the Group closer to achieving its vision of being recognised as the best financial services company in the UK.

BUSINESS AND ACTIVITIES OF LLOYDS BANKING GROUP

At 31 December 2008, the Group s activities were organised into three segments: UK Retail Banking; Insurance and Investments; and Wholesale and International Banking. Following the acquisition of HBOS plc on 16 January 2009, the Group was reorganised into four segments: Retail; Wholesale; Wealth and International; and Insurance. The Group has restated its segmental information for 2008. The Group has determined that the cost to develop the information required to restate 2007 was excessive. In order to provide comparability with the segmental information for 2007 the Group has supplementally presented its segmental information for 2008 on a consistent statutory basis (see also note 4 to the consolidated financial statements).

Further information on the current and previous segments is set out on pages 25 to 50.

MATERIAL CONTRACTS

Lloyds Banking Group plc and its subsidiaries are party to various contracts in the ordinary course of business.

In 2008, the Company entered into a placing and open offer agreement with The Commissioners of Her Majesty s Treasury (HM Treasury) and the joint sponsors and joint bookrunners named therein, as well as a preference share subscription agreement with HM Treasury, both with effect from 13 October 2008. Prior to the completion of the acquisition of HBOS, HBOS also entered into a placing and open offer agreement with HM Treasury and the joint sponsors and joint bookrunners named therein, as well as a preference share subscription agreement with HM Treasury, both with effect from 13 October 2008.

In 2009, the Company entered into a placing and compensatory open offer agreement with HM Treasury (as amended and restated on 20 March 2009 between the Company, HM Treasury, Citigroup Global Markets U.K. Equity Limited, J.P. Morgan Cazenove Limited and UBS Limited and further amended and restated between the same parties on 18 May 2009). In addition, the Company entered into a registration rights agreement with HM Treasury on 12 January 2009 (as amended with effect from 11 June 2009) pursuant to an obligation to do so under the 2008 placing and open offer agreement referred to above. The Company also entered into a resale rights agreement with HM Treasury pursuant to its obligations under the 2009 placing and open offer agreement. The Company entered into a Pre-Accession Commitments Deed dated 7 March 2009 and a Lending Commitments Deed dated 6 March 2009 (as amended on 23 March 2010) with HM Treasury, both relating to the Company s proposed participation in the Government Asset Protection Scheme. In addition, in connection with the 2009 rights issue and the Group s withdrawal from its proposed participation in the Government Asset Protection Scheme, the Company entered into a GAPS Withdrawal Deed with HM Treasury as well as the HMT Undertaking to Subscribe and the Cost Reimbursement Deed. For further details on each of the 2008 and 2009 agreements described above, see *Major shareholders and related party transactions Information about the Lloyds Banking*

Group s relationship with the UK Government.

In addition to those agreements discussed above, the Company entered into the following agreements, which it considers to be material:

RIGHTS ISSUE UNDERWRITING AGREEMENT

Pursuant to an underwriting agreement dated 3 November 2009 (entered into in relation to the 2009 rights issue described in *Major shareholders and related party transactions Information about the Lloyds Banking Group s relationship with the UK Government* between the Company, the banks, the senior co-lead managers, the co-lead managers and the co-bookrunner (all as named therein)), new shares in the Company were issued at a price of 37 pence per share. Sufficient new shares were issued to ensure that the gross proceeds of the rights issue receivable by the Company, including pursuant to the HMT Undertaking to Subscribe, were not less than £13.5 billion.

HM Treasury undertook to subscribe for its pro rata entitlement under the rights issue and the new shares that were the subject of the HMT Undertaking to Subscribe were not underwritten pursuant to the Rights Issue Underwriting Agreement. Further details of the HMT Undertaking to Subscribe are set out in *Major shareholders and related party transactions Information about the Lloyds Banking Group s relationship with the UK Government*.

In consideration of their services under the Rights Issue Underwriting Agreement, (i) the underwriters (as named in the Rights Issue Underwriting Agreement) were paid an aggregate base fee of 2.25 per cent of the issue price multiplied by the aggregate number of new shares issued (excluding the new shares that were subscribed by HMT), and (ii) the joint bookrunners (as named in the Rights Issue Underwriting Agreement) were paid additional performance-based discretionary fees. Out of such fees (to the extent received by the joint global co-ordinators (as named in the Rights Issue Underwriting Agreement), the joint global co-ordinators were to pay any sub-underwriting commissions (to the extent that sub-underwriters were procured). The joint global co-ordinators had the ability to arrange sub-underwriting in respect of some, all or none of the new shares issued (other than the new shares to be subscribed by HM Treasury).

The Company agreed to pay all costs and expenses of, or in connection with, the rights issue, the general meeting of the Company convened to approve the rights issue, the related subdivision of the Company s shares, the allotment and issue of the new shares and the Rights Issue

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Underwriting Agreement, including (but not limited to) the UK Listing Authority and the London Stock Exchange listing and trading fees, other regulatory fees and expenses, printing and advertising costs, postage, Equiniti Limited s charges (as registrar), its own and the banks , the senior co-lead managers and the co-lead managers properly incurred legal and other out of-pocket expenses, all accountancy and other professional fees, properly incurred public relations fees and expenses and all stamp duty and stamp duty reserve tax (if any) and other duties and taxes (other than corporation tax incurred by any of the banks, the senior co-lead managers and the co-lead managers on the commissions payable to them).

The obligations of the banks, the senior co-lead managers and the co-lead managers under the Rights Issue Underwriting Agreement were subject to certain limited conditions which were satisfied.

TOP UP ISSUES UNDERWRITING AGREEMENT

Pursuant to the Top Up Issues Underwriting Agreement dated 3 November 2009 among the Company, LBG Capital No.2 plc (as issuer), Lloyds TSB Bank plc (as guarantor) and the joint bookrunners (as named therein), in the event that the exchange offers described in *Risk factors Government-related risks* did not generate or were not expected to generate prior to 30 April 2010, or such other date as the Company and the joint bookrunners might agree, £7.5 billion or more of core tier 1 and/or nominal value of contingent core tier 1 capital, the joint bookrunners severally agreed to underwrite one or more further issues of enhanced capital notes in an aggregate amount sufficient to reduce such shortfall to zero by such date.

In consideration of their underwriting services under the Top Up Issues Underwriting Agreement, and subject to their obligations under the Top Up Issues Underwriting Agreement having become unconditional and the Top Up Issues Underwriting Agreement not having been terminated, the joint bookrunners were to be paid an aggregate underwriting fee of £75 million and additional performance-based discretionary fees.

The obligations of the joint bookrunners under the Top Up Issues Underwriting Agreement and, in relation to each issue of additional enhanced capital notes, the obligations of the joint bookrunners under the Top Up Issues Underwriting Agreement were subject to certain conditions which were satisfied.

Each of the Company, the issuer and the guarantor gave certain customary representations, warranties, undertakings and indemnities to the joint bookrunners, all of which have now expired.

In addition to the fees described above, the joint bookrunners and their affiliates were to be paid pursuant to the Rights Issue Underwriting Agreement and the Top Up Issues Underwriting Agreement:

(a) an aggregate transaction praecipuum of 0.088 per cent of £15.1 billion (being the aggregate of the underwriting commitments of the underwriters and the joint bookrunners), or of a sum in excess thereof dependent on the notional amount of the securities submitted in the exchange offers; and

(b) a further discretionary aggregate transaction praecipuum (to be paid at the sole discretion of the Company, as to payment and allocation) of 0.088 per cent of £15.1 billion (being the aggregate of the underwriting commitments of the underwriters and the joint bookrunners), or of a sum in excess thereof dependent on the notional amount of the securities submitted in the exchange offers.

ENVIRONMENTAL MATTERS

The Group has a long-standing commitment to managing its environmental impacts. It first introduced an environmental policy in 1996. In 2009, the Group reviewed the policy against best practice to ensure that it is fit for purpose across the whole of the Group. Further work will be undertaken during 2010 to produce and embed an enhanced and integrated environmental management system.

CLIMATE CHANGE

The UK Government is committed to reducing the country s carbon emissions by 80 per cent from 1990 levels by 2050. A central part of its strategy is the introduction of a mandatory climate change and energy savings scheme, the Carbon Reduction Commitment Energy Efficiency Scheme, due to start in April 2010. The Group qualifies as a participant in this scheme, which requires a collective 22 per cent emissions reduction from participants by 2012. The Group fully understands its obligations and is committed to driving down CO_2 emissions. It is developing a carbon management policy and strategy to deliver a single approach for the new combined Group, and continues to invest significant capital in carbon reduction projects across the Group s estate.

In 2009 the Group chaired an initiative with Business in the Community and the Cambridge Programme for Sustainability Leadership to create a Guide for Carbon Management in the Supply Chain. The guide has helped inform the Group s approach and, as a freely downloadable resource, the Group is also encouraging its suppliers and customers to use it to help manage carbon risks in the supply chain.

Lloyds Banking Group is represented by Group Executive Director Truett Tate on the Corporate Leaders Group on Climate Change . This group of leading businesses released the Copenhagen Communiqué , widely viewed as the progressive voice of business, for the Copenhagen Climate Change talks in December 2009.

BUSINESS TRAVEL

In 2009 the Group introduced a common travel policy across the organisation. It supports a focus on sustainable travel and helped the Group deliver a 13 per cent reduction in the costs of travel.

The Group s Sustainability Network holds events and runs awareness campaigns to encourage colleagues to play their part. Travel reduction was one of the Network s key themes in 2009, inspiring colleagues to take steps to reduce their travel footprints.

The Group achieved a reduction of 143,000 journeys in 2009 compared with 2008. Across the combined Group, the volume of teleconferences increased by over 40 per cent to over 1.1 million. The Group will continue to promote virtual conferencing technologies to colleagues as an environmentally friendly, cost efficient alternative to travelling.

ENVIRONMENTAL RISK MANAGEMENT

The Group has introduced policies and procedures to reduce the environmental impact of its lending activities. The Group aims to reduce environmental impacts through effective risk management. In 2009 it implemented an integrated groupwide environmental risk policy to manage these risks; this requires transactions to be assessed for material risks as part of the credit sanctioning process.

BUSINESS

EQUATOR PRINCIPLES

The Equator Principles are voluntary guidelines for the financial industry to manage social and environmental issues in project financing. Lloyds Banking Group is a signatory to the Equator Principles.

During 2009 the Group implemented a harmonised groupwide approach to monitoring and reporting Equator Principles transactions, and training colleagues on the Equator Principles. An Equator Principles Review Group has been formed, comprising experts from both Risk and Project Finance teams, and supported by external environmental consultants. This Group is responsible for reviewing all new Equator Principle transactions, to ensure that each transaction is compliant and is consistent with the group environmental risk policy, prior to being sanctioned.

Equator Principles reporting January to December 2009:

DEALS

	Equator Principle risk category			
	Category A higher risk	Category B medium risk	Category C lower risk	Total
Completed		7	7	14
In progress		4	1	5
Not completed		1		1
		12	8	20

GEOGRAPHY OF COMPLETED TRANSACTIONS

	Category A higher risk	Category B medium risk	Category C lower risk	Total
US		2	2	4
Europe		4	5	9
Middle East		1		1
		7	7	14

INDUSTRY OF COMPLETED TRANSACTIONS

	Number	£m
Renewables	4	89
Infrastructure	7	376
Energy and utilities	3	72
	14	537

PROPERTIES

As at 31 December 2009, Lloyds Banking Group occupied 3,467 properties in the UK. Of these, 953 were held as freeholds, 98 as long-term leaseholds and 2,416 as short-term leaseholds. The majority of these properties are retail branches, widely distributed throughout England, Scotland and Wales. Other buildings include the Lloyds Banking Group s head office in the City of London and customer service and support centres located to suit business needs but clustered largely in London, Birmingham, West Yorkshire, Chester and Bristol (in England), Edinburgh (in Scotland) and Cardiff and Newport (in Wales).

In addition, there are 699 properties which are either sub-let or vacant. There are also a number of ATM units situated throughout the UK, the majority of which are held as short-term leasehold. In addition, the Group also owns, leases or uses under licence properties for business operations elsewhere in the world, principally in Spain, Switzerland, Dubai, Asia and Ireland.

LEGAL ACTIONS

During the ordinary course of business the Group is subject to threatened or actual legal proceedings and regulatory challenge both in the UK and overseas.

UNARRANGED OVERDRAFT CHARGES

In April 2007, the OFT commenced an investigation into the fairness of personal current accounts and unarranged overdraft charges. At the same time, it commenced a market study into wider questions about competition and price transparency in the provision of personal current accounts.

The Supreme Court published its judgment in respect of the fairness of unarranged overdraft charges on personal current accounts on 25 November 2009, finding in favour of the litigant banks. On 22 December 2009, the OFT announced that it will not continue its investigation into the fairness of these charges. The Group is working with the regulators to ensure that outstanding customer complaints are concluded as quickly as possible and anticipate that most cases in the county courts will be discontinued. The Group expects that some customers will argue that despite the test case ruling they are entitled to a refund of unarranged overdraft charges on the basis of other legal arguments or challenges. The Group is robustly defending any such complaints or claims and does not expect any such complaints or claims to have a material effect on the Group.

The OFT however continued to discuss its concerns in relation to the personal current account market with the banks, consumer groups and other organisations under the auspices of its Market Study into personal current accounts. In October 2009, the OFT published voluntary initiatives agreed with the industry and consumer groups to improve transparency of the costs and benefits of personal current accounts and improvements to the switching process. On 16 March 2010 the OFT published a further update announcing several further voluntary industry wide initiatives to improve a customer s ability to control whether they used an unarranged overdraft and to assist those in financial difficulty. However, in light of the progress it noted in the unarranged overdraft market since July 2007 and the progress it expects to see over the next two years, it has decided to take no further action at this time and will review the unarranged overdraft market again in 2012. The OFT also announced it will shortly be commencing an investigation into the barriers to entry in the personal current accounts market.

BUSINESS

INTERCHANGE FEES

The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard issuers charged a uniform fallback interchange fee in respect of cross border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the General Court of the European Union (the General Court). Lloyds TSB Bank plc and Bank of Scotland plc (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard s position that the arrangements for the charging of a uniform fallback interchange fee are compatible with European Commission competition laws. MasterCard has announced that it has reached an understanding with the European Commission on a new methodology for calculating intra European Economic Area multi-lateral interchange fees on an interim basis pending the outcome of the appeal. Meanwhile, the European Commission and the UK s OFT are pursuing investigations with a view to deciding whether arrangements adopted by other payment card schemes for the levying of uniform fallback interchange fees in respect of domestic and/or cross-border payment transactions also infringe European Commission and/or UK competition laws. As part of this initiative, the OFT will also intervene in the General Court appeal supporting the European Commission position and Visa reached an agreement with the European Commission to reduce the level of interchange for cross-border debit card transactions to the interim levels agreed by MasterCard. The ultimate impact of the investigations on the Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

PAYMENT PROTECTION INSURANCE

UK COMPETITION COMMISSION

In January 2009, the Competition Commission completed its formal investigation into the supply of Payment Protection Insurance (PPI) services (except store card PPI) to non-business customers in the UK. Various members of the Group underwrite PPI, while other members distribute PPI, by offering it for sale with a variety of the credit products which they supply.

On 5 June 2008, the Competition Commission issued its provisional findings, to the effect that there are market features which prevent, restrict or distort competition in the supply of PPI to non-business customers, with an adverse effect on competition and with the result being detrimental to consumers.

Following consultation, the Competition Commission published its final report on 29 January 2009 setting out its remedies. In summary, the Competition Commission has decided to adopt the following remedies: (i) a prohibition on the active sale of PPI by a distributor to a customer within seven days of the distributor s sale of credit to that customer. However, customers may pro-actively return to the distributor to initiate a purchase by telephone or online from 24 hours after the credit sale; (ii) a requirement on all PPI providers to provide certain information and messages in PPI marketing materials; (iii) a requirement to provide personal PPI quotes to customers; (iv) a requirement on all PPI providers to provide certain information on PPI policies to the FSA; (v) a recommendation to the FSA that it use the information provided under the requirement in (iii) to populate its PPI price comparison tables; (vi) a requirement on distributors to provide an annual statement for PPI customers containing information on their PPI policy and what it costs; and (vii) a prohibition on the levying by distributors of payments for PPI on a single premium basis. Instead, distributors are permitted to charge only regular premiums at a constant rate, paid monthly or annually. This remedy therefore precludes the selling of multi-year PPI policies for a single premium.

On 30 March 2009, Barclays Bank PLC lodged an appeal in the Competition Appeal Tribunal against the Competition Commission s findings. In particular, it requested that the Competition Appeal Tribunal quash the decision of the Competition Commission insofar as it relates to the prohibition of distributors selling PPI at the credit point of sale and the Competition Commission s findings on market definition and the nature and extent of competition in the supply of PPI. The Group filed a notice of its intention to intervene in the appeal on 23 April 2009. On 28 April 2009, the Group was granted permission by the Competition Appeal Tribunal to intervene in the appeal. The hearing of the appeal took place from 7 September 2009 to 11 September 2009. The Competition Appeal Tribunal handed down its judgment on 16 October 2009. It found in favour of Barclays in respect of its challenge to the Competition Commission s prohibition of distributors selling PPI at the credit point of sale but it did not uphold Barclays challenge to the Competition Commission s findings on market definition. The matter has been referred back to the Competition Commission with direction to reconsider their remedies and make a new decision in accordance with the Competition Appeal Tribunal s ruling. This may or may not result in the Competition Commission ultimately reaching a different conclusion.

Depending on the outcome of the referral back to the Competition Commission, the Competition Commission s decision may have a significant adverse impact on the level of sales and thus the revenue generation and profitability of the payment protection insurance products which the Group offers its customers, but the ultimate impact would be determined by a number of factors including the extent to which the Group was able to mitigate the potentially adverse effects of such statutory changes through restructuring the payment protection products which it offers its customers and/or developing alternative products and revenue streams. To this end, the Group took a commercial decision to sell only regular monthly premium PPI to its personal loan customers in the UK from early 2009. The FSA subsequently wrote to certain other firms still selling single premium PPI with unsecured personal loans asking them to withdraw the product as soon as possible, and no later than 29 May 2009.

On 1 July 2008, the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. The Group has been working with other industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints. On 29 September 2009, the FSA issued a consultation paper on PPI complaints handling. The FSA has escalated its regulatory activity in relation to past PPI sales generally and has proposed new guidance on the fair assessment of a complaint and the calculation of redress and a new rule requiring firms to reassess historically rejected complaints. On 9 March, the FSA issued a further consultation paper on this area, the consultation period for which closed on 22 April (the Group has responded to this consultation). The FSA s proposals are materially the same, although it has placed the new rule requiring firms to reassess historically rejected claims on hold for the present.

The statement on 29 September 2009 also announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. The Group has subsequently agreed in principle that it will undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. The precise details of the review are still being discussed with the FSA. The ultimate impact on the Group of any review and/or the FSA s complaints handling proposals can only be known at the conclusion of these discussions and on publication of the FSA s final rules.

US ECONOMIC SANCTIONS

Starting in 2007 Lloyds TSB Bank plc provided information in relation to its review of historic US Dollar payments involving countries, persons or entities subject to US economic sanctions administered by the Office of Foreign Assets Control (OFAC) to a number of authorities reported to be conducting a review of sanctions compliance by non-US financial institutions. On 9 January 2009 the settlement reached by Lloyds TSB Bank plc with both the US Department of Justice and the New York County District Attorney s Office in relation to their investigations was announced. The settlement documentation contains details of the results of the investigations including the identification of certain activities relating to Iran, Sudan and Libya which Lloyds TSB Bank plc conducted during the relevant period. In 2008, Lloyds TSB Bank plc made a provision of £180 million which fully covered the settlement amount paid to the Department of Justice and the New York District Attorney s Office. On 22 December 2009 OFAC announced the settlement it had reached with Lloyds TSB Bank plc in relation to its investigation and confirmed that the settlement sum due to OFAC had been fully satisfied by Lloyds TSB Bank plc s payment to the Department of Justice and the New York District Attorney s Office. No further enforcement actions are expected in relation to the matters set out in the settlement agreements. A purported shareholder filed a derivative civil action in the Supreme Court of New York, Nassau County on 26 February 2009 against certain current and former directors, and nominally against Lloyds TSB Bank plc and the Company, seeking various forms of relief following the settlement. The derivative action is at a very early stage, but the ultimate outcome of the action is not expected to have a material impact on the Group.

OTHER LEGAL ACTIONS

In addition to the matters listed above the Group is subject to threatened or actual legal proceedings and regulatory challenge both in the UK and overseas. All such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management s best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed to properly assess the merits of the case and no provisions are held against such cases. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position.

COMPETITIVE ENVIRONMENT

The Group is a diversified UK based financial services group providing a wide range of banking and financial services, predominantly in the UK, to personal and corporate customers. Its main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

In the retail banking market, the Group competes with banks and building societies, major retailers and internet-only providers. In the mortgage market, competitors include the traditional banks and building societies and specialist mortgage providers. The Group competes with both UK and foreign financial institutions in the wholesale banking markets and with bancassurance, life assurance and general insurance companies in the UK insurance market.

The Group s businesses are subject to inherent risks arising from general and sector-specific economic conditions in the markets in which it operates, particularly the United Kingdom in which the Group s earnings are predominantly generated. Following the acquisition of HBOS, the Group now has greater exposure in a number of other jurisdictions; these include Ireland, Australia and the United States, and hence the Group is exposed to general and sector-specific economic conditions in these markets. Over approximately the past two and a half years, the global economy and the global financial system have been experiencing a period of significant turbulence and uncertainty, particularly the very severe dislocation of the financial markets around the world that began in August 2007 but substantially worsened in September 2008 and has contributed to related problems at many large global and UK commercial banks, investment banks, insurance companies and other financial and related institutions.

UK Government, EU or other intervention in the banking sector may impact the competitive position of banks within a country and among international competitors which may be subject to different forms of intervention, thus potentially putting the Group at a competitive disadvantage to other banks.

RECENT DEVELOPMENTS

SHARE CAPITAL

As part of the Group s recapitalisation and withdrawal from its proposed participation in the Government Asset Protection Scheme the Group announced on 23 November 2009 that an aggregate amount of £1.48 billion would be issued in the form of new ordinary shares of Lloyds Banking Group plc in exchange for certain existing preference shares and preferred securities. The conversion price was determined as the five day weighted average price for the five trading days ending on 11 February 2010.

On 18 February 2010, the exchange completed and 3,141 million ordinary shares in Lloyds Banking Group plc were issued as consideration for the redemption of preference shares and preferred securities. In accordance with the Group s accounting policy in respect of debt for equity exchanges, a gain of £85 million will be recognised on this exchange transaction in the year ended 31 December 2010.

SALE OF ESURE

On 11 February 2010, the Group announced the sale of its 70 per cent stake in esure, the online insurer, to a management buyout vehicle to be called esure Group Holdings Limited, led by the esure chairman, for a cash consideration slightly in excess of book value in the Lloyds Banking Group accounts. The impact on the Group s accounts is not expected to be material.

TRADING UPDATE 19 MARCH 2010

The Group issued an update on its current trading on 19 March 2010, which included the following comments:

In the first 10 weeks of 2010, the Group s trading performance has been strong and we are pleased with the Group s performance against each area of recent guidance. The banking net interest margin is trending in line with recent guidance and this has supported a good level of income growth, on a combined businesses basis and excluding last year s gains from liability management transactions.

Costs have remained well controlled and are lower than the equivalent period in 2009. Impairment provisions are currently trending at lower levels than anticipated and as a result the Group now expects to deliver a better impairment performance than previously guided, in both the retail and corporate businesses, in 2010. Overall, based on the Group s current economic and regulatory assumptions which remain unchanged since our recent 2009 preliminary results announcement, the Group believes that it will be profitable on a combined businesses basis (see *Operating and financial review and prospects Line of business information 2009 compared to 2008* and *Combined businesses basis summary 2009 compared with 2008*) in 2010.

BOARD CHANGES

On 11 February 2010, the Group announced the appointment of Glen Moreno and David Roberts as directors with effect from 1 March 2010. On 22 March 2010, the Group announced that Dr Wolfgang Berndt would retire as a director at the annual general meeting on 6 May 2010.

BUSINESS

INTERIM MANAGEMENT STATEMENT

The Group issued an Interim Management Statement on 27 April 2010, which included the following comments:

The Group is continuing to see positive trends in line with our recent trading update on 19 March 2010. In particular, impairments have slowed significantly in the first few months of the year giving us confidence that we will achieve a better financial performance than previously guided. I am pleased to report that we returned to profitability in the first quarter and expect this momentum to be sustained throughout 2010.

Eric Daniels
Group Chief Executive

Key highlights

In the first quarter of 2010 the Group returned to profitability on a combined businesses basis due mainly to a significant slowing of impairments in the wholesale business (see *Operating and financial review and prospects Line of business information 2009 compared to 2008* and *Combined businesses basis summary 2009 compared to 2008*).

The Group is delivering good income growth, on a combined businesses basis, excluding last year s impact from liability management transactions.

Banking net interest margins are running in line with recent guidance of circa 2 per cent for the full year.

Costs continue to be well controlled and remain lower than the equivalent period in 2009. Integration savings are being delivered in line with recent guidance and the Group remains on track to achieve a £2 billion run-rate of synergies and other operating efficiencies by the end of 2011.

The run rate of impairments has slowed significantly and has continued to perform better than our 2009 preliminary results guidance in both retail and corporate businesses.

Customer deposit gathering has remained robust, with good growth in balances, while lending balances are flat. Asset reductions within the Group s portfolios identified for run-off continue albeit, as expected, at a slower pace than last year.

The Group continues to de-risk its funding position, with strong term issuance in the early part of the year while continuing to maintain high levels of liquid assets.

Good trading performance with guidance reaffirmed

The Group is continuing to see good income growth on a combined businesses basis (excluding the impact of liability management exercises). In particular, margin improvements have more than offset the impact of asset reductions over the last year.

Overall banking margins are trending positively and we continue to be confident of delivering a circa 2 per cent margin for the full year.

Income in the Group s core banking businesses has continued to benefit from higher asset pricing and lower funding costs. Good progress continues to be made in improving the quality of both sides of our balance sheet as we continue to grow our customer relationship focused assets and deposits, whilst running down our non-core assets. Deposit gathering activities during the first quarter have seen continued good momentum, particularly in the Retail business where we have built on the strong product sales over the last 12 months and delivered good levels of growth in both current account and savings balances. In our Wealth business income levels were supported further by improved equity market conditions.

In Insurance, new business sales are modestly lower than the equivalent period of last year. However our decision in 2009 to refocus certain product offerings to improve returns is having a favourable impact on the profitability of those products.

The Group s strong track record of effective cost control continues to yield benefit. The integration programme is progressing well and synergy savings continue to be delivered in line with the recent guidance. As a result, the Group remains on track to deliver on its commitment to a £2 billion run-rate of synergies and other operating efficiencies by the end of 2011.

Impairments have slowed significantly as a result of proactive management and more benign economic conditions and we continue to see lower impairments in both our Retail secured and unsecured lending portfolios. In our Wholesale division, the level of impairments has been significantly lower than the last quarter of 2009 and is also at a lower level than our initial expectations for 2010. In our Wealth and International division, impairments continue at a high level, principally as a result of further provisions in Ireland relating to our commercial real estate portfolio; however, the level of impairments in the first quarter of 2010 was lower than the last quarter of 2009 and we continue to believe that we are past the peak for impairment losses in the division. We remain vigilant to changes in economic conditions and to individual lending positions and continue to monitor the position of the Irish economy in particular.

The Group is pleased to have returned to profitability, on a combined businesses basis, in the first quarter. Based on the Group s current economic and regulatory assumptions we expect this trend to continue and for the Group to deliver a combined businesses profit at both the half and full year.

Further strengthening of the balance sheet position

Customer deposits have grown robustly during the first quarter by over £5 billion, mainly in our Retail division. We are supporting our relationship customers and the economy by continuing to lend. Lending balances have remained flat overall, with assets within the Group s run-off portfolios continuing to reduce, albeit at a slower pace than last year. Our assets continue to be appropriately priced for risk and funding costs and risk-weighted assets remain broadly unchanged to the position at the end of 2009.

Since the start of 2010, we have seen further improvements in wholesale funding market conditions and we are pleased with progress on our public term issuance so far this year. The Group continues to maintain a substantial liquid asset portfolio which is now broadly equivalent to the proportion of our wholesale funding (including bank deposits) which has a maturity of less than one year. In addition, the Group has maintained the maturity profile of wholesale funding such that 50 per cent has a maturity date of over one year.

As a result, the Group has continued to improve its liquidity and funding position, further de-risking the balance sheet.

The foregoing trading update and interim management statement include certain forward looking statements with respect to management s expectations for the Group s financial condition and performance, which by their nature involve risk and uncertainty. See *Forward looking statements* and *Risk factors* for a discussion of factors that could cause actual results to differ materially from the expectations expressed in such forward looking statements.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The results discussed below are not necessarily indicative of Lloyds Banking Group s results in future periods. The following information contains certain forward looking statements. For a discussion of certain cautionary statements relating to forward looking statements, see *Forward looking statements*.

The following discussion is based on and should be read in conjunction with the consolidated financial statements and the related notes thereto included elsewhere in this annual report. For a discussion of the accounting policies used in the preparation of the consolidated financial statements, see *Accounting policies* in note 2 to the consolidated financial statements.

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OVERVIEW AND TREND INFORMATION

THE ECONOMY

2009 has been a mixed year in terms of economic developments. With an estimated fall of 5 per cent, UK GDP growth was towards the bottom end of the Group s, and the market s, range of expectations. The UK experienced the biggest recorded single-year GDP fall since the 1930s, and the peak to trough decline in GDP currently matches the early 1980s recession (see chart 1). The downturn in most other industrialised economies was of similar magnitude. In response, official interest rates have fallen to their lowest level since the Bank of England was founded. Interest rates elsewhere have also fallen to extremely low levels.

CHART 1:

UK GDP IN THE LAST THREE RECESSIONS

CHART 2:

UK EMPLOYMENT IN THE LAST THREE RECESSIONS

CHART 3:

UK COMPANY FAILURES IN THE LAST THREE RECESSIONS

Perhaps partly in response to such low interest rates, other economic indicators have not turned out so badly in 2009 as many had feared.

At the beginning of the year, most commentators would have expected such a sharp drop in GDP to result in much worse unemployment numbers than has been the case. In fact, employment has held up quite well given the severity of the decline in GDP (see chart 2). Similarly, the rate of company failures so far in this downturn has been lower than might have been expected given the severity of the GDP decline (see chart 3).

Companies went into this recession in better shape generally than during the last recession, and seem to have taken early action to cut investment, stocks and working hours. Helped by very low interest rates, the aggregate financial position of the corporate sector has remained strong. This has undoubtedly helped to limit failure rates. And this in turn has probably helped to limit the rise in unemployment the biggest single cause of job losses in most recessions is business failure.

Meanwhile, property prices have also held up better than many forecasters had expected. At the beginning of the year, the average view was that house prices would fall by around 15 per cent during 2009, and decline further in 2010. In fact, the Halifax house price index ended the year higher than twelve months earlier, and other indices showed a similar picture. House prices fell during the early part of the year, but then started to recover in the second half and finished the year still above long-term average levels relative to household incomes, albeit well down on their peak in 2007.

Commercial property prices showed a similar recovery. Having fallen sharply in late 2008 and early 2009, commercial property capital values have stabilised recently, despite continued falls in rental values, and many forecasts for 2009 and 2010 have been revised up. At the end of 2009, the consensus forecast was for modest growth in capital values this year and next, even as rental values decline further.

Looking forward, the most likely immediate economic scenario is one of slow and erratic growth. GDP is estimated to have begun to recover in Q4 2009, and may even have done so earlier once final revisions are made to earlier estimates for Q3. Survey evidence, including purchasing manager indices, was pointing to positive growth in manufacturing and services for most of the second half of 2009. Retail sales growth accelerated in late 2009, although some of this may have been spending brought forward to beat the restoration of Value Added Tax (a UK sales tax) to 17.5 per cent. Unemployment appears to have levelled off, at least temporarily, and actually fell in late 2009. Financial market conditions have continued to normalise, in line with the improving economic outlook. The consensus forecast for 2010 has risen gradually, and by the end of 2009 was suggesting 2010 GDP growth of around 1.5 per cent, close to the Group s own central scenario. This slow recovery is consistent with the sort of upturn seen after past financial crises. But even that below-trend growth relies mainly on a recovery in net external trade and an end to company destocking. Domestic demand growth is likely to be minimal in 2010.

Alternative scenarios remain possible. The Bank of England s most likely outcome, as published in the February 2010 Inflation Report, is for a somewhat faster recovery during 2010 than the consensus forecast. However, the risks around that are skewed towards the downside.

It is possible that the economy will dip again if hit by some new shock and what might start as a temporary setback to recovery could have longer-lasting effects if it damages consumer, business or financial market confidence. Furthermore, uncertainties remain about how the economy will respond as and when the Bank of England begins to reverse quantitative easing and restore interest rates to more normal levels, and the Government begins to take action to reduce the large fiscal deficit.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

IMPACT ON OUR MARKETS

2009 was a year of weakening growth in most of the Group s markets. On the retail side, net new market mortgage lending (i.e. new lending minus repayments) was very low throughout 2009, as a result of which growth in outstanding balances slowed to around 1 per cent by year end. Net new market unsecured consumer lending was very weak in the first half of the year, and turned negative in the second half.

Weakening lending growth appears to have been driven by both supply and demand. Some lenders have pulled back from the market, especially from higher-risk segments. But at the same time, data on the Group s retail customers shows that they have reacted to the recession by prioritising reducing debt. This trend is apparent across all the Group s customer groups, whether split by age, income, or indebtedness. This helps to explain why market deposit growth also weakened in 2009, despite a higher national saving ratio. Households have on average chosen to use the cash freed up by reduced spending and lower debt interest payments to pay off debt rather than save more.

Market mortgage arrears rose during the first half of 2009, but then fell back in the second half. Market credit card arrears also fell during the second half. Improving arrears trends may have been helped by households starting to pay down debt. And many mortgage borrowers will have found their debt servicing costs reduced during 2009 as their variable mortgage rates fell or as their fixed rate loans expired and they rolled off onto lower standard variable rates. Quite strong growth in the average household s real disposable income in 2009 will also have helped, aided by better-than-expected employment levels in the second half and falling inflation.

Businesses also appear to have used 2009 to strengthen their financial position where possible. Sharp cutbacks in investment spending, and in stocks, have enabled businesses in aggregate to remain in financial surplus and reduce their reliance on external credit from banks, trade creditors and others. Large companies have also taken advantage of the recovery in financial markets to increase capital market borrowing thereby further reducing bank credit demand. As a result, the outstanding stock of bank and building society lending to private non-financial businesses declined in 2009, and corporate deposits returned to positive growth despite the weakness of demand in many companies markets. Strengthened corporate finances were probably a major factor limiting the growth in company failures in 2009. Indeed, as chart 3 shows, the rate of company failures reduced in the second half of 2009.

The Group expects that the weakness of likely economic recovery will be mirrored in slow growth of major banking markets in 2010 as both households and businesses continue to restructure their finances. However, 2010 may see company failure rates rise again, since it is typically when companies have to restock to meet an upturn in demand that the financial pressures on them are greatest.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates.

The accounting policies that are deemed critical to the Group s results and financial position, based upon materiality and significant judgements and estimates, are discussed in note 3 to the consolidated financial statements.

FUTURE ACCOUNTING DEVELOPMENTS

Future developments in relation to the Group s IFRS reporting are discussed in note 56 to the consolidated financial statements.

RESULTS OF OPERATIONS 2009, 2008 AND 2007

SUMMARY

	2009	2008[1]	2007[1]
	£m	£m	£m

Net interest income	**9,026**	7,718	6,099
Other income	**36,271**	(709)	12,119
Total income	**45,297**	7,009	18,218
Insurance claims	**(22,019)**	2,859	(7,522)
Total income, net of insurance claims	**23,278**	9,868	10,696
Operating expenses	**(15,984)**	(6,100)	(5,568)
Trading surplus	**7,294**	3,768	5,128
Impairment	**(16,673)**	(3,012)	(1,796)
Share of results of joint ventures and associates	**(752)**	4	10
Gain on acquisition	**11,173**		
Profit on sale of businesses			657
Profit before tax	**1,042**	760	3,999
Taxation	**1,911**	38	(679)
Profit for the year	**2,953**	798	3,320
Profit attributable to minority interests	**126**	26	32
Profit attributable to equity shareholders	**2,827**	772	3,288
Profit for the year	**2,953**	798	3,320

1 Restated for IFRS 2 (Revised).

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

2009 COMPARED WITH 2008

Profit before tax was £282 million, or 37 per cent, higher at £1,042 million in 2009 compared to £760 million in 2008; however, the profit in 2009 included a negative goodwill credit of £11,173 million in relation to the acquisition of HBOS plc by the Group; a fee of £2,500 million paid to the UK Government as part of the agreement for the Group not to enter into the Government Asset Protection Scheme; and significant post-acquisition impairment losses in respect of the HBOS portfolios.

Total income increased by £38,288 million to £45,297 million in 2009 compared to £7,009 million in 2008. Excluding the total income of £23,240 million arising on the consolidation of HBOS s post-acquisition results, total income was £15,048 million higher at £22,057 million in 2009 compared to £7,009 million in 2008; with a reduction in the Group s net interest income being more than offset by a large increase in other income.

Net interest income was £1,308 million, or 17 per cent, higher at £9,026 million in 2009 compared to £7,718 million in 2008. Excluding the net interest income of £4,049 million arising on the consolidation of HBOS s post-acquisition results, net interest income was £2,741 million, or 36 per cent, lower at £4,977 million in 2009 compared to £7,718 million in 2008. Excluding the interest flows arising on the consolidation of HBOS s post-acquisition results, both interest income and interest expense fell in response to the historically low interest rate environment that prevailed throughout 2009; net interest income was reduced as the benefit of higher asset pricing was more than offset by the impact of lower deposit margins, reflecting the impact of falling base rates, and higher funding costs, which included the impact of the Group extending its wholesale funding maturity profile. The Group s net interest margin decreased by 157 basis points to 1.06 per cent in 2009 compared to 2.63 per cent in 2008 with reductions across the Group s businesses.

Other income was £36,980 million higher at £36,271 million in 2009 compared to a deficit of £709 million in 2008. Fee and commission income was £1,023 million, or 32 per cent, higher at £4,254 million in 2009 compared to £3,231 million in 2008. However, excluding the fee and commission income which arose on the consolidation of HBOS s post-acquisition results, fee and commission income was £479 million, or 15 per cent, lower at £2,752 million in 2009 compared to £3,231 million in 2008, largely due to a £424 million reduction in insurance broking income as a result of a market-wide move to monthly premiums on payment protection products. Net trading income improved by £28,284 million to net income of £19,098 million in 2009 compared to a net loss of £9,186 million in 2008. Excluding net trading income of £12,093 million arising from the consolidation of the post-acquisition results of HBOS, net trading income improved by £16,191 million to net income of £7,005 million in 2009 compared to a net loss of £9,186 million in 2008. Trading income in 2008 in the Group s banking operations was particularly impacted by market dislocation, leading to significant downwards valuations on a number of assets; this was not repeated in 2009. In addition there was an improvement of £14,179 million in gains on policyholder investments held in the Group s insurance businesses (and largely offset by an increase in the claims expense, see below) as the improvement in market conditions has led to trading profits in 2009, compared to substantial losses in 2008. During 2009 the Group exchanged certain existing subordinated debt securities for new securities, these exchanges resulted in a gain on extinguishment of the existing liability of £1,498 million, being the difference between the carrying amount of the securities extinguished and the fair value of the new securities together with related fees and costs.

Insurance claims were £24,878 million higher at an expense of £22,019 million in 2009 compared to a credit of £2,859 million in 2008. Excluding the insurance claims expense of £12,385 million arising on the consolidation of HBOS s post-acquisition results, insurance claims were £12,493 million higher at an expense of £9,634 million in 2009 compared to a credit of £2,859 million in 2008. The insurance claims amount in respect of life and pensions business in 2008 was a credit of £3,052 million as a result of the negative returns in that year on policyholder investments in the long-term insurance business which led to a reduction in insurance related liabilities and a credit to the insurance claims expense; positive returns in 2009 have led to the return to an insurance claims expense with the movement in claims being broadly matched by an improvement in net trading income reflecting the gains on policyholder investments. Insurance claims in respect of general insurance business were £441 million higher at £634 million in 2009 compared to £193 million in 2008. Excluding the general insurance claims of £362 million arising on the consolidation of HBOS s post-acquisition results, general insurance claims were £79 million, or 41 per cent, higher at £272 million in 2009 compared to £193 million in 2008, this was due primarily to higher payment protection insurance claims related to unemployment.

Operating expenses increased by £9,884 million, or 162 per cent, to £15,984 million in 2009 compared to £6,100 million in 2008. Excluding the operating expenses of £6,456 million arising on the consolidation of HBOS s post-acquisition results, operating expenses were £3,428 million, or 56 per cent, higher at £9,528 million in 2009 compared to £6,100 million in 2008; this increase principally reflects the £2,500 million fee paid to the UK Government as part of the agreement for the Group not to enter into the Government Asset Protection Scheme, costs of £635 million borne within the Lloyds TSB businesses in respect of the integration of the enlarged group and an increased charge in respect of goodwill impairment, only partly offset by the fact that operating expenses in 2008 included a £180 million settlement in relation to certain historic US dollar payments which was not repeated in

2009. Staff costs were £3,697 million, or 124 per cent, higher at £6,675 million compared to £2,978 million in 2008. Excluding the staff costs of £3,014 million that arose on consolidation of the post-acquisition results of HBOS, staff costs were £683 million, or 23 per cent, higher at £3,661 million in 2009 compared to £2,978 million in 2008, with particular increases in restructuring costs and other staff costs (reflecting increased use of agency staff in relation to the integration programme). Premises and equipment costs were £506 million, or 78 per cent, higher at £1,156 million in 2009 compared to £650 million in 2008. Excluding the premises and equipment costs that arose on the consolidation of the post-acquisition results of HBOS, premises and equipment costs were £84 million, or 13 per cent, higher at £734 million in 2009 compared to £650 million in 2008. Other expenses were £1,167 million, or 69 per cent, higher at £2,853 million in 2009 compared to £1,686 million in 2008. Excluding the £1,185 million of costs that arose on consolidation of the post-acquisition results of HBOS, other costs were £18 million, or 1 per cent, lower at £1,668 million in 2009 compared to £1,686 million in 2008; however operating expenses in 2008 included the £180 million settlement in relation to certain historic US dollar payments and, excluding this, operating expenses excluding HBOS in 2009 were £162 million, or 11 per cent, higher at £1,668 million compared to £1,506 million in 2008. Depreciation and amortisation costs were £1,874 million higher at £2,560 million compared to £686 million in 2008; £1,813 million of this increase reflects the impact of consolidation of the post-acquisition results of HBOS. A charge of £240 million (2008: £100 million) arose in respect of the impairment of goodwill attributable to the Group s asset finance business.

Impairment losses increased by £13,661 million to £16,673 million in 2009 compared to £3,012 million in 2008. Excluding the impairment losses of £12,257 million arising from the consolidation of HBOS s post-acquisition results, impairment losses were £1,404 million, or 47 per cent, higher at £4,416 million in 2009 compared to a £3,012 million in 2008; this increase includes £1,664 million in respect of loans and advances to customers and reflects the substantial deterioration in the credit environment; partly offset by a reduction in the charge in respect of loans and advances to banks and other impairment provisions. During 2009, following the acquisition of HBOS, the Group has experienced a significant rise in impairment levels in its lending portfolios. This largely represents falls in the value of commercial real estate and the impact of the economic deterioration during the year, including the effects of rising unemployment and reduced corporate cash flows. The Group has spent a significant amount of time analysing and addressing the issues in the legacy HBOS portfolios, with the greatest attention paid to the over-concentration in real estate related lending and those portfolios that fall outside of the Lloyds TSB risk appetite; and, as a consequence, the Group has taken prudent and material impairment charges in the period following the acquisition.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The Group s share of results of joint ventures and associates was a net loss of £752 million compared to a net profit of £4 million in 2008. However, excluding the losses of £755 million arising on the consolidation of HBOS s post-acquisition results, the share of results of joint ventures and associates was £1 million, or 25 per cent, lower at a profit of £3 million compared to a profit of £4 million in 2008.

On 16 January 2009, the Group acquired 100 per cent of the ordinary share capital of HBOS plc. The consideration for the acquisition of HBOS comprised the issue of 7,776 million ordinary shares in Lloyds Banking Group plc together with the costs of acquisition. In determining the fair value of the consideration, the Company used the share price of its equity securities quoted on the London Stock Exchange, as at the date of completion. As the fair value of the identifiable net assets acquired was greater than the total consideration paid, negative goodwill of £11,173 million arose on the acquisition. The negative goodwill is recognised as Gain on acquisition in the income statement for the year ended 31 December 2009.

The exercise to fair value the assets and liabilities of HBOS took into account prevailing market conditions at the time of completion and, where appropriate, the Group engaged independent external advisers. As the consideration paid was significantly less than the provisional fair value of the net assets acquired, the results of the fair value calculations were subject to additional challenge in accordance with the requirements of IFRS 3.

On the date that the acquisition was announced (18 September 2008) the implied goodwill was a small positive amount based on the share price of the Company and the originally announced conversion factor of 0.833 Lloyds Banking Group plc shares for each HBOS share. However, a number of factors led to negative goodwill being recognised on completion of the transaction. By the time of the recommended offer, it had become increasingly difficult for HBOS to raise funds in wholesale markets and HBOS faced an outflow of customer deposits, reflecting reduced investor and depositor confidence. Subsequent to the announcement of the offer, turbulence in the markets continued, fuelled by concerns about credit risk and worsening economic conditions. For HBOS, confidence continued to deteriorate amid ongoing funding difficulties and concerns over the extent of future credit losses. Measures by national authorities and central banks failed to stem this turbulence and the UK Government decided in October 2008 that it would be appropriate for the UK banking sector to increase its level of capitalisation. The capital raising, underwritten by the UK Government, was made available to HBOS on condition that the acquisition by the Company completed. As a consequence of the capital that HBOS was required to issue and the impact of market conditions on the future prospects of the new group, the terms of the final agreed offer were revised down to a ratio of 0.605. Additionally, the share price of the Company fell from 280p at the date of the announcement to 98.4p on 15 January 2009 reflecting both the dilutive impact of the capital that the Company raised and the turmoil in the banking sector and equity markets in general. These factors combined to reduce the value of the consideration for HBOS.

In 2009, the Group recorded a tax credit of £1,911 million compared to a tax credit of £38 million in 2008. The tax credit in 2009 on a profit before tax of £1,042 million reflects the fact that the gain on acquisition of £11,173 million is not taxable, partly offset by the impact of losses in joint ventures and associates, losses where no deferred tax is provided and the tax charge attributable to UK life insurance policyholders and the Group s interests in Open Ended Investment Companies (OEICs), which is required to be included within the income tax credit.

Total assets were £591,222 million higher at £1,027,255 million at 31 December 2009 compared to £436,033 million at 31 December 2008; loans and advances to customers were £386,625 million higher at £626,969 million at 31 December 2009 compared to £240,344 million at 31 December 2008; and customer deposits were £235,803 million higher at £406,741 million at 31 December 2009 compared to £170,938 million at 31 December 2008. These increases reflect the impact of the HBOS acquisition and, after allowing for the acquisition, total assets have reduced as the Group has commenced its announced strategy to reduce assets associated with non-relationship lending and investments, including business which is outside the Group s current risk appetite. During 2009, the Group identified approximately £300 billion of such assets; it is the Group s intention to manage these assets for value and, given the current economic climate, the primary focus will be on running these assets down over time. Over the next five years, the Group expects to achieve a reduction in these assets of approximately £200 billion (customer lending approximately £140 billion; treasury assets £60 billion). During 2009, this portfolio of assets reduced by some £60 billion. Subsequent to the HBOS acquisition, the Group s loans and advances to customers have decreased as a result of the alignment of heritage risk appetites in Retail, a reduction in wholesale lending in Corporate Markets and a reduction in Wealth and International; customer deposits also decreased as growth in Retail was offset by the planned reduction in higher interest paying term deposits elsewhere.

The Group s credit market exposures primarily relate to asset-backed securities exposures held in the Wholesale division; on the balance sheet these exposures are classified as loans and receivables, available-for-sale or trading and other financial assets at fair value through profit or loss depending on the nature of the investment. A detailed analysis of the Group s asset-backed security exposures is provided in note 54 to the consolidated financial statements on page F-110. The total exposure to asset-backed securities has increased by £29,769 million from £16,521 million at 31 December 2008 to £46,290 million at 31 December 2009; however £31,010 million of these assets arise within the heritage HBOS business and, excluding these, total exposure to asset-backed securities was £1,241 million lower at £15,280 million at 31 December 2009 compared to £16,521 million at 31 December 2008.

Mortgage-backed security exposures were £11,817 million higher at £18,218 million, although excluding the heritage HBOS exposures they were £1,303 million lower at £5,098 million compared to £6,401 million at 31 December 2008. Exposures to Alt-A US residential mortgage-backed securities were £3,479 million higher, although adjusting for the heritage HBOS assets they were £167 million lower at £321 million compared to £488 million at 31 December 2008; there is no exposure to sub-prime US residential mortgage-backed securities.

For credit market exposures the Group s approach is to analyse the underlying transaction to determine whether it needs to place reliance on any protection provided by an insurer or guarantor. In note 54 to the consolidated financial statements on page F-111 the Group discloses its exposures where reliance is placed on monoline insurers, which are limited to a total of £444 million at 31 December 2009. Of this total exposure, £436 million is rated AA with the remaining £8 million being sub-investment grade.

At the end of December 2009, the Group s capital ratios, following the capital raising in December 2009, increased with a total capital ratio on a Basel II basis of 12.4 per cent (compared to 11.2 per cent at 31 December 2008), a tier 1 ratio of 9.6 per cent (compared to 8.0 per cent at 31 December 2008) and a core tier 1 ratio of 8.1 per cent (compared to 5.6 per cent at 31 December 2008). During 2009, risk-weighted assets increased by £322,817 million to £493,307 million compared to £170,490 million at 31 December 2008; this increase reflects the impact of the HBOS acquisition and, after allowing for the acquisition, there was a small decrease in risk-weighted assets as the effect of a reduction in balance sheet assets was partly offset by the procyclical impact of the weaker economic environment.

2008 COMPARED WITH 2007

The Group s profit before tax in 2008 was £3,239 million, or 81 per cent, lower at £760 million compared to £3,999 million in 2007. Profit attributable to equity shareholders was £2,516 million, or 77 per cent, lower at £772 million compared to £3,288 million in 2007. Earnings per share were 22.2p, or 77 per cent, lower at 6.7p compared to 28.9p in 2007.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Net interest income increased by £1,619 million, or 27 per cent, to £7,718 million in 2008 from £6,099 million in 2007. Average interest-earning assets increased by £34,167 million, or 14 per cent, to £282,400 million in 2008 from £248,233 million in 2007, excluding the fine margin reverse repurchase agreement assets (instruments held for funding and liquidity purposes which are efficient in terms of regulatory capital requirements and on which, as a consequence, small interest margins are earned). The increase in average interest-earning assets consisted principally of an £8,652 million, or 9 per cent, rise in average retail mortgages and a £7,331 million, or 18 per cent, rise in corporate lending balances.

The net interest margin was 30 basis points higher at 2.63 per cent, or 27 basis points higher at 2.73 per cent excluding the fine margin reverse repurchase agreement assets. The increase in net interest margin largely reflected an improvement in margins on the unsecured lending products within UK Retail Banking, in Asset Finance and in Corporate Markets, partially offset by a deterioration in Commercial Banking margins as a result of an increase in the proportion of secured, lower margin lending; the margin within UK Retail Banking increased by 9 basis points and the margin within Wholesale and International Banking, excluding the fine margin reverse repurchase agreement balances, was 27 basis points higher.

Other income was a net expense of £709 million compared with net income of £12,119 million in 2007. The decrease of £12,828 million principally resulted from a decrease of £12,309 million in net trading income, with smaller decreases in net fee and commission income, of £87 million, other operating income, of £414 million, and insurance premium income, of £18 million. The reduction in net trading income principally arose in the Group s insurance businesses and arose from the losses on policyholder investments; this decrease was broadly matched by a reduction in the insurance claims expense and on other lines within the income statement. Net trading income in Corporate Markets was also adversely affected by the impact of the continued market turmoil in 2008. Fees and commissions receivable were £7 million higher at £3,231 million compared to £3,224 million in 2007; increases in fees from corporate banking and card services were largely offset by a reduction in fees from insurance broking and as a result of disposals in 2007. Fees and commissions payable were £94 million, or 16 per cent, higher at £694 million compared to £600 million in 2007 as a result of increases in fees payable related to added-value account packages and cards, in both cases as a result of increased business volumes. Other operating income was £414 million, or 44 per cent, lower at £528 million compared with £942 million in 2007. The majority of this reduction resulted from the deterioration of the value of in-force asset in the insurance business.

The insurance claims expense was a credit of £2,859 million in 2008 compared with an expense of £7,522 million in 2007. The negative returns in 2008 on policyholder investments in the long-term insurance business have led to a reduction in insurance-related liabilities and a credit to the insurance claims expense. The charge in respect of general insurance was £109 million, or 36 per cent, lower at £193 million in 2008 compared to £302 million in 2007, principally reflecting the absence in 2008 of the severe weather related claims experienced in 2007.

Operating expenses were £532 million, or 10 per cent, higher at £6,100 million compared to £5,568 million in 2007. Operating expenses in 2008 included provisions in respect of certain historic US dollar payments and in respect of a Financial Services Compensation Scheme levy of £180 million and £122 million, respectively, and operating expenses in 2007 included £76 million in respect of the settlement of overdraft claims (see *Operating expenses* for more detail on these items). Staff costs were £73 million, or 3 per cent, higher at £2,978 million compared with £2,905 million in 2007. Salaries were £102 million higher at £2,230 million as the decrease in costs resulting from the sale of businesses in 2007 was more than offset by annual pay awards and an increased charge in respect of share-based compensation. Social security and pension and other post-retirement costs were broadly flat at £411 million in 2008 compared with £405 million in 2007. There was a decrease of £53 million in redundancy costs as the level of particular restructuring initiatives seen in 2007 was not repeated in 2008. Other staff costs were £18 million, or 6 per cent, higher at £323 million in 2008 as a result of a further increase in agency staff costs (used to cover project work). Excluding the provisions in respect of certain historic US dollar payments and in respect of the Financial Services Compensation Scheme levy in 2008 and the settlement of overdraft claims in 2007, other administrative expenses increased £77 million, or 4 per cent, to £2,034 million in 2008 from £1,957 million in 2007.

The impairment charge in the income statement was £1,216 million, or 68 per cent, higher at £3,012 million in 2008 compared with £1,796 million in 2007. The 2008 charge comprised a charge of £2,876 million, compared to £1,721 million in 2007, in respect of impairment losses on loans and receivables, a charge of £130 million, compared to £70 million in 2007, in respect of the impairment of available-for-sale financial assets and a charge of £6 million, compared to £5 million in 2007, relating to other credit risk provisions. In UK Retail Banking the charge increased by £248 million, or 20 per cent, to £1,472 million from £1,224 million in 2007; for personal loans and overdrafts the charge increased by £100 million and the charge in respect of mortgages increased by £149 million. The impairment charge as a percentage of average lending was higher at 1.22 per cent compared to 1.10 per cent in 2007. In Wholesale and International Banking the charge in respect of impairment losses on loans and receivables increased by £905 million, or 182 per cent, to £1,402 million from £497 million in 2007, reflecting the economic slowdown in the UK and the impact of a number of high profile financial services company collapses. Overall, the Group s charge in respect of impairment losses on loans and receivables expressed as a percentage of average lending increased to 1.24 per cent compared to 0.84 per cent in 2007.

In 2007, a profit of £657 million arose on the sale of businesses, principally Abbey Life, a life assurance company, and Lloyds TSB Registrars, the company registration business of the Group.

In 2008, the Group recorded a tax credit of £38 million compared to a tax charge of £679 million in 2007. The tax credit arose as a result of the tax credits attributable to UK life insurance policyholders and the Group s interests in Open Ended Investment Companies (OEICs), which are required to be included within the income tax expense.

At the end of 2008, the total capital ratio was 11.2 per cent compared with 11.0 per cent at the end of 2007. Risk-weighted assets increased by £27,923 million, or 20 per cent; the increase in UK Retail Banking was £4,817 million, or 11 per cent, and in Wholesale and International Banking was £22,821 million, or 25 per cent. Total assets increased by £82,687 million, or 23 per cent, principally as a result of increases in loans and advances to customers, available-for-sale financial assets and derivatives.

The increase in loans and advances to customers and available-for-sale financial assets was in part caused by the strengthening of the US dollar against the pound sterling.

In accordance with the amendment to IAS 39, in 2008 the Group reviewed the categorisation of its assets classified as held for trading and available-for-sale financial assets. On the basis that there was no longer an active market for some of those assets, which are therefore more appropriately managed as loans, the Group reclassified £2,993 million of assets classified as held for trading (measured at fair value through profit or loss immediately prior to reclassification) to loans and receivables with effect from 1 July 2008 and £437 million of assets classified as available-for-sale financial assets (measured at fair value through equity) to loans and receivables with effect from 1 November 2008. If the reclassifications had not been made, the Group s income statement for 2008 would have included unrealised fair value losses on the reclassified trading assets of £347 million and an additional impairment charge of £209 million in respect of available-for-sale financial assets.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

NET INTEREST INCOME

	2009	2008	2007
Net interest income £m	**9,026**	7,718	6,099
Average interest-earning assets £m	**849,534**	293,967	262,144
Average rates:			
Gross yield on interest-earning assets %[1]	**3.32**	5.98	6.44
Interest spread %[2]	**1.02**	2.37	2.20
Net interest margin %[3]	**1.06**	2.63	2.33
Margin excluding average balances held under reverse repurchase agreements[4]:			
Net interest income £m	**9,026**	7,718	6,099
Average interest-earning assets £m	**841,713**	282,400	248,233
Net interest margin %	**1.07**	2.73	2.46

1 Gross yield is the rate of interest earned on average interest-earning assets.

2 Interest spread is the difference between the rate of interest earned on average interest-earning assets and the rate of interest paid on average interest-bearing liabilities.

3 The net interest margin represents the interest spread together with the contribution of interest-free liabilities. It is calculated by expressing net interest income as a percentage of average interest-earning assets.

4 Comparisons of net interest income and margins are impacted by the holdings of fine margin reverse repurchase agreements. To improve comparability, figures are also shown excluding average balances held under reverse repurchase agreements (2009: £7,821 million; 2008: £11,567 million; 2007: £13,911 million).

2009 COMPARED WITH 2008

Net interest income was £1,308 million, or 17 per cent, higher at £9,026 million in 2009 compared to £7,718 million in 2008. Excluding the net interest income of £4,049 million arising on the consolidation of HBOS s post-acquisition results, net interest income was £2,741 million, or 36 per cent, lower at £4,977 million in 2009 compared to £7,718 million in 2008.

Excluding the interest flows arising on the consolidation of HBOS s post-acquisition results, both interest income and interest expense fell in response to the historically low interest rate environment that prevailed throughout 2009; net interest income was reduced as the benefit of higher asset pricing was more than offset by the impact of lower deposit margins, reflecting the impact of falling base rates, and higher funding costs, which included the impact of the Group extending its wholesale funding maturity profile.

Average interest-earning assets were £555,567 million higher at £849,534 million in 2009 compared to £293,967 million in 2008. Excluding the average interest-earning assets of £526,630 million arising on the consolidation of HBOS s post-acquisition results, average interest-earning assets were £29,207 million, or 10 per cent, higher at £323,174 million in 2009 compared to £293,967 million in 2008.

Excluding the average interest-earning assets arising on the consolidation of HBOS s post-acquisition results, average personal mortgage balances within Retail were £5,973 million, or 6 per cent, higher at £106,068 million in 2009 compared to £100,095 million in 2008 as a result of the full-year effect on average balances of mortgage growth during 2008; period end mortgage balances being little changed over 2009. Average other personal lending balances within Retail were flat as the full-year effect on average balances of lending growth during 2008 has been offset by the impact of lower lending balances over 2009 as customers have reduced their personal indebtedness and not taken on new financial commitments in the current difficult economic environment. Average interest-earning assets in the Group s other businesses were £23,312 million, or 14 per cent, higher at £190,591 million in 2009 compared to £167,279 million in 2008 as the full year benefit of lending growth over 2008 more than offset the asset reductions in 2009.

The Group s net interest margin decreased by 157 basis points to 1.06 per cent in 2009 compared to 2.63 per cent in 2008 with reductions across the Group s businesses. Margins in Retail declined as the impact of higher wholesale funding costs and lower deposit margins, in the low base rate environment, was only partly offset by the benefit of higher pricing on lending products. In Wholesale margins were also reduced, again as higher wholesale funding costs were only partly offset by higher asset pricing. Declining margins in Wealth and International reflected reducing base rates, a very competitive deposit environment and the increased funding costs.

2008 COMPARED WITH 2007

Net interest income increased by £1,619 million, or 27 per cent, to £7,718 million in 2008 compared to £6,099 million in 2007. Within Insurance and Investments, net interest income was £235 million, or 65 per cent, higher as a result of a further decrease in the amounts payable to unitholders in those OEICs included in the consolidated results of the Group; since these are policyholder items there was no impact on profit attributable to shareholders. For the rest of the Group, net interest income increased by £1,384 million, or 24 per cent, to £7,120 million in 2008 compared to £5,736 million in 2007. This increase arose as a result of both asset growth and an improvement in margins.

Average interest-earning assets were £31,823 million, or 12 per cent, higher at £293,967 million in 2008 compared to £262,144 million in 2007. Excluding the fine margin reverse repurchase agreement assets held for liquidity purposes, average interest-earning assets were £34,167 million, or 14 per cent, higher at £282,400 million in 2008 compared to £248,233 million in 2007. Average interest-earning assets in UK Retail Banking were £9,234 million higher; average mortgage balances were £8,652 million higher, reflecting the Group s significantly increased share of net new mortgage lending, albeit in a reduced total market; and average balances on personal loans and overdrafts were £854 million higher although there was a small reduction in average credit card outstandings. Average interest-earning assets within the Insurance and Investments businesses, which included the mortgage book within Scottish Widows Bank, were £72 million lower; an increase of £722 million in the average mortgage balances was more than offset by a fall in deposit balances held by the consolidated funds. Within Wholesale and International Banking, average interest-earning assets increased by £22,547 million, or £24,891 million excluding the fine margin reverse repurchase agreement balances. Average balances within Corporate Markets, excluding the reverse repurchase agreement balances, were £19,333 million higher as the business improved levels of customer retention and continuing new business opportunities resulted in further growth in corporate lending and there was further balance growth in the lower margin treasury and structured finance areas. Further expansion of the Group s lending to smaller businesses led to a £2,819 million increase in average balances in Commercial Banking, and International Banking average balances were £2,907 million higher (in part reflecting exchange rate movements) although average balances within Asset Finance fell slightly.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The Group s net interest margin increased by 30 basis points to 2.63 per cent in 2008, compared to 2.33 per cent in 2007; if the average balances held under reverse repurchase agreements are excluded from both years, the margin in 2008 was 27 basis points higher at 2.73 per cent compared to 2.46 per cent in 2007. Within Insurance and Investments, the net interest income consolidated in respect of policyholder items was £190 million higher in 2008, as a result of the £229 million reduction in the amounts payable to unitholders in those OEICs included in the Group s results; this increase contributed some 7 basis points to the increase in the Group s net interest margin, excluding average balances held under reverse repurchase agreements. The net interest margin in UK Retail Banking was 9 basis points higher than in 2007, reflecting improved key product margins, particularly in unsecured personal lending and new mortgages. The margin within Wholesale and International Banking, excluding the fine margin reverse repurchase agreement balances, was 27 basis points higher. Margins continued to fall in Commercial Banking, as a result of a further change in mix towards secured, but lower margin, lending but there were improved margins in Asset Finance and within Corporate Markets. The improvement in margins in Corporate Markets reflected improvements in pricing of new lending and the benefit of favourable funding opportunities.

OTHER INCOME

	2009	2008	2007
	£m	£m	£m
Fee and commission income:			
Current account fees	**1,088**	707	693
Insurance broking	**539**	549	648
Credit and debit card fees	**765**	581	536
Trust and other fiduciary fees	**395**	413	362
Other	**1,467**	981	985
	4,254	3,231	3,224
Fee and commission expense	**(1,517)**	(694)	(600)
Net fee and commission income	**2,737**	2,537	2,624
Net trading income	**19,098**	(9,186)	3,123
Insurance premium income	**8,946**	5,412	5,430
Gain on capital transactions	**1,498**		
Other operating income	**3,992**	528	942
Total other income	**36,271**	(709)	12,119

2009 COMPARED WITH 2008

Other income was £36,980 million higher at £36,271 million in 2009 compared to a deficit of £709 million in 2008, as a result of the factors discussed below.

Fee and commission income was £1,023 million, or 32 per cent, higher at £4,254 million in 2009 compared to £3,231 million in 2008. However, excluding the fee and commission income that arose on the consolidation of HBOS s post-acquisition results, fee and commission income was £479 million, or 15 per cent, lower at £2,752 million in 2009 compared to £3,231 million in 2008. The £479 million decrease in fee and commission income excluding the fee income in HBOS is largely due to a £424 million reduction in insurance broking income as a result of a market-wide move to monthly premiums on payment protection products, rather than up-front annual income.

Fee and commission expense was £823 million, or 119 per cent, higher at £1,517 million in 2009 compared to £694 million in 2008. Excluding fees payable of £862 million arising on the consolidation of the post-acquisition results of HBOS, fee and commission expense was £39 million, or 6 per cent, lower at £655 million in 2009 compared to £694 million in 2008 primarily as a result of volume-related reductions in asset management and other fees.

Net trading income improved by £28,284 million to net income of £19,098 million in 2009 compared to a net loss of £9,186 million in 2008. Excluding net trading income of £12,093 million arising from the consolidation of the post-acquisition results of HBOS, net trading income improved by £16,191 million to net income of £7,005 million in 2009 compared to a net loss of £9,186 million in 2008. Trading income in 2008 in the Group s banking operations was particularly impacted by market dislocation, leading to significant downwards valuations on a number of assets; this was not repeated in 2009. In addition there was an improvement of £14,179 million in gains on policyholder investments held in the Group s insurance businesses (and largely offset by an increase in the claims expense) as the improvement in market conditions has led to trading profits in 2009, compared to substantial losses in 2008.

Insurance premium income was £3,534 million, or 65 per cent, higher at £8,946 million in 2009 compared to £5,412 million in 2008. Excluding the premium income of £4,718 million that arose on consolidation of the post-acquisition results of HBOS, insurance premium income was £1,184 million, or 22 per cent, lower at £4,228 million in 2009 compared to £5,412 million in 2008. Earned premiums in respect of the Group s long-term life and pensions business were £2,660 million, or 55 per cent, higher at £7,460 million in 2009 compared to £4,800 million in 2008. The consolidation of the post-acquisition results of HBOS contributed £3,890 million and, excluding this, premiums were £1,230 million, or 26 per cent, lower at £3,570 million in 2009 compared to £4,800 million in 2008; this reflects reduced new business sales as a result of the general contraction in the UK market. General insurance earned premiums were £874 million higher at £1,486 million in 2009 compared to £612 million in 2008. Excluding premiums of £828 million arising from the consolidation of the post-acquisition results of HBOS, general insurance earned premiums were £46 million, or 8 per cent, higher at £658 million in 2009 compared to £612 million in 2008; this primarily reflects modest growth in home insurance income.

During 2009 the Group exchanged certain existing subordinated debt securities for new securities, these exchanges resulted in a gain on extinguishment of the existing liability of £1,498 million, being the difference between the carrying amount of the securities extinguished and the fair value of the new securities together with related fees and costs; this gain arose because the balance sheet carrying values of these investments were in excess of market valuations at the time. In the first half of 2009, undated subordinated notes issued by a number of Group companies were exchanged for innovative tier 1 securities and senior unsecured notes issued by Lloyds TSB Bank plc. These exchanges resulted in a gain of £745 million. In July 2009, dated and undated subordinated liabilities issued by Clerical Medical Finance plc were exchanged for senior unsecured notes issued by Lloyds TSB Bank plc resulting in a gain of £30 million. In November 2009, as part of the restructuring plan that was a requirement for

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

EC approval of state aid received by the Group, the Group agreed to suspend the payment of coupons and dividends on certain of the Group s preference shares and preferred securities for the two year period from 31 January 2010 to 31 January 2012. This suspension gave rise to a partial extinguishment of the original liability, equivalent to the present value of the suspended cash flows. During December 2009, as part of the Group s recapitalisation and exit from the Government Asset Protection Scheme, certain preference shares, preferred securities and undated subordinated notes were exchanged for enhanced capital notes. These exchanges, together with the partial extinguishment of liabilities arising from the suspension of payments on coupons, resulted in a gain of £723 million.

Other operating income was £3,464 million higher at £3,992 million in 2009 compared to £528 million in 2008; excluding the income of £1,517 million that arose on the consolidation of the post-acquisition results of HBOS, other operating income was £1,947 million higher at £2,475 million in 2009 compared to £528 million in 2008, principally reflecting an improvement in the movement in value of in-force business.

2008 COMPARED WITH 2007

Other income was £12,828 million lower at a net deficit of £709 million in 2008 compared to income of £12,119 million in 2007.

Fee and commission income was £7 million higher at £3,231 million in 2008 compared to £3,224 million in 2007. UK current account fees were £14 million higher reflecting growth in the numbers of higher-fee earning accounts during 2008. Insurance broking income was £99 million lower, driven by a sharp decrease in creditor insurance income as a side-effect of the reduced availability of consumer credit. Card fees were £45 million higher; merchant service charges were higher due to continuing growth in the merchant base and interchange income was £25 million higher as a result of increased levels of card usage. Other fees and commissions were £4 million lower at £981 million; continuing increases in factoring fees, corporate banking fees and asset management fees (in part due to the contracts entered into for the ongoing management of Abbey Life funds subsequent to disposal of that business in 2007) were offset by reductions in fees following the sale of Lloyds TSB Registrars and other businesses in 2007.

Fee and commission expense was £94 million, or 16 per cent, higher at £694 million compared to £600 million in 2007. There were increases in fees payable related to added-value account packages, in line with growth in the product, and higher levels of card fees payable as a result of the increased business volumes during 2008. There were also increased levels of fees payable in respect of the Group s fund management activities and within its treasury operations.

Net trading income was £12,309 million lower at a loss of £9,186 million compared to income of £3,123 million in 2007. Of this decrease £10,917 million arose in the insurance businesses and represented reductions in the value of policyholder investments that are required to be reported gross in the income statement; the period-on-period decrease is largely matched by a compensating movement within the insurance claims figure which has moved by £10,381 million from a charge of £7,522 million in 2007 to a credit of £2,859 million in 2008. The remainder of the decrease, £1,392 million, arose within the banking businesses. Like many other financial institutions, the Group s Corporate Markets business has been significantly affected by the ongoing impact of market dislocation; this has led to a charge within trading income of £956 million, compared to a charge of £188 million in 2007. The market dislocation losses largely reflected the impact of continuing mark-to-market adjustments in certain legacy trading portfolios, resulting from the marketwide repricing of liquidity and credit, together with the write-down of a number of asset-backed securities.

Insurance premium income was £18 million lower at £5,412 million compared to £5,430 million in 2007, with life and pensions premiums being £39 million lower at £4,800 million and general insurance premiums £21 million higher at £612 million. The small reduction in life and pensions premiums reflected the impact of the sale of Abbey Life (which accounted for £232 million of the premiums in 2007) and a decrease of £44 million in annuity premiums largely offset by growth in other life and pensions products within the Scottish Widows business. The increase in non-life insurance premiums was due to growth in home insurance income more than offsetting a volume-related decrease in respect of creditor products.

Other operating income was £414 million, or 44 per cent, lower at £528 million compared to £942 million in 2007. The movement in value of in-force business was a reduction of £325 million compared to a reduction of £93 million in 2007, as an improvement in new business income was more than offset by lower income from existing business principally reflecting the adverse effect of changes made to the economic assumptions used to calculate the value of in-force business included in the balance sheet and the impact of weaker investment markets. There was a reduction of £1 million in operating lease rental income and a reduction of £49 million in car dealership income following the sale of the Dutton Forshaw business in 2007 as well as reductions in other non-fee income.

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OPERATING EXPENSES

	2009 £m	2008[1] £m	2007[1] £m
Administrative expenses:			
Staff:			
Salaries	**4,369**	2,230	2,128
Social security costs	**383**	176	167
Pensions and other post-retirement benefit schemes	**744**	235	238
Restructuring costs	**412**	14	67
Other staff costs	**767**	323	305
	6,675	2,978	2,905
Premises and equipment:			
Rent and rates	**569**	318	304
Hire of equipment	**20**	16	16
Repairs and maintenance	**226**	151	154
Other	**341**	165	145
	1,156	650	619
Other expenses:			
Communications and data processing	**668**	455	462
Advertising and promotion	**335**	194	192
Professional fees	**540**	229	279
Other	**1,310**	808	481
	2,853	1,686	1,414
Depreciation and amortisation:			
Depreciation of tangible fixed assets	**1,716**	648	594
Amortisation of acquired in-force non-participating investment contracts	**75**		
Amortisation of other intangible assets	**769**	38	36
	2,560	686	630
Impairment of goodwill	**240**	100	
Total operating expenses, excluding Government Asset Protection Scheme fee	**13,484**	6,100	5,568
Government Asset Protection Scheme fee	**2,500**		
Total operating expenses	**15,984**	6,100	5,568
Cost: income ratio (%)[2]	**68.7**	61.8	52.1

1 Restated for IFRS 2 (Revised).

2 Total operating expenses divided by total income, net of insurance claims.

2009 COMPARED WITH 2008

Operating expenses increased by £9,884 million, or 162 per cent, to £15,984 million in 2009 compared to £6,100 million in 2008. Excluding the operating expenses of £6,456 million arising on the consolidation of HBOS s post-acquisition results, operating expenses were £3,428 million, or 56 per cent, higher at £9,528 million in 2009 compared to £6,100 million in 2008; this increase principally reflects the £2,500 million fee paid to the UK Government as part of the agreement for the Group not to enter into the Government Asset Protection Scheme, costs of £635 million borne within the Lloyds TSB businesses in respect of the integration of the enlarged Group and an increased charge in respect of goodwill impairment, only partly offset by the fact that operating expenses in 2008 included a £180 million settlement in relation to certain historic US dollar payments which was not repeated in 2009.

Staff costs were £3,697 million, or 124 per cent, higher at £6,675 million compared to £2,978 million in 2008. Excluding the staff costs of £3,014 million that arose on consolidation of the post-acquisition results of HBOS, staff costs were £683 million, or 23 per cent, higher at £3,661 million in 2009 compared to £2,978 million in 2008. Excluding the costs within HBOS, salaries were £87 million, or 4 per cent, higher as the impact of annual pay rises has more than offset staff reductions; pension costs were £128 million higher principally as a result of reduced asset levels in the defined benefit schemes at the end of 2008 which led to a lower expected return; restructuring costs were £209 million higher principally as a result of staff rationalisation as part of the Group integration programme; and other staff costs were £241 million higher, partly reflecting increased use of agency staff in relation to the integration programme.

Premises and equipment costs were £506 million, or 78 per cent, higher at £1,156 million in 2009 compared to £650 million in 2008. Excluding the premises and equipment costs that arose on the consolidation of the post-acquisition results of HBOS, premises and equipment costs were £84 million, or 13 per cent, higher at £734 million in 2009 compared to £650 million in 2008; rent and rates were £30 million higher, largely as a result of rent reviews, repairs and maintenance were £24 million higher and other premises and equipment costs were £36 million higher.

Other expenses were £1,167 million, or 69 per cent, higher at £2,853 million in 2009 compared to £1,686 million in 2008. Excluding the £1,185 million of costs that arose on consolidation of the post-acquisition results of HBOS, other costs were £18 million, or 1 per cent, lower at £1,668 million in 2009 compared to £1,686 million in 2008; however operating expenses in 2008 included the £180 million settlement in relation to certain historic US dollar payments and, excluding this, operating expenses excluding HBOS in 2009 were £162 million, or 11 per cent, higher at £1,668 million compared to £1,506 million in 2008. On this basis, professional fees were higher as a result of consultancy and other costs incurred in relation to integration, the Group s consideration of the Government Asset Protection Scheme and other strategic projects; there were also increases in communications and data processing costs.

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Depreciation and amortisation costs were £1,874 million higher at £2,560 million compared to £686 million in 2008. Depreciation of tangible fixed assets was £1,068 million higher at £1,716 million compared to £648 million in 2008; £1,035 million of this increase reflects the impact of consolidation of the post-acquisition results of HBOS. Amortisation of £75 million in respect of the acquired value of in-force non-participating investment contracts and £703 million in respect of acquisition-related intangibles (brands, core deposit intangibles, purchased credit card relationships and other customer related intangibles) arose from the acquisition of HBOS.

A charge of £240 million (2008: £100 million) arose in respect of the impairment of goodwill. The Group reviews goodwill held on its balance sheet for impairment at least annually or when events or changes in economic circumstances indicate that an impairment may have taken place. Goodwill attributable to the Group s Asset Finance business, for which an impairment charge of £100 million was recognised in the Group s financial statements for the year ended 31 December 2008, has been further reviewed for impairment due to the continuing uncertainties over the short-term macroeconomic environment. As a consequence, the carrying value of the consumer finance cash generating unit in Asset Finance (within Wholesale division) has been reassessed resulting in an additional goodwill impairment charge of £240 million in the year ended 31 December 2009.

The Group also paid a fee of £2,500 million to the UK Government in respect of the Group s withdrawal from the Government Asset Protection Scheme (GAPS). The Group had entered into a Pre-Accession Deed dated 7 March 2009 relating to the proposed participation in GAPS. However, following the rights issue in November 2009, the Group withdrew from its proposed participation and, on 3 November 2009, entered into a GAPS Withdrawal Deed with HM Treasury pursuant to which, among other matters, the Group agreed to pay HM Treasury an amount of £2,500 million in recognition of the benefits to the Group s trading operations arising as a result of HM Treasury proposing to make GAPS available to the Group.

2008 COMPARED WITH 2007

Operating expenses were £532 million, or 10 per cent, higher at £6,100 million in 2008 compared to £5,568 million in 2007. Operating expenses in both 2008 and 2007 were, however, impacted by a number of individually significant items. In January 2009, the Group announced that it had reached a settlement with both the US Department of Justice and the New York County District Attorney s Office in relation to a previously disclosed investigation involving those agencies into certain historic US dollar payment practices; the Group had provided £180 million in respect of this matter in its 2008 results. The arrangements put in place to protect the depositors of Bradford & Bingley and other failed deposit taking institutions involving the Financial Services Compensation Scheme (FSCS) will result in a significant increase in the levies made by the FSCS on the industry. The Group made a provision of £122 million in 2008 in respect of its obligation for the estimated interest cost on the FSCS borrowings. During 2008, the basis of goodwill allocation in parts of the Asset Finance business was changed to treat the consumer finance business as a single cash generating unit encompassing the motor and personal finance operations which provide direct and point of sale finance. The markets in which this unit operated had been affected by the UK economic downturn, which was characterised by falling demand and increasing arrears at that point of that cycle. This, together with uncertainties over the likely short-term macroeconomic environment, resulted in a reassessment of the carrying value of the consumer finance cash generating unit and the recognition of a goodwill impairment charge of £100 million in 2008. The 2007 results included a charge of £76 million relating to the settlement of overdraft claims during that year, together with related costs. If the provision in respect of certain historic US dollar payments, the provision for the Financial Services Compensation Scheme levy and the impairment of goodwill in 2008 and the settlement of overdraft claims in 2007, are excluded, underlying operating expenses were £206 million, or 4 per cent, higher at £5,698 million in 2008 compared to £5,492 million in 2007, for the following reasons.

Staff costs were £73 million, or 3 per cent, higher at £2,978 million in 2008 compared to £2,905 million in 2007. Salaries were £102 million, or 5 per cent, higher at £2,230 million. There was a small increase in staff numbers which, together with the effect of the annual pay awards and an increased charge in respect of share-based compensation, more than offset staff reductions following the sale of businesses during 2007. National insurance costs were £9 million, or 5 per cent, higher at £176 million compared to £167 million in 2007. Pension costs were £3 million, or 1 per cent, lower at £235 million compared to £238 million in 2007; this small reduction arose because an £8 million increase in the cost of contributions to defined contribution pension schemes (which cover all eligible new employees) has been more than offset by an £11 million reduction in the charge in respect of defined benefit schemes (following further increases in asset values and expected returns at the end of 2007). There was a £53 million decrease in redundancy costs as the level of particular restructuring initiatives seen in 2007 was not repeated in 2008. Other staff costs were £18 million, or 6 per cent, higher at £323 million compared to £305 million in 2007 as a result of a further increase in costs for agency staff (used to cover project work).

Premises and equipment costs were £31 million, or 5 per cent, higher at £650 million in 2008 compared to £619 million in 2007. Rent and rates were £14 million higher, as a result of rent reviews and some new properties taken on. Hire of equipment was unchanged at £16 million and repairs and maintenance costs were £3 million lower at £151 million. Other premises and equipment costs were £20 million higher at £165 million, compared to £145 million in 2007, following an increase in losses on disposal of equipment due to the downturn in the used car market and a lower level of profits on disposal of premises as the number of particular transactions in 2007 was not repeated in 2008; there were also increases in premises management charges.

Other costs were £272 million, or 19 per cent, higher at £1,686 million in 2008 compared to £1,414 million in 2007, although excluding the £180 million provision in respect of certain historic US dollar payments and the £122 million provision for the Financial Services Compensation Scheme levy in 2008 and the charge of £76 million in respect of the settlement of overdraft claims in 2007, other costs in 2008 were £46 million, or 3 per cent, higher at £1,384 million compared to £1,338 million in 2007, for the following reasons.

Other costs were £101 million, or 25 per cent, higher at £506 million compared to £405 million in 2007; this increase reflected increased levels of operational losses, partly due to adverse fraud experience, higher insurance costs as a result of a review of the level of insurance cover held at the end of 2007, a further increase in the charge in respect of deferred acquisition costs in the insurance businesses, in part due to restructuring of certain insurance products, and a general increase in miscellaneous expenditure. Advertising and promotion costs were £2 million, or 1 per cent, higher at £194 million compared to £192 million in 2007, as a further increase in expenditure relating to the Group s sponsorship of the London 2012 Olympics and higher levels of advertising in relation to Corporate business were partly offset by the non-repetition of particular campaigns from 2007. Professional fees were £50 million, or 18 per cent, lower at £229 million compared to £279 million in 2007 as these costs in 2007 included significant expenditure on a number of projects including the transfer of the mortgage lending and deposits of Lloyds TSB Bank plc s subsidiary, Cheltenham & Gloucester plc, into Lloyds TSB Bank plc, and further mortgage securitisations. Communications and external data processing costs were £7 million, or 2 per cent, lower at £455 million compared to £462 million in 2007 as underlying increases in software and telecommunications charges were more than offset by the effect of the businesses sold in 2007, particularly the company registration business.

Depreciation and amortisation was £56 million, or 9 per cent, higher at £686 million compared to £630 million in 2007. There was a £44 million increase in the charge in respect of operating lease assets, reflecting a change in mix of the portfolio towards shorter lived assets, such as motor vehicles, and an increased charge following a review of aircraft residual values. There was a £12 million increase in depreciation of own-use assets, reflecting the recent increased levels of capital expenditure, partly in relation to software.

The cost: income ratio was 61.8 per cent in 2008 compared to 52.1 per cent in 2007.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

IMPAIRMENT

	2009 £m	2008 £m	2007 £m
Impairment losses on loans and receivables:			
Loans and advances to banks	**(3)**	135	(1)
Loans and advances to customers	**15,783**	2,584	1,722
Debt securities classified as loans and receivables	**248**	157	
Total impairment losses on loans and receivables	**16,028**	2,876	1,721
Impairment of available-for-sale financial assets	**602**	130	70
Other credit risk provisions	**43**	6	5
Total impairment charged to the income statement	**16,673**	3,012	1,796

2009 COMPARED WITH 2008

Impairment losses increased by £13,661 million to £16,673 million in 2009 compared to £3,012 million in 2008. Excluding the impairment losses of £12,257 million arising on the consolidation of HBOS s post-acquisition results, impairment losses were £1,404 million, or 47 per cent, higher at £4,416 million in 2009 compared to a £3,012 million in 2008; this increase includes £1,664 million in respect of loans and advances to customers and reflects the substantial deterioration in the credit environment; partly offset by a reduction in the charge in respect of loans and advances to banks and other impairment provisions.

The impairment charge in respect of loans and advances to customers was £13,199 million higher at £15,783 million in 2009 compared to £2,584 million in 2008. Excluding the impairment losses of £11,535 million arising on the consolidation of HBOS s post-acquisition results, impairment losses in respect of loans and advances to customers were £1,664 million, or 64 per cent, higher at £4,248 million in 2009 compared to £2,584 million in 2008. This reflects the substantial deterioration in the credit environment leading to increased charges in respect of both unsecured personal lending, as rising UK unemployment has impacted the charge in both the retail banking and asset finance operations, and non-personal lending. During 2009, following the acquisition of HBOS, the Group has experienced a significant rise in impairment levels in its lending portfolios. This largely represents falls in the value of commercial real estate and the impact of the economic deterioration during the year, including the effects of rising unemployment and reduced corporate cash flows. In Retail, impairment losses increased, particularly reflecting the impact of increases in UK unemployment during 2009 on the unsecured charge, which was partly offset by a lower secured impairment charge as house prices stabilised. The Wholesale charge increased significantly reflecting the year-on-year decline in commercial property valuations and reduced levels of corporate cash flows; in particular, the real estate related lending exposures in the heritage HBOS portfolios were more sensitive to the downturn in the economic environment. The Group has spent a significant amount of time analysing and addressing the issues in the heritage HBOS portfolios, with the greatest attention paid to the over concentration in real estate related lending and those portfolios that fall outside of the Lloyds TSB risk appetite. As a result of this portfolio review, which applied prudent assumptions to real estate asset expectations, and with the deterioration in the economy translating into lower commercial property valuations, the Group took prudent and material impairment charges in the period following the acquisition. In the Wealth and International business the impairment charge reflected significant provisions against the Irish and Australian commercial real estate portfolios.

The impairment charge in respect of loans and advances to banks improved by £138 million to a credit of £3 million compared to a charge of £135 million in 2008; this reflected a small release in 2009 whereas 2008 included a number of specific charges as a result of the economic conditions faced by some banks at that time.

The impairment charge in respect of debt securities classified as loans and receivables increased by £91 million, or 58 per cent, to £248 million in 2009 compared to £157 million in 2008; £140 million arose from the consolidation of the post-acquisition results of HBOS and there was a reduction of £49 million in respect of heritage Lloyds TSB businesses.

Impairment losses in respect of available-for-sale financial assets were £472 million higher at £602 million in 2009 compared to £130 million in 2008. This increase was principally due to the charge of £577 million arising on the consolidation of the post-acquisition results of HBOS and reflects impairment of certain debt securities taken on as part of the acquisition.

The charge in respect of other credit risk provisions was £43 million in 2009 compared to £6 million in 2008; £5 million of the charge in 2009 relates to the post-acquisition results of HBOS.

2008 COMPARED WITH 2007

The impairment charge in the income statement was £1,216 million, or 68 per cent, higher at £3,012 million in 2008 compared to £1,796 million in 2007. This comprised a charge of £2,876 million, compared to a charge of £1,721 million in 2007, in respect of impairment losses on loans and receivables, a charge of £130 million, compared to a charge of £70 million in 2007, in respect of the impairment of available-for-sale financial assets and a charge of £6 million, compared to a charge of £5 million in 2007, in respect of other credit risk provisions.

The impairment charge in respect of loans and receivables was £1,155 million, or 67 per cent, higher at £2,876 million compared to £1,721 million in 2007.

In UK Retail Banking the charge increased by £248 million, or 20 per cent, to £1,472 million from £1,224 million in 2007, resulting in a charge as a percentage of average lending of 1.22 per cent compared to 1.10 per cent in 2007. This particularly reflected an increase of £149 million in the impairment charge in respect of mortgage lending from £18 million in 2007 to £167 million in 2008 as a result of the impact of reducing house prices and a deterioratiing economic environment in the UK. Increased impairment charges also arose in respect of personal loans and overdrafts (up £100 million, or 15 per cent, from £679 million in 2007 to £779 million in 2008) as a result of higher arrears, resulting in an increase in the impairment charge, expressed as a percentage of average lending, from 5.32 per cent in 2007 to 5.73 per cent in 2008. The impairment charge in respect of credit card outstandings was flat at £526 million in 2008 compared to £527 million in 2007, despite a decrease in average balances, as a result of increased arrears and fraud losses the impairment charge in respect of card lending, expressed as a percentage of average lending, increased from 7.96 per cent in 2007 to 8.12 per cent in 2008.

A charge of £2 million, compared to £nil in 2007, in Insurance and Investments related to the mortgage lending in Scottish Widows Bank.

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In Wholesale and International Banking the impairment charge in respect of loans and receivables increased by £905 million from £497 million in 2007 to £1,402 million in 2008 and this charge as a percentage of average lending was 1.33 per cent compared to 0.57 per cent in 2007. The charge within Corporate Markets was significantly higher at £939 million in 2008 compared to £165 million in 2007 as a result of a charge of £253 million, compared to a charge of £22 million in 2007, in relation to exposures to assets affected by current capital markets uncertainties, as well as a number of charges in relation to customers affected by the severe economic downturn and to the collapse of certain financial services companies. The impairment charge in Commercial Banking was £89 million, or 90 per cent, higher at £188 million in 2008 compared to £99 million in 2007, again reflecting the impact of the economic downturn; and the charge in Asset Finance was £42 million, or 18 per cent, higher at £270 million in 2008 compared to £228 million in 2007, as a result of higher arrears.

Overall, the Group s charge in respect of impairment losses on loans and receivables expressed as a percentage of average lending increased to 1.24 per cent compared to 0.84 per cent in 2007.

A charge of £130 million in 2008, compared to a charge of £70 million in 2007, arose in respect of the impairment of available-for-sale financial assets, largely in relation to certain asset-backed security collateralised debt obligations, although £30 million of the charge in 2008 reflected the write-off of the Group s investment in Bradford & Bingley equity shares.

TAXATION

	2009 £m	2008 £m	2007 £m
UK corporation tax:			
Current tax on profits for the year	**(227)**	(667)	(763)
Adjustments in respect of prior years	**(310)**	(19)	30
	(537)	(686)	(733)
Double taxation relief	**10**	91	60
	(527)	(595)	(673)
Foreign tax:			
Current tax on profits for the year	**(221)**	(144)	(98)
Adjustments in respect of prior years	**40**	4	3
	(181)	(140)	(95)
Current tax charge	**(708)**	(735)	(768)
Deferred tax	**2,619**	773	89
Taxation credit (charge)	**1,911**	38	(679)

2009 COMPARED WITH 2008

The rate of tax is influenced by the geographic and business mix of profits. The effective rate of tax was negative in both 2009 and 2008 as tax credits arose on the profits in both years; the statutory corporation tax rates were 28 per cent in 2009 and 28.5 per cent in 2008. The tax credit is distorted, in particular, by both the gain on acquisition of £11,173 million in 2009, which does not attract a tax charge, and the goodwill impairment charges of £240 million in 2009 and £100 million in 2008 on which no tax relief can be taken. The effective tax rate is also distorted by the requirement to include, within income tax in the income statement, the tax attributable to UK life insurance policyholder earnings and the Group s interests in OEICs, being a tax charge of £410 million for 2009 compared to a tax credit of £461 million in 2008. Excluding these items the effective tax rate in 2009 was 22.5 per cent compared to 32.0 per cent in 2008. Of this 9.5 per cent decrease in the effective rate, 7.3 per cent is attributable to the impact in 2009 of losses arising in certain subsidiaries resident in Ireland, for which a deferred tax asset cannot be recognised, and the statutory tax rate is 12.5 per cent; the remainder of the decrease in the effective tax rate in 2009 on this adjusted basis reflects normal fluctuations in disallowed and non-taxable items. The Group does not expect the tax rate, excluding the impact of policyholders tax and OEICs, to vary significantly from the average UK corporation tax rate.

2008 COMPARED WITH 2007

The effective rate of tax in 2008 was a negative 4.7 per cent, as a tax credit arose on the profit for the year, compared to an effective rate of tax in 2007 of 17.0 per cent and corporation tax rates of 28.5 per cent in 2008 and 30 per cent in 2007. The effective tax rate is distorted by the requirement to include, within income tax in the income statement, the tax attributable to UK life insurance policyholder earnings and the Group s interests in OEICs, being a tax credit of £461 million for 2008 compared to a tax credit of £217 million in 2007. The effective rate in 2007 was also particularly distorted by substantial profits on disposal of businesses, on which no tax charge arose, and the impact on the tax charge of the 2007 Finance Act reduction in the corporation tax rate from 30 per cent to 28 per cent (as a result of which the Group s deferred tax liabilities were remeasured leading to a credit to the Group s tax charge of £110 million). Excluding these items the effective tax rate in 2008 was 32.0 per cent compared to 28.3 per cent in 2007. Of this 3.7 per cent increase in the effective rate, 3.9 per cent is attributable to the impact of the Group s £180 million provision in respect of certain historic US dollar payments, on which no tax relief is assumed; the remainder of the increase in the effective tax rate in 2008 on this adjusted basis reflected normal fluctuations in disallowed and non-taxable items.

ECONOMIC PROFIT

In pursuit of its aim to maximise shareholder value over time, the Group has for a number of years used a system of value based management as a framework to identify and measure value creation and has used economic profit, a non-GAAP measure, as a measure of performance. The Group continues to believe that economic profit provides important information for investors, because it captures both growth in investment and return and informs management decision making. In light of the substantial changes to the structure of the Group arising from the acquisition of HBOS and the changes in the quantum and structure of the Group s capital over 2009, the Group is in the process of determining appropriate economic profit methodologies for the enlarged group.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

INTEGRATION

Annualised cost savings from synergies and other operating efficiencies of £2 billion are now targeted by the end of 2011, an increase from the previously forecast cost savings in excess of £1.5 billion. The increase arises in the main from further efficiency gains leading to role reductions and, to a lesser extent, property and procurement benefits which are now more certain following the application of the Lloyds TSB approach to HBOS.

Total cost reductions from synergies of £534 million are ahead of the target £450 million. They are analysed by division in the table below and relate primarily to reductions in staff numbers and procurement savings.

Integration costs of £1,096 million relating to severance, IT and business costs of implementation were incurred during 2009. The severance provisions are for over 15,000 role reductions announced in the year, of which more than 11,500 relate to 2009, the balance being delivered in 2010. The overwhelming majority of role reductions in 2009 were achieved through redeployment, natural turnover and voluntary redundancy.

The Group s policy is to use natural turnover and to redeploy people wherever possible to retain their expertise and knowledge within the Group. Where it is necessary for colleagues to leave the Group, this is achieved by offering voluntary severance and by making less use of contractors and agency colleagues. Compulsory redundancies are a last resort.

Savings realised year to 31 December 2009	**£m**		**£m**
By division		**By expenditure type**	
Retail	**124**	People	**263**
Wholesale	**86**	Procurement[1]	**126**
Wealth and International	**28**	IT	**57**
Insurance	**55**	Property	**11**
Group Operations	**221**	Other	**77**
Central items	**20**		
	534		**534**

[1] Procurement benefits totalling £174 million were achieved, split £126 million against the ongoing cost base and £48 million within the £1,096 million integration costs.

Over the last year, the Group has mobilised its integration programme, building systems integration plans whilst delivering financial benefits and making good progress towards creating a truly integrated organisation. For example, the Group has published proposals to harmonise employee terms and conditions across the Group, launched a single Group Intranet to improve communication and ease contact between colleagues and enhanced the IT infrastructure to allow colleagues full connectivity at the Group s buildings. A single consistent framework of risk policies is in place, comprising 71 detailed risk policies applicable across the combined Group.

Savings to date have been driven largely from role reductions resulting from deployment of the new Group organisational design adopting the Lloyds TSB approach. The overwhelming majority of role reductions in 2009 were achieved through redeployment, natural turnover and voluntary redundancy. Only a small proportion left via compulsory redundancy. In addition the Group has ceased occupancy of 83 properties during 2009, well ahead of the start of year target of 50.

Procurement benefits in 2009 have also been significant at £174 million with approximately £1.5 billion of spend having gone through e-auctions and the Group has in parallel reviewed and consolidated key supplier contracts with over 90 per cent of spend now being through its top 1,000 suppliers.

The Group has progressed well through the IT design and is now focused on building and delivering an integrated technical infrastructure. Preparations for system integration and data migration are in full flight with the scale up of IT equipment to handle increased volumes. Detailed plans are in place, along with testing requirements that are fully commensurate with an integration of this scale.

In the circular to shareholders regarding the acquisition of HBOS, it was stated that annual cost savings of £1.5 billion (run-rate) were expected to be achieved by the end of 2011 at a cost of approximately 140 per cent. The Group is now expecting £2 billion of savings, analysed by division in the table below, at an implementation cost to synergy ratio of around 155 per cent. The increase in the ratio of implementation costs to annualised cost savings has been driven principally by a recognition of the relative complexity of the HBOS systems and processes.

The synergies achieved in the year of £534 million include a number of one-off savings, which have been excluded from the sustainable run-rate benefits. There has also been an increase in the rate of savings in the year resulting in a sustainable run-rate benefit of £766 million.

	2009		2011	
	Synergy run-rate £m	Current view of synergy targets £m	Allocation of Group Operations target to divisions £m	Current view by market facing division £m
Retail	157	378	489	867
Wholesale	157	282	250	532
Wealth and International	115	213	29	242
Insurance	99	162	77	239
Group Operations	209	907	(907)	
Central items	29	58	62	120
	766	2,000		2,000

This discussion of integration includes certain forward looking statements with respect to management s expectations for the Group s financial condition and performance, which by their nature involve risk and uncertainty. See *Forward looking statements* and *Risk factors* for a discussion of factors that could cause actual results to differ materially from the expectations expressed in such forward looking statements.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LINE OF BUSINESS INFORMATION

2009 COMPARED WITH 2008

The requirements for IFRS segmental reporting are set out in IFRS 8 Operating Segments which mandates that an entity s segmental reporting should reflect the way in which its operations are viewed and judged by its chief operating decision maker. As a consequence, the Group s statutory segmental reporting follows the combined businesses basis as explained below (see also note 4 to the consolidated financial statements).

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

The Group s activities in 2009 were organised into four financial reporting segments: Retail, Wholesale, Wealth and International and Insurance. The segmental results and comparatives are presented on the basis reviewed by the chief operating decision maker and as a consequence include the pre-acquisition results of HBOS for 2008 and the period from 1 January 2009 to 16 January 2009.

Comparisons of results on a historical consolidated statutory basis are dominated by the impact of the acquisition of HBOS as the 2009 statutory results include the results of HBOS from 16 January 2009, together with the effects of the unwind of fair value adjustments made to the HBOS balance sheet on acquisition, and the 2008 statutory results do not include any results of HBOS. In order to provide more meaningful and relevant comparatives, the results of the Group and divisions are presented on a combined businesses basis. The key principles adopted in the preparation of the combined businesses basis of reporting are described below.

In order to reflect the impact of the acquisition, the following adjustments have been made:

- the 2008 results include the results of HBOS as if it had been acquired on 1 January 2008;
- the 2009 results assume HBOS had been owned throughout the year;
- the unwind of acquisition-related fair value adjustments is shown as one line in the 2009 combined businesses income statement and has not been back-dated to 2008; and
- the gain on acquisition of HBOS and amortisation of purchased intangible assets have been excluded.

In order to present better the underlying business performance the following items, not related to the acquisition, have also been excluded:

- the results of BankWest and St. Andrews, sold in December 2008, and the related loss on disposal;
- insurance and policyholder interests volatility;
- integration costs;
- goodwill impairment; and
- Government Asset Protection Scheme fee.

Readers should be aware that the combined businesses basis has been presented for comparative purposes only and is not intended to provide proforma information or show the results of the Group if the acquisition of HBOS had taken place at an earlier date. Readers should also note that HBOS was not managed by the current management of Lloyds Banking Group in 2008.

The results of the businesses are set out below:

	2009 £m	2008 £m
Retail	**1,382**	2,542
Wholesale	**(4,703)**	(10,479)
Wealth and International	**(2,356)**	277
Insurance	**975**	1,540
Group Operations and Central items:		
Group Operations	**(149)**	(76)
Central items	**(1,449)**	(517)
	(1,598)	(593)
Loss before tax combined businesses	**(6,300)**	(6,713)

The aggregate total of the combined businesses basis segmental results is a non-GAAP measure; further discussion of this measure is set out on page 39.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RECONCILIATION OF COMBINED BUSINESSES LOSS BEFORE TAX TO STATUTORY PROFIT BEFORE TAX FOR THE YEAR

	Note	**2009 £m**	2008 £m
Loss before tax combined businesses		**(6,300)**	(6,713)
Integration costs	1	**(1,096)**	
Volatility	2	**478**	(2,349)
Government Asset Protection Scheme fee	3	**(2,500)**	
Negative goodwill credit	4	**11,173**	
Amortisation of purchased intangibles and goodwill impairment	5	**(993)**	(258)
Pre-acquisition results of HBOS plc	6	**280**	10,825
Insurance grossing adjustment	7		10
Results of BankWest and St. Andrews	8		90
Loss on disposal of businesses	9		(845)
Profit before tax statutory		**1,042**	760

1. Integration costs

One-off integration costs of £1,096 million were incurred in 2009; these relate to severance, IT and other costs of implementation. The severance provisions relate to over 15,000 role reductions announced in 2009, of which more than 11,500 relate to 2009, the balance being delivered in 2010. The overwhelming majority of role reductions in 2009 were achieved through re-deployment, natural turnover and voluntary redundancy.

2. Volatility

The Group s statutory profit before tax is significantly affected by two items that impact the underlying financial performance of the Group, namely insurance volatility, caused by movements in financial markets, and policyholder interests volatility, which reflects primarily the gross up of policyholder tax included in the Group tax charge.
During 2009, the Group s statutory profit before tax included positive insurance and policyholder interests volatility of £478 million compared to negative volatility of £2,349 million in 2008 primarily reflecting the more favourable financial markets in 2009.

Volatility comprises the following:

	2009 £m	2008 £m
Insurance volatility	**237**	(1,425)
Policyholder interests volatility	**298**	(924)
Group hedge costs	**(57)**	
Total	**478**	(2,349)

Management believes that excluding volatility from profit before tax on a combined businesses basis provides useful information for investors on the performance of the business as it excludes amounts included within profit before tax which do not accrue to the Group s equity holders and excludes the impact of changes in market variables which are beyond the control of management.

The most significant limitations associated with profit before tax excluding volatility are:

(i) Insurance volatility requires an assumption to be made for the normalised return on equities and other investments; and

(ii) Insurance volatility impacts on the Group s regulatory capital position, even though it is not included within profit before tax on a combined businesses basis.

Management compensates for the limitations above by:

(i) Monitoring closely the assumptions used to calculate the normalised return used within the calculation of insurance volatility; these assumptions are disclosed below; and

(ii) Producing separate reports on the Group s current and forecast capital ratios.

Insurance volatility

The Group s insurance businesses have liability products that are supported by substantial holdings of investments, including equities, property and fixed interest investments, all of which are subject to variations in their value. The value of the liabilities does not move exactly in line with changes in the value of the investments, yet IFRS requires that the changes in the value of both the liabilities and the investments be reflected within the income statement. As these investments are substantial and movements in their value can have a significant impact on the profitability of the Group, management believes that it is appropriate to disclose the results on the basis of an expected return in addition to results based on the actual return.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The expected sterling investment returns used to determine the normalised profit of the business, which are based on prevailing market rates and published research into historical investment return differentials, are set out below:

United Kingdom (Sterling)	**2010** %	**2009** %	2008 %
Gilt yields (gross)	**4.45**	**3.74**	4.55
Equity returns (gross)	**7.45**	**6.74**	7.55
Dividend yield	**3.00**	**3.00**	3.00
Property return (gross)	**7.45**	**6.74**	7.55
Corporate bonds in unit linked and with-profit funds (gross)	**5.05**	**4.34**	5.15
Fixed interest investments backing annuity liabilities (gross)	**5.30**	**5.72**	5.52

The impact on the results due to the actual return on these investments differing from the expected return (based upon economic assumptions made at the beginning of the year) is included within insurance volatility. Changes in market variables also affect the realistic valuation of the guarantees and options embedded within the With Profits Funds, the value of the in-force business and the value of shareholders   funds.

The liabilities in respect of the Group s annuity business are matched by a portfolio of fixed interest securities, which includes a large proportion of corporate bonds. In accordance with the approach adopted in 2008, the value of in-force business for the annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of these corporate bond holdings. The illiquidity premium is estimated to have reduced to 75 basis points as at 31 December 2009 (31 December 2008: 154 basis points) which has offset the gains on assets backing the annuity liabilities reducing the volatility of the results. Overall, the positive volatility in 2009 of £237 million, reflected a partial recovery in financial markets. During 2009, equities have recovered by 22 per cent and corporate bond spreads have narrowed, offset by a reduction in gilts reflecting an increase in yields and a reduction in property values of 6.6 per cent. This contrasts with 2008 where a 33 per cent reduction in equities was the main driver of the £1,425 million negative volatility in 2008.

Policyholder interests volatility

The application of accounting standards results in the introduction of other sources of significant volatility into the pre-tax profits of the life and pensions business. In order to provide a clearer representation of the performance of the business, and consistent with the way in which it is managed, equalisation adjustments are made to remove this volatility from underlying profits. The effect of these adjustments is separately disclosed as policyholder interests volatility; there is no impact upon profit attributable to equity shareholders over the long term.

The most significant of these additional sources of volatility is policyholder tax. Accounting standards require that tax on policyholder investment returns should be included in the Group s tax charge rather than being offset against the related income. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge. Over the longer term the charges levied to policyholders to cover policyholder tax on investment returns and the related tax provisions are expected to offset. In practice timing and measurement differences exist between provisions for tax and charges made to policyholders. Consistent with the normalised approach taken in respect of insurance volatility, differences in the expected levels of the policyholder tax provision and policyholder charges are adjusted through policyholder interests volatility. Other sources of volatility include the minorities   share of the profits earned by investment vehicles which are not wholly owned by the long-term assurance funds.

During the year ended 31 December 2009, the statutory profit before tax in both the Insurance and Wealth and International divisions included credits to other income which relate to the policyholder interests volatility credit of £298 million (2008: policyholder interests volatility charge of £924 million). The market recovery in 2009 increased policyholder tax liabilities and led to a policyholder tax charge of £346 million during the year in the Group s tax charge. This was partly offset by a credit of £48 million relating to differences in the expected levels of policyholder tax provisions and charges. This compares to 2008 when substantial policyholder tax losses were generated as a result of the fall in property, bond and equity values.

Hedge costs

To protect against further deterioration in equity market conditions, and the consequent negative impact on the value of business in force on the Group balance sheet, the Group purchased put option contracts. The charge booked for 2009 was £57 million. These options expired on 15 January 2010.

3. Government Asset Protection Scheme fee

The Group entered into an agreement in March 2009 relating to its proposed participation in the Government Asset Protection Scheme (GAPS). However, following its successful rights issue, the Group withdrew from its proposed participation and agreed to pay HM Treasury £2,500 million in recognition of the benefits to the Group s trading operations arising as a result of HM Treasury proposing to make GAPS available to the Group (see *Major shareholders and related party transactions Information about the Lloyds Banking Group s relationship with the UK Government GAPS withdrawal deed*).

4. Negative goodwill credit

On 16 January 2009, the Group acquired 100 per cent of the ordinary share capital of HBOS plc. The consideration for the acquisition of HBOS comprised the issue of 7,776 million ordinary shares in Lloyds Banking Group plc together with the costs of acquisition. In determining the fair value of the consideration, the Company used the share price of its equity securities quoted on the London Stock Exchange, as at the date of completion.

As the fair value of the identifiable net assets acquired was greater than the total consideration paid, negative goodwill of £11,173 million arose on the acquisition. The negative goodwill is recognised as Gain on acquisition in the income statement for the year ended 31 December 2009.

The exercise to fair value the assets and liabilities of HBOS took into account prevailing market conditions at the time of completion and, where appropriate, the Group engaged independent external advisers. As the consideration paid was significantly less than the provisional fair value of the net assets acquired, the results of the fair value calculations were subject to additional challenge in accordance with the requirements of IFRS 3.

On the date that the acquisition was announced (18 September 2008) the implied goodwill was a small positive amount based on the share price of the Company and the originally announced conversion factor of 0.833 Lloyds Banking Group plc shares for each HBOS share. However, a number of factors led to negative goodwill being recognised on completion of the transaction.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

By the time of the recommended offer, it had become increasingly difficult for HBOS to raise funds in wholesale markets and HBOS faced an outflow of customer deposits, reflecting reduced investor and depositor confidence. Subsequent to the announcement of the offer, turbulence in the markets continued, fuelled by concerns about credit risk and worsening economic conditions. For HBOS, confidence continued to deteriorate amid ongoing funding difficulties and concerns over the extent of future credit losses. Measures by national authorities and central banks failed to stem this turbulence and the UK Government decided in October 2008 that it would be appropriate for the UK banking sector to increase its level of capitalisation. The capital raising, underwritten by the UK Government, was made available to HBOS on condition that the acquisition by the Company completed. As a consequence of the capital that HBOS was required to issue and the impact of market conditions on the future prospects of the new group, the terms of the final agreed offer were revised down to a ratio of 0.605. Additionally, the share price of the Company fell from 280p at the date of the announcement to 98.4p on 15 January 2009 reflecting both the dilutive impact of the capital that the Company raised and the turmoil in the banking sector and equity markets in general. These factors combined to reduce the value of the consideration for HBOS.

5. Amortisation of purchased intangibles and goodwill impairment

A total of £4,650 million of the customer-related intangibles, brands, core deposit intangibles and purchased credit card relationships were recognised on the acquisition of HBOS and these are being amortised over their estimated useful lives, where this has been determined to be finite. This has resulted in a charge of £753 million in the year ended 31 December 2009.

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

The Group reviews goodwill held on its balance sheet for impairment at least annually or when events or changes in economic circumstances indicate that an impairment may have taken place. Goodwill attributable to the Group s asset finance business, for which an impairment charge of £100 million was recognised in the Group s financial statements for the year ended 31 December 2008, has again been reviewed for impairment in 2009 due to the continuing uncertainties over the short-term macroeconomic environment. As a consequence, the carrying value of the consumer finance cash generating unit within Asset Finance has been reassessed resulting in an additional goodwill impairment charge of £240 million.

The charge in 2008 of £258 million comprised impairment of goodwill, principally in relation to the heritage Lloyds TSB asset finance operations, the ICC business banking division in Ireland and a specialist area of the HBOS UK credit card business.

6. Pre-acquisition results of HBOS plc

The acquisition of HBOS plc on 16 January 2009 has had a significant effect on the comparability of the Group s financial position and results, as a consequence, the combined businesses basis results are prepared as if HBOS had been owned by the Group for the full year 2009 and throughout 2008.

7. Insurance grossing adjustment

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 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 on a separate line.

8. Results of BankWest and St. Andrews

As explained below, HBOS sold part of its Australian operations in December 2008, the trading results of these businesses up to the date of sale have been excluded from the combined businesses basis results.

9. Loss on disposal of businesses

On 19 December 2008, HBOS completed the sale of part of its Australian operations, principally Bank of Western Australia Limited and St. Andrews Australia Pty Limited, to Commonwealth Bank of Australia Limited; this resulted in a pre-tax loss on disposal of £845 million.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RETAIL

Retail is the largest retail bank in the UK and the leading provider of current accounts, savings, personal loans, credit cards and mortgages. With its strong stable of brands including Lloyds TSB, Halifax, Bank of Scotland, Birmingham Midshires and Cheltenham & Gloucester, at 31 December 2009 Retail served over 30 million customers through one of the largest branch and fee free ATM networks in the UK.

At 31 December 2009, Retail had approximately 22 million current account customers and provided social banking to over 4 million people through basic banking or social banking accounts. It was also the largest provider of personal loans in the UK, as well as being the UK s leading credit card issuer. Retail provides one in four residential mortgages making it the leading UK mortgage lender as well as being a major provider of home finance for the first time buyer. Retail is the largest private sector savings provider in the UK, with over 21 million savers at 31 December 2009. It is also a major general insurance and bancassurance distributor, selling a wide range of long-term savings, investment and general insurance products.

	2009 **£m**	2008 £m
Net interest income	**7,970**	8,454
Other income	**1,804**	2,739
Total income	**9,774**	11,193
Operating expenses	**(4,566)**	(4,963)
Trading surplus	**5,208**	6,230
Impairment	**(4,227)**	(3,695)
Share of results of joint ventures and associates	**(6)**	7
Profit before tax and fair value unwind	**975**	2,542
Fair value unwind	**407**	
Profit before tax	**1,382**	2,542

Profit before tax from Retail was £1,160 million, or 46 per cent, lower at £1,382 million in 2009 compared to £2,542 million in 2008; profit in 2009 included a credit of £407 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Profit before tax and fair value unwind decreased by £1,567 million, or 62 per cent, to £975 million in 2009 compared to £2,542 million in 2008. This decrease was driven by higher impairment losses and lower income, partly offset by a reduction in operating expenses.

Total income decreased by £1,419 million, or 13 per cent, to £9,774 million in 2009 compared to £11,193 million in 2008, reflecting a reduction in margins, lower payment protection income and non-recurring one-off income in 2008. Total income was analysed as follows:

	2009 **£m**	2008 £m
Mortgages and Savings	**3,667**	5,009
Consumer Banking	**6,107**	6,184
Total income	**9,774**	11,193

Total income in Mortgages and Savings has decreased by £1,342 million, or 27 per cent, to £3,667 million in 2009 compared to £5,009 million in 2008. The reduction in Mortgage income reflected increased wholesale money market funding costs, which was partly offset by higher asset pricing. Lower income in Savings was the result of margin pressures arising from lower base rates and the competitive environment, the impact of which was partly offset by higher customer deposits.

Income within Consumer Banking (where the principal products are current accounts and unsecured lending) was £77 million, or 1 per cent, lower at £6,107 million in 2009 compared to £6,184 million in 2008. On 1 January 2009 Retail introduced a monthly premium payment protection product and ceased selling single premium products. This new product offers customers the benefit of monthly payments and income is recognised over the life of the loan rather than all being recognised in the first year. This reduction in income, together with the effect of lower loan volumes, was broadly offset by an improved performance across the rest of Consumer Banking, including benefits from asset re-pricing.

Lending to customers in Retail, net of impairment provisions and fair value adjustments arising from the acquisition of HBOS plc by the Group, was £6,019 million, or 2 per cent, lower at £371,058 million in 2009 compared to £377,077 million in 2008; this reflects the impact of customers reducing their personal indebtedness and not taking on new financial commitments in the current difficult economic environment.

Retail continued to build its mortgage business in a contracting market by focusing on the prime mortgage market, particularly through the branch network rather than intermediaries, whilst maintaining a prudent approach to risk. Gross new mortgage lending totalled £34,666 million during 2009, compared to £78,058 million in 2008, representing a market share of 24 per cent. Retail has maintained its commitment to the housing market and first time buyers, with more than 60 per cent of new lending in 2009 being for house purchase rather than for re-mortgage. The average loan-to-value ratio at the end of 2009 was 54.8 per cent compared with 54.9 per cent at the end of 2008, whilst the average loan-to-value ratio on new residential lending in 2009 was 59.3 per cent compared with 63.1 per cent in 2008. Specialist lending balances (self certified and sub-prime) decreased slowly following the decision, at the start of the year, to withdraw from this market. New buy-to-let lending remained broadly flat at 13 per cent of total new mortgage lending; however, redemptions in this book were low.

Buy-to-let mortgage balances have increased by £2,872 million in the year. Retail continued to carefully assess the risks of such lending and as a result the average loan-to-value on new lending in the buy-to-let portfolio has fallen to 65.6 per cent at the end of 2009 compared to 73.1 per cent at the end of 2008.

Customer deposits were £7,867 million, or 4 per cent, higher at £224,149 million in 2009 compared to £216,282 million in 2008 despite the high level of term deposits maturing during the period, as a result of Halifax and Bank of Scotland deposit gathering activities in the first half of 2008. Current account balances have increased by 15 per cent in the year resulting from growth in the number of current accounts and the low interest rate environment.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Retail s net interest margin decreased by 18 basis points to 1.97 per cent in 2009 compared to 2.15 per cent in 2008, reflecting higher wholesale funding costs and reduced margins on savings products due to the low base rate environment, partly offset by higher asset pricing which led to a stronger margin in the second half of 2009.

Operating expenses decreased by £397 million, or 8 per cent, to £4,566 million in 2009 compared to £4,963 million in 2008. This decrease was driven primarily by a focus on cost control, cost savings resulting from integrating the two businesses and the benefit of a lower Financial Services Compensation Scheme levy. The reduction in operating expenses resulting from integrating the Lloyds TSB and HBOS retail businesses was delivered through streamlining management structures, consolidating the number of mortgage operational sites, integrating and simplifying the mortgage operating model, procurement savings from the rationalisation of suppliers and property savings through the consolidation of sites.

Impairment losses on loans and advances increased by £532 million, or 14 per cent, to £4,227 million in 2009 compared to £3,695 million in 2008. Impairment losses as a percentage of average advances were 1.11 per cent in 2009 compared to 0.97 per cent in 2008. Higher unemployment and the weak economy drove a significant increase in unsecured impairments which was partly offset by a lower secured impairment charge as house prices stabilised. Unsecured impairment losses are sensitive to economic conditions, particularly unemployment levels; consequently the 2009 impairment charge increased by £1,038 million to £3,438 million. The stabilisation of the housing market, in combination with lower interest rates and prudent risk management, has resulted in the secured impairment charge decreasing in 2009 by £506 million to £789 million.

Arrears levels in the secured portfolios were higher than 2008 but improved in the second half of 2009, and remained below the industry average. The percentage of mortgage cases more than three months in arrears increased to 2.3 per cent at 31 December 2009 compared to 1.8 per cent as at 31 December 2008. The stock of repossessed properties reduced by 32 per cent to 2,720 properties compared to 4,011 properties at the end of 2008 and, as a proportion of total accounts, remains lower than the industry average. Currently, average proceeds from the sale of repossessed properties are in excess of average valuations assumed in Retail s provisioning models.

Impaired loans in the unsecured lending portfolio, as at 31 December 2009, totalled £3,819 million, or 11.9 per cent of closing advances (after writing off some £2,100 million of loans provided against in earlier years). This compared with £5,350 million, or 14.7 per cent of closing advances at 31 December 2008; however, on an equivalent basis (adjusting for the write-off in 2009) impaired loans at 31 December 2008 totalled some £3,250 million, or 8.9 per cent of advances. The underlying increase in impaired loans which occurred in 2009 reflected the weak economy, particularly rising unemployment. During 2009 a number of actions have been taken which improved delinquency rates on new business.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

WHOLESALE

The Wholesale division serves in excess of a million businesses, ranging from start-ups and small enterprises to global corporations, with a range of propositions fully segmented according to customer need. The enlarged division, following the acquisition of HBOS, comprises Corporate Markets, Treasury and Trading and Asset Finance.

Corporate Markets comprises Corporate, Commercial, Corporate Real Estate, Specialist Finance and Wholesale Markets. Corporate, Commercial and Corporate Real Estate provide relationship-based banking, risk management and advisory services to corporate and commercial customers principally in the UK. Relationships with customers with an annual turnover greater than £15 million are managed within Corporate, and commercial property-based relationships (including hotel, property-based leisure and construction) are generally managed within the Corporate Real Estate business. Commercial provides financial services to business customers ranging from new start-ups to those with a turnover of up to £15 million and invoice discounting and factoring services to a broader range of customers. Specialist Finance includes the acquisition finance and private equity businesses; all new business is being written under the brands of Lloyds Acquisition Finance or Lloyds Development Capital. Wholesale Markets provides risk management solutions, specialised lending, capital markets advisory and multi-product financing solutions to its customers, whilst managing the Group s own portfolio of structured credit investments and treasury assets.

Treasury and Trading s role is to provide access to financial markets in order to meet the Group s balance sheet management requirements, and provides trading infrastructure to support execution of customer-driven risk management transactions, whilst operating within a well controlled and conservative risk appetite.

Asset Finance consists of a number of leasing, hire purchase and speciality lending businesses including Contract Hire (Lex, Autolease and Hill Hire), Specialist Assets and Consumer Finance (Black Horse Motor and Personal Finance). Hire purchase is a form of consumer financing where a customer takes possession of goods on payment of an initial deposit but the legal title to the goods does not pass to the customer until the agreed number of instalments have been paid and the option to purchase has been exercised.

	2009 £m	2008 £m
Net interest income	**4,710**	5,752
Other income	**4,199**	(302)
Total income	**8,909**	5,450
Operating expenses	**(4,106)**	(4,591)
Trading surplus	**4,803**	859
Impairment	**(15,683)**	(10,394)
Share of results of joint ventures and associates	**(720)**	(944)
Loss before tax and fair value unwind	**(11,600)**	(10,479)
Fair value unwind	**6,897**	
Loss before tax	**(4,703)**	(10,479)

Loss before tax from Wholesale improved by £5,776 million to a loss of £4,703 million in 2009 compared to a loss of £10,479 million in 2008; however, the loss in 2009 included a credit of £6,897 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Loss before tax and fair value unwind deteriorated by £1,121 million to a loss of £11,600 million in 2009 compared to a loss of £10,479 million in 2008. This deterioration was driven by higher impairment losses, only partly offset by an increase in other operating income and a decrease in operating expenses.

Total income increased by £3,459 million, or 63 per cent, to £8,909 million in 2009 compared to £5,450 million in 2008, driven by a large increase in other income.

Lending to customers in Wholesale, net of impairment provisions and fair value adjustments arising from the acquisition of HBOS plc by the Group, was £42,754 million, or 18 per cent, lower at £191,808 million in 2009 compared to £234,562 million in 2008.

Customer deposits were £4,552 million, or 3 per cent, lower at £153,389 million in 2009 compared to £157,941 million in 2008.

Net interest income was £1,042 million, or 18 per cent, lower at £4,710 million in 2009 compared to £5,752 million in 2008. The net interest margin, adjusted to exclude products where either the funding costs or the related revenues are recognised in other income, declined by 33 basis points to 1.52 per cent in 2009 compared to 1.85 per cent in 2008. This reduction in income and margin reflected higher wholesale funding costs partly offset by higher asset pricing.

Other income was £4,501 million higher at £4,199 million in 2009 compared to a deficit of £302 million in 2008. Other income in 2008 had been significantly reduced due to the effect of the dislocation in credit markets which resulted in investment valuation write-downs in the Wholesale business; these factors were not repeated in 2009. Other income in 2009 also benefited from good transaction volumes in capital markets and strong flows of client-driven derivative transactions at improved spreads.

Operating expenses decreased by £485 million, or 11 per cent, to £4,106 million in 2009 compared to £4,591 million in 2008. Operating expenses in 2008 included a £180 million settlement in relation to certain historic US dollar payments; excluding this item from 2008, operating expenses decreased by £305 million, or 7 per cent, to £4,106 million in 2009 compared to £4,411 million in 2008. This decrease reflects reduced levels of operating lease business and cost savings achieved from the integration programme, partly offset by increased investment in Wholesale s customer focused business support functions.

Impairment losses increased by £5,289 million to £15,683 million in 2009 compared to £10,394 million in 2008. Impairment losses for loans and advances as a percentage of average loans and advances to customers were 5.92 per cent in 2009 compared to 3.32 per cent in 2008. These increased impairment losses reflect the continued weak economic climate, higher levels of corporate failures, and application of prudent Lloyds Banking Group provisioning policy, notably in HBOS Corporate Real Estate and HBOS Corporate (UK and US) transactions. However, total impairment losses are expected to have peaked in the first half of 2009, amounting to £9,738 million, compared to £5,945 million in the second half, a reduction of 39 per cent.

Wholesale s share of results of joint ventures and associates improved by £224 million, or 24 per cent, to a loss of £720 million in 2009 compared to a loss of £944 million in 2008; there were lower levels of write-offs in 2009 as the majority of the book is fully written-off.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

WEALTH AND INTERNATIONAL

Wealth and International is a new division formed in 2009 to give increased focus and momentum to the private banking and asset management businesses and to closely co-ordinate the management of the Group s international businesses.

The Wealth business comprises private banking, wealth and asset management businesses in the UK and overseas. The key operations are UK and International Private Banking, which operate under the Lloyds TSB and Bank of Scotland brands, the Channel Islands and Isle of Man offshore businesses, the expatriates business and the Asset Management business which, following the completion of the sale of Insight Investment, is now consolidated within Scottish Widows Investment Partnership. In addition the Group holds a 60 per cent stake in St James s Place plc and a 55 per cent stake in Invista Real Estate, respectively the UK s largest independent listed wealth manager and real estate fund management group.

The International business comprises the Group s other international banking businesses outside the UK, with the exception of corporate business in North America which is managed through the Group s Wholesale division. These largely comprise corporate, commercial and asset finance businesses in Australia, Ireland and Continental Europe and retail businesses in Ireland, Germany and the Netherlands.

	2009 £m	2008 £m
Net interest income	**1,217**	1,314
Other income	**1,128**	1,191
Total Income	**2,345**	2,505
Operating expenses	**(1,544)**	(1,476)
Trading surplus	**801**	1,029
Impairment	**(4,078)**	(731)
Share of results of joint ventures and associates	**(21)**	(21)
Profit (loss) before tax and fair value unwind	**(3,298)**	277
Fair value unwind	**942**	
Profit (loss) before tax	**(2,356)**	277
Wealth	**198**	369
International	**(3,496)**	(92)
Profit (loss) before tax and fair value unwind	**(3,298)**	277

Profit before tax from Wealth and International was £2,633 million lower at a loss of £2,356 million in 2009 compared to a profit of £277 million in 2008; the loss in 2009 included a credit of £942 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Profit before tax and fair value unwind decreased by £3,575 million to a loss of £3,298 million in 2009 compared to a profit of £277 million in 2008. This deterioration was driven by higher impairment losses.

Total income decreased by £160 million, or 6 per cent, to £2,345 million in 2009 compared to £2,505 million in 2008. This decrease reflects lower net interest margins, and the impact of lower global stock markets particularly in the first half of the year, partly offset by favourable foreign exchange movements.

Lending to customers in Wealth and International, net of impairment provisions and fair value adjustments arising from the acquisition of HBOS plc by the Group, was £1,005 million, or 2 per cent, lower at £63,548 million in 2009 compared to £64,553 million in 2008 as net repayments and increased impairment provisions in the International businesses have been offset by the transfer of a European loan portfolio of some £7,000 million from Wholesale division.

Customer deposits were £5,058 million, or 15 per cent, lower at £29,037 million in 2009 compared to £34,095 million in 2008 primarily due to outflows in Ireland reflecting aggressive pricing from competitors who have also benefited from the Irish Government deposit guarantee.

Net interest income was £97 million, or 7 per cent, lower at £1,217 million in 2009 compared to £1,314 million in 2008. The net interest margin, adjusted to exclude earnings on policyholder funds and products where either the funding costs or the related revenues are recognised in other income, declined by 35 basis points to 1.71 per cent in 2009 compared to 2.06 per cent in 2008. This margin reduction reflects higher wholesale funding costs and lower deposit margins in the low base rate environment, partly offset by the impact of strong portfolio management in International and higher asset pricing leading to higher margins.

Other income was £63 million, or 5 per cent, lower at £1,128 million in 2009 compared to £1,191 million in 2008. This decrease was driven by falls in global stock markets, particularly in the first half of 2009, impacting sales volumes and fee income across all Wealth businesses; partly offset by favourable exchange movements in the International operations.

Operating expenses increased by £68 million, or 5 per cent, to £1,544 million in 2009 compared to £1,476 million in 2008. Adverse foreign exchange movements increased operating expenses in both the Wealth and the International businesses and additional costs resulted from investments to increase distribution capacity in Private Banking to support future growth plans, additional costs associated with the transitional services following the disposal by HBOS of BankWest and St. Andrews Australia in December 2008, the development of International s deposit taking operation in Germany and increased risk management resources to manage impaired asset portfolios in Ireland and Australia. These increases in costs were partly offset by cost savings from integration, particularly in the Asset Management business.

Impairment losses increased by £3,347 million to £4,078 million in 2009 compared to £731 million in 2008. This reflects the significant deterioration in the credit risk environment in Ireland and Australia as well as the impact of the economic environment on the UK Private Banking and Expatriate lending portfolios. Of the total impairment losses in 2009, £2,949 million arose in Ireland which experienced a significant deterioration in asset values driven by the collapse in liquidity and severe decline in the property sector where commercial real estate values fell by over 50 per cent and house prices by over 25 per cent from their peak. A further £849 million of the total impairment losses in 2009 arose in Australia, driven by concentrations in property and in other sectors such as media, printing and transport which have been hardest hit by the downturn. Business Support Units have been established in both Ireland and Australia, supplemented by a divisional sanctioning process, to provide independent divisional oversight and control of the portfolios.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

INSURANCE

The Insurance division consists of three business units:

LIFE, PENSIONS AND INVESTMENTS UK

The UK Life, Pensions and Investments business is the leading bancassurance provider in the UK and has one of the largest intermediary sales forces in the industry. The business includes Scottish Widows which, for a number of years, has been a subsidiary of the Lloyds TSB Group and the provider of long-term savings and investment products distributed through all channels of that group. Following the acquisition of HBOS, the Life, Pensions and Investments business also includes business written through the intermediary and bancassurance channels under the Clerical Medical and Halifax brands respectively.

In common with other life assurance companies in the UK, the life and pensions business of each of the life assurance companies in the Lloyds Banking Group is written in a long-term business fund. The main long-term business funds are divided into With Profit and Non-Profit sub-funds.

With-profits life and pensions products are written from the respective With Profit sub-funds in the Group. The benefits accruing from these policies are designed to provide a smoothed return to policyholders who hold their policies to maturity through a mix of annual and final (or terminal) bonuses added to guaranteed basic benefits. The guarantees generally only apply on death or maturity. The actual bonuses declared will reflect the experience of the With Profit sub-fund.

Other life and pensions products are generally written from Non-Profit sub-funds.

Examples include unit-linked policies, annuities, term assurances and health insurance (under which a predetermined amount of benefit is payable in the event of an insured event such as being unable to work through sickness). The benefits provided by linked policies are wholly or partly determined by reference to a specific portfolio of assets known as unit-linked funds.

LIFE, PENSIONS AND INVESTMENTS EUROPE

The European Life, Pensions and Investments business distributes products primarily in the German market under the Heidelberger Leben and Clerical Medical brands. The business unit was included within the International division of the former HBOS group.

GENERAL INSURANCE

The combined General Insurance business is a leading distributor of home and payment protection insurance in the UK, with products sold through the branch network, direct channels and strategic corporate partners. The business is one of the largest underwriters of personal insurance business in the UK and also has significant brokerage operations for personal and commercial insurances. It operates primarily under the Lloyds TSB, Halifax and Bank of Scotland brands.

	2009 £m	2008 £m
Net interest income	**(287)**	(345)
Other income	**2,944**	3,493
Total income	**2,657**	3,148
Insurance claims	**(637)**	(481)
Total income, net of insurance claims	**2,020**	2,667
Operating expenses	**(974)**	(1,129)
Share of results of joint ventures and associates	**(22)**	2
Profit before tax and fair value unwind	**1,024**	1,540
Fair value unwind	**(49)**	

Profit before tax		**975**	1,540
Profit before tax and fair value unwind by business unit			
Life, Pensions and Investments	UK business	**617**	826
	European business	**75**	149
General Insurance		**367**	537
Other		**(35)**	28
Profit before tax and fair value unwind		**1,024**	1,540

Profit before tax from Insurance was £565 million lower at £975 million in 2009 compared to £1,540 million in 2008. The profit in 2009 included a charge of £49 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Profit before tax and fair value unwind was £516 million lower at £1,024 million in 2009 compared to £1,540 million in 2008. This deterioration in profits followed a reduction in income and an increase in claims, due to factors including demanding market conditions, partly offset by a decrease in operating expenses.

Total income decreased by £491 million, or 16 per cent, to £2,657 million in 2009 compared to £3,148 million in 2008 due to the non-recurrence of £334 million of HBOS legacy one-off benefits, principally in Life, Pensions and Investments, enjoyed in 2008 and the impact of challenging economic conditions driving lower sales and returns, partially offset by significantly lower charges for policyholder lapses.

Net interest income was £58 million, or 17 per cent, better at a deficit of £287 million in 2009 compared to a deficit of £345 million in 2008.

Other income was £549 million, or 16 per cent, lower at £2,944 million in 2009 compared to £3,493 million in 2008. Within the life and pensions activities, new business profit was significantly impacted by the general contraction in the life, savings and investments market and the reduction also reflects the integration of the intermediary sales forces and the withdrawal of a number of legacy HBOS products with poor returns. Existing business profit within the UK life and pensions activities reduced by 10 per cent, this includes a reduction in expected return, reflecting lower asset values resulting from adverse investment markets in 2008, a lower assumed rate of return and the non-recurrence of one-off benefits enjoyed by HBOS in 2008. These impacts have been partly offset by a significant reduction in charges for policyholder lapses in 2009. Within the general insurance activities, income was lower principally due to payment protection insurance income decreasing as a result of the market-wide move to monthly premiums on payment protection, partly offset by lower distribution commission payable to the Retail division.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Insurance claims were £156 million, or 32 per cent, higher at £637 million in 2009 compared to £481 million in 2008, primarily due to higher payment protection insurance claims related to unemployment. Whilst property claims were impacted by flooding and freeze claims in the final quarter of 2009, benefits from ongoing investments in claims processes continue to be realised.

Operating expenses decreased by £155 million, or 14 percent, to £974 million in 2009 compared to £1,129 million in 2008; this is mainly due to continued focus on cost management and delivering integration synergies.

Insurance s share of results of joint ventures and associates deteriorated to a loss of £22 million in 2009 compared to a profit of £2 million in 2008.

LIFE, PENSIONS AND INVESTMENTS

UK BUSINESS

		2009 £m	2008 £m
Net interest income		**(273)**	(282)
Other income		**1,474**	1,758
Total income		**1,201**	1,476
Operating expenses		**(584)**	(650)
Profit before tax and fair value unwind		**617**	826
Profit before tax and fair value unwind analysis			
New business profit	insurance business[1]	**328**	465
	investment business[1]	**(196)**	(247)
Total new business profit		**132**	218
Existing business profit		**483**	534
Expected return on shareholders net assets		**2**	74
Profit before tax and fair value unwind		**617**	826

1 As required under IFRS, products are split between insurance and investment contracts depending on the level of insurance risk contained. For insurance contracts, the new business profit includes the net present value of profits expected to emerge over the lifetime of the contract, including profits anticipated in periods after the year of sale; for investment contracts the figure reflects the profit in the year of sale only, after allowing for the deferral of initial income and expenses. Consequently the recognition of profit for investment contracts is deferred relative to insurance contracts.

Profit before tax and fair value unwind decreased by £209 million, or 25 per cent, to £617 million in 2009 compared to £826 million in 2008. New business profit was significantly impacted by the general contraction in the life, savings and investments market but the reduction also reflects the integration of the intermediary sales forces and the withdrawal of a number of legacy HBOS products with poor returns.

Existing business profit reduced by £51 million, or 10 per cent, to £483 million in 2009 compared to £534 million in 2008. This reflects a reduction in expected return, reflecting lower asset values resulting from adverse investment markets in 2008, a lower assumed rate of return and the non-recurrence of one-off benefits in HBOS in 2008, principally relating to a move to a more market consistent basis of embedded value and enhancements to the bond proposition. Those impacts have been partly offset by a significant reduction in charges for policyholder lapses in 2009.

Expected returns on shareholders net assets were impacted both by a lower assumed rate of return and by reduced asset values as a result of severe market falls in 2008.

EUROPEAN BUSINESS

Profit before tax and fair value unwind decreased by £74 million, or 50 per cent to £75 million in 2009 compared to £149 million in 2008. New business profits reduced by £32 million driven by lower sales, reflecting economic and market conditions. Existing business profits decreased, primarily due to lower expected returns. In 2008, as a result of moving to a more market consistent basis of embedded value in HBOS, a one-off benefit of £123 million arose. The impact of this was largely offset by a significant reduction in charges for policyholder lapses in 2009.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

NEW BUSINESS

The table below provides an analysis of the present value of new business premiums (PVNBP) for business written by the Insurance division, split between the UK and European Life, Pensions and Investments businesses. PVNBP is the measure of new business premiums for the life and pensions business and OEIC sales that management monitors because it provides an indication of both the performance and the profitability of the business this is calculated as the value of single premiums plus the discounted present value of future expected regular premiums.

	2009			2008		
	UK £m	**Europe £m**	**Total £m**	UK £m	Europe £m	Total £m
Protection	**519**	**49**	**568**	492	51	543
Payment protection	**153**		**153**	679		679
Savings and investments	**2,689**	**312**	**3,001**	4,149	372	4,521
Individual pensions	**2,275**	**185**	**2,460**	4,216	306	4,522
Corporate and other pensions	**2,600**		**2,600**	2,940		2,940
Retirement income	**887**		**887**	1,451		1,451
Managed fund business	**146**		**146**	216		216
Life and pensions	**9,269**	**546**	**9,815**	14,143	729	14,872
OEICs	**3,704**		**3,704**	3,303		3,303
Total	**12,973**	**546**	**13,519**	17,446	729	18,175
Analysis by channel						
Bancassurance excluding payment protection	**6,844**		**6,844**	7,677		7,677
Payment protection	**153**		**153**	679		679
Bancassurance	**6,997**		**6,997**	8,356		8,356
Intermediary	**5,639**	**546**	**6,185**	8,704	729	9,433
Direct	**337**		**337**	386		386
Total	**12,973**	**546**	**13,519**	17,446	729	18,175

The present value of new business premiums reduced by £4,656 million, or 26 per cent, to £13,519 million in 2009 compared to £18,175 million in 2008 reflecting both a general contraction in the UK and European markets as well as the re-positioning of the UK intermediary product range. Sales through the intermediary channel were significantly impacted as the UK intermediary sales forces were integrated and a number of legacy HBOS products with poor returns were withdrawn. As a result, sales in the intermediary channel reduced by 34 per cent. Sales through the bancassurance channel, excluding payment protection, continued to perform relatively robustly with a reduction of 11 per cent. This includes Scottish Widows sales through the bancassurance network which showed good growth of 18 per cent. Sales of OEIC products were strong with an increase of 12 per cent in 2009.

GENERAL INSURANCE

	2009 £m	2008 £m
Home insurance		
Underwriting income (net of reinsurance)	**897**	885
Commission receivable	**71**	50
Commission payable	**(94)**	(70)
	874	865
Payment protection insurance		
Underwriting income (net of reinsurance)	**731**	860

Commission receivable	**13**	428
Commission payable	**(395)**	(923)
	349	365
Other		
Underwriting income (net of reinsurance)	**8**	20
Commission receivable	**69**	71
Commission payable	**(28)**	(36)
Other (including investment income)	**(6)**	93
	43	148
Net operating income	**1,266**	1,378
Claims paid on insurance contracts (net of reinsurance)	**(637)**	(481)
Operating income, net of claims	**629**	897
Operating expenses	**(262)**	(360)
Profit before tax and fair value unwind	**367**	537

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Profit before tax and fair value unwind from General Insurance decreased by £170 million, or 32 per cent, to £367 million in 2009 compared to £537 million in 2008.

Claims were £156 million, or 32 per cent, higher at £637 million compared to £481 million in 2008, primarily due to higher payment protection insurance claims related to unemployment. Whilst property claims were impacted by flooding and freeze claims in the final quarter of 2009, benefits from ongoing investments in claims processes continue to be realised.

Against the background of a particularly competitive market in which the general insurance business has a leading position, home insurance income generated modest growth of £9 million, or 1 per cent to £874 million in 2009 compared to £865 million in 2008. Payment protection insurance income decreased by £16 million, or 4 per cent, to £349 million in 2009 compared to £365 million in 2008 as a result of the market-wide move to monthly premiums on payment protection, partly offset by lower distribution commission payable to the Retail division.

Other income has reduced, primarily reflecting lower interest rates and the allocation of certain charges.

Operating expenses decreased by £98 million, or 27 per cent, to £262 million in 2009 compared to £360 million in 2008. Adjusting for the reclassification of claims handling expenses into claims paid and non-recurring marketing spend in 2008, costs improved by 10 per cent year on year, reflecting continued focus on cost management and cost savings achieved through the integration.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

GROUP OPERATIONS

	2009	2008
	£m	£m
Net interest income	**(69)**	(59)
Other income	**20**	35
Total income	**(49)**	(24)
Direct costs:		
Information technology	**(1,265)**	(1,347)
Operations	**(555)**	(542)
Property	**(979)**	(1,019)
Procurement	**(166)**	(159)
Support functions	**(101)**	(89)
	(3,066)	(3,156)
Result before recharges to divisions	**(3,115)**	(3,180)
Total net recharges to divisions	**2,941**	3,100
Share of results of joint ventures and associates	**3**	4
Loss before tax and fair value unwind	**(171)**	(76)
Fair value unwind	**22**	
Loss before tax	**(149)**	(76)

Loss before tax from Group Operations deteriorated by £73 million to £149 million in 2009 compared to £76 million in 2008. The loss in 2009 included a credit of £22 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Loss before tax and fair value unwind deteriorated by £95 million to £171 million in 2009 compared to £76 million in 2008.

Total income, excluding recharges to divisions, decreased by £25 million, to a deficit of £49 million in 2009 compared to a deficit of £24 million in 2008. Net interest income was £10 million, or 17 per cent, lower at a net expense of £69 million in 2009 compared to a net expense of £59 million in 2008. Other income was £15 million, or 43 per cent, lower at £20 million in 2009 compared to £35 million in 2008.

Direct costs were £90 million, or 3 per cent, lower at £3,066 million in 2009 compared to £3,156 million in 2008; this reflects the impact of integration synergies and a continued focus on cost management.

IT costs decreased due to the early realisation of synergy savings following the consolidation of IT operations across the Group in addition to lower investment spend as project activity was rationalised and replaced by integration activity; property costs were also lower, primarily due to the realisation of synergy savings as a result of the integration and the consolidation of premises (which has been achieved at a faster rate than originally anticipated).

Recharges to divisions were £159m, or 5 per cent, lower at £2,941 million in 2009 compared to £3,100 million in 2008.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

CENTRAL ITEMS

	2009 **£m**	2008 £m
Net interest income	**(815)**	(213)
Other income	**1,780**	(223)
Total income	**965**	(436)
Operating expenses	**(294)**	(21)
Trading surplus (deficit)	**671**	(457)
Impairment		(60)
Share of results of joint ventures and associates	**(1)**	
Profit (loss) before tax and fair value unwind	**670**	(517)
Fair value unwind	**(2,119)**	
Loss before tax	**(1,449)**	(517)

Central items are comprised of three main elements:

1 The residual net interest position arising from the Group s processes to allocate the following elements of net interest income to the divisions:

interest on the Group s equity position;

net interest margin cost resulting from central capital activities, primarily arising on the management of senior and subordinated debt and preference shares net of such cost allocated to the divisions; and

cost to the Group of funding wholesale and liquidity balances.

2 The charge for payments to the Lloyds TSB Foundations: the four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly the disabled and disadvantaged, to play a fuller role in society.

3 Central costs and other unallocated items: these relate to the on-going costs of central group activities including those of group corporate treasury (including the central hedge function), internal group audit, group risk, group compliance, group finance and group IT and operations.

Loss before tax from Central items deteriorated by £932 million to £1,449 million in 2009 compared to £517 million in 2008. The loss in 2009 included a charge of £2,119 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Profit before tax and fair value unwind was £670 million in 2009 compared to a loss of £517 million in 2008.

Total income increased by £1,401 million, to £965 million in 2009 compared to a deficit of £436 million in 2008. Net interest income was £602 million lower at a net expense of £815 million in 2009 compared to a net expense of £213 million in 2008. Other income was £2,003 million higher at £1,780 million in 2009 compared to a deficit of £223 million in 2008; this was primarily as a result of gains arising when the Group exchanged certain existing subordinated debt securities for new securities. These exchanges resulted in a gain on extinguishment of the existing liability of £1,498 million (of which £1,468 million is reflected in Central items), being the difference between the carrying amount of the securities extinguished and the fair value of the new securities together with related fees and costs.

Operating expenses were £273 million higher at £294 million in 2009 compared to £21 million in 2008; this was due in part to higher professional fees and other costs associated with a number of group-wide projects, including the proposed participation in the Government Asset Protection Scheme, and an increase in the amount of pension costs held centrally.

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

COMBINED BUSINESSES BASIS SUMMARY 2009 COMPARED WITH 2008

Readers should be aware that the combined businesses basis has been presented for comparative purposes only and is neither intended to provide proforma information nor to show the results of the Group as if the acquisition of HBOS had taken place at an earlier date. Readers should also note that HBOS was not managed by the current management of Lloyds Banking Group in 2008.

As noted on page 2, the combined businesses basis segmental results for 2009 and 2008 are presented in accordance with IFRS. However, the aggregated total of the combined businesses segmental results constitutes a non-GAAP measure as defined by the SEC.

The acquisition of HBOS plc on 16 January 2009 has had a significant impact on the results of the Group. Comparisons of the Group s performance on a statutory basis are, therefore, dominated by the impact of the acquisition of HBOS; the 2009 statutory results include the results of HBOS from 16 January 2009, together with the effects of the unwind of fair value adjustments made to the HBOS balance sheet on acquisition, and the 2008 statutory results do not include any results of HBOS.

Management uses the aggregated total of the combined businesses segmental results, a non-GAAP measure, as a measure of performance, and believes that it provides important information for investors, because it is a comparable representation of the Group s performance. Profit before tax is the comparable GAAP measure to profit before tax on a combined businesses basis; a reconciliation of the Group s statutory income statement to its combined businesses income statement is shown below. Readers should be aware that the combined businesses basis excludes certain items, as indicated in the tables below, reflected in the Group s statutory results and includes certain items, also indicated in the tables below, not reflected in the Group s statutory results. The Group refers readers to the discussion of its statutory results on pages 14 to 23.

Set out below is a reconciliation from the Group s statutory results to the combined businesses basis, together with a brief commentary.

			Removal of:				
2009	**Lloyds Banking Group statutory £m**	**Pre-acquisition results of HBOS £m**	**GAPS fee and acquisition related items[1] £m**	**Volatility £m**	**Insurance gross up £m**	**Fair value unwind £m**	**Combined businesses £m**
Net interest income	**9,026**	**243**		**11**	**1,280**	**2,166**	**12,726**
Other income	**36,271**	**(1,123)**		**(479)**	**(21,659)**	**(1,135)**	**11,875**
Total income	**45,297**	**(880)**		**(468)**	**(20,379)**	**1,031**	**24,601**
Insurance claims	**(22,019)**	**1,349**			**20,318**	**(285)**	**(637)**
Total income, net of insurance claims	**23,278**	**469**		**(468)**	**(61)**	**746**	**23,964**
Operating expenses	**(15,984)**	**(293)**	**4,589**		**61**	**18**	**(11,609)**
Trading surplus (deficit)	**7,294**	**176**	**4,589**	**(468)**		**764**	**12,355**
Impairment	**(16,673)**	**(456)**				**(6,859)**	**(23,988)**
Share of results of joint ventures and associates	**(752)**			**(10)**		**(5)**	**(767)**
Gain on acquisition	**11,173**		**(11,173)**				
Fair value unwind						**6,100**	**6,100**
Profit (loss) before tax	**1,042**	**(280)**	**(6,584)**	**(478)**			**(6,300)**

1 Includes the GAPS fee (£2,500 million), integration costs (£1,096 million), amortisation of purchased intangibles (£753 million), goodwill impairment (£240 million) and gain on acquisition.

2008	Lloyds TSB statutory[1] £m	HBOS statutory £m	Reclass- ifications £m	Removal of: BankWest and St. Andrews £m	Volatility £m	Amortisation of purchased intangibles and goodwill impairment £m	Insurance gross up £m	Combined businesses £m
Net interest income	7,718	8,171	1,906	(524)	(9)		(2,359)	14,903
Other income	(709)	(4,559)	(234)	(148)	2,358		10,225	6,933
Total income	7,009	3,612	1,672	(672)	2,349		7,866	21,836
Insurance claims	2,859	6,192	(1,570)				(7,962)	(481)
Total income, net of insurance claims	9,868	9,804	102	(672)	2,349		(96)	21,355
Operating expenses	(6,100)	(6,880)		400		258	86	(12,236)
Trading surplus	3,768	2,924	102	(272)	2,349	258	(10)	9,119
Impairment	(3,012)	(12,050)		182				(14,880)
Share of results of joint ventures and associates	4	(956)						(952)
Non-operating income		(743)	(102)	845				
Profit (loss) before tax	760	(10,825)		755	2,349	258	(10)	(6,713)

1 Restated for IFRS 2 (Revised).

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Profit before tax on a combined businesses basis improved by £413 million to a loss of £6,300 million in 2009 compared to a loss of £6,713 million in 2008; however, the loss in 2009 included a credit of £6,100 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Loss before tax and fair value unwind deteriorated by £5,687 million to a loss of £12,400 million in 2009 compared to a loss of £6,713 million in 2008. This deterioration was driven by higher impairment losses, only partly offset by an increase in other operating income and a decrease in operating expenses.

Total income increased by £2,765 million, or 13 per cent, to £24,601 million in 2009 compared to £21,836 million in 2008, driven by a large increase in other income.

Lending to customers, net of impairment provisions and fair value adjustments arising from the acquisition of HBOS plc by the Group, was £50,277 million, or 7 per cent, lower at £626,969 million in 2009 compared to £677,246 million in 2008.

Customer deposits were £2,421 million lower at £406,741 million in 2009 compared to £409,162 million in 2008.

Net interest income was £2,177 million, or 15 per cent, lower at £12,726 million in 2009 compared to £14,903 million in 2008. The net interest margin, adjusted to exclude products where either the funding costs or the related revenues are recognised in other income, declined by 24 basis points to 1.77 per cent in 2009 compared to 2.01 per cent in 2008.

Other income was £4,942 million, or 71 per cent, higher at £11,875 million in 2009 compared to £6,933 million in 2008. Other income in 2008 had been significantly reduced due to the effect of the dislocation in credit markets which resulted in investment valuation write-downs of £3,452 million in the Wholesale business; these factors were not repeated in 2009.

Operating expenses decreased by £627 million, or 5 per cent, to £11,609 million in 2009 compared to £12,236 million in 2008. Operating expenses in 2008 included a £180 million settlement in relation to certain historic US dollar payments; excluding this item from 2008, operating expenses decreased by £447 million, or 4 per cent, to £11,609 million in 2009 compared to £12,056 million in 2008.

Impairment losses increased by £9,108 million, or 61 per cent, to £23,988 million in 2009 compared to £14,880 million in 2008. Impairment losses on loans and advances to customers as a percentage of average loans and advances to customers were 3.25 per cent in 2009 compared to 1.81 per cent in 2008.

The Group s share of results of joint ventures and associates improved by £185 million, or 19 per cent, to a loss of £767 million in 2009 compared to a loss of £952 million in 2008; there were lower levels of write-offs in 2009 as the majority of the book is fully written-off.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LINE OF BUSINESS INFORMATION

2008 COMPARED WITH 2007

The requirements for IFRS segmental reporting are set out in IFRS 8 Operating Segments which mandates that an entity s segmental reporting should reflect the way in which its operations are viewed and judged by its chief operating decision maker. As a consequence, the Group s statutory segmental reporting for comparing 2008 with 2007 follows the continuing businesses basis as explained below (see also note 4 to the consolidated financial statements).

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

The Group s activities in 2008 were organised into three financial reporting segments: UK Retail Banking, Insurance and Investments and Wholesale and International Banking.

The continuing businesses basis excluded the following items:

- insurance and policyholder interests volatility
- a provision in respect of certain historic US dollar payments
- a provision in respect of the Financial Services Compensation Scheme levy
- impairment charge in respect of goodwill
- the results of discontinued businesses
- profit on sale of businesses
- the settlement of overdraft claims.

The results of the businesses are set out below:

	2008[1] £m	2007[1] £m
UK Retail Banking	1,793	1,720
Insurance and Investments	911	748
Wholesale and International Banking	274	1,300
Central group items	(599)	(13)
Profit before tax continuing businesses	2,379	3,755

A reconciliation from the continuing businesses basis to the statutory results is set out below:

	Note	2008[1] £m	2007[1] £m
Profit before tax continuing businesses		2,379	3,755
Volatility	1		

Insurance		(746)	(277)
Policyholder interests		(471)	(222)
Discontinued businesses	2		162
Profit on sale of businesses	3		657
Provision in respect of certain historic US dollar payments	4	(180)	
Provision for Financial Services Compensation Scheme levy	5	(122)	
Goodwill impairment	6	(100)	
Settlement of overdraft claims	7		(76)
Profit before tax statutory		760	3,999

1 Restated for IFRS 2 (Revised).

1. Volatility

	2008 £m	2007 £m
Insurance volatility	(746)	(277)
Policyholder interests volatility	(471)	(222)
Total volatility	(1,217)	(499)

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Insurance volatility

The Group s insurance businesses have liability products that are supported by substantial holdings of investments, including equities, property and fixed interest investments, all of which are subject to variations in their value. The value of the liabilities does not move exactly in line with changes in the value of the investments, yet IFRS requires that the changes in both the value of the liabilities and investments be reflected within the income statement. As these investments are substantial and movements in their fair value can have a significant impact on the profitability of the Insurance and Investments division, management believes that it is appropriate to disclose the division s results on the basis of an expected return in addition to the actual return. The difference between the actual return on these investments and the expected return based upon economic assumptions made at the beginning of the year is included within insurance volatility.

Changes in market variables also affect the realistic valuation of the guarantees and options embedded within products written in the Scottish Widows With Profit Fund, the value of the in-force business and the value of shareholders funds. Fluctuations in these values caused by changes in market variables, including market spreads reflecting credit risk premia, are also included within insurance volatility. These market credit spreads represent the gap between the yield on corporate bonds and the yield on government bonds, and reflect the market s assessment of credit risk. Changes in the credit spreads affect the value of the in-force business asset in respect of the annuity portfolio.

The expected investment returns used to determine the normalised profit of the business, which are based on prevailing market rates and published research into historic investment return differentials, are set out below:

	2008 %	2007 %
Gilt yield (gross)	4.55	4.62
Equity return (gross)	7.55	7.62
Dividend yield	3.00	3.00
Property return (gross)	7.55	7.62
Corporate bonds in unit-linked and with-profits funds (gross)	5.15	5.22
Fixed interest instruments backing annuity liabilities (gross)	5.56	5.09

During 2008, profit before tax included negative insurance volatility of £746 million, being a credit of £9 million to net interest income and a charge of £755 million to other income. During 2007, profit before tax included negative insurance volatility of £277 million, being a credit of £7 million to net interest income and a charge of £284 million to other income. The charge in 2008 mainly reflected the significant falls in global equity markets during the year, which resulted in total returns some 33 percentage points lower than the expected investment returns set out above. These lower than expected returns reduced the value of in-force business asset in respect of life insurance and participating investment contracts held on the balance sheet. The impact of the widening corporate bond credit spreads more than offset the inclusion of an allowance for the illiquidity premium, and resulted in a net reduction in the value of the annuity portfolio. Lower equity and bond prices also affected the valuation of the Group s investment held within the funds attributable to the shareholders. During 2007, the effect of widening credit risk spreads and falling gilt values more than offset the favourable impact of a modest increase in equity values and changes in market consistent assumptions.

Policyholder interests volatility

The application of accounting standards results in the introduction of other sources of significant volatility into the pre-tax profits of the life and pensions business. In order to provide a clearer representation of the performance of the business and consistent with the way in which it is managed, equalisation adjustments are made to remove this volatility from underlying profits. The effect of these adjustments is separately disclosed as policyholder interests volatility; there is no impact upon profit attributable to equity shareholders.

The most significant of these additional sources of volatility is policyholder tax. Accounting standards require that tax on policyholder investment returns should be included in the Group s tax charge rather than being offset against the related income. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge. Other sources of volatility include the minorities share of the profits earned by investment vehicles which are not wholly owned by the long-term assurance funds.

During 2008, profit before tax included negative policyholder interests volatility of £471 million, being a charge to other income. During 2007, profit before tax included negative policyholder interests volatility of £222 million, being a charge to other income. In both 2007 and 2008, substantial policyholder tax losses were generated as a result of a fall in property, bond and equity values. These losses reduce future policyholder tax liabilities and led to a policyholder tax credit in both years.

2. Discontinued businesses

As explained below, the Group disposed of Lloyds TSB Registrars, Abbey Life and Dutton-Forshaw during 2007. Trading results of these businesses up to the date of sale have been excluded from the continuing businesses basis results.

3. Profit on sale of businesses

During 2007, the Group disposed of Lloyds TSB Registrars, its share registration business; Abbey Life, the UK life operation which was closed to new business in 2000; and Dutton-Forshaw, its medium-size car dealership. In addition, provision was made for payments under an indemnity given in relation to a business sold in an earlier year. Together, these transactions resulted in a profit of £657 million.

4. Provision in respect of certain historic US dollar payments

In January 2009, the Group announced that it had reached a settlement with both the US Department of Justice and the New York County District Attorney s Office in relation to a previously disclosed investigation involving those agencies into certain historic US dollar payment practices; the Group provided £180 million in respect of this matter in its 2008 results.

5. Provision for Financial Services Compensation Scheme levy

The arrangements put in place to protect the depositors of Bradford & Bingley and other failed deposit taking institutions involving the Financial Services Compensation Scheme (FSCS) will result in a significant increase in the levies made by the FSCS on the industry. The Group made a provision of £122 million in respect of its then obligation for the estimated interest cost on the FSCS borrowings in its 2008 results.

6. Goodwill impairment

During 2008, the basis of goodwill allocation in parts of the Asset Finance business was changed to treat the consumer finance business as a single cash generating unit encompassing the motor and personal finance operations which provide direct and point of sale finance. The markets in which this unit operates had been affected by the UK economic downturn, which had been characterised by falling demand and increasing arrears at that point of the cycle. This, together with uncertainties over the likely short-term macroeconomic environment, resulted in a reassessment of the carrying value of the consumer finance cash generating unit and the recognition of a goodwill impairment charge of £100 million in 2008.

7. Settlement of overdraft claims

Along with a number of other UK banks, during 2007 the Group had received a number of customer claims for the repayment of overdraft fees. On 27 July 2007, several banks, together with the Office of Fair Trading, had asked the High Court of England and Wales to clarify the legal position regarding personal current account fees. The 2007 results included a charge of £76 million relating to the settlement of claims during that year, together with related costs.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

UK RETAIL BANKING

During 2008, UK Retail Banking provided banking, financial services, mortgages and private banking to some 16 million personal customers through the Group s multi-channel distribution capabilities.

The Group provided wide-reaching geographic branch coverage in England, Scotland and Wales, through over 1,950 branches of Lloyds TSB Bank, Lloyds TSB Scotland plc (Lloyds TSB Scotland) and C&G; internet banking provided online banking facilities for personal customers and telephone banking continued to grow, at the end of 2008 some 5.7 million customers had registered to use the services of PhoneBank and the automated voice response service, PhoneBank Express. The Group had one of the largest cash machine networks of any leading banking group in the UK and, at 31 December 2008, personal customers of Lloyds TSB Bank and Lloyds TSB Scotland were able to withdraw cash and check balances through over 4,200 ATMs at branches and external locations around the UK.

Lloyds TSB Bank and Lloyds TSB Scotland offered a wide range of current accounts, including interest-bearing current accounts and a range of added-value accounts; savings accounts and retail investments; and personal loans.

The Group provided a range of card-based products and services, including credit and debit cards and card transaction processing services for retailers.

In 2008 C&G was UK Retail Banking s specialist residential mortgage arranger, offering a range of mortgage products to personal customers through its own branches and those of Lloyds TSB Bank in England and Wales, as well as through the telephone, internet and postal service, Mortgage Direct; mortgages were also offered through Lloyds TSB Scotland.

UK Wealth Management provided financial planning and advice for the Group s affluent customers, providing financial solutions across investments, retirement planning and income, trusts, tax and estate planning as well as share dealing.

	2008 £m	2007 £m
Net interest income	4,110	3,695
Other income	1,766	1,797
Total income	5,876	5,492
Operating expenses	(2,611)	(2,548)
Trading surplus	3,265	2,944
Impairment	(1,472)	(1,224)
Profit before tax	1,793	1,720
Cost:income ratio	44.4%	46.4%
Total assets (year end)	£127,502m	£115,012m

Profit before tax from UK Retail Banking increased by £73 million, or 4 per cent, to £1,793 million in 2008 compared to £1,720 million in 2007.

Net interest income was £415 million, or 11 per cent, higher at £4,110 million in 2008 compared with £3,695 million in 2007, reflecting both an increase in average interest-earning assets and an improvement in the net interest margin. Average interest-earning assets were £9,234 million, or 8 per cent, higher at £120,128 million in 2008 compared to £110,894 million in 2007 as a result of lending growth, particularly within the mortgage business. Average mortgage balances were £8,652 million higher in 2008. Gross new mortgage lending for the Group totalled £27,767 million, compared to £29,431 million in 2007; net new lending totalled £10,914 million, compared to £6,647 million in 2007, resulting in a market share of net new mortgage lending of 27.5 per cent, compared to 6.2 per cent in 2007. Average balances in respect of other personal lending were £20,138 million compared with £19,426 million in 2007. Average credit card balances in 2008 were 2 per cent lower at £6,477 million compared to £6,619 million in 2007, whilst balances on personal loans and overdrafts were 7 per cent higher at £13,661 million in 2008. Overall margins in UK Retail Banking improved by 9 basis points as a result of wider margins within the unsecured personal lending business and on new mortgages.

Other income was £31 million, or 2 per cent, lower at £1,766 million compared to £1,797 million in 2007. Higher fees and commissions receivable as a result of growth in added-value current accounts and card services were more than offset by lower creditor insurance commissions and the impact of changes in product design leading to a greater proportion of earnings being recognised as net interest income rather than other income.

Operating expenses were £63 million, or 2 per cent, higher at £2,611 million in 2008 compared with £2,548 million in 2007. The Group had continued to benefit from the recent investment in reducing the levels of administration and processing work carried out in branches. This had enabled the Group to increase its focus on meeting the needs of its customers and had supported further improved productivity in the branch network sales effort. These initiatives supported a further improvement in the retail banking cost:income ratio to 44.4 per cent from 46.4 per cent in 2007.

The impairment charge on loans and advances of £1,472 million in 2008 was £248 million, or 20 per cent, higher than the £1,224 million impairment charge in 2007. The charge in respect of personal loans and overdrafts was £100 million, or 15 per cent, higher at £779 million compared to £679 million in 2007 and represented 5.73 per cent of average lending, compared to 5.32 per cent in 2007; and the charge in respect of card balances was £1 million lower at £526 million compared with £527 million in 2007. The impairment charge in Mortgages was £167 million, compared to £18 million in 2007, or 17 basis points of average mortgage lending. The most significant factors in the increase in the mortgage impairment charge during 2008 were the fall in the house price index and the deterioration in economic conditions in the UK.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

INSURANCE AND INVESTMENTS

During 2008, Insurance and Investments offered life assurance, pensions and investment products, general insurance and fund management services.

In 2008, Scottish Widows was the Group s specialist provider of life assurance, pensions and investment products, which were distributed through Lloyds TSB Bank s branch network, through independent financial advisors and directly via the telephone and the internet. The Scottish Widows brand was the main brand for new sales of the Group s life, pensions, Open Ended Investment Companies (OEICs) and other long-term savings products.

Lloyds TSB General Insurance provided general insurance through retail branches of Lloyds TSB Bank and C&G, a direct telephone operation, the internet and through third party panel or other distribution channels. Lloyds TSB General Insurance was one of the leading distributors of home insurance in the UK.

Scottish Widows Investment Partnership managed funds for the Group s retail life, pensions and investment products. Clients also included corporate pension schemes, local authorities and other institutions in the UK and overseas.

	2008 £m	2007 £m
Net interest income	(62)	(106)
Other income	1,749	1,741
Total income	1,687	1,635
Insurance claims	(193)	(302)
Total income, net of insurance claims	1,494	1,333
Operating expenses	(591)	(611)
Trading surplus	903	722
Impairment	(2)	
Profit before tax, excluding insurance grossing	901	722
Insurance grossing adjustment[1]	10	26
Profit before tax	911	748

1 The Insurance and Investment division s income statement includes income and expenditure which are attributable to the policyholders of the Group s long-term assurance funds. These items have no impact upon the profit attributable to equity shareholders and, in order to provide a clearer representation of the underlying trends within the Insurance and Investments segment, these items are shown net on a separate line in the segmental analysis above.

Analysis by area of business of profit before tax	2008 £m	2007 £m
Life, pensions and OEICs	635	597
General insurance	234	110
Scottish Widows Investment Partnership	42	41
Profit before tax	911	748

Profit before tax from the Group s Insurance and Investments business was £163 million, or 22 per cent, higher at £911 million in 2008 compared to £748 million in 2007 for the reasons discussed below.

Net interest income improved by £44 million to a net expense of £62 million in 2008 compared to a net expense of £106 million in 2007.

Other income was £8 million higher at £1,749 million in 2008 compared to £1,741 million in 2007.

Other income from Life, pensions and OEICs was flat as growth in new business profit, reflecting sales growth in insurance-accounted products, was offset by reduced existing business profits principally reflecting the adverse effect of changes made to the economic assumptions used to calculate the value of in-force business included in the balance sheet and the impact of weaker investment markets.

Other income from Scottish Widows Investment Partnership was £13 million lower; but other income from general insurance was £21 million, or 4 per cent, higher at £582 million in 2008 compared to £561 million in 2007. Insurance broking commissions receivable were £99 million, or 15 per cent, lower at £549 million in 2008 compared to £648 million in 2007; home insurance commissions were flat but creditor commissions fell in line with reduced new loan volumes. Underwriting income, net of reinsurance, was £21 million, or 4 per cent, higher at £612 million in 2008 compared to £591 million in 2007 and fees and commissions payable were £87 million, or 13 per cent, lower at £605 million in 2008 compared to £692 million in 2007.

Operating expenses were £20 million, or 3 per cent, lower at £591 million in 2008 compared to £611 million in 2007. A decrease in professional and other fees related to project work was partly offset by increased staff costs.

The performances of the life, pensions and OEICs business and the general insurance business are discussed separately below, on pages 46 and 47.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LIFE, PENSIONS AND OEICS

The table below shows the Present Value of New Business Premiums (PVNBP) which is the measure of new business premiums for the life and pensions business and OEIC sales that management monitors because it provides an indication of both the performance and the profitability of the business this is calculated as the value of single premiums plus the discounted present value of future expected regular premiums. There are three main distribution channels for the sale of the Group s life, pension and OEIC products and the tables below show the relative importance of each.

Present value of new business premiums (PVNBP)	2008 £m	2007 £m
Life and pensions:		
Protection	997	960
Savings and investments	437	913
Individual pensions	2,125	2,073
Corporate and other pensions	2,482	2,141
Retirement income	939	1,044
Managed fund business	217	486
Life and pensions	7,197	7,617
OEICs	2,897	2,807
Life, pensions and OEICs	10,094	10,424
Single premium business	7,346	8,375
Regular premium business	2,748	2,049
Life, pensions and OEICs	10,094	10,424
Bancassurance	4,247	4,096
Independent financial advisers	5,367	5,817
Direct	480	511
Life, pensions and OEICs	10,094	10,424

Overall life, pensions and OEICs sales were £330 million, or 3 per cent, lower at £10,094 million in 2008 compared to £10,424 million in 2007, for the following reasons.

Life and pension sales (including Managed fund business) were £420 million, or 6 per cent, lower at £7,197 million in 2008 compared with £7,617 million in 2007. Protection sales were £37 million, or 4 per cent, higher at £997 million compared to £960 million in 2007, but Savings and investment sales were £476 million lower at £437 million compared to £913 million in 2007, partly due to decreased Flexible Option Bond sales following changes in tax legislation which made such bonds less attractive to investors. Individual pension sales were £52 million higher at £2,125 million in 2008 compared to £2,073 million in 2007 as the negative impact of difficult market conditions were more than offset by the sales of the Retirement Account product. Corporate and other pension sales were £341 million higher at £2,482 million compared to £2,141 million in 2007 as continued product development has helped Scottish Widows to attract a number of large corporate pension schemes. Retirement income sales are £105 million lower at £939 million in 2008 compared to £1,044 million in 2007, as current market conditions have made annuity products unattractive; and Managed fund business sales were £269 million lower at £217 million compared to £486 million in 2008, again as a result of adverse market conditions.

OEICs sales increased by £90 million, or 3 per cent, to £2,897 million in 2008 compared to £2,807 million in 2007 as sales growth through the Wealth Management business has more than offset a decrease in sales elsewhere within the Bancassurance channel, as a result of a fall in consumer confidence in the investment market.

By distribution channel, Bancassurance sales were £151 million, or 4 per cent, higher at £4,247 million in 2008 compared to £4,096 million in 2007 whereas sales via independent financial advisers were £450 million, or 8 per cent, lower at £5,367 million in 2008 compared to £5,817 million in 2007.

Profit before tax from life, pensions and OEICs was £38 million, or 6 per cent, higher at £635 million in 2008 compared to £597 million in 2007, as growth in new business profit, reflecting sales growth in insurance-accounted products, has been partly offset by reduced existing business profits principally reflecting the adverse effect of changes made to the economic assumptions used to calculate the value of in-force business included in the balance sheet and the impact of weaker investment markets.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

GENERAL INSURANCE

The results of the general insurance business are set out below.

	2008 £m	2007 £m
Net interest income	6	5
Other income	582	561
Total income	588	566
Insurance claims	(193)	(302)
Total income, net of insurance claims	395	264
Operating expenses	(161)	(154)
Profit before tax	234	110

	2008 £m	2007 £m
Premium income from underwriting (net of reinsurance):		
Home	441	418
Creditor	163	164
Other	8	9
	612	591
Commissions from insurance broking:		
Creditor	428	510
Home	50	50
Other	71	88
	549	648

Profit before tax from the Group s general insurance operations was £124 million, or 113 per cent, higher at £234 million in 2008 compared to £110 million in 2007.

Net interest income was £1 million, or 20 per cent, higher at £6 million in 2008 compared to £5 million in 2007.

Other income was £21 million, or 4 per cent, higher at £582 million in 2008 compared to £561 million in 2007. Insurance broking commissions receivable were £99 million, or 15 per cent, lower at £549 million in 2008 compared to £648 million in 2007; home insurance commissions were flat but creditor commissions fell in line with reduced new loan volumes. Underwriting income, net of reinsurance, was £21 million, or 4 per cent, higher at £612 million in 2008 compared to £591 million in 2007; home insurance premiums were 6 per cent higher reflecting the success of the Home Solutions product. Fees and commissions payable were £87 million, or 13 per cent, lower at £605 million in 2008 compared to £692 million in 2007; this largely reflected reduced creditor insurance sales volumes.

Insurance claims expense was £109 million, or 36 per cent, lower at £193 million in 2008 compared to £302 million in 2007 largely as a result of the non-repetition of the £113 million increase in weather related claims in 2007, resulting from storms in January 2007 and severe flooding in June and July 2007 in the UK.

Operating expenses were £7 million, or 5 per cent, higher at £161 million in 2008 compared to £154 million in 2007 reflecting increases in staff costs and other administration charges.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

WHOLESALE AND INTERNATIONAL BANKING

In 2008, Wholesale and International Banking provided banking and related services for major UK and multinational corporates and financial institutions, and small and medium-sized UK businesses. It also provided asset finance to personal and corporate customers, managed the Group s activities in financial markets through its treasury function and provided banking and financial services overseas.

Combining the respective strengths of some 3,000 employees, Corporate Markets played an integral role in leveraging and expanding the customer franchise and building deep, long-lasting relationships with around 26,000 corporate customers at 31 December 2008. Corporate Banking managed the Group s core corporate customer franchise, providing a relationship-based financial and advisory service to the corporate market place through dedicated regional teams throughout the UK and key strategic locations abroad, including New York. Customers had access to expert advice and a broad range of financial solutions. Products and Markets was where the specialist product capability resided for transactions undertaken by the corporate customers of the Group. It offered customers a comprehensive range of finance and capital solutions, and also provided tailored risk management solutions and structured solutions across all areas of risk, including foreign exchange, interest rates, credit, inflation and commodities on behalf of the Group.

At 31 December 2008, Commercial Banking served nearly one million customers across the UK from one-person start-ups to large, established enterprises. The business focused on providing banking facilities and solutions to customers with business turnover up to £15 million per annum, and additionally provided specialised working capital finance for its customers through its Commercial Finance subsidiary, and long-term finance to the agricultural sector through the Agricultural Mortgage Corporation.

The Group s asset finance businesses provided individuals and companies with specialist personal lending, store credit and finance through leasing, hire purchase and contract hire packages. Altogether, at 31 December 2008, Asset Finance had over 1.5 million individual customers and relationships with some 22,000 companies and small businesses.

The Group had continued to shape its international network to support its UK operations. Its overseas banking operations included offices in the UK, the Channel Islands, the Isle of Man, Dubai, Hong Kong, Spain, France, Switzerland, Luxembourg, Belgium, Netherlands, Monaco, Gibraltar, Cyprus, South Africa, Japan, Singapore, Malaysia, China and the US. The business provided a wide range of private and retail banking, wealth management and expatriate services to local residents, UK expatriates, foreign nationals and to other customers and also served the corporate and institutional markets in a number of these locations.

	2008 £m	2007 £m
Net interest income	3,303	2,380
Other income	829	1,644
Total income	4,132	4,024
Operating expenses	(2,350)	(2,152)
Trading surplus	1,782	1,872
Impairment	(1,508)	(572)
Profit before tax	274	1,300
Cost:income ratio	56.9%	53.5%
Total assets (year end)	£238,832m	£163,294m

In 2008 Wholesale and International Banking recorded a profit before tax of £274 million which was £1,026 million, or 79 per cent, lower than £1,300 million in 2007, for the following reasons.

Net interest income was £923 million, or 39 per cent, higher at £3,303 million compared to £2,380 million in 2007. This increase reflected growth in interest-earning assets in Corporate Markets, Commercial Banking and International Banking. Average interest-earning assets were £22,547 million, or 17 per cent, higher at £158,254 million. Excluding the fine margin reverse repurchase agreement balances from both years, the increase was £24,891 million. The net interest margin, again excluding the fine margin reverse repurchase agreement balances, increased by 27 basis points, as a widening of margins within Corporate Markets, in part as a result of changes in funding arrangements, and Asset Finance was partly offset by decreased margins in Commercial Banking, where growth has been in lower margin secured products.

Other income was £815 million, or 50 per cent, lower at £829 million compared to £1,644 million in 2007; the significant reduction in Corporate Market s other income (£936 million lower), primarily as a result of the recent market turmoil, was partially offset by increases in Commercial Banking (£34 million, or 8 per cent, higher), Asset Finance (£40 million, or 9 per cent, higher) and International Banking (£22 million, or 12 per cent, higher).

Operating expenses were £198 million, or 9 per cent, higher at £2,350 million in 2008 compared to £2,152 million in 2007. This increase reflects the continued investment in the Group s people and infrastructure, particularly within Corporate Markets.

The impairment charge in 2008 totalled £1,508 million, compared to £572 million in 2007, an increase of £936 million. The charge in respect of loans and receivables increased by £905 million, from £497 million in 2007 to £1,402 million in 2008 and the charge as a percentage of average lending was 1.33 per cent compared to 0.57 per cent in 2007. In Corporate Markets the charge was £774 million higher, at £939 million compared to £165 million in 2007; the significant increase reflects the economic slowdown in the UK and the impact of a number of high profile financial services company collapses. In Commercial Banking the charge was £89 million, or 90 per cent, higher, at £188 million; in Asset Finance the charge was £42 million, or 18 per cent, higher, at £270 million; and in International Banking there was a charge of £6 million compared with a release of £2 million in 2007. In addition, a charge of £100 million in 2008 (2007: £70 million) arose in respect of the impairment of available-for-sale financial assets.

At 31 December 2008, Lloyds Banking Group s Corporate Markets exposure to certain categories of assets the values of which had been affected by the ongoing capital markets uncertainties was as described below:

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Asset Backed Security CDOs (ABS CDOs) and monoline Credit Default Swap (CDS) exposure: Corporate Markets had no direct exposure to US sub-prime ABS and limited indirect exposure through ABS CDOs. During 2008, the market value of the Group s holdings in ABS CDOs reduced and, as a result, Corporate Markets took an income statement charge of £92 million. Corporate Markets had no exposure to mezzanine ABS CDOs. In addition, Corporate Markets had £1,867 million, compared to £1,861 million at 31 December 2007, of ABS CDOs which remained fully cash collateralised by major global financial institutions.

At 31 December 2008, Corporate Markets had fair value exposure to one monoline financial guarantor in the form of CDS protection bought against a £256 million collateralised loan obligation. The exposure on this CDS was £10 million, following a £28 million adverse credit valuation adjustment. A restructuring of the Group s other monoline hedged ABS CDO had eliminated any reliance on the financial guarantor and had resulted in a much improved risk profile on a reduced holding of £128 million included in loans and receivables. Credit valuation adjustments and restructuring costs related to the cancelled CDS in the amount of £275 million were recognised in the income statement.

Structured Investment Vehicles (SIV): During 2008 Corporate Markets wrote down the value of its SIV exposures by £95 million. Corporate Markets had no residual exposure to SIV Capital Notes. Additionally, at 31 December 2008 Corporate Markets had a commercial paper back up liquidity facility totalling £22 million, compared to £370 million at 31 December 2007.

Financial instruments held at fair value through profit or loss: During 2008, Corporate Markets also saw a reduction in profit before tax of £653 million (excluding the £303 million described above due to valuation and restructuring costs relating to CDS) as a result of the impact of mark-to-market adjustments in certain legacy trading portfolios, reflecting the marketwide repricing of liquidity and credit.

At 31 December 2008 the trading portfolio contained £33 million of indirect exposure to US sub-prime mortgages and ABS CDOs. This super senior exposure remained protected by note subordination.

Available-for-sale financial assets: At 31 December 2008, the Group s portfolio of available-for-sale financial assets totalled £55,707 million, compared to £20,196 million at 31 December 2007, of which £55,364 million, compared to £19,662 million at 31 December 2007, were held in Corporate Markets. This increase largely reflected the Group s decision to substantially increase, for liquidity purposes, its holdings of treasury and Government guaranteed securities over the HBOS acquisition period. The available-for-sale financial assets comprised £6,273 million ABS in Cancara, the Group s hybrid Asset-Backed Commercial Paper conduit, £2,917 million Student Loan ABS, predominantly guaranteed by the US Government, £11,747 million Government bonds and short-dated bank commercial paper, £29,142 million treasury bills and other eligible bills and £5,285 million major bank senior paper and high quality ABS. Temporary mark-to-market adjustments are required to be taken through reserves. During 2008, a net £2,023 million reserves adjustment, which had no impact on the Group s capital ratios, had been made to reflect a reduction in the value of available-for-sale financial assets.

Impairment of available-for-sale financial assets: Gross impairment losses in respect of available-for-sale financial assets transferred from reserves to the income statement during 2008 totalled £130 million, compared to £70 million during 2007, of which £100 million related to Corporate Markets, compared to £70 million during 2007.

Cancara: Total exposures in Cancara were £12,615 million at 31 December 2008, comprising £6,273 million of ABS in available-for-sale financial assets and £6,342 million in loans and advances to customers. Cancara is fully consolidated in the Group s accounts. At 31 December 2008, the ABS in Cancara were 91.8 per cent and 94.2 per cent Aaa/AAA rated by Moody s and Standard & Poor s respectively, and there was no exposure either directly or indirectly to sub-prime US mortgages within the ABS portfolio. All non AAA rated ABS had been funded by the Group. At 31 December 2008 loans and advances to customers included no US sub-prime mortgage exposure.

Leveraged finance underwriting commitments: At 31 December 2008, Corporate Markets not yet syndicated leveraged loan underwriting commitments amounted to £931 million, compared to £756 million at 31 December 2007, of which £438 million were originated before the current market uncertainties. All of the underlying assets were performing satisfactorily.

The Group s exposures to categories of assets, the value of which has been affected by the ongoing capital markets uncertainties, increased significantly following the acquisition of HBOS.

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CENTRAL GROUP ITEMS

	2008[1] £m	2007[1] £m
Net interest income	(293)	(368)
Other income	(203)	352
Total income	(496)	(16)
Operating expenses	(77)	(7)
Trading surplus	(573)	(23)
Impairment	(30)	
Share of results of joint ventures and associates	4	10
Loss before tax	(599)	(13)

1 Restated for IFRS 2 (Revised).

Central group items are comprised of three main elements:

1 The funding cost of acquisitions less earnings on capital:

interest costs on central balances, which principally arise from the cost of centrally funded acquisitions net of the proceeds of any subsequent disposals, together with the funding cost of dividend flows;

net interest margin cost resulting from central capital activities, primarily arising on the management of senior and subordinated debt and preference shares net of such cost allocated to the divisions; and

earnings allocated to the UK banking businesses on equity required to support their current activities offset by the income on actual equity held in those businesses.

2 The charge for payments to the Lloyds TSB Foundations: The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly the disabled and disadvantaged, to play a fuller role in society.

3 Central costs and other unallocated items: these relate to the on-going costs of central group activities including those of group corporate treasury (including the central hedge function), internal group audit, group risk, group compliance, group finance and group IT and operations.

Loss before tax from Central group items was £599 million in 2008 compared to £13 million in 2007. Total income was a deficit of £496 million compared to a deficit of £16 million in 2007; income in 2008 was significantly affected by the impact of yield curve volatility on the fair value of derivatives entered into for risk management purposes, after taking into account the effect of hedge accounting adjustments. Operating expenses were £77 million, compared to £7 million in 2007, reflecting increased central costs that were not recharged to the divisions in connection with professional advice received during 2008 and other items; the charge for payments to the Lloyds TSB Foundations was £27 million compared to £37 million in 2007. An impairment charge of £30 million, compared to £nil in 2007, reflected the write-off of the Group s investment in Bradford & Bingley equity shares.

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CONTINUING BUSINESSES BASIS SUMMARY 2008 COMPARED WITH 2007

The continuing businesses segmental results for 2008 and 2007 are prepared in accordance with IFRS. However, the aggregated total of the continuing businesses segmental results constitutes a non-GAAP measure, as defined by the SEC.

Management used the aggregated total of the continuing businesses segmental results, a non-GAAP measure of performance, and believes that it provides important information for investors, because it provides a clearer representation of the Group s underlying business performance. Profit before tax is the comparable GAAP measure to profit before tax on a continuing businesses basis; a reconciliation of the Group s statutory income statement to its continuing businesses basis income statement is shown below. Readers should be aware that the continuing businesses basis excludes certain items, as indicated in the tables below, reflected in the Group s statutory results.

Set out below is a reconciliation from the Group s statutory results to the continuing businesses basis, together with a brief commentary.

2008	Statutory[1] £m	Removal of Volatility £m	Provision for historic US dollar payments £m	Financial Services Compensation Scheme levy £m	Goodwill impairment £m	Continuing businesses[1] £m	Removal of insurance gross up £m	Continuing businesses excluding insurance gross up[1] £m
Net interest income	7,718	(9)				7,709	(651)	7,058
Other income	(709)	1,226				517	3,624	4,141
Total income	7,009	1,217				8,226	2,973	11,199
Insurance claims	2,859					2,859	(3,052)	(193)
Total income, net of insurance claims	9,868	1,217				11,085	(79)	11,006
Operating expenses	(6,100)		180	122	100	(5,698)	69	(5,629)
Trading surplus	3,768	1,217	180	122	100	5,387	(10)	5,377
Impairment	(3,012)					(3,012)		(3,012)
Share of results of joint ventures and associates	4					4		4
Profit before tax	760	1,217	180	122	100	2,379	(10)	2,369

1 Restated for IFRS 2 (Revised).

2007	Statutory[1] £m	Removal of Volatility £m	Discontinued businesses £m	Profit on sale of businesses £m	Settlement of overdraft claims £m	Continuing businesses[1] £m	Removal of insurance gross up £m	Continuing businesses excluding insurance gross up[1] £m

Net interest income	6,099	(7)	(70)			6,022	(421)	5,601
Other income	12,119	506	(858)			11,767	(6,233)	5,534
Total income	18,218	499	(928)			17,789	(6,654)	11,135
Insurance claims	(7,522)		605			(6,917)	6,615	(302)
Total income, net of insurance claims	10,696	499	(323)			10,872	(39)	10,833
Operating expenses	(5,568)		161		76	(5,331)	13	(5,318)
Trading surplus	5,128	499	(162)		76	5,541	(26)	5,515
Impairment	(1,796)					(1,796)		(1,796)
Share of results of joint ventures and associates	10					10		10
Profit on sale and closure of businesses	657			(657)				
Profit before tax	3,999	499	(162)	(657)	76	3,755	(26)	3,729

1 Restated for IFRS 2 (Revised).

Profit before tax on a continuing businesses basis decreased by £1,376 million, or 37 per cent, to £2,379 million in 2008 compared to £3,755 million in 2007; this deterioration in profit reflected a £990 million increase in the adverse impact of market dislocation and a significant increase in impairment losses.

Total income, excluding insurance gross up, was £64 million higher at £11,199 million in 2008 compared to £11,135 million in 2007. However, excluding the negative impact on income of the market dislocation of £925 million (2007: £188 million), total income, excluding insurance gross up, was £801 million, or 7 per cent, higher at £12,124 million in 2008 compared to £11,323 million in 2007.

This growth reflected increased income from both new and existing customers, with growth in both assets and liabilities leading to higher net interest income, as well as an increase in fee-related income.

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Net interest income, excluding insurance grossing, increased by £1,457 million, or 26 per cent, to £7,058 million. During 2008, total assets increased by £82,687 million, or 23 per cent to £436,033 million, with a £30,530 million, or 15 per cent, increase in loans and advances to customers to £240,344 million compared to £209,814 million at 31 December 2007, reflecting customer lending growth in both corporate banking and mortgages. Customer deposits increased by £14,383 million, or 9 per cent, to £170,938 million compared to £156,555 million at 31 December 2007, supported by good growth in savings balances in the retail bank, where bank savings increased by 12 per cent and wealth management balances by 20 per cent.

The net interest margin was largely flat, as improved product margins were offset by an adverse mix effect. There were increased new business product margins in the mortgage and corporate businesses; however, higher growth in finer margin corporate and mortgage lending than in the wider margin unsecured consumer lending contributed to the negative mix effect which offset the increase in product margins.

Other income, excluding insurance grossing, decreased by £1,393 million, or 25 per cent, to £4,141 million, compared to £5,534 million in 2007, largely reflecting the impact of market dislocation. In the retail bank, higher fees and commissions receivable as a result of growth in added value current accounts and card services were offset by lower creditor insurance commissions and the impact of changes in product design leading to a greater proportion of earnings being recognised as net interest income rather than fee income. In addition, growth was achieved in fee-based product sales to commercial banking customers.

The Group continued to invest in improving processing efficiency, resulting in control over day-today operating costs. During 2008, operating expenses excluding the insurance grossing adjustment increased by £311 million, or 6 per cent, to £5,629 million compared to £5,318 million in 2007.

Impairment losses increased by £1,216 million, or 68 per cent, to £3,012 million in 2008 compared to £1,796 million in 2007. Excluding the impact of market dislocation of £345 million (2007: £92 million), impairment losses increased by £963 million, or 57 per cent, to £2,667 million in 2008 compared to £1,704 million in 2007.

In UK Retail Banking, impairment losses increased by £248 million, or 20 per cent, to £1,472 million, particularly reflecting the impact of lower house prices on the mortgage impairment charge. The Wholesale and International Banking charge for impairment losses increased significantly by £936 million to £1,508 million, including the £345 million impairment charge relating to the impact of market dislocation during 2008. The remaining charge reflected an increase in the level of impairments as a result of the economic slowdown in the UK and the impact of a number of high profile financial services company collapses.

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AVERAGE BALANCE SHEET AND NET INTEREST INCOME

	2009 Average balance £m	**2009 Interest income £m**	**2009 Yield %**	2008 Average balance £m	2008 Interest income £m	2008 Yield %	2007 Average balance £m	2007 Interest income £m	2007 Yield %
Assets									
Loans and receivables:									
Loans and advances to banks	**65,440**	**769**	**1.18**	39,004	1,847	4.74	39,381	2,025	5.14
Loans and advances to customers	**675,092**	**24,171**	**3.58**	218,220	13,808	6.33	191,802	13,209	6.89
Debt securities	**39,911**	**1,469**	**3.68**	2,419	61	2.52			
Lease and hire purchase receivables	**14,165**	**852**	**6.01**	9,266	706	7.62	9,488	602	6.34
Available-for-sale financial assets	**54,926**	**977**	**1.78**	25,058	1,147	4.58	21,473	1,038	4.83
Total interest-earning assets of banking book	**849,534**	**28,238**	**3.32**	293,967	17,569	5.98	262,144	16,874	6.44
Total interest-earning trading securities and other financial assets at fair value through profit or loss	**59,849**	**2,224**	**3.72**	24,292	1,577	6.49	28,524	1,542	5.41
Total interest-earning assets	**909,383**	**30,462**	**3.35**	318,259	19,146	6.02	290,668	18,416	6.34
Allowance for impairment losses on loans and advances	**(9,551)**			(2,838)			(2,268)		
Non-interest earning assets	**164,056**			60,939			66,202		
Total average assets and interest income	**1,063,888**	**30,462**	**2.86**	376,360	19,146	5.09	354,602	18,416	5.19

	2009 Average interest earning assets £m	**2009 Net interest income £m**	**2009 Net interest margin %**	2008 Average interest earning assets £m	2008 Net interest income £m	2008 Net interest margin %	2007 Average interest earning assets £m	2007 Net interest income £m	2007 Net interest margin %
Average interest-earning assets and net interest income:									
Banking business	**849,534**	**9,026**	**1.06**	293,967	7,718	2.63	262,144	6,099	2.33
Trading securities and other financial assets at fair value through profit or loss	**59,849**	**1,706**	**2.85**	24,292	1,151	4.74	28,524	1,179	4.13
	909,383	**10,732**	**1.18**	318,259	8,869	2.79	290,668	7,278	2.50

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	2009 Average balance £m	**2009 Interest expense £m**	**2009 Cost %**	2008 Average balance £m	2008 Interest expense £m	2008 Cost %	2007 Average balance £m	2007 Interest expense £m	2007 Cost %
Liabilities and shareholders funds									
Deposits by banks	**93,234**	**883**	**0.95**	42,150	1,540	3.65	38,406	1,919	5.00
Liabilities to banks under sale and repurchase agreements	**42,794**	**1,399**	**3.27**	5,643	253	4.48	3,127	153	4.89
Customer deposits	**357,323**	**4,410**	**1.23**	151,013	4,932	3.27	142,048	5,085	3.58
Liabilities to customers under sale and repurchase agreements	**41,890**	**256**	**0.61**	106	3	2.83	95	2	2.11
Debt securities in issue	**247,079**	**6,318**	**2.56**	54,359	2,227	4.10	52,743	2,680	5.08
Other interest-bearing liabilities	**10,865**	**1,621**	**14.92**	4,239			4,551	195	4.28
Subordinated liabilities	**43,033**	**4,325**	**10.05**	15,400	896	5.82	13,126	741	5.65
Total interest-bearing liabilities of banking book	**836,218**	**19,212**	**2.30**	272,910	9,851	3.61	254,096	10,775	4.24
Total interest-bearing liabilities of trading book	**28,639**	**518**	**1.81**	11,769	426	3.62	9,971	363	3.64
Total interest-bearing liabilities	**864,857**	**19,730**	**2.28**	284,679	10,277	3.61	264,067	11,138	4.22
Interest-free liabilities									
Non-interest bearing customer accounts	**6,902**			3,793			3,899		
Other interest-free liabilities	**158,881**			76,584			74,628		
Minority interests and shareholders funds	**33,248**			11,304			12,008		
Total average liabilities and interest expense	**1,063,888**	**19,730**	**1.85**	376,360	10,277	2.73	354,602	11,138	3.14

Loans and advances to banks and customers include impaired lending; interest on this lending has been recognised using the effective interest rate method, as required by IAS 39.

Average balances are based on daily averages for the principal areas of the Lloyds Banking Group s banking activities with monthly or less frequent averages used elsewhere. Management believes that the interest rate trends are substantially the same as they would be if all balances were averaged on the same basis.

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The analysis of average balances and interest for 2009 between domestic and international offices is as follows:

	Domestic			Foreign			Total		
	Average Balance £m	Interest income £m	Yield %	Average balance £m	Interest income £m	Yield %	Average balance £m	Interest income £m	Yield %
Assets									
Loans and receivables:									
Loans and advances to banks	57,500	594	1.03	7,940	175	2.20	65,440	769	1.18
Loans and advances to customers	619,856	22,092	3.56	55,236	2,079	3.76	675,092	24,171	3.58
Debt securities	38,189	1,439	3.77	1,722	30	1.74	39,911	1,469	3.68
Lease and hire purchase receivables	13,673	836	6.11	492	16	3.25	14,165	852	6.01
Available-for-sale financial assets	46,787	896	1.92	8,139	81	1.00	54,926	977	1.78
Total interest-earning assets of banking book	776,005	25,857	3.33	73,529	2,381	3.24	849,534	28,238	3.32
Total interest-earning trading securities and other financial assets at fair value through profit or loss	59,571	2,213	3.71	278	11	3.96	59,849	2,224	3.72
Total interest-earning assets	835,576	28,070	3.36	73,807	2,392	3.24	909,383	30,462	3.35
Allowance for impairment losses on loans and advances	(5,740)			(3,811)			(9,551)		
Non-interest earning assets	159,516			4,540			164,056		
Total average assets and interest income	989,352	28,070	2.84	74,536	2,392	3.21	1,063,888	30,462	2.86
Percentage of assets applicable to foreign activities (%)							7.01		

	Domestic			Foreign			Total		
	Average balance £m	Interest expense £m	Cost %	Average balance £m	Interest expense £m	Cost %	Average balance £m	Interest expense £m	Cost %
Liabilities and shareholders funds									
Deposits by banks	63,207	653	1.03	30,027	230	0.77	93,234	883	0.95
Liabilities to banks under sale and repurchase agreements	42,794	1,399	3.27				42,794	1,399	3.27
Customer deposits	349,709	4,255	1.22	7,614	155	2.04	357,323	4,410	1.23
Liabilities to customers under sale and repurchase agreements	41,827	256	0.61	63			41,890	256	0.61
Debt securities in issue	222,212	6,099	2.74	24,867	219	0.88	247,079	6,318	2.56
Other interest-bearing liabilities	10,865	1,621	14.92				10,865	1,621	14.92
Subordinated liabilities	42,183	4,276	10.14	850	49	5.76	43,033	4,325	10.05
Total interest-bearing liabilities of banking book	772,797	18,559	2.40	63,421	653	1.03	836,218	19,212	2.30
Total interest-bearing liabilities of trading book	28,639	518	1.81				28,639	518	1.81
Total interest-bearing liabilities	801,436	19,077	2.38	63,421	653	1.03	864,857	19,730	2.28
Interest-free liabilities	6,253			649			6,902		

Non-interest bearing customer accounts									
Other interest-free liabilities	**157,426**			1,455			158,881		
Minority interests and shareholders funds	**24,237**			9,011			33,248		
Total average liabilities and interest expense	**989,352**	**19,077**	**1.93**	**74,536**	**653**	**0.88**	**1,063,888**	**19,730**	**1.85**
Percentage of liabilities applicable to foreign activities (%)							**6.36**		

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CHANGES IN NET INTEREST INCOME VOLUME AND RATE ANALYSIS

The following table allocates changes in net interest income between volume and rate for 2009 compared with 2008 and for 2008 compared with 2007. Where variances have arisen from both changes in volume and rate these are allocated to volume.

	2009 compared with 2008 Increase/(decrease)			2008 compared with 2007 Increase/(decrease)		
	Total change £m	**Volume £m**	**Rate £m**	Total change £m	Volume £m	Rate £m
Interest receivable and similar income						
Loans and receivables:						
Loans and advances to banks	**(1,078)**	**311**	**(1,389)**	(178)	(18)	(160)
Loans and advances to customers	**10,363**	**16,358**	**(5,995)**	599	1,672	(1,073)
Debt securities	**1,408**	**1,380**	**28**	61	61	
Lease and hire purchase receivables	**146**	**295**	**(149)**	104	(17)	121
Available-for-sale financial assets	**(170)**	**531**	**(701)**	109	164	(55)
Total banking book interest receivable and similar income	**10,669**	**18,875**	**(8,206)**	695	1,862	(1,167)
Total interest receivable and similar income on trading securities and other financial assets at fair value through profit or loss	**647**	**1,321**	**(674)**	35	(275)	310
Total interest receivable and similar income	**11,316**	**20,196**	**(8,880)**	730	1,587	(857)
Interest payable						
Deposits by banks	**(657)**	**484**	**(1,141)**	(379)	137	(516)
Liabilities to banks under sale and repurchase agreements	**1,146**	**1,215**	**(69)**	100	113	(13)
Customer deposits	**(522)**	**2,546**	**(3,068)**	(153)	293	(446)
Liabilities to customers under sale and repurchase agreements	**253**	**255**	**(2)**	1		1
Debt securities in issue	**4,091**	**4,928**	**(837)**	(453)	66	(519)
Other interest bearing liabilities	**1,621**	**989**	**632**	(195)		(195)
Subordinated liabilities	**3,429**	**2,777**	**652**	155	132	23
Total banking book interest payable	**9,361**	**13,194**	**(3,833)**	(924)	741	(1,665)
Total interest payable on trading and other liabilities at fair value through profit or loss	**92**	**305**	**(213)**	63	65	(2)
Total interest payable	**9,453**	**13,499**	**(4,046)**	(861)	806	(1,667)

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

RISK MANAGEMENT

THE GROUP S APPROACH TO RISK

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

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

The group business risk committee and the group asset and liability committee are chaired by the group chief executive and include all members of the group executive committee. The aggregate group wide risk profile and portfolio appetite are discussed at these monthly meetings. The risk oversight committee, chaired by the deputy group chairman, comprises non-executive directors and oversees the Group s risk exposures. This second-line-of-defence committee is supported by the chief risk officer, who is independent of the front line business units, is a full member of the group executive committee and reports to the group chief executive. The chief risk officer regularly informs the risk oversight committee of the aggregate risk profile and has direct access to the deputy group chairman and the members of the risk oversight committee.

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

RISK AS A STRATEGIC DIFFERENTIATOR

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

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

As part of its integration initiative, the Group has been rolling out the methodology and financial control framework that was used by heritage Lloyds TSB; this includes compliance with the requirements of the US Sarbanes Oxley Act. This project is due to complete in time for reporting in February 2011.

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

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

STATE AID

The Group is subject to European state aid obligations as a result of the aid it received from HM Treasury. In November 2009 the European Commission, through its College of Commissioners, approved the Group s restructuring plan, which is designed to address any competition distortions arising from the benefits of state aid. The Group agreed with HM Treasury in the deed relating to its withdrawal from GAPS that it will comply with the terms of the European Commission s decision. This has placed a number of requirements on the Group including the disposal of certain portions of its business over the course of the next four years, including in particular the disposal of some parts of its retail banking business. This will require the Group to work closely with EU and UK authorities to demonstrate that it is complying with the terms of the European Commission s decision.

HM Treasury holds approximately 41.3 per cent of the Group s ordinary share capital. There is a risk that this shareholding could in future be used to seek to exercise influence over the affairs or strategic business plans of the Group, particularly if other Government priorities or HM Treasury s interests as a major shareholder in other financial institutions do not align with their interests purely as a shareholder in the Group.

United Kingdom Financial Investments has been appointed manager of HM Treasury s shareholding and the framework document between UKFI and HM Treasury states that UKFI will manage the UK financial institutions in which HM Treasury holds an interest on a commercial basis and will not intervene in day-to-day management decisions of the Investee Companies (as defined therein) . This document also makes it clear that such institutions will continue to be separate economic units with independent powers of decision and will continue to have their own independent boards and management teams, determining their own strategies and commercial policies including business plans and budgets .

In addition, the Group has made a number of undertakings to HM Treasury associated with the state aid it has received, including the provision of additional lending to certain mortgage and business sectors, and other matters relating for instance to corporate governance and staff remuneration. These commitments could limit the operational flexibility of the Group or lead HM Treasury to seek to influence the strategy of the Group in other ways.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

RISK GOVERNANCE

The Group has rolled out the heritage Lloyds TSB approach to risk appetite, policies, delegations and risk committee structure and has continued to embed these across all risk disciplines and into the business. Having achieved alignment of all high level group principles and appetites on the date of acquisition, the Group has continued to embed these at all levels.

The risk governance structure is intended to strengthen risk evaluation and management, whilst also positioning the Group to manage the changing regulatory environment in an efficient and effective manner. The risk governance structure for Lloyds Banking Group is shown in the table on page 59.

BOARD AND COMMITTEES

The board, assisted by its key risk committees (risk oversight committee and group audit committee), approves the Group s overall risk management framework. The board also reviews the Group s aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board s appetite for risk. The role of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 123 to 128, and further key risk oversight roles are described below.

In particular, the **risk oversight committee**, which comprises non-executive directors, oversees the development, implementation and maintenance of the group s overall risk management framework and its risk appetite, strategy, principles and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The risk oversight committee regularly reviews the Group s risk exposures across the primary risk drivers and the detailed risk types.

The **group executive committee** assisted by the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the effectiveness of the Group s risk management framework and the clear articulation of the Group s risk policies, whilst also reviewing the Group s aggregate risk exposures and concentrations of risk. The GEC s duties are described in greater detail on page 125.

The **group asset and liability committee** is responsible for the strategic management of the Group s assets and liabilities and the profit and loss implications of balance sheet management actions. It is also responsible for the risk management framework for market risk, liquidity risk, capital risk and earnings volatility. The group asset and liability committee is supported by the **senior asset and liability committee**, which is responsible for the review of documentation relating to the management of assets and liabilities in the Group s balance sheet and the escalation of issues of group level significance to the group asset and liability committee.

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

The group business risk committee is supported by the following committees:

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

The **group credit risk committee**, which is responsible for the development and effectiveness of the Group s credit risk management framework, clear description of the Group s credit risk appetite, setting of high level Group credit policy, and compliance with regulatory credit requirements. On behalf of the group business risk committee, the group credit risk committee monitors and reviews the Group s aggregate credit risk exposures and concentrations of risk.

The **group model governance and approvals committee**, which is responsible for setting the control framework and standards for models across the Group, including establishing appropriate levels of delegated authority, the approval of models that are considered to be material to the Group (including credit risk rating systems), and the principles underlying the Group s economic capital framework.

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

During the year, the Group has created **divisional financial control committees** to provide governance over financial statements. The meetings provide review and challenge as to the veracity of the results, press release and supporting analyst information addressing the processes that have been followed in drawing them up. Items of focus are key assumptions and areas of subjectivity in the results and ensuring proper remediation of control issues that impact internal controls over financial reporting, the Group s auditors also report findings from their audit work.

The group risk directors and divisional risk officers meet on a regular basis under the chairmanship of the chief risk officer to review and challenge the risk profile of the Group and seek to ensure that mitigating actions are appropriate. Aggregate risk reports are reviewed by this group before submission to group business risk committees and then to risk oversight committee.

Group executive directors have primary responsibility for measuring, monitoring and controlling risks within their areas of accountability and are required to establish control frameworks for their businesses that are consistent with the Group s high level policies and within the parameters set by the board, group executive committee and group risk. Compliance with policies and parameters is overseen by the risk oversight committee, the group business risk committee, the group asset and liability committee, group risk and the divisional risk officers.

RISK MANAGEMENT OVERSIGHT

The chief risk officer oversees and promotes the development and implementation of a consistent group-wide risk management framework. The chief risk officer, supported by the group risk directors and the divisional risk officers, provides objective challenge to the Group s senior management. The group executive committee and the board receive regular briefings and guidance from the chief risk officer to ensure awareness of the overarching risk management framework and a clear understanding of their accountabilities for risk and internal control.

RISK GOVERNANCE STRUCTURES

Group risk directors who report directly to the chief risk officer, are allocated responsibility for certain specific risk types and are responsible for ensuring the adequacy of the framework for their risk types as well as the oversight of the risk profile across the Group. Divisional risk officers have dual reporting lines to their own divisional executive and also to the chief risk officer and are responsible for the risk profile within their own divisions. This matrix approach enables the group executive committee members to fulfil their risk management accountabilities.

Divisional risk officers provide oversight of risk management activity for all risks within each of the Group s divisions. Reporting directly to the group executive directors responsible for the divisions and to the chief risk officer, their day-to-day contact with business management, business operations and risk initiatives seeks to provide an effective risk oversight mechanism.

The director of group audit provides independent assurance to the audit committee and the board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group audit is fully independent of group risk, seeking to ensure objective challenge to the effectiveness of the risk governance framework.

RISK MANAGEMENT IN THE BUSINESS

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

All business units, divisions and group functions complete a control self assessment annually (see page 127), reviewing the effectiveness of their internal controls and putting in place a programme of enhancements where appropriate. Managing directors of each business and each group executive committee member certify the accuracy of their assessment.

Risk management in the business forms part of a tiered risk management model, as shown above, with the divisional risk officers and group risk providing oversight and challenge, as described above, and the chief risk officer and group committees establishing the group-wide perspective.

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

RISK MANAGEMENT FRAMEWORK

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

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

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

The Lloyds Banking Group business strategy and objective is used to determine the Group s high level risk principles and risk appetite measures and metrics for the primary risk drivers (see the table on page 63). The risk appetite is proposed by the group chief executive and reviewed by various governance bodies including the group executive committee and the risk oversight committee. Responsibility for the approval of risk appetite rests with the board. The approved high level appetite and limits are delegated to individual group executive committee members by the group chief executive.

The more detailed description of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses are determined by the group chief executive, in consultation with the group business risk committee and the group asset and liability committee.

The risk principles are executed through the **policy framework and accountabilities.** These principles are supported by the policy levels below:

Principles high level principles for the six primary risk drivers

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

Detailed group policy detailed policy that applies across the Group

Divisional policy local policy that specifically applies to a division

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

Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy and the associated accountabilities are clearly outlined to all colleagues. Colleagues are expected to be aware of policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all colleagues within that area.

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

Execution of the Group s risk management framework is dependent upon a clear and consistent **risk identification** using a common language to define risks and to categories them (see the table on page 63).

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

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

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

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

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

At group level, a consolidated risk report is produced which is reviewed and debated by the group business risk committee, group executive committee, audit committee, risk oversight committee and the board to ensure that they are satisfied with the overall risk profile, risk accountabilities and mitigating actions. The consolidated risk report provides a regular assessment of the aggregate residual risk for the primary risk drivers, comparing the assessment with the previous quarter and providing a forecast for the next 12 months.

PRINCIPAL RISKS

At present the most significant risks faced by the Group, which are derived from the primary risk drivers detailed in the table on page 63, include:

Risk: Definition	Features
Credit: The risk of reductions in earnings and/or value, through Financial loss, as a result of the failure of the party with whom the Group has contracted to meet its obligations (both on and off balance sheet).	Arising in the Retail, Wholesale and Wealth and International divisions, reflecting the risks inherent in the Group s lending activities and in the Insurance division in respect of investment of own funds. Over the last two years the deteriorating economic outlook, both in the UK and overseas, brought about by the banking crisis has impacted the financial services industry resulting in further high profile losses and writedowns. The Group is impacted by the economic downturn and a further worsening of the business environment could adversely impact earnings. This poses a major risk to the Group and its lending to: Retail customers (including those in Wealth and International): where reducing affordability and/or asset values arising from a combination of house price falls, continuing high, or increasing levels of unemployment, consumer over-indebtedness, and rising interest rates impacts both secured and unsecured retail exposures. Wholesale customers (including those in Wealth and International): where companies are facing increasingly difficult business conditions, resulting in corporate default levels rising and leading to increases in corporate impairment. The Group has high levels of exposure in both the UK and internationally, including Ireland, USA, Australia and Spain. There are particular concentrations to: financial institutions, commercial real estate, and joint ventures, with high leverage and exposures through capital structure.

The Group follows a through the economic cycle, relationship based, business model with risk management processes, appetites and experienced staff in place.

Legal and regulatory: The risk of regulatory action leading to fine and/or public censure and/or successful legal action being taken against the Group as a result of failure to meet one or more legal and/or regulatory requirements either in the UK or overseas.

The industry is currently subject to a wide range of international and UK consultations on proposals to change the regulatory requirements. For example the Basel Committee on Banking Supervision has issued proposals with respect to capital and liquidity requirements for banks (Strengthening the resilience of the banking sector and International framework for liquidity risk measurement, standards and monitoring) and draft proposals have also been issued for new capital requirements for insurers (Solvency II). In the UK we have seen the Turner review and more recently, proposals have been issued for governance, recovery and resolution (Living Wills) arrangements and also, potentially conduct of business requirements, which could have significant implications for past business as well as future product offerings for customers. There is a high level of uncertainty both as to the financial outcome in terms of specific requirements and the speed of implementation in the UK and internationally.

The Group is currently assessing the impacts of these regulatory proposals, and will participate in the consultation and calibration processes to be undertaken by the various regulatory bodies during 2010. The Group currently meets and exceeds its regulatory capital requirements and expects to continue to do so. However, the FSA could impose more stringent capital and liquidity requirements, and/or introduce new ratios and/or change the manner in which it applies existing requirements to recapitalised banks, including those within the Group. Any one or combination of these events could result in the Group being forced to raise further capital or to divest assets.

The Group has made good preparations for the FSA s new liquidity regime (ILAS) and is ready to meet the reporting implications later in the year.

Lloyds Banking Group s policy is to maintain high levels of compliance with regulatory requirements and it will organise its business to maintain this level of compliance as the requirements become clearer, being mindful of maintaining an appropriate balance between risk and reward.

Risk: Definition	Features
Liquidity and funding: 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.	Arising in the banking business of the Group and impacting the Retail, Wholesale and Wealth and International divisions reflecting the risk that the Group is unable to attract and retain either retail, wholesale or corporate deposits or issue debt securities. Like all major banks, the Group is dependent on confidence in the short and longer term wholesale funding markets; should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding and provide liquidity when necessary, it could impact its ability to fund its financial obligations.
Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.	The key dependencies for successfully funding the Group s balance sheet include the continued functioning of the money and capital markets at their current levels; successful right sizing of the Group s balance sheet; the continuation of HM Treasury facilities in accordance with the terms agreed; limited further deterioration in the UK s and the Group s credit rating and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or UK Government support schemes. A return to the extreme market conditions of 2008 would place a strain on the Group s ability to meet its financial commitments. Liquidity risk is managed within a board approved framework using a range of metrics to monitor the Group s Profile against its stated appetite and potential market conditions.
Customer treatment: The risk of regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment.	Customer treatment and how the Group manages its customer relationships affects all aspects of Lloyds Banking Group s operations and is closely aligned with achievement of Lloyds Banking Group s strategic aim to create deep long lasting relationships with its customers. There is currently a high level of scrutiny regarding the treatment of customers by financial institutions from the press, politicians and regulatory bodies. The Office of Fair Trading s (OFT) investigation and legal test case in respect of unarranged overdraft charges on personal current accounts concluded in 2009, for further details see note 52 to the consolidated financial statements. The OFT is however continuing to discuss its concerns in relation to the personal current account market with the banks, consumer groups and other organisations under the auspices of its Market Study into personal current accounts. In October 2009, the OFT published voluntary initiatives agreed with the industry and consumer groups to improve transparency of the costs and benefits of personal current accounts and improvements to the switching process. The OFT aims to report on progress in respect of further changes it believes are required to make the market work in the best interest of bank customers by the end of March 2010. The Group regularly reviews its product range to ensure that it meets regulatory requirements and is competitive in the market place. Treating Customers Fairly remains the key principle underpinning the FSA s consumer protection objective. An additional challenge for Lloyds Banking Group is ensuring the fair treatment of customers during integration of the two heritage businesses. As a result the customer relationship management risks posed by integration are carefully considered through the integration governance process in place. If Lloyds Banking Group is unable to demonstrate the fair treatment of its customers there is the risk of increased complaints from customers, the potential for regulatory action (which could include reviews of past business and/or the payment of fines and compensation) and adverse media coverage (leading to reputational damage in the marketplace). The Group has policies, procedures and governance arrangements in place to facilitate the fair treatment of customers.

People: The risk of reduction in earnings and/or value, through financial or reputational loss, from failure to retain, train, reward, recruit and incentivise appropriately skilled staff, inappropriate staff behaviour or industrial action.	The delivery of Lloyds Banking Group s objectives is underpinned by the ability to attract, retain and develop the best talent in the industry. The challenges to the people agenda have never been greater with increased regulatory and public interest in remuneration practices, the effects of the Government shareholding and the impacts of integration. Lloyds Banking Group welcomes the regulation of remuneration provided there is an international consensus and will comply with the FSA Code. The Group has managed the initial stages of integration, working to establish control by defining and implementing the new organisational structures and continues to manage the relationship with colleagues during this period of change. The Group has policies, procedures and governance arrangements in place to ensure the effective management of people risk as the Group integrates and grows its business. The Group has published proposals to harmonise employee terms and conditions across the Group and is consulting with the various representative unions. The Group actively manages its relationships with unions, but is aware of the danger of industrial action, business disruption and reputational impact arising from union behaviour and communications. People risk is closely monitored as a key risk indicator, as well as being subject to oversight by the board.
Integration: The risk that Lloyds Banking Group fails to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or incurs unanticipated costs and losses associated with, the acquisition of HBOS plc.	The integration of the two legacy organisations presents one of the largest integration challenges that has been seen in the UK financial services industry. There is a risk that the Group may fail to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from the acquisition of HBOS plc by Lloyds TSB Group plc, or may incur unanticipated costs and losses associated as a result. As a consequence, the Group results may suffer as a result of operational, financial management and other integration risks. The risk of failure to deliver synergy benefits or to meet publicly stated targets could potentially result in a loss of shareholder or market confidence with negative perceptions of the Group s integration strategy. As the Group goes through the integration process there is a danger of losing key staff potentially impacting upon integration plans. The Group has created an integration execution board, chaired by the group operations director, to oversee the integration process. The Group is now one year into the integration programme and has a fully developed and functioning governance framework to manage these risks, with clear understanding of the dependencies and phased deliverables through to 2012. The programme is ahead of plan.

RISK DRIVERS

RISK DRIVERS

The Group s risk language is designed to capture the Group s primary risk drivers . A description of each primary risk driver , including definition, appetite, control and exposures, is included below. These are further sub divided into 29 more granular risk types to enable more detailed review and facilitate appropriate reporting and monitoring, as set out in the table above.

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

BUSINESS RISK

DEFINITION

Business risk is defined as the risk that the Group s earnings are adversely impacted by a sub optimal business strategy or the sub optimal implementation of the strategy. In assessing business risk, consideration is given to internal and external factors.

RISK APPETITE

Business risk appetite is encapsulated in the Group s budget and medium-term plan, which are sanctioned by the board on an annual basis. Divisions and business units plans are aligned to the Group s overall business risk appetite.

EXPOSURES

The Group s portfolio of businesses exposes it to a number of internal and external factors:

- internal factors: resource capability and availability, customer treatment, service level agreements, products and funding and the risk appetite of other risk categories; and
- external factors: economic, technological, political, social and ethical, environmental, legal and regulatory, market expectations, reputation and competitive behaviour.

MEASUREMENT

An annual business planning process is conducted at group, divisional and business unit level which includes a quantitative and qualitative assessment of the risks that could impact the Group s plans. Within the planning round, the Group conducts both scenario analysis and stress tests to assess risks to future earning streams. Stress testing and scenario analysis are fully embedded in the Group s risk management practice. The Group assesses a wide array of scenarios including economic recessions, regulatory action and scenarios specific to the operations of each part of the business.

MITIGATION

As part of the annual business planning process, the Group develops a set of management actions to prevent or mitigate the impact on earnings in the event that business risks materialise. Additionally, business risk monitoring, through regular reports and oversight, results in corrective actions to plans and reductions in exposures where necessary.

Revenue and capital investment decisions require additional formal assessment and approval. Formal risk assessment is conducted as part of the financial approval process. Significant mergers and acquisitions by business units require specific approval by the board. In addition to the standard due diligence conducted during a merger or acquisition, group risk conducts, where appropriate, an independent risk assessment of the target company.

MONITORING

The Group s strategy is reviewed and approved by the board. Reputational risk is covered at a number of levels throughout the organisation, which includes the group executive committee and the group business risk committee. Regular reports are provided to the group executive committee and the board on the progress of the Group s key strategies and plans. Group risk conducts oversight to seek to ensure that business plans remain consistent with the Group s strategy.

APPROACH

The Group has adapted the heritage Lloyds TSB business risk approach which includes stress testing the medium term plan to changes in economic assumptions. The output of this stress testing is used to determine investment decisions.

CREDIT RISK

DEFINITION

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

RISK APPETITE

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

This statement of the Group s overall appetite for credit risk is reviewed and approved annually by the board. With the support of the group credit risk committee and group business risk committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that credit risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. The credit risk exposures of the Group are set out in note 54 to the consolidated financial statements. Credit risk exposures are categorised as retail arising in the Retail and Wealth and International Divisions and wholesale arising in the Wholesale and Wealth and International Divisions.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer as required. These commitments can take the form of loans and overdrafts, or credit instruments such as guarantees and standby, documentary and commercial letters of credit. With respect to commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most retail commitments to extend credit can be cancelled and the credit worthiness of customers is monitored frequently. In addition, most wholesale commitments to extend credit are contingent upon customers maintaining specific credit standards, which are regularly monitored.

Credit risk can also arise from debt securities, private equity investments, derivatives and foreign exchange activities. Note 18 to the consolidated financial statements shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2009. 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 54 on page F-103.

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

MEASUREMENT

In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Group reflects three components: (i) the probability of default by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and their likely future development, from which the Group derives the exposure at default ; and (iii) the likely loss ratio on the defaulted obligations (the loss given default).

The Group assesses the probability of default of individual counterparties using internal rating models tailored to the various categories of counterparty. In its principal retail portfolios and a growing number of wholesale lending portfolios, exposure at default and loss given default models are also in use. They have been developed internally and use statistical analysis, combined, where appropriate, with external data and subject matter expert judgement. Each rating model is subject to a rigorous validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible. All material rating models are authorised by the group model governance committee.

Each probability of default model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. Exposures migrate between classifications if the assessment of the obligor probability of default changes. Each rating system is required to map to a master scale, which supports the consolidation of credit risk information across portfolios through the adoption of a common rating scale. Given the differing risk profiles and credit rating considerations, the underlying risk reporting has been split into two distinct master scales, a retail master scale and a wholesale master scale. (Note 54 on page F-104 provides an analysis of the portfolio).

The rating systems described above assess probability of default, exposure at default and loss given default, in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment (see note 2(H) to the consolidated financial statements on page F-14). Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the expected loss models that are used for internal operational management and banking regulation purposes.

MITIGATION

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

INTERNAL CONTROL

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

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

Credit scoring: In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring). Divisional risk departments review scorecard effectiveness and approve changes, with material changes being subject to group risk approval.

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

Controls over rating systems: The Group has established an independent team in group risk that sets common minimum standards, designed to challenge the discriminatory powers of systems, accuracy of calibration and seeks to ensure consistency over time and across obligors. Internal rating systems are developed and implemented by independent risk functions either in the business units or divisions with the business unit managing directors having ownership of the systems. Line management takes responsibility for ensuring the validation of the respective internal rating systems, supported and challenged by specialist functions in their respective division.

Cross-border and cross-currency exposures: Country limits are authorised by the Country Limits Panel taking into account economic and political factors.

Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite. Credit policy is aligned to the Group s risk appetite and restricts exposure to certain high risk and more vulnerable sectors and segments. Note 20 to the consolidated financial statements provides an analysis of loans and advances to customers by industry (for wholesale customers) and product (for retail customers). Exposures are monitored to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. The Group s large exposures are reported in accordance with regulatory reporting requirements.

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

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

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

Risk assurance and oversight: Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.

COLLATERAL

The principal collateral types for loans and advances are:

- mortgages over residential and commercial real estate;
- charges over business assets such as premises, inventory and accounts receivable;
- charges over financial instruments such as debt securities and equities; and
- guarantees received from third parties.

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

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

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

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

MASTER NETTING AGREEMENTS

Where it is efficient and likely to be effective (generally with counterparties with which it undertakes a significant volume of transactions), the Group enters into master netting agreements. Although master netting agreements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis, they do reduce the credit risk to the extent that, if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group s overall exposure to credit risk on derivative instruments subject to master netting agreements can change substantially within a short period since it is affected by each transaction subject to the agreement.

OTHER CREDIT RISK TRANSFERS

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

MONITORING

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

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

APPROACH

The Group has largely adopted the heritage Lloyds TSB credit risk approach, including governance structure, sanctioning processes and risk appetite controls and framework. Integrated, prudent through the cycle credit policies and procedures have mostly all been established and implemented across the Group, supported by robust early warning indicators and triggers.

Following a prioritised appointment process an integrated credit risk management structure is in place throughout the Group, using the most experienced and skilled resources from both heritages. Substantial work has been undertaken to analyse portfolios and where necessary the Group has taken actions to manage effectively its exposure through the economic downturn. These actions have included revised credit criteria for key products and a withdrawal from those business sectors that are outside of the Group s risk appetite.

The Group has formed a group level Credit Risk Assurance function with experienced credit professionals from both heritages. Together with Divisional Risk senior management, this team has carried out an independent risk-based review of the high risk wholesale and retail books. Nearly £150 billion of high risk wholesale assets, primarily HBOS commercial real estate and corporate exposures, have been reviewed by the team. This has required a detailed file by file review of the original credit application, subsequent management papers and an understanding of the supporting collateral. In addition, portfolio level analysis and investigation, together with statistically robust sampling of accounts, have been carried out for over £300 billion of retail assets. These comprehensive reviews have greatly enhanced the Group s knowledge and understanding of the legacy portfolios and have enabled the Group to assess and manage these exposures confidently and effectively.

To support corporate customers that encounter difficulties during the current economic downturn the Group has continued to expand its dedicated Business Support Unit (BSU) model. Teams have been strengthened in both Wholesale and Wealth and International to deal with the rise in work loads experienced during the year as the recessionary conditions took hold both in the UK and overseas. In Wholesale three teams have been created to cover Corporate Real Estate, Corporate and Commercial, and Specialist Finance customers experiencing difficulties. In Wealth and International teams have been created in Ireland and Australia. Under this model, relationship management passes early and fully to BSU; because the BSU specialists receive the customers at an earlier stage in the process they have more time to develop effective solutions. The strategy is to work alongside management teams and key stakeholders to turn around businesses in distress and re-establish these as viable entities. Where a turnaround is not feasible, exposure is minimised through a combination of appropriate asset sales, restructuring and work out strategies.

To support UK Retail customers who are encountering financial difficulties the Group has launched a cross-channel support programme. Lloyds TSB branches and telephony units have at least one trained Financial Health Specialist providing customers with budgeting and money management advice. In the Group s Halifax and Bank of Scotland businesses, customers have a dedicated telephone support line with trained specialists able to guide them through any financial difficulties. Support is also available for all customers online, and via a specially developed support brochure. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities that require restructuring.

Within Collections and Recoveries the sharing of best practice and alignment of policies across the Group, has helped to drive more effective customer outcomes and achieve operational efficiencies. The Group has strengthened resources in Collections and Recoveries to help customers in distress by offering advice and access to a wider range of options such as short-term repayment plans or the government backed Homeowners   Mortgage Support and Mortgage Rescue schemes. A core element of our relationship management approach is to contact customers showing signs of financial distress, discussing with them their circumstances and offering solutions to prevent their accounts falling into arrears. This year, nearly a quarter of a million customers have been contacted who were not yet in arrears.

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LOAN PORTFOLIO

ANALYSIS OF LOANS AND ADVANCES TO BANKS AND CUSTOMERS

The following table analyses loans to banks and customers by category of loan at 31 December for each of the five years listed.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Loans and advances to banks	**35,510**	38,868	34,845	40,639	31,656
Loans and advances to customers:					
Mortgages	**362,667**	114,643	102,739	95,601	88,895
Other personal lending	**42,958**	25,318	22,988	23,025	23,280
Agriculture, forestry and fishing	**5,130**	3,969	3,226	2,905	2,451
Energy and water supply	**3,031**	2,598	2,102	2,024	1,592
Manufacturing	**14,912**	12,057	8,385	7,513	7,923
Construction	**10,830**	3,016	2,871	2,332	2,222
Transport, distribution and hotels	**31,820**	14,664	11,573	10,490	9,465
Postal and telecommunications	**1,662**	1,060	946	831	546
Financial, business and other services	**66,923**	33,319	29,707	22,999	21,261
Property companies	**83,820**	23,318	17,576	12,896	8,713
Lease financing	**9,307**	4,546	4,686	4,802	5,815
Hire purchase	**8,710**	5,295	5,423	5,060	4,853
Total loans	**677,280**	282,671	247,067	231,117	208,672
Allowance for impairment losses	**(14,950)**	(3,594)	(2,408)	(2,194)	(2,073)
Total loans and advances net of allowance for impairment losses	**662,330**	279,077	244,659	228,923	206,599

The analysis of loans and advances as at 31 December 2009 between domestic and international offices is as follows:

	Domestic £m	**Foreign £m**	**Total £m**
Loans and advances to banks	**29,475**	**6,035**	**35,510**
Loans and advances to customers:			
Mortgages	**344,151**	**18,516**	**362,667**
Other personal lending	**40,790**	**2,168**	**42,958**
Agriculture, forestry and fishing	**4,829**	**301**	**5,130**
Energy and water supply	**1,141**	**1,890**	**3,031**
Manufacturing	**11,480**	**3,432**	**14,912**
Construction	**6,554**	**4,276**	**10,830**
Transport, distribution and hotels	**22,713**	**9,107**	**31,820**
Postal and telecommunications	**973**	**689**	**1,662**
Financial, business and other services	**58,132**	**8,791**	**66,923**
Property companies	**64,069**	**19,751**	**83,820**
Lease financing	**8,426**	**881**	**9,307**
Hire purchase	**7,671**	**1,039**	**8,710**
Total loans	**600,404**	**76,876**	**677,280**
Allowance for impairment losses	**(9,995)**	**(4,955)**	**(14,950)**
Total loans and advances net of allowance for impairment losses	**590,409**	**71,921**	**662,330**

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

SUMMARY OF LOAN LOSS EXPERIENCE

The following table analyses the movements in the allowance for impairment losses on loans and advances to banks and customers for each of the five years listed.

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Balance at beginning of year before transition to IAS 39					1,663
Adjustment to reflect transition to IAS 39 on 1 January 2005					256
Balance at beginning of year after transition to IAS 39	**3,594**	2,408	2,194	2,073	1,919
Exchange and other adjustments	**112**	43	2	(13)	1
Reclassifications					43
Acquisition and disposal of businesses and portfolios				(27)	(27)
Advances written off:					
Loans and advances to customers:					
Mortgages	**(77)**	(23)	(25)	(9)	(6)
Other personal lending	**(3,063)**	(1,206)	(1,256)	(1,195)	(904)
Agriculture, forestry and fishing	**(5)**	(2)	(1)	(1)	(1)
Energy and water supply	**(28)**	(24)	(11)	(17)	(20)
Manufacturing	**(148)**	(34)	(13)	(24)	(27)
Construction	**(336)**	(11)	(4)	(7)	(8)
Transport, distribution and hotels	**(80)**	(50)	(24)	(50)	(37)
Postal and telecommunications	**(9)**				
Financial, business and other services	**(308)**	(169)	(95)	(142)	(151)
Property companies	**(51)**	(6)		(4)	
Lease financing	**(26)**	(2)	(26)	(1)	(5)
Hire purchase	**(69)**	(59)	(87)	(39)	(77)
Loans and advances to banks					
Total advances written off	**(4,200)**	(1,586)	(1,542)	(1,489)	(1,236)
Recoveries of advances written off:					
Loans and advances to customers:					
Mortgages	**1**	1	2	2	2
Other personal lending	**107**	102	121	158	125
Energy and water supply				1	2
Manufacturing			1	3	4
Construction				1	1
Transport, distribution and hotels		1	1	4	5
Financial, business and other services	**2**	3	3	12	14
Hire purchase		5	9	9	5
Total recoveries of advances written off	**110**	112	137	190	158
Total net advances written off	**(4,090)**	(1,474)	(1,405)	(1,299)	(1,078)
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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Effect of unwinding of discount recognised through interest income	**(446)**	(102)	(104)	(100)	(87)
Allowances for impairment losses charged against income for the year:					
Loans and advances to customers:					
Mortgages	**368**	171	18	12	18
Other personal lending	**3,779**	1,455	1,313	1,349	1,192
Agriculture, forestry and fishing	**29**	2	4	1	
Energy and water supply	**55**	35	18	4	2
Manufacturing	**737**	122	19	12	(1)
Construction	**842**	61	8	5	(3)
Transport, distribution and hotels	**1,783**	66	39	29	20
Postal and telecommunications	**14**				
Financial, business and other services	**2,193**	491	151	53	7
Property companies	**5,528**	73	1		
Lease financing	**241**	1	35	4	(3)
Hire purchase	**214**	107	116	91	70
Loans and advances to banks	**(3)**	135	(1)		
Total allowances for impairment losses charged against income for the year	**15,780**	2,719	1,721	1,560	1,302
Total balance at end of year	**14,950**	3,594	2,408	2,194	2,073
Ratio of net write-offs during the year to average loans outstanding during the year	**0.6**%	0.6%	0.7%	0.7%	0.6%
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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The analysis of movements in the allowance for impairment losses on loans and advances to banks and customers for the year ended 31 December 2009 between domestic and international offices is as follows:

	Domestic £m	Foreign £m	Total £m
Balance at beginning of year	**3,575**	**19**	**3,594**
Exchange and other adjustments	**171**	**(59)**	**112**
Advances written off:			
Loans and advances to customers:			
Mortgages	**(77)**		**(77)**
Other personal lending	**(3,062)**	**(1)**	**(3,063)**
Agriculture, forestry and fishing	**(5)**		**(5)**
Energy and water supply	**(28)**		**(28)**
Manufacturing	**(147)**	**(1)**	**(148)**
Construction	**(336)**		**(336)**
Transport, distribution and hotels	**(80)**		**(80)**
Postal and telecommunications	**(9)**		**(9)**
Financial, business and other services	**(308)**		**(308)**
Property companies	**(51)**		**(51)**
Lease financing	**(25)**	**(1)**	**(26)**
Hire purchase	**(69)**		**(69)**
Loans and advances to banks			
Total advances written off	**(4,197)**	**(3)**	**(4,200)**
Recoveries of advances written off:			
Loans and advances to customers:			
Mortgages	**1**		**1**
Other personal lending	**107**		**107**
Agriculture, forestry and fishing			
Energy and water supply			
Manufacturing			
Construction			
Transport, distribution and hotels			
Postal and telecommunications			
Financial, business and other services	**1**	**1**	**2**
Hire purchase			
Total recoveries of advances written off	**109**	**1**	**110**
Total net advances written off	**(4,088)**	**(2)**	**(4,090)**

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

	Domestic £m	Foreign £m	Total £m
Effect of unwinding of discount recognised through interest income	**(446)**		**(446)**
Allowances for impairment losses charged against income for the year:			
Loans and advances to customers:			
Mortgages	**120**	**248**	**368**
Other personal lending	**3,659**	**120**	**3,779**
Agriculture, forestry and fishing	**2**	**27**	**29**
Energy and water supply	**24**	**31**	**55**
Manufacturing	**544**	**193**	**737**
Construction	**533**	**309**	**842**
Transport, distribution and hotels	**507**	**1,276**	**1,783**
Postal and telecommunications	**9**	**5**	**14**
Financial, business and other services	**1,840**	**353**	**2,193**
Property companies	**3,325**	**2,203**	**5,528**
Lease financing	**88**	**153**	**241**
Hire purchase	**135**	**79**	**214**
Loans and advances to banks	**(3)**		**(3)**
Total allowances for impairment losses charged against income for the year	**10,783**	**4,997**	**15,780**
Total balance at end of year	**9,995**	**4,955**	**14,950**

The following table analyses the coverage of the allowance for loan losses by category of loans.

	2009 Allowance £m	**2009 Percentage of loans in each category to total loans %**	2008 Allowance £m	2008 Percentage of loans in each category to total loans %	2007 Allowance £m	2007 Percentage of loans in each category to total loans %	2006 Allowance £m	2006 Percentage of loans in each category to total loans %	2005 Allowance £m	2005 Percentage of loans in each category to total loans %
Balance at year end applicable to:										
Loans and advances to banks	**149**	**5.2**	135	13.8		14.1	1	17.6	1	15.2
Loans and advances to customers:										
Mortgages	**489**	**53.6**	186	40.5	37	41.5	42	41.3	36	42.5
Other personal lending	**2,884**	**6.3**	2,047	9.0	1,795	9.3	1,720	9.9	1,533	11.2
Agriculture, forestry and fishing	**33**	**0.8**	5	1.4	5	1.3	2	1.3	2	1.2
Energy and water supply	**70**	**0.4**	33	0.9	22	0.9	14	0.9	32	0.8
Manufacturing	**699**	**2.2**	119	4.3	29	3.4	25	3.3	33	3.8
Construction	**527**	**1.6**	60	1.1	10	1.2	6	1.0	8	1.1
Transport, distribution and hotels	**1,621**	**4.7**	75	5.2	58	4.7	45	4.5	64	4.5
Postal and telecommunications	**5**	**0.2**		0.4		0.4		0.4		0.3
Financial, business and other services	**2,388**	**9.9**	596	11.7	232	12.0	166	9.9	250	10.1
Property companies	**5,504**	**12.4**	70	8.2	4	7.1	5	5.6	11	4.2
Lease financing	**224**	**1.4**	15	1.6	16	1.9	7	2.1	4	2.8

Hire purchase	**357**	**1.3**	253	1.9	200	2.2	161	2.2	99	2.3
Total balance at year end	**14,950**	**100.0**	3,594	100.0	2,408	100.0	2,194	100.0	2,073	100.0

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The analysis of the coverage of the allowance for loan losses at 31 December 2009 between domestic and international offices is as follows:

	Domestic		Foreign		Total	
	Allowance £m	Percentage of loans in each category to total loans %	Allowance £m	Percentage of loans in each category to total loans %	Allowance £m	Percentage of loans in each category to total loans %
Balance at year end applicable to:						
Loans and advances to banks	**149**	**4.9**		**7.9**	**149**	**5.2**
Loans and advances to customers:						
Mortgages	**243**	**57.2**	**246**	**24.0**	**489**	**53.6**
Other personal lending	**2,767**	**6.8**	**117**	**2.8**	**2,884**	**6.3**
Agriculture, forestry and fishing	**6**	**0.8**	**27**	**0.4**	**33**	**0.8**
Energy and water supply	**42**	**0.2**	**28**	**2.5**	**70**	**0.4**
Manufacturing	**504**	**1.9**	**195**	**4.5**	**699**	**2.2**
Construction	**217**	**1.1**	**310**	**5.6**	**527**	**1.6**
Transport, distribution and hotels	**396**	**3.8**	**1,225**	**11.8**	**1,621**	**4.7**
Postal and telecommunications		**0.2**	**5**	**0.9**	**5**	**0.2**
Financial, business and other services	**2,012**	**9.7**	**376**	**11.4**	**2,388**	**9.9**
Property companies	**3,306**	**10.7**	**2,198**	**25.7**	**5,504**	**12.4**
Lease financing	**72**	**1.4**	**152**	**1.1**	**224**	**1.4**
Hire purchase	**281**	**1.3**	**76**	**1.4**	**357**	**1.3**
Total	**9,995**	**100.0**	**4,955**	**100.0**	**14,950**	**100.0**

RISK ELEMENTS IN THE LOAN PORTFOLIO

The Group s credit risk elements analysed by categories reflecting US lending and accounting practices, which differ from those employed in the UK, are detailed below:

NON-PERFORMING LENDING

In the US, it is the normal practice to stop accruing interest when payments are 90 days or more past due or when recovery of both principal and interest is doubtful. When the loans are transferred to non-accrual status, accrued interest is reversed from income and no further interest is recognised until it becomes probable that the principal will be repaid in full. Loans on which interest has been accrued but suspended would be included in risk elements as loans accounted for on a non-accrual basis.

In the US non-performing loans and advances are typically written off more quickly than in the UK. Consequently a UK bank may appear to have a higher level of non-performing loans and advances than a comparable US bank although the reported income may be similar in both the US and the UK.

2005

In 2005, the Group adopted IAS 39, which requires that interest is accrued and recognised on all outstanding loans. The interest recognised is based on the net carrying value of the loan and is, therefore, less than that that would be recognised on a similar performing loan. Accordingly, it is no longer possible to classify non-performing lending as being accounted for on a non-accruals basis. A provision is established if there is objective evidence that impairment has occurred and the carrying value of the loan exceeds the present value of its estimated future cash flows discounted at the loan s original effective interest rate.

As a result of the changes, the Group analysed its 2005 non-performing lending between impaired loans with a provision and impaired loans contractually past due 90 days or more without a provision.

	2005 £m
Impaired lending against which provisions are held	4,122
Loans contractually past due 90 days or more as to principal or interest, but against which no provisions have been made	1,210
Total non-performing lending*	5,332

* There were no troubled debt restructurings in 2005.

2006 AND LATER YEARS

In 2007, the Group adopted IFRS 7, which requires more detailed qualitative and quantitative disclosures about its loan portfolios. Accordingly, for 2006 and later years, the table below shows separately those loans that are (i) neither past due nor impaired, (ii) past due but not impaired, (iii) impaired, not requiring a provision and (iv) impaired with a provision.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

	Loans and advances to banks £m	Loans and advances to customers: Retail mortgages £m	Retail other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
Neither past due nor impaired	**35,333**	**347,292**	**48,429**	**185,872**	**581,593**	**19,082**
Past due but not impaired		**12,587**	**1,873**	**5,118**	**19,578**	
Impaired no provision required		**2,034**	**449**	**6,603**	**9,086**	
provision held	**153**	**5,918**	**5,902**	**37,927**	**49,747**	
Gross	**35,486**	**367,831**	**56,653**	**235,520**	**660,004**	**19,082**
31 December 2008						
Neither past due nor impaired	38,716	110,148	33,571	86,707	230,426	608
Past due but not impaired	17	3,134	1,146	555	4,835	
Impaired no provision required		479	150	1,253	1,882	
provision held	135	882	4,327	1,451	6,660	
Gross	38,868	114,643	39,194	89,966	243,803	608
31 December 2007						
Neither past due nor impaired	34,845	99,828	29,850	73,475	203,153	1,189
Past due but not impaired		2,153	966	639	3,758	
Impaired no provision required		415	100	293	808	
provision held		343	3,600	560	4,503	
Gross	34,845	102,739	34,516	74,967	212,222	1,189
31 December 2006						
Neither past due nor impaired	40,638	92,873	29,364	60,005	182,242	835
Past due but not impaired		1,943	1,005	374	3,322	
Impaired no provision required		658	92	158	908	
provision held	1	127	3,580	299	4,006	
Gross	40,639	95,601	34,041	60,836	190,478	835

The analysis of lending between retail and wholesale has been prepared based upon the type of exposure and not the business segment in which the exposure is recorded. Included within retail are exposures to personal customers and small businesses, whilst included within wholesale are exposures to corporate customers and other large institutions.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The loans that are past due but not impaired are further analysed in the table below according to the number of days that have elapsed since the last payment was due from the borrower.

	Loans and advances to banks £m	Loans and advances to customers: Retail mortgages £m	Retail other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
0-30 days		**6,018**	**1,316**	**2,347**	**9,681**	
30-60 days		**2,649**	**376**	**825**	**3,850**	
60-90 days		**1,702**	**74**	**825**	**2,601**	
90-180 days		**2,216**	**48**	**560**	**2,824**	
Over 180 days		**2**	**59**	**561**	**622**	
Total		**12,587**	**1,873**	**5,118**	**19,578**	
31 December 2008						
0-30 days		1,527	853	289	2,669	
30-60 days		633	259	90	982	
60-90 days	17	424	32	70	526	
90-180 days		549	2	77	628	
Over 180 days		1		29	30	
Total	17	3,134	1,146	555	4,835	
31 December 2007						
0-30 days		1,123	781	266	2,170	
30-60 days		445	155	107	707	
60-90 days		260	29	129	418	
90-180 days		325	1	67	393	
Over 180 days				70	70	
Total		2,153	966	639	3,758	
31 December 2006						
0-30 days		1,104	797	156	2,057	
30-60 days		341	182	60	583	
60-90 days		216	26	38	280	
90-180 days		280		70	350	
Over 180 days		2		50	52	
Total		1,943	1,005	374	3,322	

A financial asset is past due if a counterparty has failed to make a payment when contractually due.

POTENTIAL PROBLEM LOANS

Potential problem loans are loans where known information about possible credit problems causes management to have concern as to the borrower s ability to comply with the present loan repayment terms.

2005

There were no similar disclosure requirements in the UK for the year ended 31 December 2005.

The following table discloses for 2005 lendings which were current as to payment of interest and principal but where concerns existed about the ability of the borrowers to comply with loan repayment terms in the near future:

	2005 £m
Potential problem lending	1,800

The figures shown for potential problem lending are not indicative of the losses that might arise should the credit quality of this lending deteriorate since they do not take into account security held.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

2006 AND LATER YEARS

IFRS 7 requires, for 2006 and later years, the disclosure of information about the credit quality of loans and advances that are neither past due nor impaired. The Group s disclosures analyse these loans between those that the Group believes are of good quality, satisfactory quality, and lower quality and those that are below standard but not impaired.

	Loans and advances to banks £m	Loans and advances to customers: Retail mortgages £m	Retail other £m	Wholesale £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2009						
Good quality	**34,434**	**335,482**	**30,743**	**61,810**		**18,702**
Satisfactory quality	**135**	**9,614**	**12,654**	**59,752**		**267**
Lower quality	**15**	**746**	**1,480**	**45,986**		**90**
Below standard, but not impaired	**749**	**1,450**	**3,552**	**18,324**		**23**
Total	**35,333**	**347,292**	**48,429**	**185,872**	**581,593**	**19,082**
31 December 2008						
Good quality	38,283	109,815	21,373	49,349		129
Satisfactory quality	215	264	9,192	31,042		411
Lower quality	204		900	5,831		56
Below standard, but not impaired	14	69	2,106	485		12
Total	38,716	110,148	33,571	86,707	230,426	608
31 December 2007						
Good quality	34,647	99,407	18,157	46,240		191
Satisfactory quality	190	378	8,964	25,013		670
Lower quality	7	1	665	2,034		327
Below standard, but not impaired	1	42	2,064	188		1
Total	34,845	99,828	29,850	73,475	203,153	1,189
31 December 2006						
Good quality	40,418	92,472	16,940	35,659		513
Satisfactory quality	201	359	9,667	21,797		314
Lower quality	17		663	2,249		3
Below standard, but not impaired	2	42	2,094	300		5
Total	40,638	92,873	29,364	60,005	182,242	835

For further details see page F-104.

INTEREST FOREGONE ON NON-PERFORMING LENDING

The table below summarises the interest foregone on impaired lending.

	2009 £m

Interest income that would have been recognised under original contract terms	**1,830**
Interest income included in profit	**(971)**
Interest foregone	**859**

TROUBLED DEBT RESTRUCTURINGS

In the US, loans whose terms have been modified due to problems with the borrower are required to be separately disclosed. If the new terms were in line with market conditions at the time of the restructuring and the restructured loan remains current as to repayment of principal and interest then the disclosure can be discontinued at the end of the first year.

As noted above, the Group adopted IFRS 7 in 2007; IFRS 7 requires the disclosure of loans that were renegotiated and that would otherwise have been past due or impaired (2009: £3,919 million; 2008: £144 million; 2007: £579 million; 2006: £342 million); see also page F-106.

FORBEARANCE

Forbearance or repayment arrangements allow a mortgage customer to repay a monthly amount which is lower than their contractual monthly payment for a short period. This period is usually for no more than 12 months and is negotiated with the customer by the mortgage collectors. During the period of forbearance, there is no clearing down of arrears such that unless the customer is paying more than their contractual minimum payment, arrears balances will remain. When customers come to the end of their arrangement period they will continue to be managed as a mainstream collections case and if unable to recover then will move toward possession.

Customers can have their arrears balance recapitalised once they have demonstrated they can pay the original contractual minimum payment, but are unable to clear their arrears. This is usually demonstrated by the customer making six consecutive contractual monthly payments. Customers are not however able to recapitalise more than twice in a five year period. Recapitalised mortgages will return to the non-impaired book and will be managed in accordance with the recapitalised terms of the mortgage.

ASSETS ACQUIRED IN EXCHANGE FOR ADVANCES

In most circumstances in the US, title to property securing residential real estate transfers to the lender upon foreclosure. The loan is written off and the property acquired in this way is reported in a separate balance sheet category with any recoveries recorded as an offset to the provision for loan losses recorded in the year. Upon sale of the acquired property, gains or losses are recorded in the income statement as a gain or loss on acquired property.

In the UK, although a bank is entitled to enforce a first charge on a property held as security, it typically does so only to the extent of enforcing its power of sale. In accordance with IFRS and industry practice, Lloyds Banking Group usually takes control of a property held as collateral on a loan at repossession without transfer of title. Loans subject to repossession continue to be reported as loans in the balance sheet. Any gains or losses on sale of the acquired property are recorded within the provision for loan losses during the reporting period.

The difference in practices has no effect on net income reported in the UK compared to that reported in the US but it does result in a difference in classification of losses and recoveries in the income statement. It also has the effect of causing UK banks to report an increased level of non-performing loans compared with US banks.

In certain circumstances the Group takes physical possession of assets held as collateral against wholesale lending. In such cases, the assets are carried on the Group s balance sheet and are classified according to the Group s accounting policies.

CROSS BORDER OUTSTANDINGS

The business of Lloyds Banking Group involves significant exposures in non-local currencies. These cross border outstandings comprise loans (including accrued interest), acceptances, interest-bearing deposits with other banks, other interest-bearing investments and any other monetary assets which are denominated in non-local currency. The following table analyses, by type of borrower, foreign outstandings which individually represent in excess of 1 per cent of Lloyds Banking Group s total assets.

	% of assets	Total £m	Governments and official institutions £m	Banks and other financial institutions £m	Commercial, industrial and other £m
As at 31 December 2009:					
United States of America	**1.9**	**19,033**	**3,266**	**2,548**	**13,219**
France	**1.4**	**14,126**	**768**	**2,932**	**10,426**
As at 31 December 2008:					
United States of America	2.0	8,928	253	1,843	6,832
France	1.1	4,735	69	2,904	1,762
Netherlands	1.0	4,449	4	1,658	2,787
As at 31 December 2007:					
Netherlands	1.8	6,245	1	3,806	2,438
United States of America	1.3	4,520	38	1,098	3,384

As at 31 December 2009, United States of America had commitments of £491 million, and France had commitments of £624 million.

As at 31 December 2009, there were no countries with cross border outstandings of between 0.75 per cent and 1 per cent of assets.

As at 31 December 2008, the countries with cross border outstandings of between 0.75 per cent and 1 per cent of assets, amounting to £8,130 million in total, were Belgium and Germany.

As at 31 December 2007, the countries with cross border outstandings of between 0.75 per cent and 1 per cent of assets, amounting to £8,505 million in total, were Germany, Republic of Ireland and Belgium.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

MARKET RISK

DEFINITION

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

RISK APPETITE

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

This statement of the Group s overall appetite for market risk is reviewed and approved annually by the board. With the support of the group asset and liability committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

EXPOSURES

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

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

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

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

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

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

Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of those assets. (This forms part of the Value of in-Force Business (ViF) see note 28 to the consolidated financial statements.)

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

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

The Group s defined benefit staff pension schemes are exposed to significant risks from the constituent parts of their assets and from the present value of their liabilities, primarily equity and real interest rate risk. For further information on pension scheme assets and liabilities please refer to note 41 to the consolidated financial statements.

MEASUREMENT

The primary market risk measure used within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. This is used for determining the Group s overall market risk appetite and for the high level allocation of risk appetite across the Group.

Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. In addition, the use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. Where VaR models are less well suited to the nature of positions, the Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity, and include interest rate repricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at group level, to simulate extreme conditions to supplement these core measures.

BANKING TRADING ASSETS AND OTHER TREASURY POSITIONS

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 300 business days, the VaR for the years ended 31 December 2009 and 2008 based on the Group s global trading positions was as detailed in the table Banking Trading Assets and Other Treasury Positions on page 78.

The risk of loss measured by the VaR model is the potential loss in earnings given the confidence level and assumptions noted above. The total and average trading VaR does not assume any diversification benefit across the four risk types, with the exception of the 2008 HBOS comparatives. VaR is a statistical measure and the trading book exposures for the two independently managed heritage banks arose from different management strategies and were measured against differing risk appetites. Separate disclosures have therefore been made for each heritage trading book for 2008 as this is considered to be a more informative approach. The 2008 HBOS comparatives have also been converted from 99 per cent 1-day to 95 per cent 1-day VaR numbers. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole. The Group internally uses VaR as the primary measure for all treasury positions arising from short term market facing activity, whether trading or banking book. Therefore the numbers below will include some risks which are also included in Banking non-trading, primarily those relating to the funding of lending activities.

BANKING TRADING ASSETS AND OTHER TREASURY POSITIONS

Lloyds Banking Group	**31 December 2009**			
	Close £m	**Average[1] £m**	**Maximum[1] £m**	**Minimum[1] £m**
Interest rate risk	**12.0**	**20.2**	**31.4**	**11.8**
Foreign exchange risk	**1.1**	**1.7**	**9.3**	**0.2**
Equity risk	**1.8**	**1.4**	**3.3**	**0.0**
Credit spread risk	**16.7**	**17.4**	**21.0**	**13.6**
Total VaR	**31.6**	**40.7**	**53.3**	**31.6**

Lloyds TSB	31 December 2008			
	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	6.7	3.4	14.7	1.0
Foreign exchange risk	3.0	1.2	4.1	0.1
Equity risk	0.0	0.3	2.7	0.0
Credit spread risk	8.0	4.9	8.1	4.1
Total VaR	17.7	9.8	25.0	5.4

HBOS (unaudited)	31 December 2008			
	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	5.9	3.9	6.4	2.0
Foreign exchange risk	4.3	5.8	11.4	0.9
Equity risk	0.1	0.1	0.8	0.0
Credit spread risk	Suspended			
Total VaR	5.9	8.5	12.8	3.5

1 For this table the average, minimum and maximum positions reflect the period from 19 January 2009 to 31 December 2009.

BANKING NON-TRADING

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

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

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

The following table shows, split by material currency, Lloyds Banking Group sensitivities as at 31 December 2009 to an immediate up and down 25 basis points change to all interest rates.

BANKING NON-TRADING

	2009		2008 (unaudited)	
	Up 25bps £m	**Down 25bps £m**	Up 25bps £m	Down 25bps £m
Sterling	**66.6**	**(66.4)**	(132.5)	135.1
US Dollar	**(5.5)**	**5.6**	(15.5)	15.6
Euro	**4.4**	**(4.4)**	(0.4)	0.4
Australian Dollar	**2.2**	**(2.3)**	0.0	0.0
Other	**(0.2)**	**0.2**	0.2	(0.3)
	67.5	**(67.3)**	(148.2)	150.8

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

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

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

PENSION SCHEMES

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION
INSURANCE PORTFOLIOS

The Group s market risk exposure in respect of insurance activities described above is measured using EEV as a proxy for economic value. The pre-tax sensitivity of EEV to standardised stresses is shown below for the years ended 31 December 2009 and 2008. The 2008 comparatives are based on a post acquisition basis assuming the legacy businesses were combined at the year end and are unaudited. During 2009, the credit spread sensitivity was changed from a 25 basis point increase to a 30 per cent widening of the spread between corporate bonds and the swap curve, including an allowance for the assumed change in the illiquidity premium. Therefore no 2008 comparative is available. Foreign exchange risk arises predominantly from overseas holdings of equities. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. Opening and closing numbers only have been provided as this data is not volatile and consequently is not tracked on a daily basis.

INSURANCE PORTFOLIOS

As at 31 December	**2009** **£m**	2008 (unaudited) £m
Equity risk (impact of 10% fall pre-tax)	**(383.6)**	(429.4)
Interest rate risk (impact of 25 basis point reduction pre-tax)	**64.0**	59.7
Credit spread risk (impact of 30% widening)	**(156.4)**	n/a

MITIGATION

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

BANKING NON-TRADING ACTIVITIES

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

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

INSURANCE ACTIVITIES

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

MONITORING

The group asset and liability committee regularly reviews high level market risk exposure including, but not limited to, the data described above. It also makes recommendations to the group chief executive concerning overall market risk appetite and market risk policy. Exposures at lower levels of delegation are monitored at various intervals according to their volatility, from daily in the case of trading portfolios to monthly or quarterly in the case of less volatile portfolios. Levels of exposures compared to approved limits are monitored locally by independent risk functions and at a high level by group risk. Where appropriate, escalation procedures are in place.

BANKING ACTIVITIES

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

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

INSURANCE ACTIVITIES

Market risk exposures from the insurance businesses are controlled via approved investment policies and triggers set with reference to the Group s overall risk appetite and regularly reviewed by the group asset and liability committee:

- The With Profit Funds are managed in accordance with the relevant fund s principles and practices of financial management and legal requirements.
- The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match the cash flows.
- Investment strategy for surplus assets held in excess of liabilities takes account of the legal, regulatory and internal business requirements for capital to be held to support the business now and in the future.

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

INSURANCE RISK

DEFINITION

The risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements. This includes fluctuations in profits due to customer behaviour.

RISK APPETITE

Insurance risk appetite is defined with regard to the quantum and composition of insurance risk that exists currently in the Group and the direction in which the Group wishes to manage this. It takes account of the need for each entity in the Group to maintain solvency in excess of the minimum level required by the entity s jurisdictional legal or regulatory requirements.

The Group s overall appetite for insurance risk is reviewed and approved annually by the board.

EXPOSURES

The major sources of insurance risk within the Group are the insurance businesses and the Group s defined benefit staff pension schemes. The nature of insurance business involves the accepting of insurance risks which relate primarily to mortality, longevity, morbidity, persistency, expenses, property damage and unemployment. The prime insurance risk carried by the Group s staff pension schemes is related to longevity.

MEASUREMENT

Insurance risks are measured using a variety of techniques including stress and scenario testing; and, where appropriate, stochastic modelling.

Current and potential future insurance risk exposures are assessed and aggregated using risk measures based on 1-in-20 year stresses and other supporting measures where appropriate, for example those set out in note 37 to the consolidated financial statements.

MITIGATION

A key element of the control framework is the consideration of insurance risk by a suitable combination of high level committees/boards. For the life assurance businesses the key control bodies are the board of Scottish Widows Group Limited and the board of HBOS Financial Services Limited with the more significant risks also being subject to approval by the group executive committee and/or Lloyds Banking Group board. For the general insurance businesses the key control bodies are the boards of the legal entities including Lloyds TSB General Insurance Limited, St. Andrew s Insurance plc and the Irish subsidiaries, with the more significant risks again being subject to group executive committee and/or Lloyds Banking Group board approval. All Group staff pension schemes issues are covered by the group asset and liability committee and the group business risk committee.

The overall insurance risk is mitigated through pooling and through diversification across large numbers of uncorrelated individuals, geographical areas, and different types of risk exposure.

Insurance risk is primarily controlled via the following processes:

- Underwriting (the process to ensure that new insurance proposals are properly assessed)
- Pricing-to-risk (new insurance proposals are priced to cover the underlying risks inherent within the products)
- Claims management

Product design

Policy wording

Product management

The use of reinsurance or other risk mitigation techniques.

In addition, limits are used as a control mechanism for insurance risk at policy level.

At all times, close attention is paid to the adequacy of reserves, solvency management and regulatory requirements.

General insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Detailed modelling, including that of the potential losses under various catastrophe scenarios, supports the choice of reinsurance arrangements. Appropriate reinsurance arrangements also apply within the life and pensions businesses with significant mortality risk and morbidity risk being transferred to our chosen reinsurers.

Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present.

In respect of insurance risks in the staff pension schemes, the Group ensures that effective communication mechanisms are in place for consultation with the trustees to assist with the management of risk in line with the Group s risk appetite.

MONITORING

Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitoring relevant experiences against expectations (for example claims experience, option take up rates, persistency experience, expenses, non-disclosure at the point of sale), as well as evaluating the effectiveness of controls put in place to manage insurance risk. Reasons for any significant divergence from experience are investigated and remedial action is taken.

Insurance risk exposures are reported and monitored regularly by the group executive committee.

OPERATIONAL RISK

DEFINITION

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

There are a number of categories of operational risk:

LEGAL AND REGULATORY RISK

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

CUSTOMER TREATMENT RISK

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

PEOPLE RISK

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

INTEGRATION RISK

The risk that Lloyds Banking Group fails to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or incurs unanticipated costs and losses associated with, the acquisition of HBOS plc.

BUSINESS PROCESS RISK

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems, people-related events and deficiencies in the performance of external suppliers/service providers.

FINANCIAL CRIME RISK

The risk of reductions in earnings and/or value, through financial or reputational loss, associated with financial crime and failure to comply with related legal and regulatory obligations (which includes compliance with economic sanctions). These losses may include censure, fines or the cost of litigation.

SECURITY RISK

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

CHANGE RISK

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

GOVERNANCE RISK

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

RISK APPETITE

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

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

For legal and regulatory risk the Group has minimal risk appetite for non-compliance with mandatory requirements and seeks to operate to high ethical standards. The Group encourages and maintains an appropriately balanced legal and regulatory compliance culture and promotes policies and procedures to enable businesses and their staff to operate in accordance with the laws, regulations and voluntary codes which impact on the Group and its activities.

EXPOSURES

The main sources of operational risk within the Group relate to the rate and scale of change arising from the Group s current integration programme, particularly in respect of people and business processes, and the legal and regulatory environment in which financial firms operate both in the UK and overseas.

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation with which the Group has to comply, along with new legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. Following the financial crisis, the pace and extent of regulatory reform proposals both in the UK and internationally have increased significantly, and can be expected to remain at high levels. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of the Group, but could for instance affect the Group s future business strategy, structure or approach to funding. Further uncertainties arise where regulations are principles-based without the regulator defining supporting minimum standards either for the benefit of the consumer or firms. This gives rise to both the risk of retrospection from any one regulator and also to the risk of differing interpretation by individual regulators.

For legal and regulatory issues there are significant reputational impacts associated with potential censure which drive the Group s stance on appetites referred to above. There are clear accountabilities and processes in place for reviewing new and changing requirements. Each division and significant business areas have a nominated individual with compliance oversight responsibility under FSA rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations, to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

Lloyds Banking Group welcomes the regulation of remuneration provided there is international consensus and we will comply with the FSA code.

MEASUREMENT

Both Lloyds TSB and HBOS had operational risk management and measurement frameworks that had been granted, by the FSA, Advanced Measurement Approach (AMA) Waivers, enabling the use of an internal model for the calculation of regulatory capital.

Throughout 2009, both frameworks have continued to operate, whilst a single integrated framework has been in the course of development. The integrated framework and capital model will be rolled out during 2010 and it is anticipated that the Group will seek a variation from the FSA to operate under a single AMA waiver.

The Lloyds TSB Group capital model calculations are driven by actual loss data (internal and external) and forward looking scenarios which value potential future risk events. External industry-wide data is collected to help with validating scenarios.

The HBOS capital model calculations are driven by risk and control assessments, validated by scenarios and internal and external loss events.

MITIGATION

Both Lloyds TSB and HBOS s operational risk management frameworks consist of the following key components:

- Identification and categorisation of the key operational risks facing a business area.
- Risk assessment, including impact assessment of financial and non-financial impacts (e.g. reputational risk) for each of the key risks to which the business area is exposed.
- Control assessment, evaluating the effectiveness of the control framework covering each of the key risks to which the business area is exposed.
- Loss and incident management, capturing actions to manage any losses facing a business area.
- The development of Key Risk Indicators for management reporting.
- Oversight and assurance of the risk management framework in divisions and businesses.
- Scenarios for estimation of potential loss exposures for material risks.

The Group purchases insurance to mitigate certain operational risk events.

MONITORING

Business unit risk exposure is aggregated at divisional level and reported to group risk where a group-wide report is prepared. The report is discussed at the monthly group compliance and operational risk committee. This committee can escalate matters to the chief risk officer, or higher committees if appropriate.

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

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

FINANCIAL SOUNDNESS

Financial soundness risk has three key risk components covering liquidity and funding risk; capital risk; and financial and prudential regulatory reporting, disclosure and tax risk.

LIQUIDITY AND FUNDING RISK

DEFINITION

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

RISK APPETITE

Liquidity and funding risk appetite for the banking businesses is set by the board and reviewed on an annual basis. This statement of the Group s overall appetite for liquidity risk is reviewed and approved annually by the board. With the support of the group asset and liability committee, the group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that liquidity risk appetite is further delegated to an appropriate level within their areas of responsibility. It is reported through various metrics that enable the Group to manage liquidity and funding constraints. The Group chief executive, assisted by the group asset and liability committee and its sub-committee the senior asset and liability committee, regularly reviews performance against risk appetite.

EXPOSURE

Liquidity exposure represents the amount of potential outflows in any future period less committed inflows. Liquidity is considered from both an internal and regulatory perspective.

MEASUREMENT

A series of measures are used across the Group to monitor both short and long term liquidity including: ratios, cash outflow triggers, liquidity gaps, early warning indicators and stress test survival period triggers. Strict criteria and limits are in place to ensure highly liquid marketable securities are available as part of the portfolio of liquid assets.

Details of contractual maturities for assets and liabilities form an important source of information for the management of liquidity risk. Note 54(4) to the consolidated financial statements sets out an analysis of assets and liabilities by relevant maturity grouping. In order to reflect more accurately the expected behaviour of the Group s assets and liabilities, measurement and modelling of the behavioural aspects of each is constructed. This forms the foundation of the Group s liquidity controls.

MITIGATION

The Group mitigates the risk of a liquidity mismatch in excess of its risk appetite by managing the liquidity profile of the balance sheet through both short-term liquidity management and long-term funding strategy. Short-term liquidity management is considered from two perspectives; business as usual and liquidity under stressed conditions, both of which relate to funding in the less than one year time horizon. Longer term funding is used to manage the Group s strategic liquidity profile which is determined by the Group s balance sheet structure. Longer term is defined as having an original maturity of more than one year.

The Group s funding and liquidity position is underpinned by its significant retail deposit base, and has been supported by stable funding from the wholesale markets with a reduced dependence on short-term funding. A substantial proportion of the retail deposit base is made up of customers current and savings accounts which, although repayable on demand, have traditionally in aggregate provided a stable source of funding. Additionally, the Group accesses the short-term wholesale markets to raise inter-bank deposits and to issue certificates of deposit and commercial paper to meet short-term obligations. The Group s short-term money market funding is based on a qualitative analysis of the market s capacity for the Group s credit. The Group has developed strong relationships with certain wholesale market segments, and also has access to central banks and corporate customers, to supplement its retail deposit base.

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group s banking businesses. The Group holds sizeable balances of high grade marketable debt securities which can be sold to provide, or used to secure, additional short term funding should the need arise from either market counterparties or central bank facilities (European Central Bank, Federal Reserve, Bank of England).

MONITORING

Liquidity is actively monitored at business unit and Group level at an appropriate frequency. Routine reporting is in place to senior management and through the Group s committee structure, in particular the group asset and liability committee and the senior asset and liability committee which meet monthly. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event. Liquidity policies and procedures are subject to independent oversight.

Daily monitoring and control processes are in place to address both statutory and prudential liquidity requirements. In addition, the framework has two other important components:

Firstly, the Group stress tests its potential cash flow mismatch position under various scenarios on an ongoing basis. The cash flow mismatch position considers on-balance sheet cash flows, commitments received and granted, and material derivative cash flows. Specifically, commitments granted include the pipeline of new business awaiting completion as well as other standby or revolving credit facilities. Behavioural adjustments are developed, evaluating how the cash flow position might change under each stress scenario to derive a stressed cash flow position. Scenarios cover both Lloyds Banking Group name specific and systemic difficulties. The scenarios and the assumptions are reviewed at least annually to gain assurance they continue to be relevant to the nature of the business.

Secondly, the Group has a contingency funding plan embedded within the Group Liquidity Policy which has been designed to identify emerging liquidity concerns at an early stage, so that mitigating actions can be taken to avoid a more serious crisis developing.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The Group has invested considerable resource to ensure that it will satisfy the governance, reporting and stress testing requirements of the FSA s new ILAS liquidity regime. This work will continue in 2010 as further parts of the ILAS regime take effect. The Group has noted the industry move towards strategic balance sheet measures of the funding profile and has started to monitor the market s net stable funding ratio and the FSA s structural funding ratio. The Group is aware that the regulatory liquidity landscape is subject to potential change. Specifically, in relation to the consultation papers issued by the Basel Committee on Banking Supervision (Strengthening the resilience of the banking sector and International framework for liquidity risk measurement, standards and monitoring) the Group is actively participating in the industry-wide consultation and calibration exercises taking place through 2010.

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

APPROACH

The Group has adopted the heritage Lloyds TSB liquidity and funding approach which involves reduced risk appetite and increasing the diversity of funding sources, supported by extensive analysis of funding needs and strong governance. The Group expects to meet its funding requirements even in a stressed scenario.

LIQUIDITY AND FUNDING MANAGEMENT IN 2009

To understand the trends in liquidity and funding the comparatives have been provided for 2008 for the combined businesses. Consequently, pages 84 to 87 covering liquidity and funding management in 2009 are unaudited.

During 2009, the Group has seen a stabilisation in the customer deposit base, in marked contrast to the volatility observed by parts of the heritage HBOS businesses in the second half of 2008. The customer loan/deposit ratio improved slightly to 169 per cent compared with 177 per cent at the previous year end. The challenge facing the Group over the medium term is to continue to access the term funding markets, and for the Group to continue to reduce its utilisation of government sponsored funding schemes. The combination of a clear focus on right-sizing the balance sheet, developing the Group s retail liability base, and strategically accessing the capital markets will enable the Group to continue to strengthen its funding base.

In keeping with the Group s strategy of right-sizing the balance sheet, total funding has reduced by £73 billion. During the year the Group has reduced its dependency on the repo market whilst also reducing its wholesale funding requirements. Additionally there has been a managed reduction in certain types of non-bank deposits, in particular certain aggressively priced corporate deposits which were sourced from HBOS customers during the crisis in the second half of 2008. Actions taken to right size the balance sheet have reduced the portion of the Group s funding that is derived from wholesale markets.

GROUP BALANCE SHEET

As at 31 December	**2009 £bn**	2008[1] £bn	2009 Change %
Assets			
Loans and advances to customers	**627.0**	677.2	(7.4)
Wholesale assets[2]	**153.6**	189.2	(18.8)
Banking assets	**780.6**	866.4	(9.9)
Total assets	**1,027.3**	1,126.7	(8.8)
Liabilities			
Non-bank deposits[3]	**371.2**	381.0	(2.6)
Wholesale funding	**325.5**	342.9	(5.1)
Repo[4]	**63.1**	116.9	(46.0)
Total equity	**44.1**	35.7	23.5
Total funding	**803.9**	876.5	(8.3)
Total liabilities and shareholders equity	**1,027.3**	1,126.7	(8.8)

1 Adjusted to reflect the completion of the assessment of the fair value of the identifiable net assets of the HBOS Group.

2 Wholesale assets comprise balances arising from banking businesses and include cash and balances at central banks, loans and advances to banks, debt securities and available-for-sale financial assets.

3 Non-bank deposits comprise balances arising from banking businesses and consist of customer deposits.

4 All of the Group s repurchase transactions are recorded as balance sheet liabilities within deposits.

The global upheaval in the financial markets that occurred during 2008 has abated during the latter part of 2009. The steps taken in 2008 by HM Treasury, through the introduction of the Government Credit Guarantee Scheme (CGS) for senior funding and other facilities including the Special Liquidity Scheme have together continued to provide assurance of liquidity support to the banking markets. Notwithstanding the improvement in market liquidity during 2009, the Group continues to be reliant upon these facilities in order to maintain its wholesale funding position. At 31 December 2009, the Group s overall support from government and central bank sponsored funding facilities totalled £157 billion, with a significant portion maturing over the course of the next two years. The Group s balance sheet reduction plans will avoid the necessity to refinance much of this funding.

The key dependencies on successfully funding the Group s balance sheet include the continued functioning of the money and capital markets at their current levels; successful rightsizing of the Group s balance sheet; the continuation of HM Treasury facilities in accordance with the terms agreed; limited further deterioration in the UK s and the Group s credit rating and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or UK Government support schemes. A return to the extreme market conditions of 2008 would place a strain on the Group s ability to meet its financial commitments.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

GROUP RETAIL AND WHOLESALE FUNDING MIX

Wholesale funding has been analysed between that monitored by the London Treasury and Trading operations and the Group s overseas Treasury operations. The wholesale funding shown excludes any repo activity.

The composition and quality of wholesale deposits are regularly reviewed by management and comprises deposits from corporates and government agencies that roll over on a regular basis and are reinvested.

WHOLESALE FUNDING BY TYPE

As at 31 December	**2009 £bn**	**2009 %**	2008 £bn	2008 %
Bank deposits	**48.6**	**7.0**	54.9	7.6
Debt securities in issue:				
Certificates of deposit	**50.9**	**7.3**	77.5	10.7
Medium term notes	**89.7**	**12.9**	63.5	8.8
Covered bonds	**28.1**	**4.0**	29.1	4.0
Commercial paper	**35.0**	**5.0**	28.9	4.0
Securitisation	**35.8**	**5.1**	43.6	6.0
	239.5	**34.3**	242.6	33.5
Subordinated debt	**37.4**	**5.4**	45.4	6.3
Total wholesale (excluding non-bank deposits)	**325.5**	**46.7**	342.9	47.4
Customer deposits	**371.2**	**53.3**	381.0	52.6
Total Group funding[1]	**696.7**	**100.0**	723.9	100.0

1 Excludes repos and total equity.

TERM FUNDING

The Group has been able to take advantage of the improved market sentiment, by extending the duration of its money market funding, and by successfully accessing the term debt markets in unguaranteed format and through the issuance of Permanent RMBS. The reduction in the volume of money market funding has contributed to an improvement in the Group s term funding ratio (wholesale funding with a remaining life of over one year) which has improved to 50 per cent at 31 December 2009 from 44 per cent at the previous year end. The Group s long term target for this ratio is 40 per cent, this seeks to ensure that maturing liabilities are spread over subsequent years.

Lloyds Banking Group has continued to extend the term of its wholesale funding. The following significant capital market transactions were undertaken in 2009:

£13.5 billion rights issue

5 billion public senior unguaranteed debt

£4 billion public RMBS

US$2 billion tier 1 capital securities

Lloyds Banking Group will continue to access the term capital markets, and has already successfully executed benchmark transactions in January 2010:

US$5 billion equivalent of public senior term funding

£2.5 billion equivalent of public RMBS

The Group had limited access to the term capital markets for large periods of 2009 due to highly market sensitive on-going negotiations around the Government Asset Protection Scheme and market recapitalisation.

Total wholesale funding is analysed by residual maturity as follows:

WHOLESALE FUNDING BY RESIDUAL MATURITY

As at 31 December	**2009 £bn**	**2009 %**	2008 £bn	2008 %
Less than one year	**161.8**	**49.7**	192.3	56.1
One to two years	**48.8**	**15.0**	29.8	8.7
Two to five years	**68.7**	**21.1**	62.2	18.1
More than five years	**46.2**	**14.2**	58.6	17.1
Total wholesale funding	**325.5**	**100.0**	342.9	100.0

During the period the Group has changed the definition of wholesale to align with that used by other international market participants to include interbank deposits, debt securities in issue and subordinated debt within this category.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The table below illustrates the Group s holding of highly liquid unencumbered assets. This liquidity is available for deployment at immediate notice and is a key component of the Group s liquidity management process.

ELIGIBLE COLLATERAL

As at 31 December	**2009** **£bn**	2008 £bn
Primary liquidity[1]	**88.4**	46.2
Secondary liquidity[2]	**62.4**	58.3
	150.8	104.5

[1] Primary liquidity is defined as FSA eligible liquid assets (UK Gilts, US Treasuries, Euro AAA government debt, unencumbered cash balances held at central banks).

[2] Secondary liquidity comprises a diversified pool of highly rated unencumbered collateral (including retained issuance)

The following tables reconcile figures reported on page 85 in the table Wholesale Funding by Type with those in the balance sheet.

RECONCILIATION OF WHOLESALE FUNDING BY TYPE TO THE BALANCE SHEET

As at 31 December 2009	**Included in funding analysis** **£bn**	**Repos and conduits** **£bn**	**Fair value and other accounting methods** **£bn**	**Balance sheet** **£bn**
Bank deposits	**48.6**	**27.6**	**6.3**	**82.5**
Debt securities in issue	**239.5**		**(6.0)**	**233.5**
Subordinated debt	**37.4**		**(2.7)**	**34.7**
Total wholesale funding	**325.5**	**27.6**		
Customer deposits	**371.2**	**35.5**		**406.7**
	696.7	**63.1**		

As at 31 December 2008	Included in funding analysis £bn	Repos and conduits £bn	Fair value and other accounting methods £bn	Balance sheet £bn
Bank deposits	54.9	95.8	4.4	155.1
Debt securities in issue	242.6	3.0	4.1	249.7
Subordinated debt	45.4		(3.2)	42.2
Total wholesale funding	342.9	98.8		
Customer deposits	381.0	18.1	10.1	409.2
	723.9	116.9		

CONTRACTUAL CASH OBLIGATIONS

The following table sets out the amounts and maturities of Lloyds Banking Group s contractual cash obligations at 31 December 2009.

	Within one year £m	One to three years £m	Three to five years £m	Over five years £m	Total £m
Enhanced capital notes				**9,047**	**9,047**
Long-term debt dated	**702**	**2,538**	**3,095**	**9,619**	**15,954**
Medium-term notes	**18,327**	**57,589**	**5,090**	**8,030**	**89,036**
Commercial paper	**34,900**				**34,900**
Covered bonds	**5,605**	**2,275**	**7,937**	**11,494**	**27,311**
Securitisation notes	**934**	**4,949**	**371**	**31,303**	**37,557**
Finance leases	**1**	**2**		**13**	**16**
Operating leases	**392**	**662**	**551**	**1,817**	**3,422**
Capital commitments	**256**	**4**			**260**
Other purchase obligations	**758**	**873**	**491**	**129**	**2,251**
	61,875	**68,892**	**17,535**	**71,452**	**219,754**

Other purchase obligations include amounts expected to be payable in respect of material contracts entered into by the Lloyds Banking Group, in the ordinary course of business, for the provision of outsourced and other services. The cost of these services will be charged to the income statement as it is incurred. The Lloyds Banking Group also has a constructive obligation to ensure that its defined post-retirement benefit schemes remain adequately funded. The amount and timing of the Lloyds Banking Group s cash contributions to these schemes is uncertain and will be affected by factors such as future investment returns and demographic changes. Lloyds Banking Group expects to make cash contributions of at least £500 million to these schemes in 2010.

At 31 December 2009, Lloyds Banking Group also had £9,726 million of preference shares, preferred securities and undated subordinated liabilities outstanding.

At 31 December 2009, the principal sources of potential liquidity for Lloyds Banking Group plc were dividends received from its directly owned subsidiary company, Lloyds TSB Bank, and loans from this and other Lloyds Banking Group companies. The ability of Lloyds TSB Bank and HBOS to pay dividends going forward, or for Lloyds TSB Bank or other Lloyds Banking Group companies to make loans to Lloyds Banking Group plc, depends on a number of factors, including their own regulatory capital requirements, distributable reserves and financial performance.

OFF-BALANCE SHEET ARRANGEMENTS

A table setting out the amounts and maturities of Lloyds Banking Group s other commercial commitments at 31 December 2009 is included in note 52 to the consolidated financial statements. These commitments are not included in Lloyds Banking Group s consolidated balance sheet.

Lending commitments are agreements to lend to customers in accordance with contractual provisions; these are either for a specified period or, as in the case of credit cards and overdrafts, represent a revolving credit facility which can be drawn down at any time, provided that the agreement has not been terminated. The total amounts of unused commitments do not necessarily represent future cash requirements, in that commitments often expire without being drawn upon.

Lloyds Banking Group s financial guarantee contracts are accounted for as financial instruments and measured at fair value on the balance sheet. The contractual nominal amounts of these guarantees totalled £18,021 million at 31 December 2009 (with £5,425 million expiring within one year; £1,996 million between one and three years; £8,398 million between three and five years; and £2,202 million over five years).

Lloyds Banking Group s banking businesses are also exposed to liquidity risk through the provision of securitisation facilities to certain corporate customers. At 31 December 2009, Lloyds Banking Group offered securitisation facilities to its corporate and financial institution client base through its conduit securitisation vehicles, Cancara, Grampian and Landale. These are funded in the global asset-backed commercial paper market. The assets and obligations of these conduits are included in Lloyds Banking Group s consolidated balance sheet. Lloyds Banking Group provides short-term asset-backed commercial paper liquidity support facilities on commercial terms to the issuers of the commercial paper, for use in the event of a market disturbance should they be unable to roll over maturing commercial paper or obtain alternative sources of funding.

Details of securitisations and other special purpose entity arrangements entered into by the Group are provided in notes 21 and 22 to the consolidated financial statements. The successful development of Lloyds Banking Group s ability to securitise its own assets has provided a mechanism to tap a well established market, thereby diversifying Lloyds Banking Group s funding base.

As indicated on page F-48, the Group s securitisations include a number of synthetic securitisation arrangements. Synthetic securitisations use credit default swaps to transfer the credit risk of the underlying assets to a third party without transferring the funding requirement. As the prices of the underlying assets fall, this creates a credit risk on the third party which typically is not collateralised. The total notional amount of credit default swaps used for synthetic securitisation transactions at 31 December 2009 was £1,308 million. The Group takes a credit valuation adjustment by reserving the current mark to market of the exposure multiplied by the credit default swap spread of the counterparty for the maturity of the exposure. At 31 December 2009, the maximum exposure to default by the underlying counterparty (which is equivalent to the fair value) was £66 million, net of the credit reserves. There have been no recent changes in the methodology for assessing credit valuation reserves on credit default swaps.

Within Lloyds Banking Group s insurance businesses, the principal sources of liquidity are premiums received from policyholders, charges levied upon policyholders, investment income and the proceeds from the sale and maturity of investments. The investment policies followed by Lloyds Banking Group s life assurance companies take account of anticipated cash flow requirements including by matching the cash inflows with projected liabilities where appropriate. Cash deposits and highly liquid government securities are available to provide liquidity to cover any higher than expected cash outflows.

CAPITAL RISK

DEFINITION

Capital risk is defined as the risk that the Group has insufficient capital to provide a sufficient resource to absorb losses or that the capital structure is inefficient.

RISK APPETITE

Capital risk appetite is set by the board and reported through various metrics that enable the Group to manage capital constraints and shareholder expectations. One of the key metrics is the Group s core tier 1 capital ratio for which the board has set a target of more than 7 per cent. The chief executive, assisted by the group asset and liability committee, regularly reviews performance against risk appetite. The board formally reviews capital risk on an annual basis.

EXPOSURE

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

MEASUREMENT

The Group s regulatory capital is divided into tiers depending on level of subordination and ability to absorb losses. Core tier 1 capital as defined in the FSA letter to the British Bankers Association in May 2009, comprises mainly shareholders equity and minority interests, after deducting goodwill, other intangible assets and 50 per cent of the net excess of expected loss over accounting provisions and certain securitisation positions. Accounting equity is adjusted in accordance with FSA requirements, particularly in respect of pensions and available for sale assets. Tier 1 capital, as defined by the European Community Banking Consolidation Directive as implemented in the UK by the Financial Services Authority s General Prudential Sourcebook (GENPRU), is core tier 1 capital plus tier 1 capital securities. Tier 2 capital, defined by GENPRU, comprises qualifying subordinated debt after deducting 50 per cent of the excess of expected loss over accounting provisions, and certain securitisation positions. Total capital is the sum of tier 1 and tier 2 capital after deducting investments in subsidiaries and associates that are not consolidated for regulatory purposes. In the case of Lloyds Banking Group, this means that the net assets of its life assurance and general insurance businesses are excluded from its total regulatory capital.

A number of limits are imposed by the FSA on the proportion of the regulatory capital base that can be made up of subordinated debt and preferred securities, for example the amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

The Capital Resources Requirement (CRR), is 8 per cent of risk weighted assets and represents the capital required under Pillar 1 of the Basel II framework. In addition, the FSA currently sets Individual Capital Guidance (ICG) for each UK bank calibrated by reference to the CRR, to address the requirements of pillar 2 of the Basel II framework.

A key input into the FSA s ICG setting process is each bank s Internal Capital Adequacy Assessment Process. The FSA s approach is to monitor the available capital resources in relation to the ICG requirement. The Group has been given an ICG by the FSA and the board has also agreed a formal buffer to be maintained in addition to this requirement. The FSA has made it clear that each ICG remains a confidential matter between each bank and the FSA.

In addition to the minimum requirement for total capital, the FSA has made further statements to explain the approach it has taken to the capital framework. These include core tier 1 and tier 1 targets under stressed conditions.

The Group undertook an extensive series of stress analysis during the year to determine the adequacy of the Group s capital resources against the FSA minimum requirements.

The Group is subject to extensive regulation and regulatory supervision in relation to the levels of capital in its business. Specifically in relation to the consultation papers issued by the Basel Committee on Banking Supervision Strengthening the resilience of the banking sector the group is participating in the industry-wide consultation and calibration exercises taking place through 2010.

MITIGATION

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

The Group is able to raise equity either via a rights issue, placing or an open offer. Placing and open offers were completed in January 2009 as part of the Group s participation in the recapitalisation of the banking sector and in June 2009 when the Group repaid preference shares which were issued to HM Treasury as part of GAPS, and a rights issue and liability management exercise was completed in December.

The Group is also able to raise Tier 2 capital by issuing subordinated liabilities. The cost and availability of subordinated liability finance are influenced by credit ratings of both the Group and the UK s sovereign rating. A reduction in these ratings could increase the interest rate payable and could reduce market access.

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

MONITORING

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group s budgeting and planning processes with updates of expected ratios reviewed regularly during the year by the group asset and liability committee. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios is made to the senior asset and liability committee and to the group asset and liability committee. As part of this reporting any guidance to the market is regularly reviewed.

CAPITAL RATIOS

	2009 £m	2008 £m
Core tier 1		
Ordinary share capital and reserves	**44,275**	9,573
Regulatory post-retirement benefit adjustments	**434**	435
Available-for-sale revaluation reserve	**914**	2,982
Cash flow hedging reserve	**305**	15
Other items	**231**	(108)
	46,159	12,897
Less deductions from core tier 1		
Goodwill and other intangible assets	**(5,779)**	(2,256)
Other deductions	**(445)**	(1,099)
Core tier 1 capital	**39,935**	9,542
Perpetual non-cumulative preference shares		
Preference share capital	**2,639**	1,966
Innovative tier 1 capital instruments		
Preferred securities	**4,956**	3,169
Less: restriction in amount eligible		(976)
Total tier 1 capital	**47,530**	13,701
Tier 2		
Available-for-sale revaluation reserve in respect of equities	**221**	8
Undated subordinated debt	**2,575**	5,189
Innovative capital restricted from tier 1		976
Eligible provisions	**2,694**	21
Dated subordinated debt	**20,068**	5,091
Deductions from tier 2		
Other deductions	**(445)**	(1,099)
Total tier 2 capital	**25,113**	10,186
Supervisory deductions		
Unconsolidated investments life	**(10,015)**	(4,208)
Unconsolidated investments other	**(1,551)**	(550)
Total supervisory deductions	**(11,566)**	(4,758)
Total capital resources	**61,077**	19,129
Risk-weighted assets (unaudited)	**493,307**	170,490
Ratios (unaudited)		
Core tier 1 ratio	**8.1%**	5.6%

Tier 1 capital ratio	**9.6%**	8.0%
Total capital ratio	**12.4%**	11.2%

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

TIER 1 CAPITAL

Core tier 1 capital increased by £30.4 billion largely reflecting the issuance of share capital during the year and retained profits.

Tier 1 capital increased by £33.8 billion principally as a result of the increase in core tier 1 capital. The remainder of the increase reflects the inclusion of HBOS tier 1 instruments, an increase in innovative securities of £2 billion as part of a liability management exercise to exchange upper tier 2 debt and a further issuance of £1.2 billion innovative securities in December 2009. This increase is offset by the effects of the offer of enhanced capital notes during December 2009; as part of the Group s recapitalisation and exit from GAPS, certain preference shares and preferred securities were exchanged for enhanced capital notes included within tier 2 capital.

MOVEMENTS IN CORE TIER 1 AND TIER 1 CAPITAL DURING THE YEAR

	Core tier 1 £m	Tier 1 £m
As at 31 December 2008	9,542	13,701
Profit attributable to ordinary shareholders	**2,827**	**2,827**
Issue of ordinary shares	**29,139**	**29,139**
Recognition of HBOS tier 1 capital instruments		**5,653**
Movement in goodwill and other intangible assets	**(2,526)**	**(2,526)**
Movement in tier 1 securities relating to ECNs exchange offer		**(5,447)**
Innovative securities exchange		**1,959**
Innovative issuance		**1,235**
Other movements	**953**	**989**
As at 31 December 2009	**39,935**	**47,530**

TIER 2 CAPITAL

Tier 2 capital has increased in the period by £14.9 billion, largely due to the acquisition of HBOS. The liability management exercises undertaken reduced tier 2 capital and increased tier 1 capital. The enhanced capital notes exchange offer completed during 2009 resulted in the exchange of certain existing tier 1 and tier 2 securities for tier 2 notes valued at £7.2 billion for regulatory purposes. Under certain specified conditions, these securities would convert to ordinary share capital and increase core tier 1 capital.

SUPERVISORY DEDUCTIONS

Supervisory deductions mainly consist of investments in subsidiary undertakings that are not within the banking group for regulatory purposes. These investments are primarily the Scottish Widows and Clerical Medical life and pensions businesses.

RISK WEIGHTED ASSETS (unaudited)

The following table sets out the Group s risk weighted assets that primarily arise in its banking businesses.

ANALYSIS OF RISK WEIGHTED ASSETS

As at 31 December	**2009 (unaudited) £bn**	2008 (unaudited) £bn

Credit risk	**452.1**	149.6
Operational risk	**25.3**	12.3
Market and counterparty risk	**15.9**	8.5
	493.3	170.4
Divisional analysis		
Retail	**128.6**	49.7
Wholesale	**286.0**	106.8
Insurance	**1.1**	0.1
Wealth and International	**63.2**	11.0
Group Operations and Central items	**14.4**	2.8
	493.3	170.4

Risk-weighted assets increased by £322.9 billion to £493.3 billion, principally as a result of the acquisition of HBOS plc which had risk-weighted assets of £328.0 billion at 31 December 2008. Subsequent to the acquisition, deteriorating economic conditions have led to increased average risk weightings. This has been offset, primarily within Wholesale, by a reduction in exposures due to impairments and asset run-off, and movements due to currency retranslations.

FINANCIAL AND PRUDENTIAL REGULATORY REPORTING, DISCLOSURE AND TAX RISK

DEFINITION

The risk of reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial, prudential regulatory and tax reporting, failure to manage the associated risks of changes in taxation rates, law, ownership or corporate structure and the failure to disclose information about the Group on a timely basis.

RISK APPETITE

The risk appetite is set by the board and reviewed on an annual basis. It includes complying with disclosure requirements within prescribed timescales and avoiding the need for restatement of published financial and prudential regulatory reporting, publicly disclosed information or tax reporting.

EXPOSURE

Exposure represents the sufficiency of the Group s policies and procedures to maintain adequate books and records to support statutory, prudential and tax reporting, to prevent and detect financial reporting fraud and to manage the Group s tax position.

MITIGATION

The Group maintains a system of internal controls, which is designed to be consistently applied and enable the preparation and disclosure of financial reporting, prudential regulatory reporting and tax returns in accordance with International Financial Reporting Standards, statutory and regulatory requirements. The system of internal control is designed to ensure that accounting policies are consistently applied, transactions are recorded and undertaken in accordance with delegated authorities and that assets are safeguarded and liabilities are properly recorded.

MONITORING

The Group has in place a disclosure committee whose responsibility is to review all significant disclosures made by the Group and to assist the group chief executive and group finance director fulfil their responsibilities under the Listing Rules and regulations emanating from the US Sarbanes-Oxley Act of 2002. A programme of work is undertaken and is designed to support an annual assessment of the effectiveness of internal controls over financial reporting, in accordance with the requirements of section 404 of the US Sarbanes-Oxley Act. It also has in place an assurance mechanism over its prudential regulatory reporting; additionally, monitoring activities are designed to identify and maintain tax liabilities and to assess the impact of emerging regulation and legislation on financial, prudential regulatory and tax reporting.

LIFE INSURANCE BUSINESSES

At 31 December 2009, the principal subsidiaries involved in the Group s life insurance operations were Scottish Widows plc (Scottish Widows) and Clerical Medical Investment Group Limited (Clerical Medical). These subsidiaries hold the only large with-profit funds managed by Lloyds Banking Group.

BASIS OF DETERMINING REGULATORY CAPITAL OF THE LIFE INSURANCE BUSINESSES

AVAILABLE CAPITAL RESOURCES

Available capital resources represent the excess of assets over liabilities calculated in accordance with detailed regulatory rules issued by the FSA. Additional rules may apply depending on the nature of the fund, as detailed below.

Statutory basis. Assets are generally valued on a basis consistent with that used for accounting purposes (with the exception that, in certain cases, the value attributed to assets is limited) and which follows a market value approach where possible. Liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses and mortality. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets in accordance with the FSA rules. Other assumptions are based on recent actual experience, supplemented by industry information where appropriate. The assessment of liabilities does not include future bonuses for with-profits policies that are at the discretion of management, but does include a value for policyholder options likely to be exercised.

Realistic basis. The FSA requires each life insurance company which contains a with-profit fund in excess of £500 million to also carry out a realistic valuation of that fund. The Group has two such funds; one within Scottish Widows and one within Clerical Medical. The word realistic in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology.

The valuation of with-profits assets in a with-profits fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in a with-profits fund (a relatively small amount of business in the case of Scottish Widows and Clerical Medical), it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

The realistic valuation of liabilities is carried out using a stochastic simulation model which values liabilities on a basis consistent with tradable market option contracts (a market-consistent basis). The model takes account of policyholder behaviour on a best-estimate basis and includes an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities. Further details regarding the stochastic simulation model are given in the section entitled *Options and guarantees* on page 96.

REGULATORY CAPITAL REQUIREMENTS

Each life insurance company must retain sufficient capital to meet the regulatory capital requirements mandated by the FSA; the basis of calculating the regulatory capital requirement is given below. Except for Scottish Widows and Clerical Medical, the regulatory capital requirement is a combination of amounts held in respect of actuarial reserves, sums at risk and maintenance expenses (the Long-Term Insurance Capital Requirement) and amounts required to cover various stress tests. The regulatory capital requirement is deducted from the available capital resources to give statutory excess capital .

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

For Scottish Widows and Clerical Medical, no amount is required to cover the impact of stress tests on the actuarial reserves. However, a further test is required in respect of the with-profit funds, which compares the level of realistic excess capital to the statutory excess capital of each with-profit fund. In circumstances where the realistic excess capital position is less than statutory excess capital , the company is required to hold additional capital to cover the shortfall, but only to the extent it exceeds the value, calculated in a prescribed way, of internal transfers from the with-profit fund. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component. The realistic excess capital is calculated as the difference between realistic assets and realistic liabilities of the with-profit fund with a further deduction to cover various stress tests.

The determination of realistic liabilities of the with-profit funds includes the value of internal transfers expected to be made from each with-profit fund to the non-profit fund held within the same life insurance entity. These internal transfers include charges on policies where the associated costs are borne by the non-profit fund. The With-Profits Insurance Capital Component may be reduced by the value, calculated in the stress test scenario, of these internal transfers, but only to the extent that credit has not been taken for the value of these charges in deriving actuarial reserves for the relevant non-profit fund.

CAPITAL STATEMENT

The following table provides more detail regarding the capital resources available to meet regulatory capital requirements in the life insurance businesses. The figures quoted are as disclosed in the Group s UK annual report and accounts and were based on management s expectations in advance of completion of the annual financial returns to the FSA; these annual financial returns have since been completed and submitted without material change to the numbers set out below. The figures allowed for a transfer of £261 million and an anticipated transfer of £147 million from long-term funds to the UK life shareholder funds as at 31 December 2009.

Following the acquisition of the life companies within HBOS plc, the format of the capital position statement has been revised to accommodate the reporting of all life assurance businesses within the Group.

CAPITAL RESOURCES

	Scottish Widows With Profit Fund £m	Clerical Medical With Profit Fund £m	UK non-profit funds £m	UK life shareholder funds £m	Overseas life business £m	Total life business £m
As at 31 December 2009						
Shareholders funds:						
Held outside the long-term funds				**1,048**	**651**	**1,699**
Held within the long-term funds			**8,011**		**405**	**8,416**
Total shareholders funds			**8,011**	**1,048**	**1,056**	**10,115**
Adjustments onto a regulatory basis:						
Unallocated surplus within insurance business	**310**	**772**				**1,082**
Value of in-force business			**(5,513)**		**(793)**	**(6,306)**
Other differences between IFRS and regulatory valuation of assets and liabilities			**253**	**(154)**	**108**	**207**
Estimated share of realistic liabilities consistent with the FSA reporting treatment	**(407)**	**(40)**				**(447)**
Qualifying loan capital				**1,165**		**1,165**
Support arrangement assets	**354**		**(354)**			
Available capital resources	**257**	**732**	**2,397**	**2,059**	**371**	**5,816**

	Scottish Widows With Profit Fund £m	UK non-profit funds £m	UK life shareholder funds £m	Overseas life business £m	Total life business £m
As at 31 December 2008 (statutory basis)					
Shareholders funds					
Held outside the long-term funds			865	2	867
Held within the long-term funds		3,762		13	3,775
Total shareholders funds		3,762	865	15	4,642
Adjustments onto a regulatory basis:					
Unallocated surplus within insurance business	293				293
Value of in-force business		(1,893)			(1,893)
Other differences between IFRS and regulatory valuation of assets and liabilities		25	(317)	(4)	(296)
Estimated share of realistic liabilities consistent with the FSA reporting treatment	(406)				(406)
Qualifying loan capital			604		604
Support arrangement assets	371	(371)			
Available capital resources	258	1,523	1,152	11	2,944

Available capital resources for with-profit funds are presented in the table on a realistic basis.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

FORMAL INTRA-GROUP CAPITAL ARRANGEMENTS

Scottish Widows has a formal arrangement with one of its subsidiary undertakings, Scottish Widows Unit Funds Limited, whereby the subsidiary company can draw down capital from Scottish Widows to finance new business which is reinsured from the parent to its subsidiary. Scottish Widows has also provided subordinated loans to its fellow group undertaking Scottish Widows Bank plc.

CONSTRAINTS OVER AVAILABLE CAPITAL RESOURCES

SCOTTISH WIDOWS

Scottish Widows was created following the demutualisation of Scottish Widows Fund and Life Assurance Society in 2000. The terms of the demutualisation are governed by a Court-approved Scheme of Transfer (the Scheme) which, inter alia, created a With Profit Fund and a Non-Participating Fund and established protected capital support for the with-profits policyholders in existence at the date of demutualisation. Much of that capital support is held in the Non-Participating Fund and, as such, the capital held in that fund is subject to the constraints noted below.

Requirement to maintain a Support Account: The Scheme requires the maintenance of a Support Account within the Non-Participating Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Participating Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account (or, if greater, the excess of realistic liabilities for business written before demutualisation over the relevant assets) in assessing the realistic value of assets available to the With Profit Fund. At 31 December 2009, the estimated value of surplus admissible assets in the Non-Participating Fund was £1,627 million (31 December 2008: £1,523 million) and the estimated value of the Support Account was £222 million (31 December 2008: £200 million).

Further Support Account: The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Participating Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Participating Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2009, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £3,823 million (31 December 2008: £3,605 million) and the estimated combined value of the Support Account and Further Support Account was £2,495 million (31 December 2008: £2,582 million).

Other restrictions in the Non-Participating Fund: In addition to the policies which existed at the date of demutualisation, the With Profit Fund includes policies which have been written since that date. As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2009 is £132 million (31 December 2008: £171 million). Scottish Widows has obtained from the FSA permission to include the value of this support in assessing the realistic value of assets available to the With Profit Fund. There is a further test requiring that no amounts can be transferred from the Non-Participating Fund of Scottish Widows unless there are sufficient assets within the Long Term Fund to meet both policyholders reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

CLERICAL MEDICAL

The surplus held in the Clerical Medical With Profit Fund can only be applied to meet the requirements of the fund itself or distributed accordingly to the prescribed rules of the fund. Shareholders are entitled to an amount not exceeding one ninth of the amount distributed to policyholders in the form of bonuses. The use of capital within the fund is also subject to the terms of the scheme of demutualisation effected in 1996 and the conditions contained in the Principles and Practices of Financial Management of the fund. Capital within the Clerical Medical Non-Profit Fund is available to meet the With Profit Fund requirements.

OTHER LIFE INSURANCE BUSINESSES

Except as described above capital held in UK non-profit funds is potentially transferable to other parts of the Group, subject to meeting the regulatory requirements of these businesses. There are no prior arrangements in place to allow capital to move freely between life insurance entities or other parts of the Group.

Overseas life business includes several life companies outside the UK, including Germany and Ireland. In all cases the available capital resources are subject to local regulatory requirements, and transfer to other parts of the Group is subject to additional complexity surrounding the transfer of capital from one country to another.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

MOVEMENTS IN REGULATORY CAPITAL

The movements in the Group s available capital resources in the life business can be analysed as follows:

MOVEMENTS IN AVAILABLE CAPITAL RESOURCES

	Scottish Widows With Profit Fund £m	Clerical Medical With Profit Fund £m	UK non-profit funds £m	UK life shareholder funds £m	Overseas life business £m	Total life business £m
As at 31 December 2008	258		1,523	1,152	11	2,944
Acquisition of life businesses		**511**	**1,205**	**1,342**	**250**	**3,308**
Changes in estimations and in demographic assumptions used to measure life assurance liabilities		**19**	**(208)**	**43**	**36**	**(110)**
Changes in regulatory requirements						
Dividends and capital transfers			**(438)**	**(453)**	**(14)**	**(905)**
Change in support arrangements	**(17)**		**17**			
New business and other factors	**16**	**202**	**298**	**(25)**	**88**	**579**
As at 31 December 2009	**257**	**732**	**2,397**	**2,059**	**371**	**5,816**

WITH-PROFIT FUNDS

Available capital in the Scottish Widows With Profit Fund has decreased from £258 million at 31 December 2008 to an estimated £257 million at 31 December 2009.

Available capital in the Clerical Medical With Profit Fund has increased from £511 million at acquisition to an estimated £732 million at 31 December 2009.

UK NON-PROFIT FUNDS

Available capital in the UK non-profit funds has increased from £1,523 million at 31 December 2008 to an estimated £2,397 million at 31 December 2009. The acquisition of Clerical Medical resulted in a £1,205 million increase. Further increases due to new business were offset by changes in assumptions and actual and proposed transfers to the UK life shareholders funds.

UK LIFE SHAREHOLDER FUNDS

Available capital in the UK life shareholder funds has increased from £1,152 million at 31 December 2008 to an estimated £2,059 million at 31 December 2009. The acquisition of Clerical Medical resulted in a £1,342 million increase. Redemption of subordinated debt (shown within dividends and capital transfers) has been partly offset by actual and proposed transfers from the long term funds.

OVERSEAS LIFE BUSINESS

The acquisition of Clerical Medical business resulted in a £250 million increase. Further increases were due to new business and changes in assumptions.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS AUDITED INFORMATION

Analysis of policyholder liabilities reported in the balance sheet in respect of the Group s life insurance business is as follows. With-profit fund liabilities are valued in accordance with FRS 27.

ANALYSIS OF POLICYHOLDER LIABILITIES

	Scottish Widows With Profit Fund £m	Clerical Medical With Profit Fund £m	UK non-profit funds £m	Overseas life business £m	Total life business £m
As at 31 December 2009					
With-profit fund liabilities	**13,347**	**10,225**	**5**		**23,577**
Unit-linked business (excluding that accounted for as non-participating investment contracts)			**32,816**	**6,864**	**39,680**
Other life insurance business			**11,449**	**183**	**11,632**
Insurance and participating investment contract liabilities	**13,347**	**10,225**	**44,270**	**7,047**	**74,889**
Non-participating investment contract liabilities			**45,328**	**1,020**	**46,348**
Total policyholder liabilities	**13,347**	**10,225**	**89,598**	**8,067**	**121,237**

	Scottish Widows With Profit Fund £m	UK non-profit funds £m	Total life business £m
As at 31 December 2008			
With-profit fund liabilities	13,293		13,293
Unit-linked business (excluding that accounted for as non-participating investment contracts)		11,480	11,480
Other life insurance business		8,364	8,364
Insurance and participating investment contract liabilities	13,293	19,844	33,137
Non-participating investment contract liabilities		14,243	14,243
Total policyholder liabilities	13,293	34,087	47,380

CAPITAL SENSITIVITIES

SHAREHOLDERS FUNDS

Shareholders funds outside the long-term business fund, other than those used to match regulatory requirements, are mainly invested in assets that are less sensitive to market conditions.

WITH-PROFIT FUNDS

The with-profit realistic liabilities and the available capital for the with-profit funds are sensitive to both market conditions and changes to a number of non-economic assumptions that affect the valuation of the liabilities of the fund. The available capital resources (and capital requirements) are sensitive to the level of the stock market, with the position worsening at low stock market levels as a result of the guarantees to policyholders increasing in value. However, the exposure to guaranteed annuity options increases under rising stock market levels. An increase in the level of equity volatility implied by the market cost of equity put options also increases the market consistent value of the options given to policyholders and worsens the capital position.

The most critical non-economic assumptions are the level of take-up of options inherent in the contracts (higher take-up rates are more onerous), mortality rates (lower mortality rates are generally more onerous) and lapses prior to dates at which a guarantee would apply (lower lapse rates are generally more onerous where guarantees are in the money). The sensitivity of the capital position and capital requirements of the with-profit funds is partly mitigated by the actions that can be taken by management.

OTHER LONG-TERM FUNDS

Outside the with-profit funds, assets backing actuarial reserves in respect of policyholder liabilities are invested so that the values of the assets and liabilities are broadly matched. The most critical non-economic assumptions are mortality rates in respect of annuity business written (lower mortality rates are more onerous). Reinsurance arrangements are in place to reduce the Group s exposure to deteriorating mortality rates in respect of life insurance contracts. In addition, poor cost control would gradually depreciate the available capital and lead to an increase in the valuation of the liabilities (through an increased allowance for future costs).

Assets held in excess of those backing actuarial reserves are invested across a range of investment categories including fixed interest securities, equities, properties and cash. The mix of investments is determined in line with the policy of Lloyds Banking Group to minimise the working capital (defined as available capital less minimum required capital) required to ensure all capital requirements continue to be met under a range of stress tests.

OPTIONS AND GUARANTEES

The Group has sold insurance products that contain options and guarantees, both within the with-profit funds and in other funds.

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 of Scottish Widows 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 2009 of £1.6 billion (2008: £2.0 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, under the realistic capital regime of the FSA, the liabilities of the with-profit funds are valued using a market-consistent stochastic simulation model. This model is used in order to place 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. The risk-free yield is defined as spot yields derived from the UK gilt yield curve.

Investment volatility. The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2009, the 10 year equity-implied at-the-money assumption was set at 26.6 per cent (31 December 2008: 34.6 per cent). The assumption for property volatility was 15 per cent (31 December 2008: 15 per cent). The volatility of interest rates has been calibrated to the implied volatility of swaptions which was broadly 15 per cent (31 December 2008: 16 per cent).

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take-up rates and assumptions regarding persistency (both of which are based on recent actual experience and include an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

OPTIONS AND GUARANTEES OUTSIDE THE WITH-PROFIT FUNDS

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 £64 million (31 December 2008: £65 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £3 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £11 million.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

INVESTMENT PORTFOLIO, MATURITIES, DEPOSITS, SHORT-TERM BORROWINGS

Trading securities and other financial assets at fair value through profit or loss; available-for-sale financial assets; and debt securities classified as loans and receivables

The following table sets out the book values and valuations of the Group s debt securities, treasury and other bills and equity shares at 31 December for each of the three years indicated.

	2009 Book value £m	**2009 Valuation £m**	2008 Book value £m	2008 Valuation £m	2007 Book value £m	2007 Valuation £m
Trading securities and other financial assets at fair value through profit or loss						
US treasury and US government agencies	**482**	**482**	258	258	38	38
Other government securities	**19,479**	**19,479**	7,106	7,106	4,872	4,872
Other public sector securities	**706**	**706**	18	18		
Bank and building society certificates of deposit	**2,034**	**2,034**	433	433	811	811
Mortgage-backed securities	**520**	**520**	369	369	157	157
Other asset-backed securities	**2,890**	**2,890**	1,342	1,342	1,927	1,927
Corporate and other debt securities	**20,668**	**20,668**	11,656	11,656	17,171	17,171
Equity shares	**84,150**	**84,150**	23,274	23,274	31,746	31,746
	130,929	**130,929**	44,456	44,456	56,722	56,722
Available-for-sale financial assets						
US treasury and US government agencies	**2,898**	**2,898**	358	358	319	319
Other government securities	**5,771**	**5,771**	510	510		
Other public sector securities	**31**	**31**	12	12	5	5
Bank and building society certificates of deposit	**1,014**	**1,014**	9,602	9,602	1,825	1,825
Mortgage-backed securities	**4,781**	**4,781**	5,700	5,700	6,050	6,050
Other asset-backed securities	**7,640**	**7,640**	8,092	8,092	4,071	4,071
Corporate and other debt securities	**19,904**	**19,904**	2,183	2,183	6,270	6,270
Equity shares	**2,031**	**2,031**	41	41	29	29
Treasury bills and other bills	**2,532**	**2,532**	29,209	29,209	1,627	1,627
	46,602	**46,602**	55,707	55,707	20,196	20,196
Debt securities classified as loans and receivables						
Mortgage-backed securities	**13,322**	**12,799**	478	402		
Other asset-backed securities	**17,137**	**15,998**	540	192		
Corporate and other debt securities	**2,623**	**3,110**	3,531	3,337		
	33,082	**31,907**	4,549	3,931		
Allowance for impairment losses	**(430)**		(133)			
	32,652	**31,907**	4,416	3,931		

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

MATURITIES AND WEIGHTED AVERAGE YIELDS OF INTEREST-BEARING SECURITIES

The weighted average yield for each range of maturities is calculated by dividing the annualised interest income prevailing at 31 December 2009 by the book value of securities held at that date.

	Maturing within one year		Maturing after one but within five years		Maturing after five but within ten years		Maturing after ten years	
	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %
Trading securities and other financial assets at fair value through profit or loss								
US treasury and US government agencies	**82**	**2.5**	**207**	**3.2**	**93**	**4.2**	**100**	**5.2**
Other government securities	**3,123**	**1.2**	**4,097**	**3.0**	**3,917**	**3.6**	**8,342**	**3.8**
Other public sector securities	**28**	**6.4**	**213**	**4.2**	**116**	**5.2**	**349**	**5.0**
Bank and building society certificates of deposit	**2,034**	**0.1**						
Mortgage-backed securities	**15**	**4.4**	**20**	**4.6**	**52**	**5.0**	**433**	**5.4**
Other asset-backed securities			**130**	**5.7**	**271**	**6.2**	**2,489**	**3.8**
Corporate and other debt securities	**2,458**	**1.1**	**4,169**	**2.6**	**4,356**	**5.1**	**9,685**	**4.6**
	7,740		**8,836**		**8,805**		**21,398**	
Available-for-sale financial assets								
US treasury and US government agencies	**2**	**4.6**	**6**	**6.8**	**2,159**	**3.6**	**731**	**5.8**
Other government securities	**83**	**0.4**	**327**	**4.6**	**2,007**	**3.5**	**3,354**	**3.7**
Other public sector securities	**31**	**9.4**						
Bank and building society certificates of deposit	**983**	**0.7**	**31**	**0.3**				
Mortgage-backed securities	**386**	**0.7**	**3,419**	**2.3**	**841**	**3.2**	**135**	**3.3**
Other asset-backed securities	**705**	**0.8**	**3,236**	**1.4**	**3,570**	**1.4**	**129**	**2.4**
Corporate and other debt securities	**2,694**	**2.0**	**12,862**	**1.2**	**4,040**	**3.4**	**308**	**5.5**
Treasury bills	**2,531**	**0.2**	**1**	**1.5**				
	7,415		**19,882**		**12,617**		**4,657**	
Debt securities classified as loans and receivables								
Mortgage-backed securities	**15**	**1.8**	**403**	**1.2**	**1,582**	**1.1**	**11,322**	**0.9**
Other asset-backed securities	**27**	**0.1**	**2,747**	**0.8**	**4,710**	**0.7**	**9,653**	**0.7**
Corporate and other debt securities	**645**	**0.5**	**1,331**	**0.8**	**210**	**8.5**	**437**	**1.8**
	687		**4,481**		**6,502**		**21,412**	

The Group s investment holdings at 31 December 2009 include £15,228 million due from the UK Government and its agencies.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

MATURITY ANALYSIS AND INTEREST RATE SENSITIVITY OF LOANS AND ADVANCES TO CUSTOMERS AND BANKS AS AT 31 DECEMBER 2009

The following table analyses the maturity profile and interest rate sensitivity of loans by type on a contractual repayment basis as at 31 December 2009.

All amounts are before deduction of impairment allowances. Demand loans are included in the maturing in one year or less category.

	Maturing in one year or less £m	Maturing after one but within five years £m	Maturing after five years £m	Total £m
Domestic				
Loans and advances to banks	**26,594**	**1,604**	**1,277**	**29,475**
Loans and advances to customers:				
Mortgages	**8,296**	**34,683**	**301,172**	**344,151**
Other personal lending	**22,359**	**13,686**	**4,745**	**40,790**
Property companies	**24,629**	**22,811**	**16,629**	**64,069**
Financial, business and other services	**25,632**	**20,873**	**11,627**	**58,132**
Transport, distribution and hotels	**10,726**	**7,474**	**4,513**	**22,713**
Manufacturing	**4,840**	**5,158**	**1,482**	**11,480**
Other	**11,874**	**9,563**	**8,157**	**29,594**
Total domestic	**134,950**	**115,852**	**349,602**	**600,404**
Foreign	**31,378**	**19,148**	**26,350**	**76,876**
Total loans	**166,328**	**135,000**	**375,952**	**677,280**
Of which:				
Fixed interest rate	**34,989**	**40,159**	**122,688**	**197,836**
Variable interest rate	**131,339**	**94,841**	**253,264**	**479,444**

DEPOSITS

The following tables show the details of the Group s average customer deposits in each of the past three years.

	2009 Average balance £m	**2009 Average rate %**	2008 Average balance £m	2008 Average rate %	2007 Average balance £m	2007 Average rate %
Non-interest bearing demand deposits	**6,902**		3,793		3,899	
Interest-bearing demand deposits	**89,603**	**0.43**	47,985	1.28	46,124	1.80
Savings deposits	**234,273**	**1.19**	84,756	3.60	77,834	3.90
Time deposits	**33,447**	**3.66**	18,272	6.94	18,090	6.73
Total average deposits	**364,225**	**1.21**	154,806	3.19	145,947	3.48

The analysis of the Group s average customer deposits for 2009 between domestic and foreign offices is as follows:

	Domestic	**Foreign**	**Total**

	Average balance £m	Average rate %	Average balance £m	Average rate %	Average balance £m	Average rate %
Non-interest bearing demand deposits	**6,253**		**649**		**6,902**	
Interest-bearing demand deposits	**88,567**	**0.44**	**1,036**	**0.19**	**89,603**	**0.43**
Savings deposits	**229,234**	**1.19**	**5,039**	**1.33**	**234,273**	**1.19**
Time deposits	**31,908**	**3.56**	**1,539**	**5.59**	**33,447**	**3.66**
Total deposits	**355,962**	**1.20**	**8,263**	**1.88**	**364,225**	**1.21**

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

CERTIFICATES OF DEPOSIT AND OTHER TIME DEPOSITS

The following table gives details of the Group s certificates of deposit issued and other time deposits as at 31 December 2009 individually in excess of US $100,000 (or equivalent in another currency) by time remaining to maturity.

	3 months or less £m	Over 3 months but within 6 months £m	Over 6 months but within 12 months £m	Over 12 months £m	Total £m
Domestic					
Certificates of deposit	**16,816**	**1,508**	**8,701**	**171**	**27,196**
Time deposits	**55,300**	**6,520**	**6,868**	**10,538**	**79,226**
	72,116	**8,028**	**15,569**	**10,709**	**106,422**
Foreign					
Certificates of deposit and other time deposits	**23,943**	**3,310**	**2,265**	**1,199**	**30,717**
Total	**96,059**	**11,338**	**17,834**	**11,908**	**137,139**

SHORT-TERM BORROWINGS

Short-term borrowings are included within the balance sheet captions Deposits by banks , Customer accounts and Debt securities in issue and are not identified separately on the balance sheet. The short-term borrowings of the Group consist of overdrafts from banks, securities sold under agreements to repurchase, notes issued as part of lending securitisations, certificates of deposit issued, commercial paper and promissory notes issued and other marketable paper. Securities sold under agreements to repurchase, certificates of deposit issued, commercial paper, securitisation notes and covered bonds are the only significant short-term borrowings of the Group.

The following tables give details of these significant short-term borrowings of the Group for each of the past three years.

	2009 £m	2008 £m	2007 £m
Liabilities in respect of securities sold under repurchase agreements			
Balance at the year end	**63,112**	24,980	733
Average balance for the year	**84,684**	5,749	3,222
Maximum balance during the year	**110,505**	24,980	3,728
Average interest rate during the year	**2.0**%	4.4%	4.8%
Interest rate at the year end	**0.5**%	3.7%	5.2%
Certificates of deposit issued			
Balance at the year end	**50,858**	33,207	14,995
Average balance for the year	**68,318**	23,082	24,085
Maximum balance during the year	**111,761**	33,207	30,467
Average interest rate during the year	**1.9**%	4.1%	5.3%
Interest rate at the year end	**0.8**%	2.2%	5.6%
Commercial paper			
Balance at the year end	**34,900**	20,644	17,388
Average balance for the year	**36,137**	21,520	14,325
Maximum balance during the year	**49,451**	28,957	17,404
Average interest rate during the year	**0.8**%	3.5%	5.3%
Interest rate at the year end	**0.8**%	0.8%	2.3%

Securitisation notes			
Balance at the year end	**37,557**	10,050	12,501
Average balance for the year	**43,869**	10,182	11,881
Maximum balance during the year	**49,766**	12,707	13,259
Average interest rate during the year	**1.7**%	4.1%	5.2%
Interest rate at the year end	**1.4**%	2.8%	5.2%
Covered bonds			
Balance at the year end	**27,311**		
Average balance for the year	**27,601**		
Maximum balance during the year	**29,408**		
Average interest rate during the year	**4.4**%		
Interest rate at the year end	**4.2**%		

MANAGEMENT AND EMPLOYEES

DIRECTORS AND SENIOR MANAGEMENT

The Group is led by the board comprising executive and non-executive directors with wide experience. The appointment of directors is considered by the nomination and governance committee and approved by the board and, following the provisions in the articles of association, they must stand for election by the shareholders at the first annual general meeting following their appointment and must retire, and may stand for re-election by the shareholders, at least every three years. Independent non-executive directors are appointed for three-year renewable terms, which may, in accordance with the articles of association, be terminated without notice or payment of compensation.

The board usually meets at least nine times a year. It has a programme designed to enable the directors regularly to review corporate strategy and the operations and results of the businesses and discharge their duties within a framework of prudent and effective controls relating to the assessing and managing of risk.

The roles of the chairman, the group chief executive and the board and its governance arrangements, including the schedule of matters specifically reserved to the board for decision, are reviewed annually. The matters reserved to the board for decision include the approval of the annual report and accounts and any other financial statements; the payment of dividends; the long-term objectives of the Group; the strategies necessary to achieve these objectives; the Group s budgets and plans; significant capital expenditure items; significant investments and disposals; the basis of allocation of capital within the Group; the organisation structure of the Group; the arrangements for ensuring that the Group manages risks effectively; any significant change in accounting policies or practices; the appointment of the Company s main professional advisers and their fees; and the appointment of senior executives within the organisation and related succession planning.

According to the articles of association, the business and affairs of the Company are managed by the directors, who have delegated to management the power to make decisions on operational matters, including those relating to credit, liquidity and market risk, within an agreed framework.

All directors have access to the services of the company secretary, and independent professional advice is available to the directors at the Group s expense, where they judge it necessary to discharge their duties as directors.

During 2009, the board, supported by JCA Group, conducted a formal evaluation of the performance of the board, its committees and individual directors. Directors were invited to comment, through questionnaires and interviews, and JCA Group s report was subsequently reviewed and discussed by the board. Where areas for improvement were identified, action has been agreed.

The chairman s performance was evaluated by the non-executive directors, taking account of the views of executive directors. This appraisal was discussed at a meeting of the non-executive directors, led by the senior independent director, without the chairman being present.

The remuneration committee reviewed the performance of the chairman, the group chief executive and the other group executive directors, when considering their remuneration arrangements. The nomination and governance committee reviewed the performance of all the directors and the independence of non-executive directors. Like all board committees, the nomination and governance committee and remuneration committee report to the board on their deliberations, including the results of the performance and independence evaluations.

The chairman has a private discussion at least once a year with each director on a wide range of issues affecting the Group, including any matters which the directors, individually, wish to raise.

There is an induction programme for all new directors, which is tailored to their specific requirements and includes visits to individual businesses and meetings with senior management. Major shareholders are also offered the opportunity to meet new non-executive directors. Additional training and updates on particular issues are arranged as appropriate.

The directors and senior management of Lloyds Banking Group plc are:

SIR WINFRIED BISCHOFF♦♦ +

Chairman

Joined the board and was appointed chairman on 15 September 2009. Previously chairman of Citigroup Inc. from December 2007 to February 2009. He joined J Henry Schroder & Co in January 1966 and became managing director of Schroders Asia in 1971, group chief executive of Schroders Plc in 1984 and chairman in 1995. Following the acquisition of Schroders investment banking business by Citigroup in 2000 he became chairman of Citigroup Europe before being appointed acting chief executive officer of Citigroup in 2007 and subsequently as chairman in the same year. A non-executive director of Eli Lilly and Company, and The McGraw Hill Companies Inc. in the United States, and chairman of the UK Career Academy Foundation. A member of the Akbank International advisory board. Aged 69.

LORD LEITCH*♦

Deputy Chairman and Independent Director

Joined the board in 2005 and was appointed deputy chairman in May 2009. Appointed chairman of Scottish Widows in 2007. Held a number of senior and general management appointments in Allied Dunbar, Eagle Star and Threadneedle Asset Management before the merger of Zurich Group and British American Tobacco s financial services businesses in 1998. Subsequently served as chairman and chief executive officer of Zurich Financial Services United Kingdom, Ireland, Southern Africa and Asia Pacific, until his retirement in 2004. Chairman of the Government s Review of Skills (published in December 2006) and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster. Former chairman of the National Employment Panel. Aged 62.

SIR JULIAN HORN-SMITH♦ +

Independent Director

Joined the board in 2005. Held a number of senior and general management appointments in Vodafone from 1984 to 2006 including a directorship of that company from 1996, group chief operating officer from 2001 and deputy chief executive officer from 2005. Previously held positions in Philips from 1978 to 1982 and Mars GB from 1982 to 1984. A non-executive director of De La Rue, Digicel Group and Emobile (Japan), a director of Sky Malta, a member of the Altimo International advisory board and a senior advisor to UBS and CVC Capital Partners in relation to the global telecommunications sector. Pro vice-chancellor of University of Bath. A former chairman of The Sage Group. Aged 61.

GLEN R MORENO♦ ++

Senior Independent Director

Chairman of Pearson, the media group, since October 2005. He is a director of Fidelity International, one of the world s largest fund management companies, and chairman of its audit committee. From 1987 to 1991 he was chief executive of Fidelity International. Until mid 2009, he was a non-executive director and senior independent director of Man Group, the FTSE 100 financial services group, and acting chairman of UKFI. He was a group executive at Citigroup; from 1969 to 1987 he held a number of senior positions at the bank in Europe and Asia. Aged 66.

MANAGEMENT AND EMPLOYEES

DAVID L ROBERTS*+

Independent Director

Executive director, member of the group executive committee and chief executive, International Retail and Commercial Banking at Barclays until December 2006. He joined Barclays in 1983 and held various senior management positions, including chief executive, Personal Financial Services and chief executive, Business Banking. He was also a non-executive director of BAA until June 2006 and a non-executive director of Absa Group Limited, one of South Africa s largest financial services groups, until October 2006. From 2007 to 2009 he was also the chairman and chief executive of BAWAG P.S.K. AG, the second largest retail bank in Austria. He is currently a member of the strategy board for Henley Business School, non-executive chairman of The Mind Gym and a non-executive director of Campion Willcocks. Aged 47.

T TIMOTHY RYAN, JR*+

Independent Director

Joined the board on 1 March 2009. President and chief executive of the Securities Industry and Financial Markets Association. Held a number of senior appointments in JP Morgan Chase from 1993 to 2008 including vice chairman, financial institutions and governments, from 2005. A director of the US-Japan Foundation, Great-West Life Annuity Insurance Co. and Putnam Investments and a member of the Global Markets Advisory Committee for the National Intelligence Council. A former director in the Office of Thrift Supervision, US Department of the Treasury and Koram Bank and the International Foundation of Election Systems. Aged 64.

MARTIN A SCICLUNA♦**+

Independent Director

Joined the board in September 2008. Chairman of Deloitte UK from 1995 to 2007 and a member of the board from 1991 to 2007. Joined the firm in 1973 and was a partner from 1982 until he retired in 2008. A member of the board of directors of Deloitte Touche Tohmatsu from 1999 to 2007. Chairman of Great Portland Estates. A member of the council of Leeds University and a governor of Berkhamsted School. Aged 59.

ANTHONY WATSON CBE♦*

Independent Director

Joined the board on 2 April 2009. Previously chief executive of Hermes Pensions Management. Held a number of senior appointments in AMP Asset Management from 1991 to 1998. A non-executive director of Hammerson, Vodafone and Witan Investment Trust, a member of the Norges Bank Investment Management advisory board and chairman of Marks and Spencer Pension Trust, Asian Infrastructure Fund and Lincoln s Inn investment committee. A former chairman of MEPC and of the Strategic Investment Board (Northern Ireland) and a former member of the Financial Reporting Council. Aged 65.

J ERIC DANIELS

Group Chief Executive

Joined the board in 2001 as group executive director, UK retail banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. A non-executive director of BT Group. Aged 58.

ARCHIE G KANE

Group Executive Director Insurance (Board Representative for Scotland)

Joined the group in 1986 and held a number of senior and general management appointments before being appointed to the board in 2000, as group executive director, IT and operations. Appointed group executive director, insurance and investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. Chairman of the Association of British Insurers and a member of The Takeover Panel. Aged 57.

G TRUETT TATE

Group Executive Director Wholesale

Joined the group in 2003 as managing director, corporate banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. A non-executive director of BritishAmerican Business Inc. Chairman of Arora Holdings and a director of Business in the Community and a director and trustee of In Kind Direct. Aged 59.

TIM J W TOOKEY

Group Finance Director

Joined the group in 2006 as deputy group finance director, before being appointed acting group finance director in April 2008. Appointed to the board in October 2008 as group finance director. Previously finance director for the UK and Europe at Prudential from 2002 to 2006 and group finance director of Heath Lambert Group from 1996 to 2002. Prior to that, he spent 11 years at KPMG. Aged 47.

HELEN A WEIR CBE

Group Executive Director Retail

Joined the board in 2004 as group finance director. Appointed as group executive director, UK retail banking in April 2008. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q, having joined that company in 1995 from McKinsey & Co where she was a senior manager. Began her career at Unilever. Member of the Financial Services Practitioner Panel and the Said Business School Advisory Board. Chair of the British Bankers Association Retail Committee. A former member of the Accounting Standards Board. Fellow of the Chartered Institute of Management Accountants. Aged 47.

*Member of the audit committee **Chairman of the audit committee ♦ Member of the nomination and governance committee ♦♦ Chairman of the nomination and governance committee Member of the remuneration committee Chairman of the remuneration committee + Member of the risk oversight committee ++ Chairman of the risk oversight committee

MANAGEMENT AND EMPLOYEES

EMPLOYEES

As at 31 December 2009, the Group employed 107,144 people (on a full-time equivalent basis), compared with 58,756 at 31 December 2008 as a result of the acquisition of HBOS. At 31 December 2009 101,696 employees were located in the UK, 3,582 in continental Europe, 652 in the Americas, and 1,214 in the rest of the world. At the same date, 51,926 people were employed in Retail, 17,489 in Wholesale, 9,989 in Wealth and International, 9,646 in Insurance, 16,037 in Group Operations, and 2,057 in other functions.

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

In the UK, the Group belongs to the major employer groups campaigning for equality for the above groups of staff, including Employers Forum on Disability, Employers Forum on Age, Stonewall and the Race for Opportunity. The Group s involvement with these organisations enables it to identify and implement best practice for its staff.

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

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in the Group. Further details are given in *Compensation*.

The Group has a code of business conduct which applies to all employees. The code as amended from time to time is available to the public on the Company s website at www.lloydsbankinggroup.com.

MEETINGS WITH SHAREHOLDERS

In order to develop an understanding of the views of major shareholders, the board receives regular reports from the group finance director and the director of investor relations.

The chairman, the group chief executive and the group finance director also have meetings with representatives of major shareholders and the senior independent director also attends some of these meetings. In addition, all directors are invited to attend investment analysts and stockbrokers briefings on the financial results.

All shareholders are encouraged to attend and participate in the Group s annual general meeting.

COMPENSATION

This is a report made by the board of Lloyds Banking Group plc, on the recommendation of the remuneration committee. It covers the current and proposed components of the remuneration policy and details the remuneration for each serving director during 2009.

REMUNERATION DECISIONS FOR 2009/2010 KEY HIGHLIGHTS

In 2010, our remuneration package will continue to have the same main elements as for 2009:

- Base salary
- Annual incentive
- Long-term incentive plan

In addition, executive directors participate in pension arrangements and receive benefits such as life assurance and medical insurance.

The following key decisions have been made for 2009/2010 remuneration:

- 2010 base salaries for executive directors will continue to be frozen at 2008 levels
- At his own request the group chief executive waived his award under the annual incentive plan for 2009
- Awards under the annual incentive plan for 2009 for executive directors amounted to between 150 per cent and 185 per cent of salary
- All awards under the annual incentive plan are deferred into shares and subject to clawback, with any awards released in 2012
- LTIP award below historic award levels at a maximum of 275 per cent of salary subject to stretching performance conditions based on EPS, economic profit and the achievement of stretching share price targets
- Any shares vesting as a result of the element of the LTIP relating to the share price targets must be retained for a further two years post vesting

The approximate make-up of the main components of our new package for executive directors on an expected value basis is shown below:

(The split in the components in the above chart are for executive directors. Comparable numbers for the group chief executive are: long term incentive 40 per cent, short term incentive 32 per cent and salary 28 per cent)

The 2010 package is designed to encourage a long-term and risk-based focus:

- Salary is a significant proportion of the total package, avoiding excessive leverage
- All incentives will be paid on a deferred basis at the end of three years
- Deferred annual incentive is subject to clawback; ie it is not released when information subsequently comes to light about the performance on which the incentive award is based, which had it been known prior to the determination of the awards would have affected the original award decision
- A combination of financial and non-financial measures encourages a long-term focus
- Economic profit, which is a risk-adjusted profit measure, is a core financial target used in both the annual incentive plan and the LTIP

Shares resulting from the vesting of the share price performance part of the LTIP must be retained for a further two years post vesting

We believe that these arrangements are well aligned with the Fast s Code of Practice on Remuneration.

COMPENSATION

GOVERNANCE AND RISK MANAGEMENT

An essential component of our approach to remuneration is the governance process that underpins it. This ensures that our 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 aligned to its long-term business strategy, its business objectives, its risk appetite and values, and recognizes the interests of relevant stakeholders. The remuneration policy and philosophy covers the whole Group, but the committee pays particular attention to the top management group and those colleagues who perform significant influence functions for the Group and those who could have a material impact on the Group s risk profile. The committee s role is to ensure that these colleagues are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organization, whilst ensuring that there is no reward for excessive risk taking.

The committee determines the pensions policy for all colleagues and advises on other major changes to employee benefits schemes. It also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount, currently £350,000, and/or whose short-term incentive opportunity exceeds £250,000.

The committee monitors the application of the authority delegated to the group executive committee and the divisional remuneration committees to ensure that policies and principles are being fairly and consistently applied. The committee liaises with the risk oversight committee and the risk function in relation to risk-adjusted performance measures.

All the independent non-executive directors are invited to attend meetings if they wish, and they receive the minutes and have the opportunity to comment and have their views taken into account before the committee s decisions are implemented.

The committee s terms of reference are available from the company secretary and are displayed on the Group s website, www.lloydsbankinggroup.com.

The committee met on 13 occasions during 2009, and the members were as follows:

Dr Wolfgang Berndt (chairman)

Sir Victor Blank (until 14 September 2009)

Sir Winfried Bischoff (from 15 September 2009)

Mr Philip Green (until 23 October 2009)

Sir Julian Horn-Smith

Lord Leitch (from 18 May 2009)

Sir David Manning (until 2 November 2009)

Ms Carolyn McCall (from 23 January 2009 until 31 December 2009)

The committee welcomed Lord Leitch and Ms Carolyn McCall to the committee and Sir Winfried Bischoff, on his appointment as chairman of the Group. We thank Sir Victor Blank, Mr Philip Green, Ms Carolyn McCall and Sir David Manning for their contributions to the committee during 2009 up until their departures from the Group.

We also thank all committee members for their commitment during the last year and attendance at the unprecedented number of meetings.

As at the date of this report, the members of the committee are Mr Watson (chairman), Sir Winfried Bischoff, Sir Julian Horn-Smith, Lord Leitch, Mr Moreno, Mr Roberts and Mr Ryan.

The committee appoints independent consultants to provide advice on specific matters according to their particular expertise. Towers Perrin, Hewitt New Bridge Street and Kepler Associates were retained by the committee during 2009 to advise on various matters relating to executive remuneration. In addition, PricewaterhouseCoopers LLP (PwC) were also retained in 2009 specifically to complete the committee s project to review executive remuneration arrangements in light of the acquisition of HBOS, given their particular expertise in the remuneration aspects of transactions. This project had commenced in 2008. As PwC are also the auditors to Lloyds Banking Group and to mitigate any threat to audit independence, Kepler Associates continue to be retained as the remuneration committee s primary independent advisors, and were commissioned to provide comment on PwC s advice.

In addition to their advice on executive remuneration, during 2009 Towers Perrin also provided market remuneration data as well as other remuneration consulting services to the Group, Hewitt New Bridge Street provided pension consulting services.

During 2009, Alithos Limited continued to provide information on behalf of the committee for the testing of total shareholder return (TSR) (calculated by reference to both dividends and growth in share price) performance conditions for the Group s long-term incentive schemes.

Mr Daniels, Mrs Risley (Group Human Resources Director) and Ms Kemp (HR Director, Total Reward) provided guidance to the committee (other than for their own remuneration). Mrs Carol Sergeant (Chief Risk Officer) also attended the committee to advise on risk matters.

The remuneration committee ensures that appropriate remuneration and governance arrangements are in place throughout the organisation, with the Group functions providing an oversight role in the development of remuneration policy and practice below the senior executive population. During 2009 as part of the review of compliance with the new FSA Code of Practice on Remuneration and the developing governance environment, the committee reviewed and adopted new terms of reference. In addition divisional remuneration committees were established to ensure a strong oversight from the group remuneration committee into the divisions.

COMPENSATION

The key developments in the committee s terms of reference are:

- Extension of its direct responsibilities to include all those colleagues who perform significant influence functions for the Group and those who could have a material impact on the Group s risk profile;
- Formalising the periodic review of the adequacy and effectiveness of the Group s remuneration policy;
- Formalising annual reporting to the board on the substance of the Group s remuneration policy and propose any substantive changes. This report will be supported by independent commentary from the chief risk officer in the context of the Group s risk appetite and by positive assurance from each group executive director that all remuneration arrangements within their division/function reflect fully the Group s overall approach to remuneration; and
- The chief risk officer will attend the remuneration committee for at least two meetings a year.

The role of the divisional remuneration committees is to ensure a strong oversight from the group remuneration committee into the divisions. Specifically:

- The relevant group executive director will be accountable for the effective implementation of the remuneration policy in their division;
- The divisional remuneration committee, which will have representation from both divisional and group reward and risk functions, will ensure that the policy is effectively and efficiently executed in the division;
- Formal positive assurance (through annual reporting) as to how the remuneration policy is being applied across the group will be provided to the group remuneration committee from each divisional remuneration committee; and
- The divisional remuneration committee will be responsible for ensuring the effective governance of divisional specific remuneration arrangements, especially the design and outcome of short-term incentive/bonus schemes.

We believe our approach is well aligned with the FSA Code of Practice on Remuneration but we will continue to work with the FSA to ensure ongoing compliance and implement changes as appropriate.

DIRECTORS REMUNERATION POLICY

The Group s remuneration policy supports our business strategy, which is based on building long-term relationships with our customers and employees, and managing the financial consequences of our business decisions across the entire economic cycle. The policy is to position base salaries to reflect the relevant market median and the total package is designed to enable upper quartile performance to be rewarded with upper quartile remuneration levels. Overall the policy is designed to ensure that cost effective packages are provided which attract and retain executive directors and senior management of the highest caliber and motivate them to perform to the highest standards. At the same time, the objective is to align individual rewards with the Group s performance, the interests of its shareholders, and a prudent approach to risk management. In this way we balance the requirements of our various stakeholders: customers, shareholders, employees, and regulators. We believe that this approach is in line with the Association of British Insurers best practice code on remuneration as well as the FSA Code of Practice on Remuneration, as the policy seeks to reward long-term value creation whilst not encouraging excessive risk taking.

We summarise below how each of these policy objectives is met by our remuneration packages.

Policy objective	How achieved
Building long-term relationships	We build relationships with our customers and people rather than viewing them as counterparties in a money-making transaction and are in the process of extending this philosophy across the integrated Group. This means that working for the Lloyds Banking Group should be about more than pay. While our relationship with our people means that we will pay them fairly and competitively, our pay is positioned conservatively against the market and we will not seek to be among the highest payers in the sector. In setting pay for executive directors, we take account of the terms and conditions applying to other

employees of the Group.

Our incentive measures are not just financial. Half of the annual incentive for executives is linked to a scorecard including how they perform against targets that measure how satisfied our customers are, and the extent to which our employees feel engaged with and committed to working for the Lloyds Banking Group, both of which are important foundations of a relationship-based strategy.

Managing the financial consequences of our business through the economic cycle

Economic profit is a key measure by which we manage our business. This measure takes into account the level of capital required to generate profits as well as the risks taken. The same level of profit generated at lower risk results in higher economic profit. Economic profit also measures risk based on an assessment of how business will perform through the economic cycle.

Therefore, for example, in good times, when default rates on loans are low, we adjust the economic profit measure downwards based on a higher average expected default experience over the economic cycle. This encourages us to avoid business and funding strategies that are only profitable during boom times but turn bad in a recession. Economic profit plays a prominent role in our incentive plans for executives, a role which was further enhanced in 2009, with its inclusion in the long-term incentive plan performance measures.

COMPENSATION

Policy objective	How achieved
Aligning individual rewards with Group performance and shareholders	The majority of our executives pay is linked to stretching performance targets through annual and long-term incentives. Performance measures on the annual incentive are directly aligned to the Group s financial and non-financial performance. Executives are aligned with shareholders through the long-term incentive plan, which pays out based on performance against Group targets over a three year period, and which is paid in shares to further improve alignment with shareholders. This objective of aligning the interests of executives with those of shareholders throughout the economic cycle can be seen through the vesting outcomes of awards made to executives under the LTIP plans. In 2009, historic LTIP and option plans from 1999, 2005 and 2006 lapsed as their performance conditions were not met. The same outcome is envisaged for the 2007 LTIP with a performance period ending in 2010. Executives are required to build up a holding in Lloyds Banking Group shares of value equal to 1.5 times salary for executive directors (2 times salary for the group chief executive). They are expected to retain 100 per cent of the net-of-tax proceeds of the 2009 LTIP until they reach this target. In addition they are required to retain any shares vesting from the share price performance element of the 2010 LTIP for a further two years post vesting. Finally, we operate tough contract provisions whereby no executive has an entitlement to more than 12 months notice, compensation on termination is limited to basic salary, and any compensation is paid monthly over 12 months and is mitigated if the executive gets another job. This approach avoids the risk of payment for failure. These requirements are among the toughest in the FTSE 100.
A prudent approach to risk management	Economic profit measures profit relative to the risk taken to generate that profit. Its use in our incentive plans therefore encourages executives to take a prudent approach to risk. We also have non-financial measures of performance against risk objectives in the plan for executives, which enables a more rounded assessment of risk-taking behavior. For the 2009 annual incentive we increased the alignment to long-term prudent risk management by deferring all of the award. For executive directors any cash incentive earned will be deferred 100 per cent into shares and paid out in 2012. If the performance that led to the incentive is found to be unsustainable during the deferral period, then some or all of the award may be forfeited. We pay competitively but not excessively. Our prudent approach to positioning compensation means that we reduce the incentives to take excessive risk for personal gain. This means that we do not attract employees with an extreme appetite for risk. We have a robust governance framework with an independent remuneration committee reviewing all compensation decisions. This approach to governance and review is cascaded through the organisation.
Cost effective packages to attract and retain executives	We aim to ensure that the totality of remuneration for executive directors is competitive against our benchmark groups. These groups are other major UK banks, and also the top 20 companies in the FTSE 100, reflecting practices in comparably sized large UK companies across all sectors. We aim to be competitively but conservatively positioned against the market. We aim to choose incentive plan targets that are directly linked to the business strategy and priorities. This not only ensures alignment with company performance, but also means that the targets are meaningful to executives and therefore motivating. This ensures that

incentive packages are valued by executives and are cost effective.

REMUNERATION FOR 2010

The remuneration committee undertook an extensive review of executive remuneration during late 2008 and into 2009 in light of the HBOS acquisition. That review in conjunction with detailed consultation with shareholders led to the remuneration decisions for 2009. The committee continued to review remuneration during 2009 in light of the FSA Code of Practice on Remuneration, the outcomes of the G20 meeting in September 2009 and Sir David Walker s review of corporate governance in UK banks and other financial industry entities. This ongoing review process has found that the structure of the remuneration package, in particular the focus on risk through the long-term incentive plan measures and balanced scorecard, was well aligned with emergent best practice in the sector.

The review process has highlighted the concern on how to maintain an appropriately competitive incentive for the senior executives of the Group, following the significant reduction in incentive levels in 2009, whilst recognizing the sensitivity of the operating environment and the fact that the Group was loss making on a combined businesses basis in 2009. Following consultation with shareholders, the remuneration committee is proposing a package for 2010 that is closely based on the structure and principles of 2009, but with an additional LTIP performance measure based on the achievement of stretching share price targets. With the addition of this performance measure, the maximum LTIP award for 2010 will be 275 per cent of salary, still 100 per cent of salary lower than the 2008 maximum level. To achieve maximum vesting of this award, not only will stretching EPS and economic profit targets need to be achieved but also stretching share price targets.

COMPENSATION

SUMMARY OF REMUNERATION ELEMENTS

The key remuneration elements for 2010 are summarised below. Each individual element is then described in more detail in the subsequent sub-sections.

Element	Level/design for 2010	Key purpose
Base salary	Base pay should be set competitively relative to FTSE 20 and banking sector competitors	Meet essential commitments of executive Retention
	In light of circumstances, no increase for 2010 and base salaries held at same level as for 2008	
Annual incentive	200 per cent of salary maximum (225 per cent for group chief executive), as for 2009	Alignment with Group performance
	Based 50 per cent on Group financial targets relating to profit before tax and economic profit	Alignment with sound risk management
	Based 50 per cent on balanced scorecard covering, customers, people, risk and build franchise	Motivation of executives
	Subject to deferral and clawback	
Long-term incentive plan	275 per cent of salary maximum, split as follows:	Motivation and retention of executives
	100 per cent on earnings per share	
	100 per cent on economic profit	Alignment with sound risk management
	75 per cent on absolute share price growth	
	Any shares vesting from the absolute share price growth element retained for a further 2 years post vesting	Alignment with long-term shareholder interests
Pension	A mixture of final salary and defined contribution pension arrangements	Enable executives to build long-term retirement savings
	From April 2012, executive directors with final salary pensions will move to a defined contribution pension arrangement, with no compensation	Retention

GENERAL CONSIDERATIONS

When deciding the approach to take for remuneration in 2010, the remuneration committee considered a range of factors. The environment for remuneration in the banking sector remains very sensitive and the committee is aware of this. Consistent with best practice, shareholders were fully consulted during the process and their views have been taken into account in the decisions the committee has made. At the same time, the ongoing challenges of the HBOS integration to create the UK s leading consumer bank were also considered by the committee as is the need to retain and motivate the management team to build on the outstanding start made to this process in 2009.

BASE SALARY

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by Towers Perrin and supplemented with information from Kepler Associates as appropriate) and then adjusted from 1 January of the following year. The remuneration committee confirmed during the 2009 review that the FTSE 20 was the most appropriate comparator group to use to benchmark overall competitiveness of the remuneration package whilst taking particular account of the remuneration practice of our direct competitors, namely the major UK banks. The FTSE 20 is regarded as providing a realistic and relevant comparison in terms of company size and complexity, as well as being a key market for talent.

However, in recognition of the current operating environment base salaries for 2010 remain unchanged from the salaries set for 2008. Base salary increases for other employees across the Group will remain in line with any market movement, but will, in general be significantly lower than in previous years.

Name	J E Daniels	A G Kane	G T Tate	T J W Tookey	H A Weir
As at 1 January 2010	£1,035,000	£590,000	£640,000	£600,000	£625,000

COMPENSATION

ANNUAL INCENTIVE PLAN

The combination of financial and non-financial measures, which support our prudent approach to managing risk, are retained in the annual incentive plan, whilst the operation of the plan is enhanced in order to increase the alignment between risk and reward still further. The committee recognises the challenges of setting robust targets in the current operating environment. Furthermore, the committee will review the performance against the targets for the 2010 annual incentive plan at the end of the year, taking into account the overall operating performance of the business in determining how much of any bonus will be paid out. The committee reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if they deemed this appropriate.

Consistent with the aim of ensuring that short-term financial results are only achievable sustainably, the committee has decided that the incentive will be deferred and released in tranches over a three year period. The deferred incentive will be subject to 100 per cent clawback if the performance that generated the incentive is found to be unsustainable.

The maximum annual incentive opportunity remains unchanged at 200 per cent (225 per cent for the group chief executive) of base salary for the achievement of exceptional performance targets.

The remuneration committee believes that the structure of the incentive in particular the use of risk-adjusted and non-financial measures has been highly successful in promoting a long-term focus within the senior management team.

LONG-TERM INCENTIVE AWARD

Given the extraordinary circumstances during 2008, the remuneration committee made a reduced maximum LTIP award of 200 per cent of salary in 2009, 175 per cent less than the maximum award for 2008. For 2010, the remuneration committee continues to believe that it is appropriate to make LTIP awards below the maximum levels that the plan allows (400 per cent) and less than the award levels for 2008 (maximum award 375 per cent). Notwithstanding the increased size and complexity of the Group since the HBOS acquisition and the concerns about retention and motivation, the committee believes that the current environment requires a demonstration of continued restraint in relation to remuneration. At the same time, the committee believes in the importance of aligning shareholder and executive motivation and therefore it has approved maximum awards for the group chief executive and executive directors for 2010 of 275 per cent of base salary of which 200 per cent of the award will be based on the same performance conditions as for 2009, namely EPS and economic profit, with the remaining 75 per cent based on the achievement of stretching share price targets.

LONG-TERM INCENTIVE PERFORMANCE MEASURES

In continuing with the same financial performance measures as for 2009, the remuneration committee has continued to create a focus on long-term performance, taking appropriate account of risk.

Performance targets have been set by reference to analysts expectations, internal business plans, competitive performance assessments and probability modelling. Stretch performance will be equated to the remuneration committee s assessment of an upper quartile performance level or greater. Shareholders have been consulted on the targets and the targets have been made more stretching as a consequence of those discussions.

The details of the targets for the proposed measures are set out below:

EARNINGS PER SHARE (APPLYING TO AWARD OF 100 PER CENT OF SALARY)

Earnings per share continues to be an important measure of our profitability and ability to generate cash. The committee has therefore decided to retain this well-recognised measure in our incentive system.

For the EPS element of the award, performance will be measured based on EPS growth over a three year period from the baseline EPS of 2009.

Vesting (%)	EPS absolute percentage

		improvement
Threshold	25%	158%
Maximum	100%	180%

ECONOMIC PROFIT (APPLYING TO AWARD OF 100 PER CENT OF SALARY)

The use of economic profit has been very successful in introducing a long-term, risk-based approach to managing our business. Economic profit is calculated on a through-the-cycle basis, considering the impact of decisions over an entire economic cycle, encouraging prudent risk management of our portfolio.

For the economic profit element of the award, performance will be based on the compound annual growth rate (CAGR) from the 2009 base over a three year period.

	Vesting (%)	CAGR growth in EP
Threshold	25%	57% pa
Maximum	100%	77% pa

COMPENSATION

ABSOLUTE SHARE PRICE GROWTH (APPLYING TO AWARD OF 75 PER CENT OF SALARY)

The absolute share price element of the award will fully align shareholder and executives interests during a period of share price recovery.

Performance will be measured based on the average absolute share price achieved during the 90 days at the end of the three year period.

	Vesting %	**Absolute share price achieved**
Threshold	0%	75p
Maximum	100%	114p

There will be an underpin to the absolute share price element of the award such that shares making up that element may only be released if both the EPS and the economic profit element have achieved a threshold level of vesting as above.

Any shares vesting as a result of this element of the 2010 award will be required to be held for a further two years post vesting.

Vesting between threshold and maximum will be on a straight line basis for all three elements.

PENSION

As stated last year, in April 2012, all executive directors will transition to defined contribution pension arrangements with contributions of 25 per cent of base salary for the group chief executive and other executive directors, with no compensation for ceasing final salary accrual.

OTHER SHARE PLANS

The executive directors are also eligible to participate in the Group s sharesave and shareplan schemes. These are all-employee share schemes.

CHAIRMAN S REMUNERATION

The chairman s remuneration comprises salary and benefits. He does not participate in the annual bonus and long-term incentive arrangements, nor is he entitled to pension benefits.

The chairman s salary was reviewed at the time of the appointment of Sir Winfried Bischoff in 2009. The review took into account the market information and also the significant amount of time the chairman would be expected to focus on the Group s activities particularly during the current period. The chairman was appointed on a salary of £700,000 per annum. His salary will next be reviewed at the end of 2010, with any adjustments effective 1 January 2011.

INDEPENDENT NON-EXECUTIVE DIRECTORS FEES

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. Directors may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the various responsibilities of a non-executive director s role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees from 1 January 2010 are unchanged and are listed below.

Board	£65,000

Audit committee chairmanship	£50,000
Audit committee membership	£20,000
Nomination and governance committee membership	£5,000
Remuneration committee chairmanship	£30,000
Remuneration committee membership	£15,000
Risk oversight committee membership	£15,000

Independent non-executive directors who serve on the boards of subsidiary companies may also receive fees from the subsidiaries. The fees paid in 2009 to the current non-executive directors are shown in the table in the following section.

COMPENSATION

REMUNERATION FOR 2009

2009 ANNUAL INCENTIVE SCHEME

The annual incentive scheme for executive directors is designed to reflect specific goals linked to the performance of the business.

Incentive awards for executive directors are based upon individual contribution and overall corporate results. Half of the incentive opportunity is driven by corporate performance based on the stretching target relating to profit before tax and economic profit. The level of achievement against the targets for profit before tax and economic profit that results in the lower payout will determine the extent to which the target has been met. The other half of the incentive opportunity is determined by divisional achievement driven through individual performance. Individual targets relevant to improving overall business performance are contained in a balanced scorecard and are grouped under the following headings:

- Financial
- Franchise growth
- Customer service
- Risk
- People development

These targets are weighted differently for each of the executive directors, reflecting differing strategic priorities. The non-financial measures include key performance indicators relating to process efficiency, service quality and employee engagement.

The maximum annual incentive opportunity is 200 per cent (225 per cent for the group chief executive) of basic salary for the achievement of exceptional performance targets. The maximum payment under the corporate half of the annual incentive is only available if exceptional performance is achieved against the stretching corporate target. An amount equal to 50 per cent of this element of the incentive is available on the achievement of the stretching corporate target. Failure to achieve at least 90 per cent of the stretching target would result in no payment under the corporate half of the incentive.

In 2009, the Group delivered a resilient trading performance against the backdrop of a marked slow down in the UK economic environment and continued challenges in financial markets. This has been a year of substantial achievement with the creation of a sound platform for future growth of the combined franchise. Positive trends have been established in margins, costs and impairments. The interest margin improved in the second half of the year and is expected to increase in 2010, with further improvements expected in subsequent years. Costs fell by 5 per cent in the year as integration related savings have started to be realised, with £534 million of cost synergy savings in 2009. Impairments peaked in the first half of the year, falling off by 21 per cent in the second half. A similar rate of improvement is expected through 2010. The Group s funding and liquidity positions were also strengthened during the year.

A number of actions were taken during the year to create a robust capital position, including the £4 billion ordinary share placing and compensating open offer in June and the successful £22.5 billion equity raising at the end of the year.

Franchise growth has been strong in both Retail and Wholesale and there has been a 48 per cent improvement in cross sales income from the Lloyds TSB customers. There were strong levels of mortgage lending with over £34 billion of gross new lending. The Lloyds TSB conservative approach to risk management has been implemented across the Group. All new lending is within the Group s risk appetite. Our employee engagement index has remained high through the year and has performed well against the UK norm.

Additionally a number of significant activities were delivered on during 2009 which were not anticipated when the targets were set. These activities have contributed to placing the Group in the best position possible to grow and develop the combined franchise. They include the largest ever capital raising and the successful conclusion of negotiations with the European Commission on State Aid. These have all been achieved at the same time as delivering the business as usual agenda and the integration programme.

Any payments under the plan are deferred 100 per cent in shares until June 2012 and subject to claw back.

The calculation of the annual incentive plan payments for executive directors, based on the achievement of performance against targets in respect of performance in 2009, has been independently checked. The bonuses awarded to directors are shown in the table below:

Name	**A G Kane**	**G T Tate**	**T J W Tookey**	**H A Weir**
Opportunity	**200%**	**200%**	**200%**	**200%**
Bonus awarded	**£885,000**	**£1,120,000**	**£1,110,000**	**£1,062,000**
% awarded	**150**	**175**	**185**	**170**

The group chief executive has chosen to waive any payment under the scheme for the second successive year.

COMPENSATION

2009 LONG-TERM INCENTIVE PLAN AWARDS

The current LTIP rules allow for awards to be made of up to 400 per cent of base salary. Under normal circumstances, awards are made of 300 per cent of salary with the additional 100 per cent available for circumstances that the remuneration committee deems to be exceptional. In 2008, awards were made of 375 per cent of base salary to the chief executive and two of the executive directors for retention purposes, and in light of data reviewed by the committee which showed total remuneration to be behind median both for the FTSE 20 and the other major UK banks.

Further information viewed by the committee through 2008 continued to show that total remuneration for the executive directors was materially behind the median of our peer groups, even before allowing for the increased responsibilities of running the combined bank and the magnitude of the task of integrating the two businesses. However, due to the external environment and following extensive consultation with shareholders, the committee determined that for 2009 the grant level for executive directors should be set at 200 per cent of base salary, 175 per cent less than the maximum award for 2008.

Details of the plan, including the specific performance conditions, can be found on page 121.

2009 NON-EXECUTIVE DIRECTORS FEES (£)

	Lloyds Banking Group fees						
	Board	**Audit committee**	**Remuneration committee**	**Nomination and governance committee**	**Risk oversight committee**	**SW Board Fees**[1]	**2009 Total**
W C G Berndt	**65,000**		**30,000**	**5,000**			**100,000**
Ewan Brown (until 5 June 2009)	**28,314**	**8,665**			**6,581**		**43,560**
J P du Plessis (until 17 April 2009)	**19,451**	**14,962**		**1,496**	**4,489**		**40,398**
P N Green (until 23 October 2009)	**52,936**	**16,288**	**12,216**				**81,440**
Sir Julian Horn-Smith	**65,000**		**15,000**	**5,000**	**15,000**		**100,000**
Lord Leitch[2]	**204,028**	**7,540**		**1,885**	**5,655**	**30,000**	**249,108**
Sir David Manning (until 2 November 2009)	**54,424**		**12,560**	**4,187**	**12,560**		**83,731**
C J McCall (until 31 December 2009)	**65,000**		**14,090**				**79,090**
T T Ryan (from 1 March 2009)	**54,167**	**16,667**			**12,500**		**83,334**
M A Scicluna	**65,000**	**41,136**			**15,000**		**121,136**
Anthony Watson (from 2 April 2009)	**48,504**	**13,095**			**9,821**		**71,420**

1 Scottish Widows Services Ltd.

2 Lord Leitch was appointed deputy chairman on 17 May 2009 when his remuneration was consolidated into an annual fee of £300,000.

COMPENSATION

DILUTION LIMITS

The following charts illustrate the shares available for the Group s share schemes.

PENSIONS

Executive directors are either entitled to participate in the Group s defined benefit pension schemes (based on salary and length of service, with a maximum pension of two thirds of final salary), or the Group s defined contribution scheme (under which their pension entitlement will be based upon both employer and employee contributions). The defined benefit schemes are closed to new entrants on recruitment.

Pension accruals under the defined benefits scheme for Messrs Daniels and Kane will continue until April 2012. Thereafter they will have the opportunity to either participate in a defined contribution scheme or to receive a cash supplement with no compensation for ceasing final salary accrual. There is no entitlement to an immediate and unreduced pension should their employment be terminated before the normal date of retirement.

SERVICE AGREEMENTS

The Group s policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months notice from the Group, but would be required to give six months notice if they wished to leave. Executive directors normally retire at age 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65.

It is the Group s policy that where compensation on early termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured, and that bonus payments should relate to the period of actual service, rather than the full notice period, and will be determined on the basis of performance.

Any entitlements under the pension scheme or equity plans will be in accordance with the scheme rules on leaving.

	Notice to be given by the Company	Date of service agreement/letter of appointment
Sir Winfried Bischoff	6 months	27 July 2009
J E Daniels	12 months	22 January 2009
A G Kane	12 months	23 January 2009
G T Tate	12 months	9 February 2009
T J W Tookey	12 months	26 January 2009
H A Weir	12 months	21 January 2009
Former director who served during 2009		
Sir Victor Blank	6 months	25 January 2006

Independent non-executive directors do not have service agreements and their appointment may be terminated, in accordance with the articles of association, at any time without compensation.

COMPENSATION

EXTERNAL APPOINTMENTS

The Group recognises that executive directors may be invited to become non-executive directors of other companies and that these appointments may broaden their knowledge and experience, to the benefit of the Group. Fees are normally retained by the individual directors as the post entails personal responsibility.

Executive directors are generally allowed to accept one non-executive directorship.

During 2009, Mr Daniels and Mrs Weir received fees of £75,000 and £30,208 respectively, which were retained by them, for serving as non-executive directors of other companies.

PERFORMANCE GRAPH

The graph below illustrates the performance of the Group measured by TSR against a broad equity market index over the past five years. The Group has been a constituent of the FTSE 100 index throughout this five year period.

TOTAL SHAREHOLDER RETURN FTSE 100 INDEX

COMPENSATION AUDITED INFORMATION

DIRECTORS EMOLUMENTS FOR 2009

	Salaries/ fees £000	Other benefits Cash £000[1]	Other benefits Non-cash £000[2]	Performance-related payments £000[3]	2009 Total £000	2008 Total £000
Current directors who served during 2009						
Executive directors						
J E Daniels	**1,035**	**78**	**8**		**1,121**	1,151
A G Kane	**590**	**24**	**24**	**885**	**1,523**	635
G T Tate	**640**	**27**	**20**	**1,120**	**1,807**	689
T J W Tookey	**600**	**25**	**1**	**1,110**	**1,736**	108
H A Weir	**625**	**59**	**21**	**1,062**	**1,767**	742
Non-executive directors						
Sir Winfried Bischoff (from 15 September 2009)	**207**	**4**			**211**	
W C G Berndt	**100**				**100**	100
Sir Julian Horn-Smith	**100**				**100**	100
Lord Leitch	**249**				**249**	165
T T Ryan (from 1 March 2009)	**83**				**83**	
M A Scicluna	**121**				**121**	33
Anthony Watson (from 2 April 2009)	**71**				**71**	
Former directors who served during 2009						
Sir Victor Blank[4] (until 14 September 2009)	**640**	**5**	**38**		**683**	669
Ewan Brown (until 5 June 2009)	**44**				**44**	122
J P du Plessis (until 17 April 2009)	**40**				**40**	119
P N Green (until 23 October 2009)	**81**				**81**	100
Sir David Manning (until 2 November 2009)	**84**				**84**	67
C J McCall (until 31 December 2009)	**79**				**79**	16
Others						807
	5,389	**222**	**112**	**4,177**	**9,900**	5,623

1 The cash column under other benefits includes flexible benefits payments (4 per cent of basic salary), the tax planning allowance for Mr Daniels, payments to certain directors who elect to take cash rather than a company car under the car scheme and the cash balance of a pension allowance for Mrs Weir. Sir Winfried Bischoff has elected to take cash rather than a company car.

2 The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance and the cost of home security in respect of Sir Victor Blank. It also includes the value of any matching shares which are received under the terms of Shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.

3 The group chief executive waived his entitlement to any bonus in respect of 2009 performance. There were no free shares awarded under Shareplan in respect of 2009.

4 Sir Victor Blank donated his salary from 30 September 2009 until 31 December 2009, amounting to £160,000 to charity. The Group was obligated to pay Sir Victor Blank s remuneration in lieu of services rendered during 2010 of £53,333. This was also donated to charity.

DIRECTORS PENSIONS

The executive directors are currently members of one of the pension schemes provided by the Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined the Lloyds TSB Group after 1 June 1989 and are members of a defined benefit scheme have pensions provided on salary in excess of the earnings cap through membership of or by an unfunded pension promise. Retirement pensions accrue at rates of between 1/60 and 1/30 of basic salary.

For those directors who are members of a defined benefit pension scheme, pension will continue to accrue until 5 April 2012. On 6 April 2012, defined benefit pension accrual will cease and directors will be offered the option to participate in the defined contribution pension scheme in operation at that date. Alternatively, they may choose not to join the scheme and elect to receive a pension cash allowance.

Directors have a normal retirement age of 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65. In the event of death in service, a lump sum of four times salary is payable plus, for members of a defined benefit scheme, a spouse s pension of two-thirds of the member s prospective pension. On death in retirement, a spouse s pension of two-thirds of the member s pension is payable. The defined benefit schemes are non-contributory. Members of defined contribution schemes are required to contribute.

COMPENSATION AUDITED INFORMATION

DEFINED CONTRIBUTION SCHEME MEMBERS

During the year to 31 December 2009 the employer has made the following contributions to the defined contribution scheme:

	£000
G T Tate	**159**
T J W Tookey	**147**
H A Weir	**122**

DEFINED BENEFIT SCHEME MEMBERS

	Accrued pension at 31 December 2009 £000 (a)	Accrued pension at 31 December 2008 £000 (b)	**Change in accrued pension £000 (a)-(b)**	**Transfer value at 31 December 2009 £000 (c)**	Transfer value at 31 December 2008 £000 (d)	**Change in transfer value £000 (c)-(d)**	**Additional pension earned to 31 December 2009 £000 (e)**	**Transfer value of the increase £000 (f)**
J E Daniels	**192**	175	**17**	**3,844**	3,263	**581**	**8**	**169**
A G Kane	**357**	342	**15**	**6,889**	6,146	**743**		

The disclosures in columns (a) to (d) are as required under section 421 of the Companies Act 2006.

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2009 and 2008, respectively.

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2009 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme. The basic method used to arrive at the factors has not changed during the year.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2008 on the assumption that the director left service at that date.

Column (e) is the increase in pension built up during the year, recognising (i) the accrual rate for the additional service based on the pensionable salary in force at the year end, and (ii) where appropriate the effect of pay changes in real (inflation adjusted) terms on the pension already earned at the start of the year.

Column (f) is the capital value of the pension in column (e).

The disclosures in columns (e) and (f) are as required by the UK Listing Authority listing rules. The requirements of the listing rules differ from those of the Companies Act. The listing rules require the additional pension earned over the year to be calculated as the difference between the pension accrued at the end of the financial year and the pension accrued at the start of the financial year less the increase in the pension earned over the year solely due to inflation. The transfer value in column (f) can differ significantly from the change in transfer value as required by the Companies Act because the additional pension accrued over the year calculated in accordance with the listing rules makes allowance for inflation, and the change in the transfer value required by the Companies Act will be significantly influenced by changes in the assumptions underlying the transfer value calculation at the beginning and end of the financial year.

Members of the Lloyds TSB Group s pension schemes have the option to pay additional voluntary contributions: neither the contributions nor the resulting benefits are included in the above table.

Major changes to the legislation governing the provision of pensions in the UK (known as pension simplification) came into effect in April 2006. Benefits from an approved pension scheme will be limited to the Lifetime Allowance, currently £1.75 million which is equivalent to an annual pension of £87,500. Any benefit in excess of this amount will incur a tax charge for the individual. The Group has agreed that if an executive director has benefits in excess of the Lifetime Allowance they may cease to accrue benefits in the Scheme and receive a salary supplement as an alternative. This will not cost the Group more than the current arrangements. The Group will not compensate any individual in respect of any increased tax liability arising from pension simplification. To date, the executive directors affected have elected to continue to accrue benefits in the approved scheme.

COMPENSATION

DIRECTORS INTERESTS

The interests, all beneficial, of those who were directors at 31 December 2009 in shares in Lloyds Banking Group were:

NUMBER OF SHARES

	At 1 January 2009 (or later date of appointment)	**At 31 December 2009**	At 25 February[1] 2010
Executive directors			
J E Daniels	423,018	**2,557,816**	2,558,383
A G Kane			