ANNUAL REPORT
AND ACCOUNTS 2010

LLOYDS
BANKING
GROUP

CREATING THE UK'S BEST FINANCIAL SERVICES PROVIDER

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www.lloydsbankinggroup.com

FORWARD LOOKING STATEMENTS

This annual report includes certain forward looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995 with respect to the business, strategy and plans of Lloyds Banking Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds Banking Group or its directors' and/or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future.

Examples of such forward looking statements include, but are not limited to, projections or expectations of the Group's future financial position including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, expenditures or any other financial items or ratios; statements of plans, objectives or goals of the Group or its management including in respect of certain synergy targets; statements about the future business and economic environments in the United Kingdom (UK) and elsewhere including future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

Factors that could cause actual business, strategy, plans and/or results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by the Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; inflation, deflation, interest rates and policies of the Bank of England, the European Central Bank and other G8 central banks; fluctuations in exchange rates, stock markets and currencies; the ability to access sufficient funding to meet the Group's liquidity needs; changes to the Group's credit ratings; the ability to derive cost savings and other benefits as well as the ability to integrate successfully the acquisition of HBOS; changing demographic developments including mortality and changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; technological changes; natural and other disasters, adverse weather and similar contingencies outside the Group's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, taxation, accounting standards or practices; regulatory capital or liquidity requirements and similar contingencies outside the Group's control; the policies and actions of governmental or regulatory authorities in the UK, the European Union (EU), the US or elsewhere; the ability to attract and retain senior management and other employees; requirements or limitations imposed on the Group as a result of HM Treasury's investment in the Group; the ability to complete satisfactorily the disposal of certain assets as part of the Group's EU State Aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations; market related trends and developments; exposure to regulatory scrutiny, legal proceedings or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors; and the success of the Group in managing the risks of the foregoing.

Lloyds Banking Group may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds Banking Group annual reviews, half-year announcements, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward looking statements contained in this annual report are made as of the date hereof, and Lloyds Banking Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this annual report to reflect any change in Lloyds Banking Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

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GROUP PROFILE

OUR VISION IS TO BE RECOGNISED AS THE BEST FINANCIAL SERVICES COMPANY IN THE UK BY SHAREHOLDERS, CUSTOMERS AND COLLEAGUES.

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.

Lloyds Banking Group was formed in January 2009 following the acquisition of HBOS and our main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision. The new Group also operates an international banking business with a global footprint in over 30 countries.

The Group is the UK's largest retail bank and has a large and diversified customer base. 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 a range of distribution channels including the largest branch network in the UK.

Lloyds Banking Group is quoted on both the London Stock Exchange and the New York Stock Exchange and is one of the largest companies within the FTSE 100.

Chairman's statement
We have a great platform for the future and have established a strong financial and operational trajectory.

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Group Chief Executive's review
We achieved a step change in our financial performance, returning the Group to profitability while absorbing the substantial costs of reducing risk in the business.

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Addressing the key issues
An overview of the key issues currently affecting the Group.

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Divisional results
Details of our operating divisions, their strategy, achievements, financial results and progress.

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Our people
A summary of our key people initiatives and how we are recruiting, retaining and rewarding our most valuable resource.

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GROUP STRUCTURE

There are four primary operating divisions within the Group: Retail, Wholesale, Wealth and International, and Insurance. The key product markets in which they participate and relative contribution to the Group's total income are presented below and a more detailed analysis of their strategy, business and performance is outlined within the Business Review. All the divisions are focused on delivering the Group Strategy and offering an integrated professional service to customers.

RETAIL

46% of total Group income[1]

Retail operates the largest retail bank in the UK and is the leading provider of current accounts, savings, personal loans, credit cards and mortgages. It serves over 30 million customers through one of the largest branch and fee free ATM networks in the UK. Retail is also a major general insurance and bancassurance distributor, offering a wide range of long-term savings, investment and general insurance products.

Key product markets:

- Secured lending – mortgages
- Unsecured lending – credit cards, loans and overdrafts
- Internet and telephone banking
- Current accounts
- Savings accounts

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WHOLESALE

36% of total Group income[1]

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.

Key product markets:

- Corporate Banking Services
- Treasury and Trading
- Asset Finance

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OUR MULTI-BRAND APPROACH

The Group operates a range of well recognised brands across our four divisions with different brands utilised for different customer segments, geographies and markets.

The main four brands operated by the Group are Lloyds TSB, Halifax, Bank of Scotland and Scottish Widows though a number of other brands are used in specialist markets.

Lloyds TSB

HALIFAX

BANK OF SCOTLAND

SCOTTISH WIDOWS

WEALTH AND INTERNATIONAL

10% of total Group income[1]

Wealth and International focuses on the private banking and asset management businesses of the Group and also operates the Group's international business.

Key product markets:

- Wealth management
- Asset management
- International Banking

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INSURANCE

8% of total Group income[1]

The Life, Pensions and Investments business is the leading bancassurance provider in the UK and is also a leading player in the intermediary channel. The general insurance business is a leading distributor of home insurance in the UK and also offers a range of other general insurance products.

Key product markets:

- Life assurance, pensions and investments
- General Insurance

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[1] Excludes Group Operations, Central items and insurance claims.

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GROUP PERFORMANCE

COMBINED BUSINESSES – RESULTS SUMMARY

	2010 £m	2009 £m
Net interest income	**13,822**	12,726
Other income	**10,164**	11,875
Total income	**23,986**	24,601
Insurance claims	**(542)**	(637)
Total income, net of insurance claims	**23,444**	23,964
Costs:		
Operating expenses	**(10,928)**	(11,609)
Impairment of tangible fixed assets	**(150)**	–
	(11,078)	(11,609)
Trading surplus	**12,366**	12,355
Impairment	**(13,181)**	(23,988)
Share of results of joint ventures and associates	**(91)**	(767)
Loss before tax and fair value unwind	**(906)**	(12,400)
Fair value unwind	**3,118**	6,100
Profit (loss) before tax – combined businesses	**2,212**	(6,300)

RECONCILIATION OF COMBINED BUSINESSES PROFIT (LOSS) BEFORE TAX TO STATUTORY PROFIT BEFORE TAX

Profit (loss) before tax – combined businesses	**2,212**	(6,300)
Integration costs	**(1,653)**	(1,096)
Volatility arising in insurance businesses	**306**	478
Government Asset Protection Scheme fee	**–**	(2,500)
Negative goodwill credit	**–**	11,173
Amortisation of purchased intangibles and goodwill impairment	**(629)**	(993)
Pension curtailment gain	**910**	–
Pre-acquisition results of HBOS plc	**–**	280
Customer goodwill payments provision	**(500)**	–
Loss on disposal of businesses	**(365)**	–
Profit before tax – statutory	**281**	1,042

KEY HIGHLIGHTS OVERVIEW

The Group returned to profitability on a combined businesses basis with profit before tax of £2,212 million

Statutory profit before tax of £281 million

Loss attributable to equity shareholders was £320 million; equivalent to a loss per share of 0.5 pence

Good trading performance against the backdrop of modest growth in the UK

Continued active support for the UK's economic recovery by providing £30 billion of gross mortgage lending (including remortgages) and £49 billion of committed gross lending to businesses, of which £11 billion was for SMEs

Strong cost performance with a 6 per cent reduction in operating expenses

Significant reduction in the impairment charge

Continued strong progress with the integration programme

Good progress on balance sheet reduction with cumulative non-core asset reduction of £105 billion

Capital position significantly improved with core tier 1 ratio increased to 10.2 per cent

Excellent progress against term funding objectives with £50 billion of wholesale term issuance in the year

£61 billion reduction in liquidity support from government and central bank facilities

PRESENTATION OF INFORMATION

In order to reflect the impact of the acquisition of HBOS, provide more relevant and meaningful comparatives and better present the underlying business performance, 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 of HBOS, the following adjustments have been made:
– the 2009 results assume HBOS had been owned throughout the year;
– the gain on acquisition of HBOS (in 2009) and amortisation of purchased intangible assets have been excluded; and
– the unwind of acquisition-related fair value adjustments is shown as one line in the combined businesses income statement.

In order to better present the underlying business performance the following items, not related to acquisition accounting, have also been excluded:
– integration costs;
– insurance and policyholder interests volatility;
– the Government Asset Protection Scheme (GAPS) fee paid in 2009;
– goodwill impairment;
– the curtailment gain in respect of the Group's defined benefit pension schemes;
– the customer goodwill payments provision; and
– loss on disposal of businesses.

Further, to enable a better understanding of the Group's core business trends and outlook, certain income statement and balance sheet information is analysed between core and non-core portfolios. Non-core portfolios consist of non-relationship assets and liabilities, together with assets and liabilities which are outside the Group's current appetite. The EU mandated retail business disposal is not included in non-core portfolios.

A full reconciliation of the combined businesses basis to the statutory basis is given in note 4 on page 170. Unless otherwise stated, the commentaries on pages 13 to 55 are on a combined businesses basis.

STRATEGY AND PROGRESS

OUR CORPORATE STRATEGY

The Group's business model is focused on the development of customer relationships, which are central to the strategy. We are constantly striving to build deep, lasting customer relationships, that will create value for our customers and subsequently value for us as a business. Customer leadership driven by superior customer insight, tailored products, better service and relationship focus, supported by industry leading efficiency and effectiveness and a prudent 'through the cycle' approach to risk is core to our strategy. It is this that will enable us to deliver on our vision of being recognised as the best financial services company in the UK by customers, colleagues and shareholders.

Our corporate strategy identifies the key strategic deliverables required to implement the business model effectively and deliver our Group vision.

The strategy is focused on being a more conservative, 'through the cycle' relationship based business. The key objectives of our strategy are:

- **Building a high performance organisation**
- **Developing strong customer franchises that are based on deep customer relationships**
- **Managing our most valuable resource, our people**

The main focus for the Group remains the financial services markets in the UK and our strategic position was strengthened through the acquisition of HBOS in January 2009. We are a well diversified UK financial services group and the largest retail financial services provider in the UK. We have leading positions in many of the markets in which we participate, a comprehensive distribution capability, well recognised brands and a large customer base. We continue to invest in products and services, systems and training that combined offer unparalleled choice and service to our customers.

We see corporate responsibility as being integral to our business strategy. We need to demonstrate that we are running our business in a responsible way; and are making a sustained, positive contribution to the economy and to society; by playing our part in the UK's economic recovery and by investing in the communities of which we are a part.

Building a high performance organisation

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

- The Group aspires to have one of the lowest cost to income ratios amongst UK financial institutions and further improving our processing efficiency and effectiveness will remain a priority. The effective integration of the HBOS business and the anticipated synergies arising from the acquisition will be key to further improving our efficiency.
- Utilising capital more effectively is increasingly important in the current environment and capital will continue to be rigorously allocated across our portfolio of businesses to support core business growth.
- The prudent Lloyds TSB 'through the cycle' approach to risk has been applied to the enlarged Group. Our conservative and prudent approach to risk is core to the business model and the 'through the cycle' approach means we will continue to support our customers throughout the economic cycle. The risk structures and frameworks that have been implemented are the foundation for good business management.

Developing strong customer franchises that are based on deep customer relationships

All our core businesses are focused on extending our customer relationships, whilst enhancing product capabilities to build competitive advantage. Ensuring we understand and effectively meet the needs of our customers from basic banking products to the more specialist services such as insurance, wealth management or corporate banking is at the heart of our business. It is also fundamental to ensuring we are developing long lasting customer relationships.

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Managing our most valuable resource, our people

Executing our strategy effectively will only be possible if we ensure deliverables are effectively aligned with our corporate strategy and we manage our most valuable resource, our people, well. Our people have the skills and capabilities to deliver the strategy but in driving performance it is important to ensure we encourage, manage and develop our staff whilst creating a great place to work.

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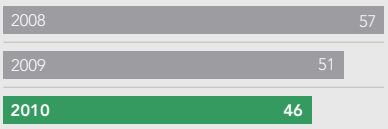
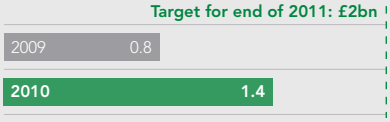
Performance measures

Underlying cost:income ratio %



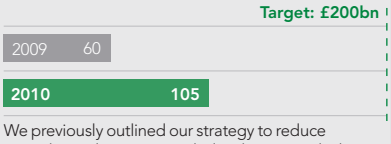
Good progress continues to be made in reducing the cost:income ratio, which fell to 46 per cent in 2010. This was driven by both higher underlying income and lower operating expenses. The Group continues to expect the cost:income ratio to reduce to approximately 40 per cent in the medium term excluding the Bank Levy.

Integration cost synergies (run-rate) £bn



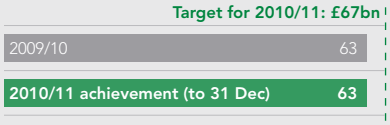
The delivery of cost synergies from the integration programme is ahead of schedule and we remain on track to deliver a run rate of more than £2 billion per annum of cost synergies and other operating efficiencies by the end of 2011.

Balance sheet reduction £bn
(Cumulative)



We previously outlined our strategy to reduce non relationship assets, including business which is outside our current risk appetite by some £200 billion. Excellent progress continues to be made against this target with a £105 billion reduction achieved to date.

Lending commitments £bn
(1 March to 28 February)



The Group continues to actively support our customers and the UK economy by lending to UK households and businesses. Under the terms of our lending commitments to the UK Government we agreed to make available gross new lending of £67 billion in the 12 months to 28 February 2011 and we remain on track to deliver this having extended £63 billion of qualifying lending by the end of December 2010.

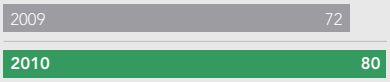
Performance measures

Customer relationships are key to our strategy and important for all our businesses. The significant differences across the divisions/businesses means financial and non-financial strategic indicators for the development of customer relationships are tracked at a divisional level and commentary is included in the specific divisional commentaries.

Performance measures

In delivering a high performance organisation, we need to have high levels of staff engagement. Every quarter we run a comprehensive confidential survey across the Group to gauge staff views on key issues and assess overall staff engagement.

Staff engagement score

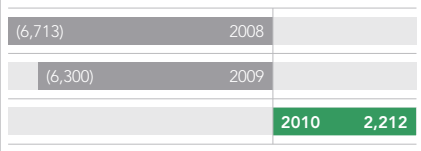


In 2010, we achieved a record response rate of 83 per cent (up from 81 per cent in 2009) which is regarded as 'best in class' and the overall engagement score increased from 72 to 80 showing the progress being made in this area.

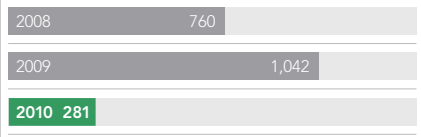
OUTPUT MEASURES

Significant progress has been made against our strategic goals and objectives during 2010, and the key performance indicators below highlight the overall progress being made by the Group. Further detail on these measures is contained within the business review.

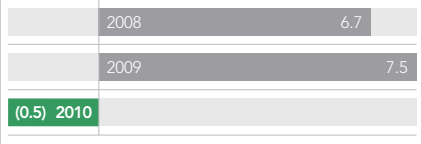
Profit (loss) before tax £m
(Combined businesses basis)



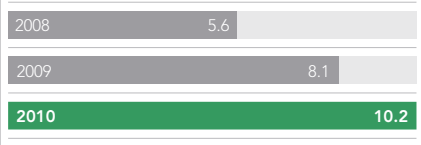
Statutory profit before tax £m



Earnings per share pence



Core tier 1 ratio %



CHAIRMAN'S STATEMENT

"We have a great platform for the future and have established a strong financial and operational trajectory. I am confident that we will be able to grow the business further over the coming years."

My second annual statement as Chairman of Lloyds Banking Group comes to you at the end of another challenging year, a year in which we have turned the corner to profitability. In doing so, we made substantial progress towards creating a strong and stable bank, one better able to serve our customers. Only by focusing on their needs and offering them products and services that address those needs, can we expect to be successful and deliver benefit to you our shareholders and to our stakeholders at large.

Supporting the UK's economic recovery

Although 2010 brought some increase in global confidence and stability, the banking industry continued to operate amidst challenging conditions.

As we emerge from the financial crisis and the economic downturn, we recognise the public concern surrounding the banking industry and know we have much work to do as an industry to rebuild trust and understanding. We also acknowledge the role that we at Lloyds Banking Group must play in that process. We can only earn that trust by addressing the fundamentals, for all our stakeholders, and by being open, transparent and engaged in the broader debate about the role of banking in the UK. We need to demonstrate that we are meeting our obligations to customers and society by proactively – and responsibly – channelling the deposits we gather into productive enterprises and households.

Banks have a central role in promoting and fuelling the economic recovery. We will continue to play our part in supporting UK growth by extending a significant amount of new lending to businesses and households. We have provided nearly £80 billion of gross lending to UK homeowners and businesses in 2010 and, as part of our SME charter, the Group is committed to helping 300,000 new start-up businesses by the end of 2012. We have already helped over 100,000 such enterprises during 2010. For the year ended 28 February 2011 we will exceed the mortgage and business lending commitments made by the Group to the UK Government.

We have also recently announced, along with four other major UK banks (and in the context of an agreement with the UK Government), our intent to help support the UK economic recovery by jointly providing the capacity to support gross new lending of £190 billion to creditworthy UK businesses (including £76 billion to small and medium sized businesses). As the largest UK focused bank, we are determined to play a full role in supporting investment by UK businesses and households. Lending is one of our core business functions and it is in our interest and that of our shareholders that we make access to responsible credit as easy as possible.

At the same time, as a responsible lender, we will seek to ensure that we lend to customers who can afford to repay their borrowing and to businesses that have a fundamentally sound business model. These are principles to which we must adhere.

Regulation

The level of industry regulation and its speed of change has never been greater. Shareholders will be aware of a number of strategic initiatives which are likely to change the shape of our industry, including the changes to capital requirements arising from Basel III and the fundamental changes to the regulatory environment in the UK, to highlight just a couple. Robust and stable regulation will be an important component in rebuilding confidence and trust and creating a healthy and sound financial system. However, we need to ensure that banks are allowed to fulfil their core purpose in delivering a smooth flow of credit to the economy. That means meeting banks' obligations to businesses, by helping them to invest, expand, export, innovate, up-skill their workforce, win new contracts and diversify their business models. For individuals, it means supporting their financial needs over their lifetime.

In 2010, the UK Government appointed The Independent Commission on Banking (ICB) to review structural measures to reform the banking system and promote stability and competition. The ICB is not expected to publish its final report until September 2011 although an important precursor of that will be the interim report expected to be published in April. It would be premature for me to seek to predict the outcome of the enquiry; however, discussions between ourselves and the ICB have been collaborative and constructive and we will welcome the increased certainty that the report's recommendations should bring.

Our community

Through the financial services we provide to our customers and the support we give to the businesses that people work for, Lloyds Banking Group plays a role in the lives of nearly everyone in the UK.

Our main contribution to society is the direct economic impact on the economy we have as a major employer and purchaser of goods and services. This economic contribution is supported by our active investment in communities across the country and our community giving programme. We invested £148 million in communities across the UK in 2010 including support for financial inclusion, sponsorship of sports for young people and donations through the Group's charitable foundations.

Our partnership of the London 2012 Olympic and Paralympic Games will bring the Games to life in the heart of communities all over Britain and 2011 will be an exciting year in the countdown to 2012. Since the launch of our Local Heroes programme we have supported 600 athletes. We have also pledged £1 billion of funding to help businesses benefit from London 2012 Games associated opportunities. In this way we have supported one in three of all businesses who have won London 2012 Olympic Games related contracts.

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Performance

As an organisation, we have made considerable progress in 2010, delivering good growth in our core business, returning to profitability and reducing the risk in the business. The integration of the HBOS business continues to progress well and we remain confident of achieving our target of run-rate synergy benefits of £2 billion per annum by the end of 2011, a substantial achievement.

In working diligently to create long term sustainable shareholder value we aim to restore our ability to pay dividends on ordinary shares as soon as market conditions and the financial performance of the Group permit. As you know this intention is subject to the expiry in 2012 of the restrictions arising from the European Commission's remedies.

Following the recapitalisation of the banking sector, HM Treasury now holds approximately 40.6 per cent of the equity capital of the Group. We are grateful and appreciative for the valuable support we have received from Government and through it the taxpayer, but our objective remains for the Group over time to operate as a wholly privately owned self-supporting commercial enterprise.

People

I have enjoyed meeting many colleagues in various visits to our operations all over the country over the past year. Gaining an on-the-spot insight into how they work to serve our stakeholders by building long term relationships with our customers and by supporting businesses has been invaluable. I must tell you that I have been impressed by their desire to work together to ensure the success of our integration, by their discipline and focus and by their commitment to their customers. It is clear that in our large and occasionally complex Group, teamwork combined with commitment, professionalism and hard work is the key to realising our promises to stakeholders.

Our people have faced a difficult year with great commitment and purpose. It is not easy or pleasant to work for a group which is continuously in the media headlines. All the more so when the delivery of our day-to-day banking and personal financial services are, in numerous surveys of our customers, judged to be at the very top or near it. On behalf of the Board I thank our colleagues for their significant achievements in 2010, which from letters and emails I receive, are as much appreciated by our shareholders as our customers.

Remuneration

Following on from the unprecedented turmoil across the sector in 2008 and 2009, the increased focus on remuneration has continued into 2010. In the context of the evolving economic environment and regulatory changes, the Remuneration Committee undertook a further review of executive remuneration in 2010. We firmly believe that remuneration policy needs to incentivise executives to continue strong, sustainable growth and delivery of value to shareholders, in light of one of the biggest integrations ever undertaken in the sector. The Committee equally however is mindful of the continued heightened awareness in the public domain around executive remuneration. Both these considerations informed the Committee's decisions on remuneration this year and that for António Horta-Osório, our new Group Chief Executive.

The Group is primarily a retail and commercial bank. This means that the payout under our Group bonus schemes for 2010 is a small percentage of overall revenues. Though profitability increased substantially our total compensation for 2010 is lower than that for 2009.

Group Chief Executive

On 28 February 2011, Eric Daniels will retire as Group Chief Executive and Director of Lloyds Banking Group plc and, in line with his contractual commitments, will retire from the Group in September 2011. His knowledge of the Group and our customers will, I am pleased to say, remain available to the Board and myself as required until then.

The Board and I are grateful to Eric Daniels for his leadership since June 2003, particularly since the announcement of the acquisition of HBOS in September 2008. The successful integration of the two companies and the sooner than expected return to profitability of the enlarged Lloyds Banking Group are testament to his leadership during a time of unprecedented financial turmoil. It is to Eric's credit that the Group is in a strong position for the next phase of its development. I personally have valued greatly the considerable management, banking and organisational expertise Eric has brought to Lloyds Banking Group as Group Chief Executive.

In November we announced the appointment of António Horta-Osório as the next Group Chief Executive. He brings with him deep experience in, and understanding of, the UK retail and commercial banking industry, as well as a track record of integrating three well respected UK retail banking franchises. António joined us in January 2011 and took over as Group Chief Executive on 1 March 2011. The Board and I look forward to working with him to ensure the success of the next stage of development of the Group, and I hope many of you will be able personally to meet him at our annual general meeting in Glasgow on Wednesday 18 May 2011.

Changes to the Board

In addition to the changes previously outlined during the year we have continued to strengthen the Board both in terms of in-depth banking experience and broader business perspectives. On 1 March 2010, two new Non-Executive Directors were appointed, Glen Moreno and David Roberts, and Anita Frew joined the Board on 1 December 2010.

We are delighted that these three outstanding individuals have agreed to contribute their judgement and varied expertise to our Board. On a personal front I am also pleased that we have expanded the proportion of women on the Board and I expect that process to continue.

Dr Wolfgang Berndt retired at the annual general meeting in May 2010, having joined the Board in 2003. I would like to thank him for his significant contribution to the Group.

Our most senior management including our Executive Directors, have made extraordinary efforts both in terms of their time, involvement and personal contribution in achieving these results. I thank all of them for their loyalty in difficult circumstances.

The full particulars and background of all our Directors are set out on pages 110 and 111.

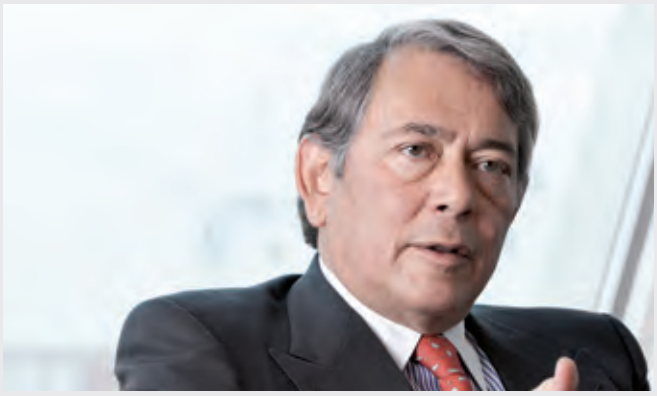
Outlook

The successful execution of our strategy demands from us focus on core markets, on customer engagement, on cost leadership, on capital efficiency and on a prudent risk and funding profile. Carried out well these attributes should enable the Group to deliver earnings growth and shareholder value whilst achieving our aim of becoming recognised as the best financial services company in the UK.

We have a great platform for the future and have established a strong financial and operational trajectory. I am confident that we will be able to grow the business further over the coming years with António Horta-Osório at the helm leading our 112,000 colleagues – a dedicated workforce and an experienced management team.

Sir Winfried Bischoff
Chairman

GROUP CHIEF EXECUTIVE'S REVIEW



"We achieved a step change in our financial performance despite slow economic growth, returning the Group to profitability while absorbing the substantial costs of reducing risk in the business."

Summary

2010 was a good year for the Group, in which we made significant progress, delivering a strong operating performance, while strengthening the business for the future.

We achieved a step change in our financial performance despite modest economic growth, returning the Group to profitability while absorbing the substantial costs of reducing risk in the business. While the significant decrease in impairments was a key driver in our return to profitability, we also saw a good performance in the core business where underlying income grew 7 per cent.

We delivered good momentum across our core businesses through the continued development of our customer relationship strategy, attracting new customers to the Group and broadening and deepening our relationships with existing customers.

We also realised substantial cost savings, and we are on track to deliver our target of £2 billion of run-rate cost synergies from the integration of HBOS by the end of 2011.

We made considerable progress during the year in reducing the Group's risk. The application of our prudent approach to restructuring of the existing book and our risk standards to all new business is being reflected in the more predictable performance of these portfolios. We also made good progress in reducing the size of our balance sheet and substantially strengthened both our capital and funding positions.

As a result of the significant progress we have made in 2010, Lloyds Banking Group is now a much stronger business and is well positioned to realise the potential within its franchise.

Results overview

On a combined businesses basis, the Group reported a £2.2 billion profit in 2010, compared to a £6.3 billion loss before tax in 2009. Underlying income grew by 3 per cent to £23.6 billion, reflecting good underlying income growth of 7 per cent in our core business, partially offset by a reduction of 9 per cent in our non-core business as a result of planned asset reductions. Operating expenses fell by 6 per cent, resulting in an improvement in our underlying cost:income ratio of 4.5 percentage points to 46.2 per cent.

On a statutory basis, the Group delivered a profit before tax of £0.3 billion in 2010. This compared to a profit of £1 billion in 2009, which benefited from an £11.2 billion negative goodwill gain associated with the purchase of HBOS.

A significant reduction in the impairment charge

We achieved a significant reduction in the impairment charge, which fell 45 per cent, with the deterioration in some of our International businesses more than offset by a substantial improvement in the rest of the Group, notably in the Wholesale division.

The considerable reductions in the Retail and Wholesale impairment charges reflect the benefit of the actions we have taken over the past two years and our ongoing effective risk management, as well as the slowly improving economic environment. While we were disappointed by the increases in the International portfolios, these reflect specific economic challenges facing Ireland, and to some degree Australia, which we are managing closely.

Good franchise momentum in 2010

We have seen good momentum across our core business franchise in 2010, supported by the extension of our relationship strategy across the Group, in what remain highly competitive markets.

In Retail, our strategy is to develop deep and enduring customer relationships through offering a broad range of products addressing customers' needs, alongside superior service and advice. We opened 1.9 million current accounts, and over 5 million new savings accounts, and increased customer deposits by 5 per cent in the year.

In Wholesale, our commitment to supporting our customers through the cycle was equally successful, and we attracted over 100,000 new start-up customers and our achievements were recognised in the marketplace by the receipt of a number of awards.

We see strong growth opportunities in Wealth, through deepening relationships with existing Group customers and through the targeted acquisition of new customers. In 2010, we saw encouraging early results from the development of our customer offerings, and we grew our UK relationship customer base by 12 per cent.

In Insurance our focus on sustainable and profitable growth led to a 13 per cent increase in profit before tax. While this strategy led to a reduction in overall sales volumes in our UK Life, Pensions and Investments business, as we stopped selling a number of low return heritage HBOS products, this resulted in a substantial increase in new business margin.

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Supporting the UK's economic recovery

During 2010 the Group continued to support the UK's economic recovery through new lending to our mortgage and business customers. The Group extended £30 billion of gross mortgage lending (including remortgages) to UK homeowners and supported over 50,000 first time buyers.

We also provided £49 billion of committed gross lending to UK businesses in 2010, of which £11 billion was for SMEs. As part of our SME Charter, the Group has committed to helping 300,000 new start-up businesses by the end of 2012, and has already helped in excess of 100,000 such enterprises during 2010. We continue to approve over 80 per cent of lending applications from SME customers. Despite the uncertain economic environment, the Group has successfully grown net lending to its core SME customers by 2.1 per cent, which compares favourably with the industry-wide reduction in SME lending reported in the latest available market statistics.

As a result of our focus, we will exceed the mortgage and business lending commitments made by the Group to the UK government for the year ended 28 February 2011.

We have recently announced, along with four other major UK banks and in the context of an agreement with the UK Government, our intent to help support the UK economic recovery by jointly providing the capacity to support gross new lending of £190 billion to creditworthy UK businesses (including £76 billion to small and medium sized businesses). We are determined to play a full role in supporting investment by UK businesses and households.

Integration programme on track

We continued to make good progress on the integration of Lloyds TSB and HBOS, one of the largest and most complex programmes undertaken in the UK, exiting the year with run-rate cost synergies of £1.4 billion, as expected. We achieved savings across a wide range of Group activities, including implementing improved processes which are now being used on a harmonised basis across the Group, and driving savings in property and procurement. As part of the integration, we have also commenced the implementation of a number of major systems changes, which will complete in 2011.

Our progress in 2010 underpins our confidence that we will deliver our target of £2 billion of annual run-rate cost synergies by the end of 2011.

Further progress in balance sheet reductions

We are pleased with the progress we have made in reducing the size of the Group's balance sheet, with over half of our five year reduction plan achieved in the first two years. Although this has had an adverse effect on income, it has resulted in a material reduction in the Group's risk profile, and a smaller balance sheet which brings associated funding benefits.

We have now achieved asset reductions totalling £105 billion in the two years since the inception of the programme, against our target of a £200 billion reduction.

Excellent progress on funding and liquidity

We made excellent progress in enhancing our funding and liquidity position in 2010, thereby further reducing the Group's risk, albeit at some incremental cost.

We increased our deposit base by 3 per cent, which, together with the reduction in the size of our balance sheet, resulted in an improvement in our loan to deposit ratio to 154 per cent at the end of 2010 from 169 per cent at the 2009 year end.

In addition, we substantially exceeded our guidance for term wholesale funding issuance, achieving £50 billion of issuance in the year. We also continued to broaden the range of our funding sources, and maintained the proportion of our wholesale funding with a maturity of more than one year at 50 per cent.

Term issuance during the year enabled us to materially reduce the liquidity we receive from government and central bank sources, by £61 billion to £97 billion at the year end and we have made further progress since then.

Capital position further strengthened

We considerably strengthened our capital position in the year, positioning us well ahead of the implementation of the Basel Committee on Banking Supervision's so called 'Basel III' capital reforms, and changes expected to a number of accounting practices.

Our core tier 1 ratio increased to 10.2 per cent, from 8.1 per cent at the end of 2009, substantially in excess of regulatory requirements. We also restructured the capital within our insurance subsidiaries, which will deliver substantial benefits under the Basel III reforms. At the year end, our tier 1 ratio was 11.6 per cent, and our total capital ratio was 15.2 per cent.

Regulatory environment

We operate in a demanding and evolving regulatory environment, and have continued to engage actively with our regulators during the year on a number of proposed reforms, ensuring we have a strong and stable banking system, which will also be able to support and serve its customers and the wider economy.

Following extensive scrutiny of the Payment Protection Insurance (PPI) market in recent years, the Financial Services Authority issued its final policy statement on PPI complaints handling in August 2010. The application of this policy, which has been challenged by the British Bankers' Association in a judicial review, could in extremis have a material effect on the Group's financial position.

Our people

I am proud of the high levels of support and service our staff have continued to deliver to our customers over the past year, in what remains a challenging environment, and in the context of the considerable changes to the Group arising from the integration. Their dedication is reflected in our significant achievements in 2010, and the Board and I are very appreciative of their contribution.

Well positioned for future success

It has been a tremendous honour and a privilege to lead our many talented and dedicated people over the last eight years, and I would like to thank my colleagues and the Board for their support over this time. I am grateful to have been given the opportunity to create the new Group. The significant progress we have made in 2010 positions the Group well for the future to meet our objective of becoming the best bank for all our stakeholders, including our customers, shareholders and employees.

J Eric Daniels
Group Chief Executive

ADDRESSING THE KEY ISSUES

The Government's shareholding

As a result of the recapitalisation of the banking sector which included the capital raisings, the Government now holds a significant stake in Lloyds Banking Group. As at the date these accounts were approved the Government's shareholding in Lloyds Banking Group was approximately 40.6 per cent. This holding is managed by United Kingdom Financial Investments (UKFI) on behalf of HM Treasury.

Information on key areas such as when the Government may reduce their holding, how the relationship with UKFI operates and the impact of the holding on our strategy is outlined below.

Share disposal

The timing of any share disposal will be at the Government's discretion, acting on the advice of UKFI.

However, within the publication 'An Introduction: Who We Are, What We Do and the Framework Document Which Governs the Relationship Between UKFI and HM Treasury', it is stated that UKFI is to 'develop and execute an investment strategy for disposing of the investments in the banks in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition'.

Working relationship with UKFI

We have a very good working relationship with UKFI who act like any value orientated shareholder with regard to the strategic development and financial performance of the Group, providing significant constructive challenge where they see fit.

The Government has made it very clear that UK financial institutions in which it holds substantial stakes will continue to operate as 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).

The future

Going forward the Group is focused on delivering strategy and subsequently value to all our shareholders. The Government holding does not affect this management focus and we remain committed to operating as a wholly privately owned, self supporting, dividend paying, commercial enterprise over time.

State aid

The European Commission required the Group to agree a restructuring plan as a result of the investment in the Group by HM Treasury. The final approval of the UK Government's state aid measures, including the terms of the final restructuring plan, was agreed by the College of Commissioners in November 2009. The plan consists of the following principal elements:

- The disposal of a retail banking business with at least 600 branches, a 4.6 per cent share of the personal current accounts market in the UK and approximately 19 per cent of the Group's mortgage assets. The business consists of: the TSB brand; the branches, savings accounts and branch based mortgages of Cheltenham & Gloucester; the branches and branch based customers of Lloyds TSB Scotland and a related banking licence; additional Lloyds TSB branches in England and Wales, with branch based customers; and, Intelligent Finance. These disposals need to be made within four years of the date of State Aid approval, so by November 2013.
- An asset reduction programme to achieve a £181 billion reduction in a specified pool of end 2008 assets by 31 December 2014; and
- Behavioural commitments, including commitments; not to make certain acquisitions for approximately three to four years; and not to make discretionary payments of coupons or to exercise voluntary call options on hybrid securities from 31 January 2010 until 31 January 2012, which will also prevent the Group from paying dividends on its ordinary shares for the same duration.

We are making good progress against the agreed asset reduction programme and continue to make good progress in preparing for the disposal of the agreed retail banking business. The final cost of disposal will depend on the buyer and the extent to which substantial IT system and infrastructure development will be necessary. Therefore the total cost is hard to predict but is likely to be substantial.

The assets and liabilities, and associated income and expenses, of the business to be divested (referred to above) cannot be determined with precision until nearer the date of sale.

Lending to aid the economic recovery

During 2010 the Group continued its policy of actively supporting the UK's economic recovery through gross new lending to our mortgage and business customers.

During the year, the Group extended £30 billion of gross mortgage lending (including remortgages) to UK homeowners (including £5 billion in new lending to first-time buyers) and £49 billion of committed gross lending to UK businesses (of which £11 billion was for SMEs). As part of our SME Charter, the Group has committed to helping 300,000 start-ups by 2012, and has already helped in excess of 100,000 new start up businesses during 2010. We continue to approve over 80 per cent of lending applications from SME customers.

As a result of our focus, these actions have allowed us to remain ahead of the mortgage and business lending commitments made by the Group to the Government for the year ended 28 February 2011.

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Group integration

As previously outlined within the Strategy and Progress section (pages 4 and 5) the integration of the HBOS business is a key deliverable for the Group.

We have now completed the second year of our three year integration programme and remain on target to deliver annualised cost savings from synergies and other operating efficiencies of £2 billion by the end of 2011. Substantial wide-ranging progress has been made during 2010, including:

Rollout of the Lloyds TSB branch counter system and processes to the Halifax and Bank of Scotland branches – completes March 2011.

Migration of 3,700 Halifax and Bank of Scotland ATMs to the Lloyds TSB platform – completes April 2011.

Implementation of a single mortgage sales platform across core mortgage brands underway.

Development and implementation of a fully scaled single IT platform which will support the Group.

Single bancassurance sales system and unified set of products delivered.

Bank of Scotland and Lloyds TSB wealth management functions brought together to form one wealth management team.

Contract Hire fleet businesses are being brought together onto a single platform.

Following a review of the business, we completed our strategic exit from Ireland by the end of 2010, including the closure of 44 Bank of Scotland Ireland branches.

Completion of the legal transfer of our businesses in Spain to form one integrated business serving both local and international communities.

Wholesale Markets Corporate business now trading under the Lloyds Bank brand.

Procurement benefits of £236 million achieved in year. Over 90 per cent of Group expenditure consolidated within our top 1,000 suppliers.

79 non-branch properties exited, bringing the total to 162 since the start of the programme.

Independent Commission on Banking

The Independent Commission on Banking (ICB) was established by the Government in June 2010 to examine the banking sector and to make recommendations on structural and related non-structural measures to promote stability and competition in the banking sector.

The Commission will make recommendations covering both:

– Structural measures to reform the banking system and promote stability and competition, including the complex issue of separating retail and investment banking functions; and

– Related non-structural measures to promote stability and competition in banking for the benefit of consumers and businesses.

In considering these measures the Commission will have regard to the legal and operational requirements of implementing the options under consideration, and the importance of generating practical recommendations. It will also take into account the findings of ongoing EU and international work, and inform the UK Government's approach to international discussions on the financial system.

The Commission will also have regard to the Government's wider goals of financial stability and creating an efficient, open, robust and diverse banking sector, with specific attention paid to the potential impact of its recommendations on:

– Financial stability;

– Lending to UK consumers and businesses and the pace of economic recovery;

– Consumer choice;

– The competitiveness of the UK financial and professional services sectors and the wider UK economy; and

– Risks to the fiscal position of the Government

The Commission will produce a final report for the Cabinet Committee on Banking, by the end of September 2011, having completed its evidence gathering phase at the end of January 2011. The written responses which the ICB have received at this stage have been published on its website. The Group's response can also be found on our website, www.lloydsbankinggroup.com.

We believe the Group's 'through the cycle' relationship based strategy is consistent with the aims of the Commission but at this time it is not possible to gauge the impact of the review on the Group. We have cooperated fully with the ICB to date and are expecting their 'options paper', which will set out their initial thoughts on potential reform, during April 2011. Following its publication, there will be a further period of consultation during which the Group will continue to be at the forefront of the debate with the ICB.

Dividend payments to shareholders

The recent financial position of the Group along with the behavioural commitments we entered into as part of the State Aid Restructuring Plan have prevented us paying dividends on our ordinary shares.

We fully understand the hardship that the lack of dividend has caused many of our shareholders, and we are working diligently to restore the ability to pay dividends and create shareholder value.

The Board intends to resume dividend payments on ordinary shares as soon as market conditions and the financial performance of the Group permit, subject to the expiry, in 2012, of the restrictions on paying dividends arising from the European Commission's remedies.

MARKETPLACE TRENDS

The Economy

The global economy has continued to recover from the deep recession of 2009, but the recovery is fairly weak by past standards and its continuation is not assured. Remaining vulnerabilities in the sustainability of public finances and the robustness of banking sectors across the US and Europe have meant that growth there has faltered during 2010 and required monetary policy to be kept highly accommodative for longer than expected at the start of the year. Ireland has required support from the IMF and EU, and other high deficit countries in the Eurozone may do so during 2011. The US has extended the Bush-era tax cuts, although it is unclear how much stimulus this will provide given the need to tighten fiscal policy significantly in the medium term.

First estimates suggest that the UK economy grew by 1.4 per cent in 2010, below the long term average of 2.25 per cent. Growth peaked in the first half due to the initial boost from companies beginning to rebuild stocks, and has slowed during the second half. Consumer confidence has fallen back and house prices have recently reversed some of their 2009 rise. Nevertheless, employment has held up relatively well, falling by much less than in previous recessions and beginning to rise much earlier, although the recent trend is broadly flat. UK corporate liquidations have been on a gradually falling trend since Q3 2009, much earlier than in previous recoveries, and are now almost back to the level at the start of the recession. Related to that, commercial property prices have now risen by 16 per cent from the trough reached in July 2009. Even though house price rises have fallen back slightly recently, average prices are still 6 per cent above their trough of April 2009.

The Group's central scenario is for the modest recovery in the UK to continue – the projection of slightly less than 2 per cent Gross Domestic Product (GDP) growth in 2011 and slightly less than 2.5 per cent in 2012 is close to consensus and slightly below the November 2010 forecasts from the Office for Budget Responsibility. Private and public sector deleveraging, which is expected to suppress economic growth, should be more than offset by a positive contribution from net external trade (reflecting the weakness of sterling), by further rebuilding of stocks by companies and by increased investment. Public spending cuts may increase unemployment slightly in 2011, but if the economy continues to grow, the private sector should be able to more than offset that impact from 2012. Similarly, further declines in corporate insolvencies are likely to be very slow, limited by the public spending cuts and the weakness of consumer spending. House prices and commercial property prices are expected to dip slightly in 2011 and then rise slowly. The US recovery is assumed to continue in 2011, and in the Eurozone there is expected to be a wide divergence in 2011 between recovery in the stronger low-deficit countries and the higher deficit countries that will struggle to grow at all. The Irish economy, to which we have exposure, is not expected to grow materially in 2011. House prices there are expected to fall a little further in 2011 before flattening in 2012; commercial property prices are expected to be flat over 2011 and 2012.

Downside risks around this scenario remain significant. Business and consumer confidence remains fragile, and the extent to which simultaneous fiscal tightening across Europe might undermine global and UK growth is unclear. Contagion from the Irish bail-out to other Eurozone economies could drive further fiscal tightening and worsen the outlook further. Rising commodity prices driven by strong recovery in Asia might fuel a further increase in inflation in the West, prompting short-term interest rates to rise more quickly than anticipated. Since any shock to growth would also worsen the outlook for both public finances and bank capital and funding, a relatively small initial shock could throw economies onto a much weaker path as governments are forced to tighten fiscal policy even further or financial institutions are constrained in their ability to lend. A 'double-dip' scenario – a second shallower recession following closely the one that the economy is just emerging from – would result in further significant increases in corporate failures and unemployment during 2011-12. In addition, residential and commercial property would suffer a second period of falling prices, tenant defaults would increase and central banks would have limited ability to cushion the downturn.

Impact on our markets

The weak economic recovery has kept growth in our markets subdued.

On the retail side, net new mortgage lending (all new lending minus repayments) continued to weaken slightly after a 72 per cent fall in 2009, so outstanding market balances grew by just 0.4 per cent. Net new unsecured consumer lending improved in 2010 after turning negative in the second half of 2010, but at £1.4 billion was less than 11 per cent of the 2007 level. Part of the weakness in lending is the natural result of some lenders having left the market, particularly in the higher risk segments of mortgages and personal loans, but we have also seen a continued desire from customers to repay debt early where they are able. Deposit market growth has also remained weak, with balances rising by 3 per cent through 2010, as deteriorating disposable incomes have squeezed savings flows.

Businesses also continue to reduce their indebtedness. Non-financial corporations shrunk their borrowings from banks and building societies by 3.9 per cent in 2010 after a 2.2 per cent reduction in 2009. Rising profits and weak investment spending boosted deposit growth in the latter part of 2009 and the first half of 2010, but deposit growth has since weakened to 1.6 per cent over 2010 as a whole, after 4.5 per cent in 2009.

Low interest rates have, however, been a key benefit to consumers and businesses throughout 2010. Arrears and defaults rose by much less during the recession than in previous recessions, and began to improve in 2010 despite the weakness of the recovery in the economy. The number of company liquidations in England and Wales fell by nearly 16 per cent in 2010 after a 23 per cent rise in 2009, reducing the rate of failure of active companies to 0.7 per cent from 0.9 per cent in 2009. The number of individual insolvencies rose by a further 0.7 per cent in 2010 after a 26 per cent rise in 2009, but insolvencies during the second half of 2010 were 8.7 per cent lower than a year earlier. The number of mortgages in arrears across the market fell by 10 per cent in 2010, and the share in arrears by more than 3 months fell to its lowest in two years by Q4 2010.

Our customer data shows that a combination of low interest rates and declining indebtedness is beginning to strengthen households' cashflow. This is positive news for both impairments' and the near-term general economic outlook. Nevertheless, we expect that a continuation of weak economic recovery will be accompanied by a sustained period of weak growth in our markets. Consumers and businesses will continue to deleverage slowly. Deposit growth will be limited by the pressure on consumers' disposable incomes from wage growth below inflation and cuts in welfare benefits, and from rising investment spend by companies. Arrears trends should continue to improve, but less quickly in the coming year than the experience through 2010.

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SUMMARY OF GROUP RESULTS

KEY HIGHLIGHTS

The Group returned to profitability on a combined businesses basis with profit before tax of £2,212 million (2009: £6,300 million loss).

Statutory profit before tax was £281 million (2009: £1,042 million, including an £11,173 million gain on the acquisition of HBOS); after charging integration costs of £1,653 million and other adjusting net charges of £278 million including a loss on disposal of businesses of £365 million.

Loss attributable to equity shareholders was £320 million (2009: profit of £2,827 million); equivalent to a loss per share of 0.5 pence (2009: earnings per share of 7.5 pence), after a charge for taxation of £539 million (2009: credit of £1,911 million) and a charge for profit attributable to non-controlling interests of £62 million (2009: £126 million).

Good trading performance against the backdrop of modest growth in UK economy.

Continued active support for the UK's economic recovery by providing £30 billion of gross mortgage lending (including remortgages) and £49 billion of committed gross lending to businesses, of which £11 billion for SMEs.

Underlying total income increased by 3 per cent to £23,641 million, including core business income growth of 7 per cent.

Banking net interest margin improved to 2.10 per cent (2009: 1.77 per cent) with the majority of the gain achieved in the first half of the year.

Significant reduction in the impairment charge. Impairment charge was 45 per cent lower at £13,181 million (2009: £23,988 million).

Strong cost performance with a 6 per cent reduction in operating expenses to £10,928 million. Further improvement in the underlying cost:income ratio to 46.2 per cent (2009: 50.7 per cent).

Continued strong progress with the integration programme delivering annual run-rate savings of £1,379 million. Confident of delivering a run-rate of £2 billion per annum by the end of 2011.

Good progress on balance sheet reduction with cumulative non-core asset reduction of £105 billion. On track to meet target of £200 billion over the next three years.

Capital position significantly improved with core tier 1 ratio increased to 10.2 per cent, primarily reflecting a reduction in risk weighted assets by 18 per cent to £406.4 billion.

Excellent progress against term funding objectives with £50 billion of wholesale term issuance in the year.

Customer relationship deposits increased by 3 per cent reflecting good growth in Retail and in Wealth and International.

Reduction in liquidity support from government and central bank facilities of £61 billion to £97 billion.

Given the flexibility and capacity we have for core business growth, we continue to believe that the Group has strong medium-term prospects, notwithstanding the economic and regulatory headwinds that we face in 2011.

2010 performance – a return to profitability and a further reduction in risk

The Group delivered a good operating performance in 2010 against the backdrop of modest growth in the UK economy, with good revenue growth in the core business, an improved net interest margin, a further reduction in costs, and continued strong progress on the integration of HBOS. The impairment charge reduced significantly, with deterioration in impairments in Ireland more than offset by substantial improvements elsewhere in the Group, particularly in the Wholesale division. As a result the Group returned to profitability in 2010 on a combined businesses basis, reporting a profit before tax of £2,212 million in 2010, compared to a loss before tax of £6,300 million in 2009.

The increase in profit before tax was primarily generated by Wholesale and Retail. Wholesale returned to profitability in 2010 delivering profit before tax of £3,257 million compared to a loss before tax of £4,703 million in 2009 reflecting a significant reduction in the impairment charge. Retail profit before tax also increased significantly to £4,716 million from £1,382 million in 2009 driven by good income growth and a significantly lower impairment charge. Insurance delivered a 13 per cent increase in profit before tax to £1,102 million as our focus on improved profitability of the product set delivered higher new business profits, despite lower sales. However, these increases were partially offset by a significant increase in loss before tax in Wealth and International to £4,824 million from £2,356 million in 2009, driven by a higher impairment charge, predominantly due to the material deterioration of the economic environment in Ireland in the last quarter of 2010.

While the majority of the Group's 2010 profit was earned in the first half, when liability management gains in the first half and losses in the second half arising from the equity conversion feature of the Enhanced Capital Notes (ECNs) are excluded, the second half saw a significant improvement in profitability when compared to the first half, driven by a significant increase in Wholesale profit, partially offset by an increased loss in Wealth and International.

Statutory profit before tax was £281 million in 2010. While this was a reduction from £1,042 million in 2009, the 2009 result had benefited from an £11,173 million credit from the gain arising on the HBOS acquisition (negative goodwill). In 2010, statutory profit included a charge for integration costs of £1,653 million (2009: £1,096 million), a provision of £500 million for customer goodwill payments, and a loss on disposal of businesses (acquired from a previous lending relationship) of £365 million; these items were partially offset by a £910 million pension curtailment gain and positive insurance volatility of £306 million. After a taxation charge of £539 million (see note 16 on page 181 and 182) and a charge for profit attributable to non-controlling interests of £62 million, loss attributable to equity shareholders was £320 million and loss per share amounted to 0.5 pence.

We further reduced risk in the business, through the reduction in the size of the Group's balance sheet in line with our strategy and through the significant improvements in our capital, funding and liquidity achieved during the year. Our core tier 1 ratio now stands at 10.2 per cent (2009: 8.1 per cent), and our loan to deposit ratio, excluding repos, improved to 154 per cent, and to 119 per cent in our core business. Through strong term wholesale funding issuance during the year, which totalled £50 billion, we maintained the maturity profile of the Group's wholesale funding, with 50 per cent having a maturity of more than one year. We also made excellent progress in reducing liquidity support from government and central bank facilities, which reduced by £60.6 billion to £96.6 billion.

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Outlook – strong medium-term prospects

Given the flexibility and capacity we have for core business growth, we continue to believe that the Group has strong medium-term prospects, notwithstanding the headwinds that we face in 2011. We give detailed comments on our prospects in the following sections.

Our medium-term targets remain unchanged. However, having joined the Group in January, António Horta-Osório will be appointed Group Chief Executive on 1 March and will be reviewing the business to further develop the strategy and actions needed to realise its full potential. He expects to report to the Board and subsequently to shareholders on the outcome of his strategic review and his plans at the end of the first half of 2011.

With the Group having returned to profitability in 2010, the risk in the business further reduced, and our improved capital, funding and liquidity positions, we now have a stronger business, which is well positioned for the future.

Note on presentation of results

To enable meaningful comparisons to be made with prior periods, and in line with previous results announcements, the income statement commentaries below are on a combined businesses basis (see 'basis of presentation' – page 153). Certain commentaries also exclude the unwind of fair value adjustments.

Further, to enable a better understanding of the Group's core business trends and outlook, certain income statement and balance sheet information is analysed between core and non-core portfolios. Non-core portfolios consist of non-relationship assets and liabilities, and assets and liabilities which are outside the Group's current appetite. The EU mandated retail business disposal is not included in non-core portfolios.

Combined businesses results summary – income

	2010 £m	2009 £m	Change %
Net interest income	**13,822**	12,726	9
Other income:			
Underlying other income	**10,361**	10,804	(4)
Liability management gains	**423**	1,498	
Reduction in fair value of equity conversion feature of ECNs	**(620)**	(427)	
	10,164	11,875	(14)
Total income	**23,986**	24,601	(2)
Insurance claims	**(542)**	(637)	
Total income, net of insurance claims	**23,444**	23,964	(2)

Underlying income

Net interest income	**13,822**	12,726	9
Underlying other income	**10,361**	10,804	(4)
Insurance claims	**(542)**	(637)	
Underlying income	**23,641**	22,893	3

Core and non-core income

Core	**19,371**	18,188	7
Non-core	**4,270**	4,705	(9)
Underlying income	**23,641**	22,893	3

A good revenue performance

Total income, net of insurance claims, decreased by 2 per cent to £23,444 million, which included a reduction of £1,075 million in gains from the Group's liability management exercises and a £193 million increase in the mark-to-market losses arising from the equity conversion feature of the Group's Enhanced Capital Notes. The total mark-to-market loss relating to the ECNs in 2010 was £620 million, and comprised a gain of £192 million in the first half of the year and a loss of £812 million in the second half.

Underlying income, excluding these items, increased by 3 per cent. The Group delivered a good revenue performance in its core business in 2010 despite subdued growth in lending markets. Core business underlying income growth of 7 per cent was, however, partially offset by a reduction in non-core income of 9 per cent, in line with progress against the Group's strategy to reduce the size of its balance sheet.

Group net interest income increased by £1,096 million, or 9 per cent, to £13,822 million. The net interest margin from our banking businesses was 33 basis points higher at 2.10 per cent, as higher asset pricing and reductions in the average spread between base rate and LIBOR more than offset lower deposit margins in Retail and increasing wholesale funding spreads. The incremental costs of wholesale funding have been recorded within Central items. The banking asset margin increased by 45 basis points to 1.56 per cent, and the banking liability margin decreased by 31 basis points to 0.97 per cent.

The majority of the net interest margin increase was achieved in the first half of the year, with only modest improvement in the second half, as previously guided, given rising wholesale market funding costs, a slowing migration of mortgages to standard variable rates, continued liability

margin pressures, and modest additional costs reflecting the successful increase in term issuance compared to our initial expectations.

In 2011, we see limited scope to increase asset pricing, with any gains likely to be offset by elevated wholesale funding costs, while liability margins will remain under pressure as a result of competitive markets and low base rates. Given these factors and the margin expansion since 2009, which we have achieved earlier than expected, we do not expect further progression in our net interest margin in 2011 compared to 2010 as a whole.

Other income decreased by 14 per cent to £10,164 million. Excluding liability management gains and movements in the fair value of the ECNs, underlying other income decreased 4 per cent. This reflected lower payment protection insurance (PPI) income as a result of the Group's decision to withdraw from writing PPI business during the year, lower overdraft charges following changes to fee structures, and loss on sale of assets arising from targeted balance sheet reductions, as well as other elements principally related to changes in financial market conditions during the year.

Core business income growth was primarily driven by a strong performance in Retail, where net interest income benefited from an increase in asset margins, the majority of which occurred in the first half of the year. This increase was partially offset however by lower savings margins. Mortgage margins reflected a continued increase in the proportion of mortgages on standard variable rates (now representing 48 per cent of outstanding balances), lower LIBOR to base rate spreads, and higher new business margins as assets were priced to appropriately reflect risk and changes in funding costs. The Group achieved a 22.1 per cent share of gross mortgage lending (2009: 24.1 per cent), in markets which remained generally subdued. Unsecured lending balances were lower, continuing the recent trend and reflecting lower customer demand and continuing customer deleveraging. During the year, we continued to build our current account and savings customer franchises in what remains a competitive market for customer deposits, and reduced the proportion of more expensive term deposits while maintaining good overall deposit growth of 5 per cent.

In Wholesale, core income grew by 4 per cent, driven by an increase in the banking net interest margin, principally from asset margin growth, which largely reflected the repricing of lending business. This was partially offset by lower net interest income in Treasury and Trading, reflecting the more stable interest rate environment. Non-core income decreased by 15 per cent, given lower interest earning asset balances resulting from the excellent progress in targeted balance sheet reductions.

In Wealth and International, core income increased by 5 per cent, driven by the positive effect of foreign exchange movements in the International business and of higher global stock markets in the Wealth businesses, partially offset by a decline in the banking net interest margin.

The present value of new business premiums in our life, pensions and investments businesses decreased by 20 per cent, largely reflecting the focus on improving the profitability of the product set and the withdrawal of certain HBOS legacy products with lower returns. However, as a result of the repositioning of the product set, the benefits of cost savings and a reduction in initial commission on OEICs in 2010, UK new business profit increased by £135 million to £267 million. This improved performance shows through the Insurance division's UK margins on an EEV basis increasing to 3.7 per cent in 2010, compared to 2.6 per cent in 2009. General Insurance delivered a robust performance after taking account of the impact of the 2010 freeze events and the Group's decision to cease writing new payment protection business during the year.

Within Group Operations and Central Items, underlying income decreased by £126 million primarily due to a reduction in the fair value of derivatives not mitigated through hedge accounting. Net interest expense was broadly unchanged at £823 million, but included capital and wholesale liquidity funding costs of £601 million (2009: £260 million) not recovered from the divisions, with the increase primarily due to higher wholesale market funding spreads and the Group's decision to accelerate its wholesale funding in 2010. These increased costs were offset by improved net interest from interest rate risk management activities.

Outlook – income

Core assets accounted for approximately 82 per cent of income in 2010 (2009: 79 per cent), with core income growing 7 per cent. In 2011, however, we expect income trends will reflect continued customer deleveraging and subdued new lending demand which, with further non-core asset reductions, will result in a continued reduction in the overall size of the Group's balance sheet. As already stated, we do not expect to see further net interest margin progression in 2011.

Over time, however, we continue to target core businesses income growth of between 6 and 7 per cent per year and believe that our margin is likely to return to more than 2.5 per cent in the medium-term (approximately 2014) reflecting the effect of modest further improvements in asset pricing, higher liability margins facilitated by higher base rates, and greater stability in wholesale funding markets. We also anticipate reducing our wholesale funding requirements over this period. This margin outlook reflects, inter alia, our core economic assumptions for the medium-term, including base rates increasing to 3.75 per cent by the end of this period and no deterioration in consumer spending, the Group's asset reduction programme, the assumed costs of refinancing as wholesale funding matures, and a narrowing of wholesale market credit spreads over the medium-term. At the same time however, it is not possible to predict what effect current regulatory discussions could have on funding costs and therefore margin.

Divisional underlying income performance

	2010			2009			Change
	Core £m	**Non-core £m**	**Total £m**	Core £m	Non-core £m	Total £m	Core %
Retail	**10,394**	**591**	**10,985**	9,386	388	9,774	11
Wholesale	**5,540**	**3,022**	**8,562**	5,336	3,573	8,909	4
Wealth and International	**1,679**	**657**	**2,336**	1,601	744	2,345	5
Insurance	**2,009**	**–**	**2,009**	1,990	–	1,990	1
Group Operations and Central items	**(251)**	**–**	**(251)**	(125)	–	(125)	
Underlying income	**19,371**	**4,270**	**23,641**	18,188	4,705	22,893	7

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Combined businesses results summary – expenses

	2010 £m	2009 £m	Change %
Operating expenses	**(10,928)**	(11,609)	6
Impairment of tangible fixed assets[1]	**(150)**	–	
	(11,078)	(11,609)	5
Integration synergies run rate at 31 December	**1,379**	766	
Underlying cost:income ratio	**46.2%**	50.7%	

[1] Further detail is given in note 15, page 181.

Strong cost management delivering benefits

The Group has an excellent track record in managing its cost base, and has delivered a strong cost performance in 2010. During 2010, operating expenses decreased by 6 per cent to £10,928 million, as substantial integration related savings were captured, together with lower levels of operating lease depreciation. After investment, ongoing business as usual expenses were held within inflationary levels. Our underlying cost:income ratio also saw further improvement to 46.2 per cent.

We have already made significant progress in capturing savings from the integration programme with annual run-rate savings totalling £1,379 million achieved as at 31 December 2010. The Group is on track to deliver a run-rate of £2 billion per annum of cost synergies and other operating efficiencies by the end of 2011.

To date, costs of preparing for the EU mandated disposal of at least 600 UK branches, associated customer assets and liabilities and a proportion of our mortgage assets, have been modest. However with integration nearing completion, activity preparing for this divestment will accelerate significantly. The final cost will depend on the buyer and the extent to which substantial IT system and infrastructure development will be necessary. Therefore the total cost is hard to predict but is likely to be substantial. These costs will be excluded from combined businesses profits.

With income growth in the short term dependent, inter alia, upon economic conditions, strong cost management will continue to be an important focus for management.

Outlook – expenses

We expect that our costs will be broadly flat in 2011, with further absolute cost savings likely to be partially offset by increased investment proposed to support the growth of the core business, increasing regulatory costs, costs resulting from the introduction of the Bank Levy (which is expected to cost around £260 million in 2011), and the combined cost in the region of £100 million of the recent rise in VAT and employers' National Insurance contributions. Excluding the cost of the Bank Levy, the Group continues to target a cost:income ratio of approximately 40 per cent in the medium term.

SUMMARY OF GROUP RESULTS

Impairment charge significantly lower

The Group achieved a significant reduction in the impairment charge in 2010, in both the core and non-core businesses. The impairment charge of £13,181 million was 45 per cent lower than the £23,988 million charge in 2009, with deterioration in Ireland more than offset by substantial improvements elsewhere in the Group, particularly in the Wholesale division.

Impaired loans increased by 10 per cent to £64,606 million, representing 10.3 per cent of closing advances, driven by an increase in impaired loans in International, partially offset by decreases in Retail and Wholesale facilitated by improving economic conditions and, in Wholesale, also as a result of write-offs of irrecoverable assets and the sale of previously impaired assets. The Group's coverage ratio increased by 1.7 per cent to 45.9 per cent, primarily as a result of an increase in provisions in International, predominantly in Ireland. Non-core loans and advances to customers generated approximately 70 per cent of the Group's impaired loans reflecting their higher risk profile, with a coverage ratio of around 50 per cent at 31 December 2010. The coverage ratio of the Group's impaired core loans and advances to customers was approximately 37 per cent.

In Retail, the improvement in credit performance was faster than expected a year ago, with the impairment charge as a percentage of average loans and advances to customers decreasing to 0.74 per cent in 2010, significantly lower than 1.11 per cent in 2009. The core business impairment charge decreased by 34 per cent, reflecting the improved quality of new business and effective portfolio management and the continuing slow recovery of the economy.

The lower secured impairment charge reflected reduced impaired loan levels and improved arrears in the first half of 2010, although in the second half, and particularly in the last quarter, we saw some signs of strain, with fewer customers returning their accounts to order than was the case six months ago. House prices fell slightly in the year and the proportion of the mortgage portfolio with an indexed loan-to-value of greater than 100 per cent was broadly stable at 13 per cent. The value of the portfolio with an indexed loan-to-value greater than 100 per cent and more than three months in arrears has increased slightly by £0.2 billion and is now £3.2 billion, representing 0.9 per cent of the portfolio. The number of mortgage customers new to arrears has also remained relatively stable in the last twelve months, and is now well below the peak experienced in the second half of 2008. However, as a result of the early signs of strain we saw in the second half of the year and the subdued economic environment, we expect to see an increase in the secured impairment charge in 2011.

The unsecured impairment charge decreased by 29 per cent, reflecting continued improving portfolio trends resulting from the Group's prudent risk appetite, management actions taken over the past two years, and stable unemployment. Unsecured impaired loans decreased by £0.8 billion to £3.0 billion as a result of fewer cases going into arrears, improved quality of new business and increased write off of impaired loans. Impairment provisions as a percentage of impaired loans decreased to 50.6 per cent from 55.3 per cent, driven largely by relatively highly provided assets being written off combined with more stringent criteria for unsecured collections repayment plans.

The Wholesale impairment charge fell significantly from £15,683 million in 2009 to £4,446 million in 2010. There was a significant reduction in both the core and non-core businesses impairment charge. The impairment charge as a percentage of average loans and advances to customers improved significantly to 2.08 per cent in 2010 compared to 5.92 per cent in 2009.

The decrease in this period generally reflects the significant actions which were taken in the first half of 2009 on the heritage HBOS portfolios (including the identification of large impairments post the HBOS acquisition, especially in corporate real estate, real estate related and Corporate (UK and US) portfolios), together with the stabilising UK and US economic environment in 2010, a low interest rate environment helping to maintain defaults at a lower level and a number of write backs due to asset disposals.

In Wealth and International, impairment charges totalled £5,988 million, up 47 per cent on £4,078 million in 2009, reflecting increasing impairment charges in corporate and real estate in Ireland and Australia. The majority of the increase was in the non-core portfolio. The level of losses continues to be dominated by the economic environment in Ireland, and to a lesser extent has also been influenced by the performance of specific areas of the Australian economy.

After the release of the Interim Management Statement on 2 November 2010, the Group saw a further significant deterioration in market conditions in Ireland, with concerns over the country's fiscal position leading ultimately to the approval of its application for EU-IMF financial support on 21 November 2010. Market sentiment continued to be negatively affected by uncertainty about the political situation and about the economic effect of the austerity measures introduced in the Irish Budget of 7 December 2010. As a result, in a statement dated 17 December 2010, we noted that any economic recovery in Ireland may take longer to achieve, that asset prices will remain depressed for longer than previously anticipated and therefore that we believed that the significant deterioration in the

Combined businesses results summary – impairment charge

	2010			2009			Change
	Core £m	**Non-core £m**	**Total £m**	Core £m	Non-core £m	Total £m	Core %
Retail							
Secured	**251**	**41**	**292**	656	133	789	62
Unsecured	**2,372**	**83**	**2,455**	3,318	120	3,438	29
	2,623	**124**	**2,747**	3,974	253	4,227	34
Wholesale	**1,276**	**3,170**	**4,446**	2,187	13,496	15,683	42
Wealth and International							
Ireland	**–**	**4,264**	**4,264**	–	2,949	2,949	–
Other	**221**	**1,503**	**1,724**	189	940	1,129	(17)
	221	**5,767**	**5,988**	189	3,889	4,078	(17)
Impairment charge	**4,120**	**9,061**	**13,181**	6,350	17,638	23,988	35

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Irish market would affect the timing and level of value realisation from this portfolio.

At the year end, compared to 30 June 2010, given the deterioration in market conditions noted above, a further approximately 10 per cent of the £27 billion Irish portfolio had become impaired, and we have increased the level of provisions against the portfolio, increasing the impairment charge relating to Irish exposures for the full year 2010 to £4.3 billion on a combined businesses basis. This has resulted in an increase in provisions as a percentage of impaired Irish loans to 53.7 per cent at the 2010 year end, in line with our expectations in our statement of 17 December 2010.

In Australia, although economic performance has been robust overall, there are significant geographical and sector variations, and property assets situated outside the principal metropolitan areas have been particularly weak. Our exposure to these areas within our Australian portfolio drove increased impairments in 2010.

Outlook – impairment

Overall, and based on our current economic assumptions for the UK and Ireland, including unemployment and property valuations, we expect to see further reductions in impairment losses in 2011 and beyond. We continue to target an improvement in the overall Group impairment charge as a percentage of average loans and advances to customers towards an expected 50-60 basis points by around 2014, as economic conditions improve.

In Retail, given our expectations for a modest improvement in the UK economic environment, and a further 2 per cent reduction in house prices in 2011, we currently expect that there will be a modest reduction in the overall Retail impairment charge in 2011. The rate of improvement is, however, expected to be significantly slower than in 2010, with the improving performance of the unsecured book more than offsetting additional secured charges.

In Wholesale, depending upon UK economic conditions, notably consumer spending, future commercial real estate price stability, the continuation of low interest rates, and the performance of individually large exposures, we would expect to see a further modest reduction in 2011 as a whole, although the timing of the trend is inherently hard to predict. As previously guided, we expect the overall net impairment charge in our traditional lending businesses (especially in the trading and manufacturing sectors) to increase in 2011, driven in part by lower write backs on asset disposals compared to 2010 and the effect of the UK government austerity measures on the wider economy. However, we also expect our impairment charges in corporate real estate and real estate related sectors to be lower than 2010 as a result of a continuing stabilisation of the existing portfolio. We remain vigilant in monitoring changes in economic conditions and to individual lending positions and we continue to invest heavily in expert resource to work with customers to restructure their businesses on to sustainable bases, thus protecting employment where possible.

Despite the worsening trend during 2010, we expect to see a reduction in the Wealth and International impairment charge in 2011, although we anticipate that conditions will remain difficult, and we will therefore continue to monitor international markets closely.

Capital resources

	2010	2009
Risk-weighted assets	**£406.4bn**	£493.3bn
Core tier 1 ratio	**10.2%**	8.1%
Tier 1 capital ratio	**11.6%**	9.6%
Total capital ratio	**15.2%**	12.4%

Strong capital ratios

Our capital ratios improved significantly during the year, primarily reflecting a reduction in risk weighted assets, and balance sheet liability management transactions. Total capital also increased through further subordinated debt issuance and through a repatriation of capital held within our insurance subsidiaries, although this increase was partially reduced by a revised approach to private equity investments which have now been deducted from total capital.

Risk weighted assets reduced by 18 per cent to £406.4 billion, driven by strong management of risk, reduced asset levels and tighter risk criteria for new business. Reductions were also achieved through changes to our credit risk measurement methodology in certain portfolios, including migrating a number of our Wholesale portfolios, which had previously been modelled on an Advanced Internal Ratings-Based Approach, to the Foundation Internal Ratings-Based Approach (FIRB) which will facilitate integration work.

Effects of Basel III on capital

During 2010 the Basel Committee on Banking Supervision has substantially refined the details of the so called 'Basel III' reforms for an enhanced global capital accord. These include increased minimum levels of, and quality standards for, capital, increased risk weighting of assets, and the introduction of a minimum leverage ratio, as well as the timing and transitional arrangements for implementation. The final details are still to be clarified, particularly as the reforms are implemented within the European and UK regulations, which may include a countercyclical buffer, requiring higher levels of capital to be held at certain points of the economic cycle, and higher capital requirements for systemically important financial institutions.

One of the key reforms impacting the Group arises from a revised treatment of the capital held within our insurance subsidiaries. During 2010, following a strategic review of our capital structure, £0.8 billion of equity was exchanged for subordinated debt within the insurance group and £1.5 billion was repatriated from the insurance group. Whilst this has no overall effect on the Group's core tier 1 capital under current Basel regulations, it does deliver a material core tier 1 capital benefit under the proposed Basel III reforms.

Outlook – capital resources

The effect of the Basel III reforms is uncertain as much will depend on business performance and mitigating actions that can be completed, even before the transition period comes in to effect. Analysis suggests that with no mitigating actions the reforms will reduce the Group's core tier 1 ratio by approximately 1.2 per cent in 2013, although lower risk weighted assets are expected from the planned reduction in the non-core balance sheet. The additional impact in 2014 of deducting the equity investment in insurance in excess of 10 per cent, transitioning in at 20 per cent per annum from 1 January 2014, would be around 0.3 per cent were the Group to take no further action to mitigate this.

The Group is confident that it is well positioned to maintain a strong capital position, meeting all regulatory requirements as currently formulated.

Based on our economic outlook, we continue to target returns on equity of more than 15 per cent over the medium to longer term. However, there continue to be material uncertainties as to future capital requirements and therefore we cannot be more specific at this stage.

Balance sheet

As at 31 December	2010 £bn	2009 £bn
Funded assets[1]	**655.0**	715.1
Non-core assets[2]	**194.7**	236.1

[1] Further analysis is set out on page 95.

[2] Further analysis is set out on page 55.

Rightsizing the balance sheet

Total Group funded assets decreased to £655.0 billion from £715.1 billion at 31 December 2009, substantially driven by reductions in non-core lending portfolios across the three banking divisions, continued customer deleveraging and de-risking and subdued demand in lending markets. We are pleased with the progress made on our balance sheet reduction plans in the period, given challenging market conditions, particularly in the latter part of 2010.

Previously, we set out our strategy to reduce non-core assets, including non-relationship assets and businesses which are outside our current appetite, by some £200 billion from a non-relationship pool of £300 billion. It continues to be our intention to manage these assets for value and, given the current economic climate, our primary focus remains on running these assets down over time. This strategy has been very effective and so far reductions of £105 billion have been achieved.

Outlook – balance sheet

We are confident of achieving our targeted further reductions in non-core assets of approximately £100 billion over the next three years. In addition, we continue to progress plans to execute the divestment of retail assets and liabilities in line with our state aid obligations.

The balance sheet reduction over time is providing the Group with increased optionality and flexibility from the resultant releases in both funding and capital. Together with initiatives to increase customer deposits in line with market growth, we expect to reduce the proportion of the Group's funding that is derived from wholesale markets and eliminate our use of government and central bank facilities by the end of 2012. This will provide capacity for core business growth in line with our relationship strategy. In 2011, however, we expect to see a continuation in the trend of customer deleveraging and generally subdued demand for new lending.

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Liquidity and funding

As at 31 December	2010	2009
Wholesale funding	**£298.0bn**	£325.5bn
Loan to deposit ratio[1]	**154%**	169%
Core business loan to deposit ratio[1]	**119%**	128%
Government and central bank funding	**£96.6bn**	£157.2bn
Proportion of wholesale funding with maturity of greater than one year	**50%**	50%

[1] Excluding repos and reverse repos.

A strengthened liquidity and funding position

The Group made excellent progress against its funding objectives in 2010 and further enhanced its liquidity position which is supported by a robust and stable customer deposit base. While total customer deposits fell 3 per cent, deposits excluding repurchase agreements increased by 3 per cent, reflecting good growth in relationship deposits in Retail and in Wealth and International.

The Group has continued to reduce its reliance on short-term wholesale funding. During the year the absolute level of Group wholesale funding fell to £298.0 billion, from £325.5 billion at the end of 2009, reflecting a reduction in balance sheet assets. By the end of 2010, our loan to deposit ratio, excluding repos and reverse repos, had improved to 154 per cent. Strong term issuance in 2010 also allowed the Group to maintain its maturity profile of wholesale funding with 50 per cent of wholesale funding having a maturity date greater than one year at 31 December 2010.

As previously guided, over the next couple of years the Group expects its public capital and senior funding issuance to be £20 billion to £25 billion per annum. We made excellent progress in 2010 on our term funding issuance plans, achieving £30 billion of publicly placed term issuance in the year. In addition, the Group issued a further £20 billion of term funding during the year via a series of privately placed funding transactions, a level which we do not expect to repeat in 2011. The Group continues to benefit from a diversity of funding sources. For example, during the year, we established a new funding programme in the US with our SEC Registered Shelf, issued inaugural Japanese Yen Samurai, Swiss Franc and Canadian Dollar bonds, and publicly launched the Lloyds TSB Bank plc Covered Bond Programme. We continue to look for opportunities to diversify our funding sources.

We welcome the proposals on minimum standards for funding liquidity published by the Basel Committee on Banking Supervision in December 2010. The introduction of the Liquidity Coverage Ratio and Net Stable Funding Ratio will raise the resilience of banks to potential liquidity shocks and provide the basis for a harmonised approach to liquidity risk management. These proposals are subject to ongoing refinement and have not yet been enacted into UK and European law. However, the Group monitors compliance against these internal metrics, and as at 31 December 2010, the Group's Liquidity Coverage Ratio was estimated at 71 per cent and the Net Stable Funding Ratio at 88 per cent. The actions already in place to reduce the size of the balance sheet are expected to ensure compliance with the future minimum standards, which are expected to be 100 per cent for both ratios, by their respective effective dates.

The Group made excellent progress on reducing its liquidity support from governmental and central bank sources, achieving reductions of £60.6 billion in 2010 leaving £96.6 billion outstanding at the year end. The Group currently receives no liquidity support from either the US Federal Reserve or the European Central Bank. The drawings from the UK Special Liquidity Scheme facilities and the issuance under the UK Credit Guarantee Scheme have various maturity dates, the last of which is in the fourth quarter of 2012. The Group is confident that all maturities can be met, and a further £13 billion of government and central bank facilities have been repaid since the year end.

Outlook – liquidity and funding

We expect the combination of continued increases in customer deposits and reductions in assets (primarily from non-core asset reduction plans) over the next three years to deliver further improvements in the Group's liquidity and funding position. As a consequence, we expect steady improvement in the overall loan to deposit ratio (which is expected to fall to below 140 per cent within three years), a reduction in wholesale funding requirements and therefore levels of ongoing term issuance, and liquidity levels to be maintained in excess of regulatory requirements.

SUMMARY OF GROUP RESULTS

Reconciliation of combined businesses results to statutory results

	2010 £ million	2009 £ million
Profit (loss) before tax – combined businesses	**2,212**	(6,300)
Integration costs	**(1,653)**	(1,096)
Volatility arising in insurance businesses	**306**	478
Amortisation of purchased intangibles and goodwill impairment	**(629)**	(993)
Pension curtailment gain	**910**	–
Customer goodwill payments provision	**(500)**	–
Loss on disposal of businesses	**(365)**	–
Government Asset Protection Scheme fee	**–**	(2,500)
Negative goodwill credit	**–**	11,173
Pre-acquisition results of HBOS plc	**–**	280
Profit before tax – statutory	**281**	1,042
Taxation	**(539)**	1,911
Profit (loss) for the year	**(258)**	2,953
Earnings per share	**(0.5)p**	7.5p

Integration costs

One-off integration costs of £1,653 million were incurred in 2010, bringing the total integration costs since the HBOS acquisition to £2,749 million. The integration costs relate to severance, IT and business costs of implementation.

Volatility arising in insurance businesses

A large proportion of the funds held by the Group's insurance businesses are invested in assets which are expected to be held on a long-term basis and which are inherently subject to short-term investment market fluctuations. Whilst it is expected that these investments will provide enhanced returns over the longer term, the short-term effect of investment market volatility can be significant. In 2010, higher equity market returns compared to our long-term assumptions have contributed to positive insurance and policyholder volatility totalling £306 million.

Pension curtailment gain

A net curtailment gain of £910 million was recognised in 2010 following changes to the Group's UK defined benefit pension schemes. In the first half of 2010 the Group implemented changes to the terms of its UK defined benefit pension schemes. As a result of these changes, the amount of any future salary increases that will be deemed pensionable will be capped each year at the lower of Retail Price Index inflation; each employee's actual percentage increase in pay; and 2 per cent of pensionable pay. This resulted in a curtailment gain of £1,019 million, but was partially offset in the second half of 2010 from a change in the commutation factors in certain defined benefit schemes.

Customer goodwill payments provision

On 21 February, 2011, we announced that we had reached a voluntary agreement with the Financial Services Authority (FSA) to initiate a customer review and contact programme regarding outstanding concerns relating to the variation of limits on some Retail mortgage contracts. These specifically related to some Halifax standard variable rate mortgage customers, where the wording in the mortgage offer documents received by these customers had the potential to cause confusion. Under the contact programme, goodwill payments will be made to affected customers.

We have made a customer goodwill payments provision in 2010 of £500 million in relation to the contact programme. This provision, which has been excluded from combined businesses profits, is expected to fully cover the costs of the programme. Further detail is given in note 45 on page 216.

Loss on disposal of businesses

During 2010, the Group recorded a loss of £365 million on the disposal of two wholly-owned subsidiary companies, acquired from a previous lending relationship, each of which owned an oil drilling rig under construction. Consistent with the Group's previous treatment, this loss has been reported outside of the Group's combined businesses results.

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Taxation

The tax charge for the year to 31 December 2010 was £539 million. This reflects a higher effective tax rate than the UK statutory rate primarily due to the effect of partially unrelieved losses in Ireland and Australia, policyholder tax, and the effect on deferred tax of the reduction in the UK corporation tax rate from 28 per cent to 27 per cent with effect from 1 April 2011.

Acquisition related balance sheet adjustments

Profit before tax includes the unwind of £3,118 million of acquisition related fair value adjustments, of which £2,229 million relates to impairments. This is ahead of our previous expectation of approximately £2,500 million due to the acceleration of amounts held against the Group's securities portfolios as expectations of future credit losses have improved. In 2011, we expect a further benefit of some £2 billion broadly in line with previous guidance. Thereafter, over the medium term, declining annual benefits are expected to accrue.

Legal and regulatory

There has been extensive scrutiny of the Payment Protection Insurance market in recent years, and the Financial Services Authority issued its final Policy Statement on PPI complaints handling in August 2010. The application of this Policy Statement could in extremis have a material impact on the Group's financial position. In October 2010, an application for judicial review was issued by the British Bankers' Association challenging the FSA's new standards for PPI complaints handling and the Financial Ombudsman Service's approach to such complaints. The hearing was held in late January 2011, and the judgement (which may be subject to appeal) is expected shortly. Further detail is given in note 54 on page 237.

The UK Government has appointed an Independent Commission on Banking (ICB) to review structural measures to reform the banking system and promote stability and competition. The ICB is not expected to publish its final report until September 2011 and it is too early to quantify any possible effect on the Group.

Financial Services Compensation Scheme (FSCS) costs in respect of certain investment company failures have now started to emerge and, although relevant costs cannot be predicted, we expect that during the course of 2011 the Group will be required to make contributions towards such costs as required by the FSCS.

Lending to homeowners and businesses

The Group continues to actively support the UK economy by lending to UK households and businesses. In 2010, we have extended £30 billion of gross mortgage lending (including remortgages) and £49 billion of committed gross lending to businesses, of which £11 billion was for SMEs.

Under the terms of our lending commitments to the UK Government, we agreed to make available gross new lending of £67 billion in the 12 months to 28 February 2011, of which £23 billion would be extended to homeowners and £44 billion to UK businesses. In the ten months from 1 March to 31 December 2010, we have extended lending that qualifies under the programme totalling over £20 billion to UK homeowners and over £42 billion to UK businesses, of which £10 billion has been extended to SMEs and we are on track to meet our lending commitments in full.

Bank of Scotland (Ireland) Limited

In February 2010, we announced that we would close our retail and intermediary business in the Republic of Ireland, and in August 2010 we announced that we would transfer, subject to the necessary approvals, the Bank of Scotland (Ireland) Limited (BOSI) business to Bank of Scotland plc. The business was transferred to Bank of Scotland plc on 31 December 2010, including all of the strategic management and decision making activities, at which point BOSI ceased to exist. As a result the Group no longer has any regulated banking business in the Republic of Ireland. Bank of Scotland plc will utilise its extensive operational and management capability, including general and credit management, oversight and control, within the UK in relation to the Irish portfolio, aiding the efficient run-down of the existing lending portfolio.

UK economic outlook

We continue to believe that a slow recovery over the next couple of years remains the most likely outcome for the UK economy. Our central planning scenario reflects a number of economic assumptions including that GDP growth will recover to approximately 1.9 per cent in 2011 with a further increase to 2.4 per cent in 2012. We expect a decrease of 2 per cent in UK house prices in 2011, with a 2 per cent increase in 2012. We also expect a decrease of 2 per cent in commercial property prices in 2011 and a recovery of 3 per cent in 2012. Finally, we believe that unemployment will peak at 8.1 per cent in 2011.

Outlook – strong medium-term prospects

Given the flexibility and capacity we have for core business growth, we continue to believe that the Group has strong medium-term prospects, notwithstanding the headwinds that we face in 2011.

Our medium-term targets remain unchanged. However, having joined the Group in January, António Horta-Osório will be appointed Group Chief Executive on 1 March, and will be reviewing the business to further develop the strategy and actions needed to realise its full potential. He expects to report to the Board and subsequently to shareholders on the outcome of his strategic review and his plans at the end of the first half of 2011.

With the Group having returned to profitability in 2010, the risk in the business further reduced, and our improved capital, funding and liquidity positions, we now have a stronger business, which is well positioned for the future.

Tim J W Tookey
Group Finance Director

SUMMARY OF GROUP RESULTS

Combined businesses segmental analysis

2010	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	9,378	4,426	1,176	(263)	(895)	13,822
Other income	1,607	4,136	1,160	2,814	447	10,164
Total income	10,985	8,562	2,336	2,551	(448)	23,986
Insurance claims	–	–	–	(542)	–	(542)
Total income, net of insurance claims	10,985	8,562	2,336	2,009	(448)	23,444
Costs:						
Operating expenses	(4,644)	(3,744)	(1,536)	(854)	(150)	(10,928)
Impairment of tangible fixed assets	–	(150)	–	–	–	(150)
	(4,644)	(3,894)	(1,536)	(854)	(150)	(11,078)
Trading surplus	6,341	4,668	800	1,155	(598)	12,366
Impairment	(2,747)	(4,446)	(5,988)	–	–	(13,181)
Share of results of joint ventures and associates	17	(95)	(8)	(10)	5	(91)
Profit (loss) before tax and fair value unwind	3,611	127	(5,196)	1,145	(593)	(906)
Fair value unwind[1]	1,105	3,130	372	(43)	(1,446)	3,118
Profit (loss) before tax	4,716	3,257	(4,824)	1,102	(2,039)	2,212
Banking net interest margin[2]	2.46%	1.88%	1.63%			2.10%
Cost:income ratio[3]	42.3%	43.5%	65.8%	42.5%		46.6%
Impairment as a percentage of average advances[4]	0.74%	2.08%	8.90%			2.01%
Key balance sheet and other items 31 December 2010	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers	363.7	173.2	55.3		0.4	592.6
Customer deposits	235.6	124.3	32.8		0.9	393.6
Risk-weighted assets	109.3	222.7	58.7		15.7	406.4

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Combined businesses segmental analysis continued

2009	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	7,970	4,710	1,217	(287)	(884)	12,726
Other income	1,804	4,199	1,128	2,944	1,800	11,875
Total income	9,774	8,909	2,345	2,657	916	24,601
Insurance claims	–	–	–	(637)	–	(637)
Total income, net of insurance claims	9,774	8,909	2,345	2,020	916	23,964
Operating expenses	(4,566)	(4,106)	(1,544)	(974)	(419)	(11,609)
Trading surplus	5,208	4,803	801	1,046	497	12,355
Impairment	(4,227)	(15,683)	(4,078)	–	–	(23,988)
Share of results of joint ventures and associates	(6)	(720)	(21)	(22)	2	(767)
Profit (loss) before tax and fair value unwind	975	(11,600)	(3,298)	1,024	499	(12,400)
Fair value unwind[1]	407	6,897	942	(49)	(2,097)	6,100
Profit (loss) before tax	1,382	(4,703)	(2,356)	975	(1,598)	(6,300)
Banking net interest margin[2]	1.97%	1.52%	1.71%			1.77%
Cost:income ratio[3]	46.7%	46.1%	65.8%	48.2%		48.4%
Impairment as a percentage of average advances[4]	1.11%	5.92%	6.04%			3.25%
Key balance sheet and other items						
31 December 2009	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers	371.1	191.8	63.5		0.6	627.0
Customer deposits	224.1	153.4	29.0		0.2	406.7
Risk-weighted assets	128.6	286.0	63.2		15.5	493.3

[1] The net credit in 2010 of £3,118 million is mainly attributable to a reduction in the impairment charge of £2,229 million and an increase in other income of £1,195 million, as losses reflected in the acquisition balance sheet valuations of the lending and securities portfolios have been incurred, together with other hedging adjustments. This has been partly offset by a charge to net interest income of £301 million. The impact of the fair value unwind on net interest income is lower than in 2009 because the liability management exercises undertaken by the Group have had the effect of crystallising a proportion of the gains reflected in the opening balance sheet valuation of HBOS's own debt; there has also been a benefit from revised expectations of future impairment losses likely to emerge from certain retail lending portfolios.

[2] The calculation basis for banking net interest margins is set out on page 54.

[3] Operating expenses divided by total income net of insurance claims.

[4] Impairment on loans and advances to customers divided by average loans and advances to customers, excluding reverse repo transactions, gross of allowance for impairment losses.

DIVISIONAL RESULTS

RETAIL

KEY OPERATING BRANDS

Lloyds TSB

HALIFAX

BANK OF SCOTLAND

C&G Cheltenham & Gloucester

BM BIRMINGHAM MIDSHIRES

INTELLIGENT FINANCE®

PROFILE

Retail operates the largest retail bank in the UK and is 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 and Cheltenham & Gloucester, it serves over 30 million customers through one of the largest branch and fee free ATM networks in the UK.

Retail is focused on effectively meeting the needs of its customers. The division has over 22 million current account customers and provides social banking to over four million people through basic banking or social banking accounts. It is also the largest provider of personal loans in the UK, as well as being the UK's leading credit card issuer. Retail provides over one in five new residential mortgages making it one of the leading UK mortgage lenders and provided over 50,000 mortgages to help first time buyers in 2010. Retail is the largest private sector savings provider in the UK. It is also a major general insurance and bancassurance distributor, offering a wide range of long-term savings, investment and general insurance products.

2010 HIGHLIGHTS

Profit before tax increased to £4,716 million, compared to £1,382 million in 2009.

Profit before tax and fair value unwind increased to £3,611 million, a strong increase of £2,636 million compared to 2009, driven by good income growth, tight cost control and a significantly lower impairment charge.

Net interest income increased by £1,408 million or 18 per cent to £9,378 million, largely as a result of the continuing re-pricing of risk, mortgage customers moving onto standard variable rates and a decrease in the LIBOR to Base Rate spread.

Other income decreased by £197 million or 11 per cent to £1,607 million, relating particularly to changes to current account overdraft structures.

Operating expenses remain tightly controlled, increasing by only 2 per cent to £4,644 million, which combined with strong income growth led to a significant reduction in the cost:income ratio to 42.3 per cent. Operating expenses benefited from continuing cost control as well as cost synergies.

The impairment charge reduced significantly to £2,747 million, down by 35 per cent, supported by prudent risk management, a stabilising economy, broadly stable house prices and low interest rates. The improvement in credit performance was faster than expected a year ago.

Loans and advances to customers decreased by £7.4 billion, or 2 per cent to £363.7 billion, as customers continued to reduce their personal indebtedness, particularly unsecured debt. While mortgage balances declined by £3.8 billion, Retail continued to support first time buyers and home movers with gross mortgage lending of £30 billion.

Customer deposits increased by £11.5 billion, or 5 per cent, to £235.6 billion, predominantly from instant access and tax free ISA accounts rather than more expensive term deposits.

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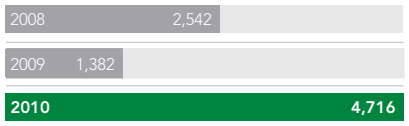
PERFORMANCE SUMMARY

	2010 £m	2009 £m	Change %
Net interest income	**9,378**	7,970	18
Other income	**1,607**	1,804	(11)
Total income	**10,985**	9,774	12
Operating expenses	**(4,644)**	(4,566)	(2)
Trading surplus	**6,341**	5,208	22
Impairment	**(2,747)**	(4,227)	35
Share of results of joint ventures and associates	**17**	(6)	
Profit before tax and fair value unwind	**3,611**	975	
Fair value unwind	**1,105**	407	
Profit before tax	**4,716**	1,382	
Banking net interest margin	**2.46%**	1.97%	
Banking asset margin	**1.93%**	1.18%	
Banking liability margin	**0.87%**	1.41%	
Cost:income ratio	**42.3%**	46.7%	
Impairment as a % of average advances	**0.74%**	1.11%	
As at 31 December	**2010 £bn**	2009 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers:			
Secured	**337.3**	341.1	(1)
Unsecured	**26.4**	30.0	(12)
	363.7	371.1	(2)
Customer deposits:			
Savings	**195.3**	185.6	5
Current accounts	**40.3**	38.5	5
	235.6	224.1	5
Risk-weighted assets	**109.3**	128.6	(15)

PERFORMANCE INDICATORS

Profit before tax

£m



Income and operating expenses growth

%

Customer deposits

£bn

Loans and advances to customers

£bn

DIVISIONAL RESULTS

RETAIL

Strategic vision

Retail's goal is to be recognised by customers as the UK's best bank. This will be achieved by building deep and enduring customer relationships which deliver real value to customers. Retail believes this strategy will drive sustainable long term value for all stakeholders. A deep understanding of customers and their needs combined with highly efficient and effective processes will allow more investment in products and services that customers really value. Retail is increasing its capabilities through the integration of Lloyds TSB and HBOS which presents a great opportunity to use the best from each heritage and significantly improve systems and processes. This includes extending Lloyds TSB's strong customer insight capabilities to Halifax and Bank of Scotland. Success for Retail will be reflected in enhanced customer service resulting in strong customer advocacy which in turn leads to lower customer acquisition costs, increased share of wallet and improved customer retention.

Progress against strategic initiatives

Deep and enduring customer relationships

The Retail strategy is to build deep and enduring relationships so that customers choose Retail's relationship brands (Lloyds TSB, Halifax and Bank of Scotland) for more of their financial needs. This is being achieved through offering a broad range of products that address customer needs, alongside superior customer service and advice. Retail also continues to work to ensure customers are the focus of business development including instituting a number of programmes to ensure key customer needs underpin ongoing product and service development.

During 2010, Retail successfully delivered a number of elements of the strategy, with a focus on rebuilding trust with customers. A primary focus was the development of products that are simple, transparent and easy for customers to understand. Customer demand for these products has been very positive. For example, the customer response to the Halifax's Clarity card has been strong with 145,000 new cards issued since its launch in July 2010. This card leads the market in terms of transparency and simplicity with a single customer interest rate and no usage fees for balance transfers, cash withdrawals and international usage.

Retail has also continued to develop its current account switching facility, which plays a key role in building a strong relationship with new customers, by making it easy for customers to switch. Experience has shown that after customers use the current account switching facility, they are over 70 per cent more likely to transfer their primary current account.

Creating products and services that customers value

A focus on customers, including active use of Retail's strong customer insight capability, ensures that products and services are customer-led in a highly competitive market. Retail has a strong record of award-winning products and services.

Retail is committed to supporting the housing market and working with customers to find solutions to their changing situations. An example of this is the recently launched Equity Support Scheme that enables customers with low or negative equity to move home. This scheme recognises that there are significant numbers of customers who are making payments on their mortgage and have a desire to move but due to lack of equity have been unable to do so. Retail has also extended its popular first time buyer 'Lend a Hand' mortgage to all home movers. This product helps customers through allowing friends and family to contribute to a savings account supporting a mortgage.

Retail continues to work to deliver products and services that address customer needs. An example of this is the recently launched Halifax Cash ISA Promise. In the month following the launch in October 2010 the ISA business performed significantly ahead of expectations with 44,000 accounts transferred, despite the launch being outside of the traditional ISA season. This industry leading promise addresses the poor transfer times between ISA providers, by promising to pay interest on new cash ISAs from the completed application date rather than when funds are transferred into the account, often weeks later. The other parts of the promise are increased information on cash ISA interest rates and an assurance that all cash ISAs are open to both new and existing customers.

Continually improving customer service

Retail continues to benefit from the opportunities afforded by its heritage businesses and is taking the best from the Lloyds TSB and HBOS franchises to create 'one best way' of doing things. Integration, together with changes in working practices, will deliver significant increases in efficiency which will allow further investment in the products and services that customers really value and will deliver a better customer experience.

Internet banking continues to grow in popularity amongst Retail's customers. To support the development and broaden the potential of this format Retail has introduced a new internet platform which was rolled out to Lloyds TSB customers during 2010. One example of the new services being delivered on this platform is Money Manager which provides an innovative tool for customers to better manage their finances.

Retail has been implementing new sales and customer service technology for mortgages and bancassurance across the network. These are being delivered to improve the quality of customer advice and increase the speed of decision making. The Mortgage Sales Platform offers customers a more comprehensive interview experience, a faster mortgage decision and 'one best way' of selling mortgages across its brands. In the bancassurance business a new platform has been rolled out to advisors, with tools which better identify customer's needs. This innovative platform also brings portfolio modelling tools to the Retail market.

Mobile banking is another key growth area and Retail is investing to make financial services more accessible and to increase the range of options available to customers. Lloyds TSB has launched a mobile banking application that allows customers to manage their money on the move, including transferring funds between accounts via their mobiles. Lloyds TSB now also offers a range of free text alerts, including balance updates and near limit alerts, thereby helping customers to better control their finances.

Integration

Retail has made good progress with integration, delivering significant cost savings and increased productivity as well as optimising performance across the business. The division has delivered run-rate synergies of £529 million at the end of 2010 and is on track to achieve run-rate synergies of £867 million by the end of 2011.

In 2010, Retail commenced the roll-out of a single counter system across all its branches providing a strong and efficient platform with increased functionality to further improve customer service. This is being supported by a 'one best way' programme that ensures there is a single efficient and effective approach to all major processes.

As part of the integration Lloyds TSB's Protection for Life bancassurance product range was extended into Halifax and Bank of Scotland. The impact of these changes has already been significant with close to 50 per cent uplift in protection new business premiums in Halifax and Bank of Scotland.

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Financial performance

Profit before tax increased to £4,716 million compared to £1,382 million in 2009, an increase of £3,334 million. This included an increase of £698 million in respect of the fair value unwind.

Profit before tax and fair value unwind increased to £3,611 million, a significant improvement compared to £975 million in 2009. This increase in profit was driven by strong income growth, tight cost control and a significant reduction in the impairment charge in the context of a stabilising economy.

Total income increased by £1,211 million, or 12 per cent, to £10,985 million. This was driven by a strong increase in net interest income of £1,408 million, partially offset by a reduction in other income of £197 million.

Net interest income increased by 18 per cent, with a significant increase in the net interest margin to 2.46 per cent, from 1.97 per cent in 2009. The asset margins expanded significantly during 2010 from 1.18 per cent to 1.93 per cent as a result of decreases in LIBOR to base rate spread and stable customer interest rates. The asset margin also widened partly as a result of mortgage customers continuing to move onto, and staying on, standard variable rates and assets being priced to more appropriately reflect risk and rising funding costs. The liability margin, on the other hand, has reduced from 1.41 per cent to 0.87 per cent as the effect of lower LIBOR to base rate spreads was partially offset by the reduction of expensive deposit balances.

Other income decreased by 11 per cent in 2010 to £1,607 million from £1,804 million largely as a result of changes to current account overdraft charges. Retail continues to focus on having fees and rates that customers understand. It is believed that this will result in stronger customer relationships as well as supporting the deepening of these relationships. An example of this focus is the changes to the overdraft charging structure for Halifax and Bank of Scotland personal current accounts at the end of 2009, which delivers a more suitable product proposition and an improved customer experience and resulted in a reduction in other income of approximately £90 million. Similarly, the changes to the Lloyds TSB current account pricing model, which became effective at the end of 2010, provide a simpler, more sustainable proposition for customers, resulting in an overall reduction in the cost of overdraft usage.

Total income is analysed as follows and reflects the trends discussed above:

	2010 £m	2009 £m	Change %
Mortgages and Savings	**4,739**	3,667	29
Consumer Banking	**6,246**	6,107	2
Total income	**10,985**	9,774	12

Operating expenses remained well controlled and increased by 2 per cent, against an increase in total income of 12 per cent, reflecting ongoing cost control and synergies from the integration. The cost:income ratio for the year improved to 42.3 per cent compared to 46.7 per cent in 2009.

The impairment charge on loans and advances decreased by £1,480 million, or 35 per cent, to £2,747 million reflecting the stabilising economy, more stable house prices, low interest rates and prudent lending criteria. As a percentage of average advances, the impairment charge decreased to 0.74 per cent, significantly lower than 1.11 per cent in 2009. The secured impairment charge reduced to £292 million from £789 million in 2009 while the unsecured impairment charge reduced to £2,455 million from £3,438 million in 2009.

The fair value unwind net credit of £1,105 million compares with £407 million in 2009. The net fair value unwind credit was larger than in 2009 which reflected a smaller charge related to the fixed rate mortgage portfolios as mortgages reached the end of their fixed term and borrowers moved to standard variable products. This was partially offset by a reduction in the credit attributed to the fixed rate savings portfolio as fixed rate term deposits, existing prior to acquisition, matured.

Balance sheet progress

Total loans and advances to customers decreased by £7.4 billion, or 2 per cent, to £363.7 billion, compared to 31 December 2009. This resulted from reduced customer demand for credit and customers continuing to reduce their personal indebtedness. The reduction in lending to customers was partly the result of the repayment of unsecured debt where balances reduced by £3.6 billion, or 12 per cent.

Secured balances were broadly stable as Retail maintained its strong commitment to the housing market and first time buyers. The proportion of mortgages on standard variable rate or equivalent products now stands at 48 per cent and is expected to rise only modestly during 2011.

The UK mortgage market for both house purchase and re-mortgaging was slightly lower in 2010, with gross market lending of £136.1 billion compared to £143.3 billion in 2009. Retail's gross mortgage lending (including remortgages) was £30 billion in 2010. This lending included full delivery on agreed lending commitments. New mortgage lending continued to be focused on supporting the housing market with more than 70 per cent of the lending being for house purchase rather than re-mortgaging. Retail remains the largest lender to first time buyers in the market helping over 50,000 customers buy their first home. It also continues to be an industry leader in its support for shared equity and shared ownership schemes.

Risk-weighted assets decreased by £19.3 billion, or 15 per cent, to £109.3 billion in 2010. This reduction was driven by lower lending balances, recalibrated downturn loss given default rates and the lower risk mix of the loan portfolio with reduced exposure to unsecured lending.

Total customer deposits increased by £11.5 billion, or 5 per cent, to £235.6 billion in the year. The growth was predominantly from instant access and tax free cash ISA accounts, rather than more expensive term deposits. This approach has helped support the net interest margin. Retail continues to perform well in the savings market, with a strong stable of savings brands which can be tailored to customer demands.

Non-core operations

Non-core operations consist of specialist mortgages (self-certified and sub-prime), selected third-party branded loans and selected third-party branded credit cards. As at 31 December 2010, these operations included loans and advances to customers of £30.6 billion (31 December 2009: £33.5 billion) and risk weighted assets of £11.2 billion (31 December 2009: £13.2 billion). In 2010 they also contributed income of £591 million (compared to £388 million in 2009) and an impairment charge of £124 million (compared to £253 million in 2009). In addition to the non-core assets, Retail continues to progress plans to divest other retail assets and liabilities in line with the state aid obligations.

DIVISIONAL RESULTS
WHOLESALE

KEY OPERATING BRANDS

Lloyds TSB

LLOYDS BANK CORPORATE MARKETS

BANK OF SCOTLAND

blackhorse

Lex Autolease

PROFILE

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 division comprises Corporate Markets, Treasury and Trading and Asset Finance.

Corporate Markets comprises Commercial, Corporate, Wholesale Markets, Wholesale Equity and Corporate Real Estate Business Support Unit. Commercial and Corporate provide relationship-based banking, risk management and advisory services to business customers, principally in the UK. Wholesale Markets provides risk management solutions, specialised lending, access to capital markets and multi-product financing solutions to its customers, whilst managing the Group's own portfolio of structured credit investments and treasury assets. Wholesale Equity manages the division's equity investment holdings (including Lloyds Development Capital). Corporate Real Estate Business Support Unit manages relationships with commercial real estate customers facing financial difficulties.

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 and speciality lending businesses including Contract Hire (Lex Autolease and Hill Hire) and Consumer Finance (Black Horse Motor and Personal Finance).

2010 HIGHLIGHTS

Profit before tax was £3,257 million compared to a loss before tax of £4,703 million in 2009.

Profit before tax and fair value unwind was £127 million, a £11,727 million improvement on the loss of £11,600 million in 2009, primarily reflecting the significant decrease in the level of impairment charge.

Net interest income decreased by 6 per cent to £4,426 million. This decrease reflected the lower interest earning asset balances, in-line with targeted balance sheet reductions and lower net interest income in Treasury and Trading, partially offset by a 36 basis point increase in the banking net interest margin.

Other income decreased marginally to £4,136 million, primarily reflecting a reduction from the higher market volatility in 2009 in Wholesale Markets and lower operating lease income in Asset Finance, partially offset by investment gains in Wholesale Equity.

Operating expenses decreased 9 per cent, reflecting reduced levels of operating lease depreciation and further cost savings achieved from the integration programme, partially offset by additional staff related costs in the Business Support Unit and continued investment in customer facing resource and systems.

Impairment charges on financial assets decreased significantly to £4,446 million, compared to £15,683 million in the previous year. The total impairment charge is 72 per cent lower than last year and continues to be primarily driven by the HBOS heritage corporate real estate and real estate related asset portfolios.

Assets decreased by 14 per cent to £240.9 billion continuing on from a 28 per cent reduction in 2009. This reflects the targeted reduction in the balance sheet, mainly in loans and advances to customers and banks in non-core business and through reductions in debt securities and available-for-sale positions.

Customer deposits excluding repos decreased 3 per cent to £114.1 billion, due to a reduction in short-term deposits in Treasury and Trading partially offset by higher deposits in Corporate Markets in line with the Group's funding strategy.

Continued progress in deepening customer relationships. Cross-selling has increased by 9 per cent, reflecting increased product capabilities and opportunities arising from applying a single sales force model on the combined customer base.

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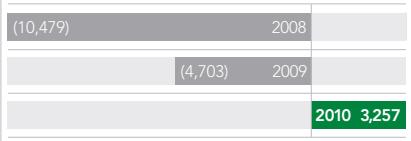
PERFORMANCE SUMMARY

	2010 £m	2009 £m	Change %
Net interest income	**4,426**	4,710	(6)
Other income	**4,136**	4,199	(2)
Total income	**8,562**	8,909	(4)
Costs:			
Operating expenses	**(3,744)**	(4,106)	9
Impairment of tangible fixed assets	**(150)**	–	
	(3,894)	(4,106)	5
Trading surplus	**4,668**	4,803	(3)
Impairment	**(4,446)**	(15,683)	72
Share of results of joint ventures and associates	**(95)**	(720)	87
Profit (loss) before tax and fair value unwind	**127**	(11,600)	
Fair value unwind	**3,130**	6,897	(55)
Profit (loss) before tax	**3,257**	(4,703)	
Banking net interest margin	**1.88%**	1.52%	
Banking asset margin	**1.28%**	1.02%	
Banking liability margin	**1.29%**	1.16%	
Cost:income ratio (excl. impairment of tangible fixed assets)	**43.7%**	46.1%	
Impairment losses as a % of average advances	**2.08%**	5.92%	
As at 31 December	**2010 £bn**	**2009 £bn**	**Change %**
Key balance sheet and other items			
Loans and advances to customers	**173.2**	191.8	(10)
Loans and advances to banks	**12.4**	18.9	(34)
Debt securities	**25.8**	31.7	(19)
Available-for-sale financial assets	**29.5**	36.9	(20)
	240.9	279.3	(14)
Customer deposits			
Customer deposits excluding repos	**114.1**	117.9	(3)
Repos	**10.2**	35.5	(71)
	124.3	153.4	(19)
Risk-weighted assets	**222.7**	286.0	(22)

PERFORMANCE INDICATORS

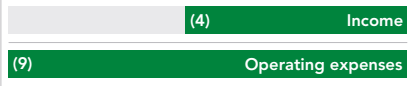
Profit (loss) before tax

£m



Income and operating expenses growth

%



Growth in cross-selling income

%

Committed gross lending

£bn

DIVISIONAL RESULTS

WHOLESALE

Strategic vision

Wholesale's strategic goal is to be recognised as the UK's leading, through-the-cycle, relationship-focused wholesale bank. The mission is to retain and deepen recurring, multi-product customer relationships building on deep insight into customer needs to provide a broad range of banking, risk management and capital market products.

Progress against strategic initiatives

Supporting customers through the cycle

Wholesale's through-the-cycle commitment to businesses is evidenced by key initiatives such as the SME Business Charter which was awarded the prize for innovation in SME finance by Business Moneyfacts in March 2010. In 2010, over 100,000 new Commercial start-up customers were attracted and over 200 regional customer events were held across the country, demonstrating our commitment to this segment. Wholesale's focus on deepening customer relationships and continued commitment to businesses was again recognised by Finance Directors of commercial and corporate companies who voted Lloyds TSB as Bank of the Year in the CBI/Real FD awards for the sixth year running in May 2010. In September 2010, our Commercial Finance business was voted as winner in the InterContinental Finance Magazine's global awards for Alternative Finance Provider of the year – United Kingdom.

Continued investment in Wholesale Markets capabilities has helped customers to diversify their funding sources and manage their interest rate and currency risks. This successful investment provides the foundations for deeper customer relationships and is earning external recognition which includes the Group being named 'The most improved European Debt Capital Markets and Syndicate team' by Euroweek in May 2010 and awarded 'Best Arranger of UK Loans' and 'Best Arranger Mid-Corporate Loans' at the 2010 Euroweek Syndicated Loan & Leveraged Finance Awards.

Integrating the businesses

Progress towards creating a single Wholesale Bank by the end of 2011 continues on track, with several notable milestones passed in 2010. Internal business structures are in place across Wholesale, and around 30 customer and data migrations successfully took place in 2010, representing assets of approximately £50 billion. The new Lloyds Bank Corporate Markets brand was launched in December, providing a single, comprehensive and consistent corporate banking and financial markets service for our customers. In the Asset Finance business, the successful integration of Lex and Autolease brands has created one of the UK's leading car leasing firms.

The focus for 2011 remains on the planning and execution of the remaining 40 migrations and strengthening risk systems, whilst ensuring that we continue to deliver our high levels of customer service. The division achieved run-rate synergies of £359 million at the end of 2010 and is on track to deliver run-rate synergies of £532 million by the end of 2011.

Prioritising businesses

In 2009, Wholesale systematically reviewed its assets, portfolios and businesses to identify those that would add most value to its relationship-focused strategic vision. In 2010, Wholesale ensured that investment in product and service capability was directed towards these core growth areas, and explored divestment opportunities for the remaining non-core assets.

Investment and change in the core growth areas continues to be embedded, with new talent joining the Group and new processes introduced to our client facing businesses. Cross-selling from deepening relationships increased by 9 per cent reflecting these enhanced product capabilities.

A number of disposals of non-core assets were completed during 2010 in line with the planned reduction of Wholesale's total assets, which includes part of the Group's commitment under the state aid restructuring plan. Wholesale continues to operate under an oversight and governance framework with the intention always of maximising long-term shareholder value from any asset sale.

Financial performance

Profit before tax was £3,257 million compared to a loss before tax of £4,703 million in 2009. The improvement of £7,960 million is after taking into account fair value unwind of £3,130 million, which decreased by £3,767 million compared to 2009.

Profit before tax and fair value unwind of £127 million was an £11,727 million improvement on the loss of £11,600 million in 2009, driven by a significant decrease in the impairment charge reflecting the stabilising economic climate, continuing to support previous guidance that the impairment charge peaked in first half of 2009.

Total income decreased by £347 million, or 4 per cent to £8,562 million mainly driven by a 6 per cent decrease in net interest income.

The decline in net interest income primarily reflects lower interest earning asset balances across loans and receivables in line with the Group's targeted balance sheet reduction, mainly in loans and advances to customers, debt securities and available for-sale-positions. Income was affected by higher funding costs and lower lending volumes, although this was partly offset by higher customer margins on new business and from re-pricing on renewals.

Banking net interest income, which excludes trading activity, increased by £330 million, to £3,683 million as lending business continued to be re-priced to reflect customer risk profiles, with lending margins increasing by 26 basis points. Deposit margins increased moderately, by 13 basis points, reflecting favourable internal liquidity rates, which was partially offset by the impact of lower LIBOR to base rate spreads. As a result, the banking net interest margin increased by 36 basis points to 1.88 per cent in 2010. The impact of re-pricing was only partially offset by a decrease in average interest earning assets and liability balances.

Other income decreased by £63 million, or 2 per cent, to £4,136 million, primarily reflecting higher levels of market volatility in 2009 which resulted in mark to market gains in Wholesale Markets, whilst 2010 experienced losses on sale of assets in targeted balance sheet reductions and lower operating lease income. Other income in 2010 benefited from investment gains in Wholesale Equity as a result of stabilisation in market conditions and improved fund investment performance, strong fee income across structuring and capital markets and more favourable performance in Treasury and Trading.

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Operating expenses decreased by £362 million, or 9 per cent, to £3,744 million primarily from a further reduction in the level of operating lease depreciation in Asset Finance and a continued focus on cost management including savings attributable to the integration programme. This was partially offset by additional costs in the Business Support Unit and continued investment in customer facing resource and systems.

The impairment charge decreased by £11,237 million to £4,446 million in December 2010. As a percentage of average loans and advances to customers, impairment charge improved to 2.08 per cent in 2010 compared to 5.92 per cent in 2009. The decrease reflects reductions, notably in the heritage HBOS corporate real estate and real estate related portfolios and heritage HBOS Corporate (UK and US) portfolios and write backs from asset disposals, due to the stabilising economic environment, low interest rates which helped to maintain defaults at reduced levels, the stabilisation of UK real estate prices and provisioning against base case assumptions undertaken on the acquired heritage HBOS portfolios in the first half of 2009. The decrease further confirms the Group's belief that the impairment charge peaked in the first half of 2009 under base case assumptions.

The share of losses from joint ventures and associates comprises a small loss of £95 million, a decrease of £625 million. This represents a net reduction in both the value and size of the portfolio compared to the prior year. The majority of the portfolio is now valued at nil with a remaining portfolio carrying value of approximately £128 million.

Fair value unwind decreased £3,767 million to £3,130 million, mainly due to lower impairments in 2010 relating to the HBOS assets that were fair valued on acquisition. The decrease was partially offset by charges relating to the expected losses on acquired debt securities and by fair value releases on sales.

Balance sheet progress

The division's asset balances (comprising loans and advances to customers and banks, debt securities and available-for-sale financial assets) reduced by £38.4 billion, or 14 per cent to £240.9 billion, primarily reflecting deleveraging by customers and continuing active de-risking of the balance sheet by either selling down or reducing holdings in debt securities and available-for-sale positions.

Loans and advances to customers decreased £18.6 billion, or 10 per cent to £173.2 billion. In Corporate Markets, balances decreased by £17.5 billion or 10 per cent, as demand for new corporate lending and refinancing of existing facilities were more than offset by the level of maturities, reflecting a continued trend of subdued corporate lending, customer deleveraging and asset sales in non-core sectors. Despite this overall reduction, net lending to core customers in the SME sector increased by 2.1 per cent. In Asset Finance, the decrease of £2.7 billion, or 23 per cent, reflected the targeted reduction in this asset class. Available for sale financial assets balances reduced by £7.4 billion, or 20 per cent, to £29.5 billion and debt securities decreased by £5.9 billion, or 19 per cent, to £25.8 billion, as Corporate Markets reduced the non-core balance sheet by either selling down or not replenishing total holdings after amortisations or maturities. Loans and advances to banks decreased £6.5 billion, or 34 per cent as the division refocused the balance sheet.

Customer deposits excluding repos decreased by £3.8 billion, or 3 per cent to £114.1 billion, due to a reduction in short-term deposits in Treasury and Trading, which was partially offset by higher deposits in Corporate Markets in line with Group's funding strategy.

Risk-weighted assets decreased by £63.3 billion, or 22 per cent to £222.7 billion, primarily reflecting the balance sheet reductions and the move to Foundation IRB from Advanced IRB for all HBOS non-retail portfolios.

Non-core operations

Non-core consists of businesses and/or business lines that are inconsistent with Wholesale's relationship-focused strategic vision of capital and liquidity efficient growth, driven by broad and deep customer relationships and within a prudent risk framework.

As at 31 December 2010, operations and portfolios considered to be non-core included assets of £126.9 billion (2009: £158.3 billion) which included £71.2 billion (2009: £83.1 billion) of loans and advances to customers, £25.4 billion (2009: £31.5 billion) of debt securities, £22.2 billion (2009: £32.0 billion) of available-for-sale financial assets and other assets of £8.1 billion (2009: £11.7 billion). Non-core risk-weighted assets were £94.8 billion (2009: £135.4 billion). Non-core portfolios and businesses include £4.9 billion (2009: £4.9 billion) of customer deposits.

In 2010, non-core businesses generated income of £3,022 million and impairment of £3,170 million, compared to 2009 income of £3,573 million and impairment of £13,496 million.

DIVISIONAL RESULTS

WHOLESALE

Corporate Markets

	2010 £m	2009 £m	Change %
Net interest income	**3,669**	3,756	(2)
Other income	**2,471**	2,541	(3)
Total income	**6,140**	6,297	(2)
Costs:			
Operating expenses	**(2,410)**	(2,461)	2
Impairment of tangible fixed assets	**(150)**	–	
	(2,560)	(2,461)	(4)
Trading surplus	**3,580**	3,836	(7)
Impairment	**(4,182)**	(14,855)	72
Share of results of joint ventures and associates	**(95)**	(717)	87
Loss before tax and fair value unwind	**(697)**	(11,736)	94
Cost:income ratio (excl. impairment of tangible fixed assets)	**39.3%**	39.1%	
Impairment as a % of average advances	**2.08%**	6.09%	
As at 31 December	**2010 £bn**	2009 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**160.2**	177.7	(10)
Risk-weighted assets	**202.1**	263.8	(23)

Loss before tax and fair value unwind decreased by £11,039 million to £697 million, due to a significant decrease in the impairment charge. Net interest income decreased by £87 million or 2 per cent. This reflected lower interest earning asset balances as a result of the ongoing focus on reducing the balance sheet. Despite increased funding costs net interest income benefited from improved margins from customer re-pricing.

Other income was £70 million or 3 per cent lower, primarily due to increased market volatility in 2009 which resulted in mark to market gains in Wholesale Markets which did not reoccur in 2010. Additionally other income benefited from investment gains in Wholesale Equity as a result of stabilising market conditions, and strong fee income across structuring and capital markets.

Operating expenses decreased by £51 million to £2,410 million due to continued synergy benefits, partially offset by investment in the Business Support Unit as well as customer facing resource and systems.

The impairment charge decreased by £10,673 million to £4,182 million reflecting a sustained decrease since the peak in first half 2009. As well as reflecting stabilising economic conditions, a significant amount of the decrease was also due to the application in 2009 of Lloyds Banking Group provisioning policy and risk review processes which were applied to the heritage HBOS corporate real estate and real estate related portfolios and heritage HBOS Corporate (UK & US) portfolio.

Impairment of tangible fixed assets of £150 million was incurred on assets held on the balance sheet as a result of the consolidation of certain entities over which the Group exercised control. A £365 million loss was recorded in 2010 on the disposal of these entities which is excluded from the Group's combined businesses profit before tax.

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Treasury and Trading

	2010 £m	2009 £m	Change %
Net interest income	**324**	544	(40)
Other income	**322**	238	35
Total income	**646**	782	(17)
Operating expenses	**(218)**	(187)	(17)
Profit before tax and fair value unwind	**428**	595	(28)
Cost:income ratio	**33.7%**	23.9%	
As at 31 December	**2010 £bn**	2009 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**4.1**	2.5	64
Risk-weighted assets	**8.6**	8.4	2

Profit before tax and fair value unwind decreased by £167 million to £428 million due to lower net interest income.

Total income decreased by £136 million, or 17 per cent. Interest income reduced as the highly volatile interest rate market evident in early 2009 was not repeated in 2010. Other income performance benefited from strong customer demand for interest rate, foreign exchange and risk management products in 2010. Trading flows are managed with the overriding aim of providing a service to customers, whilst maintaining Treasury and Trading's conservative risk appetite.

Operating expenses increased by £31 million to £218 million reflecting the investment in people and systems, in particular back office infrastructure, to support internal risk management and the customer franchise.

Asset Finance

	2010 £m	2009 £m	Change %
Net interest income	**433**	410	6
Other income	**1,343**	1,420	(5)
Total income	**1,776**	1,830	(3)
Operating expenses	**(1,116)**	(1,458)	23
Trading surplus	**660**	372	77
Impairment	**(264)**	(828)	68
Share of results of joint ventures and associates	**–**	(3)	
Profit (loss) before tax and fair value unwind	**396**	(459)	
Cost:income ratio	**62.8%**	79.7%	
Impairment as a % of average advances	**2.34%**	5.86%	
As at 31 December	**2010 £bn**	2009 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**8.9**	11.6	(23)
Operating lease assets	**3.0**	3.4	(12)
Risk-weighted assets	**12.0**	13.8	(13)

Profit before tax and fair value unwind was £396 million compared to a loss before tax and fair value unwind of £459 million in December 2009. The £855 million improvement was due to a lower impairment charge and lower operating expenses.

Total income decreased by £54 million, or 3 per cent, to £1,776 million as a result of lower business volumes on assets held under operating leases. The lower business volumes are in-line with a targeted reduction in this asset class and were partly offset by stronger margins.

Operating expenses decreased by £342 million, or 23 per cent, to £1,116 million, reflecting reduced depreciation charges on assets held under operating leases due to lower fleet size and a year on year improvement in used car values, and strong cost management and savings achieved from integration.

The impairment charge decreased by £564 million to £264 million, reflecting a stabilising economic environment and an improvement in market conditions for both the retail and non-retail consumer finance businesses. The lower impairment charge has been driven by a reduction in new cases entering arrears, the reduced book size and a better mix in the credit quality of new business being written over the last two years.

DIVISIONAL RESULTS

WEALTH AND INTERNATIONAL

KEY OPERATING BRANDS

Private Banking
Lloyds TSB

LOOK AT THINGS DIFFERENTLY
BANK OF SCOTLAND

SCOTTISH WIDOWS INVESTMENT PARTNERSHIP

Lloyds TSB | International

PROFILE

Wealth and International was formed in 2009 to give increased focus and momentum to the private banking and asset management businesses and to manage the Group's international businesses.

The Wealth business comprises private banking, wealth management and asset management. Wealth's global private banking and wealth management operations cater to the full range of wealth clients from affluent to Ultra High Net Worth within the UK, Channel Islands and Isle of Man, and internationally. Our private banking and wealth management business operates under the Lloyds TSB and Bank of Scotland brands. Our asset management business, Scottish Widows Investment Partnership, has a broad client base, managing assets for Lloyds Banking Group customers as well as a wide range of clients including pension funds, charities, local authorities, Discretionary Managers and Financial Advisers. In addition, the Group holds a 60 per cent stake in St James's Place, the UK's largest independent listed wealth manager and a 55 per cent stake in Invista Real Estate.

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 business in Australia, Ireland and Continental Europe and retail businesses in Germany and the Netherlands.

2010 HIGHLIGHTS

Loss before tax increased to £4,824 million compared to £2,356 million in 2009.

Loss before tax and fair value unwind increased by £1,898 million to £5,196 million, compared to £3,298 million in 2009, due to a higher impairment charge, predominantly in Ireland.

In Wealth, profit before tax increased by 36 per cent to £269 million. However, this was more than offset by the International loss before tax which increased by 56 per cent to £5,465 million.

Net interest income decreased by 3 per cent to £1,176 million, as an 8 basis points decline in the banking net interest margin more than offset the favourable impact of foreign currency movements, particularly the Australian dollar, and the income on the £7 billion European loan portfolio transferred in from the Wholesale division in the second half of 2009.

Operating expenses decreased by 1 per cent to £1,536 million, with cost savings achieved from integration, particularly in the asset management businesses in Wealth, partly offset by investment in International's German deposit taking operation, increased resources in business support functions and the effect of stronger foreign currency rates.

The impairment charge amounted to £5,988 million, compared to £4,078 million in 2009, reflecting the material deterioration in the economic environment in Ireland in the last quarter of 2010 that resulted in EU-IMF financial support in late November 2010 and the tightening of liquidity in the second half of 2010 in regional Australian property markets to which the Group is exposed.

Loans and advances to customers decreased by £8.2 billion, or 13 per cent, to £55.3 billion, reflecting net repayments of £4.1 billion, and additional impairment provisions in the International businesses, partly offset by foreign exchange movements of £1.1 billion.

Customer deposits increased by £3.8 billion, or 13 per cent, to £32.8 billion, due to strong inflows in UK Private Banking and Bank of Scotland Germany, partly offset by outflows in Ireland following the closure of the Irish retail branch network.

Against its strategic objectives, Wealth has demonstrated continuing strength in client acquisition through the UK franchise with a 12 per cent increase in customer numbers. In International, resources have been deployed to manage arrears, and the balance sheet reduction strategy resulted in underlying local currency advances decreasing by £4.1 billion, or 7 per cent.

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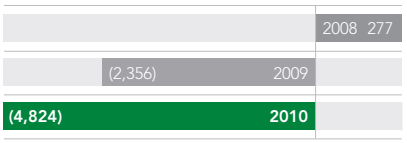
PERFORMANCE SUMMARY

	2010 £m	2009 £m	Change %
Net interest income	**1,176**	1,217	(3)
Other income	**1,160**	1,128	3
Total income	**2,336**	2,345	
Operating expenses	**(1,536)**	(1,544)	1
Trading surplus	**800**	801	
Impairment	**(5,988)**	(4,078)	(47)
Share of results of joint ventures and associates	**(8)**	(21)	62
Loss before tax and fair value unwind	**(5,196)**	(3,298)	(58)
Fair value unwind	**372**	942	(61)
Loss before tax	**(4,824)**	(2,356)	
Banking net interest margin	**1.63%**	1.71%	
Banking asset margin	**1.22%**	1.26%	
Banking liability margin	**0.83%**	0.82%	
Cost:income ratio	**65.8%**	65.8%	
Impairment as a % of average advances	**8.90%**	6.04%	
As at 31 December	**2010 £bn**	2009 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**55.3**	63.5	(13)
Customer deposits	**32.8**	29.0	13
Risk-weighted assets	**58.7**	63.2	(7)

PERFORMANCE INDICATORS

Profit (loss) before tax

£m



Income and operating expenses growth

%

Customer deposits

£bn

Wealth relationship clients

DIVISIONAL RESULTS

WEALTH AND INTERNATIONAL

Strategic vision

Wealth provides strong growth opportunities for the Group and, through deepening the relationships with existing Group clients alongside targeted external customer acquisition, Wealth's goal is to be recognised as the trusted adviser to expatriate and private banking clients both in the UK and selected international markets. Wealth's initial focus in the UK is to increase the penetration of its offering into the Group's existing customer base by the referral of wealthier customers to its private banking businesses where their wider financial needs can be more effectively met. Outside the UK, Wealth will be building on the strengths of its brand portfolio and existing expatriate, wealth management and private banking propositions.

In the International businesses, the priority is to maximise value in the medium term. International's immediate focus is on close management of the lending portfolio, particularly in the Irish business, and re-pricing assets where appropriate. At the same time International is delivering operational efficiencies, reshaping its business models and rightsizing the balance sheet to reflect the ongoing environment.

Progress against strategic initiatives

Deep and enduring customer relationships

In Wealth, the focus has been on driving additional income growth from the Group's affluent and high net worth client base through more effective use of the opportunities afforded by the Retail and Wholesale franchises to cross sell Wealth products to these customers. During 2010, customer segmentation across the Wealth businesses has been implemented and businesses transferred as appropriate to align to this segmentation, the customer referrals model has been formalised, and a new UK investment proposition launched. Continuing progress was demonstrated through a 7 per cent increase in Wealth relationship customers in 2010, including a 12 per cent increase in UK Wealth, and a 16 per cent increase in Wealth's customer deposits.

Maximising value in the short to medium term

In International, the focus remains on managing the impaired asset portfolio and continued strengthening of the control environment. Redeployment of resource from front line activity and the wider Group to manage arrears and collections is now complete and business support units are fully operational. The business aims to de-risk and reduce the balance sheet where possible, with net repayments in the International portfolio contributing £4.1 billion to the reduction in underlying local currency customer advances.

As previously announced, the Group completed a strategic review of Bank of Scotland (Ireland) Limited (BOSI) during the year, concluding that there was little opportunity for scalable growth in the future and that the business currently carried on by BOSI would merge, pursuant to a court process, into Bank of Scotland plc. This announcement followed the closure earlier in the year of BOSI's retail and intermediary business in Ireland, including all 44 Halifax retail branches.

The merger completed on 31 December 2010 at which point BOSI ceased to exist and its banking licence was relinquished. Bank of Scotland plc will utilise its extensive operational and management capability, including general and credit management, oversight and control, within the UK in relation to the Irish portfolio. This will support the efficient rundown of the remaining Irish lending portfolio.

In order to retain local administrative capability, historic knowledge and continuity of customer relationships, Bank of Scotland plc has entered into an agreement with an independent service company which will perform various administrative functions relating to the Irish business. Under this proposal the majority of BOSI employees have transferred to the service company.

Integration

Wealth and International is making excellent progress with the integration of its businesses with an annual synergies run-rate as at 31 December 2010 of £240 million, substantially achieving the end of 2011 run rate target of £242 million. The transfer of £50 billion of funds under management from Insight Investment to Scottish Widows Investment Partnership was successfully completed in the first half of 2010 along with the sale of Employee Equity Solutions and Bank of Scotland Portfolio Management Service. In the second half of 2010 the division successfully completed the integration of its Spanish businesses, while the UK Private Banking, Channel Islands and Wholesale Europe integration programmes are progressing well ensuring Wealth and International is on track to deliver targeted cost savings by the end of 2011.

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Financial performance by business unit

Wealth

	2010 £m	2009 £m	Change %
Net interest income	**345**	383	(10)
Other income	**1,018**	1,003	1
Total income	**1,363**	1,386	(2)
Operating expenses	**(1,047)**	(1,119)	6
Trading surplus	**316**	267	18
Impairment	**(46)**	(71)	35
Share of results of joint ventures and associates	**(1)**	2	
Profit before tax and fair value unwind	**269**	198	36
Cost:income ratio	**76.8%**	80.7%	
Impairment as a % of average advances	**0.48%**	0.70%	
As at 31 December	**2010 £bn**	2009 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**9.1**	9.2	(1)
Customer deposits	**26.8**	23.2	16
Risk-weighted assets	**10.4**	10.0	4

Profit before tax and fair value unwind increased by 36 per cent to £269 million due to lower costs and lower impairment charges.

Total income decreased by 2 per cent to £1,363 million. Net interest income decreased by 10 per cent, reflecting continued margin pressure driven by low base rates and a competitive deposit market. Other income increased by 1 per cent, as growth was constrained by lower asset management fee income following the sale of the external fund management business of Insight Investment in November 2009.

Operating expenses decreased by 6 per cent, driven by cost savings from integration, particularly in the Asset Management business and also include the effect of the sale of Insight Investment. On a like for like basis, excluding the costs of Insight Investment operating expenses decreased by 1 per cent.

The impairment charge decreased by 35 per cent reflecting strong credit management and improved collections and recoveries processes in 2010.

Customer deposits have increased by £3.6 billion, or 16 per cent, reflecting strong growth in the UK Private Banking business driven by the success of the Reserve savings account.

Funds under management

As at 31 December	2010 £bn	2009 £bn
SWIP:		
Internal	**118.2**	111.7
External	**28.0**	30.0
	146.2	141.7
Other Wealth:		
St James's Place	**27.0**	21.4
Invista Real Estate	**5.3**	5.4
Private and International Banking	**13.5**	15.6
Closing funds under management	**192.0**	184.1
Year ended 31 December	**2010 £bn**	2009 £bn
Opening funds under management	**184.1**	244.9
Inflows:		
SWIP and Insight – internal	**2.0**	7.1
– external	**8.9**	33.1
Other	**6.7**	4.1
	17.6	44.3
Outflows:		
SWIP and Insight – internal	**(5.6)**	(6.8)
– external	**(13.3)**	(26.4)
Other	**(5.1)**	(4.0)
	(24.0)	(37.2)
Investment return, expenses and commission	**15.1**	16.4
Net operating increase in funds[1]	**8.7**	23.5
Sale of Insight and Bank of Scotland Portfolio Management Service[2]	**(0.8)**	(84.3)
Closing funds under management	**192.0**	184.1

[1]Includes Insight Investment's external fund management business up to disposal on 2 November 2009.

[2]Insight Investment was sold on 2 November 2009. The Bank of Scotland Portfolio Management Service business was transferred to Rathbone Brothers Plc over the course of 2010.

Funds under management of £192.0 billion increased by £7.9 billion. Net outflows of £6.4 billion reflect an exceptional withdrawal from a single institutional investor in Scottish Widows Investment Partnership (SWIP), partially offset by strong net inflows in St. James's Place plc. Increases in global equity values, particularly in the second half of 2010, increased funds under management by a further £15.1 billion.

In October 2010, Invista Real Estate announced that its contracts to manage the Group's funds had been terminated on 12 months notice and that these contracts, representing £2.4 billion of Invista's total funds under management, will be managed in future by SWIP. Invista Real Estate has commenced an orderly realisation of its assets, including the remaining investment management business, and plans to return the proceeds of these realisations to shareholders.

DIVISIONAL RESULTS

WEALTH AND INTERNATIONAL

International

	2010 £m	2009 £m	Change %
Net interest income	**831**	834	
Other income	**142**	125	14
Total income	**973**	959	1
Operating expenses	**(489)**	(425)	(15)
Trading surplus	**484**	534	(9)
Impairment	**(5,942)**	(4,007)	(48)
Share of results of joint ventures and associates	**(7)**	(23)	70
Loss before tax and fair value unwind	**(5,465)**	(3,496)	(56)
Cost:income ratio	**50.3%**	44.3%	
Impairment as a % of average advances	**10.30%**	6.99%	
As at 31 December	**2010 £bn**	2009 £bn	Change %
Key balance sheet and other items			
Loans and advances to customers	**46.2**	54.3	(15)
Customer deposits	**6.0**	5.8	3
Risk-weighted assets	**48.3**	53.2	(9)

Loss before tax and fair value unwind increased by £1,969 million to £5,465 million due to a higher impairment charge, reflecting an increase of £1,315 million in Ireland and £513 million in Australia.

Total income increased by 1 per cent, but was 7 per cent lower in constant currency. This reflects lower interest earning assets and the increased strain of higher impaired assets, partly offset by additional income on the £7 billion European loan portfolio transferred from Wholesale division in the second half of 2009.

Operating expenses increased by 15 per cent, partially due to foreign exchange movements. In constant currency, operating expenses increased by 12 per cent reflecting the development of International's deposit taking operation in Germany, increased risk management resources to manage impaired asset portfolios in Ireland and Australia and costs associated with the closure of the Irish business.

The impairment charge and loans and advances to customers are summarised by key geography in the following table.

	Impairment charge		Loans and advances to customers as at 31 December	
	2010 £m	2009 £m	**2010 £bn**	2009 £bn
Ireland	**4,264**	2,949	**19.6**	25.0
Australia	**1,362**	849	**12.3**	13.0
Wholesale Europe	**210**	129	**6.9**	8.5
Latin America/Middle East	**97**	69	**0.6**	0.6
Netherlands	**9**	11	**6.8**	7.2
	5,942	4,007	**46.2**	54.3

The impairment charge increased by £1,935 million, or 48 per cent, to £5,942 million due to increased impairment charges in Ireland, particularly in the last quarter of 2010 as a result of downward revisions in the Group's Irish economic assumptions, and increased impairment charges in Australia as a result of significant contractions in liquidity in regional property markets to which the Group has exposure in the second half of 2010.

The lower credit in respect of the fair value unwind reflects the unwind profile of the original fair value adjustment which anticipated a peak in the impairment charge in 2009 based on a faster economic recovery in Ireland than is now being experienced.

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Balance sheet progress

Loans and advances to customers decreased by £8.1 billion or 15 per cent, to £46.2 billion due to net repayments of £4.1 billion across all businesses and higher impairment provisions, partly offset by an increase due to foreign exchange movements of £1.1 billion. The division is focused on de-risking and right-sizing the balance sheet, focusing on key Group relationships, as well as reducing concentrations in Commercial Real Estate. In the International businesses, drawn exposures in local currency have decreased with limited new business written within a tightened risk appetite that has been applied across the division since early 2009.

Customer deposits increased by £0.2 billion, or 3 per cent, to £6 billion with a strong performance in Bank of Scotland Germany, which has now raised over €4 billion of deposits since its launch in January 2009, offset by a fall in customer deposits in Ireland following the closure of the division's Irish retail business.

Non-core operations

Consistent with the division's strategic approach to maximising value in the medium term, a number of businesses are considered to be non-core, predominately the remaining Irish lending portfolio. As at 31 December 2010, non-core businesses included loans and advances to customers of £37.2 billion (2009: £44.3 billion), risk weighted assets of £35.0 billion (2009: £40.1 billion) and customer deposits of £0.3 billion (2009: £3.7 billion). In 2010, these non-core operations contributed income of £657 million (2009: £744 million) and an impairment charge of £5,767 million (2009: £3,889 million).

DIVISIONAL RESULTS
INSURANCE

KEY OPERATING BRANDS

SCOTTISH WIDOWS

clerical medical

Lloyds TSB

HALIFAX

BANK OF SCOTLAND

PROFILE

The Insurance division provides long term savings, protection and investment products and general insurance products to customers in the UK and Europe and consists of three business units:

Life, Pensions and Investments UK (LP&I UK): The UK Life, Pensions and Investments business is the leading bancassurance provider in the UK and has one of the largest intermediary channels in the industry. The business provides long-term savings, protection and investment products distributed through the bancassurance, intermediary and direct channels through the Lloyds TSB, Halifax, Bank of Scotland and Scottish Widows brands.

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.

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

2010 HIGHLIGHTS

Profit before tax increased by 13 per cent to £1,102 million, compared to £975 million in 2009.

Profit before tax and fair value unwind increased by 19 per cent, to £1,215 million, before a non-recurring charge of £70 million in respect of the Group's decision to cease writing new payment protection insurance (PPI) business.

Other income decreased 4 per cent to £2,814 million largely resulting from the decrease in PPI income as a result of the Group's decision to cease writing payment protection business, partially off-set by improved new business income and the higher than expected return from improved investment markets.

Total income, net of insurance claims decreased by £11 million to £2,009 million, primarily reflecting lower PPI income and claims arising from the freeze events in 2010, which are offset by reduced payment protection insurance claims and improved investment markets.

Operating expenses decreased by 12 per cent or £120 million to £854 million due to a continued focus on cost management and delivery of integration synergies.

Good progress continues to be made on integration, including the launch of a single bancassurance proposition in June 2010.

LP&I UK sales of £10,316 million (PVNBP) reduced by 20 per cent. The reduction in sales is largely due to the withdrawal of certain lower return HBOS legacy products in the second half of 2009 as the business continued to focus on value over volume and a change in mix towards protection products which, although more profitable, result in relatively lower PVNBP. An improvement in investment market conditions resulted in a reduction in sales of capital protected products.

LP&I UK margins increased to 3.7 per cent from 2.6 per cent in 2009. The improved margin reflects strategic choices made in respect of product and channel propositions as the legacy businesses are integrated in order to focus on value. The IRR on new business continues to improve and was in excess of 15 per cent in the year.

General Insurance profits increased by 1 per cent to £372 million primarily due to improved unemployment claims experience and integration synergies after taking account of continuing lower income resulting from ceasing to write new PPI business and claims related to the freeze events in 2010.

Capital management initiatives resulted in £2.3 billion mitigation of the potential impact of Basel III.

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PERFORMANCE SUMMARY

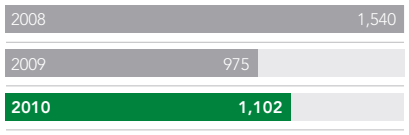
	2010 £m	2009 £m	Change %
Net interest income	**(263)**	(287)	8
Other income	**2,814**	2,944	(4)
Total income	**2,551**	2,657	(4)
Insurance claims	**(542)**	(637)	15
Total income, net of insurance claims	**2,009**	2,020	(1)
Operating expenses	**(854)**	(974)	12
Share of results of joint ventures and associates	**(10)**	(22)	55
Profit before tax and fair value unwind	**1,145**	1,024	12
Fair value unwind	**(43)**	(49)	12
Profit before tax	**1,102**	975	13
Profit before tax and fair value unwind – before impact of PPI new business closure	**1,215**	1,024	19
Other income – impact of PPI new business closure	**(70)**	–	
Profit before tax and fair value unwind	**1,145**	1,024	12
Profit before tax and fair value unwind by business unit			
Life, Pensions and Investments:			
Before impact of PPI new business closure	**753**	617	22
PPI new business closure	**(70)**	–	
UK business	**683**	617	11
European business	**110**	75	47
General insurance	**372**	367	1
Other[1]	**(20)**	(35)	43
Profit before tax and fair value unwind	**1,145**	1,024	12
EEV new business margin	**3.5%**	2.5%	

[1]The above result includes certain Group and divisional costs and income not allocated to business units, as well as the division's share of results of joint ventures and associates. The year ended 31 December 2010 includes an accounting gain on disposal of £13 million from the sale of the Group's joint venture investment in esure.

PERFORMANCE INDICATORS

Profit before tax

£m

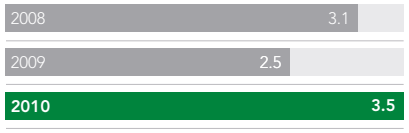


Income and operating expenses growth

%

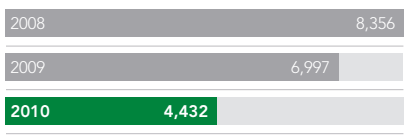
New business margin (EEV) LP&I UK

%



LP&I UK bancassurance sales

£m



DIVISIONAL RESULTS

INSURANCE

Strategic vision

The insurance division's strategic vision is to be recognised as the leading insurance business by its customers, the Group's shareholders and staff. The division has four strategic objectives to achieve its vision:

– complete the integration of the businesses;

– continue to strengthen its leading brands and grow sales profitably in its targeted markets;

– enhance the capital management and operational efficiency of existing and future business; and

– utilise the Group's strengths in distribution and asset management.

Progress against strategic initiatives

Integrating the business

The integrations of the legacy Life, Pensions and Investments businesses and the legacy General Insurance businesses have continued to progress well. The division achieved run-rate synergies of £197 million by the end of 2010 and is on track to deliver run-rate synergies of £239 million by the end of 2011.

In the Life, Pensions and Investments UK business good progress was made in integrating the legacy distribution functions in both the Intermediary and bancassurance channels. Following the integration of the Scottish Widows and Clerical Medical intermediary sales forces in July 2009, a single bancassurance proposition was launched in June 2010.

In the General Insurance business an integrated supply chain model was implemented and includes the introduction of personal claims consultants, across all brands, since July 2010.

Sustainable growth

The UK Life, Pensions and Investments business continues to make excellent progress in improving the profitability of the combined product set. Certain low returning products sold through the HBOS heritage channels have been discontinued and replaced with products providing an improved customer proposition, and enhanced shareholder value. The decision to change the mix of business from investment to protection products, while resulting in higher margins has contributed relatively lower PVNBP due to the premium size, with PVNBP in the UK business decreasing by 20 per cent. However the focus on value has resulted in strong increases in new business profits, new business margins and internal rates of return.

This focus on value over volume will continue, establishing a realistic base from which to continue to grow a business that is both profitable and focused on meeting customer needs.

In General Insurance, the combined ratio improved from 83 per cent to 79 per cent. Home insurance delivered a resilient underwriting performance in the year. Adverse weather conditions at the beginning and end of the year impacted the performance of the home book, however this was partially mitigated by improvements made to the efficiency of the claims processes.

Capital management and operational efficiency

Managing the use of the Group's capital remains a key objective of the business. Significant work has been undertaken to optimise the Insurance division's contribution to Group capital and in 2010 this resulted in £2.3 billion mitigation of the potential impact of Basel III. The Insurance division remains well capitalised as assessed via the Insurance Groups Directive regulatory measure of surplus capital. The division is progressing its plans to achieve Solvency II compliance.

The Insurance division continues to focus on cost reduction with costs decreasing by 12 per cent in 2010. Efficiencies have been achieved without compromising the quality of customer service and customer satisfaction scores have remained robust across the division.

Leveraging distribution and asset management

An integrated Life, Pensions and Investments UK bancassurance proposition was launched in June 2010. The proposition draws on product design and customer service expertise from the two heritages in order to establish a consistent base from which to further leverage the scale of the Group's bancassurance operation.

Life, Pensions and Investments

UK Business

	2010 £m	2009 £m	Change %
Net interest income	**(227)**	(273)	17
Other income	**1,408**	1,474	(4)
Total income	**1,181**	1,201	(2)
Operating expenses	**(498)**	(584)	15
Profit before tax and fair value unwind	**683**	617	11
Profit before tax and fair value unwind – before impact of PPI new business closure	**753**	617	22
Other income – impact of PPI new business closure	**(70)**	–	–
Profit before tax and fair value unwind	**683**	617	11
Profit before tax and fair value unwind by business unit			
New business profit:			
Insurance business[1]	**332**	328	1
Investment business[1]	**(65)**	(196)	67
Total new business profit	**267**	132	102
Existing business profit	**464**	431	8
Experience and assumption changes	**22**	54	(59)
Profit before tax and fair value unwind – before impact of PPI new business closure	**753**	617	22
Other income – PPI new business closure	**(70)**	–	
Profit before tax and fair value unwind	**683**	617	11
EEV new business margin (UK)	**3.7%**	2.6%	
Life, Pensions and Investments sales (PVNBP)	**10,316**	12,973	(20)

[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 income and expenses. Consequently the recognition of profit from investment contracts is deferred relative to insurance contracts.

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Life, Pensions and Investments UK delivered profit growth, before tax and fair value unwind, of £136 million, or 22 per cent, before taking into account the non-recurring £70 million charge from the Group's decision to cease writing new payment protection business. After this charge, profit before tax and fair value unwind was £683 million, an increase of 11 per cent compared to 2009.

Total new business profit increased by £135 million, or 102 per cent, to £267 million. The increase primarily reflects a reduction in initial commission on OEICs sold through the branch network and cost reductions through integration across our sales channels in addition to progress made on product participation choices.

LP&I UK margins on an EEV basis increased to 3.7 per cent in 2010 from 2.6 per cent in 2009. The improved margin reflects the strategic choices made in respect of product and channel propositions as the legacy businesses have been integrated in order to focus on value. The IRR on new business was in excess of 15 per cent in the year.

Existing business profit increased by £33 million, or 8 per cent, to £464 million. This predominantly reflects higher asset values and a higher assumed rate of return following improved market conditions in the second half of 2009.

Profits arising from experience and assumption changes decreased by £32 million to £22 million mainly reflecting the non-recurrence of benefits recognised in 2009, including a liability management gain of £30 million. During 2010 a review was undertaken into the charging between the funds of Clerical Medical prior to the acquisition of HBOS, giving rise to a charge of £132 million. Additionally assumptions regarding future maintenance expenses within the Clerical Medical business were aligned to reflect the heritage Lloyds TSB approach, giving rise to a charge of £119 million. These charges relate to pre-acquisition matters and were largely offset by the release of fair value provisions.

The capital positions of the UK life insurance companies within the Insurance division remain robust. The estimated Insurance Groups Directive capital surplus for both the Scottish Widows and HBOS Insurance groups remained consistent with last year at £1.3 billion and £1.6 billion, respectively.

European business

Profit before tax increased by 47 per cent to £110 million driven largely by experience and assumption changes. New business sales reflect difficult economic and market conditions in Germany, our main European market.

New business

An analysis of the present value of new business premiums for business written by the Insurance division, split between the UK and European Life, Pensions and Investments Businesses is given below:

	UK £m	**Europe £m**	**2010 Total £m**	UK £m	Europe £m	2009 Total £m	Change %
Analysis by product							
Protection	**574**	**56**	**630**	519	49	568	11
Payment protection	**70**	**–**	**70**	153	–	153	(54)
Savings and investments	**1,617**	**315**	**1,932**	2,689	312	3,001	(36)
Individual pensions	**1,606**	**141**	**1,747**	2,275	185	2,460	(29)
Corporate and other pensions	**2,750**	**–**	**2,750**	2,600	–	2,600	6
Retirement income	**889**	**–**	**889**	887	–	887	
Managed fund business	**177**	**–**	**177**	146	–	146	21
Life and pensions	**7,683**	**512**	**8,195**	9,269	546	9,815	(17)
OEICs	**2,633**	**–**	**2,633**	3,704	–	3,704	(29)
Total	**10,316**	**512**	**10,828**	12,973	546	13,519	(20)
Analysis by channel							
Bancassurance	**4,432**	**–**	**4,432**	6,997	–	6,997	(37)
Intermediary	**5,365**	**512**	**5,877**	5,639	546	6,185	(5)
Direct	**519**	**–**	**519**	337	–	337	54
Total	**10,316**	**512**	**10,828**	12,973	546	13,519	(20)

DIVISIONAL RESULTS

INSURANCE

The present value of new business premiums reduced by 20 per cent, to £10,828 million. This largely reflects the withdrawal in 2009 of certain HBOS legacy products with lower returns.

In the bancassurance channel the reduction reflects the removal from sale of an HBOS guaranteed investment plan sold in 2009 and, since the integrated bancassurance proposition was launched in June 2010, a change in mix away from savings products towards more profitable protection business in line with the legacy Lloyds TSB strategy. Sales of OEICs have been further adversely affected by a reduction in the volume of capital protected products given improved investment markets. However, sales of protection products have increased by 11 per cent and the aggregate new business margin has increased.

Within the intermediary channel the reduction in volumes primarily reflects the withdrawal of low returning HBOS individual pension products, partly offset by an increase in sales of the on-going Retirement Account pension product and strong sales of corporate pensions.

Funds under management

The table below shows the funds of the Life, Pensions and Investment companies within the Insurance division. These funds are predominantly managed within the Group by the Wealth and International division.

	2010 £bn	2009 £bn
Opening funds under management	**122.1**	113.7
UK business		
Premiums	**11.2**	12.2
Claims and surrenders	**(14.9)**	(13.2)
Transfers related to the sale of Insight Investment	**–**	(3.3)
Net outflow of business	**(3.7)**	(4.3)
Investment return, expenses and commission	**10.5**	12.3
Other movements[1]	**4.3**	–
Net movement	**11.1**	8.0
European business		
Net movement	**0.4**	0.6
Dividends and capital repatriation	**(0.5)**	(0.2)
Closing funds under management	**133.1**	122.1
Managed by the Group	**109.3**	102.4
Managed by third parties	**23.8**	19.7
Closing funds under management	**133.1**	122.1

[1] Other movements in funds under management incorporates alignment changes and the inclusion of managed pension funds.

Supplementary European Embedded Value (EEV) disclosures

In addition to reporting under IFRS, the Insurance division provides supplementary financial reporting for its Life, Pensions and Investments business on an EEV basis. For the purpose of EEV reporting, covered business is defined as all life, pensions and investments business written in the Insurance division. This definition therefore excludes the results of St. James's Place and the results of the business sold through the Wealth and International division which is not manufactured by the Insurance division.

	2010 £m	2009 £m	Change %
New business profit	**381**	341	12
Expected return on existing business	**347**	268	29
Expected return on shareholders' net assets	**184**	219	(16)
Profit before tax, before experience variances and assumption changes	**912**	828	10
Experience variances	**(15)**	139	
Assumption changes	**155**	(1)	
Profit before tax, volatility and other items	**1,052**	966	9
Volatility	**236**	228	4
Other items[1]	**(231)**	53	
Profit before tax	**1,057**	1,247	(15)
Taxation[2]	**(7)**	(349)	98
Profit after tax	**1,050**	898	17
EEV new business margin	**3.5%**	2.5%	

[1] Other items represent amounts not considered attributable to the underlying performance of the business. In 2010 this includes a charge of £70 million following the Group's decision to cease writing new payment protection insurance business and a charge of £132 million arising from the review of charging between the funds of Clerical Medical prior to the acquisition of HBOS.

[2] The figure for taxation in 2010 reflects the actual shareholder tax charged. This approach differs from 2009 where the tax charge was estimated based on the standard rate of corporation tax. The prior year figures have not been adjusted to reflect this change as the adjustment is between the volatility and taxation lines.

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Total profit before tax, before volatility and other items, increased by £86 million, or 9 per cent, to £1,052 million. Excluding the impact of experience variances and assumption changes, the profit before tax increased by £84 million or 10 per cent to £912 million.

New business profit has increased by 12 per cent to £381 million, reflecting an improved mix of business and cost reductions through integration across our sales channels. The improved margin reflects the strategic choices made in respect of product and channel propositions as the legacy businesses have been integrated in order to focus on value.

Expected return on existing business has increased by 29 per cent to £347 million, reflecting an increase in the value of the opening balance sheet, driven by higher asset values due to higher investment markets in 2009, and an increase in the assumed rate of return. The expected return on shareholders' net assets has reduced by 16 per cent to £184 million primarily reflecting hedging initiatives.

The net impact of experience variances is not significant, with the reduction from the prior year reflecting the non-recurrence of benefits in 2009. Assumption changes in 2010 are predominantly driven by benefits in the European business and lower assumed investment management costs in the UK business, partly offset by a charge from aligning future maintenance expense assumptions within the Clerical Medical business to reflect the heritage Lloyds TSB approach.

Composition of EEV balance sheet

	2010 £m	2009 £m
Value of in-force business (certainty equivalent)	**6,315**	5,623
Value of financial options and guarantees	**(194)**	(176)
Cost of capital	**(131)**	(150)
Non-market risk	**(137)**	(132)
Total value of in-force business	**5,853**	5,165
Shareholders' net assets	**3,748**	3,840
Total EEV of covered business	**9,601**	9,005

Reconciliation of opening EEV balance sheet to closing EEV balance sheet on covered business

	Shareholders' net assets £m	Value of in-force business £m	Total £m
As at 31 December 2008	3,948	4,155	8,103
Total profit (loss) after tax	(112)	1,010	898
Other capital movements	191	–	191
Dividends paid to Group companies	(187)	–	(187)
As at 31 December 2009	3,840	5,165	9,005
Total profit (loss) after tax	**337**	**713**	**1,050**
Other capital movements	**(4)**	**(25)**	**(29)**
Dividends received from Group companies	**70**	**–**	**70**
Dividends paid to Group companies	**(495)**	**–**	**(495)**
As at 31 December 2010	**3,748**	**5,853**	**9,601**

Analysis of shareholders' net assets on an EEV basis on covered business

	Required capital £m	Free surplus £m	Shareholders' net assets £m
As at 31 December 2008	1,401	2,547	3,948
Total profit (loss) after tax	1	(113)	(112)
Other capital movements	106	85	191
Dividends paid to Group companies	–	(187)	(187)
As at 31 December 2009	1,508	2,332	3,840
Total profit (loss) after tax	**(98)**	**435**	**337**
Other capital movements	**(186)**	**182**	**(4)**
Dividends received from Group companies	**–**	**70**	**70**
Dividends paid to Group companies	**–**	**(495)**	**(495)**
As at 31 December 2010	**1,224**	**2,524**	**3,748**

DIVISIONAL RESULTS

INSURANCE

Economic assumptions

A bottom-up approach is used to determine the economic assumptions for valuing the business in order to determine a market consistent valuation.

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds. The value of the in-force business asset for 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 risk-free rate assumed in valuing the non-annuity in-force business is the 15 year government bond yield for the appropriate territory. The risk-free rate assumed in valuing the in-force asset for the UK annuity business is presented as a single risk-free rate to allow a better comparison to the rate used for other business. That single risk-free rate has been derived to give the equivalent value to the UK annuity book, had that book been valued using the UK gilt yield curve increased to reflect the illiquidity premium described above. The risk-free rate used in valuing financial options and guarantees is defined as the spot yield derived from the yield curve for the relevant government bond. The table below shows the range of resulting yields and other key assumptions.

United Kingdom (Sterling)	2010 %	2009 %
Risk-free rate (value of in-force non-annuity business)	**3.99**	4.45
Risk-free rate (value of in-force annuity business)	**4.66**	5.05
Risk-free rate (financial options and guarantees)	**0.63 to 4.50**	0.87 to 4.76
Retail price inflation	**3.56**	3.64
Expense inflation	**4.20**	4.42

Non-economic assumptions

Future mortality, morbidity, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. These assumptions are intended to represent a best estimate of future experience.

Non-market risk

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

Sensitivity analysis

The table below shows the sensitivity of the EEV and the new business profit before tax to movements in some of the key assumptions. The impact of a change in the assumption has only been shown in one direction as the impact can be assumed to be reasonably symmetrical.

	Impact on EEV £m	Impact on new business profit before tax £m
2010 EEV/new business profit before tax		
100 basis points reduction in risk-free rate[1]	**240**	**11**
10 per cent reduction in market values of equity assets[2]	**(269)**	**n/a**
10 per cent reduction in market values of property assets[3]	**(15)**	**n/a**
10 per cent reduction in expenses[4]	**222**	**40**
10 per cent reduction in lapses[5]	**204**	**23**
5 per cent reduction in annuitant mortality[6]	**(97)**	**(3)**
5 per cent reduction in mortality and morbidity (excluding annuitants)[7]	**50**	**5**
100 basis points increase in equity and property returns[8]	**Nil**	**Nil**
25 basis points increase in corporate bond spreads[9]	**(115)**	**(5)**
10 basis points increase in illiquidity premium[10]	**56**	**n/a**

[1] In this sensitivity the impact takes into account the change in the value of in-force business, financial options and guarantee costs, statutory reserves and asset values.

[2] The reduction in market values is assumed to have no corresponding impact on dividend yields.

[3] The reduction in market values is assumed to have no corresponding impact on rental yields.

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

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

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

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

[8] Under a market consistent valuation, changes in assumed equity and property returns have no impact on the EEV.

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

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

In sensitivities 4 to 7 and 9 assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and statutory reserving bases. A change in risk discount rates is not relevant as the risk discount rate is not an input to a market consistent valuation.

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General Insurance

	2010 £m	2009 £m	Change %
Home insurance			
Underwriting income (net of reinsurance)	**922**	897	3
Commission receivable	**75**	71	6
Commission payable	**(135)**	(94)	(44)
	862	874	(1)
Payment protection insurance			
Underwriting income (net of reinsurance)	**544**	731	(26)
Commission receivable	**27**	13	
Commission payable	**(318)**	(395)	19
	253	349	(28)
Other			
Underwriting income (net of reinsurance)	**6**	8	(25)
Commission receivable	**50**	69	(28)
Commission payable	**(15)**	(28)	46
Other (including investment income)	**(34)**	(6)	
	7	43	(84)
Net operating income	**1,122**	1,266	(11)
Claims paid on insurance contracts (net of reinsurance)	**(542)**	(637)	15
Operating income, net of claims	**580**	629	(8)
Operating expenses	**(208)**	(262)	21
Profit before tax and fair value unwind	**372**	367	1
Combined ratio	**79%**	83%	

Profit before tax and fair value unwind from General Insurance increased by 1 per cent to £372 million, due primarily to improved unemployment claims experience plus integration synergies after taking account of lower income resulting from ceasing to write new PPI business and freeze related claims.

Underwriting income for home insurance showed modest growth of 3 per cent to £922 million. Home commission payable was adversely affected by the alignment of commission arrangements between the legacy businesses during the year.

PPI underwriting income decreased by £187 million, or 26 per cent, to £544 million reflecting the continued impact on new business volumes from the market wide move to monthly premiums in 2009 and the Group's withdrawal from the payment protection market on 23 July 2010. Changes in commission payable reflect lower volumes of PPI written during the year.

Claims were 15 per cent lower than 2009 at £542 million reflecting lower unemployment claims experience. The home book has been particularly affected by the freeze events experienced in January and December 2010. This has been partly offset by the benefits of ongoing claims processing improvements and integration.

Operating expenses decreased by £54 million, or 21 per cent, to £208 million primarily as a result of the alignment of commission arrangements on home insurance, the delivery of integration savings and a continued focus on cost management.

DIVISIONAL RESULTS

GROUP OPERATIONS

PROFILE

Group Operations manages the Group's technology platforms, property estate, operations, procurement services and security. Through these areas Group Operations drives efficiencies and supports income growth across multiple brands and channels using scalable platforms, common processes and leveraging the Group's purchasing power.

The division operates through four primary business functions; Information Technology; Operations; Procurement and Property. The Information Technology area provides technological expertise to each area of the Group whilst Operations includes Banking Operations, Collections and Recoveries and Payments and Business Services. The role of Procurement is to ensure that the Group gets the best value from its external expenditure and strategic suppliers and Property manages and maintains the Group's estates portfolio.

STRATEGY

Group Operations aims to be recognised as a world class operations business by colleagues, customers, stakeholders and peers whilst ensuring value through cost and process efficiency. This will be achieved by providing excellent technology and effective process to support the businesses; driving simplification, automation and continuous improvement; developing world class operations, leadership and capability; and maintaining strong controls to protect the Group.

In addition to this the Integration programme is delivering substantial synergy benefits. The focus throughout 2011 will be to complete the migration of systems and process legacies onto a single platform. This will primarily be achieved by delivering the IT consolidation, a single and centralised operating model, along with excellent disciplined procurement and rationalisation of the property portfolio.

2010 HIGHLIGHTS

2010 direct costs decreased by £109 million, or 4 per cent, to £2,973 million reflecting the continued focus on cost management and the delivery of integration synergy savings.

Information Technology costs decreased by 4 per cent, with integration savings offsetting inflationary rises.

Operations costs decreased by 7 per cent, through the continuing rationalisation of our major Operations functions and lower charges in respect of joint ventures.

Group Property costs decreased by 2 per cent, with the continuing consolidation of the heritage property portfolios delivering further integration benefits.

Procurement costs decreased by 2 per cent, reflecting the effect of negotiated lower third party costs on centrally managed contracts. In addition, Procurement has helped to deliver Group wide synergies.

Support function costs decreased by 3 per cent, primarily driven by the completion of payments filtering investment in 2009. Underlying support function costs increased largely as a result of further strengthening of the Risk function in line with increasing regulatory requirements.

PERFORMANCE SUMMARY

	2010 £m	2009[1] £m	Change %
Net interest expense	**(72)**	(69)	(4)
Other income	**49**	20	
Total income	**(23)**	(49)	53
Direct costs:			
Information technology	**(1,209)**	(1,254)	4
Operations	**(628)**	(672)	7
Property	**(968)**	(983)	2
Procurement	**(56)**	(57)	2
Support functions	**(112)**	(116)	3
	(2,973)	(3,082)	4
Result before recharges to divisions	**(2,996)**	(3,131)	4
Total net recharges to divisions	**2,930**	2,957	(1)
Share of results of joint ventures and associates	**3**	3	
Loss before tax and fair value unwind	**(63)**	(171)	63
Fair value unwind	**–**	22	
Loss before tax	**(63)**	(149)	58

[1]2009 comparative figures have been amended to reflect the effect of centralising operations across the Group as part of the integration programme. To ensure a fair comparison of the 2010 performance, 2009 direct costs have been increased with an equivalent offsetting increase in recharges to divisions.

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CENTRAL ITEMS

	2010 £m	2009 £m
Net interest expense	**(823)**	(815)
Other income	**398**	1,780
Total income	**(425)**	965
Operating expenses	**(107)**	(294)
Trading surplus	**(532)**	671
Share of results of joint ventures and associates	**2**	(1)
Profit before tax and fair value unwind	**(530)**	670
Fair value unwind	**(1,446)**	(2,119)
Loss before tax	**(1,976)**	(1,449)

Central items include income and expenditure not recharged to the divisions, including the costs of certain central and head office functions and the financial impact of hedge ineffectiveness.

Total income decreased by £1,390 million to £(425) million primarily due to a £1,045 million reduction in liability management gains, together with a £193 million increase in the mark-to-market losses arising from the equity conversion feature of the Group's Enhanced Capital Notes and a £131 million reduction in the gain on other derivatives which cannot be mitigated through hedge accounting.

Liability management gains arose on transactions undertaken in both 2009 and 2010 as part of the Group's management of capital which exchanged certain debt securities for ordinary shares or other debt instruments. These transactions resulted in a gain of £423 million in 2010 compared to a gain of £1,498 million in 2009 (of which £1,468 million is reflected in Central items). The fair value of the equity conversion feature of the Group's Enhanced Capital Notes decreased by £620 million in 2010 compared to a decrease of £427 million in 2009.

Net interest expense was broadly unchanged at £823 million, but included higher capital and wholesale liquidity funding costs of £601 million (2009: £260 million) not recovered from the divisions, with the increase primarily due to higher wholesale market funding spreads and the Group's decision to accelerate its wholesale funding in 2010. This has been offset by improved net interest from interest rate risk management activities compared to 2009.

Operating expenses reduced by £187 million to £107 million due to lower professional fees and other costs associated with capital transactions and projects.

Fair value unwind improved by £673 million to £(1,446) million primarily due to the effect of the liability management transactions leading to a reduced amortisation rate. Gains on liability management transactions included accelerated fair value amortisations.

OTHER FINANCIAL INFORMATION
VOLATILITY ARISING IN INSURANCE BUSINESSES

The Group's statutory profit before tax is affected by insurance volatility, caused by movements in financial markets, and policyholder interests volatility, which primarily reflects the gross up of policyholder tax included in the Group tax charge.

During 2010, the Group's statutory profit before tax included positive insurance and policyholder interests volatility of £306 million compared to positive volatility of £478 million in 2009 primarily reflecting the more significant improvements in financial markets in 2009. The volatility in 2010 reflects the strong performance of equity markets, partially offset by lower than expected returns on cash and fixed interest assets.

Volatility comprises the following:

	2010 £m	2009 £m
Insurance volatility	100	237
Policyholder interests volatility[1]	216	298
Total volatility	316	535
Insurance hedging arrangements	(10)	(57)
Total	306	478

[1] Includes volatility relating to the Group's interest in St James's Place.

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 value can have a significant impact on the profitability of the Group, management believes that it is appropriate to disclose the division's results on the basis of an expected return in addition to results based on the actual return.

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)	2011 %	2010 %	2009 %
Gilt yields (gross)	3.99	4.45	3.74
Equity returns (gross)	6.99	7.45	6.74
Dividend yield	3.00	3.00	3.00
Property return (gross)	6.99	7.45	6.74
Corporate bonds in unit-linked and with-profit funds (gross)	4.59	5.05	4.34
Fixed interest investments backing annuity liabilities (gross)	4.78	5.30	5.72

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 Insurance division experienced positive volatility of £100 million during 2010. This was primarily driven by strong performance on equity and property investments relative to the expected return. During 2010, equity market values increased by 9 per cent and property returns reached 19 per cent. Partly offsetting this was lower than expected returns on cash and fixed interest assets. This benefit is lower than the £237 million positive volatility reported in 2009, as 2009 included significant benefits from reductions in corporate bond spreads, which did not occur in 2010, and greater out-performance of equity markets.

Group hedging arrangements

To protect against further deterioration in equity market conditions, and the consequent negative impact on the value of in-force business on the Group balance sheet, the Group purchased put option contracts in 2009. These expired in January 2010. The charge for this option was £7 million. New protection against significant market falls, using option contracts, was acquired by the Group, financed by selling some upside potential from equity market movements. There was no initial cost associated with these hedging arrangements. On a mark-to-market valuation basis a loss of £3 million was recognised in relation to these contracts in 2010. The 2010 option contracts were replaced by the Group in January 2011 with fresh contracts to provide further protection against significant market falls. Again this was financed, at no initial cost, by selling some upside potential from equity market movements.

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, pensions and investments business. In order to provide a clearer representation of the performance of the business, and consistent with the way in which it is managed, 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 2010, 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 charge of £216 million (2009: policyholder interests volatility charge of £298 million). Strong market conditions in the latter part of 2010 resulted in increased policyholder tax liabilities and led to a policyholder tax charge of £315 million (2009: £410 million) for the year in the Group's tax charge.

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OTHER FINANCIAL INFORMATION
INTEGRATION

The Group remains on target to deliver annualised cost savings from synergies and other operating efficiencies of £2 billion by the end of 2011.

The sustainable run-rate synergies achieved as at 31 December 2010 totalled £1,379 million excluding a number of one-off savings. The table below analyses the run-rate synergies as at 31 December 2010 by division and the 2011 target run-rate of £2 billion.

	2010			2011
	Synergy run-rate as at 31 December 2010 £m	**Allocation of Group Operations run-rate to divisions £m**	**Run-rate by market facing division £m**	Target run-rate by market facing division £m
Retail	**301**	**228**	**529**	867
Wholesale	**248**	**111**	**359**	532
Wealth and International	**233**	**7**	**240**	242
Insurance	**167**	**30**	**197**	239
Group Operations	**393**	**(393)**	**–**	–
Central items	**37**	**17**	**54**	120
Total	**1,379**	**–**	**1,379**	2,000

Savings to date continue to be driven largely from role reductions resulting from deployment of the new Group organisation design adopting the Lloyds TSB approach. The overwhelming majority of role reductions have been achieved through re-deployment, natural turnover and voluntary redundancy. In addition the Group has exited 79 non-branch properties during 2010, bringing the total to 162 since the start of the integration programme.

Procurement benefits in 2010 were also significant at £236 million and supplier negotiations resulted in over 90 per cent of Group expenditure being consolidated within our top 1,000 suppliers.

The software build of the Integrated IT Platform was completed in the first half of 2010 and following extensive testing largely implemented by the end of 2010 and is now live and operational for most Lloyds TSB processes and transactions. Roll out of the Lloyds TSB counter system across Halifax and Bank of Scotland branches commenced in late 2010 and will complete during the first half of 2011. Similarly HBOS ATMs are being migrated and the Group's target mortgage sales platform rolled out to mortgage sales advisers creating a single platform for mortgage sales.

Product and channel systems are being integrated and harmonised where required and this will continue through the first half of 2011 in parallel with a detailed and rigorous programme of testing in preparation for customer data migration from HBOS systems to the single IT platform by the end of 2011.

Integration activities have continued at pace over 2010 with delivery being wide ranging and spanning Group activities. Examples include the rollout of the Lloyds TSB model of day time cash deliveries to Halifax and Bank of Scotland branches; implementation of an improved online mortgage application process for mortgage brokers; delivery of a single scalable secure Internet Banking platform; launch of an integrated product proposition for our market leading bancassurance business; migration of Asset Finance Lex customer and Bank of Scotland dealer finance books onto a single platform; and harmonisation of our loss notification and loss adjusting service processes for household insurance within our General Insurance business.

Total cost reductions from synergies of £1,361 million were achieved in the year against the integration baseline and in line with target include other operating efficiencies and one-off savings which are excluded from the reported run rate synergies. The total cost reductions relate primarily to reductions in colleague numbers, procurement and IT savings.

One-off integration costs of £1,653 million were incurred in 2010 which have been excluded from the combined businesses results. This brings the total integration costs since the HBOS acquisition to £2,749 million. The integration costs relate to severance, IT and business costs of implementation. The severance provisions are for 26,000 role reductions announced to the end of 2010, of which 22,000 have been achieved to date.

OTHER FINANCIAL INFORMATION

BANKING NET INTEREST MARGIN

	2010 £m	2009 £m
Banking net interest margin		
Banking net interest income	**13,386**	11,953
Average interest-earning assets	**637,386**	674,246
Average interest-bearing liabilities	**352,701**	347,180
Banking net interest margin	**2.10%**	1.77%
Banking asset margin	**1.56%**	1.11%
Banking liability margin	**0.97%**	1.28%

Banking net interest income is analysed for asset and liability margins based on interest earned and paid on average assets and average liabilities respectively, adjusted for Funds Transfer Pricing, which prices intra-group funding and liquidity. Centrally held wholesale funding costs and related items are included in the Group banking asset margin.

Average interest-earning assets and average interest-bearing liabilities relate solely to customer and product balances in the banking businesses on which interest is earned or paid. Funding and capital balances including debt securities in issue, subordinated debt, repurchase agreements and shareholders' equity are excluded from the calculation of average interest-bearing liabilities. However, the cost of funding these balances allocated to the banking businesses is included in banking net interest income.

A reconciliation of banking net interest income to Group net interest income which shows the items excluded in determining banking net interest income follows:

	2010 £m	2009 £m
Banking net interest income – combined businesses	**13,386**	11,953
Insurance division	**(263)**	(287)
Other net interest income (including trading activity)	**699**	1,060
Group net interest income – combined businesses	**13,822**	12,726
Fair value unwind	**(301)**	(2,166)
Insurance gross up	**(949)**	(1,280)
Volatility arising in insurance businesses	**(26)**	(11)
Pre-acquisition results of HBOS plc	**–**	(243)
Group net interest income – statutory	**12,546**	9,026

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CORE AND NON-CORE BUSINESS

Non-core portfolios consist of non-relationship assets and liabilities together with assets and liabilities which are outside the Group's current appetite. An analysis of non-core assets and liabilities and the associated income and impairment charge is shown in the table below.

2010	Underlying income[1] £m	Impairment charge £m	Loans and advances to customers £bn	Risk weighted assets £bn	Customer deposits £bn
Core portfolios					
Retail	**10,394**	**(2,623)**	**333.1**	**98.1**	**235.6**
Wholesale	**5,540**	**(1,276)**	**102.0**	**127.9**	**119.4**
Wealth and International	**1,679**	**(221)**	**18.1**	**23.7**	**32.5**
Insurance	**2,009**	**–**	**–**	**–**	**–**
Group Operations and Central items	**(251)**	**–**	**0.4**	**15.7**	**0.9**
	19,371	**(4,120)**	**453.6**	**265.4**	**388.4**
Non-core portfolios					
Retail	**591**	**(124)**	**30.6**	**11.2**	**–**
Wholesale	**3,022**	**(3,170)**	**71.2**	**94.8**	**4.9**
Wealth and International	**657**	**(5,767)**	**37.2**	**35.0**	**0.3**
	4,270	**(9,061)**	**139.0**	**141.0**	**5.2**
Total Group	**23,641**	**(13,181)**	**592.6**	**406.4**	**393.6**
	%	%	%	%	%
Core portfolios	**82**	**31**	**77**	**65**	**99**
Non-core portfolios	**18**	**69**	**23**	**35**	**1**
Total Group	**100**	**100**	**100**	**100**	**100**
2009	£m	£m	£bn	£bn	£bn
Core portfolios					
Retail	9,386	(3,974)	337.6	115.4	224.1
Wholesale	5,336	(2,187)	108.7	150.6	148.5
Wealth and International	1,601	(189)	19.2	23.1	25.3
Insurance	1,990	–	–	–	–
Group Operations and Central items	(125)	–	0.6	15.5	0.2
	18,188	(6,350)	466.1	304.6	398.1
Non-core portfolios					
Retail	388	(253)	33.5	13.2	–
Wholesale	3,573	(13,496)	83.1	135.4	4.9
Wealth and International	744	(3,889)	44.3	40.1	3.7
	4,705	(17,638)	160.9	188.7	8.6
Total Group	22,893	(23,988)	627.0	493.3	406.7
	%	%	%	%	%
Core portfolios	79	26	74	62	98
Non-core portfolios	21	74	26	38	2
Total Group	100	100	100	100	100

[1] Net of insurance claims. Excluding liability management gains and the reduction in the fair value of the equity conversion feature of the Group's Enhanced Capital Notes.

Non-core assets

Non-core portfolios primarily comprise loans and advances to customers. However, certain portfolios of debt securities, available for sale financial assets and other assets in Wholesale are also considered to be non-core. The Group's total non-core assets are shown in the table below.

As at 31 December	2010 £bn	2009[1] £bn	Change %
Non-core assets			
Loans and advances to customers	**139.0**	160.9	(14)
Debt securities	**25.4**	31.5	(19)
Available for sale financial assets	**22.2**	32.0	(31)
Other assets	**8.1**	11.7	(31)
Total non-core assets	**194.7**	236.1	(18)

[1] Total non-core assets at 31 December 2009 have been reduced by £3.9 billion from the previously presented figure of £240 billion following a reclassification between core and non-core.

FIVE YEAR FINANCIAL SUMMARY

The statutory financial information set out in the table below has been derived from the annual report and accounts of Lloyds Banking Group plc for each of the past five years.

The financial statements for each of the years presented have been audited by PricewaterhouseCoopers LLP, independent auditors.

	2010	2009	2008[6]	2007[6]	2006[6]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**24,956**	23,278	9,868	10,696	11,098
Operating expenses	**(13,270)**	(15,984)	(6,100)	(5,568)	(5,300)
Trading surplus	**11,686**	7,294	3,768	5,128	5,798
Impairment	**(10,952)**	(16,673)	(3,012)	(1,796)	(1,555)
Gain on acquisition	**–**	11,173	–	–	–
Profit before tax	**281**	1,042	760	3,999	4,249
(Loss) profit for the year	**(258)**	2,953	798	3,320	2,908
(Loss) profit for the year attributable to equity shareholders	**(320)**	2,827	772	3,288	2,804
Total dividend for the year[1]	**–**	–	648	2,026	1,927
	31 December 2010	31 December 2009	31 December 2008	31 December 2007	31 December 2006
Balance sheet data (£m)					
Share capital	**6,815**	10,472	1,513	1,432	1,429
Shareholders' equity	**46,061**	43,278	9,393	12,141	11,155
Net asset value per ordinary share	**68p**	68p	155p	212p	195p
Customer deposits	**393,633**	406,741	170,938	156,555	139,342
Subordinated liabilities	**36,232**	34,727	17,256	11,958	12,072
Loans and advances to customers	**592,597**	626,969	240,344	209,814	188,285
Total assets	**991,574**	1,027,255	436,033	353,346	343,598
	2010	2009	2008	2007	2006
Share information					
Basic earnings per ordinary share	**(0.5)p**	7.5p	6.7p	28.9p	24.8p
Diluted earnings per ordinary share	**(0.5)p**	7.5p	6.6p	28.7p	24.5p
Total dividend per ordinary share[1]	**–**	–	11.4p	35.9p	34.2p
Market price (year end)	**65.7p**	50.7p	126.0p	472.0p	571.5p
Number of shareholders (thousands)	**2,798**	2,834	824	814	870
Number of ordinary shares in issue (millions)[2]	**68,074**	63,775	5,973	5,648	5,638
	2010	2009	2008	2007	2006
Financial ratios (%)[3]					
Dividend payout ratio	**–**	–	83.9	61.6	68.7
Post-tax return on average shareholders' equity	**(0.7)**	8.8	7.0	28.1	26.6
Cost:income ratio[4]	**53.2**	68.7	61.8	52.1	47.8
	31 December 2010	31 December 2009[7]	31 December 2008[7]	31 December 2007	31 December 2006
Capital ratios (%)[5]					
Total capital	**15.2**	12.4	11.1	11.0	10.7
Tier 1 capital	**11.6**	9.6	7.9	8.1	8.2

[1] Annual dividends comprise both interim and estimated final dividend payments. Under IFRS, the total dividend for the year represents the interim dividend paid during the year and the final dividend which will be paid and accounted for during the following year.

[2] This figure excludes 81 million (2006 to 2008: 79 million) limited voting ordinary shares.

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

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

[5] Capital ratios are in accordance with Basel II requirements; other than the ratios for 2007 and 2006 which reflect Basel I.

[6] Restated in 2009 for IFRS 2 (Revised) and to separate the share of results of joint ventures and associates from total income.

[7] Restated in 2010 to reflect a prior year adjustment to available-for-sale revaluation reserves.

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OUR PEOPLE

Building long lasting relationships through people

Lloyds Banking Group's continued success depends on people. Banking is about helping people to reach their goals in life by getting the most from their money. Lloyds Banking Group makes business sense but we also need it to make sense for people – for our employees and customers. Our employees are focused on providing our customers with great service every day. They know that successful relationships are at the heart of how we do business and how we support our customers through the cycle.

To make this happen, we are creating an organisation that attracts, retains and develops the best talent in the industry and one that embraces diversity too. We want to be recognised as a great place to work.

At Lloyds Banking Group, we are committed to making a significant investment in our people. Life here is fast-moving and full of challenges as we strive to be the best. It's also incredibly rewarding. In 2010 we recorded our highest ever employee engagement score. Engaged employees are more motivated to understand customer needs and deliver outstanding service, time and time again. This is one of the ways in which we will rebuild trust in our industry. Our rewards and benefits packages, which go beyond salary and bonus, are designed to keep our employees motivated to do this.

This year we delivered a significant milestone in our integration when we harmonised Terms and Conditions for most employees in the Group. In addition, over 87,000 employees selected benefits available through our Flexible Benefits plan. Over 52,000 people showed their confidence in the Group by electing to take part in Sharesave, our employee share ownership plan that offers everyone the opportunity to buy shares over a three year period and have a long term investment in the Group's success. We made some changes to our pension schemes in April and our new scheme, 'Your Tomorrow', was awarded the Pension Quality Mark Plus – the highest quality mark available from the National Association of Pension Funds.

As a leader in financial services, we are committed to professional development and creating outstanding learning opportunities that allow people to reach their full potential. We invest in our people, offering the best coaching and training. Learning @ Lloyds Banking Group is one of the largest corporate learning facilities in Europe.

We also provide our people with the opportunity to contribute to our leading corporate and social responsibility practices, a strong part of our culture. Employees celebrated raising £3.4 million for the British Heart Foundation in just two and a half years at the end of 2010. They also demonstrated their continued commitment and enthusiasm for good causes when 21,500 voted for the 2011 Charity of the Year, Save the Children.

Our new Diversity and Inclusion strategy was launched in January 2010 and our sponsorship of London 2012 offers employees a unique opportunity to be involved both in the Games and the legacy they leave.

Integration

2010 was significant in relation to people integration. Shaping our new business for the future means having the very best people in every single role and being as efficient as possible. We have successfully managed the impact of change on our people by working at pace to establish controls and embed risk management practices, by defining and implementing the new organisational structure and selecting for it.

We continue to move toward establishing a single organisation and by 1 December 85 per cent of eligible colleagues were on the newly harmonised Terms and Conditions. This is a significant step forward on our journey towards becoming 'One Bank'.

Inevitably in bringing the two organisations together, there has been an opportunity to rationalise and this has led to a reduction in roles. Where possible we have either redeployed colleagues to other areas of the Group or reduced numbers through natural attrition. Where it has been necessary for colleagues to leave the organisation, this has been achieved by offering voluntary severance and by making less use of contractors and agency colleagues. Compulsory redundancies are always a last resort.

The focus has been on enabling the business to integrate, while also building foundations for the future to ensure the organisation can attract, retain and develop the best talent. People have been at the heart of the change programme, and a robust communications process has been followed to ensure that colleagues are aware of the changes before they happen. We have four recognised Unions who have been consulted on all proposed changes.

We have focused on bringing the majority of colleagues on to one core colleague system which involved the migration of over 63,000 colleagues on to a new platform which is now accessible to colleagues from both heritages.

We also implemented a number of new Lloyds Banking Group platforms for colleagues. In 2010 we built an integrated colleague proposition for the future with a focus on recruiting, performance management, learning, and reward and improving the direct links between these factors.

The implementation of the Resourcing Candidate Management System in 2010 provides us with one integrated Lloyds Banking Group internal role recruitment tool and also one external Lloyds Banking Group careers website. Combined, they enable integration, simplification and improvement of key elements of the recruitment process.

'Your Performance' was launched early in 2010 providing a Group wide on-line approach for managing performance with 96 per cent colleague coverage. 'Your Learning' was launched providing one integrated learning tool helping colleagues develop learning plans and record training and accreditation. 'Your Tomorrow', the first Lloyds Banking Group Defined Contribution pension scheme launched in 2010 and we auto-enrolled over 8,000 colleagues. We also completed development of an integrated Pay and Bonus tool for managing Pay 2011 and Bonus 2010 aligned directly with Performance Management.

These changes have been made with Group wide engagement, with line managers and colleagues embracing the changes.

Colleague engagement

Although 2010 has been a period of considerable change, we are proud of our continuously high levels of colleague engagement. This is vital in creating a high commitment, high performance organisation.

Every quarter we run a comprehensive and confidential colleague survey to gauge colleagues' views on key issues. The scope of the colleague survey includes all UK and International colleagues across the Group. In 2010, we achieved record response rates of 83 per cent (up from 79 per cent in 2009) which is regarded as 'best in class'. The overall Engagement Index finished the year at 80 index points, which is an increase of 8 index points from 2009. The results to individual

questions continued to improve compared with 2010, most notably in areas such as Performance Management, Learning, Customer and Leadership. The level of engagement now exceeds all of the external benchmarks, including the UK Financial Services and UK High Performance norms for the first time.

Talent, recruitment and retention

One of our highest priorities is recruiting, retaining and developing talented people. Developing colleagues and succession planning are vital in supporting our strategy and have been a major focus in 2010. During the year we have undertaken detailed talent reviews and succession planning for our most senior leaders. Through internal promotion and attracting new talent to the Group in 2010 we have improved the talent profile and succession pipeline, while mitigating the retention risks of our senior leaders.

In 2010 we recruited 147 people into the Lloyds Banking Group Graduate Leadership Programme. The strength of our Graduate Programme has been externally acknowledged with The Times rating us in the Top 30 UK organisations for graduate recruitment.

Performance and reward

Effective performance management is at the heart of our work to build a high performance culture across Lloyds Banking Group. It also plays a critical role in helping us to develop our colleagues to build long term partnerships with customers and strong relationships with each other. Every colleague has a Balanced Scorecard comprising of five areas (building the business, customer, risk, people and finance) with objectives that are aligned to our broader strategy. At the end of every year colleagues are given a performance rating based on their overall contribution during the year assessed against both what they have done (performance against their objectives) and how they have gone about doing it (performance against our values and behaviours). This performance rating is then linked to how each colleague is rewarded.

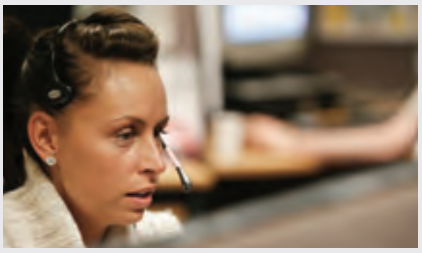
Throughout the year, line managers provide colleagues with regular open and honest feedback to help them develop the right skills and behaviours and to help them address any challenges they may face in meeting performance standards. In 2010 we launched a single approach to performance management across Lloyds Banking Group, the success of which was acknowledged at the 2010 Personnel Today Awards where it was one of the reasons why we received the top award for Managing Change.

In 2010 we introduced a cap on our Defined Benefit pension schemes that will help us to manage the significant long-term cost inherent in the scheme and continue to meet our obligations to all members in future years. Alongside this we introduced a new Defined Contribution pension scheme that gives considerable flexibility to employees to plan for retirement.

Learning and development

In 2010 we have continued to invest in the development of our colleagues across the organisation providing an average of 5.4 days formal learning per full time equivalent.

Retail Customer Service Training



A key focus for training across Retail has been the transformation of our approach in handling customer complaints. This has resulted in over 30,000 customer facing colleagues receiving training across Lloyds TSB, Halifax and Bank of Scotland Branch Networks. The key purpose of this training was to improve the experience for customers when advising us of a complaint – this included colleagues taking ownership of each complaint at first point of contact, accurate recording and effective and timely resolution. A blend of training approaches was adopted including e-learning, testing, validation and face to face sessions supported by comprehensive Senior Manager engagement. This programme has resulted in a significant improvement in the number of complaints resolved at first point of contact and is having a positive impact on our Customer Service measures.

Business focus

Our learning strategy is aligned to our goal of outperformance through cost and customer leadership. It aims to help drive high performance, greater productivity and deep lasting customer relationships by supporting the development of highly engaged, skilled colleagues and capable leaders.

To further simplify access to business aligned learning we have continued to deploy our Academies approach supported by a redesigned Learning @ Lloyds Banking Group website, which attracts around 1.7 million visits per month.

We remain committed to supporting a range of programmes linked to professional qualifications or relevant external certification. These programmes enable us to develop our colleagues in line with recognised industry standards and provide confidence to customers and other stakeholders.

Technical capabilities

Our colleagues need appropriate technical capabilities to enable them to support our customers effectively. Our business-focused learning programmes cover critical business skills such as risk, relationship management and financial management. A key focus has been supporting colleagues through the changes needed to successfully progress our integration programme.

Significant activity has taken place to support the implementation of common enhanced IT platforms designed to deliver improved customer service through our branches. Colleagues in our Telephone Banking teams also received significant investments in customer service training.

Leadership and management capability

Leaders throughout the organisation play a critical role in bringing our values to life for colleagues. The Group has continued its focus on developing and strengthening leadership and management skills with the launch of new Group wide Executive Development and Leadership and Management programmes. Using a shared Leadership language these have placed a particular emphasis on Performance Management and leading during a period of sustained rapid change.

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Diversity and inclusion

During 2010, we have continued to make strong progress in all areas of Diversity & Inclusion. With a broad strategy, significant focus has come through the appointment of five Executive Director level sponsors who cover gender and work life balance, ethnic diversity, sexual orientation, disability and generational diversity.

Our leading edge diversity and inclusion strategy, developed through active consultation across the organisation, will enhance the Group's ability to build deep and lasting relationship with colleagues, customers and suppliers.

Lloyds Banking Group Ethnic Minority Network

Mark Swyny
Lloyds Banking Group

During 2010 the GEM Network for ethnic minority colleagues marked its launch across the enlarged Group with an inspirational event held in Leeds. Themed 'Your Time to Shine' almost 300 colleagues from across the Group came together to hear from the Group's Executive Sponsor for Ethnic Diversity, Angie Risley, fellow ethnic minority colleagues' inspirational career success stories and celebrity guest speaker Tim Campbell, first winner of BBC's 'The Apprentice'.

Delegates came away from the event feeling motivated, inspired and equipped to make their career with the Group all they want it to be. Following the launch event, by the end of the year GEM Network membership increased to almost 1,500 members.

"I came away inspired and feeling that Lloyds Banking Group is the place to be for ethnic minorities. It was a life changing event for me."

Source: GEM conference feedback form.

Through reviewing our resourcing, work life balance and leadership development practices, we have continued to ensure we are able to attract, recruit and retain talented colleagues from diverse backgrounds. With diversity and inclusion integrated into the organisation's mainstream management development we are equipping our leaders to embrace inclusion and leverage the opportunities of diverse thinking. All colleagues have had the opportunity to learn more about our progress, to give their views and to participate through the Group's first national Diversity & Inclusion Week, a campaign to be repeated on an annual basis.

We also continue to make great progress on matters of disability, ethnicity and sexual orientation.

With regards to disability, we have implemented new development programmes, grown our colleague network by over 100 per cent and conducted research to better understand our disabled customer experience. In addition, we launched and sponsor the Radiate Network[1], the UK's first national network of senior disabled leaders.

Our ethnic diversity colleague network has also grown in numbers, with over 1500 colleagues participating. Alongside our internal activity, our external presence has grown through our sponsorship of the Runnymede Trust's[2] 'Snowy Peaks' report which researched ethnic minority success at senior management and executive levels.

We have also achieved excellent colleague network growth under our sexual orientation strand, with membership tripling in 2010. Externally, we continue to be active and prominent members of Stonewall[3], participating in their annual Workplace Equality Index. The Group has also achieved some firsts; our Home Loan advert featuring a gay couple was the first gay imagery from a UK financial services organisation in national press. And our sponsorship of the largest ever lesbian, gay, bisexual and transgender consumer survey – covering 23 countries and with over 8,000 UK respondents, will yield deep insights into the opportunities to strengthen our customer relationships.

HR people risk

A new area of focus for the Group has been the establishment of a People Risk function within Group Human Resources. This function aims to ensure the management of people risks are central to the development and delivery of the Group's business strategy.

People Risk is fundamental to our ongoing success as an organisation. Consequently we have built people risk management into our overall accountability framework including our Group Risk Appetite and incorporating it into our Group People Strategy.

We have created a team to lead on the development and delivery of a people risk strategy. The team will also support the establishment of people risk management across the Group. This will be achieved through effective support, challenge and oversight of risk management across Human Resources; managing and co-ordinating the Group's regulatory relationship on Human Resource issues and through strategic people risk management.

Strengthening the Group's focus in this way, the People Risk function's early priorities have included: reviewing and enhancing the co-ordination and management of the Group's Approved Persons arrangements for Significant Influence Functions, providing guidance on moderation of pay and bonuses to comply with the FSA's Remuneration Code and increasing the integration of risk into our reward and performance framework.

As we enter the final year of our integration programme, we continue to make excellent progress towards becoming 'One Bank'. We will go on building a diverse, talented and engaged workforce and equipping it with the skills it needs to provide the best customer service. By rewarding great service and strong performance appropriately, we will embed the values needed to build deep and enduring customer relationships that are at the heart of our business.

[1]Radiate is the network of high-fliers with disabilities or health conditions. It is supported by RADAR (the UK's largest disability campaigning organisation) and Lloyds Banking Group

[2]The Runnymede Trust is an independent race equality think tank

[3]Stonewall is a lesbian, gay and bisexual rights charity in the United Kingdom and the largest gay equality organisation in Europe

CORPORATE RESPONSIBILITY

Supporting our business strategy

Our business strategy is to be recognised as the UK's best financial services company. We want to be recognised and recommended as a trusted brand by customers, a good employer by colleagues and an active, valued participant in our communities.

Trust in the banking industry has been eroded over the past few years. Rebuilding stakeholders' trust in financial institutions will be central to us achieving our corporate goal.

Corporate responsibility is integral to our business strategy. We need to ensure that we are running our business in a responsible way. We need to demonstrate that we are making a sustained, positive contribution to the economy and to society; by playing our part in the UK's economic recovery and by investing in the communities of which we are a part. Finally, as a relationship-led business, we need to work on building deep and lasting relationships with our customers, employees and suppliers; by engaging with them, listening to their needs and, if appropriate, making changes to the way we do business.

The following pages set out how we are delivering on our responsibilities to all of our stakeholders. We report under three headings, Responsible Business Management; our Economic and Social Impact; and, Building Relationships.

Responsible business management

We believe that we can make our greatest contribution to society by being good at what we do, and by doing it in a responsible way. Our approach to responsible business management 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. This helps us focus on building and sustaining long-term relationships with customers. Over time, we believe that this will enable us to deliver superior, more sustainable shareholder value.

Corporate responsibility governance

We strengthened our governance framework in 2010, establishing Board representatives for key strands of our Corporate Responsibility agenda. Sir Winfried Bischoff, Chairman of Lloyds Banking Group, has overall Board responsibility for Corporate Responsibility. Truett Tate, Group Executive Director, Wholesale, is Executive Sponsor for Climate Change and Environmental Issues and Helen Weir, Group Executive Director, Retail, is Executive Sponsor for Financial Inclusion.

We also established a new Environmental Steering Group, chaired by our Group Property Director. With senior representation from across the Group, this drives our environmental strategy, targets and performance. This year, we have established a Financial Inclusion Steering Group.

The Board considers corporate responsibilty issues throughout the year, and reviews our performance on an ongoing basis. The Corporate Responsibility Steering Group, chaired by Group HR Director Angie Risley, meets on a regular basis to drive corporate responsibility strategy. Most of our activity, however, takes place in the business itself, driven by a network of senior managers who act as Corporate Responsibility champions.

Risk management

We have rolled out Lloyds TSB's conservative approach to risk across the entire Group. This prudent attitude to risk is core to the Group's business model. It is the foundation for responsible business management. The Group's risk management framework is set out on pages 69 to 70.

Reflecting the importance that we place 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. We work very closely with the FSA and UK Financial Investments to ensure that our remuneration structure is aligned to prudent risk management. Business Executives have specific risk management objectives and incentive schemes take account of performance against these. Full disclosure on Executive remuneration is on pages 124 to 141 of this report.

Responsible lending, advice and support

As a responsible lender, we wish to ensure customers only borrow what they can afford to repay. We have a responsible lending programme with internal management reporting and accountability. Our customer-facing employees are trained to offer the necessary advice and support to help customers manage their borrowing.

Each customer's circumstances are different so we use an affordability model, to better assess a customer's ability to repay. We take into account customers' current and past management of financial products. We also consider their ability to make repayments both at the time the account is opened, and throughout the duration of the loan, to ensure that the borrowing remains suitable to their circumstances.

Lloyds TSB, Halifax and Bank of Scotland all have dedicated Customer Support and Money Management units to provide specialist help to customers who are concerned about their financial situation. They are there to help customers who actively seek help with their finances, and proactively contact those who we believe are at the highest risk of missing repayments. We speak with more than 300,000 customers a month to assess their financial health and find ways in which we can help.

We have an ongoing programme to train colleagues to provide guidance and support to customers on managing their borrowing. We help them find an appropriate solution, whether through more effective budgeting, or by rescheduling their borrowing with us. We have trained over 7,000 financial health specialists available to help our customers in branches. Where appropriate, we refer customers to free and independent money advice charities. In 2010, we contributed £12.5 million to money advice and debt charities, including the Money Advice Trust and the Consumer Credit Counselling Service.

Protecting customers against financial crime

We take protecting our customers and their assets extremely seriously. We invest in activities to deter, detect and prevent fraud and we operate systems designed to ensure that our products and services are not abused for the purposes of laundering the proceeds of crime or for facilitating terrorism. We have processes in place to check the identity of customers and use various tools to monitor the validity of transactions that they make and receive.

We also want to help our customers to protect themselves from financial crime. Our various brand websites contain information to help customers to understand how to protect against the risks of common types of internet fraud. We run regular financial crime awareness campaigns, support industry education initiatives and sponsor the charity Crimestoppers.

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Environmental management

We believe that we have an important role to play in facilitating and financing the transition to a low carbon, resource efficient economy. Our vision is to be recognised by our stakeholders as a leading environmentally responsible organisation.

We are already one of the leading global financers of renewable energy (by debt underwriting capability). In 2010, Lloyds Banking Group was rated the top UK bank in the new FTSE CDP Carbon Strategy Index Series, recognising our performance in managing climate risks and grasping the emerging opportunities.

Managing environmental risks in lending

We have introduced policies and procedures to reduce the environmental impact of our lending activities. Our groupwide Environmental Risk Policy requires all business loans to be assessed for material environmental risks as part of the credit sanctioning process. Our policy is supported by a robust process which ensures that there is a consistent approach to identifying, assessing, mitigating and reporting environmental risks. Lending officers are responsible for ensuring that environmental risks are assessed and that action is taken where a risk is identified. Employees are trained in environmental risk management as part of our standard credit risk training course and have access to relevant guidance documents. In 2011, we will further strengthen our risk management process with the implementation of an online environmental risk screening tool.

Project finance: Equator Principles

Lloyds Banking Group is a signatory to the Equator Principles to support our approach to assessing and managing environmental and social issues in project finance. Lending officers are responsible for undertaking initial classification of transactions that qualify under the Equator Principles. Their assessments are subject to further review by our Equator Principles Review Group, comprising experts from both our Risk and Project Finance teams, to ensure that each transaction is compliant and is consistent with our Environmental Risk Policy. We trained over 100 employees in our Equator Principle Procedures in 2010.

The Equator Principles reporting January to December 2010 are as follows.

Deals

	A	B	C	Total
Completed	–	8	10	18
In progress	–	4	–	4
Not completed	–	5	2	7
Total	–	17	12	29

Geography of completed transactions

US	–	3	2	5
Europe	–	5	8	13
Rest of world	–	–	–	–
Total	–	8	10	18

Industry of completed transactions

	Number	£m
Renewables	8	391
Infrastructure	8	699
Energy & ulilities	2	78
Total	18	1,168

Resource efficiency

Reducing our own use of resources helps us minimise our impact on the environment as well as keeping our costs under control. In 2010, we launched Smart & Responsible, our new targeted environmental action plan. It aims to deliver significant environmental and cost savings, as well as improving colleagues' work-life balance.

We also registered for the Carbon Reduction Commitment Energy Efficiency Scheme in 2010 and will now be required to purchase allowances for each tonne of energy-related CO_2 we emit. It has significant cost implications for the Group which provides a further incentive to reduce our carbon emissions. We are already working towards achieving the Carbon Trust Standard for the Group – this standard recognises organisations that are genuinely measuring and reducing CO_2 emissions. Our goal is to reduce our energy consumption by 30 per cent by 2020.

Engaging our employees

Employees play a key role in delivering our environmental agenda. One of the main areas where colleagues can have a real impact is in business travel. We have a common travel policy in place across the Group which supports a focus on reducing travel. This has helped us increase the volume of teleconferences by 73 per cent in 2010 compared with 2009.

We strengthened our approach in 2010 with the introduction of TRAVELwise, part of the Smart & Responsible programme. We have set a TRAVELwise target to avoid 1 in 5 business flights by 2015.

CO_2 Emissions (tonnes)

	2010	2009
Total UK CO_2 emissions	**442,535**	449,207
Scope 1 emissions	**73,182**	76,387
Scope 2 emissions	**333,315**	343,693
Scope 3 emissions	**36,038**	29,127

For 2009, we have reported emissions for January to December. For 2010 and future years, we will report annual emissions from October to September. Our CO_2 emissions have been independently verified by environmental consultants by RPS Group.

Our economic and social impact

We have a presence in almost every community in the UK and touch many millions of lives. Our significant role in the financial services sector is a privilege, and one that comes with important obligations.

As a UK-focused bank, we have an important role to play in supporting the UK's economic recovery. We need to demonstrate that we are meeting our obligations to our customers by continuing to give them access to the finance they need. Whilst our main contribution to society is our direct economic impact, we strongly believe that this must also be supported by our active investment in the communities in which we operate.

Supporting the UK's economic recovery

We know that there are those who believe that the banks are not lending enough, and that it is difficult for people to obtain loans. We believe that at Lloyds Banking Group we are playing a very active part in the economic recovery. Indeed, as a UK-focused bank, we have a vital interest in supporting its recovery.

In 2010, we extended over £79 billion of new lending to homeowners and businesses. As a predominantly UK bank, the vast majority of this lending was conducted in this country. We remain ahead of the mortgage and business lending commitments made by the Group to the Government for the year ending February 2011.

During 2010 we extended £30 billion of gross mortgage lending (including remortgages) to UK homeowners, representing around 1 in 5 of all new mortgages in the UK. We extended more than £5 billion in new lending to first time buyers, helping over 50,000 customers buy their first homes in 2010. We also support various schemes which help first time buyers, including Right to Buy, Shared Equity and Shared Ownership.

We made available £49 billion of committed gross lending to UK businesses in 2010, of which £11 billion was for SMEs. We continue to approve over 80 per cent of lending applications from SMEs. As the UK's biggest provider of start up finance, we play an active part in developing the entrepreneurial culture of the UK. We helped more than 100,000 new business start ups last year.

We also actively participate in all the main Government lending programmes designed to help small businesses access the finance that they need. We are one of the most active lenders under the Government's Enterprise Finance Guarantee Scheme. To date we have offered more than 4,000 loans, nearly 30 per cent of total loans granted under the scheme, totalling around £300 million of funding being made available to SMEs across the UK.

Financial inclusion

Our approach to financial inclusion is aligned with the Government's aims to increase access to banking and credit, while, at the same time, developing consumers' financial literacy and understanding. We aim to lead the banking sector in reaching those that are financially excluded and equip them with the confidence and capability to manage their money effectively. We also have a strong commercial interest in helping to create a nation of consumers who are both comfortable and confident in dealing with the financial services sector.

In 2010, we published our first standalone Financial Inclusion Report, setting out our financial inclusion strategy and our future agenda. We have established a Financial Inclusion Steering Group to oversee our activities and strengthen our strategic approach.

We have developed dedicated products and services that address financial exclusion. With over four million accounts, we are the biggest provider of social bank accounts in the UK. Social bank accounts – often known as basic bank accounts – are a simple form of current account that are open to anyone, regardless of credit rating, as long as they have not been convicted of fraud or are an un-discharged bankrupt. They enable customers to pay household bills by direct debit, which can save them money when compared with other methods of payment. We also are the only bank to offer social banking customers a bespoke Christmas savings account, the Halifax Christmas Saver. This is an important part of our work to help close the savings gap.

We are currently providing the Government's Financial Inclusion Taskforce with insights and data we gain from our significant market share of social bank accounts, to help them understand the behaviour of vulnerable social banking customers.

Financial capability

We recognise that we are one of the most important sources of financial information and guidance for consumers. We take seriously our responsibility to raise levels of general financial understanding across the communities we serve and work closely with the Government, the FSA and other stakeholders to deliver this.

In 2010, we launched 'Money for Life', our new £4 million financial capability programme for the further education sector. We are partnering with the Consumer Financial Education Body and skills agencies in each of the four nations of the UK to promote and deliver the programme. Money for Life aims to develop the capacity of the further education sector to improve the financial capability and personal money management skills of the three million people they serve. Over the next two years we will also aim to train 500 of our employees through the programme. This training will provide them with the skills they need to support our financial education agenda in their local communities.

Money for life – supporting financial capability in the UK's further education sector

In Scotland, Money for Life is funding the creation of a DVD, scripted and produced by drama students at James Watt college, to raise awareness of financial issues amongst young offenders and those at risk of offending. A second focus group will bring together six adult learning colleges to create specially tailored interactive budgeting DVDs for learners. Stakeholders in the Highlands, Dundee and Stirling will also partner to create coaching and mentoring programmes designed to help further education tutors and facilitators gain the skills to provide financial capability support to their diverse learning groups.

Community investment

Our economic contribution to society is supported by active investment in communities and our community giving programme. We invested £148 million in communities across the UK in 2010, including support for financial inclusion and social banking, sponsorship of sports for young people and donations through the Group's charitable Foundations.

Funding grassroots charities

Much of the Group's charitable giving is channelled through the Lloyds TSB Foundations and Bank of Scotland Foundation – five independent charitable Foundations funded solely by the Group. In the last 25 years, more than £450 million has been distributed to small, grassroots charities across the UK through the Lloyds TSB Foundations. In 2010, we established the Bank of Scotland Foundation to take forward our long term community investment in Scotland.

Last year, we donated more than £29 million to the Foundations. This enabled the Foundations to distribute 1,278 grants to charities across the UK. These grants often cover charities' core costs, such as wages for key employees. In the current economic climate, when many charities are finding it difficult to attract funding, the Foundations' grants are helping many charities to survive.

Our Charity of the Year programme

Our Charity of the Year programme is our flagship fundraising initiative. It is one of the largest corporate fundraising programmes in the UK. The British Heart Foundation (BHF) was our Charity of the Year from July 2008 to December 2010. We raised £3.4 million in total for the BHF through a wide range of employee, customer and shareholder fundraising projects. The money we raised funds

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15 specialist BHF Heart Nurses and 12 healthcare assistants, nurses, psychologists and health educators, who will support 14,400 patients and their families across the UK.

In October 2010, colleagues voted for Save the Children as our Charity of the Year for 2011.

Save the Children – our Charity of the Year in 2011

Lloyds Banking Group's Charity of the Year for 2011 is Save the Children. Working together we aim to raise at least £1 million to fund 52 Save the Children Families and Schools Together (FAST) projects in some of the UK's most disadvantaged communities. FAST is a unique programme that works with three- to five-year-olds and their families to ensure that children get the best possible start to their school life. It brings together children and their parents, schools and community volunteers to help coach parents on how to support their children's development, ultimately helping them to break out of the cycle of poverty.

Employee volunteering

Our employees are our strongest link with the local communities in which we operate. We are committed to enabling employees to make a contribution to communities.

As one of the UK's biggest employers, our colleague volunteering initiatives can make a real difference. In 2010, we launched our Day to Make a Difference volunteering programme. This enables all Lloyds Banking Group employees to spend one day a year during work time volunteering for a charity or local community project of their choice. Over 7,300 employees volunteered during 2010 in their local communities.

Matched giving

Through our Matched Giving scheme, operated by our charitable Foundations, we enable employees to maximise their contributions to the charities and causes that are important to them. In 2010, employees could claim up to £500 from the Foundations to match funds they raised for charity, including our Charity of the Year, or time given in volunteering. This has been raised to £1,000 per employee in 2011.

In 2010, our colleagues claimed £1.3 million in matched funding, raising £3.2 million for charities in the process.

Community sponsorship

As the Official Banking and Insurance Partner of the London 2012 Olympic and Paralympic Games, we are using the power of the London 2012 Games to inspire young people to take part in more sport through Lloyds TSB and Bank of Scotland National School Sport Week, delivered in partnership with the charity Youth Sport Trust in England and Wales and Sport Scotland in Scotland. In 2010, almost 50 per cent of UK schools, and five million young people, took part.

We also support the future stars of Team GB and ParalympicsGB through our Local Heroes programme which will have provided funding to more than 1,000 emerging young athletes across Britain by 2012. Athletes receive £1,000 to help towards their training, equipment and travel costs.

Building relationships

We know we have much work to do as an industry to rebuild trust and relationships with our stakeholders. Our starting point is with our customers. As a bank, we have long term, sometimes lifelong, relationships with our customers. We are entrusted with peoples' money – their savings, their mortgages, their business bank accounts. Ensuring we maintain and build customers' trust is core to the sustainability of our business.

Only by focusing on customers' needs, and addressing those needs, can we expect to deliver benefit to all our stakeholders.

As a relationship-led business, our people are our most valuable resource. They are the Group's ambassadors. Building strong relationships with our people, and helping them to develop, is therefore fundamental to the success of the business and achieving our vision of being the UK's best financial services organisation. Our approach to building relationships with our people is covered separately on pages 57 to 59 of this report.

Treating customers fairly

Treating customers fairly, and ensuring that we are transparent in all our dealings with them, is central to our aim of building deep and lasting relationships with customers.

Our customer treatment standards are aligned to the FSA's best practice standards. We conduct regular testing and monitoring to check adherence with our customer treatment policies and have systems in place, such as our Whistleblowing helpline, which allow colleagues to identify and report behaviours which do not meet our high standards.

Listening to our customers

Every month we contact 75,000 customers as part of a systematic customer feedback process. We listen carefully to what our customers tell us, both good and bad, and use this to make changes where necessary. Often, we learn about the small things that cause irritation to customers. By listening to our customers, we can quickly put things right.

Addressing customers' complaints

The vast majority of our customers are happy with the service we provide. When we do receive complaints, we take them seriously, and ensure that they are dealt with quickly, fairly and consistently. Our 40,000 customer-facing and call-centre employees have also received extra, in-depth training on handling of customer complaints. We now resolve 90 per cent of complaints at first touch in a branch or over the phone with the support of our new 'Phone a Friend' complaints resolution team. Overall, we improved our customers' view of complaint handling by 10 points in 2010. However, we know we have to work hard to reduce the number of complaints we receive in the first place if we are to achieve our goal of becoming the UK's best and most recommended bank.

Delivering innovative products and services

We work hard to introduce new and innovative products that respond to customers' evolving needs, underlining our commitment to building long-term relationships with our customers.

In 2010, Halifax launched the Cash ISA Promise, an industry leading move to help drive a fairer deal for customers when transferring their cash ISA. The Cash ISA Promise enables all customers switching their existing cash ISA to Halifax, to earn interest from the first day that we receive their completed transfer form. It was launched in response to

industry-wide complaints that ISA transfers take too long, costing consumers millions in lost interest. Lloyds TSB and Bank of Scotland have also committed to paying customers interest upon receipt of their ISA applications.

Halifax also launched a 'No Fees' First Time Buyer Mortgage early in 2011 – a first among mainstream lenders. The mortgage offers Halifax current account customers a 90 per cent loan-to-value mortgage at a two year fixed-rate of 5.79 per cent. It has been specifically designed to help first time buyers by paying the fees on their mortgage.

Lloyds TSB's unique 'Lend a Hand' mortgage enables buyers to take out a mortgage with a deposit of as little as 5% at an equivalent rate to borrowers with a significantly bigger deposit. The mortgage is linked to the savings of a helper, such as a family member, to 'top up' the deposit to 25% of a property's value.

Research published by Lloyds TSB shows that, 'Second Steppers' – those still living in their first home, but looking to take their next step up the housing ladder – are the segment of the market most likely to have their equity levels affected by a reduction in house prices. Second Steppers typically bought their first homes at the height of the market and, due to market conditions, have not benefited from any increase in their equity. Originally launched for first time buyers, in 2010 'Lend a Hand' was extended to all home movers, in recognition of the challenges faced by Second Steppers of securing a larger deposit. No other major lender offers deals for customers moving house unless they have a deposit of at least 10%.

Increasing transparency

We took a number of industry leading steps in 2010 to improve transparency for savers. Lloyds TSB and Halifax have taken steps to:

- Ensure current interest rate information is clearly visible online and on paper statements.
- Offer existing savings customers access to all savings deals ensuring that no barriers exist for those wishing to switch to a better-paying savings account.
- Ensure that an online calculator is available to help customers work out exactly how much interest they can earn in different accounts.

During 2011, all of the Group's main savings brands, including Lloyds TSB, Halifax, Bank of Scotland, Cheltenham & Gloucester and Birmingham Midshires will publish savings interest rates on customer statements.

We are also investing in tools to help customers have greater control of their money. Lloyds TSB's cutting edge online 'Money Manager' service helps customers track spending patterns and manage their finances. It provides a combined view of spending across Lloyds TSB personal current accounts and credit cards, and can break down customers' expenditure under categories such as bills and shopping, helping them to budget.

Supporting Britain's businesses

We support corporate and commercial customers throughout the economic cycle to ensure their financial health, stability and growth. Through this approach we are able to build deep and lasting relationships with customers, and support their ongoing contributions to the UK economy.

As part of our award winning 2012 SME Charter, we have pledged to support 300,000 new start-ups across the country by 2012. The Charter sets out a series of commitments that form a three year programme of support for SMEs to help them grow as the recovery gains momentum. We are running 200 business seminars every year for the next three years, providing expert guidance and support for up to 90,000 SMEs on starting up, employment, exporting, bidding for London 2012 Olympic and Paralympic Games contracts, finance and sustainability.

Our dedicated Business Support Unit provides bespoke help to business customers that are facing difficulty. Wherever possible, we work to turn these businesses around and restore their financial stability so that they are able to return to mainstream banking. By focusing on helping these businesses recover, we have an opportunity to deepen relationships and retain loyal customers.

Building relationships with our suppliers

Our suppliers are important to us. We actively encourage our employees to build strong working relationships with them. We are a signatory to the Prompt Payment Code, committing to paying suppliers on time and not changing the payment terms agreed at the outset of the contract. This Code requires that we provide clear guidance on payment procedures, including redress for any disputes, and encourage similar good practice amongst our suppliers and other businesses.

Payment of suppliers

	2010	2009	2008	2007
Number of payments	**576,940**	763,917	335,713	320,579
Value (£bn)	**5.82**	5.22	2.67	2.20
Average time to pay (days)	**27.21**	28.33	26.03	28.78
Number/amount of compensation payments for late settlement	**Nil**	Nil	Nil	Nil

2010 and 2009 data represents Lloyds Banking Group. Historical data is Lloyds TSB only.

Independent assessment of our performance

In 2010, we were re-selected for the Dow Jones Sustainability Index. This comprises the top 10 per cent most sustainable companies globally, based on long-term economic, environmental and social criteria. We are the top UK bank in the new FTSE CDP Carbon Strategy Index Series launched in 2010 and a component of the Carbon Disclosure Leadership Index. We are also Platinum performers in Business in the Community's Corporate Responsibility Index and are included in the FTSE4Good Index.

Summary

Looking ahead, we need to continue to engage in open conversations with our key stakeholders and demonstrate how we are listening to their needs. We realise that it will take time to rebuild trust and understanding in the sector and we are committed to leading the way. By listening to our stakeholders, and by acting in their best interests, we will support our strategic aim of being recognised by them as the UK's best financial services organisation. Over time, we believe that this will enable us to deliver superior, more sustainable shareholder value.

Comprehensive CR resource online:
www.lloydsbankinggroup-cr.com

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RISK MANAGEMENT

UNAUDITED INFORMATION

This section contains both audited and non audited information. The audited information is that required to comply with the requirements of relevant International Financial Reporting Standards. All other information is unaudited. Each page in this section identifies which information is audited and which is not audited.

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 includes their risk performance, as a component of overall 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 initiated. 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 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 corporate 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 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 control and monitoring.

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 Committee, chaired by a Non-Executive Director, comprises other 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 Committee of the aggregate risk profile and has direct access to the Chairman and members of the Risk Committee.

RISK AS A STRATEGIC DIFFERENTIATOR

The maintenance of a strong control framework remains a priority for the 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 undertaking 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 rolled out the methodology and financial control framework that was used by the heritage Lloyds TSB Group; including compliance with the requirements of the US Sarbanes Oxley Act.

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 FUNDING AND STATE AID

HM Treasury currently holds approximately 40.6 per cent of the Group's ordinary share capital. United Kingdom Financial Investments Limited (UKFI) as manager of HM Treasury's shareholding continues to operate in line with the framework document between UKFI and HM Treasury managing the investment in the Group on a commercial basis without interference in day-to-day management decisions. There is a risk that a change in Government priorities could result in the framework agreement currently in place being replaced leading to interference in the operations of the Group, although there have been no indications that the Government intends to change the existing operating arrangements.

The Group has made a number of undertakings to HM Treasury arising from the capital and funding support, including the provision of additional lending to certain mortgage and business sectors until 28 February 2011, and other matters relating to corporate governance and colleague remuneration. However the commitments in respect of lending are subject to normal prudent commercial lending criteria and pricing, the availability of funding to support such lending and the availability of sufficient demand from creditworthy customers and potential customers. The new agreement between the leading UK banks and the Government in relation to gross business lending in the 2011 calendar year is subject to a similar set of criteria.

In addition, the Group is subject to European state aid obligations in line with the restructuring plan agreed with HM Treasury and the EU College of Commissioners in November 2009, which is designed to support the

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long-term viability of the Group and address any competition distortions arising from the benefits of state aid. This has placed a number of requirements on the Group including asset reductions in certain parts of its balance sheet by the end of 2014 and the disposal of certain portions of its business by the end of November 2013, including in particular the disposal of some parts of its retail banking business. The Group is working closely with the EU Commission, HM Treasury and the Monitoring Trustee appointed by the EU Commission.

RISK GOVERNANCE (audited)

The embedding of an integrated governance and risk management framework throughout the Group has continued, through a consistent approach to risk appetite, policies, delegations and Risk Committee structures.

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 table 1.1.

BOARD AND COMMITTEES

The Board, assisted by its key Risk Committees (Risk Committee and 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 ensure that these are consistent with the Board's appetite for risk. The role of the Board, Audit Committee and Risk Committee are shown in the corporate governance section on pages 120 to 121, and further key risk oversight roles are described below.

In particular, the **Risk Committee**, (formerly 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 that these are in line with emerging regulatory, corporate governance and industry best practice. The Risk 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 **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**. This Senior Level Committee 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. It is also supported by the **Group Market Risk Forum** which escalates matters relating to the strategic management of the Group's structural market risks, including market risks held in the Group's insurance companies.

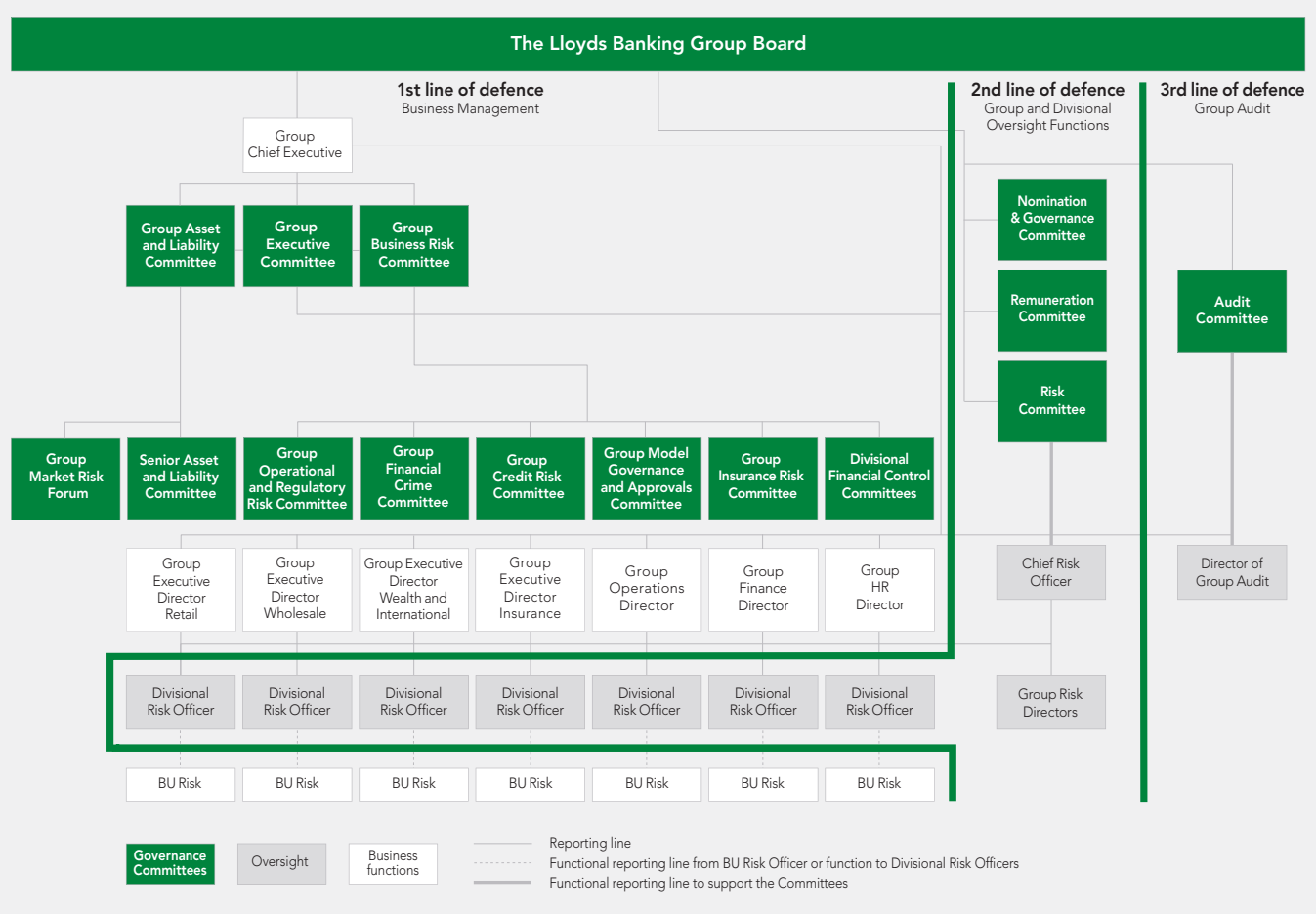
The **Group Business Risk Committee** reviews and recommends the Group's risk appetite and risk management framework, high-level group policies and the allocation of risk appetite. Group Business Risk Committee periodically reviews risk exposures and risk/reward returns and monitors the development, 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 Operational and Regulatory Risk Committee**, which is responsible for identifying current and emerging significant regulatory 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.
- The **Group Financial Crime Committee** serves as the principal Group forum for reviewing and challenging the management of financial crime risk including the overall strategy and performance. The Committee is accountable for ensuring that, at Group level, financial crime risks are effectively identified and managed within risk appetite and that strategies for financial crime prevention are effectively co-ordinated and implemented across the Group.
- The **Divisional Financial Control Committees,** which provide governance over financial statements. The meetings provide review and challenge as to the veracity of the results, press releases and supporting analyst information with oversight over 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 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 Committee.

TABLE 1.1: **RISK GOVERNANCE STRUCTURES**



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 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.

Group Risk Directors who report directly to the Chief Risk Officer, are allocated responsibility for 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 provides 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.

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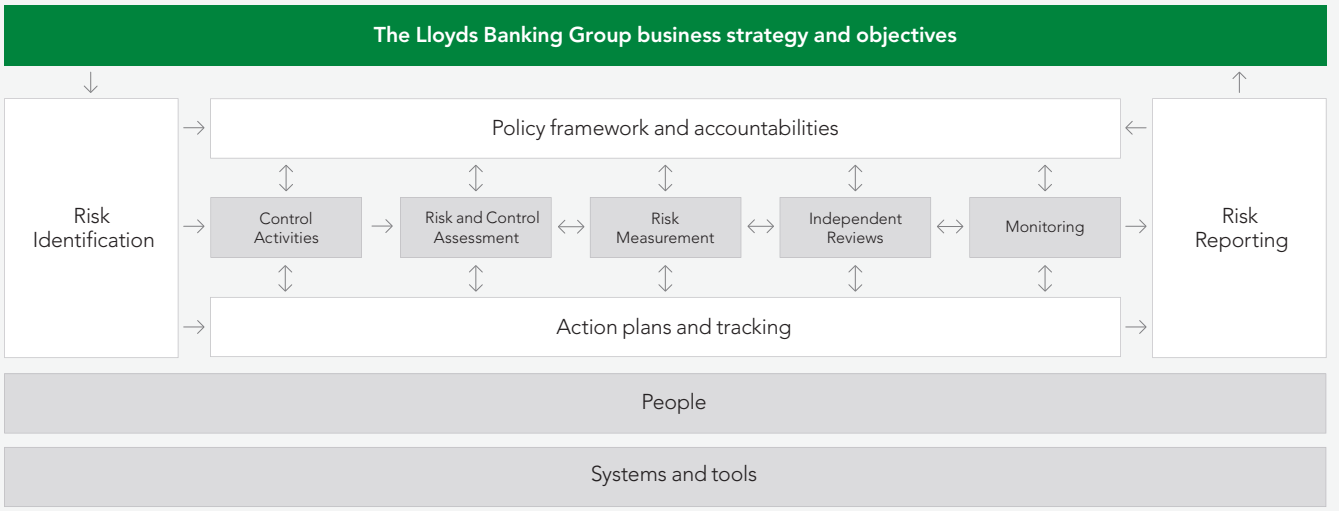
TABLE 1.2: **RISK MANAGEMENT FRAMEWORK**



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 122), 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 table 1.2. 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 objectives are used to determine the Group's high level risk principles and risk appetite measures and metrics for the primary risk drivers (see table 1.3). The risk appetite is proposed by the Group Chief Executive and reviewed by various governance bodies including the Group Executive Committee and the Risk 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 categorise them (see table 1.3 below).

Proportionate **control activities** are in place to design mitigating controls, to transfer risk where appropriate and seeks 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, reputational 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. The **monitoring** process requires that significant issues 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 to the Group Asset and Liability Committee, Group Business Risk Committee, Group Executive Committee, Risk 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, Risk 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 quarterly 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 six months.

PRINCIPAL RISKS AND UNCERTAINTIES

At present the most significant risks faced by the Group, which are derived from the primary risk drivers detailed in table 1.3 below, are:

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, to a much lesser extent in the Insurance division in respect of investment of own funds. Adverse changes in the credit quality of the Group's UK and/or international borrowers and counterparties, or in their behaviour, would be expected to reduce the value of the Group's assets and materially increase the Group's write-downs and allowances for impairment losses. Credit risk can be affected by a range of factors, including, inter alia, increased unemployment, reduced asset values, increased personal or corporate insolvency levels, reduced corporate profits, increased interest rates or higher tenant defaults. Over the last three years, the global banking crisis and economic downturn has driven cyclically high bad debt charges. These have arisen from the Group's lending to: – Wholesale customers (including those in Wealth and International): where companies continue to face difficult business conditions, resulting in elevated corporate default levels, illiquid commercial property markets and heightened impairment charges. The Group has high levels of exposure in both the UK and internationally, including Ireland, USA and Australia. There are particular concentrations to financial institutions and commercial real estate, including secondary and tertiary locations. – Retail customers (including those in Wealth and International). UK bad debts have reduced materially in 2010 as a result of risk management activity and more stable, low interest rate UK economic conditions. This portfolio will remain strongly linked to the economic environment, with inter alia house prices fall, unemployment increases, consumer over-indebtedness and rising interest rates all likely to impact both secured and unsecured retail exposures. The Group follows a through the economic cycle, relationship based, business model with risk management processes, appetites and experienced staff in place.

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Risk: Definition	Features
Legal and regulatory: 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.	Legal and regulatory exposure is driven by the significant volume of current legislation and regulation within the UK and overseas with which the Group has to comply, along with new or proposed legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. This is particularly the case in the current market environment, which is witnessing increased levels of government and regulatory intervention in the banking sector. The Group continues to face political and regulatory scrutiny as a result of the Group's perceived systemic importance following the acquisition of HBOS. At the time of the acquisition, the Office of Fair Trading (OFT) identified some competition concerns in the UK personal current accounts and mortgages markets and for SME banking in Scotland. The OFT reiterated that it would keep these under review and consider whether to refer any banking markets to the Competition Commission if it identifies any prevention, restriction or distortion of competition. The UK Government appointed an Independent Commission on Banking to review possible structural measures to reform the banking system and promote stability and competition. That commission will publish its final report by the end of September 2011. The Treasury Select Committee is conducting an examination of competition in retail banking. It is too early to quantify the potential impact of these developments on the Group. From April 2011, lead regulation and supervision of the Group's activities will begin transitioning from the FSA to the new Financial Conduct Authority for conduct of business supervision and the Prudential Regulatory Authority for capital and liquidity supervision. In addition, from 2011, the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority as new EU Supervisory Authorities are likely to have greater influence on regulatory approaches across the EU. These could lead to changes in how the Group is regulated and supervised on a day-to-day basis. Evolving capital and liquidity requirements continue to be a priority for the Group. In September 2010 and further clarified in December 2010, the Basel Committee on Banking Supervision put forward proposals for a reform package which changes the regulatory capital and liquidity standards, the definition of 'capital', introduces new definitions for the calculation of counterparty credit risk and leverage ratios, additional capital buffers and development of a global liquidity standard. Implementation of these changes is expected to be phased in between 2012 and 2018. The Group is currently assessing the impacts of these regulatory developments and will participate in the consultation and calibration processes to be undertaken by the various regulatory bodies during 2011. The insurance division is progressing its plans to achieve Solvency II compliance. The Group continues to work closely with the regulatory authorities and industry associations to ensure that it is able to identify and respond to proposed regulatory changes and mitigate against risks to the Group and its stakeholders. There is a risk that certain aspects of the Group's business may be determined by the authorities or the courts as not being conducted in accordance with applicable laws or regulations, or with what is fair and reasonable in their opinion. The Group may also be liable for damages to third parties harmed by the conduct of its business.

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. 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.	Arising in the banking business of the Group through 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, the Group's ability to fund its financial obligations could be impacted. The key dependencies for successfully funding the Group's balance sheet include the continued functioning of the money and capital markets; successful right sizing of the Group's balance sheet; the continuation of HM Treasury and Bank of England 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 wholesale funding markets. A return to the extreme market conditions of 2008 would place a strain on the Group's ability to meet its financial commitments. Liquidity and funding risks are 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.
Market Risk: The risk of reductions in earnings and/or value, through financial or reputational loss, from unfavourable market moves; including changes in, and increased volatility of, interest rates, market-implied inflation rates, credit spreads, foreign exchange rates, equity, property and commodity prices.	Market 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. The principal market risks are as follows: There is a risk to the Group's banking income arising from the level of interest rates and the margin of interbank rates over central bank rates. A further banking risk arises from competitive pressures on product terms in existing loans and deposits, which sometimes restrict the Group in its ability to change interest rates applying to customers in response to changes in interbank and central bank rates. The main equity market risks arise in the life assurance companies and staff pension schemes. Credit spread risk arises in the life assurance companies, pension schemes and banking businesses. Equity market movements and changes in credit spreads impact the Group's results. Continuing concerns about the scale of deficits in Ireland and southern European countries resulted in increased credit spreads in the areas affected, and fears of contagion affected the Euro and widened spreads between central bank and interbank rates. The Group's trading activity is small relative to its peers and is not considered to be a principal risk. The average 95 per cent 1-day trading Value at Risk (VaR) was £7.4 million for 2010.
Insurance Risk: The risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/ underwritten events and to fluctuations in the timing and amount of claims settlements.	The major sources of insurance risk are within the insurance businesses and the staff defined benefit pension schemes. Insurance risk is inherent in the insurance business and can be affected by customer behaviour. Insurance risks accepted relate primarily to mortality, longevity, morbidity, persistency, expenses, property and unemployment. The primary insurance risk carried by the Group's defined benefit pension schemes is related to longevity. Insurance risks typically, and longevity in particular, crystallise gradually over time. Actuarial assumption setting for financial reporting and liability management requires expert judgement as to when evidence of an emerging trend is sufficient to require an alteration to long-run assumptions.

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Risk: Definition	Features
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 the Group's operations and is closely aligned with achievement of the 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 FSA continues to drive focus on conduct of business activities and has established a new approach to supervision of Conduct Risk, replacing the previous 'Treating Customers Fairly' initiative for retail customers. Under this new regime the FSA has indicated that it will seek to place greater emphasis on product governance and contract terms in general, and will seek to intervene much earlier in the product lifecycle to prevent customer detriment. The FSA also continues to carry out thematic reviews on a variety of issues across the industry as a whole, for example complaints handling. The Group actively engages with the regulatory authorities and other stakeholders on these key customer treatment challenges, which includes for example, PPI (see note 54 to the financial statements on page 237 'Contingent liabilities and commitments'). The Group has policies, procedures and governance arrangements in place to facilitate the fair treatment of customers. Since the acquisition of HBOS, the Group has made significant progress in aligning its approach to Treating Customers Fairly across both heritages. In addition the Group has aligned its Treating Customers Fairly governance and management information arrangements, with customer impact being a key factor in assessing every integration proposition. The Group regularly reviews its product range to ensure that it meets regulatory requirements and is competitive in the market place.
People: 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.	The Group aims to attract, retain, and develop high calibre talent. Failure to do so would present a significant risk to delivering the Group's overall strategy and is affected by a range of factors including: – Ongoing regulatory and public interest in remuneration practices – Delivery of the Group's integration commitments, and – Uncertainty about EU state aid requirements and the Independent Commission on Banking's proposals for banking reform. The Group's remuneration arrangements encourage compliant and appropriate behaviour from colleagues, in line with group policies, values and short and long term people risk priorities. The Group has continued to work closely with regulators, to seek to ensure compliance with our obligations. However, there is recognition that international consensus must be achieved to avoid UK institutions being significantly disadvantaged in attracting and retaining the highest calibre talent. The Group continues to manage union relationships actively and the majority of colleagues are now on harmonised Terms and Conditions. There is strong ongoing commitment to support and retain colleagues throughout a period of significant integration and organisational change. Active monitoring of the Colleague Engagement Survey, allows the Group to understand engagement levels. These continue to increase and are now exceeding industry benchmarking for high performing organisations. Lloyds Banking Group is closely engaged with the UK Government and regulators on reform proposals, and with the EU on disposal arrangements, to influence and manage colleague uncertainty.
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 heritage organisations continues to be one of the largest integration challenges that has been seen in the UK financial services industry. The Group's Integration Execution Board, chaired by the Group Operations Director, continues to oversee the integration process and progress is being regularly reviewed by the Group Executive Committee and Group Board. While there continue to be delivery risks to the programme, not least the risk of new regulatory requirements which may have an effect on resourcing, the Group is now two years into the integration programme and has a fully developed and functioning governance framework to manage these risks. There is a clear understanding of the phased deliverables to ensure effective delivery through to 2012.

TABLE 1.3: **RISK DRIVERS**

Primary risk drivers	Business Risk	Credit Risk	Market Risk	Insurance Risk	Operational Risk	Financial Soundness
Detailed risk types	Execution of strategy	Retail Wholesale Wealth and International	Interest rate Foreign exchange Equity Credit spread	Mortality Longevity Morbidity Persistency Property Expenses Unemployment	Legal and regulatory Customer treatment People Supplier management Customer processes Financial crime Money laundering and sanctions Security IT systems Change Organisational infrastructure	Capital Liquidity and funding Financial and prudential regulatory reporting Disclosure Tax

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 31 more granular risk types to enable more detailed review and facilitate appropriate reporting and monitoring, as set out in table 1.3.

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 scenarios, scenarios specific to the operations of each part of the business, as well as reverse stress tests.

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.

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AUDITED INFORMATION

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 56 to the financial statements on page 251. 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 creditworthiness 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 19 to the financial statements on page 184 shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2010. 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 56 on page 251.

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-profits 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 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's rating systems assess probability of default and if Advanced, exposure at default and loss given default, in order to derive an expected loss. (If not Advanced, regulatory prescribed exposure at default and loss given default values are used in order to derive an expected loss). In contrast, impairment allowances are recognised for financial reporting purposes only for loss events that have occurred at the balance sheet date, based on objective evidence of impairment (see note 2(H) to the financial statements on page 158). 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.

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 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 validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible. The most material rating models are approved 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 rating grades if the assessment of the counterparty 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 56 to the financial statements provides an analysis of the portfolio and pages 79 to 88 provide details of our Credit risk portfolio.)

MITIGATION

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

Internal control

The Group follows a through the economic cycle, relationship based, business model with risk management processes, appetites and experienced staff in place. These policies and procedures define chosen target market and risk acceptance criteria. These have been, and will continue to be 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.

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 policies are reviewed at least annually, and any changes are subject to a review and approval process. Divisional and business unit policies include 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 models). Divisional risk departments review model effectiveness, while new models and model changes are referred by them to divisional model governance committees for approval. The most material changes are referred to the Group Model Governance Committee.

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 ensure risk models and associated rating systems are developed consistently, and are of sufficient quality to support business decisions and meet regulatory requirements. Internal rating systems are developed by 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 rating systems, supported and challenged by independent 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, financial, political and social factors. Group policies stipulate that these limits must be consistent with, and support the approved business and strategic plans of the Group.

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 countries and more vulnerable sectors and segments. Note 21 to the financial statements on page 188, provides an analysis of loans and advances to customers by industry (for wholesale customers) and product (for retail customers). Exposures are monitored to prevent an 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, within a specific industry sector.

Specialist expertise: Credit quality is maintained by specialist units providing, for example: intensive management and control (see Intensive Care section); 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. Group credit risk assurance, a group level function comprising forty seven experienced credit professionals, is also in place. In conjunction with divisional and group risk senior management, this team carries out independent risk based credit reviews, providing individual business unit assessment of the effectiveness of risk management practices and adherence to risk controls across the diverse range of the Group's wholesale and retail businesses and activities, facilitating a wide range of audit, assurance and review work. These include cyclical ('standard') credit reviews, non-standard reviews, project reviews, credit risk rating model reviews and bespoke assignments, including impairment reviews as required. The work of group credit risk assurance continues to provide executive and senior management with assurance and guidance on credit quality, effectiveness of credit risk controls and accuracy of impairments.

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AUDITED INFORMATION

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 receivables;
– 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

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 the Group Credit Risk Committee, Group Business Risk Committee and Risk Committee.

The performance of all rating models is monitored on a regular basis, in order to seek to ensure that models provide appropriate risk differentiation capability, the generated ratings remain as accurate and robust as practical, 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 appropriate Model Governance Committee.

INTENSIVE CARE OF CUSTOMERS IN DIFFICULTY

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 and established a central team managing this activity globally. Teams have been strengthened in both Wholesale and especially Wealth and International to deal with the rise in workloads experienced during the year as the recessionary conditions took hold both in the UK and overseas. In Wholesale three teams operate to support customers experiencing difficulties in Corporate Real Estate, Corporate and Commercial, and Specialist Finance. 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 early 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.

These specialist support teams utilise a range of techniques (including debt for equity swaps, sale of business and restructuring options) to preserve viable companies wherever possible and undertake regular reviews so that the customer receives the appropriate level of support. The reviews are also designed to ensure that support strategies continue to be relevant and are being executed.

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. The Group provides support to customers in difficulty via trained colleagues in branches and dedicated telephony units, and via online guidance material. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies where they have multiple credit facilities including those external to the Group, 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.

In addition, the Group participates in the following UK Government ('Government') sponsored programmes for households:

– Income Support for Mortgage Interest: This is a medium-term Government initiative that provides certain defined categories of customers, principally those who are unemployed, access to a benefit scheme, paid for by the Government, which covers all or part of the interest on the mortgage. Qualifying customers are able to claim for mortgage interest on up to £200,000 of the mortgage, and the benefit is payable for a maximum of two years. All decisions regarding an individual's eligibility and any amounts payable under the scheme rest solely with the Government. Payments are made directly to the Group by the appropriate Government department.
– Homeowner Mortgage Support Scheme: This is a medium-term Government initiative that enables borrowers affected by temporary reductions in income to access reduced payments for a period of up to two years. The Government provides a partial guarantee to the Group whilst a customer participates in the plan. Decisions on eligibility, principally whether the Group expects the borrower's earnings to recover fully, initially rest with the Group and must be made on the basis of detailed information received from an independent fee-free advisor. After a year, the customer must undergo a further full assessment made by the advice agency. The customer must pay at least 30 per cent of the interest due. Any shortfall in payments made during the period covered by the scheme is collected through increased payments over the remaining term.
– Mortgage Rescue Scheme: This is a short-term Government initiative for borrowers in difficulty and facing repossession, who would have priority for re-housing by a local authority (e.g. the elderly, disabled, single parents). Eligible customers can have their property bought in full or part by the social rented sector and then remain in their home as a tenant or shared equity partner. If the property is sold outright the mortgage is redeemed in full.
– 'Breathing space' initiative: This is a Government led initiative which requires the banking industry to allow a 'breathing space' of up to sixty days to allow borrowers in difficulty to agree a repayment plan with a debt advice charity prior to any action being taken by the bank to recover the outstanding debt.
– Delay Repossession: Under this initiative lenders will not begin repossession proceedings for at least three months when a customer is in arrears. This does not apply to fraud cases. The undertaking comes alongside an existing agreement under which mortgage providers are obliged to explore a range of options, such as payment holidays and altering the terms of a mortgage, before resorting to repossession.
– HomeBuy Direct: The HomeBuy Direct scheme covers certain newly built homes on specific housing developments across England. The scheme is provided through 'HomeBuy agents'. HomeBuy agents are housing associations that have been authorised to run schemes for people who have difficulty buying a home. Customers can only buy a home through HomeBuy Direct if their household earnings are no more than £60,000 per annum, and they cannot otherwise afford to buy a home in their area. The HomeBuy Direct scheme is open to people who rent council or housing association properties; 'key workers' in the public sector (e.g. teachers) and first-time buyers. The scheme provides up to 30 per cent of the purchase price through an equity loan that has no repayments for the first five years. After this there is an annual fee of 1.75 per cent, which will increase annually with inflation. The customer can increase their share of ownership at any time.

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As well as these Government-sponsored initiatives, the Group, through its banking businesses, also operates a number of its own schemes to assist households. These include:

– Short-term reduced or nil arrangements: This is an arrangement whereby customers who are experiencing short-term difficulties may be granted a reduced (including nil) payment arrangement. This is agreed with the customer based on their individual circumstances; nil payment arrangements can be granted for up to three months and reduced payment arrangements for up to six months. There is no reduction in contractual terms for customers on these arrangements.
– Term extensions: This allows customers to extend their mortgage term in order to reduce their contractual monthly payment. The maximum term is aligned to the overall standard term limits for mortgages and there is no forbearance of any debt.
– Transfer to interest only: This allows customers who are currently on a capital and interest repayment basis to transfer to an interest only basis for a period of time (up to three years maximum) in order to reduce their contractual monthly payment.
– Contractual repayment: This scheme allows customers in arrears, but who have made sufficient payments in a six month period, to capitalise their arrears. The contractual repayment is then adjusted to provide full repayment of the loan and full interest within the agreed original term.

The Group's accounting policy for loan renegotiations and forbearance is set out on page 159.

In addition to these household-related initiatives, the Group, through its banking businesses, participates in a number of initiatives designed to assist small and medium-sized enterprises. These include:

– The Lending Code: Introduced by the British Bankers' Association in November 2009, the Lending Code is a voluntary set of commitments and standards of good practice to ensure that lenders act fairly and reasonably in all dealings with customers.
– Statement of Principles: The Group through a number of its businesses has signed up to the Statement of Principles outlining an agreed approach to working with micro-enterprises (entities with fewer than 10 employees and having a turnover of less than €2 million). The principles include how to ensure that the right relationship is established from the start, how to help if the business faces difficulties and how businesses can work most effectively with their bank.
– As part of the Group's commitment to the Statement of Principles, it issues a Letter of Concern to customers when it has concerns about their business or the Group's relationship with them. This ensures that the customer understands the Group's concerns; the approach aims to generate early dialogue between the customer and the Group, so that a joint approach to the situation can be developed.
– Business Lending Taskforce: The Group through its banking businesses is actively involved in the recently set up Business Lending Taskforce, which has committed to 17 actions in three broad areas: (i) improving customer relationships; (ii) ensuring better access to finance; and (iii) providing better information and promoting understanding.

OUR CREDIT RISK PORTFOLIO IN 2010

OVERVIEW

– The Group achieved a significant reduction in the impairment charge in 2010 to £13,181 million (from £23,988 million in 2009), due to the stabilisation of the wholesale portfolios and good retail affordability and performance. Improvements in Wholesale and Retail more than offset increased impairment charges in Ireland and Australia, caused by difficult market conditions.
– Prudent, 'through the cycle' credit policies and procedures are in place throughout the Group, focusing on development of enduring client relationships. This resulted in higher quality new business being originated across the UK. Very little new origination took place outside the UK.
– The Group's level of impairment is being managed successfully in the current challenging economic environment by the Wholesale business support units and Retail collection and recovery units. The business support model has been expanded from Wholesale across Wealth and International division, with a central team established to manage its business support activity globally. The Group has also strengthened resources within Retail collections and recoveries to enable more timely engagement with customers experiencing difficulties to drive more effective customer outcomes.
– The Group actively reduced limits to Portugal, Ireland, Italy, Greece and Spain over the last two years, with the associated country risk profile modest in the context of the Group's asset base. Except for Ireland, the 2011 base case impairment forecast for these countries is de-minimis in the context of the Group.
– The closure of our Bank of Scotland (Ireland) Limited business was completed on the 31 December 2010 and a new operating structure came into existence, focused on intensive management of the closed book to optimise the winding up of our lending.

TABLE 1.4: **IMPAIRMENTS ON GROUP LOANS AND ADVANCES (audited)**

As at 31 December 2010	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Retail	**368,981**	**9,750**	**2.6**	**3,096**	**31.8**
Wholesale	**187,651**	**34,514**	**18.4**	**15,855**	**45.9**
Wealth and International	**66,368**	**20,342**	**30.7**	**10,684**	**52.5**
Hedging and other items	**3,378**	**–**	**–**	**–**	**–**
	626,378	**64,606**	**10.3**	**29,635**	**45.9**
Impairment provisions	**(29,635)**				
Fair value adjustments	**(4,146)**				
	592,597				
As at 31 December 2009					
Retail	378,005	11,015	2.9	3,806	34.6
Wholesale	210,934	35,114	16.6	17,179	48.9
Wealth and International	69,402	12,704	18.3	5,003	39.4
Hedging and other items	1,663				
	660,004	58,833	8.9	25,988	44.2
Impairment provisions	(25,988)				
Fair value adjustments	(7,047)				
	626,969				

[1] Impairment provisions include collective unimpaired provisions.

TABLE 1.5: **IMPAIRMENT CHARGE BY DIVISION (audited)**

	2010 £m	2009 £m	Change %
Retail	**2,747**	4,227	35
Wholesale	**4,446**	15,683	72
Wealth and International	**5,988**	4,078	(47)
Total impairment charge	**13,181**	23,988	45

EUROPEAN SOVEREIGN EXPOSURES (unaudited)

As at 31 December 2010, the Group had in aggregate, minimal direct exposure to the national and local governments of Portugal, Ireland, Italy, Greece and Spain.

OUTLOOK – GROUP (unaudited)

Based on its latest economic assumptions, as set out on page 12, the Group expects an improved impairment charge in 2011 compared with 2010.

While the second half of 2010 has seen most countries exiting from recession, forecasts are that the UK recovery will continue to be at a modest pace and is likely to be protracted. The risks to the impairment charge remain skewed to the downside across all lending businesses. In the UK, business and consumer confidence remain fragile and the extent to which simultaneous fiscal tightening might undermine global and UK growth is unclear. Contagion from the Irish bail-out to other Eurozone economies could drive further fiscal tightening and worsen the outlook further. Rising commodity prices driven by strong recovery in Asia might fuel a further increase in inflation, prompting short-term interest rates to rise more quickly than anticipated. Potential interest rate rises, public spending cuts and reduced consumer spending could cause cashflow stress and higher levels of default amongst mid-market corporates and Commercial customers in particular. In addition, in our commercial real estate book, any deterioration in the economy could increase the level of tenant defaults and reduce capital values further from an already depressed level, particularly in the regions. Further significant falls in house prices, real disposable household income or increasing interest rates, would result in a higher secured retail impairment charge relative to current expectations.

A 'double-dip' scenario – a second recession following closely the one from which the economy is just emerging – remains a key downside risk to UK impairment charges. This is because it would result in further significant increases in corporate failures and unemployment during 2011-12, as well as causing a second period of falling prices for residential and commercial property, tenant defaults would increase and central banks would have limited ability to cushion the downturn. Together, these factors could lead to increased impairments across the Group's UK portfolios.

The Group's exposure to Ireland and Australia is being closely managed. In post bail-out Ireland, the fragility of the economy and political system could cause further credit quality deterioration within our closed book. Australia, while benefiting from a commodities export boom, continues to be affected by deteriorating property markets in the geographic areas and property classes where the Group is exposed. Base rate increases are an additional threat to affordability in our Australian property and acquisition finance books.

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RETAIL

OVERVIEW (unaudited)

– The Retail impairment charge was £2,747 million in 2010, a decrease of £1,480 million, or 35 per cent, from 2009.

– The decrease in the Retail impairment charge was driven primarily by the improved quality of new business and effective portfolio management, coupled with a continuing slow recovery of the economy. The Retail impairment charge for loans and advances to customers, as an annualised percentage of average loans and advances to customers, decreased to 0.74 per cent from 1.11 per cent in 2009.

– New lending quality continues to be good with subsequent early arrears at pre-recessionary levels.

– Average loan-to-value on new mortgage lending in the year was 60.9 per cent (59.3 per cent for 2009) while the average indexed loan-to-value on the mortgage portfolio was 55.6 per cent (54.8 per cent at 31 December 2009) consistent with a net fall in house prices since December 2009.

– Overall volume of customers entering arrears in 2010 compared to 2009 was lower for unsecured lending and flat for secured lending. Secured early arrears balances increased in the second half of 2010.

TABLE 1.6: **RETAIL IMPAIRMENT CHARGE (audited)**

	2010 £m	2009 £m	Change %
Secured	**292**	789	63
Unsecured	**2,455**	3,438	29
Total impairment charge	**2,747**	4,227	35

Retail's impairment charge decreased by £1,480 million to £2,747 million in 2010 compared with 2009 and was lower in both secured and unsecured portfolios. This improvement was driven primarily by the improved quality of new business and effective portfolio management, coupled with the continuing slow recovery of the economy. The lower secured impairment charge reflected a reduction in impaired loans and improved arrears in the first half of 2010. Across Retail in 2010, there were fewer cases going into arrears. The impairment charge on loans and advances to customers, as an annualised percentage of average loans and advances to customers, decreased to 0.74 per cent from 1.11 per cent in 2009.

IMPAIRED LOANS AND PROVISIONS (audited)

Retail impaired loans decreased by £1.2 billion to £9.8 billion compared with 31 December 2009 and, as a percentage of closing loans and advances to customers, decreased to 2.6 per cent from 2.9 per cent at 31 December 2009. The reduction in the value of impaired loans reflected the continuing low interest rate environment for mortgages and fewer unsecured loans going into arrears. Impairment provisions, as a percentage of impaired loans, reduced to 31.8 per cent from 34.6 per cent at 31 December 2009 largely driven by more stringent criteria for new and existing unsecured collections repayment plans resulting in highly provided assets being written-off.

TABLE 1.7: **IMPAIRMENTS ON RETAIL LOANS AND ADVANCES (audited)**

As at 31 December 2010	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Secured	**341,069**	**6,769**	**2.0**	**1,589**	**23.5**
Unsecured	**27,912**	**2,981**	**10.7**	**1,507**	**50.6**
Total gross lending	**368,981**	**9,750**	**2.6**	**3,096**	**31.8**
Impairment provisions	**(3,096)**				
Fair value adjustments	**(2,154)**				
	363,731				

As at 31 December 2009	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Secured	345,900	7,196	2.1	1,693	23.5
Unsecured	32,105	3,819	11.9	2,113	55.3
Total gross lending	378,005	11,015	2.9	3,806	34.6
Impairment provisions	(3,806)				
Fair value adjustments	(3,141)				
	371,058				

[1] Impairment provisions include collective unimpaired provisions.

The Retail division's loans and advances to customers are analysed in the following table:

TABLE 1.8: **RETAIL LOANS AND ADVANCES TO CUSTOMERS (audited)**

As at 31 December	2010 £m	2009 £m
Secured:		
Mainstream	**265,368**	270,069
Buy to let	**46,356**	44,236
Specialist	**29,345**	31,595
	341,069	345,900
Unsecured:		
Credit cards	**11,207**	12,301
Personal loans	**13,881**	16,940
Bank accounts	**2,624**	2,629
Others, including joint ventures	**200**	235
	27,912	32,105
Total Retail gross lending	**368,981**	378,005

OUTLOOK – RETAIL (unaudited)

The Group remains cautious about the pace and consistency of economic recovery and how this may impact our customers. The outlook assumes a slow economic recovery resulting in an improvement in the unsecured impairment charge. In the secured portfolio however, there are a mixture of signals from lead indicators, including falling house prices and an increase in secured arrears in the second half of 2010, which lead Retail to expect a higher secured impairment charge in 2011. Overall the Group anticipates a modest reduction in Retail's 2011 impairment charge based on the current outlook of a modestly improving economic environment.

SECURED

SECURED IMPAIRMENT CHARGE (unaudited)

The impairment charge decreased by £497 million, to £292 million in 2010 compared to the previous year. The main drivers of the reduction were continued benefits from internal activities (risk and collections policies), maintained affordability and the continuing slow recovery of the economy. However, for the second half of 2010 the impairment charge was greater than the first half due to falling house prices combined with a worsening house price outlook towards the end of the period. The impairment charge for loans and advances to customers, as a percentage of average loans and advances to customers, decreased to 0.09 per cent from 0.23 per cent in 2009.

Provisions held against secured assets reflect adequate allowance for incurred losses including customers currently on repayment plans or in financial difficulties who are maintaining their repayments whilst interest rates are very low.

SECURED IMPAIRED LOANS (unaudited)

Impaired loans decreased by £0.4 billion to £6.8 billion at 31 December 2010 and, as a percentage of closing loans and advances to customers, reduced to 2.0 per cent from 2.1 per cent at 31 December 2009. The reduction in the value of impaired loans reflects the continued ability of customers to afford their mortgage payments in a low interest rate environment.

The number of customers going into arrears remained stable throughout 2010. In the second half of 2010 fewer accounts in arrears returned to order resulting in higher early arrears balances for 31 December 2010 compared to 30 June 2010. As reported at the 2009 year end, Specialist lending remains closed to new business and this book is in run-off.

SECURED ARREARS (unaudited)

The percentage of mortgage cases greater than three months in arrears (excluding repossessions) remained stable at 2.3 per cent at 31 December 2010 compared to 31 December 2009.

TABLE 1.9: **MORTGAGES GREATER THAN THREE MONTHS IN ARREARS (EXCLUDING POSSESSIONS) (audited)**

Greater than three months in arrears (excluding repossessions)	Number of cases		Total mortgage accounts %	
	31 Dec 2010 Cases	31 Dec 2009 Cases	31 Dec 2010 %	31 Dec 2009 %
Mainstream	**55,675**	57,837	**2.1**	2.1
Buy to let	**7,577**	7,557	**1.8**	1.9
Specialist	**12,582**	13,848	**6.4**	6.6
Total	**75,834**	79,242	**2.3**	2.3

Greater than three months in arrears (excluding repossessions)	Value of debt[1]		Total mortgage balances %	
	31 Dec 2010 £m	31 Dec 2009 £m	31 Dec 2010 %	31 Dec 2009 %
Mainstream	**6,247**	6,407	**2.4**	2.4
Buy to let	**1,157**	1,159	**2.5**	2.6
Specialist	**2,262**	2,498	**7.7**	7.9
Total	**9,666**	10,064	**2.8**	2.9

[1]Value of debt represents total book value of mortgages in arrears but not repossessed.

The stock of repossession cases rose from 2,720 at 31 December 2009 to 3,043 at 31 December 2010. This still represents a relatively low proportion of the portfolio and was broadly consistent with prior years.

Secured loan to value analysis (unaudited)

Management actions have resulted in new lending quality remaining strong. The average loan-to-value ratio (LTV) for new mortgages and further advances written in 2010 was 60.9 per cent compared with 59.3 per cent for 2009. This is primarily driven by a greater proportion of new lending to first-time buyers and home movers delivering on the Group's commitment to support new home owners. The average indexed LTV on the mortgage portfolio at 31 December 2010 was 55.6 per cent compared with 54.8 per cent at 31 December 2009. House prices, having initially increased, fell in the second half of 2010 resulting in the indexed LTV in excess of 100 per cent ending 2010 at 13.2 per cent of the mortgage portfolio (£44.9 billion), compared with 13.0 per cent (£44.8 billion) at 31 December 2009. The tables below show LTVs across the principal mortgage portfolios.

The increased average LTVs for impaired Buy to let mortgages, is driven by the modest net fall in house prices and the seasoning of higher risk lending that was closed at the start of 2009.

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TABLE 1.10: **ACTUAL AND AVERAGE LTVS ACROSS THE PRINCIPAL MORTGAGE PORTFOLIOS (audited)**

As at 31 December 2010	Mainstream %	Buy to let %	Specialist[1] %	Total %
Less than 60%	**33.0**	**11.4**	**14.0**	**28.5**
60% to 70%	**12.1**	**11.1**	**9.4**	**11.7**
70% to 80%	**16.1**	**21.9**	**15.9**	**16.8**
80% to 90%	**15.3**	**18.0**	**21.3**	**16.2**
90% to 100%	**11.9**	**19.1**	**20.0**	**13.6**
Greater than 100%	**11.6**	**18.5**	**19.4**	**13.2**
Total	**100.0**	**100.0**	**100.0**	**100.0**
Average loan-to-value:				
Stock of residential mortgages	**51.9**	**75.6**	**72.9**	**55.6**
New residential lending	**60.0**	**66.5**	**n/a**	**60.9**
Impaired mortgages	**72.3**	**97.8**	**87.3**	**78.0**

As at 31 December 2009	Mainstream %	Buy to let %	Specialist[1] %	Total %
Less than 60%	34.4	12.0	14.3	29.7
60% to 70%	11.9	11.3	9.7	11.6
70% to 80%	15.2	20.2	17.0	16.0
80% to 90%	14.3	19.1	21.5	15.6
90% to 100%	12.2	21.4	20.3	14.1
Greater than 100%	12.0	16.0	17.2	13.0
Total	100.0	100.0	100.0	100.0
Average loan-to-value:				
Stock of residential mortgages	51.0	75.2	72.3	54.8
New residential lending	58.3	65.6	73.7	59.3
Impaired mortgages	71.1	91.5	85.6	76.5

[1]Specialist lending is closed to new business and is in run-off.

UNSECURED (unaudited)

In 2010 the impairment charge on loans and advances to customers reduced by £983 million to £2,455 million compared with 2009. This reflected a continuation of the improving portfolio trends resulting from the Group's prudent risk appetite, with a focus on lending towards existing customers, combined with stable unemployment.

A combination of reduced demand from customers for personal unsecured borrowing and the Group's prudent risk policy contributed to loans and advances to customers reducing by £4.2 billion to £27.9 billion at 31 December 2010.

Impaired loans decreased by £0.8 billion to £3.0 billion which represented 10.7 per cent of closing loans and advances to customers at 31 December 2010, compared with 11.9 per cent at 31 December 2009. The movement in impaired loans is consistent with the trends seen in both the flow of accounts to arrears and arrears balances, both of which have fallen across all unsecured products during 2010. This is a result of tightening credit policy across the credit lifecycle, including stronger controls on customer affordability, set against a stable economic environment. Retail's exposure to revolving credit products has been actively managed to ensure that it is appropriate to customers' changing financial circumstances. The portfolios' results are supported by pre-recessionary levels of early arrears for accounts acquired in the last two years, highlighting an underlying improvement in the risk profile of the business.

Impairment provisions decreased by £0.6 billion, compared with 31 December 2009, to £1.5 billion. Impairment provisions, as a percentage of impaired loans, decreased to 50.6 per cent at 31 December 2010 from 55.3 per cent at 31 December 2009, largely driven by more stringent criteria for new and existing unsecured collections repayment plans resulting in highly provided assets being written-off.

WHOLESALE

OVERVIEW (unaudited)

– Impairment charge for 2010 decreased significantly to £4,446 million, from £15,683 million for 2009.
– Impairment experience in 2010 was better than guided a year ago as stabilising economic conditions led to lower impairment charges especially in the corporate real estate, real estate related and Corporate (UK and US) portfolios.
– A robust credit risk management and control framework is in place across the combined portfolios and a prudent risk appetite approach (largely based on Lloyds TSB's model) continues to be embedded across the division. Significant resources have been deployed into the business support units focused on key and vulnerable obligors and asset classes.

TABLE 1.11: **WHOLESALE IMPAIRMENT CHARGE (audited)**

	2010 £m	2009 £m	Change %
Corporate Markets	**4,182**	14,855	72
Asset Finance	**264**	828	68
Total impairment charge	**4,446**	15,683	72

Wholesale's impairment charge decreased by £11,237 million, or 72 per cent, compared to £15,683 million for 2009. Impairment charges as an annualised percentage of average loans and advances to customers reduced to 2.08 per cent from 5.92 per cent in 2009. Significant actions were taken in the first half of 2009 on the heritage HBOS portfolios, including the identification of large impairments post the HBOS acquisition especially in corporate real estate, real estate related and Corporate (UK and US) portfolios. Together with the stabilising UK and US economic environment in 2010, a low interest rate environment helping to maintain defaults at a lower level and a number of write backs due to asset disposals, impairment charges have decreased substantially compared with 2009.

IMPAIRED LOANS AND PROVISIONS (audited)

Wholesale's impaired loans reduced by £600 million to £34,514 million compared with 31 December 2009. The reduction is due to new impaired assets (mainly in the Corporate Real Estate Business Support Unit) being offset by write-offs on irrecoverable assets and the sale of previously impaired assets. Impairment provisions also reduced as a result of the write-offs and a lower impairment rate on recently impaired assets. As a result, impairment provisions as a percentage of impaired loans reduced to 45.9 per cent from 48.9 per cent at 31 December 2009. As a percentage of closing loans and advances to customers, impaired loans increased to 18.4 per cent from 16.6 per cent at 31 December 2009. This increase is essentially a factor of the reducing level of total loans and advances to customers as at 31 December 2010 compared with 31 December 2009. We continue to monitor our vulnerable portfolios within Wholesale and, where appropriate, remedial risk mitigating actions are being undertaken.

OUTLOOK – WHOLESALE (unaudited)

The potential effects of the UK Government's austerity measures on portfolios vulnerable to Government spending cuts are currently unknown. Although appropriate early warning indicators and action plans are in place to help mitigate against this, we would expect some negative effect on the portfolio. This is especially so in the traditional customer lending businesses, which are vulnerable to reduced consumer spending as a result of tax rises, and other UK Government austerity measures. As previously guided, we expect the overall net impairment charges in our traditional lending businesses (especially in the trading and manufacturing sectors) to increase in 2011, driven in part by a lower benefit from write backs on asset disposals and the effect of the UK Government austerity measures on the wider economy.

Wholesale retains some material single obligor concentrations on weaker credits, especially from the heritage HBOS real estate and real estate related portfolios. These portfolios (especially the secondary and tertiary assets which comprise a large part of the heritage HBOS corporate real estate and real estate related portfolio) remain vulnerable to an increase in tenancy defaults and reduced capital values from an already depressed level, particularly in the regions. However, against our base case assumptions, we expect our impairment charges in corporate real estate to be lower than 2010 as a result of a continuing stabilisation of the existing portfolio and actions taken in 2009 and 2010. Whilst we therefore remain cautious in respect of the outlook for 2011, we do expect a modest reduction in the total impairment charge for 2011 as a whole.

TABLE 1.12: **IMPAIRMENTS ON WHOLESALE LOANS AND ADVANCES (audited)**

As at 31 December 2010	Balance £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Corporate Markets:					
Corporate	81,171	6,635	8.2	3,629	54.7
Commercial	29,148	2,856	9.8	993	34.8
Corporate Real Estate BSU	26,151	17,518	67.0	8,091	46.2
Wholesale Equity	140	108	77.1	107	99.1
Wholesale Markets	40,042	5,718	14.3	1,992	34.8
Total Corporate Markets	176,652	32,835	18.6	14,812	45.1
Treasury and Trading	1,050	–	–	–	–
Asset Finance	9,949	1,679	16.9	1,043	62.1
Total Wholesale	187,651	34,514	18.4	15,855	45.9
Reverse repos	3,096				
Impairment provisions	(15,855)				
Fair value adjustments	(1,665)				
Loans and advances to customers	173,227				
Loans and advances to banks	12,409				
Debt securities[2]	25,781				
Available-for-sale financial assets[3]	29,458				

[1] Impairment provisions include collective unimpaired provisions.

[2] Of which Wholesale Markets is £25,120 million, Wholesale Equity £487 million, Treasury and Trading £163 million, Asset Finance £7 million, Corporate £2 million and Commercial £2 million.

[3] Of which Wholesale Markets is £21,279 million, Wholesale Equity £2,109 million, Treasury and Trading £6,011 million and Corporate £59 million.

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As at 31 December 2009	Balance £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Corporate Markets:					
Corporate	96,865	9,362	9.7	4,698	50.2
Commercial	29,223	2,695	9.2	956	35.5
Corporate Real Estate BSU	25,509	16,505	64.7	8,234	49.9
Wholesale Equity	505	413	81.8	385	93.2
Wholesale Markets	44,606	4,170	9.3	1,675	40.2
Total Corporate Markets	196,708	33,145	16.8	15,948	48.1
Treasury and Trading	1,394	–	–	–	–
Asset Finance	12,832	1,969	15.3	1,231	62.5
Total Wholesale	210,934	35,114	16.6	17,179	48.9
Reverse repos	1,108				
Impairment provisions	(17,179)				
Fair value adjustments	(3,055)				
Loans and advances to customers	191,808				
Loans and advances to banks	18,862				
Debt securities	31,736				
Available-for-sale financial assets	36,867				

[1] Impairment provisions include collective unimpaired provisions.

CORPORATE (unaudited)

The £81,171 million of loans and advances to customers in the Corporate portfolio is structured across a number of different portfolios and sectors as discussed below:

UK and US Corporate – Showed resilience during 2010 with the impairment charge significantly lower than 2009 levels and modest recoveries as asset prices improved during the first half of the year. Sentiment among UK corporates during the second half of the year changed as the scale of the Government austerity measures became clearer although most effects are not expected to be felt until 2011. Major corporate balance sheets are relatively strong with adequate levels of undrawn committed bank facilities available and continued access to the capital markets. In the Corporate North American portfolio significant reductions were achieved in the non-core portfolio, mostly in the first half when secondary markets were fairly buoyant. Impairments were significantly lower than in 2009 albeit the overall position is improved by some write backs.

Mid-market Corporate – As anticipated, the slightly more benign conditions experienced in the first half of 2010 were not sustained in the second half in the corporate mid-market. Impairments rose during the second half of the year, albeit to levels still significantly below those experienced in 2009, with legacy issues in the heritage HBOS portfolio continuing to be a significant driver of impairments in 2010. Although a number of exporters have been able to take advantage of a beneficial exchange rate, the corporate middle market is dominated by domestically focused businesses and the prospect of public sector spending cuts, tax increases and continuing high commodity and import prices is likely to see confidence remain fragile in 2011.

Corporate Real Estate – The focus is to continue to improve and re-balance the risk profile of the existing portfolio and apply conservative and prudent lending policies in relation to new business. A significant percentage concentration of customer lending is in real estate and real estate related investment lending, especially heritage HBOS and sustainability of its cashflow in 2010 has been key to the relative resilience seen in the investment market to date. The portfolio remains vulnerable to tenant default and asset price falls due to a significant element of investment lending in the portfolio, a large element of which is supported by secondary or tertiary assets. Refinancing risk remains an emerging issue with significant maturities due in the next few years.

Financial Institutions – As part of the Group's funding, liquidity and general hedging requirements, Corporate maintains relationships with many major financial institutions throughout the world. During the second half of 2010, concerns about sovereign fiscal deficits and public sector debt levels increased our scrutiny of the European banking sector, in particular the weaker Eurozone countries. Trading exposures are in large part collateralised and interbank activity is mainly with high investment grade counterparties.

COMMERCIAL (unaudited)

The Commercial portfolio's impairment experience has remained steady throughout the year, although a slightly higher run rate was observed in the second half, but overall was materially below that incurred in 2009. Portfolio metrics including delinquencies and assets under close monitoring, while improving through supportive management actions, remain above benign levels.

CORPORATE REAL ESTATE BUSINESS SUPPORT UNIT (unaudited)

The Corporate Real Estate Business Support Unit portfolios have endured a significant level of stress as a consequence of the unprecedented scale and pace of deterioration in the property sector since the peak in 2007, coupled with the previous aggressive lending appetite in the heritage HBOS business. Against significant impairments taken in 2009, experience in 2010 is materially lower. This reflects the stabilising economic environment and the prudent provisioning undertaken on the HBOS corporate real estate and real estate related portfolio in 2009. The Group continues to remain cautious regarding the short to medium term prospects for the sector.

The management of the distressed portfolio remains key not only to mitigating loss for the Group, but also for the Group as a major lender within the property sector to ensure that the strategies adopted do not adversely impact on a market that remains fragile. During 2010, a number of restructurings, good level of asset reduction, and continued active management led to a fall in impairments compared to the previous year.

On the property investment side there have been signs of recovery in capital values, specifically at the prime end of the commercial market and in London generally. Since the half year, this recovery has slowed as investor activity and sentiment cooled. Rental values remain fragile across most property sectors.

WHOLESALE EQUITY

The Wholesale Equity portfolio (assets representing 'Equity Risk' including ordinary equity, preference shares and debt securities) totals £5.6 billion (split £4.2 billion on balance sheet commitments and £1.4 billion as yet undrawn, the majority of which relates to the Funds Investment business). The portfolio comprises the two core businesses, Lloyds Development Capital and Project Finance with the remaining businesses (Joint Ventures Equity, BSU Investment portfolios and Fund Investments) all now categorised as non-core.

In terms of market sentiment, the second half of 2010 saw a gradual uptick in main share indices (UK, Europe and USA) which, despite episodic volatility has contributed to a relatively stable valuation position combined with some indication that there may be a slow recovery in market activity. While signs are on balance currently positive, we remain cautious on prospects for value recovery looking into 2011.

WHOLESALE MARKETS

Loans and advances to customers of £40.0 billion largely comprise balances in the Structured Corporate Finance portfolio, which includes Acquisition Finance (leveraged lending – £11.6 billion), Project Finance and asset based finance. The Acquisition Finance portfolio continues to be significantly affected by the economic environment, with a relatively high proportion of deals being restructured. The rate of new problem loans started to abate in the second half of 2009 and this trend continued during 2010. Refinancing risk is an issue for Acquisition Finance, with significant loan maturities due in the next few years. In Ship Finance, global markets, especially the dry bulk and container sectors, experienced considerable pressure during 2009, leading to higher impairment levels. The container sector strengthened during 2010, but the Group expects the shipping sector to remain challenging into 2011.

Wholesale Markets is also responsible for the Treasury Assets portfolio which mainly encompasses a portfolio of Asset-Backed Securities (ABS) and financial institution Floating Rate Note positions. Further details of Wholesale Division's Asset-Backed Securities is provided in note 18 to the financial statements on page 183. The size of the Treasury Assets portfolio has reduced through asset sales and amortisation.

TREASURY AND TRADING

Treasury and Trading acts as the link between the wholesale markets and the Group's balance sheet management activities and provides pricing and risk management solutions to both internal and external clients.

The portfolio comprises £10.7 billion of loans and advances to banks, £6.0 billion of Available-for-Sale debt securities and £1.1 billion of loans and advances to customers (excluding reverse repos).

The majority of Treasury and Trading's funding and risk management activity is transacted with investment grade counterparties and much of it is on a secured basis, such as repos. Derivative transactions with wholesale counterparties are typically collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement. Treasury and Trading has reduced the government bond portfolio in response to growing concern over market conditions in Europe. The credit quality of the government bond portfolio is almost solely AAA rated sovereign debt.

ASSET FINANCE

The credit quality of the retail portfolios continues to be relatively stable with key risk indicators continuing to show signs of improvement. Impairments in 2010 were lower than anticipated, particularly in the second charge secured portfolio and the retail motor loans portfolio. Asset quality also continues to improve in response to the continuing strategy to enhance the quality of new business written and following the closure of new business by the Personal Financial Services business. The credit quality profile across the non-retail portfolios also continues to be relatively stable, and impairment levels significantly less than 2009, reflecting a material slow down in new default cases. Exposures to the Fleet Operator sector, particularly a small number of daily/flexi rental operators, continue to require intensive management to support customers through their financial difficulties, but have not affected impairment levels to the extent seen in 2009.

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WEALTH AND INTERNATIONAL

OVERVIEW (unaudited)

– Increased impairment charges in commercial real estate portfolios in Ireland and Australia were the primary drivers of a divisional increase in impairment of 47 per cent in 2010 compared with 2009.

– Impairment charges in Ireland increased significantly in the last quarter of 2010 reflecting a material deterioration in market conditions that resulted in EU-IMF financial support in late November 2010.

– As part of the closure of Bank of Scotland (Ireland) Limited, a dedicated UK based business support unit credit team has been put in place to manage the wind down of the Irish book.

– Increased impairment charges in Australia are primarily due to real estate concentrations in specific geographical and industry sectors where liquidity has significantly contracted in 2010.

TABLE 1.13: **WEALTH AND INTERNATIONAL IMPAIRMENT CHARGE (audited)**

	2010 £m	2009 £m	Change %
Wealth	**46**	71	**35**
International:			
Ireland	**4,264**	2,949	**(45)**
Australia	**1,362**	849	**(60)**
Wholesale Europe	**210**	129	**(63)**
Other	**106**	80	**(33)**
	5,942	4,007	**(48)**
Total impairment charge	**5,988**	4,078	**(47)**

Wealth and International's impairment charge increased by £1,910 million to £5,988 million in 2010 compared with 2009. Impairment charges as a percentage of average loans and advances to customers increased to 8.90 per cent from 6.04 per cent in 2009.

IMPAIRED LOANS AND PROVISIONS (audited)

Total impaired loans increased by £7,638 million to £20,342 million compared with £12,704 million at 31 December 2009 and as a percentage of closing loans and advances to customers increased to 30.7 per cent from 18.3 per cent at 31 December 2009. The level of impaired loans in the International business is supported by detailed portfolio reviews conducted during 2010.

In December 2010, responsibility for impaired assets in Ireland was transferred from the local BSU team to a dedicated UK based BSU credit team to manage the wind down of the lending book. In Australia, this activity continues to be managed locally and strengthened through deployment of additional staff. Responsibility for these areas has been consolidated within a new central team, which has considerable experience in work-out strategies and will manage this activity globally for the Group.

Impairment provisions as a percentage of impaired loans increased to 52.5 per cent from 39.4 per cent at 31 December 2009. In the International business the increase in impairment provisions is due to a higher level of impaired loans and an increased coverage level, particularly in Ireland.

OUTLOOK – WEALTH AND INTERNATIONAL (unaudited)

Impairment charges in the division are expected to reduce in 2011 compared to the current year charge, although economic conditions in Ireland continue to be monitored closely. The outlook also remains cautious for the Group's Australian exposures, where there continues to be limited liquidity in regional property markets to which the Group is exposed.

TABLE 1.14: **IMPAIRMENTS ON WEALTH AND INTERNATIONAL LOANS AND ADVANCES (audited)**

As at 31 December 2010	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Wealth	**9,472**	**353**	**3.7**	**116**	**32.9**
International:					
Ireland	**27,428**	**14,445**	**52.7**	**7,763**	**53.7**
Australia	**14,587**	**4,187**	**28.7**	**2,208**	**52.7**
Wholesale Europe	**7,322**	**1,007**	**13.8**	**420**	**41.7**
Other	**7,559**	**350**	**4.6**	**177**	**50.6**
	56,896	**19,989**	**35.1**	**10,568**	**52.9**
Wealth and International	**66,368**	**20,342**	**30.7**	**10,684**	**52.5**
Impairment provisions	**(10,684)**				
Fair value adjustments	**(327)**				
	55,357				

As at 31 December 2009	Loans and advances £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £	Impairment provisions as a % of impaired loans %
Wealth	9,523	281	3.0	100	35.6
International:					
Ireland	29,104	9,712	33.4	3,601	37.1
Australia	14,057	2,030	14.4	966	47.6
Wholesale Europe	8,781	537	6.1	243	45.3
Other	7,937	144	1.8	93	64.6
	59,879	12,423	20.7	4,903	39.5
Wealth and International	69,402	12,704	18.3	5,003	39.4
Impairment provisions	(5,003)				
Fair value adjustments	(851)				
	63,548				

[1] Impairment provisions include collective unimpaired provisions.

WEALTH

Total impaired loans increased by £72 million, or 26 per cent to £353 million compared with £281 million at 31 December 2009 and as a percentage of closing loans and advances increased to 3.7 per cent from 3.0 per cent at 31 December 2009. Impairment charges decreased by £25 million to £46 million compared to £71 million in 2009. This reduction is primarily due to the mortgage lending business in Spain where there has been improved credit management of the book during 2010.

IRELAND

Total impaired loans increased by £4,733 million, or 49 per cent to £14,445 million compared with £9,712 million at 31 December 2009 and as a percentage of closing loans and advances increased to 52.7 per cent from 33.4 per cent at 31 December 2009. Impairment charges increased by £1,315 million to £4,264 million compared to £2,949 million in 2009. Impairment charges as a percentage of average loans and advances to customers increased to 15.4 per cent from 9.9 per cent in 2009.

Further deterioration in the Irish economy resulted in increased impaired loans in 2010 and coverage levels significantly increased in the last quarter of 2010 reflecting downward revisions in the Group's Irish economic assumptions.

TABLE 1.15: **IMPAIRMENTS ON IRELAND LOANS AND ADVANCES**

As at 31 December 2010	Gross loans £m	Impaired loans £m	Provisions £m
Commercial Real Estate	**11,685**	**9,232**	**4,791**
Corporate	**8,070**	**4,343**	**2,356**
Retail	**7,673**	**870**	**616**
Total	**27,428**	**14,445**	**7,763**
As at 31 December 2009	Gross loans £m	Impaired loans £m	Provisions £m
Commercial Real Estate	11,738	6,114	2,154
Corporate	9,094	3,002	1,159
Retail	8,272	596	288
Total	29,104	9,712	3,601

The most significant contribution to impairment in Ireland is the commercial real estate portfolio. Impairment provisions provide 52 per cent coverage on impaired commercial real estate loans – reflecting peak to trough falls in commercial property and house prices widening to 60 per cent and 38 per cent respectively. Mortgage lending at the year end comprised 96 per cent of the retail portfolio with impaired loans of £0.8 billion and impairment coverage of 65 per cent.

Following the closure of the Irish business, the portfolio is in run-off although current levels of redemptions and recoveries are low due to a severe lack of liquidity.

AUSTRALIA

Total impaired loans increased by £2,157 million, or 106 per cent to £4,187 million compared with £2,030 million at 31 December 2009 and as a percentage of closing loans and advances increased to 28.7 per cent from 14.4 per cent at 31 December 2009. Impairment charges increased by £513 million to £1,362 million compared to £849 million in 2009. Impairment charges as a percentage of average loans and advances to customers increased to 9.3 per cent from 6.3 per cent in 2009.

Although the economic performance for Australia has been more robust, exposure to the New Zealand and non-metropolitan Australian commercial real estate sectors remains a key influence on impairment performance. These markets have suffered a significant reduction in liquidity in 2010, driving increased impaired lending and also constraining recoveries.

WHOLESALE EUROPE

Total impaired loans increased by £470 million, or 88 per cent to £1,007 million compared with £537 million at 31 December 2009 and as a percentage of closing loans and advances increased to 13.8 per cent from 6.1 per cent at 31 December 2009. Impairment charges increased by £81 million to £210 million compared to £129 million in 2009. Impairment charges as a percentage of average loans and advances to customers increased to 2.8 per cent from 2.3 per cent in 2009. Commercial real estate is the primary driver of the impairment charge in Wholesale Europe reflecting a small number of specific transactions.

OTHER INTERNATIONAL

Total impaired loans increased by £206 million, or 143 per cent to £350 million compared with £144 million at 31 December 2009 and as a percentage of closing loans and advances increased to 4.6 per cent from 1.8 per cent at 31 December 2009. Impairment charges increased by £26 million to £106 million compared to £80 million in 2009. Impairment charges as a percentage of average loans and advances to customers increased to 1.3 per cent from 1.0 per cent in 2009. The most significant contribution to the impairment charge is from a limited number of corporate exposures which at the year end comprised 82 per cent of impaired lending and 92 per cent of the impairment charge in 2010.

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.

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AUDITED INFORMATION

Risk also arises from the margin of interbank rates over central bank rates. A further banking risk arises from competitive pressures on product terms in existing loans and deposits, which sometimes restricts the Group in its ability to change interest rates applying to customers in response to changes in interbank and central bank rates.

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 see note 30 to the financial statements on page 194.)
– 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 43 to the financial statements on page 208.

MEASUREMENT

The following market risk measures are used for risk reporting and setting risk appetite limits and triggers:

Value at Risk: for short term liquid positions a 1-day 95 per cent VaR is used; for structural positions a 1-year 95 per cent VaR is used

Standard Stresses: Interest Rates 25bp; Equities 10 per cent; Credit Spreads relative 30 per cent widening

Bespoke Extreme Stress Scenarios: e.g. stock market crash

Both VaR and standard stress measures are also used in setting divisional market risk appetite limits and triggers.

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. Trading book VaR (1-day 99 per cent) is back-tested daily against profit and loss.

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 2010 and 2009 based on the Group's global trading positions was as detailed in table 1.16.

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 five risk types, which now includes inflation. 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 trading book positions arising from short term market facing activity.

TABLE 1.16: **BANKING – TRADING ASSETS AND OTHER TREASURY POSITIONS**

As at 31 December	2010				2009
	Close £m	Average £m	Maximum £m	Minimum £m	Close restated £m
Interest rate risk	**3.9**	**4.4**	**8.0**	**2.3**	7.1
Foreign exchange risk	**0.4**	**0.4**	**0.8**	**0.1**	1.1
Equity risk	**–**	**–**	**0.2**	**–**	–
Credit spread risk	**1.6**	**2.4**	**4.3**	**1.2**	4.1
Inflation risk	**0.3**	**0.2**	**0.7**	**–**	0.2
Total VaR	**6.2**	**7.4**	**13.0**	**4.2**	12.5

2009 VaR has been restated to reflect trading risk only. Risk relating to the funding of the lending business is reported in the Banking-Non-Trading section of the report.

Banking – non-trading

Market risk in non-trading books consists almost entirely of exposure to changes in interest rates including the margin between interbank and central bank 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 2010 to an immediate up and down 25 basis points change to all interest rates.

TABLE 1.17: **BANKING – NON-TRADING**

	2010		2009	
	Up 25bps £m	**Down 25bps £m**	Up 25bps £m	Down 25bps £m
Sterling	**(86.9)**	**88.4**	66.6	(66.4)
US Dollar	**11.1**	**(11.4)**	(5.5)	5.6
Euro	**8.9**	**(9.0)**	4.4	(4.4)
Australian Dollar	**(1.2)**	**1.2**	2.2	(2.3)
Other	**(3.0)**	**3.1**	(0.2)	0.2
	(71.1)	**72.3**	67.5	(67.3)

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.

The schemes' main exposures are to equity risk, real rate risk and credit spread risk. Accounting for the pension schemes under International Accounting Standard (IAS)19 spreads any adverse impacts of these risks over time.

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 2010 and 2009. 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.

TABLE 1.18: **INSURANCE PORTFOLIOS**

As at 31 December	**2010 £m**	2009 £m
Equity risk (impact of 10% fall pre-tax)	**(367.4)**	(383.6)
Interest rate risk (impact of 25 basis point reduction pre-tax)	**82.1**	64.0
Credit spread risk (impact of relative 30% widening)	**(163.0)**	(156.4)

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 Senior Asset and Liability Committee and the group market risk forum regularly review high level market risk exposure including, but not limited to, the data described above. They also make 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 centrally 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 Senior Asset and Liability Committee and the Group Market Risk Forums:

– 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.

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– 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 (audited)

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 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 39 to the financial statements on page 206.

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 review 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 review. 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.

The most significant insurance risks in the life assurance companies are longevity risk and persistency risk. The merits of longevity risk transfer and hedging solutions are regularly reviewed. By their nature persistency risks are difficult to hedge.

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 (unaudited)

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

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

People
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.

Supplier management
The risk of reductions in earnings and/or value through financial or reputational loss from services with outsourced partners or third-party suppliers.

Customer processes
The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from poor externally facing business processes. Customer process risk includes customer transaction and processing errors due to incorrect capturing of customer information and/or system failure.

Financial crime
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, these losses may include censure, fines or the cost of litigation.

Money laundering and sanctions
The risk of reductions in earnings and/or value, through financial or reputational loss, associated with failure to comply with prevailing legal and regulatory obligations on activities related to money laundering, sanctions and counter terrorism, these losses may include censure, fines or the cost of litigation.

Security
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.

IT systems
The risk of reductions in earnings and/or value through financial or reputational loss resulting from the development, delivery and maintenance of effective IT solutions.

Change
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.

Organisational infrastructure
The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from poor internally facing business processes at group, divisional or business unit level. Organisational infrastructure 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.

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
By its very nature, operational risks can arise from a wide range of the Group's activities that involve people, processes and systems. The Group's principal operational risks relate to the Group's ability to attract, retain and motivate its people, the rate and scale of change arising from the Group's integration programme, the way in which the Group treats its customers and the legal and regulatory environment in which it operates.

The Group continues to face risks relating to its ability to attract, retain, and develop high calibre talent, as a result of challenges arising from ongoing regulatory and public interest in remuneration practices, delivery of the Group's integration commitments; and uncertainty from EU state aid requirements and Independent Commission on Banking proposals on banking reform.

The integration programme continues to be one of the largest integration exercises undertaken by a financial services firm. The breadth of the integration programme is such that all parts of the Group are impacted to a large or small degree, with the greatest impact being on the Retail bank. Although now over two years into the successful implementation of the programme, there continue to be delivery risks as the programme moves into its final phase of execution.

Customer treatment and how the Group manages its customer relationships affects all aspects of the Group's operations and is closely aligned with achievement of the 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, which includes, for example PPI (see note 54 to the financial statements on page 237 'Contingent Liabilities and Commitments').

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation within the UK and overseas with which the Group has to comply, along with new or proposed legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. This is particularly the case in the current market environment, which is witnessing increased levels of government and regulatory intervention in the banking sector.

MEASUREMENT
Both Lloyds TSB and HBOS had operational risk Advanced Measurement Approach Waivers, granted by the FSA, enabling the use of an internal capital model for calculating regulatory capital. As part of its integration programme, Lloyds Banking Group is in the process of moving to The Standardised Approach (TSA) and, in anticipation of this, calculated regulatory capital for the year ended 31 December 2010 on the basis of TSA.

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MITIGATION

The Group's operational risk management framework consists 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 Operational and Regulatory 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 (audited)

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 (audited)

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 (audited)

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. 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 (audited)

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 (audited)

A series of measures are used across the Group to monitor both short and long term liquidity including: ratios, cash outflow triggers, wholesale funding maturity profile, early warning indicators and stress test survival period triggers. The Board approved liquidity risk appetite links a number of these measures to balance sheet progression set out in the group funding plan, with regular reporting to the Board. 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 56(4) to the financial statements on page 263 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 (audited)

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 customer 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 interbank 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 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 as set out in Table 1.21 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 and Reserve Bank of Australia).

MONITORING (audited)

Liquidity is actively monitored at business unit and Group level. 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.

The Group has invested considerable resource to ensure that it satisfies the governance, reporting and stress testing requirements of the FSA's new ILAS liquidity regime. The Group has noted the industry move towards strategic balance sheet measures of the funding profile and has started to monitor and forecast the Group's Net Stable Funding Ratio (NSFR) and Liquidity Coverage Ratio (LCR). The Group is aware that the regulatory liquidity landscape is subject to potential change. Specifically, in relation to the 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 has actively participated in the industry-wide consultation and calibration exercises which took 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.

LIQUIDITY AND FUNDING MANAGEMENT IN 2010 (unaudited)

During 2010 liquidity and funding remained a key area of focus for the Group and the industry as a whole. Like all major banks, the Group is dependent on confidence in the short and longer term wholesale funding markets; should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding and liquidity where necessary, its ability to fund its financial obligations could be affected.

The Group is reliant on both wholesale funding markets and the legacy Government and central bank facilities to support its balance sheet. The liquidity and funding challenges facing the Group over the medium term continue to be ensuring sustainable access to wholesale funding markets, and the repayment of Government and central bank facilities. The combination of a clear focus on right-sizing the balance sheet, continued development of the Group's customer deposit base, and strategic access to the capital markets will enable the Group to strengthen its funding base while reducing its overall wholesale funding requirement.

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

During 2010, the Group further improved the diversification of funding supporting its balance sheet. Wholesale funding reduced by £27.5 billion whilst customer deposits increased by £11.3 billion, resulting in a more stable liability base. The customer loan to deposit ratio improved to 154 per cent compared with 169 per cent at 31 December 2009.

At 31 December 2010, the Group's further overall support from legacy Government and central bank facilities totalled £96.6 billion, a reduction of £60.6 billion compared with 31 December 2009. These facilities have various maturity dates, the last of which is in the fourth quarter of 2012. The Group's plan to right size the balance sheet is expected to avoid the necessity to refinance much of this. Repayment of the remaining amount will be achieved by a combination of customer deposit growth and term wholesale issuance.

TABLE 1.19: **ANALYSIS OF GOVERNMENT AND CENTRAL BANK FACILITIES (audited)**

As at 31 December	2010 £bn	2009 £bn
Credit Guarantee scheme	**45.4**	50.0
Other	**51.2**	107.2
Total Government and central bank facilities	**96.6**	157.2

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UNAUDITED INFORMATION

The Group's wholesale term funding ratio (wholesale funding with a remaining life of over one year as a percentage of total funding) at 31 December 2010 has been maintained at 50 per cent.

Despite the market disruption as a result of European sovereign risk concerns during 2010, the Group outperformed its term wholesale issuance plans, allowing an accelerated repayment of Government and central bank facilities and thus reducing the on-going reliance on short term funding. The Group continued to fund itself successfully in the short term money markets, extending the maturity profile of this source of funding. The Group anticipates that wholesale markets will remain vulnerable to periods of disruption during 2011. To mitigate the impact of such events, the Group has been actively diversifying its funding sources and investor base.

In June 2010, the FSA introduced a new liquidity framework (Individual Liquidity Adequacy Standards – ILAS) bringing in enhanced systems and controls, quantitative requirements, reporting requirements and stress testing. As part of the ILAS framework, the FSA has issued an Individual Liquidity Guidance (ILG) to the Group, representing a new regulatory requirement, which was effective from 1 June 2010. The Group has maintained its liquidity levels above the ILG regulatory minimum since inception.

Late in 2010, the Basel Committee on Banking Supervision refined the details of the Basel III reforms to ensure the strengthening of global liquidity standards. This supplemented the 2008 published Principles of Sound Liquidity Risk Management and Supervision ('Sound Principles'). These principles have been strengthened by the development of two principal liquidity measures.

The first measure promotes short term resilience of the liquidity profile by ensuring that banks have sufficient high quality liquid assets to meet potential funding outflows in a stressed environment within a one month period. This is measured by the LCR. The second promotes resilience over a longer time horizon by requiring banks to fund their activities with a more stable source of funding on a going concern basis. This is measured by NSFR which has a time horizon of one year and has been developed to ensure a sustainable maturity structure of assets and liabilities.

The Group welcomes the Basel Committee's Sound Principles. The introduction of the LCR (January 2015) and NSFR (January 2018) will raise the resilience of banks to potential liquidity shocks and provide the basis for a harmonised approach to liquidity risk management. At 31 December 2010, the Group's internal calculation of the LCR was 71 per cent and the NSFR was 88 per cent; the guidance issued by the Basel Committee is still subject to final ratification by the EU and the methodology is likely to be refined on the basis of feedback from banks and regulators during the observation period. The actions already announced to right size the balance sheet are expected to ensure compliance with the future minimum standards, which are expected to be 100 per cent for both ratios by their respective effective dates.

TABLE 1.20: **GROUP FUNDING POSITION (audited)**

As at 31 December	2010 £bn	2009 £bn	Change %
Funding Requirement			
Loans and advances to customers[1]	**589.5**	625.9	(6)
Loans and advances to banks[2]	**10.5**	16.1	(35)
Debt securities	**25.7**	32.7	(21)
Available-for-sale financial assets – secondary[3]	**25.7**	37.7	(32)
Cash balances[4]	**3.6**	2.7	33
Funded assets	**655.0**	715.1	(8)
On balance sheet primary liquidity assets[5]			
Reverse repurchase agreements	**7.3**	5.3	38
Balances at central banks – primary[4]	**34.5**	36.3	(5)
Available-for-sale financial assets – primary	**17.3**	8.9	94
Held to maturity	**7.9**	–	
	67.0	50.5	33
Other assets[6]	**269.6**	261.7	3
Total Group assets	**991.6**	1,027.3	(3)
Less: Other liabilities[6]	**(229.1)**	(223.4)	3
Funding requirement	**762.5**	803.9	(5)
Funded by			
Customer deposits[7]	**382.5**	371.2	3
Wholesale funding	**298.0**	325.5	(8)
Repurchase agreements	**35.1**	63.1	(44)
Total equity	**46.9**	44.1	6
Total funding	**762.5**	803.9	(5)

[1] Excludes £3.1 billion (31 December 2009: £1.1 billion) of reverse repurchase agreements.

[2] Excludes £15.6 billion (31 December 2009: £15.1 billion) of loans and advances to banks within the insurance businesses and £4.2 billion (31 December 2009: £4.2 billion) of reverse repurchase agreements.

[3] Secondary liquidity assets comprise a diversified pool of highly rated unencumbered collateral (including retained issuance).

[4] Cash balances and Balances at central banks – primary are combined in the Group's balance sheet.

[5] Primary liquidity assets are FSA eligible liquid assets including UK Gilts, US Treasuries, Euro AAA government debt and unencumbered cash balances held at central banks.

[6] Other assets and other liabilities primarily include balances in the Group's insurance businesses and the fair value of derivative assets and liabilities.

[7] Excluding repurchase agreements of £11.1 billion (31 December 2009: £35.5 billion).

TABLE 1.21: **GROUP FUNDING BY TYPE**

As at 31 December	2010 £bn	2010 %	2009 £bn	2009 %
Deposits from banks[1]	**26.4**	**3.9**	48.6	7.0
Debt securities in issue:[1]				
Certificates of deposit	**42.4**	**6.2**	50.9	7.3
Commercial paper	**32.5**	**4.8**	35.0	5.0
Medium-term notes[2]	**87.7**	**12.9**	89.7	12.9
Covered bonds	**32.1**	**4.7**	28.1	4.0
Securitisation	**39.0**	**5.7**	35.8	5.1
	233.7	**34.3**	239.5	34.3
Subordinated liabilities[1]	**37.9**	**5.6**	37.4	5.4
Total wholesale funding[3]	**298.0**	**43.8**	325.5	46.7
Customer deposits	**382.5**	**56.2**	371.2	53.3
Total Group funding[4]	**680.5**	**100.0**	696.7	100.0

[1] A reconciliation to the Group's balance sheet is provided on page 97.

[2] Medium-term notes include £45.4 billion of funding from the Credit Guarantee scheme.

[3] The Group's definition of wholesale funding aligns with that used by other international market participants; including interbank deposits, debt securities in issue and subordinated liabilities.

[4] Excluding repos and total equity.

Total wholesale funding is analysed by residual maturity as follows:

TABLE 1.22: **WHOLESALE FUNDING BY RESIDUAL MATURITY**

As at 31 December	2010 £bn	2010 %	2009 £bn	2009 %
Less than one year	**148.6**	**49.9**	161.8	49.7
One to two years	**46.8**	**15.7**	48.8	15.0
Two to five years	**52.3**	**17.6**	68.7	21.1
More than five years	**50.3**	**16.8**	46.2	14.2
Total wholesale funding	**298.0**	**100.0**	325.5	100.0

TERM ISSUANCE

The stabilisation of the term wholesale markets observed in the first quarter of 2010 and the continued functioning of these markets throughout the year, despite the European Sovereign credit concerns, enabled the Group to outperform its term issuance plan for 2010. The Group has taken advantage of the improved market sentiment by successfully accessing a number of markets, both secured and unsecured. The table below summarises the Group's term issuance during 2010. Exceeding term funding plans in 2010 contributed to the acceleration in repaying Government and central bank facilities during the year.

TABLE 1.23: **ANALYSIS OF 2010 TERM ISSUANCE**

	Sterling £bn	US Dollar £bn	Euro £bn	Other currencies £bn	Total £bn
Securitisation	**3.5**	**5.2**	**2.1**	**0.7**	**11.5**
Medium-term notes	**1.1**	**3.7**	**2.7**	**2.2**	**9.7**
Covered bonds	**–**	**–**	**3.7**	**–**	**3.7**
Subordinated liabilities	**0.7**	**2.5**	**1.3**	**–**	**4.5**
Private placements[1]	**4.6**	**4.6**	**10.6**	**0.8**	**20.6**
Total Issuance	**9.9**	**16.0**	**20.4**	**3.7**	**50.0**

[1] Private placements include structured bonds and term repurchase agreements (repos).

LIQUIDITY PORTFOLIO

The table below illustrates the Group's holding of highly liquid unencumbered assets. This liquidity is available for deployment at immediate notice, subject to complying with regulatory requirements, and is a key component of the Group's liquidity management process.

TABLE 1.24: **LIQUIDITY PORTFOLIO**

As at 31 December	2010 £bn	2009 £bn
Primary liquidity[1]	**97.5**	88.4
Secondary liquidity[2]	**62.4**	62.4
Total	**159.9**	150.8

[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).

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AUDITED INFORMATION

Following the introduction of the FSA's Individual Liquidity Guidance under ILAS, the Group now manages its liquidity position as a coverage ratio (proportion of stressed outflows covered by primary liquid assets) rather than by reference to a quantum of liquid assets; the liquidity position reflects a buffer over the regulatory minimum. The Group receives no recognition under ILAS for assets held for secondary liquidity purposes.

The following tables reconcile figures reported on page 96.

TABLE 1.25: **RECONCILIATION OF GROUP FUNDING FIGURE FROM TABLE 1.21 TO THE BALANCE SHEET**

As at 31 December 2010	Included in funding analysis (above) £bn	Repos £bn	Fair value and other accounting methods £bn	Balance Sheet £bn
Deposits from banks	**26.4**	**24.0**	**–**	**50.4**
Debt securities in issue	**233.7**	**–**	**(4.8)**	**228.9**
Subordinated liabilities	**37.9**	**–**	**(1.7)**	**36.2**
Total wholesale funding	**298.0**	**24.0**		
Customer deposits	**382.5**	**11.1**	**–**	**393.6**
Total	**680.5**	**35.1**		

As at 31 December 2009	Included in funding analysis (above) £bn	Repos £bn	Fair value and other accounting methods £bn	Balance Sheet £bn
Deposits from banks	48.6	27.6	6.3	82.5
Debt securities in issue	239.5	–	(6.0)	233.5
Subordinated liabilities	37.4	–	(2.7)	34.7
Total wholesale funding	325.5	27.6		
Customer deposits	371.2	35.5		406.7
Total	696.7	63.1		

CAPITAL RISK

DEFINITION

Capital risk is defined as the risk of the Group having a sub-optimal amount or quality of capital or that capital is inefficiently deployed across the Group.

RISK APPETITE

Capital risk appetite is set by the Board and reported through various metrics that enable the Group to manage capital constraints and market expectations. The Group Chief Executive, assisted by the Group Asset and Liability Committee, regularly reviews performance against risk appetite. A key metric is the Group's core tier 1 capital ratio. The Group's target for this and other aspects of appetite will be reviewed in 2011 in the light of further clarity of regulatory and accounting reforms.

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 maintaining sufficient capital resources to prevent such exposures whilst 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 non-controlling interests, after deducting goodwill, other intangible assets and 50 per cent of the net excess of expected loss over accounting provisions and certain securitisation positions. Accounting equity is adjusted in accordance with FSA requirements, particularly in respect of pensions and Available-for-Sale assets. Tier 1 capital, as defined by the European Community Banking Consolidation Directive as implemented in the UK by the FSA's General Prudential Sourcebook (GENPRU), is core tier 1 capital plus tier 1 capital securities. 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 and the non-financial entities that are held by our private equity (including venture capital) 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 minimum total capital required under pillar 1 of the Basel II framework is the Capital Resources Requirement (CRR) calculated as 8 per cent of risk weighted assets.

In order to address the requirements of pillar 2 of the Basel II framework, the FSA currently sets additional minimum requirements through the issuance of Individual Capital Guidance (ICG) for each UK bank calibrated by reference to the CRR. A key input into the FSA's ICG setting process is each bank's Internal Capital Adequacy Assessment Process. The Group has been given an ICG by the FSA and the Group maintains a buffer in addition to this requirement. The FSA has made

it clear that ICG remains a confidential matter between each bank and the FSA.

In addition to the minimum requirements for total capital, the FSA has made statements to explain it also operates a framework of targets and expected buffers for core tier 1 and tier 1.

The Group seeks to ensure that the regulatory minimum requirements are met at all times and undertakes an extensive series of stress analyses during the year to determine the adequacy of the Group's capital resources against the FSA minimum requirements in severe economic conditions.

During 2010 the Basel Committee on Banking Supervision has substantially refined the details of the so called 'Basel III' reforms for an enhanced global capital accord. These include increased minimum levels of and quality standards for capital, increased risk weighting of assets, and the introduction of a minimum leverage ratio, as well as the timing and transitional arrangements for implementation. The final details are still to be clarified, particularly as the reforms are implemented within the European and UK regulations, which may include a countercyclical buffer, requiring higher levels of capital to be held at certain points of the economic cycle, and higher capital requirements for systemically important financial institutions.

The effect of the Basel III reforms is uncertain as much will depend on business performance and mitigating actions that can be completed, even before the transition period comes in to effect. However lower risk weighted assets are expected from the planned reduction in the non-core balance sheet. Analysis suggests that with no mitigating actions the reforms will reduce the Group's core tier 1 ratio by approximately 1.2 per cent in 2013. The additional impact in 2014 of deducting the equity investment in insurance in excess of 10 per cent, transitioning in at 20 per cent per annum from 1 January 2014, would be around 0.3 per cent were the Group to take no further action to mitigate this. The Group is confident that it is well positioned to maintain a strong capital position, meeting all regulatory requirements as currently formulated.

MITIGATION

The Group has developed procedures 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 accumulate additional capital through profit retention, by raising equity via, for example, a rights issue or debt exchange and by raising tier 1 and tier 2 capital by issuing subordinated liabilities. The cost and availability of additional capital is dependent upon market conditions and perceptions at the time.

The Group has in issue as part of tier 2 capital resources, enhanced capital notes 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.

Additional measures which have been used to manage the Group's capital position include seeking to strike an appropriate balance of capital held within its insurance and banking subsidiaries and through improving the quality of its capital through liability management exercises. Regulatory requirements are primarily controlled through the quality and volume of lending but are also affected through the modelling approaches used to determine risk weighted assets and expected losses.

MONITORING

Capital is actively managed and regulatory ratios are a key factor in the Group's budgeting and planning processes. 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, including those that would occur under stressed scenarios, is made to the Senior Asset and Liability Committee, the Group Asset and Liability Committee and the Board.

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TABLE 1.26: CAPITAL RESOURCES

As at 31 December	2010 £m	2009[1] £m
Core tier 1		
Ordinary share capital and reserves	**46,879**	44,275
Regulatory post-retirement benefit adjustments	**(1,052)**	434
Available-for-sale revaluation reserve	**285**	783
Cash flow hedging reserve	**391**	305
Other items	**306**	231
	46,809	46,028
Less deductions from core tier 1		
Goodwill and other intangible assets	**(5,224)**	(5,779)
Other deductions	**(214)**	(445)
Core tier 1 capital (audited)	**41,371**	39,804
Perpetual non-cumulative preference shares		
Preference share capital[2]	**1,507**	2,639
Innovative tier 1 capital instruments		
Preferred securities[2]	**4,338**	4,956
Deductions from tier 1		
Other deductions	**(69)**	–
Total tier 1 capital (audited)	**47,147**	47,399
Tier 2		
Available-for-sale revaluation reserve in respect of equities	**462**	221
Undated subordinated debt	**1,968**	2,575
Eligible provisions	**2,468**	2,694
Dated subordinated debt	**23,167**	20,068
Less: deductions from tier 2		
Other deductions	**(283)**	(445)
Total tier 2 capital (audited)	**27,782**	25,113
Supervisory deductions		
Unconsolidated investments – life	**(10,042)**	(10,015)
Unconsolidated investments – general insurance and other	**(3,070)**	(1,551)
Total supervisory deductions	**(13,112)**	(11,566)
Total capital resources (audited)	**61,817**	60,946
Risk-weighted assets (unaudited)	**406,372**	493,307
Ratios (unaudited)		
Core tier 1 ratio	**10.2%**	8.1%
Tier 1 capital ratio	**11.6%**	9.6%
Total capital ratio	**15.2%**	12.4%

[1] Restated to reflect a prior year adjustment to Available-for-Sale revaluation reserves (see note 1 to the financial statements on page 153).

[2] Covered by grandfathering provisions issued by FSA.

TIER 1 CAPITAL

Core tier 1 capital increased by £1,567 million largely reflecting the issue of ordinary shares in exchange for certain preference shares, preferred securities and undated subordinated debt issued by the Group. This has been partially offset by a deduction in respect of post-retirement benefits reflecting the impact of the curtailment gain, which is not allowed for capital purposes and a commitment to make increased deficit contributions to the HBOS final salary pension scheme following the completion of an actuarial valuation.

Tier 1 capital has decreased by £252 million over the year. The increase in core tier 1 capital was more than offset by the redemption of the preference shares and preferred securities as part of the liability management exercises referred to above.

TABLE 1.27: **MOVEMENTS IN CORE TIER 1 AND TIER 1 CAPITAL DURING THE YEAR**

	Core tier 1 £m	Tier 1 £m
At 31 December 2009	39,804	47,399
Loss attributable to ordinary shareholders	**(320)**	**(320)**
Issue of ordinary shares	**2,237**	**2,237**
Increase in regulatory post-retirement benefit adjustments	**(1,486)**	**(1,486)**
Redemption of preference shares and preferred securities	**–**	**(1,869)**
Decrease in goodwill, intangible assets and other deductions	**786**	**717**
Other movements	**350**	**469**
At 31 December 2010	**41,371**	**47,147**

TIER 2 CAPITAL

Tier 2 capital has increased principally as a result of new issues of tier 2 debt and favourable foreign exchange rate movements partially offset by the redemption of undated subordinated debt described above, amortisation for regulatory purposes of dated subordinated debt and lower eligible provisions.

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, together with the general insurance business. Supervisory deductions relating to these businesses have benefitted from repatriation of capital during the year. Also included within deductions for other unconsolidated investments at 31 December 2010 are investments in non-financial entities that are held by our private equity (including venture capital) businesses. These investments were previously risk weighted in accordance with industry wide guidance provided by the FSA. This guidance has now expired.

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RISK WEIGHTED ASSETS

The following table sets out the Group's risk weighted assets that primarily arise in its banking businesses.

TABLE 1.28: **ANALYSIS OF RISK WEIGHTED ASSETS**

As at 31 December	2010 £m	2009 £m
Divisional analysis of risk weighted assets		
Retail	**109,254**	128,592
Wholesale	**222,716**	285,951
Wealth and International	**58,714**	63,249
Group Operations and Central items	**15,688**	15,515
	406,372	493,307
Risk type analysis of risk weighted assets		
Advanced IRB	**–**	92,076
Foundation IRB	**114,490**	67,621
Retail IRB	**105,475**	124,503
Other IRB	**14,483**	22,418
Advanced Approach	**234,448**	306,618
Standardised Approach	**124,492**	145,486
Credit risk	**358,940**	452,104
Operational risk	**31,650**	25,339
Market and counterparty risk	**15,782**	15,864
Total risk weighted assets	**406,372**	493,307

Risk weighted assets decreased by £86,935 million to £406,372 million. This reflects balance sheet reductions across all banking divisions, a revised assessment of Retail secured lending risk weighted assets following improvements in the economic outlook and changes introduced as a result of continuing the process of integrating the two heritage organisations' regulatory capital approaches which have impacted particularly on Wholesale.

The FSA has issued the Group an integrated waiver direction effective from 31 December 2010. The principal changes resulting from this are to move the heritage HBOS non-retail Advanced IRB portfolios to a Foundation IRB approach. All material retail portfolios across the Group remain on Retail IRB. In anticipation of moving to The Standardised Approach (TSA) for measurement of operational risk, the Group has calculated operational risk weighted assets on the basis of TSA.

The Group has adopted Foundation IRB as the interim capital calculation approach for all non-retail exposures in Wholesale and Wealth and International. The Group has adopted the Lloyds TSB relationship model and risk appetite and many of its risk management models and methodologies and as such, believe that converging on Foundation IRB will facilitate integration work. This change has resulted in a reduction in risk weighted assets of approximately £23 billion.

TABLE 1.29: **ANALYSIS OF CAPITAL RATIOS**

As at 31 December	Lloyds TSB Bank Group		BOS Group	
	2010 £m	2009[1] £m	2010 £m	2009[1] £m
Tier 1	**49,375**	18,153	**21,470**	23,988
Tier 2	**21,073**	7,700	**15,002**	14,112
Supervisory deductions	**(13,112)**	(5,182)	**(1,672)**	(1,062)
Total capital	**57,336**	20,671	**34,800**	37,038
RWAs	**406,372**	174,472	**250,598**	322,866
Ratios				
Core tier 1	**10.5%**	7.0%	**8.3%**	7.0%
Tier 1	**12.2%**	10.4%	**8.6%**	7.4%
Total capital	**14.1%**	11.8%	**13.9%**	11.5%

[1] Restated to reflect a prior year adjustment to Available-for-Sale revaluation reserves (see note 1 to the financial statements on page 153).

Capital is managed at Group level and surplus capital is retained, where possible, at Lloyds Banking Group holding company level as this provides the Group with maximum flexibility on how to deploy its capital.

Capital ratios for Lloyds TSB Bank Group reflect a change in shareholding completed during the year whereby HBOS plc and its subsidiaries are now subsidiaries of Lloyds TSB Bank plc. Capital ratios of both Lloyds TSB Bank Group and BOS Group have improved during the year primarily due to reductions in risk weighted assets.

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 accurate 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, prudential regulatory and tax reporting or publicly disclosed information.

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 to enable the preparation and disclosure of financial, prudential regulatory and tax reporting in accordance with applicable 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, 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 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 is undertaken. The Group 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

The business transacted by the life insurance companies within the Group comprises unit-linked business, non profit business and with-profits business. Several companies transact either unit-linked and/or non-profit business, but Scottish Widows plc (Scottish Widows) and Clerical Medical Investment Group Limited (Clerical Medical) hold the only large With Profit Funds managed by the 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.

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. If the market is not active, the Group establishes a fair value by using valuation techniques. 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.

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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 Resilience Capital Requirement). The regulatory capital requirement is deducted from the available capital resources to give 'statutory excess capital'.

For Scottish Widows and Clerical Medical, no Resilience Capital Requirement is required. However, a further test is required in respect of the With Profit Funds. This involves comparing the statutory basis of assessment with a realistic basis of assessment as described below.

'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 fact that assumptions are best-estimate as opposed to prudent. This realistic valuation is an assessment of the financial position of a With Profit Fund calculated under a methodology prescribed by the FSA.

The valuation of with-profits assets in a With Profit Fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in a With Profit 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. In addition, the realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

The realistic valuation of liabilities includes an allowance for future bonuses. Options and guarantees are valued using a stochastic simulation model which values these 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 107.

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 Risk Capital Margin). In circumstances where the 'realistic excess capital' position is less than the 'statutory excess capital', the company is required to hold additional capital to cover the shortfall. Any additional capital requirement under this test is referred to as the With Profit Insurance Capital Component.

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 may include charges on policies where the associated costs are borne by the Non Profit Fund. The With Profit 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 based on management's current expectations pending completion of the annual financial returns to the FSA. The figures allow for a transfer of £150 million and an anticipated transfer of £260 million from the UK non-profit funds to the UK life shareholder funds. They also allow for a transfer of £115 million from the UK non-profit funds to the Scottish Widows With Profit Fund relating to closure under the Scottish Widows' demutualisation scheme of an account in respect of unclaimed compensation payments. Within the With Profit Fund the £115 million transfer is fully offset by an increase in liabilities. An equal liability is released from the holding company of Scottish Widows plc leading to a broadly neutral impact on the Group's net assets.

TABLE 1.30: **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 2010 (statutory basis)						
Shareholders' funds:						
Held outside the long-term funds	–	–	–	1,414	721	2,135
Held within the long-term funds	–	–	8,029	–	401	8,430
Total shareholders' funds	–	–	8,029	1,414	1,122	10,565
Adjustments onto a regulatory basis:						
Unallocated surplus within insurance business	322	321	–	–	–	643
Value of in-force business	–	–	(6,172)	–	(843)	(7,015)
Other differences between IFRS and regulatory valuation of assets and liabilities	–	–	625	(919)	111	(183)
Estimated share of 'realistic' liabilities consistent with the FSA reporting treatment	(409)	(58)	–	–	–	(467)
Qualifying loan capital	–	–	–	1,991	–	1,991
Support arrangement assets	344	–	(344)	–	–	–
Available capital resources	257	263	2,138	2,486	390	5,534

	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 (statutory basis)						
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

Available capital resources for With-Profit Funds are presented in the table on a 'realistic' basis as this is more onerous than on a regulatory basis.

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. No such arrangement exists for Clerical Medical.

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 2010, the estimated value of surplus admissible assets in the Non-Participating Fund was £1,693 million (31 December 2009: £1,627 million) and the estimated value of the Support Account was £197 million (31 December 2009: £222 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 2010, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £4,322 million (31 December 2009: £3,823 million) and the estimated combined value of the Support Account and Further Support Account was £2,446 million (31 December 2009: £2,495 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 2010 is £147 million (31 December 2009: £132 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.

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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 according 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 on traditional with-profits business. 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.

MOVEMENTS IN REGULATORY CAPITAL

The movements in the Group's available capital resources in the life business can be analysed as follows:

TABLE 1.31: **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 2009	257	732	2,397	2,059	371	5,816
Changes in estimations and in demographic assumptions used to measure life assurance liabilities	**(2)**	**2**	**(40)**	**11**	**64**	**35**
Dividends and capital transactions	**–**	**–**	**(534)**	**377**	**(44)**	**(201)**
Change in support arrangements	**(10)**	**–**	**10**	**–**	**–**	**–**
New business and other factors	**12**	**(471)**	**305**	**39**	**(1)**	**(116)**
As at 31 December 2010	**257**	**263**	**2,138**	**2,486**	**390**	**5,534**

WITH PROFITS FUNDS

Available capital in the Scottish Widows With Profit Fund at 31 December 2010 is unchanged from 31 December 2009 at an estimated £257 million.

Available capital in the Clerical Medical With Profit Fund has decreased from £732 million at 31 December 2009 to an estimated £263 million at 31 December 2010. The fund commenced a distribution of the excess estate from 1 February 2010 by enhancing the level of future expected benefit payments

UK NON PROFIT FUNDS

Available capital in the UK Non Profit Funds has decreased from £2,397 million at 31 December 2009 to an estimated £2,138 million at 31 December 2010. Increases in available capital from new business were offset by changes in assumptions and proposed transfers to the UK Life Shareholder Funds. A transfer to the Scottish Widows With Profit Fund also resulted in a decrease of £115 million in available capital.

UK LIFE SHAREHOLDER FUNDS

Available capital in the UK Life Shareholder Funds has increased from £2,059 million at 31 December 2009 to an estimated £2,486 million at 31 December 2010. The receipt of £410 million proposed transfers from the UK Non Profit Fund and the £176 million impact of a capital restructuring exercise in the Scottish Widows Group to help mitigate the potential impacts of Basel III have been partially offset by the payment of coupons on subordinated debt and a dividend of £210 million from Scottish Widows plc to its parent company.

OVERSEAS LIFE BUSINESS

Available capital has increased over 2010 due to profits emerging on the in force business partially offset by new business strain.

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.

TABLE 1.32: **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 2010					
With Profit Fund liabilities	**13,845**	**10,394**	**5**	**–**	**24,244**
Unit-linked business (excluding that accounted for as non-participating investment contracts)	**–**	**–**	**38,641**	**8,011**	**46,652**
Other life insurance business	**–**	**–**	**8,527**	**90**	**8,617**
Insurance and participating investment contract liabilities	**13,845**	**10,394**	**47,173**	**8,101**	**79,513**
Non-participating investment contract liabilities	**–**	**–**	**47,058**	**4,304**	**51,362**
Total policyholder liabilities	**13,845**	**10,394**	**94,231**	**12,405**	**130,875**

	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

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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. Various hedging strategies are used to manage these exposures.

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 reduce 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 reserves are invested predominantly in cash and cash like instruments. The investment strategy is determined in line with the policy of Lloyds Banking Group to minimise both the profit volatility and 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 2010 of £1.8 billion (2009: £1.6 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 both the Clerical Medical and Scottish Widows 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 2010, the 10 year equity-implied at-the-money assumption was set at 26.1 per cent (31 December 2009: 26.6 per cent). The assumption for property volatility was 15 per cent (31 December 2009: 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 2009: 15 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

A number of typical guarantees are provided outside the With Profit Funds such as guaranteed payments on death (e.g. Term assurance) or guaranteed income for life (e.g. annuities). In addition, certain personal pension policyholders in Scottish Widows, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £57 million (31 December 2009: £64 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 £10 million.

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BOARD OF DIRECTORS

NON-EXECUTIVE DIRECTORS

Sir Winfried Bischoff
NG Re Ri
Chairman

Joined the Board and was appointed Chairman in 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 in 1984 and Chairman in 1995. Following the acquisition of Schroders' investment banking business by Citigroup in 2000, 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. He is a member of the National Advisory Board of UK Career Academy Foundation (Chairman until October 2010) and a member of the Akbank International Advisory Board. Chairman of the Advisory Council of TheCityUK. Aged 69.

Lord Leitch
A NG Re
Deputy Chairman
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. Chancellor of Carnegie College. Former Chairman of the National Employment Panel and of the ABI. Aged 63.

Anita M Frew
A Ri
Independent Director

Joined the Board on 1 December 2010. Chairman of Victrex, the FTSE 250 global manufacturer of high performance polymers, having previously been the Senior Independent Director. Since 2000, she has held a portfolio of Non-Executive Directorships, currently holding positions as Senior Non-Executive Director of Aberdeen Asset Management and as Non-Executive Director of IMI and Northumbrian Water. Prior to this she was Executive Director of Abbott Mead Vickers, Director of Corporate Development at WPP Group, and has held various investment and marketing roles at Scottish Provident and the Royal Bank of Scotland. Aged 53.

Sir Julian Horn-Smith
NG Re Ri
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 adviser to UBS and CVC Capital Partners in relation to the global telecommunications sector. Deputy Chairman of Vallar plc. Pro Vice-Chancellor of University of Bath. A former Chairman of The Sage Group. Aged 62.

Glen R Moreno
NG
Senior Independent Director

Joined the Board on 1 March 2010. Chairman of Pearson, the media group, since October 2005. A Director of Fidelity International, one of the world's largest fund management companies, and Chairman of its Audit Committee. Deputy Chairman of The Financial Reporting Council. From 1987 to 1991 was Chief Executive of Fidelity International. Until mid 2009, was a Non-Executive Director and Senior Independent Director of Man Group, the FTSE 100 financial services group, and acting Chairman of UKFI. Former Group Executive of Citigroup from 1969 to 1987 and he held a number of senior positions at the bank in Europe and Asia. Aged 67.

David L Roberts
A NG Ri Re
Independent Director

Joined the Board on 1 March 2010. Executive Director, member of the Group Executive Committee and Chief Executive, International Retail and Commercial Banking at Barclays until December 2006. Joined Barclays in 1983 and held various senior management positions, including Chief Executive, Personal Financial Services and Chief Executive, Business Banking. 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. Non-Executive Chairman of The Mind Gym. Aged 48.

T Timothy Ryan, Jr
A Re Ri
Independent Director

Joined the Board in 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 Supervison, US Department of the Treasury and Koram Bank and the International Foundation of Election Systems. Aged 65.

Martin A Scicluna
A NG Ri
Independent Director

Joined the Board in 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 60.

Anthony Watson CBE
A NG Re
Independent Director

Joined the Board in 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 and Lincoln's Inn Investment Committee. A former Chairman of MEPC, the Asian Infrastructure Fund and of the Strategic Investment Board (Northern Ireland) and a former member of the Financial Reporting Council. Aged 65.

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EXECUTIVE DIRECTORS

J Eric Daniels
Group Chief Executive
(Until 28 February 2011)

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. A Non-Executive Director of BT Group. Aged 59.

António Horta-Osório
Group Chief Executive
(From 1 March 2011)

Joined the Board on 17 January 2011 as an Executive Director and will become Group Chief Executive on 1 March 2011. Started his career at Citibank Portugal where he was head of capital markets. At the same time, was an assistant professor at Universidade Catolica Portuguesa. Then worked for Goldman Sachs in New York and London. In 1993, joined Grupo Santander as Chief Executive of Banco Santander de Negocios Portugal and then became Chief Executive Officer of Banco Santander Brazil. In 2000, became Chief Executive Officer of Santander Totta, and Chairman from 2006 until 2011, as well as Executive Vice President of Grupo Santander and a member of its Management Committee. He joined Santander UK, as a Non-Executive Director in November 2004 and from August 2006 until November 2010, was its Chief Executive. He is also a Non-Executive Director of the Court of the Bank of England until 28 February 2011. Aged 47.

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. ABI Board member (and former ABI Chairman, 2007-10). Member of TheCityUK Advisory Council and Scottish Government's Financial Services Advisory Board. Aged 58.

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 and AFME. Chairman of Arora Holdings and a Director of Business in the Community and a Director and Trustee of In Kind Direct. Aged 60.

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. A member of the British Bankers' Association and Chairman of its Audit Committee and Remuneration Committee. Fellow of the Institute of Chartered Accountants in England and Wales. Aged 48.

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 Council. 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 48.

Harry F Baines
Company Secretary

COMMITTEE ROLES AND RESPONSIBILITIES

A

Audit Committee
To monitor and review the formal arrangements established by the Board in respect of the financial statements and reporting of the Group; internal controls and the Risk Management Framework; internal audit; and the Group's relationship with its external auditors.

NG

Nomination & Governance Committee
To keep the Board's governance arrangements under review and make appropriate recommendations to the Board to ensure that the Company's arrangements are consistent with best practice corporate governance standards.

Re

Remuneration Committee
To set the principles and parameters of remuneration policy for the Group, and to oversee remuneration policy and outcomes for those colleagues covered by the scope of the Committee.

Ri

Risk Committee
To review and report its conclusions to the Board on the Group's risk appetite and Risk Management Framework. The Committee has a forward looking perspective, anticipating changes in business conditions.

● Chairman of Committee

DIRECTORS' REPORT

RESULTS

The consolidated income statement shows a loss attributable to equity shareholders for the year ended 31 December 2010 of £320 million.

PRINCIPAL ACTIVITIES, BUSINESS REVIEW, FUTURE DEVELOPMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company is a holding company and its subsidiary undertakings provide a wide range of banking and financial services through branches and offices in the UK and overseas. A review of the development and performance of the business during the financial year and an indication of the likely future developments are given on pages 3 to 108. Key performance indicators are shown on page 5. Information regarding the financial risk management objectives and internal control policies of the Company and its subsidiary undertakings in relation to the preparation of consolidated financial statements is given within the risk management report and corporate governance report respectively. Details of the Company's principal risks and uncertainties are set out on pages 70 to 108. The financial risk management objectives and internal control policies in relation to the use of financial instruments is given on pages 65 to 108 and in notes 55 and 56 on pages 240 to 265.

POST BALANCE SHEET EVENTS

Details are given in note 59 on page 270.

DIRECTORS

Biographical details of directors are shown on pages 110 and 111. Particulars of their emoluments and interests in shares in the Company are given on pages 124 to 141. Changes to the composition of the Board since 1 January 2010 are shown below:

Dr W C G Berndt retired from the Board on 6 May 2010. Mr G R Moreno and Mr D L Roberts joined the Board on 1 March 2010 and Ms A M Frew joined the Board on 1 December 2010. Mr A Horta-Osório joined the Board on 17 January 2011. Mr J E Daniels will retire from the Board on 28 February 2011 and will be succeeded as Group Chief Executive by Mr A Horta-Osório on 1 March 2011.

Ms A M Frew and Mr A Horta-Osório were appointed to the Board after the annual general meeting held in 2010 and will therefore stand for election at the forthcoming annual general meeting. Under the articles of association, Sir Julian Horn-Smith and Mr G T Tate are required to retire from the Board at the annual general meeting. However, in the interests of good corporate governance and in accordance with the provisions of the UK Corporate Governance Code, effective from 2012, the Board has decided that all of the directors will retire voluntarily and submit themselves for re-election at the annual general meeting.

DIRECTORS' CONFLICTS OF INTEREST

The Board, as permitted by the Company's articles of association, has authorised all potential conflicts of interest declared by individual directors. Decisions regarding these conflicts of interest could only be taken by directors who had no interest in the matter. In taking the decision, the directors acted in a way they considered, in good faith, would be most likely to promote the Company's success. The directors had the ability to impose conditions, if thought appropriate, when granting authorisation. Any authorities given will be reviewed at least every 15 months. No director is permitted to vote on any resolution or matter where he or she has an actual or potential conflict of interest. The Board confirms that it did not authorise any material conflicts during the year.

DIRECTORS' INDEMNITIES

The directors, including the former director who retired during the year, have entered into individual deeds of indemnity with the Company which constituted 'qualifying third party indemnity provisions' and 'qualifying pension scheme indemnity provisions' for the purposes of the Companies Act 2006. These deeds were in force during the whole of the financial year or from the date of appointment in respect of the directors who joined the Board in 2010 and 2011. The indemnities remain in force for the duration of a director's period of office. Deeds for existing directors are available for inspection at the Company's registered office.

CORPORATE GOVERNANCE REPORT

The corporate governance report can be found on pages 114 to 123 and forms part of this directors' report.

SHARE CAPITAL

Information about share capital is shown in note 47 on pages 222 to 224.

CHANGE OF CONTROL

The Company is party to significant contracts that are subject to change of control provisions in the event of a takeover bid.

In addition, the Company is party to a deed of covenant with each of the four Lloyds TSB Foundations (the 'Foundations') which hold limited voting shares in the Company (the limited voting shares are further described in note 47 on page 224). Under the terms of the deeds of covenant, the Company makes an annual payment to each of the Foundations. In the event of a successful offer for more than 50 per cent of the issued ordinary share capital of the Company, each limited voting share would convert to an ordinary share under the terms of the Company's articles of association. The payment obligation under the deeds of covenant would come to an end one year following the conversion of the limited voting shares.

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GOING CONCERN

The going concern of the Company and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the directors have considered a number of key dependencies which are set out in the risk management section under Principal Risks: Liquidity and Funding on page 72 and Financial Soundness on pages 93 to 102 and additionally have considered projections for the Group's capital and funding position. Having considered these, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

EMPLOYEES

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

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

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

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

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

DONATIONS

The income statement includes a charge for charitable donations totalling £30,750,000 in 2010 (2009: £33,477,000), including £28,228,000 (2009: £28,228,000) which will be paid under the deeds of covenant to the four Lloyds TSB Foundations during 2011.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

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

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

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 2006, is 44. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2010 bears to the aggregate of the amounts invoiced by suppliers during the year.

DIRECTORS' RESPONSIBILITY STATEMENT

Each of the directors, whose names and functions are listed on pages 110 and 111 of this annual report, confirm that, to the best of his or her knowledge:

- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and Group; and
- the management report contained in the Business Review includes a fair review of the development and performance of the business and the position of the Company and Group, together with a description of the principal risks and uncertainties that they face.

AUDITORS AND AUDIT INFORMATION

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

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditors and authorising the Audit Committee to set their remuneration will be proposed at the annual general meeting.

On behalf of the Board

Harry F Baines
Company Secretary
24 February 2011

Company number 95000

CORPORATE GOVERNANCE REPORT

A PERSONAL STATEMENT FROM SIR WINFRIED BISCHOFF

Rebuilding trust in financial institutions generally is central also to achieving our aim of being recognised as the UK's best bank. We are judged on how we do business, and how we respond to our stakeholders' issues and needs. In particular, we are judged on the effectiveness of our decision making.

We understand the reliance that investors, customers and other stakeholders place on our corporate governance arrangements and the need to ensure the integrity of those processes. At the same time, I am aware from discussions with shareholders that there is a strong desire to understand more about the Board's thinking in this area, not just the end result. By way of response, I want to use this statement to explain our approach to corporate governance and how we have ensured compliance with all the principles of the Financial Reporting Council's Combined Code (the Code), for our financial year ended 31 December 2010.

LEADERSHIP AND ACCOUNTABILITY

As Chairman of Lloyds Banking Group plc, a role that I am honoured to perform, I am responsible for leadership of the Board and for ensuring its effectiveness.

We operate a unitary Board with all Directors collectively responsible for the long term success of the Company. The Chairman ensures that Directors are kept advised of key developments, that they receive timely and relevant information and are involved in relevant decisions. It is expected that all Directors, but particularly the Non-Executive Directors, constructively challenge proposals that come to the Board for decision.

I meet regularly with the Non-Executive Directors without the Executive Directors being present, either in private sessions held following Board or Committee meetings or in separately arranged meetings. The Executive Directors are aware of such meetings through our Board calendar. At the same time, we have provision for the Non-Executive Directors to meet with the Group Chief Executive without the Chairman, so that there can be feedback both ways.

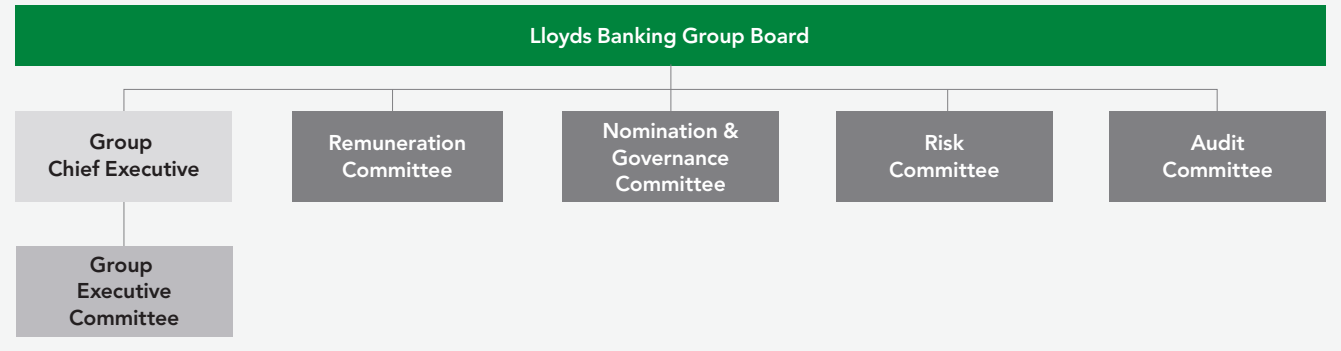
I have enjoyed a constructive relationship with Eric Daniels, our Group Chief Executive, and with the wider Board over the last 18 months. I look forward to a similar relationship with António Horta-Osório, our new Group Chief Executive, when he takes over on 1 March 2011.

A sound relationship between the Chairman and Group Chief Executive based on a mutual understanding of our respective responsibilities is essential to maintaining an open culture with the wider Board. The Group Chief Executive manages the business day to day which in my view is the number one priority for any company. The Chairman manages the Board. There are in addition many other areas which we in turn share or to which each one of us contributes in varying degree. Of course, responsibilities are clearly defined both in our terms of appointment and in the Board Governance Framework which sets out the respective roles and responsibilities of the Chairman, Group Chief Executive, Senior Independent Director and Non-Executive Directors.

The Board Governance Framework is the Board's operating manual and sets out the matters that the Board has reserved to itself, including the development and setting of strategy and long term objectives; approval of the medium term plan and financial budgets; capital and structure of capital; significant contracts and various statutory and regulatory approvals.

In addition to the matters that it reserves to itself, the Board delegates certain matters to its Committees. This delegation ensures that adequate time is devoted by Board members to the independent oversight of key controls.

All Committees act under terms of reference which are proposed by the Nomination & Governance Committee and then approved by the Board and reviewed regularly. During 2010, all terms of reference were reviewed and updated. Copies of the current terms of reference are available on our website, www.lloydsbankinggroup.com.



All Committees report to the Board through reports from Committee Chairmen with respect to each meeting. During 2010, the Chairman's Committee was disbanded. Matters previously delegated to the Chairman's Committee were either transferred to the Nomination & Governance Committee which reports to the Board, or a Board agenda review meeting. Further information on the membership, role and activities of each of the Committees during 2010 is detailed on pages 120 and 121.

All other matters, including responsibility for managing the business day to day, are delegated to the Group Chief Executive.

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Through the Executive Governance Framework approved by the Board, the Group Chief Executive reserves certain matters to himself and, subject to financial limits, delegates responsibilities to the Executive Directors and his other direct reports who collectively make up the Group Executive Committee.

The frameworks are reviewed by the Board at least annually. In 2010, a comprehensive review of both frameworks was undertaken to ensure that they remained appropriate for the enlarged group. Changes were made to ensure that the Board devotes the right amount of time and attention to key matters.

In 2010, we held a total of 17 Board meetings of which nine were scheduled at the start of the year. The much larger number of meetings than anticipated reflects the challenging environment in which we continue to operate and the need to keep the Board informed of developments in a timely manner.

Details of attendance at meetings are set out on page 119. When meetings are called at short notice, it is not always possible for all Directors to attend. As Chairman, it is my practice to seek to contact any Directors that are unable to attend to obtain their views before any decision is taken.

All Directors participate in the development of strategy. In addition to discussions at regular Board meetings, we held two strategy development sessions in 2010, one in April and the other in November. Each lasted two days. The time spent at these meetings not only enables the Board to devote time to its strategic priorities but also to foster closer working relationships between Board members.

EFFECTIVENESS

Since joining the Board in September 2009, one of my priorities has been to review the composition of the Board to ensure that the overall Board and Committee structure is appropriate for an organisation of the breadth and scale of Lloyds Banking Group.

I lead the review of the composition of the Board, which is a continuous process, through the Nomination & Governance Committee which I chair. The Nomination & Governance Committee makes recommendations to the Board on matters relating to Board membership and governance. Membership of the Nomination & Governance Committee at present comprises the Deputy Chairman, the Senior Independent Director, the Chairman of the Audit, Remuneration and Risk Committees and one other independent Non-Executive Director. The Group Chief Executive is normally asked to attend. This provides a broad perspective of views of the Board and its Committees. The role of the Nomination & Governance Committee is explained on pages 120 and 121 and its key areas of activity in 2010 are explained below.

BOARD COMPOSITION

In 2010, the Nomination & Governance Committee formulated a board composition policy statement which lays down the principles that are applied when reviewing Board composition. The policy has been adopted by the Board and covers matters such as:

Skills and experience

In reviewing composition, the Board aims to ensure that its membership represents a mix of backgrounds and experience that will enhance the quality of its deliberations and decisions. As part of our ongoing review, we identify specific skills that we look for in prospective new Directors, having regard to the skills of the Board overall at the time, and the need to address longer term succession and current business priorities. The annual Board evaluation is instrumental in identifying any new skills requirements, as well as possible shortcomings, gaps and inefficiencies. We conducted Board evaluations in 2009 and 2010 with the help of outside consultants.

All Directors are required to have good – and in most cases have deep – experience and understanding of the banking and financial services sector. The complexity of the Group means that broader skills are also required. Maintaining the right balance is an ongoing priority. The appointments of Glen Moreno and David Roberts in March 2010 enhanced the Board's collective banking skills with the majority of the Non-Executives, including myself, having substantial banking experience. This is complemented by the strong financial, accounting and commercial backgrounds of other Non-Executive Directors. The changes made to the Board during 2010 are explained in **Board Changes** below.

Diversity

The Board is keen to ensure that, subject to merit, its membership reflects diversity in the broadest sense including diversity of gender, ethnicity and background. Appointments made to the Board during 2010 reflect this policy. Further information is provided in **Board Changes** below.

As one of the founding Chairmen of The 30% Club, I am committed to improving the representation of women on UK corporate boards, including the goal of ensuring at least 30 per cent representation of women on boards by 2015. Chairmen, I believe, have an obligation to speed up the pace of change and to influence the board selection process to widen the talent pool for consideration. To do this, we need to champion diversity within our own organisations, and as part of that, develop our female talent and be prescriptive with search agencies to work towards an aspirational target for better female representation on boards.

Board size

Our aim is to ensure that the size of the Board is sufficient to reflect a broad range of views and perspectives whilst allowing all Directors to participate effectively in meetings. At year end, the Board comprised 14 directors which is within the range, albeit at the upper end, set by the Nomination & Governance Committee.

Mix of Independent and Executive Directors

Our Board's preference is to ensure a strong majority of independent directors. At year end, our Board comprised five Executive Directors, eight independent Non-Executive Directors and myself as Chairman. The Code requirement that at least half the Board should be independent Non-Executive Directors has been met throughout the year.

Independence

The Nomination & Governance Committee is responsible for assessing the independence of Non-Executive Directors on appointment and annually. It is satisfied that throughout the year, all Non-Executive Directors were independent as to both character and judgement.

In assessing independence, the Committee does not rely solely on the Code criteria but considers whether, in fact, the Non-Executive is demonstrably independent and free of relationships and other circumstances that could affect their judgement. It does this with reference to the individual performance and conduct in reaching decisions. It also takes account of any relationships that have been disclosed and authorised by the Board. In the view of the Nomination & Governance Committee, Glen Moreno, who was between January 2009 and August 2009 acting Chairman of United Kingdom Financial Investments which manages the Government's shareholding in the Group, continues to exercise his own and robustly independent judgement at all times.

Succession planning

This is a key aspect of our overall review of Board composition and is explained fully in **Succession Planning** below.

BOARD CHANGES

The Nomination & Governance Committee has overseen a number of changes to the Board during the year. For new Non-Executive Directors, the process was conducted by the Nomination & Governance Committee with the support of an executive search firm, JCA Group. The Group Chief Executive's succession process was managed by a special sub-committee; details of which are set out in **Group Chief Executive Succession**.

– Glen Moreno and David Roberts were appointed on 1 March 2010 specifically to enhance the Board's banking skills and expertise. Glen Moreno combines strong financial services and commercial experience gained in both an executive and non-executive capacity in the UK and internationally, while David Roberts' in-depth commercial and retail banking expertise complements the broader perspectives of other Non-Executives.

  The appointment of Glen Moreno presented an opportunity to separate the roles of Deputy Chairman and Senior Independent Director both previously carried out by Lord Leitch. With effect from 1 March 2010, Glen Moreno was appointed Senior Independent Director; Lord Leitch remains Deputy Chairman.

  As Senior Independent Director, Glen Moreno acts as the primary sounding board to me as Chairman and as an intermediary for other Non-Executive Directors. He is supported in this latter task by the Deputy Chairman. The Deputy Chairman is also Chairman of Scottish Widows Group, the UK's largest life insurance company and an important component of our Group.

– Anita Frew joined the Board on 1 December 2010. In March 2010, after strengthening the banking experience on the Board, it was agreed that there was a need for someone with a more diverse financial and commercial background. Anita's extensive experience of public companies across a range of sectors, including manufacturing as well as banking and asset management, has enhanced the diversity of perspectives on the Board.

– António Horta-Osório joined the Board as an Executive Director on 17 January 2011 and succeeds Eric Daniels as Group Chief Executive on 1 March 2011. The process leading to his appointment is explained in **Group Chief Executive Succession**.

In addition to the above appointments, the following retirements were announced in the year:

– Dr Wolfgang Berndt retired from the Board at the annual general meeting in May 2010. Dr Berndt joined the Board in 2003 and during his tenure made a significant contribution to the Group particularly in the areas of strategy and measurement of results. As Chairman of the Remuneration Committee, he advocated a constructive and open dialogue with shareholders. He was succeeded as Chairman of the Remuneration Committee by Anthony Watson.

– In September 2010, consistent with his contractual obligations and entitlements, Eric Daniels gave twelve months notice of his intention to retire as Group Chief Executive and director of Lloyds Banking Group plc (and principal subsidiaries). Eric Daniels will retire from the Board on 28 February 2011, but in line with his contractual obligations, he will remain an employee of the Company for the remainder of his notice period. Under this arrangement, I will be able to draw on his knowledge and experience of our operations and customers, and these skills will also be available to support the Group, where needed.

Biographies for all current directors can be found on pages 110 and 111.

ELECTION AND RE-ELECTION

Anita Frew and António Horta-Osório were appointed to the Board after the annual general meeting held in 2010 and will therefore stand for election at the forthcoming annual general meeting. Under the articles of association, Sir Julian Horn-Smith and Truett Tate are required to retire from the Board at the annual general meeting. However, in the interests of good corporate governance and in accordance with provisions of the UK Corporate Governance Code, effective from 2012, we have decided that all of the directors will retire voluntarily and submit themselves for re-election at the annual general meeting.

SUCCESSION PLANNING

The Nomination & Governance Committee oversees the Board's arrangements for the longer term succession of Board and Committee members.

Non-Executive succession planning

Non-Executive succession planning is addressed as part of our ongoing review of Board composition. Our policy takes account of the need regularly to refresh our intake of Non-Executives to bring new perspectives, to ensure appropriate representation on each of the Board's Committees and

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to plan for longer term succession. The average tenure of our Non-Executive Directors is nearly three years. Non-Executive Directors are currently appointed for three year terms. Following the move to annual re-election of Directors, Non-Executive Directors will in future be appointed on a rolling 12 months basis.

Group Chief Executive Succession

As Chairman, I am responsible for the succession arrangements relating to the Group Chief Executive, including process and the production of a plan. It is important to maintain a thorough understanding of the market to ensure that the plan is regularly reviewed and refreshed. If not already known to me, I take the time to get to know potential candidates so that I can assess their suitability for our Board.

In September 2010, immediately following the announcement of Eric Daniels' retirement, a subcommittee of the Board (the Succession Committee) was established under my Chairmanship to lead the search for a suitable successor. Other members of the Succession Committee were Lord Leitch (Deputy Chairman), Glen Moreno (Senior Independent Director) and Anthony Watson (Chairman of the Remuneration Committee), all independent Non-Executive Directors. The Succession Committee met at least once a week between September and November 2010 and was supported by the Group HR Director and the Head of Secretariat.

The Succession Committee's remit was to appoint a successor who would be capable of leading the Group to the next stage of its development. It was agreed that an extensive search should be conducted encompassing internal, external and international candidates. Given the profile, breadth and challenges of the role, together with the need to be able successfully to lead the Group in the next phase of its development, it was clear that an exceptional candidate was required.

The starting point for identification of suitable candidates was our Chief Executive Succession plan which included António Horta-Osório. We also considered other candidates, including one internal candidate.

In view of our succession plan, we did not appoint an executive search firm to assist with the search and selection process. The executive search firm, JCA Group, was involved in the process which enabled us to appoint our new Group Chief Executive. However I handled the approach to and the appointment of, António Horta-Osório in conjunction with the Succession Committee.

António Horta-Osório stood out in an excellent short list. His skills closely match the role specification agreed by the Succession Committee including:

– strong retail and commercial banking experience gained in the UK and internationally, including experience at chief executive officer level, of running large scale, multi-product, multi-brand businesses;

– a proven track record of successful integration of retail banks in the UK and in Europe as part of a multi-jurisdictional, multi-brand organisation;

– strong understanding of the operational and regulatory environment in which banks operate both in the UK and globally, including a deep understanding of capital and liquidity management and the potential impacts of global regulatory change initiatives;

– the ability to foster a culture of fairness for customers, shareholders and colleagues; and

– the ability to provide leadership and strategic direction, to deliver growth in tough market conditions.

Following an intensive interview process and extensive due diligence, António Horta-Osório was named as our new Group Chief Executive in November 2010.

Executive Directors and senior executives

The Nomination & Governance Committee and the Board are responsible for oversight of the process for succession and management development of the most senior executives both at and below Board level, including Executive Directors and members of the Group Executive Committee. The primary responsibility for this, however, rests with the Group Chief Executive. Arrangements are reviewed at least annually with the latest review taking place in June 2010.

THE WALKER REVIEW

In November 2009, Sir David Walker published his '*Review of corporate governance in UK banks and other financial industry entities*' (the Walker Review). The Nomination & Governance Committee was responsible for overseeing the Group's implementation of the Walker Review recommendations. Although not yet fully in force, the Group has agreed to adopt those recommendations that did not require further clarification or regulatory pronouncement including with respect to the annual re-election of all Directors. A review of Board procedures was undertaken including:

Directors' induction

All Directors are expected to make an informed contribution based on an understanding of the Group's business model and the key challenges facing the Group and its businesses. To ensure they can contribute from an early stage, they undergo an extensive induction on appointment.

Early in 2010, the Board reviewed and refreshed its induction programme to meet the Walker Review recommendation of a formal, substantive and personalised induction. All Directors appointed during 2010 have undertaken a three stage induction process comprising:

– a corporate induction, which provides an overview of the Group, its strategy, operational structures and main business activities;

– governance and Directors' responsibilities, which explains the role and statutory duties of a Non-Executive Director including the roles and responsibilities owed by banks and other financial services firms to the FSA and other regulatory bodies; and

– a bespoke induction plan prepared in consultation with me, tailored to the individual needs of the Director, to the specific role that they will carry out, and their skills/experience to date.

Board training

The Board receives regular refresher training and information sessions to address current business or emerging issues. During 2010, Non-Executives undertook approximately five days of training, including 12 hours of structured training during Board meetings. This is delivered through a variety of means, including sessions on matters such as liquidity and funding, stress testing, living wills, the Bribery Act and special Board sessions covering matters such as the Individual Capital Adequacy Assessment Process and training for Approved Persons. In addition, the Audit Committee arranged a series of 'deep dives' to which all Board members were invited, and which provided an in-depth review of the operations of each of the business divisions and of the latest accounting standards and operating methodologies. Half day sessions were delivered for each division amounting to three days in total.

Time commitments

The Nomination & Governance Committee reviewed and formalised the expected time commitments for Non-Executive Directors. The review laid down the expected time commitment for the Board, Committees and special responsibilities, eg Senior Independent Director, based on scheduled meetings only.

In 2010, as in 2009, the time commitment demanded of all Non-Executive Directors was considerable and substantially in excess of the time envisaged in their terms of appointment. There has been no adjustment to fees to reflect the increased workload since January 2008. I am grateful to our Non-Executives for the considerable personal contribution that they make to our Board and for accommodating the additional demands, often at short notice and at unsociable hours.

BOARD EVALUATION AND PERFORMANCE

The Nomination & Governance Committee recommended to the Board that, as in 2009, the 2010 evaluation should again be facilitated externally. Given the number of new entrants to this market, we agreed that we should explore the range of services available. Following a tender process and interviews, Dr Tracy Long of Boardroom Review was appointed to conduct the 2010 process. Boardroom Review has no other relationship with the Company.

The review was conducted between October 2010 and February 2011 through confidential interviews with all Board directors and the Company Secretary, observation of a Board meeting and a review of selected papers. The review was designed to be forward looking, assessing the quality of the Board's decision making and debate, and its overall contribution to, and impact on, the long term health and success of the business. The review identified the strengths of the Board and its Committees and highlighted areas for the Board to work on in order to prepare for future challenges. The Board evaluation also provides feedback on the individual performance of Directors which informs a general assessment and my assessment which is used for individual feedback.

As Senior Independent Director, Glen Moreno leads the review of my performance with the Board and provides feedback in a face-to-face meeting.

REMUNERATION

The Remuneration Committee, chaired by Anthony Watson, is responsible for overseeing the Group's remuneration arrangements and compliance with the FSA's Remuneration Code. The Remuneration Committee's terms of reference were amended in 2010 to address the recommendation of the Walker Review and, more recently, the FSA Remuneration Code, that performance related pay should be more closely aligned to the long term interests of the Company and its risk management systems. The Remuneration Committee's terms of reference are available on our website, www.lloydsbankinggroup.com.

An overview of the Remuneration Committee is set out on pages 120 and 121. The work of the Remuneration Committee is explained in the Directors' remuneration report on pages 124 to 141.

SHAREHOLDER ENGAGEMENT

The Board recognises the importance of promoting mutual understanding between the Company and its shareholders through greater engagement. In 2010, there was regular dialogue with institutional shareholders with more than 300 equity investor meetings undertaken in the year. Many of these meetings were undertaken by senior management (primarily the Group Chief Executive and Group Finance Director) or Board members. As Chairman, I have attended a number of meetings with shareholders to discuss governance and strategic direction. Anthony Watson, as Chairman of the Remuneration Committee, regularly meets our larger shareholders to discuss executive remuneration issues while Glen Moreno, the Senior Independent Director, separately meets with a range of major shareholders.

The Board is kept advised of the views of major shareholders by means of regular updates at Board and Committee meetings. It also receives monthly reports on market and investor sentiment and shareholder analysis.

Investor Relations has primary responsibility for managing day-to-day communications with institutional shareholders. Supported by the Group Chief Executive and Group Finance Director, they achieve this through a combination of briefings to analysts and institutional shareholders (both at results briefings and throughout the year), as well as site visits and individual discussions with institutional shareholders.

The Company Secretary oversees communications with private shareholders. The Group's annual general meeting provides an opportunity to meet the Group's Directors and to hear more about the strategy of the Group. Shareholders are encouraged to attend the annual general meeting and to raise any questions at the meeting or in advance, using the email address shown in the pack which will be sent to shareholders in March 2011.

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Scottish Widows Investment Partnership, one of Europe's largest asset managers and a Group company, complies with the principles of the Financial Reporting Council's Stewardship Code, published in July 2010. Details of Scottish Widows Investment Partnership's approach to stewardship and corporate governance can be found on its website, www.swip.com.

In conclusion, I am pleased to confirm that the Group complied with all relevant provisions of the Code throughout the year ending 31 December 2010. As an early adopter of several of the recommendations contained in the Walker Review, I believe the Group is well placed to comply with new provisions contained in the UK Corporate Governance Code which will apply to future reports, and to benefit thereby.

Sir Winfried Bischoff
Chairman

ATTENDANCE AT MEETINGS

The attendance of directors at Board meetings and at meetings of the Audit, Nomination & Governance, Remuneration and Risk Committees of which they were members during 2010 are shown in the table. Some Directors attended relevant Committee meetings as attendees periodically throughout the year, which are not shown below. In addition, the Audit Committee arranged six half day 'deep dive' meetings during 2010 which were open to and attended by other members of the Board.

	Board meetings			Audit Committee		Nomination & Governance Committee		Remuneration Committee		Risk Committee
	Regular	Ad hoc	Total	Regular	Ad hoc	Regular	Ad hoc	Regular	Ad hoc	Regular
Number of meetings during the year	9	8	17	7	1	3	2	4	11	4
Current directors who served during 2010										–
Sir Winfried Bischoff	9	7	16			3	2	4	11	4
J E Daniels	9	7	16							
A M Frew[1]	1(1)	–	1	1(1)	–					–
Sir Julian Horn-Smith	9	4	13			1	2	3	6	4
A G Kane	9	7	16							
Lord Leitch[2]	8	8	16	6	1	3	1	4	11	2(2)
G R Moreno[3]	7	6(7)	13			2(2)	1(1)	–	4(5)	2(2)
D L Roberts[4]	7	6(7)	13	5(5)	1	1(2)	0(1)	3(3)	7(8)	3(3)
T T Ryan[5]	9	6	15	7	–			3(3)	6(8)	4
M A Scicluna[6]	9	7	16	7	1	2(2)	–			4
G T Tate	9	8	17							
T J W Tookey	9	8	17							
Anthony Watson[7]	9	6	15	7	1	2(2)	–	3(3)	7(8)	2(2)
H A Weir	9	8	17							
Former directors who served during 2010										
Dr W C G Berndt[8]	4	2(3)	6			1(1)	2(2)	2(2)	6(6)	

[1] Appointed to the Board, Audit and Risk Committees on 1 December 2010.

[2] Stood down from the Risk Committee on 14 April 2010.

[3] Appointed to the Board, Nomination & Governance, Remuneration and Risk Committees on 1 March 2010. Stood down from the Remuneration Committee on 17 June 2010 and the Risk Committee on 1 September 2010.

[4] Appointed to the Board, Audit, Remuneration and Risk Committees on 1 March 2010. Appointed as Chairman of the Risk Committee and to the Nomination & Governance Committee with effect from 1 September 2010.

[5] Appointed to the Remuneration Committee on 1 March 2010.

[6] Appointed to the Nomination & Governance Committee on 6 May 2010.

[7] Appointed as Chairman of the Remuneration Committe and to the Nomination & Governance Committee, and stood down from the Risk Committee, on 6 May 2010.

[8] Left the Board on 6 May 2010.

Numbers in brackets show the maximum number of possible meetings that each Director could have attended in 2010 including those ad hoc or called at short notice.

BOARD COMMITTEES

The table below sets out a summary of the membership and role of each of the Board Committees, along with the activities they performed during 2010. There is a standing invitation for all Non-Executive Directors to attend Committee meetings of which they are not members. All Committee terms of reference are available from the Company Secretary and are displayed on our website, www.lloydsbankinggroup.com.

Committee	Chairman	Membership	Purpose
Audit	Martin Scicluna	Anita Frew Lord Leitch David Roberts Tim Ryan Anthony Watson	To monitor and review the formal arrangements established by the Board in respect of: (a) the financial statements and reporting of the Group; (b) internal controls and the risk management framework; (c) internal audit; and (d) the Group's relationship with its external auditors.
Nomination & Governance	Sir Winfried Bischoff	Sir Julian Horn-Smith Lord Leitch Glen Moreno David Roberts Martin Scicluna Anthony Watson	To keep the Board's governance arrangements under review and make appropriate recommendations to the Board to ensure that the Company's arrangements are consistent with best practice corporate governance standards.
Remuneration	Anthony Watson	Sir Winfried Bischoff Sir Julian Horn-Smith Lord Leitch David Roberts Tim Ryan	To set the principles and parameters of remuneration policy for the Group, and to oversee remuneration policy and outcomes for those colleagues specified in the terms of reference.
Risk	David Roberts	Sir Winfried Bischoff Anita Frew Sir Julian Horn-Smith Anthony Watson Martin Scicluna	To review and report its conclusions to the Board on: (a) the Group's risk appetite; and (b) the Group's risk management framework, taking a forward looking perspective and anticipating changes in business conditions.

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Responsibilities		2010 Activities	
– reviews the financial statements published in the name of the Board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; – reviews the scope of the work of the group audit department, reports from that department and the adequacy of its resources; – reviews the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations; – approves the external auditors' terms of engagement and remuneration;	– assesses the external auditors' independence and objectivity; – recommends the external auditors' appointment, re-appointment and removal; – reviews the results of the external audit and its cost effectiveness; – reviews reports from the auditors on audit planning and their findings on accounting and internal control systems; and – reviews procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence.	– reviewed and recommended to the Board the Group annual and interim reports and accounts; – reviewed significant accounting matters as discussed with the auditors; – reviewed the Group's position as a going concern; – reviewed the appointment of the auditors and approved their remuneration; – attended six half day 'deep dive' sessions with each of the divisions – reviewed litigation and regulatory risks;	– received reports from the Divisional Financial Control Committees and the Group Business Risk Committee; – received reports from the internal audit department on internal controls, including SOX reports; – reviewed the Group's key finance programmes; – reviewed details of the Group's whistle blowing procedures and incidents; – discussed the mis-selling of PPI; and – discussed the level of impairments, specifically in Ireland, amongst other countries.
– reviews the structure, size and composition of the Board; – oversees the selection process for prospective Directors; – makes recommendations to the Board on potential appointments and re-appointments of Directors at the end of their specified term; – considers Board succession;	– oversees the annual evaluation of the performance of the Board; – reviews the Board's governance arrangements; – oversees the Group's implementation of governance requirements; and – oversees the process for appointments of new Non-Executive Directors and makes recommendations to the Board.	– reviewed and recommended to the Board the appointment of a new Group Chief Executive and three Non-Executive Directors; – adopted a Board Governance Framework and Executive Governance Framework; – reviewed the time commitment of Board Directors; – reviewed updates on corporate governance at each meeting;	– reviewed the Board evaluation process and results; and – adopted a board composition policy statement.
Information about the Remuneration Committee's responsibilities is given in the Directors' remuneration report on pages 124 to 141.		Information about the Remuneration Committee's activities during 2010 is given in the Directors' remuneration report on pages 124 to 141.	
– facilitates the involvement of Non-Executive Directors in risk issues and aids their understanding of these issues; – oversees adherence to Group risk policies and standards and considers any material amendments to them; and – reviews the work of the Group risk division.		– reviewed the Group consolidated risk report and received an update from the Chief Risk Officer at each meeting; – reviewed the risk and control frameworks; – reviewed the Internal Capital Adequacy Assessment Process report;	– reviewed the Group's funding plan and stress testing process; – participated in 'deep dives' in conjunction with each division and with members of the group risk team; – reviewed the Group's risk appetite framework; and – reviewed the Group's report on financial crime.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report, the Directors' remuneration report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and parent Company financial statements in accordance with IFRSs as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Company and Group for that period. In preparing these financial statements, the Directors are required to: select suitable accounting policies and then apply them consistently; make judgements and accounting estimates that are reasonable and prudent; state whether applicable IFRSs as adopted by the European Union have been followed.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

A copy of the financial statements is placed on our website www.lloydsbankinggroup.com. The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

COMPLIANCE WITH THE BRITISH BANKERS' ASSOCIATION CODE FOR FINANCIAL REPORTING DISCLOSURE

In September 2010, the British Bankers' Association published a Code for Financial Reporting Disclosure (the 'Disclosure Code'). The Disclosure Code sets out five disclosure principles together with supporting guidance. The principles are that UK banks: commit to providing high quality, meaningful and decision-useful disclosures; commit to ongoing review of, and enhancement to, their financial instrument disclosures for key areas of interest; will assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance; will seek to enhance the comparability of financial statement disclosures across the UK banking sector; and will clearly differentiate in their annual reports between information that is audited and information that is unaudited.

The Group and other major UK banks have voluntarily adopted the Disclosure Code in their 2010 financial statements. The Group's 2010 financial statements have therefore been prepared in compliance with the Disclosure Code's principles.

INTERNAL CONTROL

The Board of Directors is responsible for the establishment and review of the Group's system of internal control, which is designed to ensure effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. It should be noted, however, that such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. In establishing and reviewing the system of internal control, the Directors have regard to the nature and extent of relevant risks, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The Directors and senior management are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of published policies and procedures and regular management briefings. A requirement to comply with internal control risk policies is a key component of individual staff objectives expressed in the balanced scorecard. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. In addition, there is an annual control self assessment exercise whereby the key businesses and head office functions review specific controls and attest to the accuracy of their assessments. The assessment covers all enterprise-wide risk management categories and is in accordance with the principles of the Code. As in previous years, this exercise was completed for the year ended 31 December 2010. All returns have been satisfactorily completed and appropriately certified.

The effectiveness of the internal control system is reviewed regularly by the Board and the Audit Committee, which also receives reports of reviews undertaken around the Group by group risk and group audit. The Audit Committee receives reports from the Company's auditors, PricewaterhouseCoopers LLP (which include details of significant internal control matters that they have identified), and has a discussion with the auditors at least once a year without executives present, to ensure that there are no unresolved issues of concern.

There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. This process has been in place for the year under review and up to the date of the approval of the annual report and is regularly reviewed by the Board.

Information regarding the main features of the internal control and risk management systems in relation to the financial reporting process is given within the risk management report on pages 65 to 108.

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AUDITOR INDEPENDENCE AND REMUNERATION

Both the Board and the external auditors have safeguards in place to protect the independence and objectivity of the external auditors. The Audit Committee has a comprehensive policy to regulate the use of auditors for non-audit services. This policy sets out the nature of work the external auditors may not undertake, which includes work which will ultimately be subject to external audit, internal audit services and secondments to senior management positions in the Group that involve decision-making. It also includes the Group's policy on hiring former external audit staff. For those services that are deemed appropriate for the auditors to carry out, the policy sets out the approval process that must be followed for each type of assignment. The Chairman of the Audit Committee must be consulted regarding potential instructions in respect of allowable non-audit services with a value above defined fee limits.

Each year the Audit Committee establishes a limit on the fees that can be paid to the external auditors in respect of non-audit services and monitors quarterly the amounts paid to the auditors in this regard. The external auditors also report regularly to the Audit Committee on the actions that they have taken to comply with professional and regulatory requirements and current best practice in order to maintain their independence. This includes the rotation of key members of the audit team. Total auditor remuneration analysed between audit and other services is shown in note 11 to the financial statements on page 177.

The Audit Committee evaluated the performance of the external auditors during the year and will periodically continue to do so. The Audit Committee has not considered it necessary to require an independent tender process.

STATUTORY AND REGULATORY DISCLOSURES

Information that is required to be disclosed in the corporate governance report under the Companies Act 2006 and the FSA's Disclosure and Transparency rules can be found in the Directors' report, on the Shareholder information page and in the share capital note.

DIRECTORS' REMUNERATION REPORT

STATEMENT BY THE CHAIRMAN OF THE REMUNERATION COMMITTEE

As the new Chairman of the Group's Remuneration Committee I am pleased to present the Directors' remuneration report for 2010, for which we will be seeking approval from shareholders at our annual general meeting in May.

Firstly I would like to extend my thanks to Dr Wolfgang Berndt who chaired the Committee admirably through a challenging period and I am delighted to be given the opportunity to lead the Committee as we build the trust with all our stakeholders to ensure the best remuneration structure possible.

During the past year the Committee has undertaken a great deal of work to ensure a continued prudent approach to our remuneration policy while recognising the need to attract, incentivise and retain our key people. Shareholders may care to note that of the six current members of the Committee, four have joined within the last 18 months.

We have carried out a wide-ranging and considered consultation with shareholders. I have very much enjoyed the opportunity that this has given me to exchange views on the Group's remuneration strategy. We have carefully reflected on the feedback from shareholders and this has directly influenced our approach.

There continues to be a high level of interest in remuneration in both the sector as a whole and Lloyds Banking Group arrangements. Throughout the year we have sought to take this into account along with shareholders' views on remuneration, ensuring continued compliance with the FSA Code of Practice on Remuneration whilst balancing these factors with what is right for our business. We held fifteen Remuneration Committee meetings during the year, at which a wide range of matters were discussed. This gives an indication of the importance we place on ensuring the effectiveness of the Group's remuneration structures.

Our conclusion, following the considerable amount of consultation and an in depth analysis of performance, was that 2010 outcomes should demonstrate the exercise of restraint rather than fully reflect improved performance and we should retain a broadly similar structural approach for 2011.

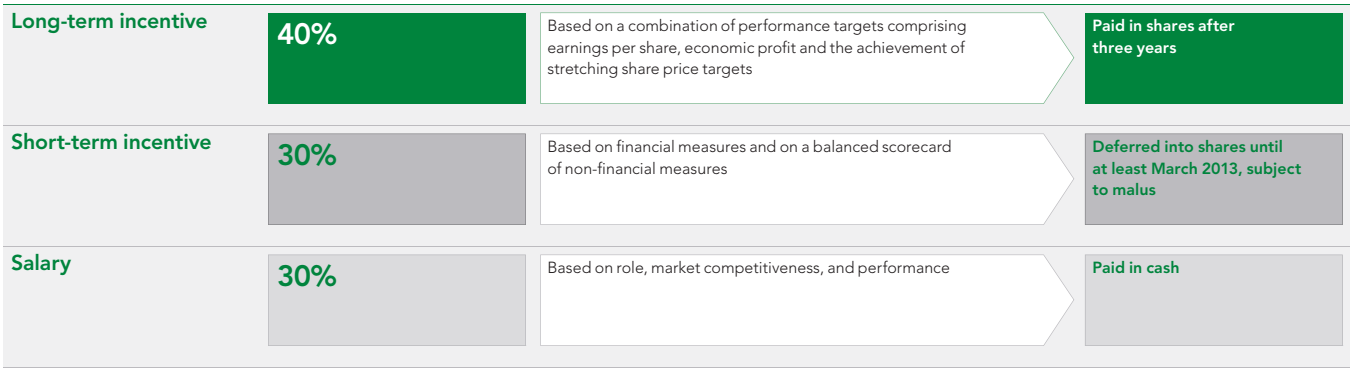
2010 REMUNERATION OUTCOMES

The Group has made significant progress during the year. We have also reduced the level of risk in our business in reaction to the economic events that had a particularly deep impact on the banking sector and we are endeavouring, as a business, to continue to support the UK's economic recovery.

Our decision making has focussed on balancing shareholders' views on remuneration with the need to attract, incentivise and retain the right people, in light of improved business performance. In reaching a decision on the size of the bonus pool as a whole and for the Executive Directors in particular, the Committee took into account the need for adjustments to reflect the Group's current profitability and current and future risk. The Committee worked closely with the Group Risk Committee in making its decision. As a result:

– There were no salary increases made to Executive Directors in 2010.
– We have ensured that any bonuses paid in respect of performance in 2010 have been rigorously tested against targets. The use of risk-adjusted and non-financial measures under this plan has been highly successful in promoting a long-term focus within the senior management team.
– To ensure a prudent approach is applied in practice we have exercised downward discretion on the annual bonuses; the payouts are lower than if they were calculated on a purely formulaic basis. Exercising its discretion, the Committee has been mindful, amongst other things, of the appropriate balance of profit between shareholders and staff, key balance sheet metrics, share price performance, the quality of profits and future risks as well as the competitive environment.
– Furthermore, 100 per cent of any award will be deferred into shares and will not be released until March 2013 at the earliest. In order to increase alignment with shareholders, this will be subject to malus if performance is not sustained.
– Awards made in March 2010 under the Long Term Incentive Plan ('LTIP') were below 2008 levels by up to 100 per cent of salary and lower than the market practice for long-term incentives in our sector.

The approximate make-up of the main components of our 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)

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OUR APPROACH TO REMUNERATION FOR 2011

The changes at Board level, including my appointment as Chairman of this Committee, provided us with an excellent opportunity to review the structure and quantum of our remuneration. This review included an open and transparent dialogue with shareholders and I intend to maintain the renewed commitment to shareholder engagement that we have demonstrated.

Our principal focus was to ensure an appropriate alignment between performance and pay in terms of both business strategy and risk profile.

We continue to have concerns that our remuneration framework is uncompetitive and this is an area that will be kept under close and continuous review by the committee. However, our approach to remuneration in 2011 remains broadly unchanged from last year:

– We are proposing increases to Executive Director base salaries for 2011, in line with those for the wider workforce. This will be our first increase since 2008.
– The annual incentive opportunity for 2011 will stay the same as in previous years.
– The bonus will continue to be based on a combination of Group financial measures and a balanced scorecard of business financial and non-financial measures, including customers, people and risk.
– Awards under the LTIP remain below 2008 levels and will be limited to 300 per cent of salary (except for António Horta-Osório).
– The performance measures for the LTIP will include Economic Profit and EPS, as in previous years, together with a measure of delivery to shareholders using absolute Total Shareholder Return (TSR).

We are also proposing a change to the delivery of remuneration and shareholders will be asked at the annual general meeting to approve a resolution to use newly issued shares to settle deferred bonus and LTIP awards, rather than market purchased shares. In response to concerns about the level of risk in the banking sector, we believe that this is an effective way of improving our capital position.

The Board has appointed António Horta-Osório as our new Group Chief Executive who starts on 1 March 2011. He will be undertaking a review of strategy. When this is complete we will review the remuneration arrangements to ensure they remain consistent with the strategy and if appropriate will consult with shareholders on any changes needed.

CONCLUSION

During the course of 2010 our consultation with shareholders on executive remuneration has helped ensure that:

– We are rewarding executives for delivery of the most important drivers of the business, improving both the financial and non-financial health of the business and with a medium and longer term focus on risk, capital and liquidity of the business.
– We have a prudent approach to remuneration with the structure for 2011 designed to reflect corporate and personal performance.
– We strike an appropriate balance by considering both the sensitivity of the current environment and the longer term policy objectives to support the Group's business strategy.
– Our approach is fully aligned with the FSA Remuneration Code of Practice.

We therefore recommend this report to shareholders and ask for your support at the forthcoming annual general meeting.

Anthony Watson CBE
Chairman, Remuneration Committee

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 2010.

The Group has complied throughout the period with the requirements of the UK Corporate Governance Code (previously known as the Combined Code) in relation to Directors' remuneration. In addition, the report has been prepared in accordance with the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008.

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, business objectives, risk appetite and values and recognises the interests of relevant stakeholders. The Group has a conservative business model characterised by a risk culture founded on prudence and accountability. The remuneration policy and philosophy covers the whole Group, but the Committee pays particular attention to the top management population, including the highest paid employees in each division, 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 and reward to encourage them to enhance the performance of the Group and that they are recognised for their individual contribution to the success of the organisation, whilst ensuring that there is no reward for excessive risk taking.

The Committee determines the pensions policy for the Group 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 and bonus exceeds a specified amount, currently £750,000. To ensure compliance with the FSA Code of Practice, the Committee approves remuneration for remuneration Code Staff and that of senior risk and compliance officers.

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 closely with the Risk Committee and the risk function in relation to risk-adjusted performance measures, including consideration of both current and future risk. Together the management of remuneration and risk form an integral part of the Board's determination of Group corporate strategy.

All the independent Non-Executive Directors are invited to attend meetings and have the opportunity to comment on proposals 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. These terms were updated in January 2011 to ensure continued compliance with the FSA Code.

The members of the Committee during 2010 were as follows:

– Dr Wolfgang Berndt (chairman to 6 May 2010)
– Anthony Watson (chairman from 6 May 2010)
– Sir Winfried Bischoff
– Sir Julian Horn-Smith
– Lord Leitch
– Glen Moreno (from 1 March 2010 to 17 June 2010)
– David Roberts (from 1 March 2010)
– Tim Ryan (from 1 March 2010)

During 2010, the Committee met 15 times and considered the following principal matters:

– Review of remuneration arrangements for senior executives. Upon the appointment of the new Group Chief Executive we have deferred the implementation of this work until the completion of the strategy review and will consult shareholders during 2011
– Determination of the appropriate remuneration packages for the new Group Chief Executive and a number of other senior new hires
– Determination of bonus pools based on Group performance and risk adjustments
– Performance conditions for the Long Term Incentive Plan
– Bonus and salary awards for Executive Directors and key senior managers
– Approval of remuneration and terms of service that fall within the Committee's terms of reference, including new executive appointments
– Feedback from the Remuneration Committee Chairman on his meetings with the FSA and shareholders

We thank all committee members for their commitment during the last year and attendance at meetings.

The Committee appoints independent consultants to provide advice on specific matters according to their particular expertise. During the year, the Committee conducted a review of their independent advisors and appointed Deloitte LLP to advise the Committee. Deloitte has voluntarily signed up to the Remuneration Consultants' Code of Conduct and are judged by the Committee to be independent. Kepler Associates were also retained by the Committee during 2010 to advise on various matters relating to executive remuneration.

During 2010, Alithos Limited continued to provide information on behalf of the Committee for the testing of TSR performance conditions for the Group's long-term incentive plans (calculated by reference to both dividends and growth in share price).

Eric Daniels, Angie Risley (Group HR Director), Liz Jackson (HR Director, Reward from March 2010) and Harriet Kemp (HR Director, Total Reward until March 2010) provided guidance to the Committee (other than for their own remuneration). Carol Sergeant (Chief Risk Officer) and Tim Tookey (Group Finance Director) also attended the Committee to advise as and when necessary on risk and financial matters.

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DIRECTORS' REMUNERATION POLICY

Following review in 2010, the Group's remuneration policy continues to support our business values and strategy, 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.

Our policy is intended to ensure that our remuneration offer is both cost effective and enables us to attract and retain Executive Directors and senior management of the highest calibre, motivating them to perform to the highest standards.

Our objective is to align individual reward 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: our customers, shareholders, employees, and regulators. This approach is in line with the Association of British Insurers best practice code on remuneration and the FSA Remuneration Code of Practice, 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 offer.

Policy objective	How achieved
Building long-term relationships	We build relationships with our customers and people. Working for Lloyds Banking Group is about more than pay. Our relationship with our people means that we want to pay them fairly and competitively, but our pay is positioned conservatively against the market and we do not seek to align with the highest payers in the sector. In setting pay for Executive Directors and senior managers, we take account of relative pay positioning and target levels of variable remuneration opportunity for all levels of employees in the Group. Our incentive measures are not just financial. Our Balanced scorecards include objectives that cover effective risk management, lending to Corporates including SMEs and retail customers, performance 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.
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 the business will perform through the economic cycle. 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, with its inclusion in both the annual and LTIP performance measures.
Aligning individual rewards with Group performance and shareholders	Our executives' annual and long-term incentives are based on stretching performance objectives and targets in the Group Balanced Scorecard. This balanced scorecard is derived from the Medium Term Plan which defines the financial and non-financial targets within our agreed risk appetite over a three year period. The annual bonus for Executive Directors is deferred into shares and released over a period of not less than two years, helping to increase alignment with shareholders. These deferrals are subject to malus in the event of unsustainable performance. Executives are also aligned with shareholders through the LTIP, which pays out in shares to improve alignment with shareholders based on performance against Group financial targets over a three year period. We operate tough contract provisions relative to market practice, whereby no executive has an entitlement to more than 12 months' notice (not taking into account recruitment provisions), pay in lieu of notice is limited to basic salary, 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 encourages executives to take a prudent approach to risk. We also have non-financial measures of performance against risk objectives in both the annual and long-term plans for executives. For the 2010 annual incentive plan we increased the alignment to long-term prudent risk management by deferring 100 per cent of the award subject to malus over two years. If the performance is unsustainable during the deferral period some or all of the award may be forfeited. We have a robust governance framework with an independent Remuneration Committee reviewing all compensation decisions for senior executives. This approach to governance and review is cascaded through the organisation. We also ensure that all control function employees are assessed and their remuneration determined jointly by the relevant business Director and the control function Director. Senior risk and compliance officers are also reviewed by the Remuneration Committee.

Policy objective	How achieved
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 the top 20 companies in the FTSE 100, reflecting practices in large UK companies across all sectors. We aim to be competitively but conservatively positioned against the market, although for executive directors we have taken the decision to adopt a position that is behind market for 2011 in view of public concern. We select incentive plan targets that are directly linked to the business strategy and priorities, ensuring alignment with company performance, targets that are meaningful to executives and incentive packages that are valued by executives and cost effective.

SUMMARY

Following extensive consultation with shareholders, the Remuneration Committee is proposing a package for Executive Directors for 2011 that is closely based on the structure and principles of 2010 as follows:

Element	Level/design for 2011	Key purpose
Base salary	Base pay should be set relative to FTSE 20 and banking sector competitors In light of circumstances, there will be increases to base salaries in line with the wider population of employees resulting in a lower quartile position	To provide the basis for a competitive package
Annual incentive	200 per cent of salary maximum (225 per cent for the Group Chief Executive) Based on Group financial targets relating to profit before tax and economic profit as well as balanced scorecard measures covering divisional financial targets, customers (e.g. SME lending), people, risk and building the business Subject to deferral and malus in line with FSA requirements	Alignment with Group performance Motivation of executives Pay for performance Alignment with sound risk management
Long-term incentive plan	Annual awards of up to 300 per cent of salary vesting based on financial measures including Economic Profit and EPS and alignment with shareholders based on absolute TSR A higher award will be made to António Horta-Osório as detailed on page 129	Motivation and retention of executives Alignment with sound risk management Alignment with long-term shareholder interests
Pension	Defined contribution pension provision for new entrants From April 2012, any executive director in office at that time with a legacy final salary pension will move to a defined contribution pension arrangement	Enable executives to build long-term retirement savings Retention

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GROUP CHIEF EXECUTIVE TRANSITION

Eric Daniels

On 20 September 2010, Eric Daniels announced his intention to retire from Lloyds Banking Group on 30 September 2011. Mr Daniels will stand down from the Board on 28 February 2011.

He will continue to receive his basic salary, pension contribution and other benefits under the terms of his contract until retirement. 100 per cent of his bonus received in respect of 2010 will be deferred into shares in two equal tranches, vesting in March 2013 and March 2014 and subject in part to a holding period on vesting.

His outstanding long-term incentive awards will continue to vest at the end of the relevant three year performance period to the extent the performance conditions have been met and will be pro-rated for service.

António Horta-Osório

António Horta-Osório was appointed to the Board on 17 January 2011 and succeeds Eric Daniels as Group Chief Executive on 1 March 2011. In line with the Group's prudent remuneration policy and the current operating environment, his salary was set on recruitment at the same level as the outgoing Group Chief Executive's at £1,035,000. Recognising that this is behind the market, the committee decided to award an increase in line with the the other Executive Directors, effective from his start date. He also has a 'reference salary' of £1,220,000 that will be used to calculate certain elements of long-term remuneration, including his LTIP from 2012 and pension.

He will participate in the Group's annual incentive scheme for the calendar year 2011. His annual bonus maximum opportunity for 2011 will be 225 per cent of basic salary. This will be subject to deferral on terms at a minimum in line with the FSA Code and the deferred element will be subject to malus if the performance that generated the incentive is found to be unsustainable.

The Group agreed, as a condition of his accepting the appointment of Group Chief Executive on 1 March 2011, to grant him an LTIP award over the Group's shares with a market value equal to 420 per cent of his base salary as at 7 March.

His award will be made under Listing Rule 9.4(2) of the Listing Rules in order to facilitate his appointment as Group Chief Executive. The Board considered that it was essential to the success of the recruitment process to make this LTIP award to him. The award is on similar terms to awards granted under the LTIP including the performance conditions which will apply to LTIP awards granted in 2011 described on page 131.

He will be eligible for a pension allowance in respect of future service of 50 per cent of reference salary per annum including his flexible benefit allowance. He has the option to take this as a cash allowance or contribution to a pension scheme/vehicle. He has been granted a number of one-off awards to compensate him for outstanding share and cash awards forfeited on his resignation from the Santander Group. These include:

– Performance shares of 1,707,763 due to vest in 2013 subject to the Group's TSR performance against sector peer group, broadly equivalent to the performance conditions of Santander Group
– Restricted shares of 4,348,029 due to vest between 2011 – 2013 subject to remaining in employment
– Cash amounting to £516,000 vesting in three equal tranches in 2011 – 2013

The awards above vest in different proportions at different times to reflect the vesting periods of the Santander Group share awards which the awards replace. On his resignation from Banco Santander, he suffered significant loss in relation to his previous pension accrual. Lloyds Banking Group will compensate him in part for the loss of this income through the provision of an unfunded unapproved retirement benefit scheme (UURBS) up to a maximum of 26.5 per cent of base salary. If he achieves the performance conditions described below at the maximum level, the pension accrued would still only represent 60 per cent of the pension forfeited by him. This pension is payable from retirement at age 65.

In order to fully promote alignment with shareholders, this pension provision will accrue over the first six years' of service and is entirely dependent on the achievement of share price targets as follows:

– At retirement, a percentage of reference salary (or basic salary if higher) for each of the first five calendar years of employment if in the last 90 days of that year the average share price of Lloyds Banking Group exceeds 75p ('Average Share Price'). The percentage applicable is 4 per cent in year 1, 3.5 per cent in year 2 and 3 per cent in years 3, 4 and 5.
– Plus an additional 2 per cent for each year if the Average Share Price exceeds:
– Year 1: 90p
– Year 2: 102p
– Years 3-5 inclusive: 114p
– If at the end of the fifth year of employment the aggregate percentage pension accrued is less than 26.5 per cent, he may accrue up to a further 4.5 per cent in the sixth year (to an overall maximum of 26.5 per cent of base salary) if the Average Share Price for that year exceeds 75p and up to a further 2 per cent if the Average Share Price for that year exceeds 114p.

BASE SALARY

Base salaries are reviewed annually, taking into account individual performance and market information (which is provided by Towers Watson and supplemented with information from Deloitte LLP) and normally adjusted from 1 January of the relevant year. The remuneration committee confirmed during the 2010 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.

Our review showed that salary levels are significantly below market. However, we have continued to show restraint and made a moderate increase to base salaries in 2011, in line with the salary increase budget for other employees in the Group.

Name	J E Daniels	António Horta-Osório	A G Kane	G T Tate	T J W Tookey	H A Weir
As at 1 January 2011	£1,035,000	£1,061,000[1]	£601,800	£656,000	£615,000	£641,000
As at 1 January 2010	£1,035,000	–	£590,000	£640,000	£600,000	£625,000

[1] With effect from 17 January 2011

ANNUAL INCENTIVE PLAN

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. Incentive opportunity is driven by corporate performance based on profit before tax and economic profit, together with divisional achievement and individual performance. Individual targets relevant to improving overall business performance are contained in a balanced scorecard and are grouped under the following headings:

– Financial
– Building the Business
– 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 risk management, SME lending, process efficiency, service quality and employee engagement.

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.

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.

Consistent with the aim of ensuring that short-term financial results are only rewarded if they promote sustainable growth, the 2010 annual incentive is subject to deferral in shares until at least March 2013. This deferred amount is subject to malus if the performance that generated the incentive is found to be unsustainable.

The committee reserves the right to exercise its discretion in reducing any payment that otherwise would have been earned, if they deem this appropriate.

The key achievements of the Group are set out in the Group Chief Executive's review on pages 8 and 9 of this Annual Report.

The calculation of the annual incentive plan outcomes for Executive Directors, based on the achievement of performance against targets in respect of performance in 2010, has been vigorously discussed by the Remuneration Committee. The bonuses awarded to directors are shown in the table below:

Name	J E Daniels	A G Kane	G T Tate	T J W Tookey	H A Weir
Maximum Opportunity	225%	200%	200%	200%	200%
% awarded for 2010	140%	130%	164%	157%	140%
Bonus awarded for 2010	£1,450,000	£767,000	£1,050,000	£942,000	£875,000

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LONG-TERM INCENTIVE AWARD

The current LTIP rules allow for awards to be made of up to 400 per cent of base salary. Under normal circumstances, awards can be made of up to 300 per cent of salary with the additional 100 per cent available for circumstances that the Remuneration Committee deems to be exceptional. In 2010, awards were made of up to 275 per cent of base salary to the executive directors. In 2011, the committee intends to make awards of 300 per cent of salary. As noted, for António Horta-Osório his award for 2011 will be 420 per cent of his base salary.

LONG-TERM INCENTIVE PERFORMANCE MEASURES

During the 2010 review, the Committee was particularly mindful of driving sustainable performance through the cycle without encouraging excessive risk taking. The Committee has consulted widely with shareholders on the topic of performance measures and sharing the growth in the Company appropriately between shareholders and management. The Committee believes that the performance measures for the 2011 LTIP award for the Executive Committee should be Economic Profit (EP), Earnings per share (EPS) and absolute Total Shareholder Return. These measures capture risk measurement, profit growth and shareholder experience and align shareholder experience and management reward.

At this time the Committee is not in a position to determine the metrics that will attach to these performance measures as the new Group Chief Executive is completing a strategic review of the business. We believe it is critical to ensure that the 2011 LTIP is aligned with the new strategic direction of the Company and the goals we will set for ourselves over the medium term. Therefore the Committee intends to determine the appropriately stretching and challenging metrics following the completion of the strategic review and to consult with shareholders on the metrics during the summer prior to communicating them to participants. The Committee recognise this is an unusual approach but given the circumstances believe it is the best way to align management reward and the strategy over the next three years.

The metrics set by the Committee following the strategic review and consultation with major shareholders will be put to the annual general meeting in 2012 for approval.

Details of current LTIP awards are provided on page 139.

PENSION

Executive directors are entitled to participate in the Group's defined contribution scheme (under which their pension entitlement will be based upon both employer and employee contributions). Company contributions are 25 per cent of salary, with the exception of António Horta-Osório who is eligible for 50 per cent of reference salary, including his flexible benefit allowance. These can be taken as cash or pension contributions.

At the date of this report, two executive directors remain in a defined benefit scheme. Pension accruals under the defined benefits scheme for Eric Daniels and Archie Kane will continue until the date of retirement or April 2012 whichever is earlier. Thereafter Archie Kane 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. The defined benefit schemes are closed to new entrants.

Details of pension contributions and accruals are shown on page 135.

OTHER SHARE PLANS

The executive directors are also eligible to participate in the Group's 'sharesave' and 'share incentive' plans. These are 'all-employee' share plans.

SHAREHOLDING GUIDELINES

Executives are required to build up a holding in Lloyds Banking Group shares of value equal to 1.5 times gross salary (2 times gross 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.

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 as part of the remuneration review in 2010. The review took into account 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. Following this review, it was determined to maintain the chairman's salary at £700,000 per annum.

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. Non-Executive 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 were reviewed in 2010 and remain unchanged as listed below.

Non-Executive Director – base fee	£65,000
Senior Independent Director	£50,000
Audit Committee Chairmanship	£50,000
Audit Committee Membership	£20,000
Remuneration Committee Chairmanship	£30,000
Remuneration Committee Membership	£15,000
Risk Committee Chairmanship	£40,000
Risk Committee Membership	£15,000
Nomination & Governance Committee Membership	£5,000

In the case of the Nomination & Governance Committee, membership currently comprises the Deputy Chairman, Senior Independent Director and chairs of the Board Committees (the fees for which include membership of the Nomination & Governance Committee) and one other Independent Non-Executive Director. Only this director receives an attendance fee, which is £5,000.

Independent Non-Executive Directors who serve on the Boards of subsidiary companies may also receive fees from the subsidiaries.

2010 NON-EXECUTIVE DIRECTORS' FEES (£)

	Board	Senior Independent Director	Audit Committee	Remuneration Committee	Nomination & Governance Committee	Risk Oversight Committee	SW Board fees[1]	2010 Total
W C G Berndt (until 6 May 2010)	22,698			10,726	1,497			34,921
A M Frew (from 1 December 2010)	5,417		1,667			1,250		8,334
Sir Julian Horn-Smith	65,000			15,000	5,000	15,000		100,000
Lord Leitch[2]	187,494		16,666	12,506			90,910	307,576
G R Moreno (from 1 March 2010)	54,167	50,000	3,333	6,667		20,000		134,167
D L Roberts (from 1 March 2010)	54,167		16,667	12,500		20,833		104,167
T T Ryan	65,000		20,000	12,500		15,000		112,500
M A Scicluna	65,000		50,000			15,000		130,000
Anthony Watson[3]	65,000		20,000	22,321		7,500		114,821

[1] Scottish Widows Services Limited

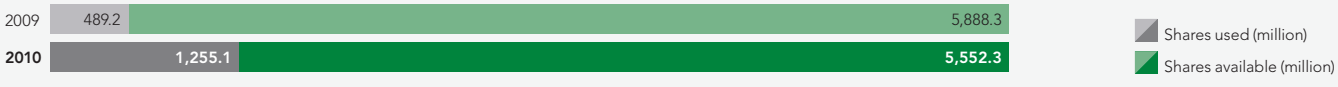
[2] Lord Leitch's composite fee of £300,000 was amended to a fee of £200,000 from 1 March plus a £60,000 fee for Scottish Widows Services Ltd. The Scottish Widows fee was increased to £120,000 from 27 April 2010. Lord Leitch stood down as Senior Independent Director on 28 February 2010.

[3] Appointed Chairman of the Remuneration Committee in May 2010.

DILUTION LIMITS

The following charts illustrate the shares available for the Group's share plans.

ALL PLANS (10% OF THE ISSUED ORDINARY SHARE CAPITAL OF THE GROUP IN ANY CONSECUTIVE 10 YEARS)



EXECUTIVE PLANS (5% OF THE ISSUED ORDINARY SHARE CAPITAL OF THE GROUP IN ANY CONSECUTIVE 10 YEARS)

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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.

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
António Horta-Osório	24 months	3 November 2010
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

António Horta-Osório's initial contract will be for a two year term, diminishing to 12 months notice over the first year of employment.

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.

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 2010, Eric Daniels received fees of £75,000 which was retained by him, for serving as Non-Executive Director of BT plc.

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

DIRECTORS' EMOLUMENTS FOR 2010

	Salaries/ fees £000	Other benefits Cash £000[1]	Other benefits Non-cash £000[2]	Performance-related payments £000[3]	2010 Total £000	2009 Total £000
Current directors who served during 2010						
Executive Directors						
J E Daniels	1,035	78	9	1,450	2,572	1,121
A G Kane	590	24	27	767	1,408	1,523
G T Tate	640	27	28	1,050	1,745	1,807
T J W Tookey	600	36	1	942	1,579	1,736
H A Weir	625	57	21	875	1,578	1,767
Non-Executive Directors						
Sir Winfried Bischoff	700	12			712	211
A M Frew (from 1 December 2010)	8				8	
Sir Julian Horn-Smith	100				100	100
Lord Leitch	308				308	249
G R Moreno (from 1 March 2010)	134				134	
D L Roberts (from 1 March 2010)	104				104	
T T Ryan	113				113	83
M A Scicluna	130				130	121
Anthony Watson	115				115	71
Former director who served during 2010						
W C G Berndt (until 6 May 2010)	35				35	100
Others						1,011
	5,237	234	86	5,084	10,641	9,900

[1] The cash column under 'other benefits' includes flexible benefits payments (4 per cent of basic salary), the tax planning allowance for Eric Daniels, payments to certain directors who elect to take cash rather than a company car under the car scheme and a spouse's travel allowance for Truett Tate.

[2] The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance. It also includes the value of any matching shares which are received under the terms of Sharematch, 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] Bonuses awarded in respect of 2010 performance will be subject to 100 per cent deferral into shares until at least March 2013.

Sir Victor Blank was entitled to the use of his company car until 30 April 2010, resulting in a benefit in kind tax charge of £10,490.

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DIRECTORS' PENSIONS

The Executive Directors are currently members of one of the pension schemes provided by Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined 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, or the date of leaving if earlier. 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.

DEFINED CONTRIBUTION SCHEME MEMBERS

During the year to 31 December 2010 the Group has made the following contributions to the defined contribution scheme:

	£000
G T Tate	**160**
T J W Tookey	**150**
H A Weir	**125**

DEFINED BENEFIT SCHEME MEMBERS

	Accrued pension at 31 December 2010 £000 (a)	Accrued pension at 31 December 2009 £000 (b)	Change in accrued pension £000 (a)-(b)	Transfer value at 31 December 2010 £000 (c)	Transfer value at 31 December 2009 £000 (d)	Change in transfer value £000 (c)-(d)	Additional pension earned to 31 December 2010 £000 (e)	Transfer value of the increase £000 (f)
J E Daniels	**210**	193	**17**	**5,030**	3,844	**1,186**	**17**	**413**
A G Kane	**372**	357	**15**	**8,657**	6,889	**1,768**	**15**	**342**

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 2010 and 2009, respectively.

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2010 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2009 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 £1.8 million which is equivalent to an annual pension of £90,000. Any benefit in excess of this amount will incur a tax charge for the individual. The Government has announced that the life time allowance will decrease to £1.5 million from April 2012. 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.

DIRECTORS' INTERESTS

The beneficial interests, of those who were directors at 31 December 2010 in ordinary shares of Lloyds Banking Group were:

NUMBER OF SHARES

	At 1 January 2010 (or later date of appointment)	At 31 December 2010	At 24 February[1] 2011
Executive Directors			
J E Daniels	2,557,816	**2,560,770**	2,561,234
A G Kane	1,224,960	**1,227,914**	1,228,378
G T Tate	526,061	**529,015**	529,480
T J W Tookey	97,727	**123,891**	124,355
H A Weir	425,162	**428,116**	428,580
Non-Executive Directors			
Sir Winfried Bischoff	585,000	**800,000**	
A M Frew	–	**–**	
Sir Julian Horn-Smith	27,890	**227,890**	
Lord Leitch	55,787	**55,787**	
G R Moreno	200,000	**500,000**	
D L Roberts	–	**378,670**	
T T Ryan	75,877	**100,877**	
M A Scicluna	56,226	**56,226**	
Anthony Watson	51,357	**226,357**	

[1] The changes in beneficial interests between 31 December 2010 and 24 February 2011 related to 'partnership' and 'matching' shares acquired under the Lloyds Banking Group Share Incentive Plan.

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INTERESTS IN SHARE OPTIONS

	At 1 January 2010	Granted during the year	Exercised during the year	Lapsed during the year	Share adjustment	At 31 December 2010	Exercise price	Exercise periods From	Exercise periods To	Notes
J E Daniels	131,484	–	–	–	**133,567**	**265,051**	207.97p	18/3/2007	17/3/2014	c, e, i
	430,547	–	–	–	**437,367**	**867,914**	235.26p	17/3/2008	16/3/2015	d, e, i
	6,906	–	–	**6,906**	–	–	68.95p	–	–	a, h
	–	**19,399**	–	–	–	**19,399**	46.78p	1/6/2013	30/11/2013	a, g
A G Kane	64,786	–	–	**64,786**	–	–	549.5p	6/3/2003	5/3/2010	b, f
	11,841	–	–	**11,841**	–	–	615.5p	8/8/2003	7/8/2010	b, f
	34,759	–	–	–	**35,309**	**70,068**	324.92p	6/3/2004	5/3/2011	b, i
	73,255	–	–	–	**74,414**	**147,669**	207.97p	18/3/2007	17/3/2014	c, e, i
	247,891	–	–	–	**251,818**	**499,709**	235.26p	17/3/2008	16/3/2015	d, e, i
	6,906	–	–	**6,906**	–	–	68.95p	–	–	a, h
	–	**19,399**	–	–	–	**19,399**	46.78p	1/6/2013	30/11/2013	a, g
G T Tate	64,400	–	–	–	**65,420**	**129,820**	207.97p	18/3/2007	17/3/2014	c, e, i
	27,357	–	–	–	**27,790**	**55,147**	199.91p	12/8/2007	11/8/2014	c, e, i
	247,891	–	–	–	**251,818**	**499,709**	235.26p	17/3/2008	16/3/2015	d, e, i
	6,906	–	–	**6,906**	–	–	68.95p	–	–	a, h
	–	**19,399**	–	–	–	**19,399**	46.78p	1/6/2013	30/11/2013	a, g
T J W Tookey	6,906	–	–	**6,906**	–	-	68.95p	–	–	a, h
	–	**19,399**	–	–	–	**19,399**	46.78p	1/6/2013	30/11/2013	a, g
H A Weir	77,868	–	–	–	**79,100**	**156,968**	210.70p	29/4/2007	28/4/2014	c, e, i
	247,891	–	–	–	**251,818**	**499,709**	235.26p	17/3/2008	16/3/2015	d, e, i
	6,906	–	–	**6,906**	–	–	68.95p	–	–	a, h
	–	**19,399**	–	–	–	**19,399**	46.78p	1/6/2013	30/11/2013	a, g

a Sharesave.

b Executive option granted between March 2000 and March 2001.

c Executive option granted between March 2004 and August 2004.

d Executive option granted from March 2005.

e Exercisable to the extent at which the performance condition vested.

f Lapsed on 10th anniversary of date of grant as the performance conditions had not been met.

g Not exercisable as the option has not been held for the period required by the relevant scheme.

h Options lapsed as sharesave contract was cancelled.

i Options granted under these plans were adjusted on 13 August 2010, as a result of the capital raising activities of 2009. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of the capital raising events.

None of the other directors at 31 December 2010 had options to acquire shares in Lloyds Banking Group plc or its subsidiaries.

The market price for a share in the Company at 1 January 2010 and 31 December 2010 was 50.69p and 65.70p, respectively. The range of prices between 1 January 2010 and 31 December 2010 was 46.58p to 78.40p.

The following table contains information on the performance conditions for executive options granted since 2000. The Remuneration Committee chose the relevant performance conditions because they were felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Options granted	Performance conditions
March 2000 – March 2001	Growth in earnings per share which is equal to the aggregate percentage change in the retail price index plus three percentage points for each complete year of the relevant period plus a further condition that the Company's ranking based on TSR over the relevant period should be in the top 50 companies of the FTSE 100. As the performance conditions for those options granted in March 2000 and August 2000 were not met, the options lapsed in March 2010 and August 2010 respectively.
March 2004 – August 2004	That the Company's ranking based on TSR over the relevant period against a comparator group (17 UK and international financial services companies including Lloyds Banking Group) must be at least ninth, when 14 per cent of the option will be exercisable. If the Company is ranked first in the group, then 100 per cent of the option will be exercisable and if ranked tenth or below the performance condition is not met. Options granted in 2004 became exercisable as the performance condition was met on the re-test. The performance condition vested at 24 per cent for Truett Tate's March option and at 14 per cent for all other options granted to Executive Directors during 2004.
March 2005 – August 2005	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds Banking Group) must be at least eighth, when 30 per cent of the option will be exercisable. If the Company is ranked first to fourth position in the group, then 100 per cent of the option will be exercisable and if ranked ninth or below, the performance condition is not met. Options granted in 2005 became exercisable as the performance condition was met when tested. Grants vested at 82.5 per cent for all options granted to Executive Directors.

LLOYDS TSB EXECUTIVE RETENTION PLAN 2006

On 26 March 2008 (prior to his appointment as an Executive Director), Tim Tookey was granted an award under the Lloyds TSB Executive Retention Plan 2006. The award is satisfied in cash only and, subject to continued employment, gives him the right to receive an amount equal to the total value of 218,400 Lloyds Banking Group shares on the dates of vesting, as adjusted in August 2010 as a result of various corporate actions in 2009 on the same basis as the Lloyds TSB Long Term Incentive Plan. The award vests as to 50 per cent on 26 March 2011 and 50 per cent on 26 March 2013. He has agreed to reinvest the cash proceeds into Lloyds Banking Group shares. As an Executive Director, he is no longer eligible to be granted awards under this plan.

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LLOYDS TSB LONG-TERM INCENTIVE PLAN

The following table shows conditional shares awarded under the plan. Further information regarding this plan can be found on pages 140 and 141.

	At 1 January 2010	Awarded during the year	Vested during the year	Lapsed during the year	Share adjustment	At 31 December 2010	Year of vesting	Notes
J E Daniels	699,725	–	–	699,725	–	–	2010	
	1,098,372	–	–	–	592,385	1,690,757	2011	a, b
	1,496,843	–	–	–	807,292	2,304,135	2012	a, c
	2,245,265	–	–	–	1,210,939	3,456,204	2012	a, c
	–	5,135,781	–	–	–	5,135,781	2013	e
A G Kane	400,884	–	–	400,884	–	–	2010	
	541,252	–	–	–	291,913	833,165	2011	a, b
	853,273	–	–	–	460,196	1,313,469	2012	a, c
	1,279,909	–	–	–	690,293	1,970,202	2012	a, c
	–	2,927,643	–	–	–	2,927,643	2013	e
G T Tate	437,328	–	–	437,328	–	–	2010	
	679,186	–	–	–	366,305	1,045,491	2011	a, b
	925,583	–	–	–	499,195	1,424,778	2012	a, c
	1,388,376	–	–	–	748,793	2,137,169	2012	a, c
	–	3,175,748	–	–	–	3,175,748	2013	e
T J W Tookey	69,242	–	39,339	73,545	37,344	–	2010	d
	93,266	–	–	–	50,301	143,567	2011	a, b
	867,735	–	–	–	467,995	1,335,730	2012	a, c
	1,301,603	–	–	–	701,994	2,003,597	2012	a, c
	–	2,977,264	–	–	–	2,977,264	2013	e
H A Weir	419,106	–	–	419,106	–	–	2010	
	663,267	–	–	–	357,720	1,020,987	2011	a, b
	903,891	–	–	–	487,495	1,391,386	2012	a, c
	1,355,836	–	–	–	731,243	2,087,079	2012	a, c
	–	3,101,317	–	–	–	3,101,317	2013	e

a Conditional awards of shares made under this plan prior to 2010 were adjusted on 13 August 2010 as a result of the Capitalisation Issue and Rights Issue of 2009. These adjustments were made using a standard HMRC formula, to negate the dilutionary impact of the above corporate actions.

b Award price adjusted to 229.55p from 353.36p.

c Award price adjusted to 35.93p from 55.31p.

d Award vested at 31 per cent for Tim Tookey as he was not a director at the time the award was made. At vesting his award was adjusted to 106,586 from 69,242 to reflect the Capitalisation Issue and Rights Issue of 2009. The 'vested during the year' figure includes 6,298 dividend shares accumulated prior to the stopping of dividend payments. Award price adjusted to 267.3p from 539p. The closing market price of the Group's ordinary shares on the date of release was 64.05p.

e Share price on date of award 55.42p.

The following table contains information on the performance conditions for awards made under the long-term incentive plan. The Remuneration Committee chose the relevant performance conditions because they were felt to be challenging, aligned to shareholders' interests and appropriate at the time.

LTIP award	Performance conditions
March 2007	For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period needed to be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the retail price index over the same period. If it was less than 3 per cent per annum, the EPS Award would lapse. If the increase was more than 3 per cent but less than 6 per cent per annum, then the proportion of shares released would be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2007 and ended on 31 December 2009. For the other 50 per cent of the award (the 'TSR Award') – the Group's TSR needed to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award would vest where the Group's TSR was equal to median and vesting would occur on a straight line basis in between these points. Where the Group's TSR was below the median of the comparator group, the TSR Award would lapse. The relevant period commenced on 8 March 2007 (the date of award) and ended on 7 March 2010. At the end of the relevant period, neither of the performance conditions had been met and the Awards lapsed. Tim Tookey was not an Executive Director when his award was made in 2007, and as such his award vested at 31 per cent on the same basis as other award recipients below the Group Executive Committee level.
March and April 2008	For 50 per cent of the award (the 'EPS Award') – the performance condition was as described for March 2007 with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010. For the other 50 per cent of the award (the 'TSR Award') – the performance condition was as described for March 2007 with the relevant performance period commencing on 6 March 2008 (the date of the March award) and ending on 5 March 2011.
April 2009	**EPS:** The release of 50 per cent of the shares will be dependent on the extent to which growth in EPS achieves cumulative EPS targets over the three year period from January 2009 to December 2011. **Economic profit:** The release of the remaining 50 per cent of shares will be dependent on the extent to which the Group achieves cumulative Economic Profit targets over the three year period from January 2009 to December 2011. As indicated in last year's report, and as a consequence of the Group's non participation in GAPS, in June 2010 the Remuneration Committee determined that it was appropriate for the performance measures relative to those conditions to be restated:

EPS	Vesting %	Growth in EPS
Threshold	25%	26%
Maximum	100%	36%

Economic profit	Vesting %	Absolute improvement in adjusted EP
Threshold	25%	100%
Maximum	100%	202%

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AUDITED INFORMATION

April 2009
Integration Award

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

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

Performance for each of the first two years of the award has been assessed and all targets have been met or exceeded.

March 2010

EPS: Relevant to 36 per cent of the award. Performance will be measured based on absolute improvement in adjusted EPS over the three financial years starting on 1 January 2010 relative to an adjusted fully diluted 2009 EPS base.

Economic Profit: Relevant to 36 per cent of the award. Performance will be measured based on the compound annual growth rate of adjusted Economic Profit over the three financial years starting on 1 January 2010 relative to 2009 adjusted Economic Profit base.

Absolute Share Price: Relevant to 28 per cent of the award. Performance will be measured based on the Absolute Share Price on 26 March 2013, being the third anniversary of the award date.

The targets are:

EPS	Vesting %	Absolute improvement in adjusted EPS
Threshold	25%	158%
Maximum	100%	180%

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

Economic profit	Vesting %	Compound annual growth rate of adjusted EP
Threshold	25%	57% p.a.
Maximum	100%	77% p.a.

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

Absolute Share Price	Vesting %	Absolute Share Price
Threshold	0%	75p
Maximum	100%	114p

Vesting between threshold and maximum will be on a straight line basis, provided that shares comprised in the Absolute Share Price element of the award may only be released if both the EPS and Economic Profit performance measures have been satisfied at the threshold level or above.

Alithos Limited provided information for the testing of the TSR performance conditions for the Company's long-term incentive plan. EPS is the Group's normalised earnings per share as shown in the Group's report and accounts, subject to such adjustments as the Remuneration Committee regards as necessary for consistency.

None of those who were Directors at the end of the year had any other interest in the capital of Lloyds Banking Group plc or its subsidiaries.

The register of Directors' interests, which is open to inspection, contains full particulars of Directors' shareholdings and options to acquire shares in Lloyds Banking Group.

On behalf of the Board

Harry F Baines
Company Secretary
24 February 2011

OTHER REMUNERATION DISCLOSURE

EMOLUMENTS OF THE FIVE HIGHEST PAID SENIOR EXECUTIVES

	Employee				
	1 £000	2 £000	3 £000	4 £000	5 £000
Fixed					
Cash based	**500**	**735**	**300**	**480**	**335**
Total fixed	**500**	**735**	**300**	**480**	**335**
Variable[1]					
Upfront cash	**2**	**2**	**2**	**2**	**2**
Deferred cash	**0**	**0**	**0**	**0**	**0**
Upfront shares	**0**	**0**	**0**	**0**	**0**
Deferred shares	**3,998**	**1,200**	**1,498**	**658**	**848**
Long term incentive plan	**205**	**927**	**92**	**263**	**137**
Total variable pay	**4,205**	**2,129**	**1,592**	**923**	**987**
Pension cost[2]	**125**	**184**	**75**	**120**	**84**
Total remuneration	**4,830**	**3,048**	**1,967**	**1,523**	**1,406**

[1] Variable pay in respect of performance year 2010.

[2] Pension cost based on an average pension cost of 25 per cent of salary.

There were no sign-on or severance payments made in respect of this group

The aggregate remuneration of Directors and Senior Management (being members of the Group Executive Committee) for the year ended 31 December 2010 was £16,466,363

The aggregate amount set aside or accrued to provide pension, retirement or similar benefits for Directors and Senior Management for the year ended 31 December 2010 was £1,273,750 based on average pension cost of 25 per cent of salary.

Executive Directors and members of Senior Management are generally subject to notice periods of up to 12 months. António Horta-Osório has a notice period of 24 months diminishing to 12 months over the first year of his employment.

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REPORT OF THE INDEPENDENT AUDITORS ON THE CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

We have audited the group financial statements of Lloyds Banking Group plc for the year ended 31 December 2010 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Directors' Responsibilities Statement on page 122, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

OPINION ON FINANCIAL STATEMENTS

In our opinion the group financial statements:

– give a true and fair view of the state of the group's affairs as at 31 December 2010 and of its loss and cash flows for the year then ended;
– have been properly prepared in accordance with IFRSs as adopted by the European Union; and
– have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

– the information given in the Directors' Report for the financial year for which the group financial statements are prepared is consistent with the group financial statements; and
– the information given in the Corporate Governance Statement set out on pages 114 to 123 with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

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MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

We have nothing to report in respect of the following:

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

– certain disclosures of directors' remuneration specified by law are not made; or
– we have not received all the information and explanations we require for our audit; or
– a corporate governance statement has not been prepared by the parent company.

Under the Listing Rules we are required to review:

– the directors' statement, on page 113, in relation to going concern;
– the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
– certain elements of the report to shareholders by the Board on directors' remuneration.

OTHER MATTER

We have reported separately on the parent company financial statements of Lloyds Banking Group plc for the year ended 31 December 2010 and on the information in the Directors' Remuneration Report that is described as having been audited.

Ian Rankin
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
24 February 2011

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

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

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2010

	Note	2010 £ million	2009 £ million
Interest and similar income		**29,340**	28,238
Interest and similar expense		**(16,794)**	(19,212)
Net interest income	5	**12,546**	9,026
Fee and commission income		**4,415**	4,254
Fee and commission expense		**(1,682)**	(1,517)
Net fee and commission income	6	**2,733**	2,737
Net trading income	7	**15,724**	19,098
Insurance premium income	8	**8,148**	8,946
Other operating income	9	**4,316**	5,490
Other income		**30,921**	36,271
Total income		**43,467**	45,297
Insurance claims	10	**(18,511)**	(22,019)
Total income, net of insurance claims		**24,956**	23,278
Operating expenses	11	**(13,270)**	(15,984)
Trading surplus		**11,686**	7,294
Impairment	12	**(10,952)**	(16,673)
Share of results of joint ventures and associates	13	**(88)**	(752)
Gain on acquisition	14	**–**	11,173
Loss on disposal of businesses	15	**(365)**	–
Profit before tax		**281**	1,042
Taxation	16	**(539)**	1,911
(Loss) profit for the year		**(258)**	2,953
Profit attributable to non-controlling interests		**62**	126
(Loss) profit attributable to equity shareholders		**(320)**	2,827
(Loss) profit for the year		**(258)**	2,953
Basic earnings per share	17	**(0.5)p**	7.5p
Diluted earnings per share	17	**(0.5)p**	7.5p
Dividend per share for the year		**–**	–
Dividend for the year	51	**–**	–

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

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2010

	2010 £ million	2009 £ million
(Loss) profit for the year	**(258)**	2,953
Other comprehensive income		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value	**1,231**	2,234
Income statement transfers in respect of disposals	**(399)**	(97)
Income statement transfers in respect of impairment	**114**	621
Other income statement transfers	**(110)**	(93)
Taxation	**(343)**	(417)
	493	2,248
Movement in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**(1,048)**	(530)
Net income statement transfers	**932**	121
Taxation	**30**	119
	(86)	(290)
Currency translation differences:		
Currency translation differences, before tax	**(129)**	(37)
Taxation	**–**	(182)
	(129)	(219)
Other comprehensive income for the year, net of tax	**278**	1,739
Total comprehensive income for the year	**20**	4,692
Total comprehensive income attributable to non-controlling interests	**57**	107
Total comprehensive income attributable to equity shareholders	**(37)**	4,585
Total comprehensive income for the year	**20**	4,692

CONSOLIDATED BALANCE SHEET

at 31 December 2010

	Note	2010 £ million	2009 £ million
Assets			
Cash and balances at central banks		**38,115**	38,994
Items in the course of collection from banks		**1,368**	1,579
Trading and other financial assets at fair value through profit or loss	18	**156,191**	150,011
Derivative financial instruments	19	**50,777**	49,928
Loans and receivables:			
Loans and advances to banks	20	**30,272**	35,361
Loans and advances to customers	21	**592,597**	626,969
Debt securities	24	**25,735**	32,652
		648,604	694,982
Available-for-sale financial assets	26	**42,955**	46,602
Held-to-maturity investments	27	**7,905**	–
Investment properties	28	**5,997**	4,757
Investments in joint ventures and associates	13	**429**	479
Goodwill	29	**2,016**	2,016
Value of in-force business	30	**7,367**	6,685
Other intangible assets	31	**3,496**	4,087
Tangible fixed assets	32	**8,190**	9,224
Current tax recoverable		**621**	680
Deferred tax assets	44	**4,164**	5,006
Retirement benefit assets	43	**736**	–
Other assets	33	**12,643**	12,225
Total assets		**991,574**	1,027,255

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

The directors approved the consolidated financial statements on 24 February 2011.

Sir Winfried Bischoff
Chairman

J Eric Daniels
Group Chief Executive

Tim J W Tookey
Group Finance Director

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CONSOLIDATED BALANCE SHEET
at 31 December 2010

Equity and liabilities	Note	2010 £ million	2009[1] £ million
Liabilities			
Deposits from banks	34	**50,363**	82,452
Customer deposits	35	**393,633**	406,741
Items in course of transmission to banks		**802**	1,037
Trading and other financial liabilities at fair value through profit or loss	36	**26,762**	28,271
Derivative financial instruments	19	**42,158**	40,485
Notes in circulation		**1,074**	981
Debt securities in issue	37	**228,866**	233,502
Liabilities arising from insurance contracts and participating investment contracts	38	**80,729**	76,179
Liabilities arising from non-participating investment contracts	40	**51,363**	46,348
Unallocated surplus within insurance businesses	41	**643**	1,082
Other liabilities	42	**29,696**	29,320
Retirement benefit obligations	43	**423**	780
Current tax liabilities		**149**	51
Deferred tax liabilities	44	**247**	209
Other provisions	45	**1,532**	983
Subordinated liabilities	46	**36,232**	34,727
Total liabilities		**944,672**	983,148
Equity			
Share capital	47	**6,815**	10,472
Share premium account	48	**16,291**	14,472
Other reserves	49	**11,575**	7,217
Retained profits	50	**11,380**	11,117
Shareholders' equity		**46,061**	43,278
Non-controlling interests		**841**	829
Total equity		**46,902**	44,107
Total equity and liabilities		**991,574**	1,027,255

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

[1]Restated (see note 1).

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2010	24,944	7,217	11,117	43,278	829	44,107
Comprehensive income						
(Loss) profit for the year	–	–	(320)	(320)	62	(258)
Other comprehensive income						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	498	–	498	(5)	493
Movement in cash flow hedging reserve, net of tax	–	(86)	–	(86)	–	(86)
Currency translation differences, net of tax	–	(129)	–	(129)	–	(129)
Total other comprehensive income	–	283	–	283	(5)	278
Total comprehensive income	–	283	(320)	(37)	57	20
Transactions with owners						
Dividends	–	–	–	–	(47)	(47)
Issue of ordinary shares	2,237	–	–	2,237	–	2,237
Redemption of preference shares	11	(11)	–	–	–	–
Cancellation of deferred shares	(4,086)	4,086	–	–	–	–
Purchase/sale of treasury shares	–	–	429	429	–	429
Employee share option schemes:						
Value of employee services	–	–	154	154	–	154
Change in non-controlling interests	–	–	–	–	2	2
Total transactions with owners	(1,838)	4,075	583	2,820	(45)	2,775
Balance at 31 December 2010	23,106	11,575	11,380	46,061	841	46,902

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves[1] £ million	Retained profits[1] £ million	Total £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2009:						
As previously stated	3,609	(2,476)	8,260	9,393	306	9,699
Prior year adjustment[1]	–	131	(131)	–	–	–
Restated	3,609	(2,345)	8,129	9,393	306	9,699
Comprehensive income						
Profit for the year	–	–	2,827	2,827	126	2,953
Other comprehensive income						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	2,248	–	2,248	–	2,248
Movement in cash flow hedging reserve, net of tax	–	(290)	–	(290)	–	(290)
Currency translation differences, net of tax	–	(200)	–	(200)	(19)	(219)
Total other comprehensive income	–	1,758	–	1,758	(19)	1,739
Total comprehensive income	–	1,758	2,827	4,585	107	4,692
Transactions with owners						
Dividends	–	–	–	–	(116)	(116)
Issue of ordinary shares:						
Placing and open offer	649	3,781	–	4,430	–	4,430
Issued on acquisition of HBOS	1,944	5,707	–	7,651	–	7,651
Placing and compensatory open offer	3,905	–	–	3,905	–	3,905
Rights issue	13,112	–	–	13,112	–	13,112
Issued to Lloyds TSB Foundations	41	–	–	41	–	41
Adjustment on acquisition	–	–	–	–	5,567	5,567
Transfer to merger reserve	(1,000)	1,000	–	–	–	–
Redemption of preference shares	2,684	(2,684)	–	–	–	–
Purchase/sale of treasury shares	–	–	45	45	–	45
Employee share option schemes:						
Value of employee services	–	–	116	116	–	116
Extinguishment of non-controlling interests	–	–	–	–	(5,035)	(5,035)
Total transactions with owners	21,335	7,804	161	29,300	416	29,716
Balance at 31 December 2009[1]	24,944	7,217	11,117	43,278	829	44,107

[1]Restated (see note 1).

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2010

	Note	2010 £ million	2009 £ million
Profit before tax		**281**	1,042
Adjustments for:			
Change in operating assets	57(A)	**31,860**	61,942
Change in operating liabilities	57(B)	**(45,683)**	(105,927)
Non-cash and other items	57(C)	**11,173**	8,907
Tax received		**332**	301
Net cash used in operating activities		**(2,037)**	(33,735)
Cash flows from investing activities			
Purchase of available-for-sale financial assets		**(42,662)**	(455,816)
Proceeds from sale and maturity of available-for-sale financial assets		**45,999**	490,561
Purchase of held-to-maturity investments		**(4,228)**	–
Purchase of fixed assets		**(3,216)**	(2,689)
Proceeds from sale of fixed assets		**1,354**	2,129
Acquisition of businesses, net of cash acquired	57(F)	**(73)**	16,227
Disposal of businesses, net of cash disposed	57(G)	**428**	411
Net cash (used in) provided by investing activities		**(2,398)**	50,823
Cash flows from financing activities			
Dividends paid to non-controlling interests	57(E)	**(47)**	(116)
Interest paid on subordinated liabilities		**(1,942)**	(2,622)
Proceeds from issue of subordinated liabilities	57(E)	**3,237**	4,187
Proceeds from issue of ordinary shares	57(E)	**–**	21,533
Repayment of subordinated liabilities	57(E)	**(684)**	(6,897)
Change in stake of non-controlling interests		**2**	(33)
Net cash provided by financing activities		**566**	16,052
Effects of exchange rate changes on cash and cash equivalents		**479**	(210)
Change in cash and cash equivalents		**(3,390)**	32,930
Cash and cash equivalents at beginning of year		**65,690**	32,760
Cash and cash equivalents at end of year	57(D)	**62,300**	65,690

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 BASIS OF PREPARATION

The consolidated financial statements of Lloyds Banking Group plc have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and its predecessor body. The EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. As stated on page 113, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

During 2010, the International Financial Reporting Interpretations Committee clarified the treatment of amounts previously recognised in equity in respect of assets that were transferred from the available-for-sale category to the loans and receivables category. When an impairment loss is recognised in respect of such transferred financial assets, the unamortised balance of any available-for-sale revaluation reserve that remains in equity should be transferred to the income statement and recorded as part of the impairment loss. The Group has changed its accounting policy to reflect this clarification. Under the Group's previous accounting policy, when such a transferred financial asset became impaired, not all of the unamortised amounts previously transferred to equity were recycled to the income statement and therefore continued to be accreted over the expected remaining life of the financial asset. This change is applied retrospectively and the effect has been to reduce retained profits and increase available-for-sale revaluation reserves by £131 million at 1 January 2009; shareholders' equity is unchanged. There was no material effect on the Group's income statement during 2009.

Also during 2010, the Group has classified assets as held-to-maturity for the first time. Purchases of government debt securities of £4,228 million made in the second half of 2010 were classified as held-to-maturity on acquisition, were initially recognised at fair value including direct and incremental transaction costs and are being measured subsequently at amortised cost, using the effective interest method. Further, on 1 November 2010, government debt securities with a carrying value of £3,601 million, previously classified as available-for-sale, were reclassified to held-to-maturity. Unrealised gains on the transferred securities of £223 million previously taken to equity continue to be held in the available-for-sale revaluation reserve and will be amortised to the income statement over the remaining lives of the securities using the effective interest method or until the assets become impaired.

The Group has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2010. None of these standards or amendments have had a material impact on these financial statements.

(i) IFRS 3 *Business Combinations*. This revised standard applies prospectively to business combinations from 1 January 2010. The revised standard continues to require the use of the acquisition method of accounting for business combinations. All payments to purchase a business are to be recorded at fair value at the acquisition date, some contingent payments are subsequently remeasured at fair value through income, goodwill may be calculated based on the parent's share of net assets or it may include goodwill related to the non-controlling interest, and all transaction costs are expensed (other than those in relation to the issuance of debt instruments or share capital).

(ii) IAS 27 *Consolidated and Separate Financial Statements*. Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control; any remaining interest in an investee is remeasured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.

(iii) IFRIC 17 *Distributions of Non-cash Assets to Owners*. Provides accounting guidance for non-reciprocal distributions of non-cash assets to owners (and those in which owners may elect to receive a cash alternative).

(iv) Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – 'Eligible Hedged Items'*. Clarifies how the principles underlying hedge accounting should be applied in particular situations.

(v) *Improvements to IFRSs* (issued April 2009). Sets out minor amendments to IFRS standards as part of the annual improvements process.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2010 and which have not been applied in preparing these financial statements are given in note 58.

2 ACCOUNTING POLICIES

The Group's accounting policies are set out below.

(A) CONSOLIDATION

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

(1) Subsidiaries

Subsidiaries include entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Details of the principal subsidiaries are given in note 9 to the parent company financial statements.

Investment vehicles, such as Open Ended Investment Companies (OEICs), where the Group has control, typically through acting as fund manager and the life funds having a beneficial interest greater than 50 per cent, are consolidated. The non-controlling unitholders' interest is reported in other liabilities.

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

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

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

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

(2) Joint ventures and associates

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

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

(B) GOODWILL

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

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

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(C) OTHER INTANGIBLE ASSETS

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

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

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

(D) REVENUE RECOGNITION

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

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

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

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

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

(E) FINANCIAL ASSETS AND LIABILITIES

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

(1) Financial instruments at fair value through profit or loss

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

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

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

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

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Refer to note 3 (Critical accounting estimates and judgements: Fair value of financial instruments) and note 55(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

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

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

(2) Available-for-sale financial assets

Debt securities and equity shares that are not classified as trading securities, at fair value through profit or loss, held-to-maturity investments or as loans and receivables are classified as available-for-sale financial assets and are recognised in the balance sheet at their fair value, inclusive of transaction costs. Available-for-sale financial assets are those intended to be held for an indeterminate period of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in other comprehensive income, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement. Interest calculated using the effective interest method and foreign exchange gains and losses on debt securities denominated in foreign currencies are recognised in the income statement.

The Group is permitted to transfer a financial asset from the available-for-sale category to the loans and receivables category where that asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale) and where there is both the intention and ability to hold that financial asset for the foreseeable future. Reclassification of a financial asset from the available-for-sale category to the held-to-maturity category is permitted when the Group has the ability and intent to hold that financial asset to maturity.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable. Effective interest rates for financial assets reclassified to the loans and receivables and held-to-maturity categories are determined at the reclassification date. Any previous gain or loss on a transferred asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the effective interest method or until the asset becomes impaired. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the effective interest method.

When an impairment loss is recognised in respect of available-for-sale assets transferred, the unamortised balance of any available-for-sale reserve that remains in equity is transferred to the income statement and recorded as part of the impairment loss.

(3) Loans and receivables

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

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. These loans and advances to customers continue to be recognised by the Group, together with a corresponding liability for the funding.

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(4) Held-to-maturity investments

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

– those that the Group designates upon initial recognition as at fair value through profit or loss;

– those that the Group designates as available-for-sale; and

– those that meet the definition of loans and receivables.

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

(5) Borrowings

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

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

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

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

(6) Sale and repurchase agreements

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

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

(7) Derecognition of financial assets and liabilities

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

– substantially all of the risks and rewards of ownership have been transferred; or

– the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

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

(F) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and option pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 3 (Critical accounting estimates and judgements: Fair value of financial instruments) and note 55(3) (Financial instruments: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

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

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

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

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

(1) Fair value hedges

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

(2) Cash flow hedges

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

(3) Net investment hedges

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

(G) OFFSET

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

(H) IMPAIRMENT OF FINANCIAL ASSETS

(1) Assets accounted for at amortised cost

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition of the financial asset and prior to the balance sheet date, there is objective evidence that a financial asset or group of financial assets has become impaired.

Where such an event has had an impact on the estimated future cash flows of the financial asset or group of financial assets, an impairment allowance is recognised. The amount of impairment allowance is the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If the asset has a variable rate of interest, the discount rate used for measuring the impairment allowance is the current effective interest rate.

Subsequent to the recognition of an impairment loss on a financial asset or a group of financial assets, interest income continues to be recognised on an effective interest rate basis, on the asset's carrying value net of impairment provisions. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

Impairment allowances are assessed individually for financial assets that are individually significant. Such individual assessment is used primarily for the Group's wholesale lending portfolios in the Wholesale and Wealth and International divisions. Impairment allowances for portfolios of smaller balance homogenous loans such as most residential mortgages, personal loans and credit card balances in the Group's retail portfolios in both the Retail and Wealth and International divisions that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis.

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INDIVIDUAL ASSESSMENT

In respect of individually significant financial assets in the Group's wholesale lending portfolios, assets are reviewed on a regular basis and those showing potential or actual vulnerability are placed on a watch list where greater monitoring is undertaken and any adverse or potentially adverse impact on ability to repay is used in assessing whether an asset should be transferred to a dedicated Business Support Unit. Specific examples of trigger events that would lead to the initial recognition of impairment allowances against lending to corporate borrowers (or the recognition of additional impairment allowances) include (i) trading losses, loss of business or major customer of a borrower, (ii) material breaches of the terms and conditions of a loan facility, including non-payment of interest or principal, or a fall in the value of security such that it is no longer considered adequate, (iii) disappearance of an active market because of financial difficulties, or (iv) restructuring a facility with preferential terms to aid recovery of the lending (such as a debt for equity swap).

For such individually identified financial assets, a review is undertaken of the expected future cash flows which requires significant management judgement as to the amount and timing of such cash flows. Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of costs to realise, whether or not foreclosure or realisation of the collateral is probable.

For impaired debt instruments which are held at amortised cost, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows. A reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment.

COLLECTIVE ASSESSMENT

In respect of portfolios of smaller balance, homogenous loans, the asset is included in a group of financial assets with similar risk characteristics and collectively assessed for impairment. Segmentation takes into account factors such as the type of asset, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Generally, the impairment trigger used within the impairment calculation for a loan, or group of loans, is when they reach a pre-defined level of delinquency or where the customer is bankrupt. Loans where the Group provides arrangements that forgive a portion of interest or principal are also deemed to be impaired and loans that are originated to refinance currently impaired assets are also defined as impaired.

In respect of the Group's secured mortgage portfolios, the impairment allowance is calculated based on a definition of impaired loans which are those six months or more in arrears (or where the borrower is bankrupt or is in possession). The estimated cash flows are calculated based on historical experience and are dependent on estimates of the expected value of collateral which takes into account expected future movements in house prices, less costs to sell.

For unsecured personal lending portfolios, the impairment trigger is generally when the balance is two or more instalments in arrears or where the customer has exhibited one or more of the impairment characteristics noted above. While the trigger is based on the payment performance or circumstances of each individual asset, the assessment of future cash flows uses historical experience of cohorts of similar portfolios such that the assessment is considered to be collective. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the cohort and historical loss experience for similar assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

The collective provision also includes provision for inherent losses, that is losses that have been incurred but have not been identified at the balance sheet date. The loans that are not currently recognised as impaired are grouped into homogenous portfolios by key risk drivers. An assessment is made, based on statistical techniques, of the likelihood of each account becoming recognised as impaired within an emergence period, with the economic loss that each portfolio is likely to generate were it to become impaired. The emergence period is the time between the loss event and the date the impairment is recognised. The emergence period is determined by local management for each portfolio. In general the periods used across the Group vary between one month and twelve months based on historical experience.

LOAN RENEGOTIATIONS AND FORBEARANCE

In certain circumstances, the Group will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. There are a number of different types of loan renegotiation, including the capitalisation of arrears, payment holidays, interest rate adjustments and extensions of the due date of payment. Where the renegotiated payments of interest and principal will not recover the original carrying value of the asset, the asset continues to be reported as past due and is considered impaired. Where the renegotiated payments of interest and principal will recover the original carrying value of the asset, the loan is no longer reported as past due or impaired provided that payments are made in accordance with the revised terms. In other cases, renegotiation may lead to a new agreement, which is treated as a new loan.

WRITE OFFS

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

DEBT FOR EQUITY EXCHANGES

Equity securities acquired in exchange for loans in order to achieve an orderly realisation are accounted for as a disposal of the loan and an acquisition of equity securities. Where control is obtained over an entity as a result of the transaction, the entity is consolidated; where the Group has significant influence over an entity as a result of the transaction, the investment is accounted for by the equity method of accounting (see (A) above). Any subsequent impairment of the assets or business acquired is treated as an impairment of the relevant asset or business and not as an impairment of the original instrument.

(2) Available-for-sale financial assets

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

(I) INVESTMENT PROPERTY

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

(J) TANGIBLE FIXED ASSETS

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

Premises (excluding land):

– Freehold/long and short leasehold premises: shorter of 50 years and the remaining period of the lease

– Leasehold improvements: shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease

Equipment:

– Fixtures and furnishings: 10-20 years

– Other equipment and motor vehicles: 2-8 years

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

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

(K) LEASES

(1) As lessee

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

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

(2) As lessor

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee but not necessarily legal title. All other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments, together with any unguaranteed residual value, is recognised as a receivable, net of provisions, within loans and advances to

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banks and customers. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance lease income. Finance lease income is recognised in interest income over the term of the lease using the net investment method (before tax) so as to give a constant rate of return on the net investment in the leases. Unguaranteed residual values are reviewed regularly to identify any impairment.

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

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

(L) PENSIONS AND OTHER POST-RETIREMENT BENEFITS

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

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

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

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

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

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

(M) SHARE-BASED COMPENSATION

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

(N) TAXATION

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

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

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset

or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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

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

(O) INSURANCE

The Group undertakes both life insurance and general insurance business.

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

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

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

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

The general insurance business issues only insurance contracts.

(1) Life insurance business

(i) ACCOUNTING FOR INSURANCE AND PARTICIPATING INVESTMENT CONTRACTS

Premiums and claims

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

Liabilities

– Insurance and participating investment contracts in the Group's with-profit funds

Liabilities of the Group's with-profit funds, including guarantees and options embedded within products written by these funds, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime, except that projected transfers out of the funds into other Group funds are recorded in the unallocated surplus (see below). Further details on the realistic capital regime are given on page 103. Changes in the value of these liabilities are recognised through insurance claims.

– Insurance and participating investment contracts which are not unit-linked or in the Group's with-profit funds

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life insurance and annuity benefits where future mortality is uncertain.

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

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

– Insurance and participating investment contracts which are unit-linked

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

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Unallocated surplus

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

(ii) ACCOUNTING FOR NON-PARTICIPATING INVESTMENT CONTRACTS

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

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

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

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

(iii) VALUE OF IN-FORCE BUSINESS

The Group recognises as an asset the value of in-force business in respect of insurance contracts and participating investment contracts. The asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts written at the balance sheet date. This is determined after making appropriate assumptions about future economic and operating conditions such as future mortality and persistency rates and includes allowances for both non-market risk and for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

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

(2) General insurance business

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

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

(3) Liability adequacy test

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

(4) Reinsurance

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

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

(P) FOREIGN CURRENCY TRANSLATION

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

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

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

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

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

(Q) PROVISIONS AND CONTINGENT LIABILITIES

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

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

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

(R) SHARE CAPITAL

(1) Share issue costs

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

(2) Dividends

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

(3) Treasury shares

Where the Company or any member of the Group purchases the Company's share capital, the consideration paid is deducted from shareholders' equity as treasury shares until they are cancelled. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

(S) CASH AND CASH EQUIVALENTS

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

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3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

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

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

The estimates and judgements applied to these areas in the preparation of the Group's financial statements are summarised below.

ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

At 31 December 2010 gross loans and receivables totalled £667,555 million (2009: £710,362 million) against which impairment allowances of £18,951 million (2009: £15,380 million) had been made (see note 25). The Group's accounting policy for losses arising on financial assets classified as loans and receivables is described in note 2(H)(1); this note also provides an overview of the methodologies applied.

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

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

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

Given the relative size of the mortgage portfolio, a key variable is UK house prices which determine the collateral value supporting loans in such portfolios. The value of this collateral is estimated by applying changes in house price indices to the original assessed value of the property. If average house prices were 10 per cent lower than those estimated at 31 December 2010, the Retail division's impairment charge would increase by approximately £250 million.

In addition, a collective unimpaired provision is made for loan losses that have been incurred but have not been separately identified at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Wholesale division, an increase of one month in the loss emergence period in respect of the loan portfolio assessed for collective unimpaired provisions would result in an increase in the collective unimpaired provision of approximately £333 million.

UNWIND OF HBOS ACQUISITION FAIR VALUE ADJUSTMENTS

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

In the periods subsequent to the acquisition, many of the fair value adjustments unwind and are recognised in the Group's income statement. The fair value adjustments made to debt securities and subordinated liabilities unwind over the expected remaining life of the related securities except in the event that the liability is extinguished, in which case the remaining unamortised fair value adjustment is recognised in the income statement immediately. The fair value adjustment relating to loans and receivables broadly comprises two elements; an element reflecting expected future impairment losses at the date of acquisition and an element reflecting market liquidity. The element relating to market liquidity unwinds to the income statement over the estimated useful lives of the related assets. However, significant management judgement is required to determine the timing of the unwind of the element relating to future credit losses. This includes the identification of losses which were expected at the date of acquisition and assessing whether anticipated losses will still be incurred. In 2010, a net credit of £3,118 million to the income statement relates to the unwind of HBOS acquisition fair value adjustments. Of that amount, £2,229 million relates to impairment losses incurred which were expected at the date of acquisition and £845 million relates to a reassessment of future credit losses.

FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with IFRS 7, the Group categorises financial instruments carried on the balance sheet at fair value using a three level hierarchy. Financial instruments categorised as level 1 are valued using quoted market prices and therefore there is minimal judgement applied in determining fair value. However, the fair value of financial instruments categorised as level 2 and, in particular, level 3 is determined using valuation techniques including discounted cash flow analysis and valuation models. These require management judgement and contain significant estimation uncertainty.

In particular, significant judgement is required by management in determining appropriate assumptions to be used for level 3 financial instruments. At 31 December 2010, the Group classified £7,468 million of financial assets and £257 million of financial liabilities as level 3. The effect of applying reasonably possible alternative assumptions in determining the fair value of the Group's level 3 financial assets is set out in note 55.

RECOVERABILITY OF DEFERRED TAX ASSETS

At 31 December 2010 the Group carried deferred tax assets on its balance sheet of £4,164 million (2009: £5,006 million) and deferred tax liabilities of £247 million (2009: £209 million) (note 44). This presentation takes into account the ability of the Group to net deferred tax assets and liabilities only where there is a legally enforceable right of offset. Note 44 presents the Group's deferred tax assets and liabilities by type. The largest category of deferred tax asset relates to tax losses carried forward. At 31 December 2010, the Group recognised a deferred tax asset of £6,572 million (2009 £5,925 million) in respect of tax losses carried forward.

The recognition of a deferred tax asset in respect of tax losses is permitted only to the extent that it is probable that future taxable profits will be available to utilise the tax losses carried forward. The assessment of future taxable profits involves significant estimation uncertainty, principally relating to management's projections of future taxable income which are based on business plans. These projections include assumptions about the future strategy of the Group, the economic and regulatory environment in which the Group operates, future tax legislation, customer behaviour, and the ability of the Group to deliver expected integration benefits, amongst other variables. At 31 December 2010, management has concluded that future taxable profits generated by the Group companies with tax losses carried forward are expected to be sufficient to utilise the tax losses carried forward in full.

RETIREMENT BENEFIT OBLIGATIONS

The net asset recognised in the balance sheet at 31 December 2010 in respect of the Group's retirement benefit obligations was £313 million (comprising an asset of £736 million and a liability of £423 million) (2009: a liability of £780 million) of which an asset of £479 million (2009: a liability of £619 million) related to defined benefit pension schemes. As explained in note 2(L), the Group adopts the corridor approach to the recognition of actuarial gains and losses in respect of its pension schemes and as a consequence has not recognised actuarial losses of £959 million (2009: £2,936 million). The defined benefit pension schemes' gross deficit totalled £480 million (2009: £3,555 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

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

The effect on the gross defined benefit pension scheme asset or liability and on the pension charge in the Group's income statement of changes to the principal actuarial assumptions is set out in note 43.

VALUATION OF ASSETS AND LIABILITIES ARISING FROM LIFE INSURANCE BUSINESS

At 31 December 2010, the Group recognised a value in-force business asset of £5,898 million (2009: £5,140 million) and an acquired value in-force business asset of £1,469 million (2009: £1,545 million). The value in-force business asset represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. The acquired value in-force business asset represents the contractual rights to benefits from providing investment management services in relation to non-participating investment contracts acquired in business combinations and portfolio transfers. The methodology used to value these assets is set out in note 2(O)(1). The valuation or recoverability of these assets requires assumptions to be made about future economic and operating conditions which are inherently uncertain and changes could significantly affect the value attributed to these assets. The key assumptions that have been made in determining the carrying value of the value in-force business assets at 31 December 2010 are set out in note 30.

At 31 December 2010, the Group carried liabilities arising from insurance contracts and participating investment contracts of £80,729 million (2009: £76,179 million). The methodology used to value these liabilities is described in note 2(O)(1). Elements of the liability valuations require assumptions to be made about future investment returns, future mortality rates and future policyholder behaviour and are subject to significant management judgement and estimation uncertainty. The key assumptions that have been made in determining the carrying value of these liabilities are set out in note 38.

The effect on the Group's profit before tax and shareholders' equity of changes in key assumptions used in determining the life insurance assets and liabilities is set out in note 39.

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4 SEGMENTAL ANALYSIS

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

The Group Executive Committee has been determined to be the chief operating decision maker for the Group. The Group's operating segments reflect its organisational and management structures. The Group Executive Committee reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources. 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 continue to be 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 the comparatives for 2009 include the pre-acquisition results of HBOS for the period from 1 January 2009 to 16 January 2009.

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

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 segmented according to customer need. The division comprises Corporate Markets, Treasury and Trading and Asset Finance.

Wealth and International was created in 2009 to give increased focus and momentum to the Group's private banking and asset management activities and to closely co-ordinate the management of its international businesses. Wealth comprises the Group's private banking, wealth and asset management businesses in the UK and overseas. International comprises corporate, commercial, asset finance and retail businesses, principally in Australia and Continental Europe.

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

Other includes the results of managing the Group's technology platforms, branch and head office property estate, operations (including payments, banking operations and collections) and procurement services, the costs of which are predominantly recharged to the other divisions. It also reflects other items not recharged to the divisions, including hedge ineffectiveness and certain capital and wholesale liquidity funding costs.

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

For those derivative contracts entered into by business units for risk management purposes, the business unit retains the amount that would have been recognised on an accrual accounting basis (an amount equal to the interest element of the next payment on the swap) and transfers the remainder of the fair value of the swap to the central group segment where the resulting accounting volatility is managed though the establishment of hedge accounting relationships. Any change in fair value of the hedged instrument attributable to the hedged risk is also recorded within the central group segment. This allocation of the fair value of the swap and change in fair value of the hedged instrument attributable to the hedged risk avoids accounting asymmetry in segmental results and records volatility in the central group segment where it is managed.

	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Other £m	Reported basis total £m
Year ended 31 December 2010						
Net interest income	9,378	4,426	1,176	(263)	(895)	13,822
Other income (net of fee and commission expense)	1,607	4,136	1,160	2,814	447	10,164
Total income	10,985	8,562	2,336	2,551	(448)	23,986
Insurance claims	–	–	–	(542)	–	(542)
Total income, net of insurance claims	10,985	8,562	2,336	2,009	(448)	23,444
Costs:						
Operating expenses	(4,644)	(3,744)	(1,536)	(854)	(150)	(10,928)
Impairment of tangible fixed assets	–	(150)	–	–	–	(150)
	(4,644)	(3,894)	(1,536)	(854)	(150)	(11,078)
Trading surplus	6,341	4,668	800	1,155	(598)	12,366
Impairment	(2,747)	(4,446)	(5,988)	–	–	(13,181)
Share of results of joint ventures and associates	17	(95)	(8)	(10)	5	(91)
Profit (loss) before tax and fair value unwind	3,611	127	(5,196)	1,145	(593)	(906)
Fair value unwind	1,105	3,130	372	(43)	(1,446)	3,118
Profit (loss) before tax	4,716	3,257	(4,824)	1,102	(2,039)	2,212
External revenue	13,603	3,969	3,000	3,180	234	23,986
Inter-segment revenue	(2,618)	4,593	(664)	(629)	(682)	–
Segment revenue	10,985	8,562	2,336	2,551	(448)	23,986
Segment external assets	370,708	355,582	85,158	144,540	35,586	991,574
Segment customer deposits	235,591	124,262	32,784	–	996	393,633
Other segment items reflected in income statement above:						
Depreciation and amortisation	384	1,133	87	135	64	1,803
Increase in value of in-force business	–	–	2	787	–	789
Defined benefit scheme charges	176	89	36	28	126	455
Other segment items:						
Additions to tangible fixed assets	126	1,708	20	585	777	3,216
Investments in joint ventures and associates at end of year	139	127	158	–	5	429

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	Retail £m	Wholesale £m	Wealth and International £m	Insurance £m	Other £m	Reported basis total £m
Year ended 31 December 2009						
Net interest income	7,970	4,710	1,217	(287)	(884)	12,726
Other income (net of fee and commission expense)	1,804	4,199	1,128	2,944	1,800	11,875
Total income	9,774	8,909	2,345	2,657	916	24,601
Insurance claims	–	–	–	(637)	–	(637)
Total income, net of insurance claims	9,774	8,909	2,345	2,020	916	23,964
Operating expenses	(4,566)	(4,106)	(1,544)	(974)	(419)	(11,609)
Trading surplus	5,208	4,803	801	1,046	497	12,355
Impairment	(4,227)	(15,683)	(4,078)	–	–	(23,988)
Share of results of joint ventures and associates	(6)	(720)	(21)	(22)	2	(767)
Profit (loss) before tax and fair value unwind	975	(11,600)	(3,298)	1,024	499	(12,400)
Fair value unwind	407	6,897	942	(49)	(2,097)	6,100
Profit (loss) before tax	1,382	(4,703)	(2,356)	975	(1,598)	(6,300)
External revenue	14,221	4,165	2,859	3,780	(424)	24,601
Inter-segment revenue	(4,447)	4,744	(514)	(1,123)	1,340	–
Segment revenue	9,774	8,909	2,345	2,657	916	24,601
Segment external assets	383,588	401,836	86,272	135,814	19,745	1,027,255
Segment customer deposits	224,149	153,389	29,037	–	166	406,741
Other segment items reflected in income statement above:						
Depreciation and amortisation	196	1,284	84	152	147	1,863
(Decrease) increase in value of in-force business	–	–	(5)	1,097	–	1,092
Defined benefit scheme charges	190	112	40	39	156	537
Other segment items:						
Additions to tangible fixed assets	65	2,969	53	255	487	3,829
Investments in joint ventures and associates at end of year	30	189	123	(14)	151	479

4 SEGMENTAL ANALYSIS continued

RECONCILIATION OF REPORTED BASIS TO STATUTORY RESULTS

The reported basis is the basis on which financial information is presented to the chief operating decision maker which excludes certain items included in the statutory results. The table below reconciles the statutory results to the reported basis.

		Removal of:					
	Lloyds Banking Group statutory £m	Acquisition related items, including pension, curtailment gain[1] £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Customer goodwill payments provision and loss on disposal of businesses £m	Fair value unwind £m	Reported basis £m
Year ended 31 December 2010							
Net interest income	12,546	–	26	949	–	301	13,822
Other income	30,921	–	(332)	(19,162)	–	(1,263)	10,164
Total income	43,467	–	(306)	(18,213)	–	(962)	23,986
Insurance claims	(18,511)	–	–	17,967	–	2	(542)
Total income, net of insurance claims	24,956	–	(306)	(246)	–	(960)	23,444
Costs:							
Operating expenses	(13,068)	1,320	–	246	500	74	(10,928)
Impairment of tangible fixed assets	(202)	52	–	–	–	–	(150)
	(13,270)	1,372	–	246	500	74	(11,078)
Trading surplus (deficit)	11,686	1,372	(306)	–	500	(886)	12,366
Impairment	(10,952)	–	–	–	–	(2,229)	(13,181)
Share of results of joint ventures and associates	(88)	–	–	–	–	(3)	(91)
Loss on disposal of businesses	(365)	–	–	–	365	–	–
Fair value unwind		–	–	–	–	3,118	3,118
Profit (loss) before tax	281	1,372	(306)	–	865	–	2,212

[1] Comprises the pension curtailment gain (£910 million, see note 43), integration costs (£1,653 million) and amortisation of purchased intangibles (£629 million).

		Removal of:					
	Lloyds Banking Group statutory £m	Pre-acquisition results of HBOS £m	Government Asset Protection Scheme fee and acquisition related items[1] £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Fair value unwind £m	Reported basis £m
Year ended 31 December 2009							
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] Comprises the gain on acquisition (£11,173 million), the Government Asset Protection Scheme fee (£2,500 million), integration costs (£1,096 million), amortisation of purchased intangibles (£753 million) and goodwill impairment (£240 million).

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4 SEGMENTAL ANALYSIS continued

GEOGRAPHICAL AREAS

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

	2010			2009		
	UK £m	**Non-UK £m**	**Total £m**	UK £m	Non-UK £m	Total £m
Total income	**39,263**	**4,204**	**43,467**	42,572	2,725	45,297
Total assets	**873,138**	**118,436**	**991,574**	916,734	110,521	1,027,255

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

5 NET INTEREST INCOME

	Weighted average effective interest rate			
	2010 %	2009 %	**2010 £m**	2009 £m
Interest and similar income:				
Loans and advances to customers, excluding lease and hire purchase receivables	**4.28**	3.58	**25,459**	24,171
Loans and advances to banks	**0.72**	1.18	**512**	769
Debt securities held as loans and receivables	**4.41**	3.68	**1,377**	1,469
Lease and hire purchase receivables	**6.74**	6.01	**626**	852
Interest receivable on loans and receivables	**3.96**	3.43	**27,974**	27,261
Available-for-sale financial assets	**2.88**	1.78	**1,311**	977
Held-to-maturity investments	**2.51**	–	**55**	–
Total interest and similar income	**3.89**	3.32	**29,340**	28,238
Interest and similar expense:				
Deposits from banks, excluding liabilities under sale and repurchase transactions	**0.78**	0.95	**(319)**	(883)
Customer deposits, excluding liabilities under sale and repurchase transactions	**1.51**	1.23	**(5,381)**	(4,410)
Debt securities in issue	**2.49**	2.56	**(5,833)**	(6,318)
Subordinated liabilities	**10.98**	10.05	**(3,619)**	(4,325)
Liabilities under sale and repurchase agreements	**1.18**	1.95	**(744)**	(1,655)
Interest payable on liabilities held at amortised cost	**2.19**	2.13	**(15,896)**	(17,591)
Other	**6.97**	14.92	**(898)**	(1,621)
Total interest and similar expense	**2.27**	2.30	**(16,794)**	(19,212)
Net interest income			**12,546**	9,026

Included within interest and similar income is £1,288 million (2009: £971 million) in respect of impaired financial assets. Net interest income also includes a charge of £932 million (2009: charge of £121 million) transferred from the cash flow hedging reserve (see note 49).

6 NET FEE AND COMMISSION INCOME

	2010 £m	2009 £m
Fee and commission income:		
Current accounts	**1,086**	1,088
Credit and debit card fees	**812**	765
Other	**2,517**	2,401
Total fee and commission income	**4,415**	4,254
Fee and commission expense	**(1,682)**	(1,517)
Net fee and commission income	**2,733**	2,737

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

7 NET TRADING INCOME

	2010 £m	2009 £m
Foreign exchange translation gains	**70**	283
Gains on foreign exchange trading transactions	**377**	488
Total foreign exchange	**447**	771
Investment property gains (losses) (note 28)	**434**	(214)
Securities and other gains (see below)	**14,843**	18,541
Net trading income	**15,724**	19,098

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

	2010 £m	2009 £m
Net income arising on assets held at fair value through profit or loss:		
Debt securities, loans and advances	**2,292**	4,297
Equity shares	**10,333**	11,475
Total net income arising on assets held at fair value through profit or loss	**12,625**	15,772
Net expense arising on liabilities held at fair value through profit or loss – debt securities in issue	**(231)**	(125)
Total net gains arising on assets and liabilities held at fair value through profit or loss	**12,394**	15,647
Net gains on financial instruments held for trading	**2,449**	2,894
Securities and other gains	**14,843**	18,541

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8 INSURANCE PREMIUM INCOME

	2010 £m	2009 £m
Life insurance		
Gross premiums	**7,026**	7,768
Ceded reinsurance premiums	**(253)**	(308)
Net earned premiums	**6,773**	7,460
Non-life insurance		
Gross written premiums	**1,332**	1,390
Ceded reinsurance premiums	**(104)**	(101)
Net written premiums	**1,228**	1,289
Change in provision for unearned premiums (note 38(2))	**156**	171
Change in provision for ceded unearned premiums (note 38(2))	**(9)**	26
Net earned premiums	**1,375**	1,486
Total net earned premiums	**8,148**	8,946

Life insurance gross premiums can be further analysed as follows:

	2010 £m	2009 £m
Life and pensions	**6,428**	7,070
Annuities	**583**	685
Other	**15**	13
Gross premiums	**7,026**	7,768

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

	2010 £m	2009 £m
Credit protection	**363**	417
Home	**964**	968
Health	**5**	5
Gross written premiums	**1,332**	1,390

9 OTHER OPERATING INCOME

	2010 £m	2009 £m
Operating lease rental income	**1,410**	1,509
Rental income from investment properties (note 28)	**337**	358
Other rents receivable	**41**	51
Gains less losses on disposal of available-for-sale financial assets (note 49)	**399**	97
Movement in value of in-force business (note 30)	**789**	1,169
Gains on capital transactions	**423**	1,498
Other income	**917**	808
Total other operating income	**4,316**	5,490

GAINS ON CAPITAL TRANSACTIONS

During 2010 and 2009, as part of the Group's management of capital, the Group exchanged certain existing subordinated debt securities for new securities. These exchanges resulted in a gain on extinguishment of the existing liabilities of £423 million (2009: £1,498 million), being the difference between the carrying amount of the securities extinguished and the fair value of the new securities issued together with related fees and costs.

On 18 February 2010, as part of the Group's recapitalisation and exit from its proposed participation in the Government Asset Protection Scheme, Lloyds Banking Group plc issued 3,141 million ordinary shares in exchange for certain existing preference shares and preferred securities. This exchange resulted in a gain of £85 million.

During March 2010 the Group entered into a bilateral exchange, under which certain Enhanced Capital Notes denominated in Japanese yen were exchanged for an issue of new Enhanced Capital Notes denominated in US dollars; the securities subject to the exchange were cancelled and a profit of £20 million arose.

In addition, during May and June 2010 the Group completed the exchange of a number of outstanding capital securities issued by Lloyds Banking Group plc and certain of its subsidiaries for ordinary shares in Lloyds Banking Group plc, generating additional core tier 1 capital for the Group. The securities subject to exchange were cancelled, generating a total profit of £318 million for the Group.

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10 INSURANCE CLAIMS

Insurance claims comprise:

	2010 £m	2009 £m
Life insurance and participating investment contracts		
Claims and surrenders:		
Gross	**(9,397)**	(8,010)
Reinsurers' share	**159**	146
	(9,238)	(7,864)
Change in insurance and participating investment contract liabilities (note 38(1)):		
Change in gross liabilities	**(4,622)**	(5,922)
Change in reinsurers' share of liabilities	**256**	177
	(4,366)	(5,745)
Change in non-participating investment contract liabilities:		
Change in gross liabilities	**(4,872)**	(7,458)
Change in reinsurers' share of liabilities	**65**	–
	(4,807)	(7,458)
Change in unallocated surplus (note 41)	**439**	(318)
Total life insurance and participating investment contracts	**(17,972)**	(21,385)
Non-life insurance		
Claims and claims paid:		
Gross	**(470)**	(542)
Reinsurers' share	**11**	16
	(459)	(526)
Change in liabilities (note 38(2)):		
Gross	**(82)**	(111)
Reinsurers' share	**2**	3
	(80)	(108)
Total non-life insurance	**(539)**	(634)
Total insurance claims	**(18,511)**	(22,019)
Life insurance and participating investment contracts gross claims can also be analysed as follows:		
Deaths	**(662)**	(637)
Maturities	**(1,763)**	(2,107)
Surrenders	**(5,904)**	(4,225)
Annuities	**(741)**	(710)
Other	**(327)**	(331)
Total life insurance gross claims	**(9,397)**	(8,010)

A non-life insurance claims development table is included in note 38.

11 OPERATING EXPENSES

	2010 £m	2009 £m
Staff costs:		
Salaries	**4,220**	4,369
Social security costs	**396**	383
Pensions and other post-retirement benefit schemes (note 43):		
Curtailment gain[1]	**(910)**	–
Other	**628**	744
	(282)	744
Restructuring costs	**119**	412
Other staff costs	**1,016**	767
	5,469	6,675
Premises and equipment:		
Rent and rates	**601**	569
Hire of equipment	**18**	20
Repairs and maintenance	**199**	226
Other	**407**	341
	1,225	1,156
Other expenses:		
Communications and data processing	**891**	668
Advertising and promotion	**362**	335
Professional fees	**742**	540
Customer goodwill payments provision (note 45)	**500**	–
Other	**1,447**	1,310
	3,942	2,853
Depreciation and amortisation:		
Depreciation of tangible fixed assets (note 32)	**1,635**	1,716
Amortisation of acquired value of in-force non-participating investment contracts (note 30)	**76**	75
Amortisation of other intangible assets (note 31)	**721**	769
	2,432	2,560
Impairment of tangible fixed assets[2] (note 32)	**202**	–
Goodwill impairment (note 29)	**–**	240
Total operating expenses excluding Government Asset Protection Scheme fee	**13,270**	13,484
Government Asset Protection Scheme fee	**–**	2,500
Total operating expenses	**13,270**	15,984

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

	2010	2009
UK	**118,149**	125,109
Overseas	**4,830**	6,891
Total	**122,979**	132,000

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

[2] £52 million of the impairment of tangible fixed assets relates to integration activities.

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11 OPERATING EXPENSES continued

	2010 £m	2009 £m
Fees payable for the audit of the Company's current year annual report	1.9	2.2
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	17.9	18.8
Other services supplied pursuant to legislation	6.2	4.2
Total audit fees	26.0	25.2
Other services – audit related fees	1.8	5.3
Total audit and audit related fees	27.8	30.5
Services relating to taxation	1.0	1.0
Other non-audit fees:		
Services relating to corporate finance transactions	1.9	0.3
Other services	9.7	8.9
Total other non-audit fees	11.6	9.2
Total fees payable to the Company's auditors by the Group	40.4	40.7

Other non-audit fees include the costs associated with the Group's preparations for ensuring that the heritage HBOS businesses complied fully with the requirements of the Sarbanes-Oxley Act by 31 December 2010.

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

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings. Other services supplied pursuant to legislation relate primarily to the costs associated with the Sarbanes-Oxley Act audit requirements together with the cost of the audit of the Group's Form 20-F filing.

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

Services relating to taxation: This category includes tax compliance and tax advisory services.

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital transactions and other assurance and advisory services.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to the provision of advice on tax issues, assistance in transactions involving the acquisition and disposal of businesses and accounting advice.

The Group has procedures that are designed to ensure auditor independence, including that fees for audit and non-audit services are approved in advance. This approval can be obtained either on an individual engagement basis or, for certain types of non-audit services, particularly those of a recurring nature, through the approval of a fee cap covering all engagements of that type provided the fee is below that cap. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant fee cap must be pre-approved by the Audit Committee on an individual engagement basis. On a quarterly basis, the Audit Committee receives a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

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

	2010 £m	2009 £m
Audits of Group pension schemes	0.3	0.3
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	0.8	0.6
Reviews of the financial position of corporate and other borrowers	17.2	19.3
Acquisition due diligence and other work performed in respect of potential venture capital investments	1.2	1.4

12 IMPAIRMENT

	2010 £m	2009 £m
Impairment losses on loans and receivables:		
Loans and advances to banks	**(13)**	(3)
Loans and advances to customers	**10,727**	15,783
Debt securities classified as loans and receivables	**57**	248
Total impairment losses on loans and receivables (note 25)	**10,771**	16,028
Impairment of available-for-sale financial assets	**106**	602
Other credit risk provisions (note 45)	**75**	43
Total impairment charged to the income statement	**10,952**	16,673

13 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES

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

	Joint ventures		Associates		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Share of income statement amounts:						
Income	**318**	708	**135**	5	**453**	713
Expenses	**(209)**	(544)	**(91)**	(96)	**(300)**	(640)
Impairment	**(126)**	(272)	**(92)**	(114)	**(218)**	(386)
Insurance claims	**–**	(465)	**–**	–	**–**	(465)
Loss before tax	**(17)**	(573)	**(48)**	(205)	**(65)**	(778)
Tax	**(22)**	24	**(1)**	2	**(23)**	26
Share of post-tax results	**(39)**	(549)	**(49)**	(203)	**(88)**	(752)
Share of balance sheet amounts:						
Current assets	**3,370**	2,754	**378**	605	**3,748**	3,359
Non-current assets	**2,868**	4,662	**1,184**	1,611	**4,052**	6,273
Current liabilities	**(588)**	(2,175)	**(433)**	(494)	**(1,021)**	(2,669)
Non-current liabilities	**(5,324)**	(4,871)	**(1,026)**	(1,613)	**(6,350)**	(6,484)
Share of net assets at 31 December	**326**	370	**103**	109	**429**	479
Movement in investments over the year:						
At 1 January	**370**	55	**109**	–	**479**	55
Adjustment on acquisition	**–**	956	**–**	219	**–**	1,175
Additional investments	**71**	140	**6**	12	**77**	152
Acquisitions	**–**	3	**–**	60	**–**	63
Disposals	**(68)**	(199)	**(2)**	(39)	**(70)**	(238)
Share of post-tax results	**(39)**	(549)	**(49)**	(203)	**(88)**	(752)
Dividends paid	**–**	(21)	**(1)**	–	**(1)**	(21)
Exchange and other adjustments	**(8)**	(15)	**40**	60	**32**	45
Share of net assets at 31 December	**326**	370	**103**	109	**429**	479

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13 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES continued

The Group's unrecognised share of losses of associates for the year is £8 million (2009: £64 million) and of joint ventures is £180 million (2009: £424 million). For entities making losses, subsequent profits earned are not recognised until previously unrecognised losses are extinguished. The Group's unrecognised share of losses net of unrecognised profits on a cumulative basis of associates is £104 million (2009: £64 million) and of joint ventures is £339 million (2009: £424 million).

The Group's principal joint venture investment at 31 December 2010 was in Sainsbury's Bank plc; the Group owns 50 per cent of the ordinary share capital of Sainsbury's Bank plc, whose business is banking and principal area of operation is the UK. Sainsbury's Bank plc is incorporated in the UK and the Group's interest is held by a subsidiary.

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

14 GAIN ON ACQUISITION IN 2009

On 16 January 2009, the Group acquired 100 per cent of the ordinary share capital of HBOS plc, which together with its subsidiaries undertakes banking, insurance and other financial services related activities in the UK and in certain overseas locations.

The table below sets out the fair value of the identifiable net assets acquired.

At the time of the recommended offer for HBOS in September 2008, it had become increasingly difficult for HBOS to raise funds in wholesale markets and their Board sought to restore confidence and stability through an agreement to be acquired by Lloyds TSB Group plc announced on 18 September 2008 at the original terms of 0.833 Lloyds TSB Group plc shares for each HBOS share. However turbulence in the markets continued and the UK Government decided in October 2008 that it would be appropriate for the UK banking sector to increase its level of capitalisation. As a consequence of the recapitalisation of HBOS and the impact of the deteriorating market conditions the terms of the final agreed offer were revised down to a ratio of 0.605 per HBOS share.

As the fair value of the identifiable net assets acquired was greater than the total consideration paid, negative goodwill arose on the acquisition. The negative goodwill was recognised as a 'Gain on acquisition' in the income statement for the year ended 31 December 2009. In accordance with accounting requirements, the measurement period for the fair values of the acquired assets and liabilities ended on 15 January 2010 (one year from the date of acquisition); no further fair value adjustments were made beyond those reflected in the Group's 31 December 2009 financial statements.

	Book value as at 16 January 2009 £m	Fair value adjustments £m	Fair value as at 16 January 2009 £m
Assets			
Cash and balances at central banks	2,123	–	2,123
Items in the course of collection from banks	523	–	523
Trading and other financial assets at fair value through profit or loss	83,857	–	83,857
Derivative financial instruments	54,840	(808)	54,032
Loans and receivables:			
Loans and advances to banks	15,751	43	15,794
Loans and advances to customers	450,351	(13,512)	436,839
Debt securities	39,819	(1,411)	38,408
Available-for-sale financial assets	27,151	–	27,151
Investment properties	3,002	–	3,002
Investments in joint ventures and associates	1,152	23	1,175
Value of in-force business	3,152	561	3,713
Other intangible assets	104	4,650	4,754
Tangible fixed assets	5,721	(14)	5,707
Current tax recoverable	1,050	–	1,050
Deferred tax assets	2,556	(602)	1,954
Other assets	7,601	(905)	6,696
Total assets	698,753	(11,975)	686,778

	Book value as at 16 January 2009 £m	Fair value adjustments £m	Fair value as at 16 January 2009 £m
Liabilities			
Deposits from banks	87,731	109	87,840
Customer deposits	223,859	835	224,694
Items in course of transmission to banks	521	–	521
Trading and other financial liabilities at fair value through profit or loss	16,360	–	16,360
Derivative financial instruments	45,798	–	45,798
Notes in circulation	936	–	936
Debt securities in issue	191,566	(6,247)	185,319
Liabilities arising from insurance contracts and participating investment contracts	36,405	282	36,687
Liabilities arising from non-participating investment contracts	28,168	13	28,181
Unallocated surplus within insurance businesses	526	–	526
Other liabilities	14,732	(312)	14,420
Retirement benefit obligations	(474)	832	358
Current tax liabilities	58	–	58
Deferred tax liabilities	245	(142)	103
Other provisions	146	606	752
Subordinated liabilities	29,240	(9,192)	20,048
Total liabilities	675,817	(13,216)	662,601
Net assets acquired	22,936	1,241	24,177

Fair value of net assets acquired	24,177
Adjust for:	
Preference shares[1]	(3,917)
Non-controlling interests	(1,300)
Adjusted net assets of HBOS acquired	18,960
Consideration inclusive of acquisition costs:	
Issue of 7,776 million ordinary shares of 25p in Lloyds Banking Group plc[2]	(7,651)
Fees and expenses related to the transaction	(136)
Total consideration	(7,787)
Gain on acquisition in 2009	11,173

[1] On 16 January 2009, the Group cancelled the following HBOS preference share issuances in exchange for preference shares issued by Lloyds Banking Group plc: 6.475 per cent non-cumulative preference shares of £1 each, 6.3673 per cent non-cumulative fixed to floating preference shares of £1 each and 6.0884 per cent non-cumulative preference shares of £1 each. The fair value of the Lloyds Banking Group preference shares issued was deducted from the net assets acquired for the purposes of calculating the gain arising on acquisition.

[2] The calculation of consideration was based on the closing price of Lloyds TSB ordinary shares of 98.4p on 16 January 2009; 12,852 million HBOS shares were exchanged for Lloyds Banking Group shares at a ratio of 0.605 shares per HBOS share.

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15 LOSS ON DISPOSAL OF BUSINESSES

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

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

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

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

16 TAXATION

(A) ANALYSIS OF TAX (CHARGE) CREDIT FOR THE YEAR

	2010 £m	2009 £m
UK corporation tax:		
Current tax on profit for the year	**(146)**	(227)
Adjustments in respect of prior years	**310**	(310)
	164	(537)
Double taxation relief	**1**	10
	165	(527)
Foreign tax:		
Current tax on profit for the year	**(82)**	(221)
Adjustments in respect of prior years	**49**	40
	(33)	(181)
Current tax credit (charge)	**132**	(708)
Deferred tax (note 44):		
Origination and reversal of temporary differences	**(393)**	2,429
Reduction in UK corporation tax rate	**(137)**	–
Adjustments in respect of prior years	**(141)**	190
	(671)	2,619
Tax (charge) credit	**(539)**	1,911

The (charge) credit for tax on the profit for 2010 and 2009 is based on a UK corporation tax rate of 28.0 per cent.
The above income tax (charge) credit is made up as follows:

	2010 £m	2009 £m
Tax charge attributable to policyholders	**(315)**	(410)
Shareholder tax (charge) credit	**(224)**	2,321
Tax (charge) credit	**(539)**	1,911

(B) FACTORS AFFECTING THE TAX (CHARGE) CREDIT FOR THE YEAR

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

	2010 £m	2009 £m
Profit before tax	**281**	1,042
Tax charge thereon at UK corporation tax rate of 28.0 per cent (2009: 28.0 per cent)	**(79)**	(292)
Factors affecting charge:		
UK corporation tax rate change	**(137)**	–
Goodwill	**–**	3,061
Disallowed and non-taxable items	**5**	408
Overseas tax rate differences	**134**	(352)
Gains exempted or covered by capital losses	**65**	(14)
Policyholder interests	**(227)**	(295)
Tax losses where no deferred tax provided	**(487)**	(332)
Adjustments in respect of previous years	**218**	(66)
Effect of results of joint ventures and associates	**(25)**	(211)
Other items	**(6)**	4
Tax (charge) credit on profit on ordinary activities	**(539)**	1,911

17 EARNINGS PER SHARE

	2010 £m	2009 £m
(Loss) profit attributable to equity shareholders – basic and diluted	**(320)**	2,827
	2010 million	2009 million
Weighted average number of ordinary shares in issue – basic	**67,117**	37,674
Adjustment for share options and awards	**–**	255
Weighted average number of ordinary shares in issue – diluted	**67,117**	37,929
Basic earnings per share	**(0.5)p**	7.5p
Diluted earnings per share	**(0.5)p**	7.5p

Basic earnings per share are calculated by dividing the net profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the year, which has been calculated after deducting 8 million (2009: 10 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, if any, that arise in respect of share options and awards granted to employees. The number of shares that could have been acquired at the average annual share price of the Company's shares based on the monetary value of the subscription rights attached to outstanding share options and awards is determined. This is deducted from the number of shares issuable under such options and awards to leave a residual bonus amount of shares which are added to the weighted-average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

In December 2009, as part of the Group's recapitalisation and exit from the Government Asset Protection Scheme, the Group entered into an agreement with holders of certain existing liabilities to exchange these for ordinary shares or for cash on 18 February 2010. The weighted average number of anti-dilutive shares arising from this transaction that have been excluded from the calculation of diluted earnings per share was 294 million at 31 December 2009. On 18 February 2010, the above exchange completed and 3,141 million new ordinary shares in Lloyds Banking Group plc were issued.

The weighted-average number of anti-dilutive share options and awards excluded from the calculation of diluted earnings per share was 92 million at 31 December 2010 (2009: 393 million).

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18 TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

These assets are comprised as follows:

	2010			2009		
	Trading assets £m	Other financial assets at fair value through profit or loss £m	Total £m	Trading assets £m	Other financial assets at fair value through profit or loss £m	Total £m
Loans and advances to customers	**9,486**	**325**	**9,811**	13,579	166	13,745
Loans and advances to banks	**2,734**	**–**	**2,734**	4,702	635	5,337
Debt securities:						
Government securities	**1,623**	**22,217**	**23,840**	2,936	17,025	19,961
Other public sector securities	**–**	**919**	**919**	6	700	706
Bank and building society certificates of deposit	**3,692**	**606**	**4,298**	2,034	–	2,034
Asset-backed securities:						
Mortgage-backed securities	**–**	**422**	**422**	–	520	520
Other asset-backed securities	**1,020**	**1,592**	**2,612**	891	1,999	2,890
Corporate and other debt securities	**4,919**	**16,190**	**21,109**	3,097	17,571	20,668
	11,254	**41,946**	**53,200**	8,964	37,815	46,779
Equity shares:						
Listed	**–**	**50,227**	**50,227**	–	55,685	55,685
Unlisted	**6**	**39,986**	**39,992**	–	28,465	28,465
	6	**90,213**	**90,219**	–	84,150	84,150
Treasury and other bills	**227**	**–**	**227**	–	–	–
Total	**23,707**	**132,484**	**156,191**	27,245	122,766	150,011

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

(i) financial assets backing insurance contracts and investment contracts of £129,702 million (31 December 2009: £118,573 million) which are so designated because the related liabilities either have cash flows that are contractually based on the performance of the assets or are contracts whose measurement takes account of current market conditions and where significant measurement inconsistencies would otherwise arise;

(ii) loans and advances to customers of £109 million (31 December 2009: £166 million) which are economically hedged by interest rate derivatives which are not in hedge accounting relationships and where significant measurement inconsistencies would otherwise arise if the related derivatives were treated as trading liabilities and the loans and advances were carried at amortised cost; and

(iii) private equity investments of £1,733 million (31 December 2009: £1,880 million) that are managed, and evaluated, on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

The maximum exposure to credit risk at 31 December 2010 of the loans and advances to banks and customers designated at fair value through profit or loss was £325 million (2009: £166 million); the Group does not hold any credit derivatives or other instruments in mitigation of this risk. There was no significant movement in the fair value of these loans attributable to changes in credit risk which is determined by reference to the publicly available credit ratings of the instruments involved.

The Group's Wholesale division had exposure to negative basis asset-backed securities of £1,067 million (31 December 2009: £1,174 million) of which £1,067 million (31 December 2009: £970 million) were protected by monoline financial guarantors (note 56).

Included in the amounts reported above are assets subject to repurchase agreements with a carrying value of £824 million (2009: £3,250 million); the value of the related liability is £828 million (2009: £3,009 million). In all cases the transferee has the right to sell or repledge the assets concerned.

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £12,211 million (2009: £17,991 million). Collateral is held with a fair value of £14,299 million (2009: £21,462 million), all of which the Group is able to repledge. At 31 December 2010, £3,161 million had been repledged (2009: £14,963 million).

19 DERIVATIVE FINANCIAL INSTRUMENTS

The Group holds derivatives as part of the following strategies:

– Customer driven, where derivatives are held as part of the provision of risk management products to Group customers;

– To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value, cash flow and net investment hedge approaches as described in note 56; and

– Derivatives held in policyholder funds as permitted by the investment strategies of those funds,

Derivatives are classified as trading except those designated as effective hedging instruments which meet the criteria under IAS 39. Derivatives are held at fair value on the Group's balance sheet. A description of the methodology used to determine the fair value of derivative financial instruments and the effect of using reasonably possible alternative assumptions for those derivatives valued using unobservable inputs is set out in note 55.

The principal derivatives used by the Group are as follows:

– Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

– Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.

– Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. The Group also uses credit default swaps to securitise, in combination with external funding, £4,149 million (2009: £6,455 million) of corporate and commercial banking loans.

– Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities, in the form of published indices on or before a specified future date.

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19 DERIVATIVE FINANCIAL INSTRUMENTS continued

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

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2010			
Trading and other			
Exchange rate contracts:			
Spot, forwards and futures	212,832	2,513	2,242
Currency swaps	108,216	5,696	1,773
Options purchased	18,096	602	–
Options written	19,387	–	536
	358,531	8,811	4,551
Interest rate contracts:			
Interest rate swaps	1,397,157	28,448	29,202
Forward rate agreements	718,227	309	287
Options purchased	59,578	2,371	–
Options written	60,828	–	2,180
Futures	23,361	3	1
	2,259,151	31,131	31,670
Credit derivatives	7,108	256	207
Embedded equity conversion feature	–	1,177	–
Equity and other contracts	22,597	1,996	1,332
Total derivative assets/liabilities – trading and other	2,647,387	43,371	37,760
Hedging			
Derivatives designated as fair value hedges:			
Currency swaps	9,418	606	35
Interest rate swaps	75,831	4,366	1,200
	85,249	4,972	1,235
Derivatives designated as cash flow hedges:			
Interest rate swaps	112,507	2,199	3,042
Futures	1,299	1	–
Currency swaps	17,745	232	121
	131,551	2,432	3,163
Derivatives designated as net investment hedges:			
Cross currency swaps	86	2	–
Total derivative assets/liabilities – hedging	216,886	7,406	4,398
Total recognised derivative assets/liabilities	2,864,273	50,777	42,158

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Further details are provided in note 56(3).

The embedded equity conversion feature of £1,177 million (31 December 2009: £1,797 million) reflects the value of the equity conversion feature contained in the Enhanced Capital Notes issued by the Group in 2009; the loss of £620 million arising from the change in fair value over 2010 (2009: loss of £427 million) is included within net gains on financial instruments held for trading within net trading income (note 7).

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2009			
Trading and other			
Exchange rate contracts:			
Spot, forwards and futures	149,701	1,675	1,695
Currency swaps	130,954	6,853	1,787
Options purchased	11,130	678	–
Options written	11,072	–	431
	302,857	9,206	3,913
Interest rate contracts:			
Interest rate swaps	1,092,319	23,799	24,153
Forward rate agreements	840,539	441	400
Options purchased	68,267	1,700	–
Options written	57,772	–	1,656
Futures	12,938	2	7
	2,071,835	25,942	26,216
Credit derivatives	19,673	1,711	444
Embedded equity conversion feature	–	1,797	–
Equity and other contracts	27,391	1,842	1,225
Total derivative assets/liabilities – trading and other	2,421,756	40,498	31,798
Hedging			
Derivatives designated as fair value hedges:			
Currency swaps	26,162	635	107
Interest rate swaps	80,085	3,989	985
Options written	628	–	144
	106,875	4,624	1,236
Derivatives designated as cash flow hedges:			
Interest rate swaps	222,548	4,749	7,285
Futures	5,137	1	3
Currency swaps	8,937	8	144
Options purchased	2,754	4	–
	239,376	4,762	7,432
Derivatives designated as net investment hedges:			
Cross currency swaps	2,507	44	19
Total derivative assets/liabilities – hedging	348,758	9,430	8,687
Total recognised derivative assets/liabilities	2,770,514	49,928	40,485

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19 DERIVATIVE FINANCIAL INSTRUMENTS continued

HEDGED CASH FLOWS

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

2010	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	**223**	**328**	**560**	**434**	**310**	**451**	**445**	**160**	**2,911**
Forecast payable cash flows	**(70)**	**(44)**	**(165)**	**(93)**	**(67)**	**(616)**	**(916)**	**(200)**	**(2,171)**
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	**223**	**445**	**443**	**434**	**310**	**466**	**435**	**155**	**2,911**
Forecast payable cash flows	**(70)**	**(97)**	**(113)**	**(93)**	**(67)**	**(675)**	**(884)**	**(172)**	**(2,171)**

2009	0-1 years £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	5-10 years £m	10-20 years £m	Over 20 years £m	Total £m
Hedged forecast cash flows expected to occur:									
Forecast receivable cash flows	14	33	–	3	47	424	374	140	1,035
Forecast payable cash flows	(336)	(698)	(304)	(258)	(121)	(409)	(694)	(111)	(2,931)
Hedged forecast cash flows affect profit or loss:									
Forecast receivable cash flows	14	33	–	8	68	435	341	136	1,035
Forecast payable cash flows	(336)	(698)	(419)	(206)	(81)	(444)	(647)	(100)	(2,931)

20 LOANS AND ADVANCES TO BANKS

	2010 £m	2009 £m
Lending to banks	**1,042**	3,705
Money market placements with banks	**29,250**	31,805
Total loans and advances to banks before allowance for impairment losses	**30,292**	35,510
Allowance for impairment losses (note 25)	**(20)**	(149)
Total loans and advances to banks	**30,272**	35,361

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £4,185 million (2009: £4,188 million). Collateral is held with a fair value of £3,909 million (2009: £4,167 million), all of which the Group is able to repledge.

Included in the amounts reported above are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £4 million (2009: £19 million).

21 LOANS AND ADVANCES TO CUSTOMERS

	2010 £m	2009 £m
Agriculture, forestry and fishing	**5,558**	5,130
Energy and water supply	**3,576**	3,031
Manufacturing	**11,495**	14,912
Construction	**7,904**	10,830
Transport, distribution and hotels	**34,176**	31,820
Postal and telecommunications	**1,908**	1,662
Property companies	**78,263**	83,820
Financial, business and other services	**59,363**	66,923
Personal:		
Mortgages	**356,261**	362,667
Other	**36,967**	42,958
Lease financing	**8,291**	9,307
Hire purchase	**7,208**	8,710
Total loans and advances to customers before allowance for impairment losses	**610,970**	641,770
Allowance for impairment losses (note 25)	**(18,373)**	(14,801)
Total loans and advances to customers	**592,597**	626,969

Included in the amounts reported above are reverse repurchase agreements treated as collateralised loans with a carrying value of £3,096 million (2009: £1,108 million). Collateral is held with a fair value of £2,987 million (2009: £1,102 million), all of which the Group is able to repledge.
Included in the amounts reported above are collateral balances in the form of cash provided in respect of reverse repurchase agreements amounting to £42 million (2009: £22 million).

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

	2010 £m	2009 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**1,358**	1,374
Later than 1 year and not later than 5 years	**2,522**	3,577
Later than 5 years	**7,218**	7,911
	11,098	12,862
Unearned future finance income on finance leases	**(2,603)**	(3,428)
Rentals received in advance	**(183)**	(119)
Commitments for expenditure in respect of equipment to be leased	**(21)**	(8)
Net investment in finance leases	**8,291**	9,307

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

	2010 £m	2009 £m
Not later than 1 year	**986**	1,008
Later than 1 year and not later than 5 years	**1,965**	2,403
Later than 5 years	**5,340**	5,896
Net investment in finance leases	**8,291**	9,307

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21 LOANS AND ADVANCES TO CUSTOMERS continued

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2010 and 2009 no contingent rentals in respect of finance leases were recognised in the income statement. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £287 million (2009: £123 million).

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

	2010 £m	2009 £m
Not later than 1 year	**11**	4
Later than 1 year and not later than 5 years	**44**	46
Later than 5 years	**6**	5
Total unguaranteed residual values	**61**	55

22 SECURITISATIONS AND COVERED BONDS

SECURITISATION PROGRAMMES

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

COVERED BOND PROGRAMMES

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

22 SECURITISATIONS AND COVERED BONDS continued

The Group's principal securitisation and covered bond programmes, together with the balances of the advances subject to securitisation and the carrying value of the notes in issue at 31 December, are listed below. The notes in issue are reported in note 37.

	2010		2009	
	Gross assets securitised £m	Notes in issue £m	Gross assets securitised £m	Notes in issue £m
Securitisation programmes[1]				
UK residential mortgages	**146,200**	**114,428**	152,443	129,698
Commercial loans	**11,860**	**8,936**	13,071	8,266
Irish residential mortgages	**6,007**	**6,191**	6,522	6,585
Credit card receivables	**7,327**	**3,856**	5,155	2,699
Dutch residential mortgages	**4,526**	**4,316**	4,800	4,663
Personal loans	**3,012**	**2,011**	3,730	2,613
PFI/PPP and project finance loans	**776**	**110**	877	45
Corporate loans and revolving credit facilities	**–**	**–**	595	7
Motor vehicle loans	**926**	**975**	443	470
	180,634	**140,823**	187,636	155,046
Less held by the Group		**(100,081)**		(117,489)
Total securitisation programmes (note 37)		**40,742**		37,557
Covered bond programmes				
Residential mortgage-backed	**93,651**	**73,458**	99,753	76,636
Social housing loan-backed	**3,317**	**2,181**	3,356	2,735
	96,968	**75,639**	103,109	79,371
Less held by the Group		**(43,489)**		(52,060)
Total covered bond programmes (note 37)		**32,150**		27,311
Total securitisation and covered bond programmes		**72,892**		64,868

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

Cash deposits of £36,579 million (31 December 2009: £31,480 million) held by the Group are restricted in use to repayment of the debt securities issued by the SPEs, the term advances relating to covered bonds and other legal obligations.

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23 SPECIAL PURPOSE ENTITIES

In addition to the special purpose entities discussed in note 22, which are used for securitisation and covered bond programmes, the Group sponsors four asset-backed conduits, Argento, Cancara, Grampian and Landale, which invest in debt securities and client receivables. All the external assets in these conduits are consolidated in the Group's financial statements and are included in the credit market exposures set out in note 56. The total consolidated exposures in these conduits are set out in the table below:

	Argento £m	Cancara £m	Grampian £m	Landale £m	Total £m
At 31 December 2010					
Loans and advances	–	3,957	–	–	3,957
Debt securities classified as loans and receivables:					
Asset-backed securities	1,448	–	6,957	–	8,405
Corporate and other debt securities	202	–	–	–	202
	1,650	–	6,957	–	8,607
Debt securities classified as available-for-sale financial assets (note 26):					
Asset-backed securities	1,436	2,587	–	–	4,023
Corporate and other debt securities	463	–	–	–	463
	1,899	2,587	–	–	4,486
Total assets	3,549	6,544	6,957	–	17,050
At 31 December 2009					
Loans and advances	–	3,681	–	–	3,681
Debt securities classified as loans and receivables	–	15	9,867	698	10,580
Debt securities classified as available-for-sale financial assets (note 26):					
Asset-backed securities	–	5,382	–	–	5,382
Total assets	–	9,078	9,867	698	19,643

OTHER SPECIAL PURPOSE ENTITIES

During 2009, the Group established Lloyds TSB Pension ABCS (No 1) LLP and Lloyds TSB Pension ABCS (No 2) LLP and transferred approximately £5 billion of assets, primarily comprising notes in certain of the Group's securitisation programmes, in aggregate to these entities. Further details are provided in note 43.

24 DEBT SECURITIES CLASSIFIED AS LOANS AND RECEIVABLES

Debt securities accounted for as loans and receivables comprise:

	2010 £m	2009 £m
Asset-backed securities:		
Mortgage-backed securities	11,650	13,322
Other asset-backed securities	12,827	17,137
Corporate and other debt securities	1,816	2,623
Total debt securities classified as loans and receivables before allowance for impairment losses	26,293	33,082
Allowance for impairment losses (note 25)	(558)	(430)
Total debt securities classified as loans and receivables	25,735	32,652

Included in the amounts reported above are assets subject to repurchase agreements with a carrying value of £1,386 million (2009: £11,752 million); the value of the related liability is £1,043 million (2009: £7,970 million). In all cases the transferee has the right to sell or repledge the assets concerned.

25 ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	Loans and advances to customers £m	Loans and advances to banks £m	Debt securities £m	Total £m
Balance at 1 January 2009	3,459	135	133	3,727
Exchange and other adjustments	95	17	49	161
Advances written off	(4,200)	–	–	(4,200)
Recoveries of advances written off in previous years	110	–	–	110
Unwinding of discount	(446)	–	–	(446)
Charge (release) to the income statement (note 12)	15,783	(3)	248	16,028
At 31 December 2009	14,801	149	430	15,380
Exchange and other adjustments	**(2)**	**(5)**	**119**	**112**
Advances written off	**(6,966)**	**(111)**	**(48)**	**(7,125)**
Recoveries of advances written off in previous years	**216**	**–**	**–**	**216**
Unwinding of discount	**(403)**	**–**	**–**	**(403)**
Charge (release) to the income statement (note 12)	**10,727**	**(13)**	**57**	**10,771**
At 31 December 2010	**18,373**	**20**	**558**	**18,951**

Of the total allowance in respect of loans and advances to customers, £15,585 million (2009: £12,756 million) related to lending that had been determined to be impaired (either individually or on a collective basis) at the reporting date.

Of the total allowance in respect of loans and advances to customers, £6,076 million (2009:£5,297 million) was assessed on a collective basis.

26 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2010			2009		
	Conduits £m	Other £m	Total £m	Conduits £m	Other £m	Total £m
Debt securities:						
Government securities	**–**	**12,552**	**12,552**	–	8,669	8,669
Other public sector securities	**–**	**29**	**29**	–	31	31
Bank and building society certificates of deposit	**–**	**407**	**407**	–	1,014	1,014
Asset-backed securities:						
Mortgage-backed securities	**3,203**	**1,090**	**4,293**	3,481	1,300	4,781
Other asset-backed securities	**820**	**4,399**	**5,219**	1,901	5,739	7,640
Corporate and other debt securities	**463**	**11,669**	**12,132**	–	19,904	19,904
	4,486	**30,146**	**34,632**	5,382	36,657	42,039
Equity shares:						
Listed	**–**	**72**	**72**	–	102	102
Unlisted	**–**	**2,183**	**2,183**	–	1,929	1,929
	–	**2,255**	**2,255**	–	2,031	2,031
Treasury bills and other bills:						
Treasury bills and similar securities	**–**	**6,068**	**6,068**	–	2,532	2,532
Total available-for-sale financial assets	**4,486**	**38,469**	**42,955**	5,382	41,220	46,602

Details of the Group's asset-backed conduits shown in the table above are included in note 23.

Included within asset-backed securities are £9,392 million (31 December 2009: £12,421 million) managed by the Wholesale division. Further information on these exposures is provided in note 56.

Included in the amounts reported above are assets subject to repurchase agreements with a carrying value of £1,467 million (2009: £7,438 million); the value of the related liability is £1,378 million (2009: £6,834 million). In all cases the transferee has the right to sell or repledge the assets concerned.

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26 AVAILABLE-FOR-SALE FINANCIAL ASSETS continued

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in note 2(H). Included in available-for-sale financial assets at 31 December 2010 are debt securities individually determined to be impaired whose gross amount before impairment allowances was £2 million (31 December 2009: £144 million) and in respect of which no collateral was held.

On 1 November 2010, the Group reclassified £3,601 million of government securities from available-for-sale financial assets to held-to-maturity investments (note 27). Further information on the reclassification of financial assets is provided in note 55.

27 HELD-TO-MATURITY INVESTMENTS

	2010 £m	2009 £m
Debt securities: government securities	**7,905**	–

On 1 November 2010, the Group reclassified £3,601 million of government securities from available-for-sale financial assets to held-to-maturity investments.

28 INVESTMENT PROPERTIES

	2010 £m	2009 £m
At 1 January	**4,757**	2,631
Exchange and other adjustments	**(6)**	(15)
Adjustment on acquisition	**–**	3,002
Additions:		
Acquisitions of new properties	**398**	151
Consolidation of new subsidiary undertakings	**921**	–
Additional expenditure on existing properties	**52**	67
Total additions	**1,371**	218
Disposals	**(559)**	(865)
Changes in fair value (note 7)	**434**	(214)
At 31 December	**5,997**	4,757

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

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

	2010 £m	2009 £m
Rental income (note 9)	**337**	358
Direct operating expenses arising from investment properties that generate rental income	**77**	64

Capital expenditure in respect of investment properties:

	2010 £m	2009 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	**86**	57

29 GOODWILL

	2010 £m	2009 £m
At 1 January	**2,016**	2,256
Impairment charged to the income statement	**–**	(240)
At 31 December	**2,016**	2,016
Cost[1]	**2,362**	2,362
Accumulated impairment losses	**(346)**	(346)
At 31 December	**2,016**	2,016

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

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,016 million (31 December 2009: £2,016 million), £1,836 million (or 91 per cent of the total) has been allocated to Scottish Widows in the Group's Insurance division and £170 million (or 8 per cent of the total) to Asset Finance in the Group's Wholesale division.

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

In 2009, the markets in which the Consumer Finance unit of Asset Finance operates had deteriorated further with both macroeconomic and market conditions worsening, leading to a fall off in demand and increasing arrears. This, together with continuing uncertainties over the likely short-term macroeconomic environment, had resulted in a reassessment of the carrying value of the consumer finance cash generating unit and the recognition of a goodwill impairment charge of £240 million during 2009, reflecting the write down of the entire balance of goodwill allocated to the Consumer Finance unit of Asset Finance and leaving goodwill of £170 million in the Autolease unit of Asset Finance.

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 15 per cent (gross of tax). The cash flows beyond the five-year period are extrapolated using a growth rate of 0.5 per cent which does not exceed the long-term average growth rates for the markets in which Asset Finance participates.

30 VALUE OF IN-FORCE BUSINESS

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

	2010 £m	2009 £m
Acquired value of in-force non-participating investment contracts	**1,469**	1,545
Value of in-force insurance and participating investment contracts	**5,898**	5,140
Total value of in-force business	**7,367**	6,685

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

	2010 £m	2009 £m
At 1 January	**1,545**	–
Adjustment on acquisition	**–**	1,620
Amortisation taken to income statement (note 11)	**(76)**	(75)
At 31 December	**1,469**	1,545

The acquired value of in-force non-participating investment contracts includes £356 million (2009: £379 million) in relation to OEIC business.

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30 VALUE OF IN-FORCE BUSINESS continued

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

	2010 £m	2009 £m
At 1 January	**5,140**	1,893
Adjustment on acquisition	**–**	2,093
Exchange and other adjustments	**(31)**	(15)
Movements in the year:		
New business	**497**	563
Existing business:		
Expected return	**(400)**	(456)
Experience variances	**85**	84
Non-economic assumption changes	**306**	135
Economic variance	**301**	843
Movement in the value of in-force business taken to income statement (note 9)	**789**	1,169
At 31 December	**5,898**	5,140

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

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

ECONOMIC ASSUMPTIONS

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

A market consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date. The risk-free rate used for the value of financial options and guarantees is defined as the spot yield derived from the relevant government bond yield curve in line with FSA realistic balance sheet assumptions. Further information on options and guarantees can be found on page 107.

The liabilities in respect of the Group's UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds. The value of the in-force business asset for UK annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of these corporate bond holdings. The illiquidity premium is estimated to be 75 basis points as at 31 December 2010 (31 December 2009: 75 basis points).

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

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

	2010 %	2009 %
Risk-free rate (value of in-force non-annuity business)	**3.99**	4.45
Risk-free rate (value of in-force annuity business)	**4.66**	5.05
Risk-free rate (financial options and guarantees)	**0.63 to 4.50**	0.87 to 4.76
Retail price inflation	**3.56**	3.64
Expense inflation	**4.20**	4.42

30 VALUE OF IN-FORCE BUSINESS continued

NON-MARKET RISK

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

NON-ECONOMIC ASSUMPTIONS

Future mortality, morbidity, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. These assumptions are intended to represent a best estimate of future experience.

Further information about the effect of changes in key assumptions is given in note 39.

31 OTHER INTANGIBLE ASSETS

	Brands £m	Core deposit intangible £m	Purchased credit card relationships £m	Customer-related intangibles £m	Capitalised software enhancements £m	Total £m
Cost:						
At 1 January 2009	–	–	–	63	320	383
Adjustment on acquisition	596	2,770	300	984	104	4,754
Additions	–	–	–	–	63	63
Disposals of businesses	–	–	–	(170)	–	(170)
At 31 December 2009	596	2,770	300	877	487	5,030
Additions	**–**	**–**	**–**	**–**	**153**	**153**
Disposals	**–**	**–**	**–**	**–**	**(30)**	**(30)**
At 31 December 2010	**596**	**2,770**	**300**	**877**	**610**	**5,153**
Accumulated amortisation:						
At 1 January 2009	–	–	–	12	174	186
Charge for the year	21	393	58	237	60	769
Disposals of businesses	–	–	–	(12)	–	(12)
At 31 December 2009	21	393	58	237	234	943
Charge for the year	**25**	**400**	**60**	**161**	**75**	**721**
Disposals	**–**	**–**	**–**	**–**	**(7)**	**(7)**
At 31 December 2010	**46**	**793**	**118**	**398**	**302**	**1,657**
Balance sheet amount at 31 December 2010	**550**	**1,977**	**182**	**479**	**308**	**3,496**
Balance sheet amount at 31 December 2009	575	2,377	242	640	253	4,087

Included within brands above are assets of £380 million (31 December 2009: £380 million) that have been determined to have indefinite useful lives and are not amortised. These brands use the Bank of Scotland name which has been in existence for over 300 years. These brands are well established financial services brands and there are no indications that they should not have an indefinite useful life.

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

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

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32 TANGIBLE FIXED ASSETS

	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m
Cost:				
At 1 January 2009	1,516	3,148	1,564	6,228
Exchange and other adjustments	19	(38)	281	262
Adjustment on acquisition	966	825	3,916	5,707
Additions	113	1,317	1,949	3,379
Disposals	(153)	(130)	(1,326)	(1,609)
At 31 December 2009	2,461	5,122	6,384	13,967
Exchange and other adjustments	**26**	**34**	**(76)**	**(16)**
Additions	**175**	**766**	**1,672**	**2,613**
Disposals	**(222)**	**(338)**	**(1,693)**	**(2,253)**
Disposal of businesses	**–**	**(1,005)**	**–**	**(1,005)**
At 31 December 2010	**2,440**	**4,579**	**6,287**	**13,306**
Accumulated depreciation and impairment:				
At 1 January 2009	789	2,208	266	3,263
Exchange and other adjustments	(19)	(12)	113	82
Depreciation charge for the year	132	450	1,134	1,716
Disposals	(18)	(49)	(251)	(318)
At 31 December 2009	884	2,597	1,262	4,743
Exchange and other adjustments	**2**	**(3)**	**30**	**29**
Impairment charged to the income statement	**–**	**202**	**–**	**202**
Depreciation charge for the year	**146**	**535**	**954**	**1,635**
Disposals	**(31)**	**(341)**	**(976)**	**(1,348)**
Disposal of businesses	**–**	**(145)**	**–**	**(145)**
At 31 December 2010	**1,001**	**2,845**	**1,270**	**5,116**
Balance sheet amount at 31 December 2010	**1,439**	**1,734**	**5,017**	**8,190**
Balance sheet amount at 31 December 2009	1,577	2,525	5,122	9,224

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

	2010 £m	2009 £m
Receivable within 1 year	**1,168**	845
1 to 5 years	**1,791**	1,939
Over 5 years	**638**	88
Total future minimum rentals receivable	**3,597**	2,872

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2010 and 2009 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £55 million at 31 December 2010 (£79 million at 31 December 2009) is expected to be received under non-cancellable sub-leases of the Group's premises.

The impairment charge of £202 million comprises £150 million relating to oil drilling rigs under construction acquired from a previous lending relationship in Wholesale (note 15) and £52 million relating to integration activities (note 11).

33 OTHER ASSETS

	2010 £m	2009 £m
Assets arising from reinsurance contracts held (note 38 and note 40)	**2,146**	1,875
Deferred acquisition and origination costs (see below)	**602**	533
Settlement balances	**985**	1,587
Other assets and prepayments	**8,910**	8,230
Total other assets	**12,643**	12,225

Deferred acquisition and origination costs:

	2010 £m	2009 £m
At 1 January	**533**	196
Adjustment on acquisition	**–**	422
Costs deferred, net of amounts amortised to the income statement	**69**	(84)
Exchange and other adjustments	**–**	(1)
At 31 December	**602**	533

34 DEPOSITS FROM BANKS

	2010 £m	2009 £m
Liabilities in respect of securities sold under repurchase agreements	**24,017**	27,558
Other deposits from banks	**26,346**	54,894
Deposits from banks	**50,363**	82,452

Included in the amounts reported above are deposits held as collateral for facilities granted, with a carrying value of £22,420 million (2009: £28,924 million) and a fair value of £25,626 million (2009: £36,016 million).

Included in the amounts reported above are collateral balances in the form of cash provided in respect of repurchase agreements amounting to £nil (2009: £19 million).

35 CUSTOMER DEPOSITS

	2010 £m	2009 £m
Non-interest bearing current accounts	**22,897**	9,264
Interest bearing current accounts	**77,785**	93,887
Savings and investment accounts	**222,226**	207,474
Liabilities in respect of securities sold under repurchase agreements	**11,145**	35,554
Other customer deposits	**59,580**	60,562
Customer deposits	**393,633**	406,741

Included in the amounts reported above are deposits held as collateral for facilities granted, with a carrying value of £11,112 million (2009: £35,504 million) and a fair value of £11,278 million (2009: £35,468 million).

Included in the amounts reported above are collateral balances in the form of cash provided in respect of repurchase agreements amounting to £122 million (2009: £203 million).

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36 TRADING AND OTHER FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2010 £m	2009 £m
Liabilities held at fair value through profit or loss (debt securities)	**6,665**	6,160
Trading liabilities:		
Liabilities in respect of securities sold under repurchase agreements	**14,612**	21,389
Short positions in securities	**1,755**	202
Other	**3,730**	520
	20,097	22,111
Trading and other financial liabilities at fair value through profit or loss	**26,762**	28,271

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2010 was £6,607 million, which was £58 million lower than the balance sheet carrying value (31 December 2009: £5,866 million, which was £294 million lower than the balance sheet carrying value). At 31 December 2010 there was a cumulative £11 million increase in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of Lloyds TSB Bank plc, the issuing entity within the Group. Of the £11 million increase, none arose in 2010 and £11 million arose in 2009.

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

37 DEBT SECURITIES IN ISSUE

	2010 £m	2009 £m
Medium-term notes issued	**80,975**	82,876
Covered bonds (note 22)	**32,150**	27,311
Certificates of deposit issued	**42,276**	50,858
Securitisation notes (note 22)	**40,742**	37,557
Commercial paper	**32,723**	34,900
Total debt securities in issue	**228,866**	233,502

38 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS

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

	2010			2009		
	Gross £m	Reinsurance[1] £m	Net £m	Gross £m	Reinsurance[1] £m	Net £m
Life insurance (see (1) below):						
Insurance contracts	**61,871**	**(2,044)**	**59,827**	56,800	(1,831)	54,969
Participating investment contracts	**17,642**	**–**	**17,642**	18,089	–	18,089
	79,513	**(2,044)**	**77,469**	74,889	(1,831)	73,058
Non-life insurance contracts (see (2) below):						
Unearned premiums	**632**	**(22)**	**610**	788	(31)	757
Claims outstanding	**584**	**(15)**	**569**	502	(13)	489
	1,216	**(37)**	**1,179**	1,290	(44)	1,246
Total	**80,729**	**(2,081)**	**78,648**	76,179	(1,875)	74,304

[1] Reinsurance balances are reported within other assets (note 33).

38 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

(1) LIFE INSURANCE

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

	Insurance contracts	Participating investment contracts	Gross £m	Reinsurance £m	Net £m
At 1 January 2009	21,518	11,619	33,137	(380)	32,757
New business	4,455	122	4,577	(28)	4,549
Changes in existing business	971	374	1,345	(149)	1,196
Change in liabilities charged to the income statement (note 10)	5,426	496	5,922	(177)	5,745
Adjustment on acquisition	29,996	5,996	35,992	(1,367)	34,625
Exchange and other adjustments	(140)	(22)	(162)	93	(69)
At 31 December 2009	56,800	18,089	74,889	(1,831)	73,058
New business	**3,807**	**325**	**4,132**	**(48)**	**4,084**
Changes in existing business	**1,348**	**(858)**	**490**	**(208)**	**282**
Change in liabilities charged to the income statement (note 10)	**5,155**	**(533)**	**4,622**	**(256)**	**4,366**
Exchange and other adjustments	**(84)**	**86**	**2**	**43**	**45**
At 31 December 2010	**61,871**	**17,642**	**79,513**	**(2,044)**	**77,469**

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

	2010			2009		
	With-profit fund £m	Non-profit fund £m	Total £m	With-profit fund £m	Non-profit fund £m	Total £m
Insurance contracts	**13,598**	**48,273**	**61,871**	12,066	44,734	56,800
Participating investment contracts	**10,647**	**6,995**	**17,642**	11,506	6,583	18,089
Total	**24,245**	**55,268**	**79,513**	23,572	51,317	74,889

With-profit fund realistic liabilities

(I) BUSINESS DESCRIPTION

The Group has with-profit funds within Scottish Widows plc and Clerical Medical Investment Group Limited containing both insurance contracts and participating investment contracts.

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

(II) METHOD OF CALCULATION OF LIABILITIES

With-profit liabilities are stated at their realistic value, the main components of which are:

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

The realistic assessment is carried out using a stochastic simulation model which values liabilities on a market consistent basis. The calculation of realistic liabilities uses best estimate assumptions for mortality, persistency rates and expenses. These are calculated in a similar manner to those used for the value of in-force business as discussed in note 30.

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38 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

(III) ASSUMPTIONS

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

Investment returns and discount rates

The realistic capital regime dictates that with-profit fund liabilities are valued on a market-consistent basis. This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The with-profit fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as the spot yield derived from the relevant government bond yield curve. Further information on significant options and guarantees is given on page 107.

Guaranteed annuity option take-up rates

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

Investment volatility

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

Mortality

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

Lapse rates (persistency)

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

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

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

Non-profit fund liabilities

(I) BUSINESS DESCRIPTION

The Group principally writes the following types of life insurance contracts within its non-profit funds. Shareholder profits on these types of business arise from management fees and other policy charges.

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

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

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

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

– Traditional and unit linked endowment or pensions business; and

– Life insurance business.

(II) METHOD OF CALCULATION OF LIABILITIES

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

38 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

(III) ASSUMPTIONS

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

Interest rates

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

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

Mortality and morbidity

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

Lapse rates (persistency)

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

Maintenance expenses

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

Key changes in assumptions

A detailed review of the Group's assumptions in 2010 resulted in the following key impacts on profit before tax:

– Change in persistency assumptions (£38 million decrease)

– Change in the assumption in respect of future mortality rates (£40 million increase)

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

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38 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

(2) NON-LIFE INSURANCE

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

	2010 £m	2009 £m
Credit protection	**380**	533
Home	**833**	754
Health	**3**	3
Total gross non-life insurance contract liabilities	**1,216**	1,290

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

The reserving methodology and associated assumptions are set out below:

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

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

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

	Gross £m	Reinsurance £m	Net £m
Provisions for unearned premiums			
At 1 January 2009	472	–	472
Adjustment on acquisition	487	(4)	483
Increase in the year	1,267	(101)	1,166
Release in the year	(1,438)	75	(1,363)
Change in provision for unearned premiums charged to income statement (note 8)	(171)	(26)	(197)
Exchange and other adjustments	–	(1)	(1)
At 31 December 2009	788	(31)	757
Increase in the year	**1,230**	**(104)**	**1,126**
Release in the year	**(1,386)**	**113**	**(1,273)**
Change in provision for unearned premiums charged to income statement (note 8)	**(156)**	**9**	**(147)**
Exchange and other adjustments	**–**	**–**	**–**
At 31 December 2010	**632**	**(22)**	**610**

38 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

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

	Gross £m	Reinsurance £m	Net £m
Claims outstanding			
Notified claims	160	(5)	155
Incurred but not reported	23	–	23
At 1 January 2009	183	(5)	178
Adjustment on acquisition	208	(5)	203
Cash paid for claims settled in the year	(513)	14	(499)
Increase (decrease) in liabilities:			
Arising from current year claims	623	(15)	608
Arising from prior year claims	1	(2)	(1)
Change in liabilities charged to income statement (note 10)	111	(3)	108
At 31 December 2009	502	(13)	489
Cash paid for claims settled in the year	**(467)**	**11**	**(456)**
Increase (decrease) in liabilities:			
Arising from current year claims	**581**	**(12)**	**569**
Arising from prior year claims	**(32)**	**(1)**	**(33)**
Change in liabilities charged to income statement (note 10)	**82**	**(2)**	**80**
At 31 December 2010	**584**	**(15)**	**569**
Notified claims	**420**	**(4)**	**416**
Incurred but not reported	**164**	**(11)**	**153**
At 31 December 2010	**584**	**(15)**	**569**
Notified claims	289	(9)	280
Incurred but not reported	213	(4)	209
At 31 December 2009	502	(13)	489

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38 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

NON-LIFE INSURANCE CLAIMS DEVELOPMENT TABLE

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

NON-LIFE INSURANCE ALL RISKS – GROSS

	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	Total £m
Accident year							
Estimate of ultimate claims costs:							
At end of accident year	211	208	317	205	639	**609**	**2,189**
One year later	207	206	311	199	539		
Two years later	204	204	299	195			
Three years later	202	204	292				
Four years later	201	205					
Five years later	201						
Current estimate in respect of above claims	201	205	292	195	539	**609**	**2,041**
Current estimate of claims relating to general insurance business acquired in 2009	284	326	394	263	–	**–**	**1,267**
Current estimate of cumulative claims	485	531	686	458	539	**609**	**3,308**
Cumulative payments to date	(472)	(520)	(671)	(430)	(443)	**(226)**	**(2,762)**
Liability recognised in the balance sheet	13	11	15	28	96	**383**	**546**
Liability in respect of earlier years[1]							**22**
Total liability included in the balance sheet							**568**

[1] This balance includes £2 million of claims relating to general insurance business acquired during 2009.

The liability of £568 million shown in the above table excludes £16 million of unallocated claims handling expenses.

39 LIFE INSURANCE SENSITIVITY ANALYSIS

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

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

	Change in variable	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
As at 31 December 2009			
Non-annuitant mortality[1]	5% reduction	80	58
Annuitant mortality[2]	5% reduction	(120)	(86)
Lapse rates[3]	10% reduction	168	121
Future maintenance and investment expenses[4]	10% reduction	207	149
Risk-free rate[5]	0.25% reduction	56	40
Guaranteed annuity option take up[6]	5% addition	(7)	(5)
Equity investment volatility[7]	1% addition	(13)	(9)
Widening of credit default spreads on corporate bonds[8]	0.25% addition	(144)	(104)
Increase in illiquidity premia[9]	0.10% addition	78	56

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

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

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

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

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

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

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

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

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

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

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40 LIABILITIES ARISING FROM NON-PARTICIPATING INVESTMENT CONTRACTS

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

	Gross £m	Reinsurance £m	Net £m
At 1 January 2009	14,243	–	14,243
Adjustment on acquisition	28,181	–	28,181
New business	3,498	–	3,498
Changes in existing business	430	–	430
Exchange and other adjustments	(4)	–	(4)
At 31 December 2009	46,348	–	46,348
New business	**3,953**	**(65)**	**3,888**
Changes in existing business	**1,070**	**–**	**1,070**
Exchange and other adjustments	**(8)**	**–**	**(8)**
At 31 December 2010	**51,363**	**(65)**	**51,298**

41 UNALLOCATED SURPLUS WITHIN INSURANCE BUSINESSES

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

	2010 £m	2009 £m
At 1 January	**1,082**	270
Adjustment on acquisition	**–**	526
Change in unallocated surplus recognised in the income statement (note 10)	**(439)**	318
Exchange and other adjustments	**–**	(32)
At 31 December	**643**	1,082

42 OTHER LIABILITIES

	2010 £m	2009 £m
Settlement balances	**1,269**	2,070
Unitholders' interest in Open Ended Investment Companies	**15,617**	12,415
Other creditors and accruals	**12,810**	14,835
Other liabilities	**29,696**	29,320

43 RETIREMENT BENEFIT OBLIGATIONS

	2010 £m	2009 £m
Charge to the income statement		
Defined benefit pension schemes[1]	**(467)**	529
Other post-retirement benefit schemes	**12**	7
Total defined benefit schemes	**(455)**	536
Defined contribution pension schemes	**173**	208
Total charge to the income statement	**(282)**	744

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

	2010 £m	2009 £m
Amounts recognised in the balance sheet		
Defined benefit pension schemes	**479**	(619)
Other post-retirement benefit schemes	**(166)**	(161)
Total amounts recognised in the balance sheet	**313**	(780)

	2010 £m	2009 £m
Amounts recognised in the balance sheet		
Retirement benefit assets	**736**	–
Retirement benefit obligations	**(423)**	(780)
Total amounts recognised in the balance sheet	**313**	(780)

PENSION SCHEMES

Defined benefit schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas, the three most significant being the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2 and the HBOS Final Salary Pension Scheme. These schemes provide retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes at 31 December 2010 was generally 55 although certain categories of member are deemed to have a contractual right to retire at 50.

The latest full valuations of the two Lloyds TSB schemes were carried out as at 30 June 2008; the latest full valuation of the HBOS scheme was carried out as at 31 December 2008. The results have been updated to 31 December 2010 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2010 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The Group's obligations in respect of its defined benefit schemes are funded. During 2009, the Group's contributions to its defined benefit schemes of £1,859 million included one-off contributions to the Lloyds TSB Group Pension Scheme No 1 and Lloyds TSB Group Pension Scheme No 2 of approximately £1 billion in aggregate. These contributions took the form of interests in limited liability partnerships for each of the two schemes which contained assets of approximately £5 billion in aggregate entitling the schemes to annual payments of approximately £215 million in aggregate until 31 December 2014. Thereafter, assuming that all distributions have been made, the value of the partnership interests will equate to a nominal amount. At 31 December 2010, the limited liability partnerships held assets of approximatey £4.9 billion; cash payments of £215 million were made to the pension schemes during the year. The limited liability partnerships are fully consolidated in the Group's balance sheet (see note 23).

The Group currently expects to pay contributions of approximately £625 million to its defined benefit schemes in 2011.

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43 RETIREMENT BENEFIT OBLIGATIONS continued

	2010 £m	2009 £m
Amount included in the balance sheet		
Present value of funded obligations	**(26,862)**	(27,073)
Fair value of scheme assets	**26,382**	23,518
	(480)	(3,555)
Unrecognised actuarial losses	**959**	2,936
Net amount recognised in the balance sheet	**479**	(619)

	2010 £m	2009 £m
Movements in the defined benefit obligation		
At 1 January	**(27,073)**	(15,617)
Adjustment on acquisition	**–**	(7,046)
Current service cost	**(384)**	(395)
Employee contributions	**(4)**	(2)
Interest cost	**(1,474)**	(1,383)
Actuarial gains (losses)	**140**	(3,568)
Benefits paid	**950**	932
Past service cost	**(46)**	(67)
Curtailments	**1,081**	–
Settlements	**6**	8
Exchange and other adjustments	**(58)**	65
At 31 December	**(26,862)**	(27,073)

	2010 £m	2009 £m
Changes in the fair value of scheme assets		
At 1 January	**23,518**	13,693
Adjustment on acquisition	**–**	6,743
Expected return	**1,507**	1,320
Employer contributions	**648**	1,859
Employee contributions	**4**	2
Actuarial gains	**1,624**	886
Benefits paid	**(950)**	(932)
Settlements	**(9)**	(12)
Exchange and other adjustments	**40**	(41)
At 31 December	**26,382**	23,518
Actual return on scheme assets	**3,131**	2,206

43 RETIREMENT BENEFIT OBLIGATIONS continued

ASSUMPTIONS

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

	2010 %	2009 %
Discount rate	**5.50**	5.70
Rate of inflation:		
Retail Prices Index	**3.40**	3.40
Consumer Price Index	**2.90**	–
Rate of salary increases	**2.00**	3.75
Rate of increase for pensions in payment	**3.20**	3.20
	Years	Years
Life expectancy for member aged 60, on the valuation date:		
Men	**27.2**	27.1
Women	**28.3**	28.2
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**28.2**	28.7
Women	**29.9**	29.8

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 as at 31 December 2010 is assumed to live for, on average, 27.2 years for a male and 28.3 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

SENSITIVITY ANALYSIS

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

	Increase (decrease) in the income statement charge		Increase (decrease) in the net defined benefit pension scheme asset	
	2010 £m	2009 £m	2010 £m	2009 £m
Inflation:[1]				
Increase of 0.2 per cent	**14**	69	**(791)**	(795)
Decrease of 0.2 per cent	**(15)**	(60)	**754**	763
Discount rate:[2]				
Increase of 0.2 per cent	**(20)**	(68)	**930**	937
Decrease of 0.2 per cent	**15**	82	**(976)**	(985)
Expected life expectancy of members:				
Increase of one year	**40**	79	**(620)**	(590)
Decrease of one year	**(41)**	(76)	**632**	603

[1] At 31 December 2010, the assumed rate of inflation is 3.4 per cent (31 December 2009 3.4 per cent).

[2] At 31 December 2010, the assumed discount rate is 5.5 per cent (31 December 2009 5.7 per cent).

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43 RETIREMENT BENEFIT OBLIGATIONS continued

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

	2010 %	2009 %
Equities and alternative assets	**8.3**	8.4
Fixed interest gilts	**4.5**	3.7
Index linked gilts	**4.1**	4.0
Non-Government bonds	**6.0**	6.7
Property	**7.5**	6.4
Money market instruments and cash	**4.3**	3.8

The expected return on scheme assets in 2011 will be calculated using the following assumptions:

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

Composition of scheme assets:

	2010 £m	2009 £m
Equities	**11,856**	10,934
Fixed interest gilts	**2,237**	2,038
Index linked gilts	**4,159**	2,917
Non-Government bonds	**2,922**	2,148
Property	**1,654**	1,577
Money market instruments, cash and other assets and liabilities	**3,554**	3,904
At 31 December	**26,382**	23,518

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

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

Experience adjustments history:

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Present value of defined benefit obligation	**(26,862)**	(27,073)	(15,617)	(16,795)	(17,378)
Fair value of scheme assets	**26,382**	23,518	13,693	16,112	15,279
	(480)	(3,555)	(1,924)	(683)	(2,099)
Experience gains (losses) on scheme liabilities	**496**	31	(39)	(185)	(50)
Experience gains (losses) on scheme assets	**1,624**	886	(3,520)	139	314

43 RETIREMENT BENEFIT OBLIGATIONS continued

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

	2010 £m	2009 £m
Current service cost	**384**	395
Interest cost	**1,474**	1,383
Expected return on scheme assets	**(1,507)**	(1,320)
Net actuarial losses recognised in year	**43**	–
Curtailments (see below)	**(910)**	–
Settlements	**3**	4
Past service cost	**46**	67
Total defined benefit pension expense	**(467)**	529

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

Defined contribution schemes

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

During the year ended 31 December 2010 the charge to the income statement in respect of defined contribution schemes was £173 million (2009: £208 million), representing the contributions payable by the employer in accordance with each scheme's rules.

OTHER POST-RETIREMENT BENEFIT SCHEMES

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

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 30 June 2008; this valuation has been updated to 31 December 2010 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 7.54 per cent (2009: 7.33 per cent).

Amount included in the balance sheet:

	2010 £m	2009 £m
Present value of unfunded obligations	**(175)**	(170)
Unrecognised actuarial losses	**9**	9
Retirement benefit obligation recognised in the balance sheet	**(166)**	(161)

Movements in the other post-retirement benefits obligation:

	2010 £m	2009 £m
At 1 January	**(170)**	(118)
Exchange and other adjustments	**2**	7
Adjustment on acquisition	**–**	(55)
Actuarial loss	**–**	(5)
Insurance premiums paid	**5**	8
Charge for the year	**(12)**	(7)
At 31 December	**(175)**	(170)

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44 DEFERRED TAX

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

	2010 £m	2009 £m
Asset at 1 January	**4,797**	833
Exchange and other adjustments	**68**	107
Adjustment on acquisition	**–**	1,851
Disposals	**–**	16
Income statement (charge) credit (note 16):		
Due to change in UK corporation tax rate	**(137)**	–
Other	**(534)**	2,619
	(671)	2,619
Amount (charged) credited to equity:		
Available-for-sale financial assets (note 49)	**(330)**	(395)
Net investment hedges (note 49)	**–**	(358)
Cash flow hedges (note 49)	**33**	119
Share-based compensation	**20**	5
	(277)	(629)
Asset at 31 December	**3,917**	4,797

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

Statutory position	2010 £m	2009 £m	Tax disclosure	2010 £m	2009 £m
Deferred tax assets	**4,164**	5,006	Deferred tax assets	**8,513**	8,579
Deferred tax liabilities	**(247)**	(209)	Deferred tax liabilities	**(4,596)**	(3,782)
Asset at 31 December	**3,917**	4,797	**Asset at 31 December**	**3,917**	4,797

44 DEFERRED TAX continued

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

	2010 £m	2009 £m
Accelerated capital allowances	**(470)**	1,039
Pensions and other post-retirement benefits	**(391)**	(199)
Long-term assurance business	**(110)**	(188)
Allowances for impairment losses	**73**	(128)
Trading losses	**873**	4,000
Tax on fair value of acquired assets	**(715)**	(2,022)
Other temporary differences	**69**	117
Deferred tax (charge) credit in the income statement	**(671)**	2,619

Deferred tax assets and liabilities are comprised as follows:

	2010 £m	2009 £m
Deferred tax assets:		
Pensions and other post-retirement benefits	**33**	424
Allowances for impairment losses	**612**	474
Other provisions	**231**	232
Derivatives	**221**	155
Available-for-sale asset revaluation	**519**	936
Tax losses carried forward	**6,572**	5,925
Other temporary differences	**325**	433
Total deferred tax assets	**8,513**	8,579

	2010 £m	2009 £m
Deferred tax liabilities:		
Accelerated capital allowances	**(562)**	(92)
Long-term assurance business	**(1,630)**	(1,530)
Tax on fair value of acquired assets	**(2,097)**	(1,913)
Effective interest rates	**(74)**	(88)
Other temporary differences	**(233)**	(159)
Total deferred tax liabilities	**(4,596)**	(3,782)

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44 DEFERRED TAX continued

The Finance (No. 2) Act 2010 includes legislation to reduce the main rate of corporation tax from 28 per cent to 27 per cent with effect from 1 April 2011. This resulted in a reduction in the Group's net deferred tax asset at 31 December 2010 of £132 million.

The proposed further reductions in the rate of corporation tax by 1 per cent per annum to 24 per cent by 1 April 2014 are expected to be enacted separately each year starting in 2011. The effect of these further changes upon the Group's deferred tax balances and leasing business cannot be reliably quantified at this stage.

DEFERRED TAX ASSETS

Deferred tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits is probable. Group companies have recognised deferred tax assets of £6,572 million (2009: £5,925 million) in relation to trading tax losses carried forward. After reviews of medium-term profit forecasts, the Group considers that there will be sufficient profits in the future against which these losses will be offset.

Deferred tax assets of £396 million (31 December 2009: £487 million) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

Deferred tax assets of £227 million (31 December 2009: £349 million) have not been recognised in respect of trading losses carried forward, mainly in certain overseas companies as there are limited predicted future trading profits. Trading losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of unrelieved foreign tax carried forward as at 31 December 2010 of £62 million (31 December 2009: £53 million), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. These tax credits can be carried forward indefinitely.

DEFERRED TAX LIABILITIES

Future transfers from Scottish Widows plc's long-term business funds to its Shareholder Fund will be subject to a shareholder tax charge. Under IAS 12, no provision is required to be made to the extent that the timing of such transfers is under Scottish Widows plc's control. Accordingly, deferred tax liabilities of £90 million (2009: £90 million) have not been recognised.

Scottish Widows plc has a taxable difference of £152 million (2009: £152 million) in respect of its holding of a life insurance subsidiary. No deferred tax liability is required to be recognised in respect of this taxable temporary difference under IAS 12 as Scottish Widows plc does not intend to dispose of this subsidiary company.

45 OTHER PROVISIONS

	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Customer goodwill payments £m	Restructuring provisions £m	Vacant leasehold property £m	Other £m	Total £m
At 1 January 2010	72	460	–	116	108	227	983
Exchange and other adjustments	16	(26)	–	(1)	4	9	2
Transfers	–	49	–	–	–	–	49
Provisions applied	(9)	(222)	–	(16)	(1)	(5)	(253)
Charge for the year	75	83	500	23	35	35	751
At 31 December 2010	154	344	500	122	146	266	1,532

45 OTHER PROVISIONS continued

PROVISIONS FOR CONTINGENT LIABILITIES AND COMMITMENTS
Provisions are held in cases where the Group is irrevocably committed to advance additional funds, but where there is doubt as to the customer's ability to meet its repayment obligations.

CUSTOMER REMEDIATION PROVISIONS
The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes have been found to be deficient. During 2010 management has again reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and £83 million has been charged to the income statement. At 31 December 2010 the remaining provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks.

CUSTOMER GOODWILL PAYMENTS
Lloyds Banking Group has been in discussion with the FSA regarding the application of an interest variation clause in certain Bank of Scotland plc variable rate mortgage contracts where the wording in the offer documents received by certain customers had the potential to cause confusion. The relevant mortgages were written between 2004 and 2007 by Bank of Scotland plc under the 'Halifax' brand. In February 2011, the Group reached agreement with the FSA in relation to initiating a customer review and contact programme and making goodwill payments to affected customers. In order to make these goodwill payments, Bank of Scotland plc has applied for a Voluntary Variation of Permission to carry out the customer review and contact programme to bring it within section 404F(7) of FSMA 2000. The Group has made a provision of £500 million in relation to this programme.

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

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

OTHER
Other provisions include the provisions which the Group carries in respect of its obligations arising from the liquidation of UIC Insurance Company Limited (UIC). The Group has indemnified a third party against losses arising from a reinsurance contract written by UIC which is subject to asbestos and pollution claims in the US. The ultimate cost and timing of payments under the indemnity remain uncertain. The provision held represents management's current best estimate of the cost after having regard to actuarial estimates of future losses.

46 SUBORDINATED LIABILITIES

	2010 £m	2009 £m
Preference shares	**1,165**	1,983
Preferred securities	**4,538**	5,078
Undated subordinated liabilities	**2,002**	2,665
Enhanced capital notes	**9,235**	9,047
Dated subordinated liabilities	**19,292**	15,954
Total subordinated liabilities	**36,232**	34,727

The securities in this note will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preferred shares and securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of holders of the dated subordinated liabilities. The subordination of the dated enhanced capital notes ranks equally with that of the dated subordinated liabilities. The Group has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the year (2009: none). No repayment or purchase by the issuer of the subordinated liabilities may be made prior to their stated maturity without the consent of the Financial Services Authority.

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46 SUBORDINATED LIABILITIES continued

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

	£m
At 1 January 2010	**34,727**
Issued during the year	**3,511**
Repurchases and redemptions during the year	**(3,618)**
Foreign exchange and other movements	**1,612**
At 31 December 2010	**36,232**

	Note	2010 £m	2009 £m
Preference shares			
6% Non-cumulative Redeemable Preference Shares	a	**–**	–
6.267% Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	d, e	**269**	327
9¼% Non-cumulative Irredeemable £1 preference shares (£300 million)	e	**235**	197
9¾% Non-cumulative Irredeemable £1 preference shares (£100 million)	b, c, e	**30**	72
6.413% Fixed-to-Floating Rate US$1 series A preference shares (US$750 million)	e	**113**	115
5.92% Fixed-to-Floating Rate US$1 series B preference shares (US$750 million)	d, e	**9**	90
6.657% Fixed-to-Floating rate US$1 preference shares (US$750 million)	e	**5**	28
7.875% Non-cumulative callable preference shares (US$1,250 million)	b, e	**277**	680
7.875% Non-cumulative callable preference shares (€500 million)	b, e	**182**	417
6.475% fixed rate non-cumulative callable preference shares (£186 million)	b, c, e	**34**	45
6.0884% fixed-to-floating rate non-cumulative callable preference shares (£745 million)	b, e	**9**	10
6.3673% fixed-to-floating non-cumulative callable preference shares (£335 million)	b, e	**2**	2
Total preference shares		**1,165**	1,983

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

b As part of the Group's recapitalisation and exit from the Government Asset Protection Scheme, following an exchange offer, on 1 December , 10 December and 15 December 2009, certain holders of certain series elected to exchange some or all of the preference shares they held for equity issued by Lloyds Banking Group plc on 18 February 2010.

c Following an invitation to certain eligible retail holders on 15 December 2009, certain holders of certain series elected to sell some or all of the preference shares they held to Lloyds Banking Group plc in January 2010.

d Following conclusion of a limited number of privately negotiated bilateral exchanges on 7 May 2010, certain holders of certain series elected to exchange some or all of the preference shares they held for equity issued by Lloyds Banking Group plc.

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

46 SUBORDINATED LIABILITIES continued

	Note	2010 £m	2009 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)	a, c	**249**	645
7.375% Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	a, b	**16**	306
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	a	**241**	456
7.834% Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	a, b	**4**	43
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	a, b	**85**	82
13.00% Step-up Perpetual Capital Securities callable 2019 (£784 million)	a, b	**10**	9
13.00% Euro Step-up Perpetual Capital Securities callable 2019 (€532 million)	b	**56**	47
12% Fixed to Floating Rate Perpetual Tier 1 Capital Securities callable 2024 (US$2,000 million)		**1,288**	1,235
13.00% Sterling Step-up Perpetual Capital Securities callable 2029 (£700 million)	a, b	**662**	666
6.071% Non-cumulative Perpetual Preferred Securities of US$1,000 each (US$750 million)		**336**	240
6.85% Non-cumulative Perpetual Preferred Securities of US$1,000 each (US$1,000 million)	c	**107**	–
6.461% Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities Series A of £1,000 each (£600 million)		**421**	398
8.117% Non-cumulative Perpetual Preferred Securities Series 1 of £1,000 each (Class A) (£250 million)	c, d	**253**	234
7.754% Non-cumulative Perpetual Preferred Securities Series 2 of £1,000 each (Class B) (£150 million)		**98**	93
7.881% Guaranteed Non-voting Non-cumulative Preferred Securities (£245 million)		**173**	151
7.627% Fixed to Floating Rate Guaranteed Non-voting Non-cumulative Preferred Securities (€415 million)	c	**308**	259
4.939% Non-voting Non-cumulative Perpetual Preferred Securities (€750 million)	b	**17**	10
Perpetual Regulatory Tier One Securities (£300 million)		**214**	204
Total preferred securities		**4,538**	5,078

a As part of the Group's recapitalisation and exit from the Government Asset Protection Scheme, following an exchange offer, on 1 December 2009, 10 December and 15 December 2009 certain holders of certain series elected to exchange some or all of the notes they held for equity issued by Lloyds Banking Group plc on 18 February 2010.

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

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

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

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46 SUBORDINATED LIABILITIES continued

	Note	2010 £m	2009 £m
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:			
Series 1 (US$750 million)	b, c, d	**173**	408
Series 2 (US$500 million)	b, c, d	**181**	262
Series 3 (US$600 million)	b, c, d	**232**	326
11¾% Perpetual Subordinated Bonds (£100 million)		**102**	102
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)	b, d, e	**6**	5
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million) (Scottish Widows plc)	a	**550**	547
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	b	**–**	–
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	b	**1**	–
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	b	**–**	–
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	b	**–**	–
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	b	**10**	10
5.625% Cumulative Callable Fixed to Floating Rate Undated Subordinated Notes (£500 million)	b	**–**	1
4.875% Undated Subordinated Fixed to Floating Rate Instruments (€750 million)	b	**65**	60
Floating Rate Undated Subordinated Notes (€500 million)	b	**42**	41
5.375% Undated Fixed to Floating Rate Subordinated Notes (US$1,000 million)	b	**12**	3
5.125% Undated Subordinated Fixed to Floating Notes (€750 million)	b	**47**	39
5.75% Undated Subordinated Step-up Notes (£600 million)		**3**	2
6.05% Fixed to Floating Rate Undated Subordinated Notes (€500 million)	d	**57**	50
7.5% Undated Subordinated Step-up Notes (£300 million)		**3**	4
3.50% Undated Subordinated Yen Step-up Notes (JPY 42.5 billion)	c	**–**	267
8.625% Perpetual Subordinated Notes (£200 million)	b	**21**	18
7.375% Undated Subordinated Guaranteed Bonds (£200 million) (Clerical Medical Finance plc)		**35**	35
Floating Rate Undated Subordinated Step-up Notes (€300 million)	d	**63**	58
Floating Rate Primary Capital Notes (US$250 million)	b, c, d	**118**	146
10.25% Subordinated Undated Instruments (£100 million)	b	**1**	1
12% Perpetual Subordinated Bonds (£100 million)	b	**21**	22
8.75% Perpetual Subordinated Bonds (£100 million)	b	**4**	6
13.625% Perpetual Subordinated Bonds (£75 million)	b	**20**	33
9.375% Perpetual Subordinated Bonds (£50 million)	b	**16**	26
5.75% Undated Subordinated Step-up Notes (£500 million)		**3**	3
4.25% Perpetual Fixed/Floating Rate Reset Subordinated Guaranteed Notes (€750 million) (Clerical Medical Finance plc)		**215**	190
7.375% Subordinated Undated Instruments (£150 million)	b	**1**	–
Total undated subordinated liabilities		**2,002**	2,665

a Scottish Widows plc may elect to defer interest on these securities although in that event Scottish Widows plc cannot declare or pay a dividend on any ordinary share capital until any deferred payments have been made.

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

c Following an exchange offer, on 28 May 2010 and 14 June 2010, certain holders elected to exchange some or all of the notes they held for equity issued by Lloyds Banking Group plc.

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

e The fixed rate on this security was reset from 6.625 per cent to 4.6482 per cent with effect from 15 July 2010.

46 SUBORDINATED LIABILITIES continued

With the exception of the two series identified in note b, the ECNs were issued in lower tier 2 format and are convertible into ordinary shares on the breach of a defined trigger. The trigger on the ECNs offered in the exchange will be if the published core tier 1 ratio of the Group falls below 5 per cent (as defined by the Financial Services Authority in May 2009).

	Note	2010 £m	2009 £m
Enhanced capital notes			
7.5884% Enhanced Capital Notes due 2020 (Series 1) (£732 million)		**694**	690
7.8673% Enhanced Capital Notes due 2019 (Series 2) (£331 million)		**336**	316
7.975% Enhanced Capital Notes due 2024 (Series 3) (£102 million)		**98**	96
7.869% Enhanced Capital Notes due 2020 (Series 8) (£596 million)		**589**	572
8.875% Enhanced Capital Notes due 2020 (Series 12) (€125 million)		**116**	117
9.334% Enhanced Capital Notes due 2020 (Series 14) (£208 million)		**233**	218
6.439% Enhanced Capital Notes due 2020 (Series 15) (€710 million)		**562**	557
6.385% Enhanced Capital Notes due 2020 (Series 18) (€662 million)		**525**	517
11.04% Enhanced Capital Notes due 2020 (Series 19) (£736 million)		**872**	871
15% Enhanced Capital Notes due 2019 (Series 21) (£775 million)		**1,145**	1,125
15% Enhanced Capital Notes due 2019 (Series 22) (€487 million)		**635**	646
15% Enhanced Capital Notes due 2029 (Series 23) (£68 million)		**111**	108
9.125% Enhanced Capital Notes due 2020 (Series 27) (£148 million)		**158**	153
11.125% Enhanced Capital Notes due 2020 (Series 31) (£39 million)		**45**	45
7.375% Enhanced Capital Notes due 2020 (Series 32) (€95 million)		**82**	80
Floating Rate Enhanced Capital Notes due 2020 (Series 33) (€53 million)	a	**41**	42
12.75% Enhanced Capital Notes due 2020 (Series 34) (£57 million)		**75**	74
8.07% Enhanced Capital Notes due 2020 (Series 35) (¥20,000 million)	c	**–**	156
7.625% Enhanced Capital Notes due 2020 (Series 36) (€226 million)		**189**	193
6.75% Enhanced Capital Notes due 2020 (Series 37) (¥17,000 million)	c	**–**	121
7.625% Enhanced Capital Notes due 2019 (Series 39) (£151 million)		**142**	142
9% Enhanced Capital Notes due 2019 (Series 40) (£97 million)		**103**	100
8.125% Enhanced Capital Notes due 2019 (Series 41) (£4 million)		**4**	4
14.5% Enhanced Capital Notes due 2022 (Series 42) (£79 million)		**115**	115
9.875% Enhanced Capital Notes due 2023 (Series 44) (£57 million)		**67**	62
11.25% Enhanced Capital Notes due 2023 (Series 45) (£95 million)		**115**	115
10.5% Enhanced Capital Notes due 2023 (Series 46) (£69 million)		**79**	78
11.875% Enhanced Capital Notes due 2024 (Series 47) (£35 million)		**45**	45
9% Enhanced Capital Notes due 2029 (Series 49) (£107 million)		**112**	108
8.5% Enhanced Capital Notes due 2032 (Series 50) (£104 million)		**105**	100
16.125% Enhanced Capital Notes due 2024 (Series 52) (£61 million)		**99**	100
7.875% Enhanced Capital Notes due 2020 (US$986 million)		**631**	599
8% Fixed to Floating Rate Undated Enhanced Capital Notes callable 2022 (US$1,259 million)	b	**674**	639
8.5% Undated Enhanced Capital Notes callable 2021 (Series 2) (US$277 million)	b	**150**	143
7.875% Enhanced Capital Notes due 2020 (US$408 million)		**288**	–
Total enhanced capital notes		**9,235**	9,047

a Interest is payable quarterly in arrears at a rate of 3 month EURIBOR plus 3.1 per cent per annum.

b Issued in upper tier 2 format.

c Following conclusion of a privately negotiated bilateral exchange on 19 March 2010, certain holders elected to exchange some or all of the notes they held for enhanced capital notes issued by Lloyds Banking Group Capital No. 2 plc.

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46 SUBORDINATED LIABILITIES continued

	Note	2010 £m	2009 £m
Dated subordinated liabilities			
6 1/4% Subordinated Notes 2010 (€400 million)		–	375
12% Guaranteed Subordinated Bonds 2011 (£100 million)	a	109	108
7.70% Notes 2010 (US$500 million)		–	327
9 1/8% Subordinated Bonds 2011 (£150 million)		147	152
4 3/4% Subordinated Notes 2011 (€850 million)		764	771
6.50% Notes 2011 (US$150 million)		99	102
5.50% Subordinated Fixed Rate Notes 2012 (€750 million)		657	654
6.25% Instruments 2012 (€12.8 million)		10	10
6.125% Notes 2013 (€325 million)		289	296
4.25% Subordinated Guaranteed Notes 2013 (US$1,000 million)		619	594
5 7/8% Subordinated Guaranteed Bonds 2014 (€750 million)		739	768
5 7/8% Subordinated Notes 2014 (£150 million)		149	154
11% Subordinated Bonds 2014 (£250 million)		297	304
6 5/8% Subordinated Notes 2015 (£350 million)		343	335
4.875% Subordinated Notes 2015 (€1,000 million)		838	875
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	b	296	296
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	b	432	445
Callable Floating Rate Subordinated Notes 2016 (€500 million)	b	401	374
Subordinated Notes 2016 (€500 million)	b	417	389
Notes 2016 (US$750 million)	b	440	367
Subordinated Lower Tier II Notes 2017 (€1,000 million)		758	704
Subordinated Callable Notes 2017 (US$1,000 million)		548	464
Subordinated Callable Floating Rate Instruments 2017 (Aus$400 million)		255	209
6.75% Subordinated Callable Fixed/Floating Rate Instruments 2017 (Aus$200 million)		127	101
5.109% Callable Fixed to Floating Rate Notes 2017 (Can$500 million)		305	263
6.305% Lower Tier II Subordinated Notes 2017 (£500 million)		486	474
5.625% Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)		946	979
10.5% Subordinated Bonds 2018 (£150 million)		171	165
6.75% Subordinated Fixed Rate Notes 2018 (US$2,000 million)		1,176	917
6.375% Instruments 2019 (£250 million)		236	227
4.375% Callable Fixed to Floating Rate Subordinated Notes 2019 (€750 million)		600	602
6.5% Dated Subordinated Notes 2020 (€1,500 million)		1,353	–
6.9625% Subordinated Fixed to Floating Rate Notes due 2020 callable 2015 (£750 million)		715	755
Subordinated Floating Rate Notes 2020 (€100 million)		86	89
7.375% Dated Subordinated Notes 2020		4	–
6.5% Subordinated Fixed Rate Notes 2020 (US$2,000 million)		1,202	–
9.375% Subordinated Bonds 2021 (£500 million)		647	268
5.374% Subordinated Fixed Rate Notes 2021 (€160 million)		139	132
6.45% Fixed/Floating Subordinated Guaranteed Bonds 2023 (€400 million) (Clerical Medical Finance plc)		173	171
7.07% Subordinated Fixed Rate Notes 2023 (€175 million)		162	128
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		324	322
9 5/8% Subordinated Bonds 2023 (£300 million)		332	333
4.50% Fixed Rate Step-up Subordinated Notes due 2030 (€750 million)		463	478
7.625% Dated Subordinated Notes 2025 (£750 million)		763	–
6.00% Subordinated Notes 2033 (US$750 million)		275	477
Total dated subordinated liabilities		19,292	15,954

a Issued by a group undertaking under the Company's subordinated guarantee.

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

47 SHARE CAPITAL

(1) AUTHORISED SHARE CAPITAL

As permitted by the Companies Act 2006, the Company removed references to authorised share capital from its articles of association at the annual general meeting on 5 June 2009. This change took effect from 1 October 2009.

(2) ISSUED AND FULLY PAID SHARE CAPITAL

	2010 Number of shares	2009 Number of shares	2010 £m	2009 £m
Ordinary shares of 10p (formerly 25p) each				
At 1 January	**63,774,511,536**	5,972,855,669	**6,378**	1,493
Issued on redemption of preference shares and other subordinated liabilities in 2010	**4,299,422,579**	–	**429**	–
Placing and open offer	**–**	2,596,653,203	**–**	649
Issued on acquisition of HBOS	**–**	7,775,694,993	**–**	1,944
Capitalisation issue	**–**	407,943,501	**–**	102
Placing and compensatory open offer	**–**	10,408,535,000	**–**	2,602
Subdivision	**–**	–	**–**	(4,074)
Rights issue	**–**	36,505,088,579	**–**	3,651
Issued to the Lloyds TSB Foundations	**–**	107,740,591	**–**	11
Issued under employee share schemes	**195,339**	–	**–**	–
At 31 December	**68,074,129,454**	63,774,511,536	**6,807**	6,378
Limited voting ordinary shares of 10p (formerly 25p) each				
At 1 January	**80,921,051**	78,947,368	**8**	20
Capitalisation issue	**–**	1,973,683	**–**	–
Subdivision	**–**	–	**–**	(12)
At 31 December	**80,921,051**	80,921,051	**8**	8
Deferred shares of 15p each				
At 1 January	**27,242,603,417**	–	**4,086**	–
Subdivision of ordinary shares	**–**	27,161,682,366	**–**	4,074
Subdivision of limited voting ordinary shares	**–**	80,921,051	**–**	12
Cancellation of deferred shares	**(27,242,603,417)**	–	**(4,086)**	–
At 31 December	**–**	27,242,603,417	**–**	4,086
Total issued share capital			**6,815**	10,472

On 5 November 2010 the Company cancelled all of its deferred shares and an amount of £4,086 million was credited to the capital redemption reserve.

Share subdivision in 2009

At the general meeting held on 26 November 2009 the Company's shareholders approved the subdivision of the ordinary shares with each ordinary share of 25 pence subdivided into one ordinary share of 10 pence and a deferred share of 15 pence. In addition, the shareholders approved the subdivision of the limited voting ordinary shares with each share of 25 pence subdivided into one limited voting ordinary share of 10 pence and a deferred share of 15 pence.

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47 SHARE CAPITAL continued

Share issuances

On 18 February 2010, the Company issued 3,141 million ordinary shares as consideration for the redemption of certain preference shares and preferred securities.

During May and June 2010, the Company issued a further 1,158 million ordinary shares in relation to three separate exchanges for preference shares and other subordinated liabilities issued by the Group.

(3) SHARE CAPITAL AND CONTROL

There are no restrictions on the transfer of shares in the Company other than as set out in the articles of association and:

– certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws);

– pursuant to the UK Listing Authority's listing rules where directors and certain employees of the Company require the approval of the Company to deal in the Company's shares; and

– pursuant to the rules of some of the Company's employee share plans where certain restrictions may apply while the shares are subject to the plans.

Where, under an employee share plan operated by the Company, participants are the beneficial owners of shares but not the registered owners, the voting rights are normally exercised by the registered owner at the direction of the participant. Outstanding awards and options would normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions at that time.

In addition, the Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

Information regarding significant direct or indirect holdings of shares in the Company can be found on page 284.

The directors have authority to allot and issue ordinary and preference shares and to make market purchases of ordinary and preference shares as granted at the annual general meeting on 6 May 2010. The authority to issue shares and the authority to make market purchases of shares will expire at the annual general meeting. Shareholders will be asked, at the annual general meeting, to give similar authorities.

Subject to any rights or restrictions attached to any shares, on a show of hands at a general meeting of the Company every holder of shares present in person or by proxy and entitled to vote has one vote and on a poll every member present and entitled to vote has one vote for every share held.

Further details regarding voting at the annual general meeting can be found in the notes to the notice of the annual general meeting.

Ordinary shares

The holders of ordinary shares (excluding the limited voting ordinary shares), who held 99.9 per cent of the total ordinary share capital as at 31 December 2010, are entitled to receive the Company's report and accounts, attend, speak and vote at general meetings and appoint proxies to exercise voting rights. Holders of ordinary shares (excluding the limited voting ordinary shares) may also receive a dividend (subject to the provisions of the Company's articles of association and the restrictions noted below) and on a winding up may share in the assets of the Company.

47 SHARE CAPITAL continued

In November 2009, as part of the restructuring plan that was a requirement for European Commission 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. Consequently, the terms of these instruments prevent the Company from making dividend payments on ordinary shares.

Limited voting ordinary shares

The limited voting ordinary shares are held by the Lloyds TSB Foundations (the Foundations). The holders of the limited voting ordinary shares, who held 0.1 per cent of the total ordinary shares as at 31 December 2010, are entitled to receive copies of every circular or other document sent out by the Company to the holders of other ordinary shares. These shares carry no rights to dividends but rank pari passu with the ordinary shares in respect of other distributions and in the event of winding up. These shares do not have any right to vote at general meetings other than on resolutions concerning acquisitions or disposals of such importance that they require shareholder consent, or for the winding up of the Company, or for a variation in the class rights of the limited voting ordinary shares. In the event of an offer for more than 50 per cent of the issued ordinary share capital of the Company, each limited voting ordinary share will convert into an ordinary share and shall rank equally with the ordinary shares in all respects from the date of conversion.

Preference shares

The Company has in issue various classes of preference shares which are all classified as liabilities under IFRS and details of which are shown in note 46.

48 SHARE PREMIUM ACCOUNT

	2010 £m	2009 £m
At 1 January	**14,472**	2,096
Shares issued on redemption and exchange of preference shares and other subordinated liabilities[1]	**1,808**	–
Capitalisation issue	**–**	(102)
Placing and Compensatory Open Offer of ordinary shares	**–**	1,303
Transfer to merger reserve[2]	**–**	(1,000)
Rights issue	**–**	9,461
Issued to Lloyds TSB Foundations	**–**	30
Redemption of preference shares[3]	**11**	2,684
At 31 December	**16,291**	14,472

[1] On 18 February 2010, the Company issued 3,141 million ordinary shares as consideration for the redemption of certain preference shares and preferred securities; and during May and June 2010, the Company issued a further 1,158 million ordinary shares in relation to three separate exchanges for preference shares and other subordinated liabilities issued by the Group. A total share premium of £1,808 million was recorded in respect of these transactions.

[2] Distributable reserves of £1,000 million arose on the issue of preference shares in January 2009 which were classified as debt. In June 2009, these preference shares were redeemed out of the proceeds of the placing and compensatory open offer of ordinary shares and the distributable element of this issue was transferred from the share premium account to the merger reserve.

[3] In January 2010, the Company repurchased and cancelled certain preference shares amounting to £14 million. This resulted in a transfer of £3 million from the merger reserve to the capital redemption reserve and a transfer of £11 million from the merger reserve to the share premium account. In December 2009, the Group redeemed eight issues of preference shares in exchange for the issuance of enhanced capital notes. This resulted in a transfer of £26 million from the merger reserve to the capital redemption reserve and a transfer of £2,684 million from the merger reserve to the share premium account.

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49 OTHER RESERVES

	2010 £m	2009[1] £m
Other reserves comprise:		
Merger reserve	**8,107**	8,121
Capital redemption reserve	**4,115**	26
Revaluation reserve in respect of available-for-sale financial assets	**(285)**	(783)
Cash flow hedging reserve	**(391)**	(305)
Foreign currency translation reserve	**29**	158
At 31 December	**11,575**	7,217

[1] Restated (see note 1).

The merger reserve primarily comprises the premium on shares issued on 13 January 2009 under the placing and open offer and shares issued on 16 January 2009 on the acquisition of HBOS plc.

The capital redemption reserve represents transfers from the merger reserve in accordance with companies' legislation and amounts transferred from share capital following the cancellation of the deferred shares.

The revaluation reserve in respect of available-for-sale financial assets represents the cumulative after tax unrealised change in the fair value of financial assets classified as available-for-sale since initial recognition, or in the case of available-for-sale financial assets obtained on acquisitions of businesses, since the date of acquisition.

The cash flow hedging reserve represents the cumulative after tax gains and losses on effective cash flow hedging instruments that will be reclassified to the income statement in the periods in which the hedged item affects profit or loss.

The foreign currency translation reserve represents the cumulative after-tax gains and losses on the translation of foreign operations and exchange differences arising on financial instruments designated as hedges of the Group's net investment in foreign operations.

Movements in other reserves were as follows:

	2010 £m	2009 £m
Merger reserve		
At 1 January	**8,121**	343
Placing and open offer	**–**	3,781
Shares issued on acquisition of HBOS	**–**	5,707
Issue of preference shares[1]	**–**	1,000
Redemption of preference shares[2]	**(14)**	(2,710)
At 31 December	**8,107**	8,121

	2010 £m	2009 £m
Capital redemption reserve		
At 1 January	**26**	–
Cancellation of deferred shares (note 47)	**4,086**	–
Redemption of preference shares[2]	**3**	26
At 31 December	**4,115**	26

[1] Distributable reserves of £1,000 million arose on the issue of preference shares in January 2009 which were classified as debt. In June 2009, these preference shares were redeemed out of the proceeds of the placing and compensatory open offer of ordinary shares and the distributable element of this issue was transferred to the merger reserve.

[2] In January 2010, the Company repurchased and cancelled certain preference shares amounting to £14 million. This resulted in a transfer of £3 million from the merger reserve to the capital redemption reserve and a transfer of £11 million from the merger reserve to the share premium account. Details of the preference shares repurchased are set out in note 46. In December 2009, the Group redeemed eight issues of preference shares in exchange for the issuance of enhanced capital notes. This resulted in a transfer of £26 million from the merger reserve to the capital redemption reserve and a transfer of £2,684 million from the merger reserve to the share premium account.

49 OTHER RESERVES continued

	2010 £m	2009 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January:		
As previously stated		(2,982)
Prior year adjustment		131
Restated (note 1)	**(783)**	(2,851)
Change in fair value of available-for-sale financial assets	**1,231**	2,035
Change in fair value attributable to non-controlling interests	**–**	(1)
Deferred tax	**(460)**	(276)
Current tax	**(8)**	(2)
	763	1,756
Income statement transfers:		
Disposals (note 9)	**(399)**	(97)
Deferred tax	**106**	23
	(293)	(74)
Impairment	**114**	621
Deferred tax	**(5)**	(168)
	109	453
Other transfers	**(110)**	(93)
Deferred tax	**29**	26
	(81)	(67)
At 31 December	**(285)**	(783)

	2010 £m	2009 £m
Cash flow hedging reserve		
At 1 January	**(305)**	(15)
Change in fair value of hedging derivatives	**(1,048)**	(530)
Deferred tax	**272**	148
Current tax	**(3)**	–
	(779)	(382)
Income statement transfer (note 5)	**932**	121
Deferred tax	**(239)**	(29)
	693	92
At 31 December	**(391)**	(305)

	2010 £m	2009 £m
Foreign currency translation reserve		
At 1 January	**158**	178
Currency translation differences arising in the year	**33**	(652)
Foreign currency losses on net investment hedges	**(162)**	814
Current tax	**–**	176
Deferred tax	**–**	(358)
	(162)	632
At 31 December	**29**	158

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50 RETAINED PROFITS

	2010 £m	2009 £m
At 1 January:		
As previously stated		8,260
Prior year adjustment		(131)
Restated (note 1)	**11,117**	8,129
(Loss) profit for the year	**(320)**	2,827
Purchase/sale of treasury shares	**429**	45
Employee share option schemes – value of employee services	**154**	116
At 31 December	**11,380**	11,117

Retained profits are stated after deducting £47 million (2009: £48 million) representing 49 million (2009: 49 million) treasury shares held.

Value of employee services includes a credit of £134 million (2009: £111 million) reflecting the income statement charge in respect of SAYE and executive options, together with a related tax credit of £20 million (2009: tax credit £5 million). Purchase/sale of treasury shares includes a credit of £409 million (2009: £128 million) relating to the cost of other share scheme awards.

51 ORDINARY DIVIDENDS

No dividends were paid on ordinary shares during 2009 or 2010 and the directors do not propose to pay a final dividend in respect of 2010; in November 2009, as part of the restructuring plan that was a requirement for European Commission 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. Consequently, the terms of these instruments prevent the Company from making dividend payments on ordinary shares.

In addition, the trustees of the following holdings of Lloyds Banking Group plc shares in relation to employee share schemes retain the right to receive dividends but chose to waive their entitlement to the dividends on those shares as indicated: the Lloyds Banking Group Share Incentive Plan (holding at 31 December 2010: 5,744,722 shares, at 31 December 2009: 3,028,623 shares, waived right to all dividends), the Lloyds TSB Group Employee Share Ownership Trust (holding at 31 December 2010: 283,109,984 shares, at 31 December 2009: 1,301,968 shares, waived right to all dividends), Lloyds TSB Group Holdings (Jersey) Limited (holding at 31 December 2010: 42,846 shares, at 31 December 2009: 42,846 shares, waived right to all but a nominal amount of 1 penny in total) and the Lloyds TSB Qualifying Employee Share Ownership Trust (holding at 31 December 2010: 1,398 shares, at 31 December 2009: 1,398 shares, waived right to all but a nominal amount of 1 penny in total).

52 SHARE-BASED PAYMENTS

CHARGE TO THE INCOME STATEMENT

The charge to the income statement is set out below:

	2010 £m	2009 £m
Deferred bonus plan	**390**	18
Executive and SAYE plans:		
Options granted in the year	**59**	13
Options granted in prior years	**75**	98
	134	111
Share plans:		
Shares granted in the year	**3**	26
Shares granted in prior years	**49**	102
	52	128
Total charge to the income statement	**576**	257

52 SHARE-BASED PAYMENTS continued

During the year ended 31 December 2010 the Group operated the following share-based payment schemes, all of which are equity settled.

DEFERRED BONUS PLANS

Bonuses in respect of the performance in 2010 of employees within certain of the Group's bonus plans have been recognised in these financial statements in full. The amounts to be settled in shares are included within the total charge to the income statement detailed above.

LLOYDS BANKING GROUP EXECUTIVE SHARE OPTION SCHEMES

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

Performance conditions for executive options

FOR OPTIONS GRANTED UP TO MARCH 2001

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

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

FOR OPTIONS GRANTED FROM AUGUST 2001 TO AUGUST 2004

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

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

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

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

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

FOR OPTIONS GRANTED IN 2005

The same conditions applied as for grants made up to August 2004, except that:

– the performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc;

– if the performance condition was not met at the end of the third subsequent year, the options would lapse; and

– the full grant of options became exercisable only if the Group was ranked in the top four places of the comparator group. A sliding scale applied between fourth and eighth positions. If Lloyds Banking Group was ranked below the median (ninth or below) the options would lapse.

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

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52 SHARE-BASED PAYMENTS continued

Movements in the number of share options outstanding under the executive share option schemes during 2009 and 2010 are set out below:

	2010		2009	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**8,784,978**	**476.56**	11,203,628	490.05
Rebasement adjustment[1]	**7,523,547**	**(26.43)**	–	–
Exercised	**–**	**–**	–	–
Forfeited	**(2,945,224)**	**296.36**	(2,418,650)	536.46
Outstanding at 31 December	**13,363,301**	**233.09**	8,784,978	476.56
Exercisable at 31 December	**13,363,301**	**233.09**	8,784,978	476.56

[1] Options granted under this plan were adjusted on 13 August 2010 as a result of the Capitalisation Issue, the Placing and Compensatory Open Offer and the Rights Issue of 2009. The adjustment was made using a standard Her Majesty's Revenue & Customs (HMRC) formula, to negate the dilutionary impact of these corporate actions.

No options were exercised during 2010 or 2009. The weighted average remaining contractual life of options outstanding at the end of the year was 3.6 years (2009: 4.3 years).

SAVE-AS-YOU-EARN SCHEMES

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

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

	2010		2009	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**130,133,992**	**177.60**	190,478,449	152.54
Adjustment on acquisition	**–**	**–**	53,755,275	415.21
Rebasement adjustment[1]	**22,382,641**	**(416.83)**	–	–
Granted	**655,712,663**	**46.78**	–	–
Exercised	**(195,339)**	**49.30**	–	–
Forfeited	**(13,922,185)**	**57.34**	(9,581,800)	400.93
Cancelled	**(107,144,275)**	**66.53**	(93,599,380)	206.07
Expired	**(18,923,463)**	**179.35**	(10,918,552)	470.16
Outstanding at 31 December	**668,044,034**	**49.59**	130,133,992	177.60
Exercisable at 31 December	**663,942**	**172.93**	754,554	317.32

[1] Options granted under these plans were adjusted on 13 August 2010 as a result of the Capitalisation Issue, the Placing and Compensatory Open Offer and the Rights Issue of 2009. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of these corporate actions.

The weighted average share price at the time that the options were exercised during 2010 was £0.69 (2009: £nil). The weighted average remaining contractual life of options outstanding at the end of the year was 2.7 years (2009: 2.7 years).

The weighted average fair value of SAYE options granted during 2010 was £0.33 (2009: £nil). The values for the SAYE options have been determined using a standard Black-Scholes model.

For the HBOS sharesave plan, no options were exercised during 2010 or 2009. The options outstanding at 31 December 2010 had an exercise price of £1.8066 (2009: £3.64) and a weighted average remaining contractual life of 2.9 years (2009: 4.0 years).

52 SHARE-BASED PAYMENTS continued

OTHER SHARE OPTION PLANS

Lloyds Banking Group Executive Share Plan 2003

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

	2010		2009	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**26,099,185**	**Nil**	857,611	Nil
Granted	**13,429,561**	**Nil**	24,704,070	Nil
Rebasement adjustment[1]	**12,501,246**	**Nil**	1,876,005	Nil
Exercised	**(2,661,703)**	**Nil**	(157,105)	Nil
Forfeited	**(1,673,532)**	**Nil**	(1,181,396)	Nil
Outstanding at 31 December	**47,694,757**	**Nil**	26,099,185	Nil
Exercisable at 31 December	**–**	**Nil**	33,794	Nil

[1] Options granted under this plan were adjusted on 2 July 2009 as a result of the Placing and Compensatory Open Offer and on 13 August 2010 as a result of the Capitalisation Issue and Rights Issue of 2009. The adjustments were made, where applicable, using a standard HMRC formula, to negate the dilutionary impact of these corporate actions.

The weighted average fair value of options granted in the year was £0.63 (2009: £0.68). The weighted average share price at the time that the options were exercised during 2010 was £0.63 (2009: £0.71). The weighted average remaining contractual life of options outstanding at the end of the year was 2.4 years (2009: 3.0 years).

HBOS share option plans

The table below details the outstanding options for the HBOS Share Option Plan, the St James's Place Share Option Plan, and the 1995 and 1996 Bank of Scotland Executive Stock Option schemes. The final award under the HBOS Share Option Plan was made in 2004. Under this plan, options over shares, at market value with a face value equal to 20 per cent of salary, were granted to employees with the exception of certain senior executives. A separate option plan exists for some partners of St James's Place, which grants options in respect of Lloyds Banking Group plc shares. The final award under the St James's Place Share Option Plan was made in 2009. Movements in the number of share options outstanding under these schemes are set out below:

	2010		2009	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January (16 January 2009)	**14,301,748**	**880.27**	13,040,430	1,167.26
Rebasement adjustment[1]	**12,899,990**	**(61.23)**	–	–
Granted	**–**	**–**	4,040,555	104.50
Forfeited	**(2,506,244)**	**611.90**	(2,779,237)	1,099.02
Outstanding at 31 December	**24,695,494**	**415.70**	14,301,748	880.27
Exercisable at 31 December	**15,320,780**	**593.79**	9,198,557	1,169.14

[1] Options granted under these plans were adjusted on 13 August 2010 as a result of the Capitalisation Issue, the Placing and Compensatory Open Offer and the Rights Issue of 2009. The adjustment was made using a standard HMRC formula, to negate the dilutionary impact of these corporate actions.

No options were exercised during 2010 or 2009. The options outstanding under the HBOS Share Option Plan and St James's Place Share Option Plan at 31 December 2010 had exercise prices in the range of £0.5183 to £8.7189 (2009: £1.05 to £17.576) and a weighted average remaining contractual life of 3.0 years.

No options were outstanding under the Bank of Scotland Executive Stock Option schemes at 31 December 2010. Options outstanding at 31 December 2009 had exercise prices in the range of £8.834 to £10.009 and a weighted average remaining contractual life of 0.8 years.

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52 SHARE-BASED PAYMENTS continued

OTHER SHARE PLANS

Lloyds Banking Group Long-Term Incentive Plan

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

The performance conditions for awards made in March and August 2007 are as follows:

(i) For 50 per cent of the award (the EPS Award) – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period needed to be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Prices Index over the same period. If it was less than 3 per cent per annum the EPS Award would lapse. If the increase was more than 3 per cent but less than 6 per cent per annum then the proportion of shares released would be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2007 and ended on 31 December 2009.

(ii) For the other 50 per cent of the award (the TSR Award) – it was necessary for the Group's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award would vest where the Group's total shareholder return was equal to median and vesting would occur on a straight line basis in between these points. Where the Group's total shareholder return was below the median of the comparator group, the TSR Award would lapse. The relevant period commenced on 8 March 2007 and ended on 7 March 2010.

As a consequence of the acquisition of HBOS and the general market turmoil, in March 2009 the Remuneration Committee decided that the performance test for the 2007 awards should be based on the performance of the Group up to 17 September 2008, the date prior to the announcement of the HBOS acquisition. The performance test was on a fair value basis, on the estimated probability, as at that date, of achieving the performance conditions. As a consequence, for all participants, other than those who were Executive Directors at the time the award was granted and a small number of other senior executives, the share awards vested at 31 per cent in March 2010.

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

(i) For 50 per cent of the award (the EPS Award) – the performance condition is as described for the 2007 awards with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010.

(ii) For the other 50 per cent of the award (the TSR Award) – the performance condition is as described for the 2007 awards, except that the comparator group comprises of 13 companies, with the relevant performance period commencing on 6 March 2008 (the date of the first award) and ending on 5 March 2011.

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 Group 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.

As for the 2007 LTIP awards, as a consequence of the acquisition of HBOS and the general market turmoil, in March 2009 the Remuneration Committee decided that the performance test for the 2008 awards should be based on the performance of the Group up to 17 September 2008, the date prior to the announcement of the HBOS acquisition. The performance test was on a fair value basis, on the estimated probability, as at that date, of achieving the performance conditions. As a consequence, for all participants, other than those who were Executive Directors at the time the award was granted and a small number of other senior executives, the share awards will vest at 29 per cent in March 2011.

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

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

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

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

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

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

52 SHARE-BASED PAYMENTS continued

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

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

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

Performance against the first two years of the award has been assessed and all targets have been met or exceeded.

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

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

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

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

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

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

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

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

	2010 Number of shares	2009 Number of shares
Outstanding at 1 January	**223,233,052**	22,237,282
Granted	**148,810,591**	199,293,192
Rebasement adjustment	**106,990,259**	10,443,102
Forfeited	**(31,891,411)**	(8,740,524)
Outstanding at 31 December	**447,142,491**	223,233,052

The fair value of the share awards granted in 2010 was £0.61 (2009: £0.68).

Conditional awards of shares made under this plan were adjusted on 2 July 2009 as a result of the Placing and Compensatory Open Offer and on 13 August 2010 as a result of the Capitalisation Issue and Rights Issue of 2009. The adjustments were made, where applicable, using a standard HMRC formula, to negate the dilutionary impact of the above corporate actions.

Performance share plan

Under the performance share plan, introduced during 2005, participating executives were eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 and 2005 bonus. The maximum match was two performance shares for each bonus share, awarded at the end of a three year period. The actual number of shares awarded was dependent on the Group's total shareholder return performance measured over a three year period, compared to other companies in the comparator group. The maximum of two performance shares for each bonus share would be awarded only if the Group's total shareholder return performance placed it first in the comparator group; one performance share for each bonus share would be granted if the Group was placed fifth; and one performance share for every two bonus shares if the Group was placed eighth (median). Between first and fifth position, and fifth and eighth position, sliding scales would apply. If the total shareholder return performance was below median, no performance shares would be awarded. There was no retest. Whilst income tax and national

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52 SHARE-BASED PAYMENTS continued

insurance were deducted from the bonus before deferral into the plan, where a match of performance shares was justified, these shares would have been awarded as if income tax and national insurance had not been deducted.

The performance condition attached to the March 2006 award was not met, with Lloyds Banking Group ranked in ninth place. Bonus shares were released on 20 March 2009, at which time the performance shares lapsed.

	2010 Number of shares	2009 Number of shares
Outstanding at 1 January	–	941,324
Lapsed	–	(941,324)
Outstanding at 31 December	–	–

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

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

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2009									
Exercise price range									
£0 to £1	–	–	–	–	–	–	Nil	3.1	26,099,185
£1 to £2	–	–	–	139.00	2.5	107,939,699	104.50	2.3	4,019,026
£2 to £3	–	–	–	220.98	3.9	18,054,765	–	–	–
£3 to £4	–	–	–	349.18	2.0	2,842,644	394.64	5.2	721,886
£4 to £5	464.19	4.9	7,526,441	427.04	1.8	1,296,884	499.91	0.2	273,986
£5 to £6	552.02	0.2	515,527	–	–	–	573.60	0.6	53,328
£6 to £7	653.55	1.2	743,010	–	–	–	640.00	0.0	2,388,026
£7 to £8	–	–	–	–	–	–	707.40	0.2	6,845,496

52 SHARE-BASED PAYMENTS continued

The fair value calculations at 31 December 2010 for grants made in the year are based on the following assumptions:

	SAYE	Other option schemes	Other share plans
Risk-free interest rate	1.80%	0.76%	1.33%
Expected life	3.0 years	1-5 years	2-4 years
Expected volatility	85%	83%	70%
Expected dividend yield	1.4%	0.5%	0.9%
Weighted average share price	0.59	0.67	0.67
Weighted average exercise price	0.48	Nil	Nil
Expected forfeitures	4%	4%	4%

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

SHARE INCENTIVE PLAN

Free shares

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

No free shares were awarded in 2009 or 2010.

Matching shares

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

The number of shares awarded relating to matching shares in 2010 was 17,411,651 (2009: 16,746,310), with an average fair value of £0.63 (2009: £0.69), based on market prices at the date of award.

53 RELATED PARTY TRANSACTIONS

KEY MANAGEMENT PERSONNEL

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

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

	2010 £m	2009 £m
Compensation		
Salaries and other short-term benefits	15	17
Post-employment benefits	2	1
Total compensation	17	18

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53 RELATED PARTY TRANSACTIONS continued

Aggregate contributions in respect of key management personnel to defined contribution pension schemes were £0.4 million (2009: £0.4 million).

	2010 million	2009 million
Share option plans		
At 1 January	**2**	2
Granted, including certain adjustments[1] (includes entitlements of appointed directors)	**4**	–
At 31 December	**6**	2

[1] Adjustments have been made, using a standard HMRC formula, to negate the dilutionary impact of the Group's 2009 capital raising activities.

	2010 million	2009 million
Share plans		
At 1 January	**19**	7
Granted, including certain adjustments[1] (includes entitlements of appointed directors)	**39**	17
Exercised/lapsed (includes entitlements of former directors)	**(2)**	(5)
At 31 December	**56**	19

[1] Adjustments have been made, using a standard HMRC formula, to negate the dilutionary impact of the Group's 2009 capital raising activities.

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

	2010 £m	2009 £m
Loans		
At 1 January	**2**	3
Advanced (includes loans of appointed directors)	**2**	–
Repayments (includes loans of former directors)	**(1)**	(1)
At 31 December	**3**	2

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 0.50 per cent and 17.90 per cent in 2010 (2009: 1.28 per cent and 24.90 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2009: £nil).

	2010 £m	2009 £m
Deposits		
At 1 January	**4**	6
Placed (includes deposits of appointed directors)	**12**	12
Withdrawn (includes deposits of former directors)	**(12)**	(14)
At 31 December	**4**	4

Deposits placed by key management personnel attracted interest rates of up to 4.25 per cent (2009: 6.50 per cent).

At 31 December 2010, the Group did not provide any guarantees in respect of key management personnel (2009: none).

At 31 December 2010, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £2 million with six directors and four connected persons (2009: £2 million with seven directors and four connected persons).

SUBSIDIARIES

Details of the principal subsidiaries are given in note 9 to the parent company financial statements. In accordance with IAS 27, transactions and balances with subsidiaries have been eliminated on consolidation.

53 RELATED PARTY TRANSACTIONS continued

HM TREASURY

In January 2009, HM Treasury became a related party of the Company following its subscription for ordinary shares issued under a placing and open offer. As at 31 December 2010, HM Treasury held a 41 per cent interest (December 2009: 43 per cent) in the Company's ordinary share capital and consequently HM Treasury remained a related party of the Company throughout 2010.

Capital transactions

During 2010 HM Treasury has not subscribed for any of the Company's ordinary or preference share capital, with the decline in the percentage of ordinary shares held by HM Treasury reflecting the issuance by the Company of ordinary shares as set out in note 47.

Lending commitments

On 23 March 2010, the Company entered into a deed poll in favour of HM Treasury, the Department for Business, Innovation and Skills and the Departments for Communities and Local Government confirming its lending commitments for the 12 month period commencing 1 March 2010. The Company agreed, subject to, amongst other things, sufficient customer demand, to provide gross new lending to UK businesses of £44,000 million and to adjust the undertakings (but not the level of lending agreed in 2009) given in connection with lending to homeowners for the 12 month period. This additional lending is expressed to be subject to the Group's prevailing commercial terms and conditions (including pricing and risk assessment) and, in relation to mortgage lending, the Group's standard credit and other acceptance criteria.

Credit Guarantee Scheme

HM Treasury launched the Credit Guarantee Scheme in October 2008 as part of a range of measures announced by the UK Government intended to ease the turbulence in the UK banking system. It charges a commercial fee for the guarantee of new short and medium-term debt issuance. The fee payable to HM Treasury on guaranteed issues is based on a per annum rate of 50 basis points plus the median five-year credit default swap spread. At 31 December 2010, the Group had £45,308 million (2009: £49,954 million) of debt issued under the Credit Guarantee Scheme. During 2010, the Group redeemed £4,987 million of bonds. The Group's income statement includes fees of £454 million (2009: £498 million) payable to HM Treasury in respect of guaranteed funding.

There were no other material transactions between the Group and HM Treasury during 2010 that were not made in the ordinary course of business or that were unusual in their nature or conditions.

OTHER RELATED PARTY TRANSACTIONS

Pensions funds

The Group provides banking and some investment management services to certain of the Group pension funds. At 31 December 2010, customer deposits of £64 million (2009: £99 million) and investment and insurance contract liabilities of £850 million (2009: £691 million) related to the Group's pension funds.

Open Ended Investment Companies (OEICs)

The Group manages 402 (2009: 382) OEICs, and of these 111 (2009: 108) are consolidated. The Group invested £1,460 million (2009: £1,271 million) and redeemed £982 million (2009: £1,076 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £7,920 million (2009: £6,954 million) at 31 December. The Group earned fees of £271 million from the unconsolidated OEICs (2009: £217 million). The Company held no investments in OEICs at any time during 2009 or 2010.

Joint ventures and associates

The Group provides both administration and processing services to its principal joint venture, Sainsbury's Bank plc. The amounts receivable by the Group during the year were £31 million (2009: £34 million), of which £8 million was outstanding at 31 December 2010 (2009: £10 million). At 31 December 2010, Sainsbury's Bank plc also had balances with the Group that were included in loans and advances to banks of £1,277 million (2009: £1,218 million) and deposits by banks of £1,358 million (2009: £1,405 million).

At 31 December 2010 there were loans and advances to customers of £5,660 million (2009: £12,235 million) outstanding and balances within customer deposits of £151 million (2009: £254 million) relating to other joint ventures and associates.

In addition to the above balances, the Group has a number of other associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2010, these companies had total assets of approximately £12,216 million (2009: £14,840 million), total liabilities of approximately £11,937million (2009: £15,300 million) and for the year ended 31 December 2010 had turnover of approximately £3,829 million (2009: £10,570 million) and made a net profit of approximately £182 million (2009: net loss of £572 million). In addition, the Group has provided £3,316 million (2009: £6,014 million) of financing to these companies on which it received £93 million (2009: £191 million) of interest income in the year.

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54 CONTINGENT LIABILITIES AND COMMITMENTS

UNARRANGED OVERDRAFT CHARGES

In April 2007, the Office of Fair Trading (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 anticipates 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. It is not practicable to quantify the claims. The Group is robustly defending any such complaints or claims and does not expect any such complaints or claims to have a material adverse 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.

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's position and Visa reached an agreement with the European Commission to reduce the level of interchange for crossborder 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

There has been extensive scrutiny of the Payment Protection Insurance (PPI) market in recent years.

In October 2010, the UK Competition Commission (Competition Commission) confirmed its decision to prohibit the active sale of PPI by a distributor to a customer within seven days of a sale of credit. This followed the completion of its formal investigation into the supply of PPI services (other than store card PPI) to non-business customers in the UK in January 2009 and a referral of the proposed prohibition to the Competition Appeal Tribunal. Following an earlier decision to stop selling single premium PPI products, the Group ceased to offer PPI products to its customers in July 2010.

On 1 July 2008, the Financial Ombudsman Service (FOS) referred concerns regarding the handling of PPI complaints to the Financial Services Authority (FSA) as an issue of wider implication. On 29 September 2009 and 9 March 2010, the FSA issued consultation papers on PPI complaints handling. The FSA 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. The FSA published its Policy Statement on 10 August 2010, setting out a new set of rules for PPI complaints handling and redress which had to be implemented by 1 December 2010.

On 8 October 2010, the British Bankers Association (BBA), the principal trade association for the UK banking and financial services sector, filed an application for permission to seek judicial review against the FSA and the FOS. The BBA is seeking an order quashing the FSA Policy Statement and an order quashing the decision of the FOS to determine PPI sales in accordance with the guidance published on its website in November 2008. The Judicial hearing was held in late January 2011 and the judgment (which may be subject to appeal) is expected shortly.

This legal challenge has affected the implementation of the Policy Statement, since the challenge has called into question the standards to be applied when assessing PPI complaints. As a result of that challenge, a large number of complaints cannot be decided until the outcome of the legal challenge is clear and implemented.

The ultimate impact on the Group of the FSA's complaints handling policy (if implemented in full) and the FOS's most recent approach to PPI complaints could be material to the Group's financial position, although the precise effect can only be assessed once the legal proceedings have been finally determined and the steps the Group may be required to take identified and implemented. In addition, it is not practicable to quantify the potential financial impact of the implementation of the Policy Statement given the material uncertainties around, for example, applicable time

54 CONTINGENT LIABILITIES AND COMMITMENTS continued

periods, the extent of application of root cause analysis, the treatment of evidence and the ultimate emergence period for complaints, driven in large part by the activities of the claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs. No provision has been made in these financial statements to reflect implementation of the FSA's complaint handling policy in its current form.

Following concerns expressed by the FSA, it announced in its statement on 29 September 2009 that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. Lloyds Banking Group has 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 Lloyds Banking Group of any review could be material but can only be known at the conclusion of these discussions.

US SANCTIONS

In January 2009 Lloyds TSB Bank plc announced the settlement it had reached with the US Department of Justice and the New York County District Attorney's Office in relation to their investigations into historic US dollar payment practices involving countries, persons or entities subject to the economic sanctions administered by the US Office of Foreign Assets Control (OFAC). 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 County District Attorney's Office. No further enforcement actions are expected in relation to the matters set out in the settlement agreements.

On 26 February 2009 a purported shareholder filed a derivative civil action in the Supreme Court of New York, Nassau County against certain current and former directors, and nominally against Lloyds TSB Bank plc and Lloyds Banking Group plc, seeking various forms of relief. The derivative action is at an early stage and settlement is being discussed and the ultimate outcome is not expected to have a material impact on the Group.

EUROPEAN UNION GENDER DIRECTIVE

An opt-out clause to the European Union Gender Directive currently permits insurers to take gender into account as a risk factor when pricing contracts. In March 2011, the European Court of Justice is expected to rule on whether this infringes fundamental European rights for equal treatment. If the European Court of Justice rules that the opt-out clause does infringe such rights, it could alter the market and alter prices for insurance products to a significant extent. At the date of these financial statements, no provision has been made for the potential costs of rectifying contracts in existence at 31 December 2010, should this ultimately be required. The ultimate impact on the Group can only be known following the European Court of Justice's ruling. However, the Group does not expect the final outcome of this matter to have a material adverse effect on its financial position.

OTHER LEGAL ACTIONS AND REGULATORY MATTERS

In the course of its business, the Group is engaged in discussions with the FSA in relation to a range of conduct of business matters, especially in relation to retail products including packaged bank accounts, mortgages, structured products and pensions. The Group is keen to ensure that any regulatory concerns regarding product governance or contract terms are understood and addressed. The ultimate impact on the Group of these discussions can only be known at the conclusion of such discussions.

In addition, during the ordinary course of business the Group is subject to other threatened and actual legal proceedings (which may include class action lawsuits brought on behalf of customers, shareholders or other third parties), regulatory investigations, regulatory challenges and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed properly to assess the merits of the case and no provisions are held against such matters. However the Group does not currently expect the final outcome of any such matter to have a material adverse effect on its financial position.

CONTINGENT LIABILITIES AND COMMITMENTS ARISING FROM THE BANKING BUSINESS

Acceptances and endorsements arise where Lloyds Banking Group agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, where Lloyds Banking Group has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Performance bonds and other transaction-related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs and Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

Lloyds Banking Group's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held.

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54 CONTINGENT LIABILITIES AND COMMITMENTS continued

	2010 £m	2009 £m
Contingent liabilities		
Acceptances and endorsements	**48**	59
Other:		
Other items serving as direct credit substitutes	**1,319**	1,494
Performance bonds and other transaction-related contingencies	**2,812**	4,555
	4,131	6,049
Total contingent liabilities	**4,179**	6,108

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

	2010 £m	2009 £m
Commitments		
Documentary credits and other short-term trade-related transactions	**255**	288
Forward asset purchases and forward deposits placed	**887**	758
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**8,113**	9,058
Other commitments	**60,528**	64,786
	68,641	73,844
1 year or over original maturity	**47,515**	53,693
Total commitments	**117,298**	128,583

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £63,630 million (2009: £74,477 million) was irrevocable.

OPERATING LEASE COMMITMENTS

Where a Group company is the lessee the future minimum lease payments under non-cancellable premises operating leases are as follows:

	2010 £m	2009 £m
Not later than 1 year	**356**	392
Later than 1 year and not later than 5 years	**1,120**	1,213
Later than 5 years	**1,706**	1,817
Total operating lease commitments	**3,182**	3,422

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments.

CAPITAL COMMITMENTS

Excluding commitments in respect of investment property (note 28), capital expenditure contracted but not provided for at 31 December 2010 amounted to £339 million (2009: £203 million). Of this amount, £282 million (2009: £198 million) related to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

55 FINANCIAL INSTRUMENTS

(1) MEASUREMENT BASIS OF FINANCIAL ASSETS AND LIABILITIES

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

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2010								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	38,115	–	38,115
Items in the course of collection from banks	–	–	–	–	–	1,368	–	1,368
Trading and other financial assets at fair value through profit or loss	–	23,707	132,484	–	–	–	–	156,191
Derivative financial instruments	7,406	43,371	–	–	–	–	–	50,777
Loans and receivables:								
Loans and advances to banks	–	–	–	–	30,272	–	–	30,272
Loans and advances to customers	–	–	–	–	592,597	–	–	592,597
Debt securities	–	–	–	–	25,735	–	–	25,735
	–	–	–	–	648,604	–	–	648,604
Available-for-sale financial assets	–	–	–	42,955	–	–	–	42,955
Held-to-maturity investments	–	–	–	–	–	7,905	–	7,905
Total financial assets	7,406	67,078	132,484	42,955	648,604	47,388	–	945,915
Financial liabilities								
Deposits from banks	–	–	–	–	–	50,363	–	50,363
Customer deposits	–	–	–	–	–	393,633	–	393,633
Items in course of transmission to banks	–	–	–	–	–	802	–	802
Trading and other financial liabilities at fair value through profit or loss	–	20,097	6,665	–	–	–	–	26,762
Derivative financial instruments	4,398	37,760	–	–	–	–	–	42,158
Debt securities in issue	–	–	–	–	–	228,866	–	228,866
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	80,729	80,729
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	51,363	51,363
Unallocated surplus within insurance businesses	–	–	–	–	–	–	643	643
Subordinated liabilities	–	–	–	–	–	36,232	–	36,232
Total financial liabilities	4,398	57,857	6,665	–	–	709,896	132,735	911,551

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	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2009								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	38,994	–	38,994
Items in the course of collection from banks	–	–	–	–	–	1,579	–	1,579
Trading and other financial assets at fair value through profit or loss	–	27,245	122,766	–	–	–	–	150,011
Derivative financial instruments	9,430	40,498	–	–	–	–	–	49,928
Loans and receivables:								
Loans and advances to banks	–	–	–	–	35,361	–	–	35,361
Loans and advances to customers	–	–	–	–	626,969	–	–	626,969
Debt securities	–	–	–	–	32,652	–	–	32,652
	–	–	–	–	694,982	–	–	694,982
Available-for-sale financial assets	–	–	–	46,602	–	–	–	46,602
Total financial assets	9,430	67,743	122,766	46,602	694,982	40,573	–	982,096
Financial liabilities								
Deposits from banks	–	–	–	–	–	82,452	–	82,452
Customer deposits	–	–	–	–	–	406,741	–	406,741
Items in course of transmission to banks	–	–	–	–	–	1,037	–	1,037
Trading and other financial liabilities at fair value through profit or loss	–	22,111	6,160	–	–	–	–	28,271
Derivative financial instruments	8,687	31,798	–	–	–	–	–	40,485
Debt securities in issue	–	–	–	–	–	233,502	–	233,502
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	76,179	76,179
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	46,348	46,348
Unallocated surplus within insurance businesses	–	–	–	–	–	–	1,082	1,082
Subordinated liabilities	–	–	–	–	–	34,727	–	34,727
Total financial liabilities	8,687	53,909	6,160	–	–	758,459	123,609	950,824

(2) RECLASSIFICATION OF FINANCIAL ASSETS

In 2010 the Group reviewed its approach to managing a portfolio of government securities held as a separately identifiable component of the Group's liquidity portfolio. Given the long-term nature of this portfolio, the Group concluded that certain of these securities will be able to be held until they reach maturity. Consequently, on 1 November 2010, government securities with a fair value of £3,601 million were reclassified from available-for-sale financial assets to held-to-maturity investments reflecting the Group's positive intent and ability to hold them until maturity.

In 2009, no financial assets were reclassified.

In 2008, in accordance with the amendment to IAS39 that became applicable during that year, the Group reviewed the categorisation of its financial assets classified as held for trading and available-for-sale. On the basis that there was no longer an active market for some of those assets, which are therefore more appropriately managed as loans, with effect from 1 July 2008, the Group transferred £2,993 million of assets previously classified as held for trading into loans and receivables. With effect from 1 November 2008, the Group transferred £437 million of assets previously classified as available-for-sale financial assets into loans and receivables. At the time of these transfers, the Group had the intention and ability to hold them for the foreseeable future or until maturity. As at the date of reclassification, the weighted average effective interest rate of the assets transferred was 6.3 per cent with the estimated recoverable cash flows of £3,524 million.

55 FINANCIAL INSTRUMENTS continued

Carrying value and fair value of reclassified assets

The table below sets out the carrying value and fair value of reclassified financial assets

	2010		2009		2008	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
From held for trading to loans and receivables	**750**	**727**	1,833	1,822	2,883	2,926
From available-for-sale financial assets to loans and receivables	**313**	**340**	394	422	454	402
From available-for-sale financial assets to held-to-maturity investments	**3,455**	**3,539**	–	–	–	–
Total carrying value and fair value	**4,518**	**4,606**	2,227	2,244	3,337	3,328

During the year ended 31 December 2010, the carrying value of assets reclassified to loans and receivables decreased by £1,164 million due to sales and maturities of £1,220 million, accretion of discount of £34 million and foreign exchange and other movements of £22 million.

Additional fair value gains (losses) that would have been recognised had the reclassifications not occurred

The table below shows the additional gains (losses) that would have been recognised in the Group's income statement if the reclassifications had not occurred.

	2010				2009			2008	
	Reclassified in 2010 £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From held for trading to loans and receivables	**–**	**–**	**(34)**	**(34)**	–	208	208	(347)	(347)

The table below shows the additional gains (losses) that would have been recognised in other comprehensive income if the reclassifications had not occurred.

	2010				2009			2008	
	Reclassified in 2010 £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From available-for-sale financial assets to loans and receivables	**–**	**–**	**69**	**69**	–	161	161	(108)	(108)

Actual amounts recognised in respect of reclassified assets

After reclassification the reclassified financial assets contributed the following amounts to the Group income statement.

	2010				2009			2008	
	Reclassified in 2010 £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From held for trading to loans and receivables:									
Net interest income	**–**	**–**	**24**	**24**	–	55	55	31	31
Impairment losses	**–**	**–**	**(6)**	**(6)**	–	(49)	(49)	(158)	(158)
Total amounts recognised	**–**	**–**	**18**	**18**	–	6	6	(127)	(127)

	2010				2009			2008	
	Reclassified in 2010 £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2009 £m	Reclassified in 2008 £m	Total £m	Reclassified in 2008 £m	Total £m
From available-for-sale financial assets to loans and receivables:									
Net interest income	**–**	**–**	**1**	**1**	–	34	34	3	3
Impairment losses	**–**	**–**	**(2)**	**(2)**	–	(56)	(56)	(23)	(23)
Total amounts recognised	**–**	**–**	**(1)**	**(1)**	_	(22)	(22)	(20)	(20)

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55 FINANCIAL INSTRUMENTS continued

(3) FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The following table summarises the carrying values of financial assets and liabilities presented on the Group's balance sheet. The fair values presented in the table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

	Carrying value 2010 £m	Carrying value 2009 £m	Fair value 2010 £m	Fair value 2009 £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	**156,191**	150,011	**156,191**	150,011
Derivative financial instruments	**50,777**	49,928	**50,777**	49,928
Loans and receivables:				
Loans and advances to banks	**30,272**	35,361	**30,236**	35,335
Loans and advances to customers	**592,597**	626,969	**580,343**	609,647
Debt securities	**25,735**	32,652	**26,937**	31,907
Available-for-sale financial assets	**42,955**	46,602	**42,955**	46,602
Held-to-maturity investments	**7,905**	–	**7,716**	–
Financial liabilities				
Deposits from banks	**50,363**	82,452	**50,520**	82,366
Customer deposits	**393,633**	406,741	**394,393**	406,555
Trading and other financial liabilities at fair value through profit or loss	**26,762**	28,271	**26,762**	28,271
Derivative financial instruments	**42,158**	40,485	**42,158**	40,485
Debt securities in issue	**228,866**	233,502	**229,375**	235,170
Liabilities arising from non-participating investment contracts	**51,363**	46,348	**51,363**	46,348
Financial guarantees	**54**	38	**54**	38
Subordinated liabilities	**36,232**	34,727	**38,083**	33,660

Valuation methodology

Financial instruments include financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted market prices are not available, or are unreliable because of poor liquidity, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that do not meet the definition of a financial instrument. These items include intangible assets, such as the value of the Group's branch network, the long-term relationships with depositors and credit card relationships; premises and equipment; and shareholders' equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

Valuation control framework

The key elements of the control framework for the valuation of financial instruments include model validation, product implementation review and independent price verification. These functions are carried out by appropriately skilled risk and finance teams, independent of the business area responsible for the products.

Model validation covers both qualitative and quantitative elements relating to new models. In respect of new products, a product implementation review is conducted pre- and post-trading. Pre-trade testing ensures that the new model is integrated into the Group's systems and that the profit and loss and risk reporting are consistent throughout the trade life cycle. Post-trade testing examines the explanatory power of the implemented model, actively monitoring model parameters and comparing in-house pricing to external sources. Independent price verification procedures cover financial instruments carried at fair value. The frequency of the review is matched to the availability of independent data, monthly being the minimum. Valuation differences in breach of established thresholds are escalated to senior management. The results from independent pricing and valuation reserves are reviewed monthly by senior management.

Formal committees, consisting of senior risk, finance and business management, meet at least quarterly to discuss and approve valuations in more judgemental areas, in particular for unquoted equities, structured credit, over-the-counter options and the Credit Valuation Adjustment (CVA) reserve.

55 FINANCIAL INSTRUMENTS continued

Fair value of financial instruments carried at amortised cost

LOANS AND RECEIVABLES

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair values of asset-backed securities and secondary loans, which were previously within assets held for trading and were reclassified to loans and receivables, are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

DEPOSITS FROM BANKS AND CUSTOMER DEPOSITS

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

DEBT SECURITIES IN ISSUE AND SUBORDINATED LIABILITIES

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using quoted market prices.

HELD-TO-MATURITY INVESTMENTS

The fair values of government securities are based on market prices.

Valuation of financial instruments carried at fair value

The valuations of financial instruments have been classified into three levels according to the quality and reliability of information used to determine the fair values.

LEVEL 1 PORTFOLIOS

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise treasury bills and other government securities.

LEVEL 2 PORTFOLIOS

Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data. Examples of such financial instruments include most over-the-counter derivatives, financial institution issued securities, certificates of deposit and certain asset-backed securities.

LEVEL 3 PORTFOLIOS

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include the Group's venture capital and unlisted equity investments which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings multiples and estimated future cash flows. Certain of the Group's asset-backed securities and derivatives, principally where there is no trading activity in such securities, are also classified as level 3.

The table below provides an analysis of the financial assets and liabilities of the Group that are carried at fair value in the Group's consolidated balance sheet, grouped into levels 1 to 3 based on the degree to which the fair value is observable.

VALUATION HIERARCHY

	At 31 December 2010			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Trading and other financial assets at fair value through profit or loss	113,242	40,113	2,836	156,191
Available-for-sale financial assets	14,481	25,828	2,646	42,955
Derivative financial instruments	985	47,806	1,986	50,777
Financial assets	128,708	113,747	7,468	249,923
Trading and other financial liabilities at fair value through profit or loss	864	25,898	–	26,762
Derivative financial instruments	42	41,913	203	42,158
Financial guarantees	–	–	54	54
Financial liabilities	906	67,811	257	68,974

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55 FINANCIAL INSTRUMENTS continued

There were no significant transfers between level 1 and level 2 during the year.

	At 31 December 2009			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Trading and other financial assets at fair value through profit or loss	103,853	43,246	2,912	150,011
Available-for-sale financial assets	12,881	31,110	2,611	46,602
Derivative financial instruments	977	47,014	1,937	49,928
Financial assets	117,711	121,370	7,460	246,541
Trading and other financial liabilities at fair value through profit or loss	511	27,760	–	28,271
Derivative financial instruments	66	40,222	197	40,485
Financial guarantees	–	–	38	38
Financial liabilities	577	67,982	235	68,794

MOVEMENTS IN LEVEL 3 PORTFOLIO

The table below analyses movements in the level 3 financial assets portfolio.

	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale £m	Derivative assets £m	Total financial assets £m
At 1 January 2009	1,672	3,161	136	4,969
Exchange and other adjustments	(232)	(205)	74	(363)
Adjustment on acquisition	3,386	2,291	569	6,246
Losses recognised in the income statement	(114)	(452)	(1,005)	(1,571)
Gains recognised in other comprehensive income	–	191	–	191
Purchases	374	422	2,224	3,020
Sales	(465)	(671)	(61)	(1,197)
Transfers into the level 3 portfolio	33	48	–	81
Transfers out of the level 3 portfolio	(1,742)	(2,174)	–	(3,916)
At 31 December 2009	2,912	2,611	1,937	7,460
Exchange and other adjustments	**28**	**12**	**2**	**42**
Gains (losses) recognised in the income statement	**199**	**(56)**	**(667)**	**(524)**
Gains recognised in other comprehensive income	**–**	**271**	**–**	**271**
Purchases	**921**	**664**	**–**	**1,585**
Sales	**(550)**	**(560)**	**–**	**(1,110)**
Transfers into the level 3 portfolio	**64**	**–**	**780**	**844**
Transfers out of the level 3 portfolio	**(738)**	**(296)**	**(66)**	**(1,100)**
At 31 December 2010	**2,836**	**2,646**	**1,986**	**7,468**
Gains (losses) recognised in the income statement relating to those assets held at 31 December 2010	**151**	**(81)**	**(667)**	**(597)**
Gains recognised in other comprehensive income relating to those assets held at 31 December 2010	**–**	**269**	**–**	**269**

55 FINANCIAL INSTRUMENTS continued

The table below analyses movements in the Level 3 financial liabilities portfolio.

	Derivative liabilities £m	Financial guarantees £m	Total financial liabilities £m
At 1 January 2009	578	35	613
Exchange and other adjustments	(179)	–	(179)
Adjustment on acquisition	1,102	–	1,102
Gains recognised in the income statement	(47)	–	(47)
Additions	–	3	3
Redemptions	(474)	–	(474)
Transfers out of the level 3 portfolio	(783)	–	(783)
At 31 December 2009	197	38	235
Exchange and other adjustments	**13**	**–**	**13**
Gains recognised in the income statement	**–**	**–**	**–**
Additions	**–**	**16**	**16**
Redemptions	**(210)**	**–**	**(210)**
Transfers into the level 3 portfolio	**203**	**–**	**203**
At 31 December 2010	**203**	**54**	**257**
Gains (losses) recognised in the income statement relating to those liabilities held at 31 December 2010	**–**	**–**	**–**

Transfers out of the level 3 portfolio arise when inputs that could have a significant impact on the instrument's valuation become market observable after previously having been non-market observable. In the case of asset-backed securities this can arise if more than one consistent independent source of data becomes available. Conversely transfers into the portfolio arise when consistent sources of data cease to be available.

Included within the gains (losses) recognised in the income statement are losses of £597 million (2009: £1,542 million) related to financial instruments that are held in the level 3 portfolio at the year end. These amounts are included in other operating income.

Included within the gains (losses) recognised in other comprehensive income are gains of £269 million (2009: £190 million) related to financial instruments that are held in the level 3 portfolio at the year end.

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			At 31 December 2010			At 31 December 2009	
				Effect of reasonably possible alternative assumptions			
	Valuation basis/technique	Main assumptions	Carrying value £m	Favourable changes £m	Unfavourable changes £m	Carrying value £m	Effect of reasonably possible alternative assumptions
Trading and other financial assets at fair value through profit or loss							
Asset-backed securities	Lead manager or broker quote/consensus pricing from market data provider	Use of single pricing source	**283**	**8**	**(8)**	970	74
Equity investments	Various valuation techniques	Earnings, net asset value and earnings multiples, forecast cash flows	**2,072**	**135**	**(111)**	1,396	n/a
Unlisted equities and property partnerships in the life funds			**481**	**–**	**–**	546	n/a
			2,836			2,912	
Available-for-sale financial assets							
Asset-backed securities	Lead manager or broker quote/consensus pricing from market data provider	Use of single pricing source	**579**	**34**	**(34)**	744	10
Equity investments	Various valuation techniques	Earnings, net asset value, underlying asset values, property prices, forecast cash flows	**2,067**	**141**	**(91)**	1,867	n/a
			2,646			2,611	
Derivative financial assets							
	Industry standard model/consensus pricing from market data provider	Prepayment rates, probability of default, loss given default and yield curves. Equity conversion feature spread	**1,986**	**157**	**(27)**	1,937	84
Financial assets			**7,468**			7,460	
Derivative financial liabilities							
	Industry standard model/consensus pricing from market data provider	Prepayment rates, probability of default, loss given default and yield curves	**203**	**–**	**–**	197	8
Financial guarantees			**54**	**–**	**–**	38	n/a
Financial liabilities			**257**			235	

55 FINANCIAL INSTRUMENTS continued

The main products where level 3 valuations have been used are described below:

Asset-backed securities

Where there is no trading activity in asset-backed securities, valuation models, consensus pricing information from third party pricing services and broker or lead manager quotes are used to determine an appropriate valuation. Asset-backed securities are then classified as either level 2 or level 3 depending on whether there is more than one consistent independent source of data. If there is a single, uncorroborated market source for a significant valuation input or where there are materially inconsistent levels then the security is reported as level 3. Asset classes classified as level 3 mainly comprise certain residential mortgage-backed securities, collateralised loan obligations and collateralised debt obligations.

Equity investments (including venture capital)

Unlisted equities and fund investments are accounted for as trading and other financial assets at fair value through profit or loss or as available-for-sale financial assets. These investments are valued using different techniques as a result of the variety of investments across the portfolio in accordance with the Group's valuation policy and are calculated using International Private Equity and Venture Capital Guidelines.

Depending on the business sector and the circumstances of the investment, unlisted equity valuations are based on earnings multiples, net asset values or discounted cash flows.

– A number of earnings multiples are used in valuing the portfolio including price earnings, earnings before interest and tax and earnings before interest, tax, depreciation and amortisation. The particular multiple selected being appropriate for the type of business being valued and is derived by reference to the current market-based multiple. Consideration is given to the risk attributes, growth prospects and financial gearing of comparable businesses when selecting an appropriate multiple.
– Discounted cash flow valuations use estimated future cash flows, usually based on management forecasts, with the application of appropriate exit yields or terminal multiples and discounted using rates appropriate to the specific investment, business sector or recent economic rates of return. Recent transactions involving the sale of similar businesses may sometimes be used as a frame of reference in deriving an appropriate multiple.
– For fund investments the most recent capital account value calculated by the fund manager is used as the basis for the valuation and adjusted, if necessary, to align valuation techniques with the Group's valuation policy.

Unquoted equities and property partnerships in the life funds

Third party valuations are used to obtain the fair value of unquoted investments. Management take account of any pertinent information, such as recent transactions and information received on particular investments, to adjust the third party valuations where necessary.

Derivatives

Where the Group's derivative assets and liabilities are not traded on an exchange, they are valued using valuation techniques, including discounted cash flow and options pricing models, as appropriate. The types of derivatives classified as level 2 and the valuation techniques used include:

– Interest rate swaps which are valued using discounted cash flow models; the most significant inputs into those models are interest rate yield curves which are developed from publicly quoted rates.
– Foreign exchange derivatives that do not contain options which are priced using rates available from publicly quoted sources.
– Credit derivatives, except for the items classified as level 3, which are valued using publicly available yield and credit default swap (CDS) curves; the Group uses standard models with observable inputs.
– Less complex interest rate and foreign exchange option products which are valued using volatility surfaces developed from publicly available interest rate cap, interest rate swaption and other option volatilities; option volatility skew information is derived from a market standard consensus pricing service. For more complex option products, the Group calibrates its models using observable at-the-money data; where necessary, the Group adjusts for out-of-the-money positions using a market standard consensus pricing service.

Complex interest rate and foreign exchange products where there is significant dispersion of consensus pricing or where implied funding costs are material and unobservable are classified as level 3.

Where credit protection, usually in the form of credit default swaps, has been purchased or written on asset-backed securities, the security is referred to as a negative basis asset-backed security and the resulting derivative assets or liabilities have been classified as either level 2 or level 3 according to the classification of the underlying asset-backed security.

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The Group's level 3 derivative assets include £1,177 million (31 December 2009: £1,797 million) in respect of the value of the embedded equity conversion feature of the enhanced capital notes issued in December 2009. The embedded equity conversion feature is valued by comparing the market price of the enhanced capital notes with the market price of similar bonds without the conversion feature. The latter is calculated by discounting the expected enhanced capital note cash flows in the absence of a conversion using prevailing market yields for similar capital securities without the conversion feature. The market price of the enhanced capital notes was calculated with reference to multiple broker quotes. Movements in the fair value of the derivative are recorded in net trading income.

Level 3 derivative assets also include £96 million (31 December 2009: £140 million) in respect of credit default swaps written on level 3 negative basis asset-backed securities calculated as set out in the table below:

	2010 £m	2009 £m
Fair value before credit valuation adjustment	**114**	346
Less: credit valuation adjustment	**(18)**	(206)
Carrying value	**96**	140

SENSITIVITY OF LEVEL 3 VALUATIONS

Asset-backed securities

Reasonably possible alternative valuations have been calculated for asset-backed securities by using alternative pricing sources and calculating an absolute difference. The pricing difference is defined as the absolute difference between the actual price used and the closest, alternative price available.

Derivative financial instruments

(i) In respect of the embedded equity conversion feature of the enhanced capital notes, the sensitivity was based on the absolute difference between the actual price of the enhanced capital note and the closest, alternative broker quote available plus the impact of applying a 10 bps increase/decrease in the market yield used to derive a market price for similar bonds without the conversion feature. The effect of interdependency of the assumptions is not material to the effect of applying reasonably possible alternative assumptions to the valuations of derivative financial instruments.

(ii) In respect of credit default swaps written on level 3 negative basis asset-backed securities, reasonably possible alternative valuations have been calculated by flexing the spread between the underlying asset and the credit default swap, or adjusting market yields, by a reasonable amount. The sensitivity is determined by applying a 60 bps increase/decrease in the spread between the asset and the credit default swap.

Venture capital and equity investments

The valuation techniques used for unlisted equities and venture capital investments vary depending on the nature of the investment. Third party valuers have been used to determine the value of unlisted equities and property partnerships included in the Group's life insurance funds. As these factors differ for each investment, depending on the nature of the valuation technique used and the inputs, there is no single common factor that could be adjusted to provide a reasonable alternative valuation for these investment portfolios.

55 FINANCIAL INSTRUMENTS continued

DERIVATIVE VALUATION ADJUSTMENTS

Derivative financial instruments which are carried in the balance sheet at fair value are adjusted where appropriate to reflect credit risk, market liquidity and other risks.

(i) Uncollateralised derivative valuation adjustments, excluding monoline counterparties

The following table summarises the movement on this revaluation adjustment account during 2010.

Uncollateralised derivative valuation adjustments

	£m
At 31 December 2009	662
Income statement charge	**20**
Transfers	**(112)**
At 31 December 2010	**570**

Represented by:

	2010 £m	2009 £m
Credit Valuation Adjustment (CVA)	**671**	892
Debit Valuation Adjustment (DVA)	**(298)**	(230)
Funding Valuation Adjustment	**197**	–
	570	662

Valuation adjustments are applied to the Group's over-the-counter derivative exposures with counterparties that are not subject to standard interbank collateral arrangements. These valuation adjustments reflect the different credit and funding exposures that such counterparties represent.

A Credit Valuation Adjustment (CVA) is applied to the Group's over-the-counter uncollateralised derivative exposures to adjust the derivative valuations provided by standard interbank interest rate curves. The Group uses a bilateral simulation model to develop expected future exposures. This calculates a CVA for scenarios where the Group has a positive future exposure (asset) and a Debit Valuation Adjustment (DVA) where the Group has a negative future exposure (liability).

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

Market Credit Default Swap (CDS) spreads are used to develop the probability of default for quoted counterparties. For unquoted counterparties, internal credit ratings and market sector CDS curves and recovery rates are used. The Loss Given Default (LGD) is based on market recovery rates and internal credit assessments. The combination of a one notch deterioration in the credit rating of derivative counterparties and a 10 per cent increase in LGD increases the CVA by £120 million. Current market value is used to estimate the projected exposure for products not supported by the model, which are principally complex interest rate options that are traded in very low volumes. For these, the CVA is calculated on an add-on basis (in total contributing £29 million of the overall CVA balance at 31 December 2010).

The Debit Valuation Adjustment (DVA) is sensitive to the Group's own CDS spread. A 1 per cent rise in this spread would lead to an increase in the DVA of £65 million to £363 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates. Due to the nature of the Group's business the CVA/DVA exposures tend to be on average the same way around such that the valuation adjustments fall when interest rates rise. A 1 per cent rise in interest rates would lead to a £109 million fall in the overall valuation adjustment to £461 million. The CVA model used by the Group does not assume any correlation between the level of interest rates and default rates.

In addition, in 2010 the Group has included a Funding Valuation Adjustment to adjust for the net cost of funding certain uncollateralised derivative positions where the Group considers that this cost is included in market pricing. This adjustment is calculated on the expected future exposure discounted at a suitable cost of funds. A 10 bps increase in the cost of funds will increase the funding valuation adjustment by £5 million.

(ii) Uncollateralised derivative valuation adjustments – monoline counterparties

The Group has no significant derivative exposures remaining against monoline counterparties as shown in note 56(3). The remaining valuation adjustment on these limited positions is shown in the table below.

Monoline derivative valuation adjustments

	2010 £m	2009 £m
Credit Valuation Adjustment – monoline counterparties	**17**	200

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(iii) Market liquidity

The Group includes mid to bid-offer valuation adjustments against the expected cost of closing out the net market risk in the Group's trading positions within a timeframe that is consistent with historical trading activity and spreads that the trading desks have accessed historically during the ordinary course of business in normal market conditions.

At 31 December 2010, the Group's derivative trading business held mid to bid-offer valuation adjustments of £66 million (31 December 2009: £70 million).

(iv) Libor/Overnight Index Swap (OIS) basis

The Group's derivative trading business applies £70 million (31 December 2009: £nil) of valuation adjustments against the changing market approach to valuing derivatives that are subject to daily collateral margin, where standard market practice is to pay interest on an Overnight Index Swap (OIS) basis rather than a Libor rate.

No credit valuation adjustment is taken on collateralised swaps (31 December 2009: £25 million).

56 FINANCIAL RISK MANAGEMENT

As a bancassurer, financial instruments are fundamental to the Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the Group.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and foreign exchange risk; and liquidity risk. Information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk and the Group's management of capital can be found on pages 65 to 108. The following additional disclosures, which provide quantitative information about the risks within financial instruments held or issued by the Group, should be read in conjunction with that earlier information.

(1) INTEREST RATE RISK

In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There is a relatively small volume of deposits whose rate is contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However, a significant proportion of the Group's lending assets, for example many personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio.

At 31 December 2010 the aggregate notional principal of interest rate swaps designated as fair value hedges was £75,831 million (2009: £80,085 million) with a net fair value asset of £3,166 million (2009: asset of £3,004 million) (note 19). The gains on the hedging instruments were £280 million (2009: losses of £995 million). The losses on the hedged items attributable to the hedged risk were £452 million (2009: gains of £1,181 million).

In addition the Group has cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. Note 19 shows when the hedged cash flows are expected to occur and when they will affect income for designated cash flow hedges. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2010 was £112,507 million (2009: £222,548 million) with a net fair value liability of £843 million (2009: £2,536 million) (note 19). In 2010, ineffectiveness recognised in the income statement that arises from cash flow hedges was a gain of £160 million (2009: nil). There were no transactions for which cash flow hedge accounting had to be ceased in 2010 or 2009 as a result of the highly probable cash flows no longer being expected to occur.

(2) CURRENCY RISK

Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to the market and liquidity risk function in London. Associated VaR and the closing, average, maximum and minimum are disclosed on page 89.

56 FINANCIAL RISK MANAGEMENT continued

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group hedges part of the currency translation risk of the net investment in certain foreign operations using currency borrowings and cross currency derivatives. At 31 December 2010 the aggregate notional principal of these currency borrowings was £5,135 million; the aggregate notional principal of the cross currency derivatives was £86 million (2009: cross currency swaps £2,507 million) with a net fair value asset of £2 million (2009: asset of £25 million) and they were designated on an after-tax basis as hedges of net investments in foreign operations. In 2010, an ineffectiveness loss of £28 million before tax and £20 million after tax (2009: ineffectiveness of £nil before tax and £nil after tax) was recognised in the income statement arising from net investment hedges.

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

Functional currency of Group operations

	2010 £m	2009 £m
Euro:		
Gross exposure	**2,468**	2,764
Net investment hedge	**(3,270)**	(2,651)
	(802)	113
US dollar:		
Gross exposure	**47**	(184)
Net investment hedge	**(145)**	62
	(98)	(122)
Swiss franc:		
Gross exposure	**53**	2,552
Net investment hedge	**–**	(2,467)
	53	85
Australian dollar:		
Gross exposure	**1,567**	1,869
Net investment hedge	**(1,634)**	(1,832)
	(67)	37
Japanese yen:		
Gross exposure	**17**	3,220
Net investment hedge	**–**	(3,207)
	17	13
Other non-sterling	**155**	316
Total structural foreign currency exposures, after net investment hedges	**(742)**	442

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56 FINANCIAL RISK MANAGEMENT continued

(3) CREDIT RISK

The Group's credit risk exposure arises predominantly in the United Kingdom, the European Union, Australia and the United States.

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

	2010 £m	2009 £m
Loans and receivables:		
Loans and advances to banks	**30,292**	35,510
Loans and advances to customers	**610,970**	641,770
Debt securities	**26,293**	33,082
Deposit amounts available for offset[1]	**(8,105)**	(13,373)
Impairment allowances	**(18,951)**	(15,380)
	640,499	681,609
Available-for-sale financial assets (excluding equity shares)	**40,700**	44,571
Held-to-maturity investments	**7,905**	–
Trading and other financial assets at fair value through profit or loss (excluding equity shares)	**65,972**	65,861
Derivative assets, before netting	**50,777**	49,928
Amounts available for offset under master netting arrangements[1]	**(31,740)**	(21,698)
	19,037	28,230
Assets arising from reinsurance contracts held	**2,146**	1,875
Financial guarantees	**22,975**	18,021
Irrevocable loan commitments and other credit-related contingencies[2]	**67,809**	80,585
Maximum credit risk exposure	**867,043**	920,752
Maximum credit risk exposure before offset items	**906,888**	955,823

[1] Deposit amounts available for offset and amounts available for offset under master netting arrangements do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

[2] See note 54 – Contingent liabilities and commitments for further information.

A general description of collateral held in respect of financial instruments is disclosed on page 77.

Loans and advances to banks – the Group may require collateral before entering into a credit commitment with another bank, depending on the type of the financial product and the counterparty involved, and netting agreements are obtained whenever possible and to the extent that such agreements are legally enforceable.

Available-for-sale debt securities, treasury and other bills, held-to-maturity investments, and trading and other financial assets at fair value through profit or loss – the credit quality of the Group's available-for-sale debt securities, treasury and other bills, held-to-maturity investments, and the majority of the Group's trading and other financial assets at fair value through profit or loss held is set out below. An analysis of trading and other financial assets at fair value through profit or loss is included in note 18 and a similar analysis for available-for-sale financial assets is included in note 26. The Group's held-to-maturity investments are all government debt securities. The Group's non-participating investment contracts are all unit-linked. Trading and other financial assets at fair value through profit or loss which back those investment contracts were £129,702 million (2009: £118,573 million). Movements in the fair value of such assets, including movements arising from credit risk, are borne by the contract holders.

Derivative assets – the Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. An analysis of derivative assets is given in note 19. Of the net derivative assets of £19,037 million (31 December 2009: £28,230 million), cash collateral of £1,429 million (31 December 2009: £6,645 million) was held and a further £8,385 million was due from OECD banks (31 December 2009: £13,004 million).

Assets arising from reinsurance contracts held – of the assets arising from reinsurance contracts held at 31 December 2010 of £2,146 million (31 December 2009: £1,875 million), £671 million (31 December 2009: £510 million) were due from insurers with a credit rating of AA or above.

56 FINANCIAL RISK MANAGEMENT continued

Financial guarantees – these represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards.

Reverse repo and repo transactions – for reverse repo transactions which are accounted for as collateralised loans, it is the Group's policy to seek collateral which is at least equal to the amount loaned. At 31 December 2010, the fair value of collateral accepted under reverse repo transactions that the Group is permitted by contract or custom to sell or repledge was £21,195 million (2009: £26,731 million). Of this, £3,161 million (2009: £14,963 million) was sold or repledged as at 31 December 2010. The fair value of collateral pledged in respect of repo transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to repledge was £53,781 million (31 December 2009: £96,409 million).

Stock lending – in addition to financial assets on the balance sheet which are subject to repurchase agreements, there were financial assets on the balance sheet pledged as collateral as part of securities lending transactions which amounted to £124,139 million at 31 December 2010 (2009: £92,449 million).

Stock borrowing – Securities held as collateral as stock borrowed or under reverse repurchase agreements amounted to £93,419 million at 31 December 2010 (2009: £95,881 million), of which £55,554 million at 31 December 2010 (2009: £77,455 million) had been resold or repledged as collateral for the Group's own transactions.

Loans and advances

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2010						
Neither past due nor impaired	**30,259**	**339,509**	**45,058**	**159,274**	**543,841**	**12,545**
Past due but not impaired	**–**	**13,215**	**1,289**	**3,427**	**17,931**	**–**
Impaired – no provision required	**–**	**2,189**	**433**	**5,313**	**7,935**	**–**
– provision held	**20**	**5,591**	**5,149**	**45,931**	**56,671**	**–**
Gross	**30,279**	**360,504**	**51,929**	**213,945**	**626,378**	**12,545**
Allowance for impairment losses	**(20)**	**(2,073)**	**(2,587)**	**(24,975)**	**(29,635)**	**–**
Fair value adjustments	**13**				**(4,146)**	**–**
Net	**30,272**				**592,597**	**12,545**
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
Allowance for impairment losses	(149)	(1,774)	(3,379)	(20,835)	(25,988)	–
Fair value adjustments	24				(7,047)	–
Net	35,361				626,969	19,082

The disclosures in the table above and those on pages 255 to 257 are produced under the combined businesses approach used for the Group's segmental reporting. The Group believes that, for reporting periods immediately following a significant acquisition such as the acquisition of HBOS in 2009, this combined businesses basis, which includes the allowance for loan losses at the acquisition date on a gross basis, more fairly reflects the underlying provisioning status of the loans. The remaining acquisition-related fair value adjustments in respect of this lending are therefore identified separately in this table.

The analysis of lending between retail and 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.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(H). All impaired loans which exceed certain thresholds, principally within the Group's Wholesale division, are individually assessed for impairment by reviewing expected future cash flows including those that could arise from the realisation of security. Included in loans and receivables are advances individually determined to be impaired with a gross amount before impairment allowances of £51,608 million (31 December 2009: £44,675 million) which have associated collateral with a fair value of £14,869 million (31 December 2009: £10,217 million).

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The table below sets out the reconciliation of the allowance for impairment losses of £18,373 million (31 December 2009: £14,801 million) shown in note 25 to the allowance for impairment losses on a combined businesses basis of £29,635 million (31 December 2009: £25,988 million) shown above:

	2010 £m	2009 £m
Allowance for impairment losses on loans and advances to customers	**18,373**	14,801
HBOS allowance at 16 January 2009[1]	**11,147**	11,147
Amounts subsequently written off	**(9,136)**	(6,155)
	2,011	4,992
HBOS charge covered by fair value adjustments[2]	**8,823**	6,242
Foreign exchange and other movements	**428**	(47)
Allowance for impairment losses on loans and advances to customers on a combined businesses basis	**29,635**	25,988

[1] Comprises an allowance held at 31 December 2008 of £10,693 million and a charge for the period from 1 January 2009 to 16 January 2009 of £454 million.

[2] This represents the element of the charge on loans and advances to customers in HBOS's results that was included within the Group's fair value adjustments in respect of the acquisition of HBOS on 16 January 2009.

Loans and advances which are neither past due nor 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 2010						
Good quality	**29,835**	**332,614**	**30,076**	**57,552**		**12,220**
Satisfactory quality	**265**	**5,259**	**11,084**	**42,906**		**163**
Lower quality	**16**	**834**	**1,170**	**45,750**		**83**
Below standard, but not impaired	**143**	**802**	**2,728**	**13,066**		**79**
Total loans and advances which are neither past due nor impaired	**30,259**	**339,509**	**45,058**	**159,274**	**543,841**	**12,545**
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 loans and advances which are neither past due nor impaired	35,333	347,292	48,429	185,872	581,593	19,082

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Wholesale lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models.

56 FINANCIAL RISK MANAGEMENT continued

Loans and advances which are past due but not impaired

	Loans and advances to banks £m	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m
		Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	
31 December 2010						
0-30 days	–	**6,498**	**1,004**	**1,331**	**8,833**	–
30-60 days	–	**2,674**	**246**	**498**	**3,418**	–
60-90 days	–	**1,811**	**29**	**394**	**2,234**	–
90-180 days	–	**2,223**	**10**	**337**	**2,570**	–
Over 180 days	–	**9**	–	**867**	**876**	–
Total loans and advances which are past due but not impaired	–	**13,215**	**1,289**	**3,427**	**17,931**	–
Fair value of collateral held		**11,467**	**n/a**	**n/a**	**n/a**	
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 loans and advances which are past due but not impaired	–	12,587	1,873	5,118	19,578	–
Fair value of collateral held		10,845	n/a	n/a	n/a	

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

Collateral held against retail mortgage lending is principally comprised of residential properties; their fair value has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations. The resulting valuation has been limited to the principal amount of the outstanding advance in order to provide a clearer representation of the Group's credit exposure.

Lending decisions are based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values for non-mortgage lending are assessed more rigorously at the time of loan origination or when taking enforcement action and may fluctuate, as in the case of floating charges, according to the level of assets held by the customer. Whilst collateral is reviewed on a regular basis in accordance with business unit credit policy, this varies according to the type of lending and collateral involved. It is therefore not practicable to estimate and aggregate current fair values of collateral for non-mortgage lending.

Renegotiated loans and advances

Loans and advances that were renegotiated during the year and that would otherwise have been past due or impaired at 31 December 2010 totalled £5,475 million (31 December 2009: £3,919 million).

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56 FINANCIAL RISK MANAGEMENT continued

Forbearance arrangements

The Group operates a number of schemes to assist borrowers. Further details of these schemes is set out in the risk report on pages 78 and 79.

The Group operates schemes that allow customers to repay a monthly amount which is lower than their contractual monthly payment for a short period. These forbearance arrangements include short-term reduced or nil payment arrangements and transfers to interest only mortgages, as described on page 79. 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 and the loan will continue to be reported as impaired. 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.

Under the Group's contractual repayment scheme, also described on page 79, customers can have their arrears balance capitalised 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. Such recapitalised loans are not considered to be impaired as the Group continues to expect to recover the original carrying amount of the loan. Consequently, recapitalised mortgages will return to the non-impaired book and will be managed in accordance with the recapitalised terms of the mortgage.

In addition, the Group participates in a number of UK Government sponsored programmes designed to support households, which are described on page 78. Where these schemes provide borrowers with a state benefit that is used to service the loan, there is no change in the reported status of the loan which is managed and reported in accordance with its original terms.

Repossessed collateral

	2010 £m	2009 £m
Residential property	**1,046**	1,353
Other	**32**	701
Total repossessed collateral	**1,078**	2,054

In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against wholesale lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

Loan-to-value ratio of mortgage lending

	2010 £m	2009 £m
Analysis by loan-to-value ratio of the Group's residential mortgage lending which is neither past due nor impaired:		
Less than 70 per cent	**140,267**	142,614
70 per cent to 80 per cent	**57,979**	54,079
80 per cent to 90 per cent	**53,732**	52,238
Greater than 90 per cent	**87,531**	98,361
Total residential mortgage lending which is neither past due nor impaired	**339,509**	347,292

56 FINANCIAL RISK MANAGEMENT continued

An analysis of the Group's debt securities, treasury and other bills and derivative financial instruments by credit rating is provided below.

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2010							
Debt securities, treasury and other bills held at fair value through profit or loss							
Trading assets:							
Government securities	651	888	–	84	–	–	1,623
Bank and building society certificates of deposit	–	3,086	506	100	–	–	3,692
Other asset-backed securities	191	633	196	–	–	–	1,020
Corporate and other debt securities	1,205	1,209	1,839	183	13	470	4,919
Total debt securities held as trading assets	2,047	5,816	2,541	367	13	470	11,254
Treasury bills and other bills	219	8	–	–	–	–	227
Total held as trading assets	2,266	5,824	2,541	367	13	470	11,481
Other assets held at fair value through profit or loss:							
Government securities	20,509	1,113	408	33	6	148	22,217
Other public sector securities	778	62	68	2	–	9	919
Bank and building society certificates of deposit	52	107	447	–	–	–	606
Asset-backed securities:							
Mortgage-backed securities	259	68	48	23	–	24	422
Other asset-backed securities	298	372	458	384	70	10	1,592
	557	440	506	407	70	34	2,014
Corporate and other debt securities	3,870	1,619	4,397	3,269	1,275	1,760	16,190
Total other assets held at fair value through profit or loss	25,766	3,341	5,826	3,711	1,351	1,951	41,946
Total held at fair value through profit or loss	28,032	9,165	8,367	4,078	1,364	2,421	53,427
Derivative financial instruments							
Trading and other	157	18,161	13,486	1,006	86	10,475	43,371
Hedging	57	1,992	4,368	46	–	943	7,406
Total derivative financial instruments	214	20,153	17,854	1,052	86	11,418	50,777
Debt securities classified as loans and receivables							
Asset-backed securities:							
Mortgage-backed securities	6,524	2,856	1,057	840	222	151	11,650
Other asset-backed securities	7,535	2,514	1,377	475	823	103	12,827
	14,059	5,370	2,434	1,315	1,045	254	24,477
Corporate and other debt securities	163	164	459	106	166	758	1,816
Total debt securities classified as loans and receivables	14,222	5,534	2,893	1,421	1,211	1,012	26,293
Available-for-sale financial assets							
Debt securities:							
Government securities	12,462	78	–	–	–	12	12,552
Other public sector securities	–	–	–	–	–	29	29
Bank and building society certificates of deposit	–	225	162	20	–	–	407
Asset-backed securities:							
Mortgage-backed securities	2,809	673	601	202	8	–	4,293
Other asset-backed securities	3,625	781	395	115	79	224	5,219
	6,434	1,454	996	317	87	224	9,512
Corporate and other debt securities	1,135	4,824	5,150	913	42	68	12,132
Total debt securities	20,031	6,581	6,308	1,250	129	333	34,632
Treasury bills and other bills	4,439	–	1,629	–	–	–	6,068
Total held as available-for-sale financial assets	24,470	6,581	7,937	1,250	129	333	40,700
Held-to-maturity investments							
Government securities	7,905	–	–	–	–	–	7,905

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56 FINANCIAL RISK MANAGEMENT continued

An analysis of the Group's debt securities, treasury and other bills and derivative financial instruments by credit rating is provided below.

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2009							
Debt securities held at fair value through profit or loss							
Trading assets:							
Government securities	2,100	806	–	–	–	30	2,936
Other public sector securities	–	–	6	–	–	–	6
Bank and building society certificates of deposit	–	1,037	997	–	–	–	2,034
Other asset-backed securities	331	379	181	–	–	–	891
Corporate and other debt securities	1,025	312	1,328	348	72	12	3,097
Total held as trading assets	3,456	2,534	2,512	348	72	42	8,964
Other assets held at fair value through profit or loss:							
Government securities	16,025	581	337	26	–	56	17,025
Other public sector securities	675	16	–	–	–	9	700
Asset-backed securities:							
Mortgage-backed securities	316	134	45	24	–	1	520
Other asset-backed securities	403	325	654	333	265	19	1,999
	719	459	699	357	265	20	2,519
Corporate and other debt securities	4,070	1,359	4,540	3,407	1,062	3,133	17,571
Total other assets held at fair value through profit or loss	21,489	2,415	5,576	3,790	1,327	3,218	37,815
Total held at fair value through profit or loss	24,945	4,949	8,088	4,138	1,399	3,260	46,779
Derivative financial instruments							
Trading and other	887	13,674	14,173	889	169	10,706	40,498
Hedging	628	2,509	5,163	91	–	1,039	9,430
Total derivative financial instruments	1,515	16,183	19,336	980	169	11,745	49,928
Debt securities classified as loans and receivables							
Asset-backed securities:							
Mortgage-backed securities	9,183	2,470	805	682	182	–	13,322
Other asset-backed securities	11,824	2,465	1,449	277	965	157	17,137
	21,007	4,935	2,254	959	1,147	157	30,459
Corporate and other debt securities	–	439	823	69	306	986	2,623
Total debt securities classified as loans and receivables	21,007	5,374	3,077	1,028	1,453	1,143	33,082
Available-for-sale financial assets							
Debt securities:							
Government securities	8,222	263	35	–	–	149	8,669
Other public sector securities	–	–	–	–	–	31	31
Bank and building society certificates of deposit	22	499	452	22	19	–	1,014
Asset-backed securities:							
Mortgage-backed securities	3,820	555	215	156	35	–	4,781
Other asset-backed securities	6,080	731	448	179	186	16	7,640
	9,900	1,286	663	335	221	16	12,421
Corporate and other debt securities	2,002	7,342	8,802	1,350	228	180	19,904
Total debt securities	20,146	9,390	9,952	1,707	468	376	42,039
Treasury bills and other bills	269	2,263	–	–	–	–	2,532
Total held as available-for-sale financial assets	20,415	11,653	9,952	1,707	468	376	44,571

56 FINANCIAL RISK MANAGEMENT continued

CREDIT MARKET EXPOSURES

The Group's credit market exposures primarily relate to asset-backed securities exposures held in Wholesale division. These exposures are classified as loans and receivables (note 24), available-for-sale financial assets (note 26) or trading and other financial assets at fair value through profit or loss (note 18) depending on the nature of the investment.

	Loans and receivables £m	Available-for-sale £m	Trading and other financial assets at fair value through profit or loss £m	Net exposure as at 31 December 2010 £m	Net exposure as at 31 December 2009 £m
Asset-backed securities					
Mortgage-backed securities:					
US residential mortgage-backed securities	**4,242**	**–**	**–**	**4,242**	4,826
Non-US residential mortgage-backed securities	**4,916**	**2,982**	**–**	**7,898**	9,655
Commercial mortgage-backed securities	**2,397**	**1,119**	**–**	**3,516**	3,737
	11,555	**4,101**	**–**	**15,656**	18,218
Collateralised debt obligations:					
Corporate	**43**	**–**	**–**	**43**	86
Commercial real estate	**306**	**–**	**–**	**306**	509
Other	**106**	**39**	**–**	**145**	196
Collateralised loan obligations	**3,578**	**1,108**	**–**	**4,686**	5,745
	4,033	**1,147**	**–**	**5,180**	6,536
Personal sector:					
Auto loans	**569**	**339**	**–**	**908**	1,730
Credit cards	**1,795**	**338**	**–**	**2,133**	3,720
Personal loans	**663**	**263**	**–**	**926**	999
	3,027	**940**	**–**	**3,967**	6,449
Federal family education loan programme					
Student loans	**5,078**	**2,699**	**–**	**7,777**	9,244
Other asset-backed securities	**572**	**463**	**–**	**1,035**	1,183
Total uncovered asset-backed securities	**24,265**	**9,350**	**–**	**33,615**	41,630
Negative basis[1]	**–**	**42**	**1,067**	**1,109**	1,233
Total Wholesale asset-backed securities	**24,265**	**9,392**	**1,067**	**34,724**	42,863
Direct	**15,860**	**5,369**	**1,067**	**22,296**	27,599
Conduits (note 23)	**8,405**	**4,023**	**–**	**12,428**	15,264
Total Wholesale asset-backed securities	**24,265**	**9,392**	**1,067**	**34,724**	42,863

[1] Negative basis means bonds held with separate matching credit default swap protection.

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56 FINANCIAL RISK MANAGEMENT continued

The table below sets out Wholesale division's net exposure to US residential mortgage-backed securities (RMBS) by vintage.

	Pre-2005 £m	2005 £m	2006 £m	2007 £m	Net exposure as at 31 December 2010 £m	Net exposure as at 31 December 2009 £m
Asset class						
Prime	233	215	66	28	542	859
Alt-A	121	765	1,437	1,377	3,700	3,967
Sub-prime	–	–	–	–	–	–
Total net exposure to US RMBS	354	980	1,503	1,405	4,242	4,826

Exposures to monolines

During 2009 all exposure to sub-investment grade monolines on CDS contracts was written down to zero, leaving limited exposure to monoline insurers as set out below.

	Credit default swaps		Wrapped loans and receivables		Wrapped bonds	
	Notional £m	Exposure[1] £m	Notional £m	Exposure[2] £m	Notional £m	Exposure[3] £m
Investment grade	1,060	40	330	214	–	–
Sub-investment grade	–	–	–	–	–	–
Total monoline insurers	1,060	40	330	214	–	–

[1] The exposure to monolines arising from credit default swaps is calculated as the mark-to-market of the CDS protection purchased from the monoline after credit valuation adjustments.

[2] The exposure to monolines on wrapped loans and receivables and bonds is the internal assessment of amounts that will be recovered from the monoline guarantor on interest and principal shortfalls.

[3] In addition, the Group has £1,985 million (31 December 2009: £2,703 million) of monoline wrapped bonds and £425 million (31 December 2009: £791 million) of monoline liquidity commitments on which the Group currently places no reliance on the guarantor.

56 FINANCIAL RISK MANAGEMENT continued

An analysis of the Wholesale division's asset-backed securities portfolio by credit rating is provided below.

	Net Exposure £m	AAA £m	AA £m	A £m	BBB £m	BB £m	B £m	Below B £m
Asset class								
Mortgage-backed securities								
US residential mortgage-backed securities:								
Prime	542	312	110	82	26	9	3	–
Alt-A	3,700	2,037	801	591	186	66	19	–
Sub-prime	–	–	–	–	–	–	–	–
	4,242	2,349	911	673	212	75	22	–
Non-US residential mortgage-backed securities	7,898	6,170	1,415	237	76	–	–	–
Commercial mortgage-backed securities	3,516	754	1,390	637	585	62	–	88
	15,656	9,273	3,716	1,547	873	137	22	88
Collateralised debt obligations								
Corporate	43	5	27	–	–	–	–	11
Commercial real estate	306	18	–	–	105	128	27	28
Other	145	–	–	–	–	105	–	40
Collateralised loan obligations	4,686	760	2,189	1,210	140	234	98	55
	5,180	783	2,216	1,210	245	467	125	134
Personal sector								
Auto loans	908	764	68	44	–	32	–	–
Credit cards	2,133	1,762	371	–	–	–	–	–
Personal loans	926	230	306	325	65	–	–	–
	3,967	2,756	745	369	65	32	–	–
Federal family education loan programme								
Student loans	7,777	7,646	–	48	64	19	–	–
Other asset-backed securities	1,035	114	–	296	517	108	–	–
Negative basis[1]								
Monolines	1,067	191	633	243	–	–	–	–
Banks	42	42	–	–	–	–	–	–
	1,109	233	633	243	–	–	–	–
Total as at 31 December 2010	34,724	20,805	7,310	3,713	1,764	763	147	222
Total as at 31 December 2009	42,863	31,086	6,375	2,915	1,276	725	92	394

[1] The external credit rating is based on the bond ignoring the benefit of the CDS.

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56 FINANCIAL RISK MANAGEMENT continued

(4) LIQUIDITY RISK

The table below analyses assets and liabilities of the Group into relevant maturity groupings based on the remaining contractual period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

Maturities of assets and liabilities

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2010						
Assets						
Cash and balances at central banks	**37,737**	**70**	**308**	**–**	**–**	**38,115**
Trading and other financial assets at fair value through profit or loss	**7,579**	**9,541**	**8,948**	**6,192**	**123,931**	**156,191**
Derivative financial instruments	**2,889**	**1,691**	**3,860**	**17,492**	**24,845**	**50,777**
Loans and advances to banks	**22,520**	**2,754**	**2,550**	**1,529**	**919**	**30,272**
Loans and advances to customers	**58,392**	**10,549**	**28,193**	**114,102**	**381,361**	**592,597**
Debt securities held as loans and receivables	**57**	**250**	**374**	**2,941**	**22,113**	**25,735**
Available-for-sale financial assets	**2,745**	**5,503**	**3,535**	**12,761**	**18,411**	**42,955**
Held-to-maturity investments	**110**	**–**	**–**	**–**	**7,795**	**7,905**
Other assets	**4,920**	**585**	**1,140**	**604**	**39,778**	**47,027**
Total assets	**136,949**	**30,943**	**48,908**	**155,621**	**619,153**	**991,574**
Liabilities						
Deposits from banks	**24,445**	**10,308**	**4,152**	**9,467**	**1,991**	**50,363**
Customer deposits	**311,899**	**14,557**	**30,790**	**33,802**	**2,585**	**393,633**
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	**11,938**	**4,313**	**8,469**	**20,003**	**24,197**	**68,920**
Debt securities in issue	**24,151**	**39,243**	**46,629**	**67,190**	**51,653**	**228,866**
Liabilities arising from insurance and investment contracts	**15,425**	**1,550**	**5,337**	**20,174**	**90,249**	**132,735**
Other liabilities	**15,426**	**595**	**933**	**8,049**	**8,920**	**33,923**
Subordinated liabilities	**122**	**1,294**	**1,317**	**9,049**	**24,450**	**36,232**
Total liabilities	**403,406**	**71,860**	**97,627**	**167,734**	**204,045**	**944,672**
As at 31 December 2009						
Assets						
Cash and balances at central banks	38,569	–	23	–	402	38,994
Trading and other financial assets at fair value through profit or loss	22,912	6,047	10,517	9,666	100,869	150,011
Derivative financial instruments	15,222	1,245	3,756	15,611	14,094	49,928
Loans and advances to banks	24,641	2,783	4,759	1,880	1,298	35,361
Loans and advances to customers	84,441	12,623	30,296	126,355	373,254	626,969
Debt securities held as loans and receivables	92	143	557	4,149	27,711	32,652
Available-for-sale financial assets	1,205	3,134	3,172	19,885	19,206	46,602
Other assets	6,247	448	564	385	39,094	46,738
Total assets	193,329	26,423	53,644	177,931	575,928	1,027,255
Liabilities						
Deposits from banks	45,877	15,522	16,612	1,106	3,335	82,452
Customer deposits	326,931	26,637	18,234	30,627	4,312	406,741
Derivative financial instruments, trading and other financial liabilities at fair value through profit or loss	26,494	4,655	9,330	17,827	10,450	68,756
Debt securities in issue	37,981	36,321	33,475	75,912	49,813	233,502
Liabilities arising from insurance and investment contracts	57,797	1,480	2,975	12,151	49,206	123,609
Other liabilities	3,674	502	1,372	4,056	23,757	33,361
Subordinated liabilities	55	280	754	8,568	25,070	34,727
Total liabilities	498,809	85,397	82,752	150,247	165,943	983,148

56 FINANCIAL RISK MANAGEMENT continued

The above tables are provided on a contractual basis. The Group's assets and liabilities may be repaid or otherwise mature earlier or later than implied by their contractual terms and readers are, therefore, advised to use caution when using this data to evaluate the Group's liquidity position.

The table below analyses financial instrument liabilities of the Group, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2010						
Deposits from banks	**24,911**	**11,804**	**4,301**	**10,557**	**922**	**52,495**
Customer deposits	**306,469**	**15,031**	**32,626**	**38,529**	**3,019**	**395,674**
Trading and other financial liabilities at fair value through profit or loss	**11,293**	**2,218**	**5,125**	**5,544**	**3,632**	**27,812**
Debt securities in issue	**31,234**	**41,143**	**52,582**	**91,893**	**35,201**	**252,053**
Liabilities arising from non-participating investment contracts	**12,944**	**91**	**265**	**1,743**	**36,320**	**51,363**
Subordinated liabilities	**–**	**1,107**	**4,615**	**17,702**	**35,067**	**58,491**
Total non-derivative financial liabilities	**386,851**	**71,394**	**99,514**	**165,968**	**114,161**	**837,888**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**26,069**	**14,832**	**8,942**	**65,734**	**42,410**	**157,987**
Gross settled derivatives – inflows	**(10,442)**	**(14,978)**	**(9,270)**	**(66,232)**	**(41,815)**	**(142,737)**
Gross settled derivatives – net flows	**15,627**	**(146)**	**(328)**	**(498)**	**595**	**15,250**
Net settled derivatives liabilities	**2,492**	**2,066**	**5,797**	**11,576**	**3,331**	**25,262**
Total derivative financial liabilities	**18,119**	**1,920**	**5,469**	**11,078**	**3,926**	**40,512**
As at 31 December 2009						
Deposits from banks	46,260	15,250	19,232	1,229	892	82,863
Customer deposits	305,782	37,691	32,848	28,229	4,020	408,570
Trading and other financial liabilities at fair value through profit or loss	14,592	3,668	6,116	3,224	1,275	28,875
Debt securities in issue	40,505	38,431	34,909	117,856	25,863	257,564
Liabilities arising from non-participating investment contracts	46,040	4	58	185	186	46,473
Subordinated liabilities	75	1,004	1,745	15,702	35,737	54,263
Total non-derivative financial liabilities	453,254	96,048	94,908	166,425	67,973	878,608
Derivative financial liabilities:						
Gross settled derivatives – outflows	10,707	4,844	8,309	35,793	38,505	98,158
Gross settled derivatives – inflows	(6,547)	(4,501)	(8,165)	(35,306)	(36,311)	(90,830)
Gross settled derivatives – net flows	4,160	343	144	487	2,194	7,328
Net settled derivatives liabilities	15,107	2,180	9,395	8,721	1,777	37,180
Total derivative financial liabilities	19,267	2,523	9,539	9,208	3,971	44,508

In addition, the Group has a maximum credit risk exposure of £22,975 million (2009: £18,021 million) in respect of financial guarantees.

The principal amount for undated subordinated liabilities with no redemption option is included within the over five years column; interest of approximately £448 million (2009: £555 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond five years.

Further information on the Group's liquidity exposures is provided on pages 93 to 97.

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56 FINANCIAL RISK MANAGEMENT continued

Liabilities arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2010	**2,481**	**1,459**	**5,072**	**18,431**	**53,286**	**80,729**
As at 31 December 2009	6,263	2,303	4,796	17,890	44,927	76,179

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

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2010					
Acceptances	**48**	**–**	**–**	**–**	**48**
Other contingent liabilities	**1,897**	**1,248**	**269**	**717**	**4,131**
Total contingent liabilities	**1,945**	**1,248**	**269**	**717**	**4,179**
Lending commitments	**76,456**	**22,537**	**13,424**	**3,739**	**116,156**
Other commitments	**1,038**	**61**	**–**	**43**	**1,142**
Total commitments	**77,494**	**22,598**	**13,424**	**3,782**	**117,298**
Total contingents and commitments	**79,439**	**23,846**	**13,693**	**4,499**	**121,477**

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2009					
Acceptances	59	–	–	–	59
Other contingent liabilities	2,670	1,356	1,144	879	6,049
Total contingent liabilities	2,729	1,356	1,144	879	6,108
Lending commitments	82,997	20,497	18,040	6,003	127,537
Other commitments	921	105	14	6	1,046
Total commitments	83,918	20,602	18,054	6,009	128,583
Total contingents and commitments	86,647	21,958	19,198	6,888	134,691

57 CONSOLIDATED CASH FLOW STATEMENT

(A) CHANGE IN OPERATING ASSETS

	2010 £m	2009 £m
Change in loans and receivables	**40,101**	50,935
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**(7,378)**	12,063
Change in other operating assets	**(863)**	(1,056)
Change in operating assets	**31,860**	61,942

57 CONSOLIDATED CASH FLOW STATEMENT continued

(B) CHANGE IN OPERATING LIABILITIES

	2010 £m	2009 £m
Change in deposits from banks	**(32,162)**	(71,267)
Change in customer deposits	**(13,249)**	11,474
Change in debt securities in issue	**(5,655)**	(26,578)
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	**160**	(27,037)
Change in investment contract liabilities	**8,161**	5,415
Change in other operating liabilities	**(2,938)**	2,066
Change in operating liabilities	**(45,683)**	(105,927)

(C) NON-CASH AND OTHER ITEMS

	2010 £m	2009 £m
Depreciation and amortisation	**2,432**	2,560
Impairment of tangible fixed assets	**202**	–
Revaluation of investment properties	**(434)**	214
Allowance for loan losses	**10,771**	16,028
Write-off of allowance for loan losses	**(6,909)**	(4,090)
Impairment of available-for-sale financial assets	**106**	602
Impairment of goodwill	**–**	240
Change in insurance contract liabilities	**4,021**	5,986
Customer goodwill payments provision	**500**	–
Other provision movements	**49**	95
Net (credit) charge in respect of defined benefit schemes	**(455)**	529
Contributions to defined benefit schemes	**(653)**	(1,867)
Gain on acquisition	**–**	(11,173)
Other non-cash items	**(2,933)**	(2,806)
Total non-cash items	**6,697**	6,318
Interest expense on subordinated liabilities	**3,619**	2,550
Other	**857**	39
Total other items	**4,476**	2,589
Non-cash and other items	**11,173**	8,907

(D) ANALYSIS OF CASH AND CASH EQUIVALENTS AS SHOWN IN THE BALANCE SHEET

	2010 £m	2009 £m
Cash and balances at central banks	**38,115**	38,994
Less: mandatory reserve deposits[1]	**(1,089)**	(728)
	37,026	38,266
Loans and advances to banks	**30,272**	35,361
Less: amounts with a maturity of three months or more	**(4,998)**	(7,937)
	25,274	27,424
Total cash and cash equivalents	**62,300**	65,690

[1] Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents at 31 December 2010 is £14,694 million (2009: £13,323 million) held within the Group's life funds, which is not immediately available for use in the business.

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57 CONSOLIDATED CASH FLOW STATEMENT continued

(E) ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	2010 £m	2009 £m
Share capital (including share premium account and merger reserve):		
At 1 January	**33,065**	3,952
Issued on acquisition of HBOS	**–**	7,651
Transfer to capital redemption reserve	**(4,089)**	(26)
Issued on redemption of preference shares and other subordinated securities in 2010	**2,237**	–
Cash proceeds from issue of share capital:		
Placing and open offer	**–**	4,430
Placing and compensatory open offer	**–**	3,905
Rights issue	**–**	13,112
Other	**–**	41
	–	21,488
At 31 December	**31,213**	33,065

	2010 £m	2009 £m
Non-controlling interests:		
At 1 January	**829**	306
Exchange and other adjustments	**(5)**	(19)
Adjustment on acquisition of HBOS	**–**	5,567
Repayment of capital to and extinguishment of non-controlling interests	**–**	(5,035)
Change in non-controlling interests	**2**	–
Minority share of profit after tax	**62**	126
Dividends paid to non-controlling interests	**(47)**	(116)
At 31 December	**841**	829

	2010 £m	2009 £m
Subordinated liabilities:		
At 1 January	**34,727**	17,256
Exchange and other adjustments	**(1,048)**	133
Adjustment on acquisition of HBOS	**–**	20,048
Issue of subordinated liabilities	**3,237**	4,187
Repayment of subordinated liabilities	**(684)**	(6,897)
At 31 December	**36,232**	34,727

57 CONSOLIDATED CASH FLOW STATEMENT continued

(F) ACQUISITION OF GROUP UNDERTAKINGS AND BUSINESSES

	2010 £m	2009 £m
Net assets acquired:		
Cash and balances at central banks	–	2,123
Derivatives, trading and other financial assets at fair value through profit or loss	–	137,889
Loans and receivables:		
Loans and advances to customers	–	436,839
Loans and advances to banks	–	15,794
Debt securities	–	38,408
	–	491,041
Available-for-sale financial assets	–	27,151
Investment properties	–	3,002
Value of in-force business	–	3,713
Intangible assets	–	4,754
Tangible fixed assets	–	5,707
Other assets	–	11,398
Deposits from banks	–	(87,840)
Customer deposits	–	(224,694)
Derivatives, trading and other financial liabilities at fair value through profit or loss	–	(62,158)
Debt securities in issue	–	(185,319)
Insurance liabilities	–	(36,687)
Liabilities arising from non-participating investment contracts	–	(28,181)
Other liabilities	–	(17,316)
Retirement benefit obligations	–	(358)
Subordinated liabilities	–	(20,048)
Preference shares	–	(3,917)
Non-controlling interests	–	(1,300)
Total net assets acquired	–	18,960
Satisfied by:		
Issue of shares	–	(7,651)
Gain on acquisition	–	(11,173)
Cash and cash equivalents acquired, net of acquisition costs	–	16,341
	–	(2,483)
Net cash inflow arising from acquisition of HBOS	–	16,477
Acquisition of and additional investment in joint ventures	**(65)**	(215)
Net cash (outflow) inflow arising from acquisitions in the year	**(65)**	16,262
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**(8)**	(35)
Net cash (outflow) inflow	**(73)**	16,227

(G) DISPOSAL AND CLOSURE OF GROUP UNDERTAKINGS AND BUSINESSES

	2010 £m	2009 £m
Intangible assets	–	170
Other net assets and liabilities	**428**	241
Net cash inflow from disposals	**428**	411

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58 FUTURE ACCOUNTING DEVELOPMENTS

The following pronouncements will be relevant to the Group but were not effective at 31 December 2010 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of change	IASB effective date
Amendment to IAS 32 *Financial Instruments: Presentation – 'Classification of Rights Issues'*	Requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated.	Annual periods beginning on or after 1 February 2010.
Improvements to IFRSs (issued May 2010)	Sets out minor amendments to IFRS standards as part of the annual improvements process.	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 July 2010.
IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*	Clarifies that when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the debtor issuing its own equity instruments to the creditor, a gain or loss is recognised in the income statement representing the difference between the carrying value of the financial liability and the fair value of the equity instruments issued; the fair value of the financial liability is used to measure the gain or loss where the fair value of the equity instruments cannot be reliably measured. This interpretation is consistent with the Group's existing accounting policy.	Annual periods beginning on or after 1 July 2010.
Amendment to IFRIC 14 *Prepayments of a Minimum Funding Requirement*	Applies when an entity is subject to minimum funding requirements in respect of its defined benefit plans and makes an early payment of contributions to cover those requirements and permits such an entity to treat the benefit of such an early payment as an asset.	Annual periods beginning on or after 1 January 2011.
Amendments to IAS 24 *Related Party Disclosures*	Simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for related party transactions with government related entities.	Annual periods beginning on or after 1 January 2011.
Amendments to IFRS 7 *Financial Instruments Disclosures – 'Disclosures-Transfers of Financial Assets'*	Requires additional disclosures in respect of risk exposures arising from transferred financial assets.	Annual periods beginning on or after 1 July 2011.
Amendments to IAS 12 *Income Taxes – 'Deferred Tax: Recovery of Underlying Assets'*	Introduces a rebuttable presumption that investment property measured at fair value is recovered entirely through sale and that deferred tax in respect of such investment property is recognised on that basis.	Annual periods beginning on or after 1 January 2012.
IFRS 9 *Financial Instruments*[1]	Replaces those parts of IAS 39 *Financial Instruments: Recognition and Measurement* relating to the classification, measurement and derecognition of financial assets and liabilities. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument. The available-for-sale financial asset and held-to-maturity investment categories in the existing IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39.	Annual periods beginning on or after 1 January 2013.

[1] IFRS 9 is the initial stage of the project to replace IAS 39. Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39. The effective date of the standard is annual periods beginning on or after 1 January 2013.

At the date of this report, IFRS 9, the Amendments to IFRS 7 and the Amendments to IAS 12 are awaiting EU endorsement.

59 POST BALANCE SHEET EVENTS

Lloyds Banking Group has been in discussion with the FSA regarding the application of an interest variation clause in certain Bank of Scotland plc variable rate mortgage contracts where the wording in the offer documents received by certain customers had the potential to cause confusion. The relevant mortgages were written between 2004 and 2007 by Bank of Scotland plc under the 'Halifax' brand. In February 2011, the Group reached agreement with the FSA in relation to initiating a customer review and contact programme and making goodwill payments to affected customers. In order to make these goodwill payments, Bank of Scotland plc has applied for a Voluntary Variation of Permission to carry out the customer review and contact programme to bring it within section 404F(7) of FSMA 2000. The Group has made a provision of £500 million in relation to this programme.

60 APPROVAL OF FINANCIAL STATEMENTS

The consolidated financial statements were approved by the directors of Lloyds Banking Group plc on 24 February 2011.

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REPORT OF THE INDEPENDENT AUDITORS ON THE PARENT COMPANY FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

We have audited the parent company financial statements of Lloyds Banking Group plc for the year ended 31 December 2010 which comprise the parent company balance sheet, the parent company statement of changes in equity, the parent company cash flow statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As explained more fully in the Directors' Responsibilities Statement on page 122, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

OPINION ON FINANCIAL STATEMENTS

In our opinion the parent company financial statements:

– give a true and fair view of the state of the Company's affairs as at 31 December 2010 and of its cash flows for the year then ended;
– have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
– have been prepared in accordance with the requirements of the Companies Act 2006.

OPINION ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

In our opinion:

– the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
– the information given in the Directors' Report for the financial year for which the parent company financial statements are prepared is consistent with the parent company financial statements.

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

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

– adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
– the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
– certain disclosures of directors' remuneration specified by law are not made; or
– we have not received all the information and explanations we require for our audit.

OTHER MATTER

We have reported separately on the group financial statements of Lloyds Banking Group plc for the year ended 31 December 2010.

Ian Rankin
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Edinburgh
24 February 2011

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

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

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PARENT COMPANY BALANCE SHEET

at 31 December 2010

	Note	2010 £ million	2009 £ million
Assets			
Non-current assets:			
Investment in subsidiaries	9	**38,194**	32,584
Loans to subsidiaries	9	**8,332**	7,466
Deferred tax asset	2	**6**	3
		46,532	40,053
Current assets:			
Derivative financial instruments		**1,664**	2,260
Other assets		**1,040**	304
Amounts due from subsidiaries	3	**217**	1,446
Cash and cash equivalents		**375**	2,837
Current tax recoverable		**109**	72
		3,405	6,919
Total assets		**49,937**	46,972
Equity and liabilities			
Capital and reserves:			
Share capital	4	**6,815**	10,472
Share premium account	4	**16,291**	14,472
Merger reserve	5	**7,764**	7,778
Capital redemption reserve	5	**4,115**	26
Retained profits	6	**2,276**	2,547
Total equity		**37,261**	35,295
Non-current liabilities:			
Subordinated liabilities	7	**4,074**	4,205
Current liabilities:			
Debt securities in issue	8	**549**	326
Other liabilities		**8,053**	7,146
		8,602	7,472
Total liabilities		**12,676**	11,677
Total equity and liabilities		**49,937**	46,972

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

The directors approved the parent company financial statements on 24 February 2011.

Sir Winfried Bischoff
Chairman

J Eric Daniels
Group Chief Executive

Tim J W Tookey
Group Finance Director

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

at 31 December 2010

	Share capital and premium £ million	Merger reserve £ million	Capital redemption reserve £ million	Retained profits[1] £ million	Total £ million
Balance at 1 January 2009	3,609	–	–	2,147	5,756
Total comprehensive income[1]	–	–	–	303	303
Issue of ordinary shares:					
Placing and open offer	649	3,781	–	–	4,430
Issued on acquisition of HBOS	1,944	5,707		–	7,651
Placing and compensatory open offer	3,905	–	–	–	3,905
Rights issue	13,112	–	–	–	13,112
Issued to Lloyds TSB Foundations	41	–	–	–	41
Transfer to merger reserve	(1,000)	1,000	–	–	–
Redemption of preference shares	2,684	(2,710)	26	–	–
Purchase/sale of treasury shares	–	–	–	23	23
Employee share option schemes:					
Value of employee services	–	–	–	74	74
Balance at 31 December 2009	24,944	7,778	26	2,547	35,295
Total comprehensive income[1]	**–**	**–**	**–**	**(799)**	**(799)**
Issue of ordinary shares	**2,237**	**–**	**–**	**–**	**2,237**
Cancellation of deferred shares	**(4,086)**	**–**	**4,086**	**–**	**–**
Redemption of preference shares	**11**	**(14)**	**3**	**–**	**–**
Purchase/sale of treasury shares	**–**	**–**	**–**	**399**	**399**
Employee share option schemes:					
Value of employee services	**–**	**–**	**–**	**129**	**129**
Balance at 31 December 2010	**23,106**	**7,764**	**4,115**	**2,276**	**37,261**

[1]Total comprehensive income comprises only the profit (loss) for the year; no income statement has been shown for the parent company, as permitted by section 408 of the Companies Act 2006.

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PARENT COMPANY CASH FLOW STATEMENT

at 31 December 2010

	2010 £ million	2009 £ million
(Loss) profit before tax	**(961)**	182
Dividend income	**–**	(354)
Fair value and exchange adjustments	**198**	(428)
Change in other assets	**1,021**	(1,277)
Change in other liabilities and other items	**(2,466)**	7,020
Tax received (paid)	**122**	(70)
Net cash (used in) provided by operating activities	**(2,086)**	5,073
Cash flows from investing activities		
Costs incurred in respect of the acquisition of HBOS plc	**–**	(138)
Additional capital injection into HBOS plc	**–**	(8,500)
Additional capital injection into Lloyds TSB Bank plc	**–**	(5,600)
Amounts advanced to subsidiaries	**(1,425)**	(7,593)
Redemption of loans to subsidiaries	**850**	1,552
Net cash used in investing activities	**(575)**	(20,279)
Cash flows from financing activities		
Dividends received from subsidiaries	**–**	354
Proceeds from issue of debt securities	**549**	–
Repayment of debt securities in issue	**(350)**	(2,045)
Proceeds from issue of subordinated liabilities	**–**	1,000
Repayment of subordinated liabilities	**–**	(4,000)
Proceeds from issue of ordinary shares	**–**	21,533
Net cash provided by financing activities	**199**	16,842
Change in cash and cash equivalents	**(2,462)**	1,636
Cash and cash equivalents at beginning of year	**2,837**	1,201
Cash and cash equivalents at end of year	**375**	2,837

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

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

The Company has applied International Financial Reporting Standards as adopted by the European Union in its financial statements for the year ended 31 December 2010. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 Financial Instruments: Recognition and Measurement relaxes some of the hedge accounting requirements; the Company has not taken advantage of this relaxation, and therefore there is no difference in application to the Company between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of all derivative contracts.

The accounting policies of the Company are the same as those of the Group which are set out in note 2 to the consolidated financial statements, except that it has no policy in respect of consolidation and investments in subsidiaries are carried at historical cost, less any provisions for impairment.

2 DEFERRED TAX ASSET

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

	2010 £m	2009 £m
At 1 January	3	–
Income statement credit	3	3
At 31 December	6	3

The deferred tax asset relates to temporary differences.

3 AMOUNTS DUE FROM SUBSIDIARIES

These comprise short-term lending to subsidiaries, repayable on demand. The fair values of amounts owed by subsidiaries are equal to their carrying amounts. No provisions have been recognised in respect of amounts owed by subsidiaries.

4 SHARE CAPITAL AND SHARE PREMIUM

Details of the Company's share capital and share premium account are as set out in notes 47 and 48 to the consolidated financial statements.

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5 OTHER RESERVES

The merger reserve comprises the premium on shares issued on 13 January 2009 under the placing and open offer and shares issued on 16 January 2009 on the acquisition of HBOS plc.

The capital redemption reserve represents transfers from the merger reserve in accordance with companies' legislation and amounts transferred from share capital following the cancellation of the deferred shares.

Movements in other reserves were as follows:

	2010 £m	2009 £m
Merger reserve		
At 1 January	**7,778**	–
Placing and open offer	**–**	3,781
Shares issued on acquisition of HBOS	**–**	5,707
Issue of preference shares[1]	**–**	1,000
Redemption of preference shares[2]	**(14)**	(2,710)
At 31 December	**7,764**	7,778

	2010 £m	2009 £m
Capital redemption reserve		
At 1 January	**26**	–
Redemption of preference shares[2]	**3**	26
Cancellation of deferred shares	**4,086**	–
At 31 December	**4,115**	26

[1] Distributable reserves of £1,000 million arose on the issue of preference shares in January 2009 which were classified as debt. In June 2009, these preference shares were redeemed out of the proceeds of the placing and compensatory open offer of ordinary shares and the distributable element of this issue was transferred to the merger reserve.

[2] In January 2010, the Company repurchased and cancelled certain preference shares amounting to £14 million. This resulted in a transfer of £3 million from the merger reserve to the capital redemption reserve and a transfer of £11 million from the merger reserve to the share premium account. Details of the preference shares redeemed are set out in note 46 to the consolidated financial statements. In December 2009, the Group redeemed eight issues of preference shares in exchange for the issuance of enhanced capital notes. This resulted in a transfer of £26 million from the merger reserve to the capital redemption reserve and a transfer of £2,684 million from the merger reserve to the share premium account.

6 RETAINED PROFITS

	£m
At 1 January 2009	2,147
Profit for the year	303
Purchase/sale of treasury shares	23
Employee share option schemes: value of employee services	74
At 31 December 2009	2,547
Loss for the year	**(799)**
Purchase/sale of treasury shares	**399**
Employee share option schemes: value of employee services	**129**
At 31 December 2010	**2,276**

Details of the Company's dividends are as set out in note 51 to the consolidated financial statements.

7 SUBORDINATED LIABILITIES

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer. Any repayments of subordinated liabilities require the consent of the Financial Services Authority.

	Note	2010 £m	2009 £m
Preference shares			
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a	**279**	327
7.875% Non-Cumulative Preference Shares (€500 million)	a	**57**	115
7.875% Non-Cumulative Preference Shares (US$1,250 million)	a	**119**	236
9 1/4% Non-Cumulative Irredeemable Preference Shares (£300 million)	a	**239**	216
9 3/4% Non-Cumulative Irredeemable Preference Shares (£100 million)	a	**49**	79
6.475% Non-Cumulative Preference Shares (£186 million)	a	**34**	45
6.0884% Non-Cumulative Fixed to Floating Rate Preference Shares (£745 million)	a	**9**	10
6.3673% Non-Cumulative Fixed to Floating Rate Preference Shares (£335 million)	a	**2**	2
6.413% preference shares (US$750 million)	a	**98**	82
5.92% preference shares (US$750 million)	a	**110**	167
6.657% preference shares (US$750 million)	a	**115**	97
6% Non-Cumulative Redeemable Preference Shares	a	**–**	–
Total preference shares		**1,111**	1,376
Undated subordinated liabilities			
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	b	**11**	117
6.475% Undated Subordinated Notes callable 2024 (£102 million)		**80**	72
6.0884% Undated Subordinated Notes callable 2015 (£732 million)		**578**	520
6.3673% Undated Subordinated Notes callable 2019 (£331 million)		**266**	234
6.369% Undated Subordinated Notes callable 2015 (£597 million)		**480**	420
6.413% Undated Subordinated Notes callable 2035 (US$375 million)		**155**	133
5.92% Undated Subordinated Notes callable 2015 (US$378 million)		**164**	135
6.657% Undated Subordinated Notes callable 2037 (US$316 million)		**130**	112
6.267% Undated Subordinated Notes callable 2016 (US$466 million)		**198**	166
Total undated subordinated liabilities		**2,062**	1,909
Dated subordinated liabilities			
9 1/8% Subordinated Bonds 2011 (£150 million)		**152**	152
5 7/8% Subordinated Guaranteed Bonds 2014 (€750 million)		**749**	768
Total dated subordinated liabilities		**901**	920
Total subordinated liabilities		**4,074**	4,205

a Further information regarding these issues can be found in note 46 to the consolidated financial statements.

b In certain circumstances, these bonds would acquire the characteristics of preference share capital. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of the 6 per cent non-cumulative redeemable preference shares. At the callable date the coupon on these bonds will be reset by reference to the applicable five year benchmark gilt rate. Further information regarding this can be found in note 46 to the consolidated financial statements.

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8 DEBT SECURITIES IN ISSUE

These comprise US$862.5 million 7.75% Public Income Notes due 2050 issued by the Company in July 2010. The debt securities in issue in 2009 comprised US$528 million Thirteen-Month Extendible Short-Term Notes issued by the Company in July 2008.

9 RELATED PARTY TRANSACTIONS

In January 2009 HM Treasury became a related party of the Company and has remained so during 2010. Further information on the relationship and transactions with HM Treasury is given in note 53 to the consolidated financial statements.

KEY MANAGEMENT PERSONNEL

The key management personnel of the Group and the Company are the same. The relevant disclosures are given in note 53 to the consolidated financial statements.

The Company has no employees (2009: nil).

As discussed in note 52 to the consolidated financial statements, the Group provides share-based compensation to employees through a number of schemes; these are all in relation to shares in the Company and the cost of providing those benefits is recharged to the employing companies in the Group on a cash basis.

INVESTMENT IN SUBSIDIARIES

	2010 £m	2009 £m
At 1 January	**32,584**	5,589
Investment in HBOS plc:		
Acquisition of ordinary share capital	**–**	7,787
Purchase of preference share capital	**–**	3,917
Additional capital injections	**–**	9,691
	–	21,395
Capital injections into Lloyds TSB Bank plc	**27,005**	5,600
Transfer of HBOS to Lloyds TSB Bank plc	**(21,395)**	–
Total investment in subsidiaries	**38,194**	32,584

As part of a reorganisation of the Lloyds Banking Group on 1 January 2010, the Company transferred its direct investment in 100 per cent of the issued ordinary share capital of HBOS plc to its subsidiary, Lloyds TSB Bank plc. The consideration for this transfer was the issue of 21.4 million shares by Lloyds TSB Bank plc to the Company for a total value of £21,395 million.

The principal subsidiaries, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds Banking Group plc, are:

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

[1] Indirect interest.

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

9 RELATED PARTY TRANSACTIONS continued

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

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

Loans to subsidiaries

	2010 £m	2009 £m
At 1 January	**7,466**	3,009
Exchange and other adjustments	**291**	(395)
Amounts advanced	**1,425**	6,404
Redemptions	**(850)**	(1,552)
At 31 December	**8,332**	7,466

In addition the Company carried out banking activities through its subsidiary, Lloyds TSB Bank plc. At 31 December 2010, the Company held deposits of £375 million with Lloyds TSB Bank plc (2009: £2,837 million). Given the volume of transactions flowing through the account, it is not meaningful to provide gross inflow and outflow information. Included within subordinated liabilities is £2,073 million (2009: £1,899 million) and within other liabilities is £7,988 million (2009: £6,999 million) due to subsidiary undertakings. In addition, at 31 December 2010 the Company had interest rate and currency swaps with Lloyds TSB Bank plc with an aggregate notional principal amount of £2,504 million and a net positive fair value of £1,664 million (2009: notional principal amount of £11,373 million and a net positive fair value of £2,260 million), of which contracts with an aggregate notional principal amount of £1,754 million and a net positive fair value of £330 million (2009: notional principal amount of £1,460 million and a net positive fair value of £343 million) were designated as fair value hedges to manage the Company's issuance of subordinated liabilities and debt securities in issue.

Related party information in respect of other related party transactions is given in note 53 to the consolidated financial statements.

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10 FINANCIAL INSTRUMENTS

MEASUREMENT BASIS OF FINANCIAL ASSETS AND LIABILITIES

The accounting policies in note 2 to the consolidated financial statements describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the Company's financial assets and liabilities by category and by balance sheet heading.

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Held for trading at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2010					
Financial assets:					
Cash and cash equivalents	**–**	**–**	**–**	**375**	**375**
Derivative financial instruments	**330**	**1,334**	**–**	**–**	**1,664**
Loans to subsidiaries	**–**	**–**	**8,332**	**–**	**8,332**
Amounts due from subsidiaries	**–**	**–**	**217**	**–**	**217**
Total financial assets	**330**	**1,334**	**8,549**	**375**	**10,588**
Financial liabilities:					
Debt securities in issue	**–**	**–**	**–**	**549**	**549**
Subordinated liabilities	**–**	**–**	**–**	**4,074**	**4,074**
Total financial liabilities	**–**	**–**	**–**	**4,623**	**4,623**
As at 31 December 2009					
Financial assets:					
Cash and cash equivalents	–	–	–	2,837	2,837
Derivative financial instruments	343	1,917	–	–	2,260
Loans to subsidiaries	–	–	7,466	–	7,466
Amounts due from subsidiaries	–	–	1,446	–	1,446
Total financial assets	343	1,917	8,912	2,837	14,009
Financial liabilities:					
Debt securities in issue	–	–	–	326	326
Subordinated liabilities	–	–	–	4,205	4,205
Total financial liabilities	–	–	–	4,531	4,531

Note 55 to the consolidated financial statements outlines the valuation hierarchy into which financial instruments measured at fair value are categorised.

The derivative assets designated as hedging instruments represent level 2 portfolios. Of derivative assets classified as held for trading (not being designated as hedging instruments) shown above, £157 million (31 December 2009: £120 million) represents level 2 portfolios and £1,177 million (31 December 2009: £1,797 million) represents level 3 portfolios. The level 3 derivatives reflect the value of the equity conversion feature of the Enhanced Capital Notes issued in December 2009 as part of Lloyds Banking Group's recapitalisation and exit from the Government Asset Protection Scheme.

The following reconciliation shows the movements in derivative financial instrument assets within level 3 portfolios:

	Total £m
As at 31 December 2009	1,797
Losses recognised in the income statement	**(620)**
As at 31 December 2010	**1,177**

10 FINANCIAL INSTRUMENTS continued

INTEREST RATE RISK AND CURRENCY RISK

The Company is exposed to interest rate risk and currency risk on its debt securities in issue and its subordinated debt.

As discussed in note 9, the Company has entered into interest rate and currency swaps with its subsidiary, Lloyds TSB Bank plc, to manage these risks.

CREDIT RISK

The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiary, Lloyds TSB Bank plc, and subsidiaries of this company.

LIQUIDITY RISK

The table below analyses financial instrument liabilities of the Company, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2010						
Debt securities in issue	**11**	**–**	**32**	**728**	**–**	**771**
Subordinated liabilities	**–**	**–**	**202**	**4,024**	**2,380**	**6,606**
Total financial instrument liabilities	**11**	**–**	**234**	**4,752**	**2,380**	**7,377**
As at 31 December 2009						
Debt securities in issue	–	326	–	–	–	326
Subordinated liabilities	–	878	53	2,316	4,323	7,570
Total financial instrument liabilities	–	1,204	53	2,316	4,323	7,896

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £302 million (2009: £282 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The valuation techniques for the Company's financial instruments are as discussed in note 55 to the consolidated financial statements.

	Carrying value 2010 £m	Carrying value 2009 £m	Fair value 2010 £m	Fair value 2009 £m
Financial assets:				
Cash and cash equivalents	**375**	2,837	**375**	2,837
Derivative financial instruments	**1,664**	2,260	**1,664**	2,260
Loans to subsidiaries	**8,332**	7,466	**8,713**	7,816
Amounts due from subsidiaries	**217**	1,446	**217**	1,446
Financial liabilities:				
Debt securities in issue	**549**	326	**549**	326
Subordinated liabilities	**4,074**	4,205	**4,207**	3,995

11 POST BALANCE SHEET EVENTS

Details of the Company's post balance sheet events are set out in note 59 to the consolidated financial statements.

12 APPROVAL OF THE FINANCIAL STATEMENTS AND OTHER INFORMATION

The parent company financial statements were approved by the directors of Lloyds Banking Group plc on 24 February 2011.

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.

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SHAREHOLDER INFORMATION

At 31 December 2010	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 99	155,943	5.54	6.0	0.01
100 – 499	1,660,508	59.30	379.1	0.56
500 – 999	457,334	16.36	315.3	0.46
1,000 – 4,999	409,324	14.66	834.6	1.23
5,000 – 9,999	55,587	2.00	388.1	0.58
10,000 – 49,999	51,828	1.86	1,022.2	1.52
50,000 – 99,999	4,312	0.15	289.5	0.43
100,000 – 999,999	2,373	0.09	583.3	0.88
1,000,000 and over	1,108	0.04	64,256.0	94.33
	2,798,317	100.00	68,074.1	100.00

SUBSTANTIAL SHAREHOLDINGS

At the date of this report a notification had been received that The Solicitor for the Affairs of Her Majesty's Treasury had a direct interest of 40.56 per cent in the issued share capital with rights to vote in all circumstances at general meetings. No other notification has been received that anyone has an interest of 3 per cent or more in the issued ordinary share capital.

SHARE PRICE INFORMATION

In addition to listings in the financial pages of the press, the latest price of Lloyds Banking Group shares on the London Stock Exchange can be obtained by telephoning 09058 890 190.
Visit www.londonstockexchange.com for details.

SHARE DEALING FACILITIES

Lloyds Banking Group offers shareholders a choice of two dealing services:

Lloyds TSB Share Dealing

– Internet dealing. Visit www.lloydstsbsharedealing.com

– Telephone dealing. Call 0845 60 60 560

Internet services are available 24/7 and telephone services are available between 8.00am and 6.00pm, Monday to Friday. Details of any dealing costs are available when you log on to the share dealing website or when you call the above number. To open a Lloyds TSB Share Dealing Account you must be 18 years of age or over and be resident in the UK. You can apply online or by post.

Halifax Share Dealing

– Internet dealing. Visit www.halifaxsharedealing.co.uk

– Telephone dealing. Call 08457 22 55 25

Internet services are available 24/7 and telephone dealing services are available between 8.00am and 9.15pm, Monday to Friday, and 9.00am to 1pm, Saturday. To open a Halifax Share Dealing Account you must be 18 years of age or over and be resident in the UK, Jersey, Guernsey or the Isle of Man.

Shareholders in the Lloyds Banking Group Shareholder Account can only trade by telephone through the Halifax Share Dealing Service on 08705 711 117.

INDIVIDUAL SAVINGS ACCOUNTS (ISAS)

The Company provides a number of options for investing in Lloyds Banking Group shares through an ISA. For details contact: Lloyds TSB Share Dealing, Halifax Share Dealing or Equiniti Limited.

AMERICAN DEPOSITARY RECEIPTS (ADRs)

Lloyds Banking Group shares are traded in the USA through an NYSE-listed sponsored ADR facility, with The Bank of New York Mellon as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4.

For details contact: The Bank of New York Mellon Shareowner Services, PO Box 358516, Pittsburgh, Pennsylvania 15252-8516.
Telephone: 1-866-259-0336 (US toll free), international callers: +1 201-680-6825. Alternatively visit www.adrbnymellon.com or email shrrelations@bnymellon.com

CORPORATE RESPONSIBILITY

A copy of the Group's corporate responsibility report may be obtained by writing to Corporate Responsibility, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN. This information together with the Group's code of business conduct is also available on the Group's website www.lloydsbankinggroup.com

SHAREHOLDER ENQUIRIES

The Company's share register and the Lloyds Banking Group Shareholder Account are maintained by Equiniti Limited. Contact them if you have enquiries about your Lloyds Banking Group shareholding, including those concerning the following matters:

– Change of name or address

– Loss of share certificate

– Dividend information, including loss of dividend warrant or tax voucher.

Contact details for Equiniti Limited can be found on the back cover.

Equiniti operates a web based enquiry and portfolio management service for you to receive shareholder communications electronically. You can change your address or bank details either by telephone or online. Additionally you can register proxy appointments and voting instructions on your shareholding online. Visit www.shareview.co.uk for details.

ANNUAL GENERAL MEETING

The annual general meeting will be held at 11.00am on Wednesday 18 May 2011 in Hall 5 at the Scottish Exhibition and Conference Centre in Glasgow.

Calls to 09058 and 0871 numbers are charged at 55p and 8p per minute, respectively, from a BT landline. The price of calls from mobiles and other networks may vary. Calls from outside the United Kingdom are charged at applicable international rates. The call prices we have quoted were correct in February 2011.

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GLOSSARY

Asset-Backed Securities (ABS)	Asset-backed securities are securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages but could also include leases, credit card receivables, motor vehicles, student loans. Further information on the Group's investments in ABS is given in note 56.
Alt-A	Alt-A are mortgage loans regarded as lower risk than sub-prime, but they share higher risk characteristics than lending under normal criteria. Further information on the Group's exposure to Alt-A investments is given in note 56.
Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Such a customer is also said to be in a state of delinquency. When a customer is in arrears, the entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue.
Asset-backed commercial paper	See **Commercial Paper**
Basel II	The capital adequacy framework issued by the Basel Committee on Banking Supervision in June 2006 in the form of the 'International Convergence of Capital Measurement and Capital Standards'.
Basel III	The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 and due to be phased in from 1 January 2013 onwards.
Basis point	One hundredth of a per cent (0.01 per cent). 100 basis points is 1 per cent. Used in quoting movements in interest rates or yields on securities.
Collateralised Debt Obligation (CDO)	A security issued by a third party which references ABSs or other assets purchased by the issuer. Lloyds Banking Group has invested in instruments issued by other banking groups, including Collateralised Loan Obligations and Commercial Real Estate CDOs. Details of these investments are given in note 56.
Collateralised Loan Obligation (CLO)	A security backed by the repayments from a pool of commercial loans. CLOs are usually structured products with different tranches whereby senior classes of holder receive repayment before other tranches are repaid.
Collectively assessed loan impairment provision	A provision established following an impairment assessment on a collective basis for homogeneous groups of loans, such as credit card receivables and personal loans, that are not considered individually significant and for loan losses that have been incurred but not separately identified at the balance sheet date.
Commercial Mortgage-Backed Securities	Commercial Mortgage-Backed Securities are securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from mortgage repayments of interest and principal. Further information on the Group's investment in CMBS is given in note 56.
Commercial Paper	Commercial paper is an unsecured promissory note issued to finance short-term credit needs. It specifies the face amount paid to investors on the maturity date. Commercial Paper can be issued as an unsecured obligation of the Group or, for example when issued by the Group's conduits, as an asset-backed obligation. (in such case it is referred to as **asset-backed commercial paper**). Commercial Paper is usually issued for periods from as little as a week up to nine months.
Commercial Real Estate	Commercial real estate includes office buildings, industrial property, medical centres, hotels, malls, retail stores, shopping centres, farm land, multifamily housing buildings, warehouses, garages, and industrial properties.
Conduits	A financial vehicle that holds asset-backed securities which are financed with short-term deposits (generally commercial paper) that use the asset-backed securities as collateral. The conduit will often have a liquidity line provided by a bank that it can draw down on in the event that it is unable to issue funding to the market. The Group sponsors four asset-backed conduits, Argento, Cancara, Grampian and Landale. Further details are provided in note 23.
Contractual maturities	Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.
Core Tier 1 capital	As defined by the FSA mainly comprising shareholders' equity and equity non-controlling interests after deducting goodwill, other intangible assets and other regulatory deductions. Further details are given in the Capital Risk section on page 97.
Core Tier 1 ratio	Core Tier 1 capital as a percentage of risk weighted assets.
Cost:Income ratio	Operating expenses compared to total income net of insurance claims. The Group calculates this ratio using the 'reported basis' which is the basis on which financial information is reported internally to management.
Coverage ratio	Impairment provisions as a percentage of impaired loans.
Covered mortgage bonds	A bond backed by a pool of mortgage loans. The mortgages remain on the issuer's balance sheet. The issuing bank can change the make-up of the loan pool or the terms of the loans to preserve credit quality. Covered bonds thus have a higher risk weighting than mortgage-backed securities because the holder is exposed to both the non-payment of the mortgages and the financial health of the issuer. The Group issues covered bonds as part of its funding activities. Further details are provided in note 22.

GLOSSARY

Credit Default Swap	A credit default swap is also referred to as a credit derivative. It is an arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency.
Credit derivatives	A credit derivative is a financial instrument that derives its value from the credit rating of an underlying instrument carrying the credit risk of the issuing entity. The principal type of credit derivatives are credit default swaps, which are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. The Group also uses credit default swaps to securitise corporate and commercial banking loans in combination with external funding.
Credit risk spread (or credit spread)	The credit spread is the yield spread between securities with the same currency and maturity structure but with different associated credit risks, with the yield spread rising as the credit rating worsens. It is the premium over the benchmark or risk-free rate required by the market to take on a lower credit quality.
Credit valuation adjustments	These are adjustments to the fair values of derivative assets to reflect the creditworthiness of the counterparty. Further details are given in note 55.
Customer deposits	Money deposited by account holders. Such funds are recorded as liabilities of the Group. The Group includes certain **repos** within customer deposits.
Debt restructuring	This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as reducing the debt or interest charged on the loan.
Debt securities	Debt securities are assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.
Debt securities in issue	These are unsubordinated debt securities issued by the Group. They include commercial paper, certificates of deposit, bonds and medium-term notes.
Delinquency	See Arrears.
Embedded equity conversion feature	An embedded equity conversion feature is a derivative contained within the terms and conditions of a debt instrument that enables or requires the instrument to be converted into equity under a particular set of circumstances. The Group's enhanced capital notes (ECNs) contain such a feature whereby these notes convert to ordinary shares in the event that the consolidated Core Tier 1 ratio of the Group falls below 5 per cent.
Enhanced Capital Notes (ECNs)	The Group's ECN's are subordinated notes issued by the Group that contain an embedded equity conversion feature. Further details of these are given in note 46.
Expected loss	This is the amount of loss that can be expected by the Group calculated in accordance with FSA rules. In broad terms it is calculated by multiplying the Default Frequency by the Loss Given Default by the Exposure at Default.
Exposure at Default	An estimate of the amount expected to be owed by a customer at the time of the customer's default.
Fair value adjustment	Fair value adjustments arise on acquisition when assets and liabilities are acquired at fair values that are different from the carrying values in the acquired company. In respect of the Group's acquisition of HBOS the principal adjustments were write-downs in respect of loans and advances to customers and debt issued.
First/Second Lien	A first lien gives the holder (usually the bank lending the funds) the first right to collect compensation from the sale of the underlying collateral in the event of a default on the loan. A second lien may be issued against the same collateral but in the case of default, compensation for this debt will only be received after the first lien has been repaid.
Full time equivalent	A full time employee is one that works a standard five day week. The hours or days worked by part time employees are measured against this standard and accumulated along with the number of full time employees and counted as full time equivalents. This is a more consistent measure of the amount of time worked than employee numbers which will fluctuate as the mix of part-time and full-time employees changes.
Funded/unfunded exposures	Exposures where the notional amount of the transaction is either funded or unfunded.
Guaranteed mortgages	Mortgages for which there is a guarantor to provide the lender a certain level of financial security in the event of default of the borrower.
Home Loans	A loan to purchase a residential property which is then used as collateral to guarantee repayment of the loan. The borrower gives the lender a **lien** against the property, and the lender can foreclose on the property if the borrower does not repay the loan per the agreed terms.

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Impaired loans	Impaired loans are loans where the Group does not expect to collect all the contractual cash flows or to collect them when they are contractually due.
Impairment allowances	Impairment allowances are a provision held on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. An impairment allowance may either be individual or collective.
Impairment losses	An impairment loss is the reduction in value that arises following an impairment review of an asset that determines that the asset's value is lower than it's carrying value. For impaired financial assets measured at amortised cost, impairment losses are the difference between the carrying value and the present value of estimated future cash flows, discounted at the asset's original effective interest rate. Impairment losses can be difficult to assess and the critical accounting estimates and judgements in note 3 detail the key assessments made when determining impairment losses.
Individually/Collectively Assessed	Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.
Individually assessed loan impairment provisions	Impairment loss provisions for individually significant impaired loans are assessed on a case-by-case basis, taking into account the financial condition of the counterparty, any guarantor and the realisable value of any collateral held.
Investment grade	This refers to the highest range of credit ratings, from 'AAA' to 'BBB' as measured by external credit rating agencies.
Liquidity and Credit enhancements	Credit enhancement facilities are used to enhance the creditworthiness of financial obligations and cover losses due to asset default. Two general types of credit enhancement are third-party loan guarantees (such as **guaranteed mortgages**) and self-enhancement through overcollateralisation (in the case of **covered bonds**). Liquidity enhancement makes funds available if required, for other reasons than asset default, eg to ensure timely repayment of maturing commercial paper.
Loan to deposit ratio	The ratio of loans and advances to customers net of allowance for impairment losses and excluding reverse repurchase agreements divided by customer deposits excluding repurchase agreements.
Loan-to-value ratio (LTV)	The loan-to-value ratio is a mathematical calculation which expresses the amount of a mortgage balance outstanding as a percentage of the total appraised value of the property. A high LTV indicates that there is less value to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance of the loan.
Loans past due	Loans are past due when a counterparty has failed to make a payment when contractually due.
Loss given default (LGD)	The estimated loss that will arise if a customer defaults. It is calculated after taking account of credit risk mitigation and includes the cost of recovery.
Monolines	A monoline insurer is defined as an entity which specialises in providing credit protection to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically provided in the form of derivatives such as **credit default swaps** referencing the underlying exposures held.
Mortgage-backed securities	See Residential and Commercial mortgage-backed securities.
Mortgage related assets	Assets which are referenced to underlying mortgages.
Mortgage vintage	The year the mortgage was issued.
Medium Term Notes	Medium term notes are a form of corporate borrowing covering maturity periods ranging from nine months to 30 years. Details of the notes issued under the Group's medium term notes programmes are given in note 37.
Negative basis bonds	**ABS** held with a separately purchased matching **credit default swaps** to protect against the risk of default of the security. The Group refers to ABS without the benefit of CDS protection as **Uncovered ABS**. Details of the Group's exposure to negative basis bonds is given in note 56.
Negative Equity Mortgages	Negative equity occurs when the value of the property purchased using the mortgage is below the balance outstanding on the loan. Negative equity is the value of the asset less the outstanding balance on the loan.
Net Interest Income	The difference between interest received on assets and interest paid on liabilities.
Net interest margin	Net interest margin is net interest income as a percentage of average interest-earning assets. Details of the Group's banking net interest margin are given on page 54.
Over the counter derivatives	Over the counter derivatives are derivatives for which the terms and conditions can be freely negotiated by the counterparties involved, unlike exchange traded derivatives which have standardised terms.
Prime	Prime mortgages are those granted to the most creditworthy category of borrower.

GLOSSARY

Private equity investments	Private equity is equity securities in operating companies not quoted on a public exchange. Investment in private equity often involves the investment of capital in private companies or the acquisition of a public company that results in the delisting of public equity. Capital for private equity investment is raised by retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.
Private equity investments	Private equity is equity securities in operating companies not quoted on a public exchange. Investment in private equity often involves the investment of capital in private companies or the acquisition of a public company that results in the delisting of public equity. Capital for private equity investment is raised by retail or institutional investors and used to fund investment strategies such as leveraged buyouts, venture capital, growth capital, distressed investments and mezzanine capital.
Probability of default	The likelihood that a customer will default on their obligation within the next year.
Renegotiated loans	Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower. In the latter case renegotiation can result in an extension of the due date of payment or repayment plans under which the Group offers a concessionary rate of interest to genuinely distressed borrowers. This will result in the asset continuing to be overdue and will be impaired where the renegotiated payments of interest and principal will not recover the original carrying amount of the asset. In other cases, renegotiation will lead to a new agreement, which is treated as a new loan.
Repurchase agreements or 'repos'	Short-term funding agreements which allow a borrower to sell a financial asset, such as ABS or Government bonds as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan.
Retail Loans	Money loaned to individuals rather than institutions. These include both secured and unsecured loans such as mortgages and credit card balances.
Residential Mortgaged-Backed Securities (RMBS)	Residential Mortgage-Backed Securities are a category of **ABS**. They are securities that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Risk-weighted assets	A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with the Basel Capital Accord as implemented by the FSA.
Securitisation	Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. Securitisation is the process by which ABS are created. A company sells assets to an special purpose entity which then issues securities backed by the assets. This allows the credit quality of the assets to be separated from the credit rating of the original company and transfers risk to external investors. Assets used in securitisations include mortgages to create mortgage-backed securities or residential mortgage-backed securities (RMBS) as well as commercial mortgage-backed securities. The Group has established several securitisation structures as part of its funding and capital management activities. These generally use mortgages, corporate loans and credit cards as asset pools. A listing of these programmes with the amounts secured and associated funding raised is given in note 22.
Special Purpose Entities (SPEs)	SPEs are entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Group uses a number of SPEs, including those set-up under **securitisation** programmes, and as **conduits**. Where the Group has control of these entities or retains the risks and rewards relating to them they are consolidated within the Group's results.
Student loan related assets	Assets which are referenced to underlying student loans. (See note 56).
Sub-investment grade	This refers to credit ratings issued by external credit rating agencies that are below 'BBB' grade or its equivalent.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer. Details of the Group's subordinated liabilities are set out in note 46.
Sub-Prime	Sub-prime is defined as loans to borrowers typically having weakened credit histories that include payment delinquencies and potentially more severe problems such as court judgements and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, high debt-to-income ratios, or other criteria indicating heightened risk of default.
Synthetic CDO	A security that it similar in structure to a CDO whereby the pool of referenced assets is created synthetically usually by credit default swaps.
Tier 1 capital	A measure of a bank's financial strength defined by the FSA. It captures Core Tier 1 capital plus other Tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies. Further details are given in the Capital Risk section on page 97.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk-weighted assets.

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Tier 2 capital	A component of regulatory capital defined by the FSA, mainly comprising qualifying subordinated loan capital, certain non-controlling interests and eligible collective impairment allowances. Further details are given in the Capital Risk section on page 97.
Uncovered ABS	ABS held without the benefit of separately purchased matching credit default swaps to protect against the risk of default of the security. Details of the Group's uncovered ABS are given in note 56.
Value at Risk	Value at Risk is an estimate of the potential loss in earnings which might arise from market movements under normal market conditions, if the current positions were to be held unchanged for one business day, measured to a confidence level of 95 per cent.
Wrapped loans and bonds	If a loan or bond (usually an **ABS** security) is originally issued with a credit default swap already attached, the package is called a 'wrapped bond' or 'wrapped loan'. The Group's exposure to wrapped loans and bonds is set out in note 56.
Write Downs	The depreciation or lowering of the value of an asset in the books to reflect a decline in their value, or expected cash flows.

ABBREVIATIONS

ABS	Asset-Backed Securities
ADRs	American Depositary Receipts
BHF	British Heart Foundation
BOSI	Bank of Scotland (Ireland) Limited
BSU	Business Support Unit
CAGR	Compound Annual Growth Rate
CDO	Collateralised Debt Obligation
CDS	Credit Default Swap
CRR	Capital Resources Requirement
CVA	Credit Valuation Adjustment
ECNs	Enhanced Capital Notes
EEV	European Embedded Value
EPS	Earnings Per Share
EU	European Union
FSA	Financial Services Authority
FOS	Financial Ombudsman
GAPS	Government Asset Protection Scheme
HMRC	Her Majesty's Revenue & Customs
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICB	Independent Commission on Banking
ICG	Individual Capital Guidance
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
ISA	Individual Savings Account
LCR	Liquidity Coverage Ratio
LIBOR	London Inter-Bank Offered Rate
LTIP	Long Term Incentive Plan
LTV	Loan-to-value
NSFR	Net Stable Funding Ratio
OEICs	Open Ended Investment Companies
OFAC	Office of Foreign Assets Control
OFT	Office of Fair Trading
PFI	Private Finance Initiative
PPI	Payment Protection Insurance
PPP	Public Private Partnerships
PVNBP	Present Value of New Business Premiums
SAYE	Save-As-You-Earn
SME's	Small and Medium sized enterprises
SPE	Special Purpose Entity
SWIP	Scottish Widows Investment Partnership
TSR	Total Shareholder Return
UK	United Kingdom of Great Britain and Northern Ireland
UKFI	United Kingdom Financial Investment Limited
US	United States of America
VaR	Value-at-Risk
VAT	Value Added Tax

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Executive producer Lora Starling
Front cover photography – Carol Walker/www.naturepl.com
Directors' portraits – Marcus Ginns

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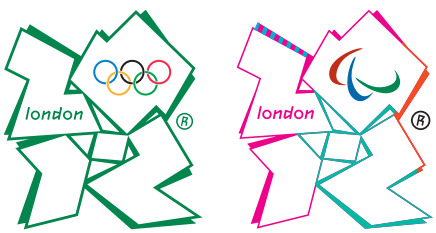
HEAD OFFICE
25 Gresham Street
London EC2V 7HN
Telephone +44 (0)20 7626 1500

REGISTERED OFFICE
The Mound
Edinburgh EH1 1YZ
Registered in Scotland no 95000

INTERNET
www.lloydsbankinggroup.com

REGISTRAR
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA
Telephone 0871 384 2990
Textphone 0871 384 2255
Overseas +44 (0)121 415 7066
www.equiniti.com



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