Lloyds Banking Group plc
Form 20-F
March 08, 2016

As filed with the Securities and Exchange Commission on 8 March 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

OR

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

For the fiscal year ended 31 December 2015

OR

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

OR

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

Commission file number 001-15246

LLOYDS BANKING GROUP plc

(previously Lloyds TSB Group plc)

(Exact name of Registrant as Specified in Its Charter)

Scotland

(Jurisdiction of Incorporation or Organization)

25 Gresham Street
London EC2V 7HN
United Kingdom

(Address of Principal Executive Offices)

Malcolm Wood, Company Secretary
Tel +44 (0) 20 7356 1274, Fax +44 (0) 20 7356 1808
25 Gresham Street
London EC2V 7HN
United Kingdom

(Name, telephone, e-mail and/or facsimile number and address of Company contact person)

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

Title of each class	**Name of each exchange on which registered**
Ordinary shares of nominal value 10 pence each, represented by American Depositary Shares	The New York Stock Exchange
$1,250,000,000 3.5% Senior Notes due 2025	The New York Stock Exchange
$1,000,000,000 4.5% Subordinated Securities due 2024	The New York Stock Exchange
$2,500,000,000 6.375% Senior Notes due 2021	The New York Stock Exchange
$1,000,000,000 2.7% Senior Notes due 2020	The New York Stock Exchange
$1,000,000,000 2.4% Senior Notes due 2020	The New York Stock Exchange
$1,000,000,000 2.35% Senior Notes due 2019	The New York Stock Exchange
$1,000,000,000 2.3% Senior Notes due 2018	The New York Stock Exchange
$700,000,000 2% Senior Notes due 2018	The New York Stock Exchange
$300,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,250,000,000 1.75% Senior Notes due 2018	The New York Stock Exchange
$400,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,000,000,000 1.75% Senior Notes due 2018	The New York Stock Exchange
$500,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,500,000,000 4.20% Senior Notes due 2017	The New York Stock Exchange
$2,250,000,000 4.875% Senior Notes due 2016	The New York Stock Exchange

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

None

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

7.50% Fixed Rate Reset Additional Tier 1 Perpetual Subordinated Contingent Convertible Securities

The number of outstanding shares of each of Lloyds Banking Group plc's classes of capital or common stock as of 31 December 2015 was:

Ordinary shares, nominal value 10 pence each	71,373,735,357
Limited voting shares, nominal value 10 pence each	80,921,051
Preference shares, nominal value 25 pence each	412,204,151
Preference shares, nominal value 25 cents each	1,206,888
Preference shares, nominal value 25 euro cents each	Nil

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes x No o

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

Yes o No x

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

Yes x No o

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

Yes o No o

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

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

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

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

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

Item 17 o Item 18 o

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

Yes o No x

TABLE OF CONTENTS

PRESENTATION OF INFORMATION

In this annual report, references to the ‘Company’ are to Lloyds Banking Group plc; references to ‘Lloyds Banking Group’, ‘Lloyds’ or the ‘Group’ are to Lloyds Banking Group plc and its subsidiary and associated undertakings; references to ‘Lloyds Bank’ are to Lloyds Bank plc (previously Lloyds TSB Bank plc); and references to the ‘consolidated financial statements’ or ‘financial statements’ are to Lloyds Banking Group’s consolidated financial statements included in this annual report. References to the ‘Financial Conduct Authority’ or ‘FCA’ and to the ‘Prudential Regulation Authority’ or ‘PRA’ are to the United Kingdom (the UK) Financial Conduct Authority and the UK Prudential Regulation Authority. References to the ‘Financial Services Authority’ or ‘FSA’ are to their predecessor organisation, the UK Financial Services Authority.

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

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

Lloyds Banking Group publishes its consolidated financial statements expressed in British pounds (‘pounds sterling’, ’sterling’ or ’£’), the lawful currency of the UK. In this annual report, references to ‘pence’ and ‘p’ are to one-hundredth of one pound sterling; references to ‘US dollars’, ‘US$’ or ’$’ are to the lawful currency of the United States (the US); references to ‘cent’ or ‘c’ are to one-hundredth of one US dollar; references to ‘euro’ or ’€’ are to the lawful currency of the member states of the European Union (EU) that have adopted a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty of European Union; references to ‘euro cent’ are to one-hundredth of one euro; and references to ‘Japanese yen’, ‘Japanese ¥’ or ’¥’ are to the lawful currency of Japan. Solely for the convenience of the reader, this annual report contains translations of certain pounds sterling amounts into US dollars at specified rates. These translations should not be construed as representations by Lloyds Banking Group that the pounds sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or at any other rate. Unless otherwise stated, the translations of pounds sterling into US dollars have been made at the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) in effect on 31 December 2015, which was $1.4746 = £1.00. The Noon Buying Rate on 31 December 2015 differs from certain of the actual rates used in the preparation of the consolidated financial statements, which are expressed in pounds sterling, and therefore US dollar amounts appearing in this annual report may differ significantly from actual US dollar amounts which were translated into pounds sterling in the preparation of the consolidated financial statements in accordance with IFRS.

BUSINESS OVERVIEW

Lloyds Banking Group is a leading provider of financial services to individual and business customers in the UK. At 31 December 2015, total Lloyds Banking Group assets were £806,688 million and Lloyds Banking Group had 75,306 employees (on a full-time equivalent basis). Lloyds Banking Group plc's market capitalisation at that date was £52,153 million. The Group reported a profit before tax for the 12 months to 31 December 2015 of £1,644 million, and its capital ratios at that date were 21.5 per cent for total capital, 16.4 per cent for tier 1 capital and 12.8 per cent for common equity tier 1 capital.

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

	2015	2014	2013
	£m	£m	£m
Net interest income	11,318	10,660	7,338
Other income	11,832	19,232	30,647
Total income	23,150	29,892	37,985
Insurance claims	(5,729)	(13,493)	(19,507)
Total income, net of insurance claims	17,421	16,399	18,478
Operating expenses	(15,387)	(13,885)	(15,322)
Trading surplus	2,034	2,514	3,156
Impairment	(390)	(752)	(2,741)
Profit before tax	1,644	1,762	415

Lloyds Banking Group's main business activities are retail and commercial banking and long-term savings, protection and investment. Services are offered through a number of well recognised brands including Lloyds Bank, Halifax, Bank of Scotland and Scottish Widows, and through a range of distribution channels including the largest branch network in the UK and a comprehensive digital proposition.

At 31 December 2015, the Group's four primary operating divisions, which are also reporting segments, were: Retail; Commercial Banking; Consumer Finance and Insurance. Retail provides banking, mortgages and other financial services to personal and small business customers in the UK. Commercial Banking provides banking and related services to business clients, from SMEs to large corporates. Consumer Finance provides a range of products including motor finance, credit cards, and European mortgages and deposit taking. Insurance provides long-term savings, protection and investment products as well as general insurance products in the UK.

Profit before tax is analysed on pages 15 to 18 on a statutory basis and, in order to provide a more comparable representation of business performance of the Group's segments, on pages 26 to 36 on an underlying basis. The key principles adopted in the preparation of this basis of reporting are described on page 26. The Group Executive Committee, which is the chief operating decision maker for the Group, reviews the Group's internal reporting based around these segments (which reflect the Group's organisational and management structures) in order to assess performance and allocate resources; this reporting is on an underlying basis. IFRS 8, *Operating Segments* requires that the Group presents its segmental profit before tax on the basis reviewed by the chief operating decision maker that is most consistent with the measurement principles used in measuring the Group's statutory profit before tax. Accordingly, the Group presents its segmental underlying basis profit before tax in note 4 to the financial statements in compliance with IFRS 8. The table below shows the results of Lloyds Banking Group's segments in the last three fiscal years, and their aggregation. Further information on non-GAAP measures and the reconciliations required by the Securities and Exchange Commission's Regulation G are set out on pages F-23 to F-26.

	2015 £m	2014 £m	2013 £m
Retail	3,514	3,228	3,015
Commercial Banking	2,431	2,206	1,890
Consumer Finance	1,005	1,010	965
Insurance	962	922	1,088
Other	200	390	(792)
Profit before tax – underlying basis	8,112	7,756	6,166

Lloyds Banking Group plc was incorporated as a public limited company and registered in Scotland under the UK Companies Act 1985 on 21 October 1985 with the registered number 95000. Lloyds Banking Group plc's registered office is The Mound, Edinburgh EH1 1YZ, Scotland, and its principal executive offices in the UK are located at 25 Gresham Street, London EC2V 7HN, United Kingdom, telephone number + 44 (0) 20 7626 1500.

2

SELECTED CONSOLIDATED FINANCIAL DATA

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

	2015	2014	2013	2012[1]	2011[1]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	17,421	16,399	18,478	20,517	20,802
Operating expenses	(15,387)	(13,885)	(15,322)	(15,974)	(13,259)
Trading surplus	2,034	2,514	3,156	4,543	7,543
Impairment losses	(390)	(752)	(2,741)	(5,149)	(8,094)
Profit (loss) before tax	1,644	1,762	415	(606)	(551)
Profit (loss) for the year	956	1,499	(802)	(1,387)	(554)
Profit (loss) for the year attributable to equity shareholders	466	1,125	(838)	(1,471)	(627)
Dividends for the year[2,3]	1,962	535	–	–	–
Balance sheet data at 31 December (£m)					
Share capital	7,146	7,146	7,145	7,042	6,881
Shareholders’ equity	41,234	43,335	38,989	41,896	45,506
Other equity instruments	5,355	5,355	–	–	–
Customer deposits	418,326	447,067	439,467	426,216	413,906
Subordinated liabilities	23,312	26,042	32,312	34,092	35,089
Loans and advances to customers	455,175	482,704	492,952	516,764	565,638
Total assets[1]	806,688	854,896	842,380	933,064	970,609
Share information					
Basic earnings (loss) per ordinary share	0.8p	1.7p	(1.2)p	(2.1)p	(0.9)p
Diluted earnings (loss) per ordinary share	0.8p	1.6p	(1.2)p	(2.1)p	(0.9)p
Net asset value per ordinary share	57.9p	60.7p	54.6p	59.5p	66.1p
Dividends per ordinary share[2,4]	2.75p	0.75p	–	–	–
Equivalent cents per share[2,4,5]	3.91c	1.16c	–	–	–
Market price per ordinary share (year end)	73.1p	75.8p	78.9p	47.9p	25.9p
Number of shareholders (thousands)	2,563	2,626	2,681	2,733	2,770
Number of ordinary shares in issue (millions)[6]	71,374	71,374	71,368	70,343	68,727
Financial ratios (%)[7]					
Dividend payout ratio[8]	359.3	45.1	–	–	–
Post-tax return on average shareholders’ equity	1.3	2.9	(2.0)	(3.3)	(1.4)
Post-tax return on average assets	0.11	0.17	(0.09)	(0.14)	(0.06)
Average shareholders’ equity to average assets	5.1	4.7	4.7	4.6	4.5
Cost:income ratio[9]	88.3	84.7	82.9	77.9	63.7
Capital ratios (%)[10,11,12]					
Total capital	21.5	22.0	20.8	17.3	15.6
Tier 1 capital	16.4	16.5	14.5	13.8	12.5
Common equity tier 1 capital/Core tier 1 capital	12.8	12.8	14.0	12.0	10.8

1 Restated, where appropriate, in 2013 for IAS 19 (Revised) and IFRS 10.

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

3 Dividends for the year in 2015 include a recommended special dividend totalling £357 million.

4 Dividends per ordinary share in 2015 include a recommended special dividend of 0.5 pence.

5 Translated into US dollars at the Noon Buying Rate on the date each payment was made, with the exception of the final and special dividends in respect of 2015, which have been translated at the Noon Buying Rate on 26 February 2016.

6 This figure excludes the limited voting ordinary shares owned by the Lloyds Bank Foundations.

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

8 Total dividend for the year divided by earnings attributable to ordinary shareholders adjusted for tax relief on distributions to other equity holders.

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

10 Capital ratios for 2012 and earlier years were not restated to reflect the adoption of IAS 19 (Revised) in 2013.

11 Capital ratios for 2013 and earlier years are in accordance with modified Basel II framework as implemented by the PRA.

12 Capital ratios for 2014 are in accordance with the CRD IV rules implemented by the PRA on 1 January 2014.

3

EXCHANGE RATES

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

	2016 January	2015 December	2015 November	2015 October	2015 September	2015 August
US dollars per pound sterling:						
High	1.47	1.52	1.54	1.55	1.56	1.57
Low	1.42	1.47	1.50	1.52	1.51	1.54

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

	2015	2014	2013	2012	2011
US dollars per pound sterling:					
Average	1.53	1.65	1.57	1.59	1.61

On 26 February 2016, the latest practicable date, the US dollar Noon Buying Rate was $1.39 = £1.00. Lloyds Banking Group makes no representation that amounts in pounds sterling have been, could have been or could be converted into US dollars at that rate or at any of the above rates.

BUSINESS

HISTORY AND DEVELOPMENT OF LLOYDS BANKING GROUP

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

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

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

The HBOS Group had been formed in September 2001 by the merger of Halifax plc and Bank of Scotland. The Halifax business began with the establishment of the Halifax Permanent Benefit Building Society in 1852; the society grew through a number of mergers and acquisitions including the merger with Leeds Permanent Building Society in 1995 and the acquisition of Clerical Medical in 1996. In 1997 the Halifax converted to plc status and floated on the London stock market. Bank of Scotland was founded in July 1695, making it Scotland's first and oldest bank.

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

Pursuant to two placing and open offers which were completed by the Company in January and June 2009 and the Rights Issue completed in December 2009, the UK Government acquired 43.4 per cent of the Company's issued ordinary share capital. As announced, at 4 December 2015 UKFI held approximately 6.6 billion shares in the Group representing a stake of approximately 9.2 per cent, following a sale of 4,282 million shares on 20 September 2013, a further sale of 5,555 million shares on 31 March 2014, the effects of a trading plan with Morgan Stanley & Co. International plc (Morgan Stanley) that was announced on 17 December 2014 and extended on both 1 June 2015 and 4 December 2015, and the effects of issues of ordinary shares. The trading plan provides Morgan Stanley with full discretion to effect a measured and orderly sell down of shares in the Group on behalf of the UK Government above a share price of 73.6 pence. The trading plan will terminate no later than 30 June 2016. The plan may be stopped earlier than 30 June 2016, for example to ensure that HMT retains sufficient shares for the proposed retail offer, which was originally expected to be launched in Spring 2016 but has been delayed following recent market volatility. The UK Government has instructed Morgan Stanley that up to but no more than 15 per cent of the aggregate total trading volume in the Group is to be sold over the duration of the trading plan. Although the UK government may have sold shares since its last notification (approximately 9.2 per cent) on 4 December 2015 its holding remains above 9 per cent.

Pursuant to its decision approving state aid to the Group, the European Commission required the Group to dispose of a retail banking business meeting minimum requirements for the number of branches, share of the UK personal current accounts market and proportion of the Group's mortgage assets. Following disposals in 2014, the Group retained an interest of approximately 50 per cent in TSB as at 31 December 2014. The Group sold its remaining interest in TSB to

Banco de Sabadell (Sabadell) in 2015, with the acquisition becoming unconditional in all respects on 30 June 2015 following the receipt of all relevant regulatory clearances.

4

BUSINESS

STRATEGY OF LLOYDS BANKING GROUP

The Group is a leading provider of financial services to individual and business customers in the UK. The Group's main business activities are retail and commercial banking, and long-term savings, protection and investment. Services are provided through a number of well recognised brands including Lloyds Bank, Halifax, Bank of Scotland and Scottish Widows and through a range of distribution channels, including the largest branch network in the UK and a comprehensive digital proposition.

The Group operates a simple, low-risk, customer focused retail and commercial banking business primarily in the UK. The Group's corporate strategy is built around being the best bank for individual and business customers across the UK and creating value by investing in areas that make a real difference to these customers.

Following the successful delivery of the Group's 2011 strategy that underpinned the Group's low cost, low risk, customer focused, UK retail and commercial banking business model, the Group outlined the next phase of its strategy in October 2014. The Group's strategy is focused upon delivering value and high quality experiences for customers alongside superior and sustainable financial performance within a prudent risk and conduct framework. This will be achieved through three strategic priorities which will be consistently applied across all divisions:

CREATING THE BEST CUSTOMER EXPERIENCE

The Group's ambition is to create the best customer experience through its multi brand, multi channel approach, combining comprehensive online and mobile capabilities with face to face services. This involves transforming the Group's digital presence while sustaining extensive customer reach through a branch network focused on delivering high quality service and the right outcomes for customers.

BECOMING SIMPLER AND MORE EFFICIENT

The Group is focused on creating operational capability which is simpler and more efficient than today and will become more responsive to changing customer expectations while maintaining its cost leadership amongst UK high street banks. This includes a second phase of the Simplification programme to achieve run-rate savings of £1 billion per annum by the end of 2017. In order to achieve these savings, the Group will invest around £1.6 billion over three years on initiatives to simplify processes and increase automation.

DELIVERING SUSTAINABLE GROWTH

As the UK economy continues to recover, the Group will seek Group-wide growth opportunities whilst maintaining its prudent risk appetite. This will be achieved by maintaining market leadership in its retail business lines while also focusing on areas where the Group is currently under represented.

SUMMARY

The Group is creating a simpler, more agile, efficient and responsive customer focused organisation which operates sustainably and responsibly and Helps Britain Prosper. The achievement of our strategy could not happen without the support of our colleagues. We are therefore committed to 'building the best team' to create a high performance organisation. The Group believes that the successful execution of the next phase of its strategy will enable delivery of superior and sustainable returns for shareholders.

BUSINESS AND ACTIVITIES OF LLOYDS BANKING GROUP

At 31 December 2015 the Group's activities were organised into four financial reporting segments: Retail; Commercial Banking; Consumer Finance and Insurance.

Further information on the Group's segments is set out on pages 26 to 36 and in note 4 to the financial statements.

MATERIAL CONTRACTS

The Company and its subsidiaries are party to various contracts in the ordinary course of business.

For information relating to the Company's relationship with the UK Government see *Major Shareholders and Related Party Transactions – Information about the Lloyds Banking Group's relationship with the UK Government*. For information relating to the Group's relationship with the TSB Group see *Major Shareholders and Related Party Transactions – Information about the Lloyds Banking Group's relationship with the TSB Group*.

BUSINESS

ENVIRONMENTAL MATTERS

The Group's ability to help Britain prosper is inextricably linked to wider environmental issues. Man-made climate change and global trends such as resource scarcity, extreme weather and rising energy and commodity prices have an impact on the Group's stakeholders and its own operations.

The Group recognises the global challenge posed by these wider issues, and its responsibility to reduce the environmental impacts of its business operations. The Group is committed to managing its direct environmental impacts in a responsible manner and reducing its greenhouse gas emissions. The Group does this through its Environmental Action Plan, through which it aims to maximise the opportunity to create business value and minimise business risk in relation to its direct environmental impact.

The Group's approach towards managing its environmental impact is set out in its Environmental Statement, available on the Responsible Business section of the Group's corporate website.

Greenhouse gas emissions

The Group has voluntarily reported greenhouse gas emissions and environmental performance since 2009, and since 2013 this has been in line with the requirements of the Companies Act 2006. Deloitte LLP has reviewed a selection of non-financial KPIs, indicated by providing limited assurance using the International Standard on Assurance Engagements (ISAE) 3000 (Revised). Their full, independent assurance statement is available online at www.lloydsbankinggroup.com/RBdownloads.

CO_2e emissions (tonnes)

	Oct 2014 – Sept 2015	Oct 2013 – Sept 2014
Total CO_2e	398,191	441,703
Total scope 1	57,761	60,019
Total scope 2	241,008	264,252
Total scope 3	99,422	117,432

Restated 2013/2014 emissions data to improve the accuracy of reporting, using actual data to replace estimations and the re-categorisation of the emissions from the Group's owned vehicles.

Emissions in tonnes CO_2e in line with the GHG Protocol Corporate Standard revised issue (2004). Criteria used to measure and report Scope 1, 2, 3 emissions is provided in the Lloyds Banking Group criteria statement available online at www.lloydsbankinggroup.com/ResponsibleBusiness

Indicator is subject to limited ISAE 3000 (Revised) assurance by Deloitte LLP for the 2015 Annual Responsible Business Reporting. Deloitte LLP's 2015 assurance statement and the 2015 Reporting Criteria are available online at www.lloydsbankinggroup.com/RBdownloads

Methodology

The Group follows the principles of the Greenhouse Gas (GHG) Protocol Corporate Accounting and Reporting Standard to calculate its Scope 1, 2 and 3 emissions from its worldwide operations.

The reporting period is 1 October 2014 to 30 September 2015, which is different to that of the Group's Directors' Report (January 2015 – December 2015). This is in line with Regulations in that the majority of the emissions reporting year falls within the period of the Directors' Report. Emissions are reported based on an operational boundary. The scope of reporting is in line with the GHG Protocol and covers Scope 1, Scope 2 and Scope 3 emissions. Reported Scope 1 emissions cover emissions generated from gas and oil used in buildings, emissions from UK company-owned vehicles used for business travel and emissions from the use of air conditioning and chiller/refrigerant plant. Reported Scope 2 emissions cover emissions generated from the use of electricity. Reported Scope 3 emissions relate to business travel undertaken by colleagues and emissions associated with the extraction and distribution of each of the Group's energy sources – electricity, gas and oil. A detailed definition of these emissions can be found in the Group's 2015 Reporting Criteria online at www.lloydsbankinggroup.com/RBdownloads.

Intensity ratio

An intensity ratio of GHG gases per £m of underlying income has been selected.

	Oct 2014 – Sept 2015	Oct 2013– Sep 2014
GHG emissions per unit of underlying income	22.3	24.0

Omissions

Emissions associated with joint ventures and investments are not included in this disclosure as they fall outside the scope of the Group's operational boundary. The Group does not have any emissions associated with heat, steam or cooling and is not aware of any other material sources of omissions from its reporting.

6

PROPERTIES

At 31 December 2015, Lloyds Banking Group occupied 2,388 properties in the UK. Of these, 696 were held as freeholds and 1,692 as leasehold. The majority of these properties are retail branches, widely distributed throughout England, Scotland, Wales and Northern Ireland. Other buildings include the Lloyds Banking Group's head office in the City of London with other customer service and support centres located to suit business needs but clustered largely in eight core geographic conurbations – London, Edinburgh, Glasgow, Midlands (Birmingham), Northwest (Chester and Manchester), West Yorkshire (Halifax and Leeds), South (Brighton and Andover) and Southwest (Bristol and Cardiff).

In addition, there are 122 properties which are either sub-let or vacant. There are also a number of ATM units situated throughout the UK, the majority of which are held as leasehold. The Group also has business operations elsewhere in the world, primarily holding property on a leasehold basis.

LEGAL ACTIONS AND REGULATORY MATTERS

During the ordinary course of business the Group is subject to threatened or actual legal proceedings and regulatory reviews and investigations both in the UK and overseas. Set out below is a summary of the more significant matters. Further details are included in notes 39 and 49 to the financial statements.

INTERCHANGE FEES

With respect to multi-lateral interchange fees (MIFs), the Group is not directly involved in the on-going investigations and litigation (as described below) which involve card schemes such as Visa and MasterCard. However, the Group is a member of Visa and MasterCard and other card schemes.

- The European Commission continues to pursue certain competition investigations into MasterCard and Visa probing, amongst other things, MIFs paid in respect of cards issued outside the EEA;

- Litigation continues in the English Courts against both Visa and MasterCard. This litigation has been brought by several retailers who are seeking damages for allegedly 'overpaid' MIFs. From publicly available information, it is understood these damages claims are running to different timescales with respect to the litigation process, and their outcome remains uncertain. It is also possible that new claims may be issued.

On 2 November 2015, Visa Inc announced its proposed acquisition of Visa Europe, which remains subject to completion. As set out in the announcement by the Group on 2 November, the Group's share of the sale proceeds will comprise upfront consideration of cash (the amount of which remains subject to adjustment prior to completion) and preferred stock. The preferred stock will be convertible into Class A Common Stock of Visa Inc or its equivalent upon occurrence of certain events. As part of this transaction, the Group and certain other UK banks also entered into a Loss Sharing Agreement (LSA) with Visa Inc, which clarifies how liabilities will be allocated between the parties should the litigation referred to above result in Visa Inc being liable for damages payable by Visa Europe. Visa Inc may only have recourse to the LSA once €1 billion of damages have been applied to the value of the UK preferred stock received by Visa UK members (including the Group) as part of the consideration to the transaction. The value of the preferred stock will be reduced (by making a downward adjustment to the conversion rate) in an amount equal to any covered losses. The maximum amount of liability to which the Group may be subject under the LSA is capped at the cash consideration to be received by the Group. Visa Inc may also have recourse to a general indemnity, currently in place under Visa Europe's Operating Regulations, for damages claims concerning inter or intra-regional MIF setting activities.

The ultimate impact on the Group of the above investigations and the litigation against Visa and MasterCard cannot be known before the conclusion of these matters.

PAYMENT PROTECTION INSURANCE

The Group increased the provision for PPI costs by a further £4,000 million in 2015, bringing the total amount provided to £16,025 million. This included an additional £2,100 million in the fourth quarter, largely to reflect the impact of our interpretation of the proposals contained within the Financial Conduct Authority's (FCA) consultation paper regarding a potential time bar and the Plevin case. As at 31 December 2015, £3,458 million or 22 per cent of the total provision, remained unutilised with £2,950 million relating to reactive complaints and associated administration costs.

The volume of reactive PPI complaints has continued to fall, with an 8 per cent reduction in 2015 compared with 2014, to approximately 8,000 complaints per week. Whilst direct customer complaint levels fell 30 per cent year-on-year, those from Claims Management Companies (CMCs) have remained broadly stable and as a result, CMCs now account for over 70 per cent of complaints.

On 26 November 2015, the FCA published a consultation paper (CP15/39: Rules and guidance on payment protection insurance complaints) proposing (i) the introduction of a deadline by which consumers would need to make their PPI complaints including an FCA led communications campaign, and (ii) rules and guidance about how firms should handle PPI complaints in light of the Supreme Court's decision in Plevin v Paragon Personal Finance Limited [2014] UKSC 61 (Plevin).

Based on recent trends, and in light of the proposals from the FCA, the Group now expects a higher level of complaints than previously assumed including those related to Plevin. As a result the Group has increased the total expected reactive complaint volumes to 4.7 million with approximately 1.3 million still expected to be received. This is equivalent to approximately 10,000 net complaints per week on average through to the proposed time bar of mid-2018.

Monthly complaints trends could vary significantly throughout this period, given they are likely to be impacted by a number of factors including the potential impact of the FCA's proposed communication campaign as well as changes in the regulation of CMCs.

7

BUSINESS

The provision includes an estimate to cover redress that would be payable under the FCA's proposed new rules and guidance in light of Plevin.

Quarter	Average monthly reactive complaint volume	**Quarter on quarter %**	**Year on year %**
Q1 2013	61,259	(28 %)	
Q2 2013	54,086	(12 %)	
Q3 2013	49,555	(8 %)	
Q4 2013	37,457	(24 %)	
Q1 2014	42,259	13 %	(31%)
Q2 2014	39,426	(7 %)	(27%)
Q3 2014	40,624	3 %	(18%)
Q4 2014	35,910	(12 %)	(4 %)
Q1 2015	37,791	5 %	(11%)
Q2 2015	36,957	(2 %)	(6 %)
Q3 2015	37,586	2 %	(7 %)
Q4 2015	33,998	(10 %)	(5 %)

The Group continues to progress the re-review of previously handled cases and expects this to be substantially complete by the end of the first quarter of 2016. During the year the scope has been extended by 0.5 million to 1.7 million cases relating largely to previously redressed cases, in addition to which, higher overturn rates and average redress have been experienced. At the end of January 2016, 77 per cent of cases had been reviewed and 77 per cent of all cash payments made.

The Group has completed its Past Business Review (PBR) where it has been identified that there was a risk of potential mis-sale for certain customers, albeit monitoring continues. No further change has been made to the amount provided.

The Group expects to maintain the PPI operation on its current scale for longer than previously anticipated given the update to volume related assumptions and the re-review of previously handled cases continuing into the first quarter of 2016. The estimate for administrative expenses, which comprise complaint handling costs and costs arising from cases subsequently referred to the FOS, is included in the provision increase outlined above.

Sensitivities

The Group estimates that it has sold approximately 16 million policies since 2000. These include policies that were not mis-sold. Since the commencement of the PPI redress programme in 2011 the Group estimates that it has contacted, settled or provided for almost 49 per cent of the policies sold since 2000, covering both customer-initiated complaints and actual and PBR mailings undertaken by the Group.

The total amount provided for PPI represents the Group's best estimate of the likely future cost. However a number of risks and uncertainties remain in particular with respect to future volumes. The cost could differ materially from the Group's estimates and the assumptions underpinning them, and could result in a further provision being required. There is significant uncertainty around the impact of the proposed FCA media campaign and CMC and customer activity in the lead up to the proposed time bar.

Key metrics and sensitivities are highlighted in the table below:

Sensitivities[1]	To date unless noted	Future	Sensitivity
Customer initiated complaints since origination (m)[2]	3.4	1.3	0.1 = £200m
Average uphold rate per policy[3]	76%	89%	1% = £35m
Average redress per upheld policy[4]	£1,810	£1,400	£100 = £170m
Administrative expenses (£m)	2,710	665	1 case = £450

1 All sensitivities exclude claims where no PPI policy was held.

2 Sensitivity includes complaint handling costs. Future volume includes complaints falling into the Plevin rules and guidance. As a result, the sensitivity per 100,000 complaints includes cases where the average redress would be lower than historical trends.

3 The percentage of complaints where the Group finds in favour of the customer excluding PBR. The 76 per cent uphold rate per policy is based on the six months to 31 December 2015. Future uphold rate and sensitivities are influenced by a proportion of complaints falling under the Plevin rules and guidance which would otherwise be defended.

4 The amount that is paid in redress in relation to a policy found to have been mis-sold, comprising, where applicable, the refund of premium, compound interest charged and interest at 8 per cent per annum. Actuals are based on the six months to 31 December 2015. Future average redress is influenced by expected compensation payments for complaints falling under the Plevin rules and guidance.

INVESTIGATIONS AND LITIGATION RELATING TO INTERBANK OFFERED RATES, AND OTHER REFERENCE RATES

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

Certain Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar, Japanese Yen and Sterling LIBOR. The lawsuits, which contain broadly similar allegations, allege violations of the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act and the Commodity Exchange Act, as well as various state statutes and common law doctrines. Certain of the plaintiffs' claims, including those asserted under US anti-trust laws, have been dismissed by the US Federal Court for Southern District of New York (the District Court). That court's

8

dismissal of plaintiffs' anti-trust claims has been appealed to the New York Federal Court of Appeal. The OTC and Exchange – Based plaintiffs' claims were dismissed in November 2015 for lack of personal jurisdiction against the Group.

Certain Group companies are also named as defendants in UK based claims raising LIBOR manipulation allegations in connection with interest rate hedging products.

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

CUSTOMER CLAIMS IN RELATION TO INSURANCE BRANCH BUSINESS IN GERMANY

The Group has received a number of claims from customers relating to policies issued by Clerical Medical Investment Group Limited (recently renamed Scottish Widows Limited) but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. Following decisions in July 2012 from the Federal Court of Justice (FCJ) in Germany the Group recognised provisions totalling £520 million during the period to 31 December 2014. Recent experience has been slightly adverse to expectations and the Group has noted decisions of the FCJ in 2014 and 2015 involving German insurers in relation to a German industry-wide issue regarding notification of contractual 'cooling off' periods. Accordingly, a provision increase of £25 million has been recognised giving a total provision of £545 million. The remaining unutilised provision as at 31 December 2015 is £124 million (31 December 2014: £199 million).

The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will only be known once all relevant claims have been resolved.

INTEREST RATE HEDGING PRODUCTS

In June 2012, a number of banks, including the Group, reached agreement with the FSA (now FCA) to carry out a review of sales made since 1 December 2001 of interest rate hedging products (IRHP) to certain small and medium-sized businesses. As at 31 December 2015 the Group had identified 1,735 sales of IRHPs to customers within scope of the agreement with the FCA which have opted in and are being reviewed and, where appropriate, redressed.

The Group agreed that it would provide redress to any in-scope customers where appropriate. The Group continues to review the remaining cases within the scope of the agreement with the FCA and has met all of the regulator's requirements to date.

During 2015, the Group has charged a further £40 million in respect of redress and related administration costs, increasing the total amount provided for redress and related administration costs for in-scope customers to £720 million (31 December 2014: £680 million). As at 31 December 2015, the Group has utilised £652 million (31 December 2014: £571 million), with £68 million (31 December 2014: £109 million) of the provision remaining.

FCA REVIEW OF COMPLAINT HANDLING

On 5 June 2015 the FCA announced a settlement with the Group totalling £117 million following its investigation into aspects of the Group's PPI complaint handling process during the period March 2012 to May 2013. The FCA did not find that the Group acted deliberately. The Group has reviewed all customer complaints fully defended during the Relevant Period. The remediation costs of reviewing these affected cases are not materially in excess of existing provisions.

PROVISIONS FOR OTHER LEGAL ACTIONS AND REGULATORY MATTERS

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Group also receives complaints and claims from customers in connection with its past conduct and, where significant, provisions are held against the costs expected to be incurred as a result of the conclusions reached. During 2015, the Group charged an additional £655 million (2014: £430 million), including £225 million (2014: £nil) in response to complaints concerning packaged bank accounts and £282 million (2014: £318 million) in respect of other matters within the Retail division. In addition, the Group has charged a further £148 million (2014: £112 million) in respect of a number of product rectifications primarily in Insurance and Commercial Banking.

At 31 December 2015, provisions for other legal actions and regulatory matters of £813 million (31 December 2014: £521 million) remained unutilised, principally in relation to the sale of bancassurance products and packaged bank accounts and other Retail provisions.

UK SHAREHOLDER LITIGATION

In August 2014, the Group and a number of former directors were named as defendants in a claim filed in the English High Court by a number of claimants who held shares in Lloyds TSB Group plc (LTSB) prior to the acquisition of HBOS plc, alleging breaches of fiduciary and tortious duties in relation to information provided to shareholders in connection with the acquisition and the recapitalisation of LTSB. It is currently not possible to determine the ultimate impact on the Group (if any), but the Group intends to defend the claim vigorously.

FINANCIAL SERVICES COMPENSATION SCHEME

The Financial Services Compensation Scheme (FSCS) is the UK's independent statutory compensation fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable or likely to be unable to pay claims against it. The FSCS is funded by levies on the authorised financial services industry. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. At 31 March 2015, the end of the latest FSCS scheme year, the principal balance outstanding on these loans was £15,797 million (31 March 2014: £16,591 million). Although the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. The amount of future levies payable by the Group depends on a number of factors including the amounts recovered by the FSCS from asset sales, the Group's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of deposit-taking participants.

TAX AUTHORITIES

The Group provides for potential tax liabilities that may arise on the basis of the amounts expected to be paid to tax authorities including open matters where Her Majesty's Revenue and Customs (HMRC) adopt a different interpretation and application of tax law. The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Group that their interpretation of the UK rules, permitting the offset of such losses, denies the claim; if HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities of approximately £600 million and a reduction in the Group's deferred tax asset of approximately £400 million. The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due. There are a number of other open matters on which the Group is in discussion with HMRC; none of these is expected to have a material impact on the financial position of the Group.

RESIDENTIAL MORTGAGE REPOSSESSIONS

In August 2014, the Northern Ireland High Court handed down judgment in favour of the borrowers in relation to three residential mortgage test cases, concerning certain aspects of the Group's practice with respect to the recalculation of contractual monthly instalments of customers in arrears. The FCA has indicated that it will issue a Consultation Paper in relation to industry practice in this area in February 2016. The Group will respond as appropriate to this and any investigations, proceedings, or regulatory action that may in due course be instigated as a result of these issues.

THE FINANCIAL CONDUCT AUTHORITY'S ANNOUNCEMENT ON TIME-BARRING FOR PPI COMPLAINTS AND PLEVIN V PARAGON PERSONAL FINANCE LIMITED

On 26 November 2015 the FCA issued a Consultation Paper on the introduction of a deadline by which consumers would need to make their PPI complaints or else lose their right to have them assessed by firms or the Financial Ombudsman Service, and proposed rules and guidance concerning the handling of PPI complaints in light of the Supreme Court's decision in Plevin v Paragon Personal Finance Limited [2014] UKSC 61 (Plevin). The Financial Ombudsman Service is also considering the implications of Plevin for PPI complaints. The implications of potential time-barring and the Plevin decision in terms of the scope of any court proceedings or regulatory action remain uncertain.

CONTINGENT LIABILITIES IN RESPECT OF OTHER LEGAL ACTIONS AND REGULATORY MATTERS

In addition, during the ordinary course of business the Group is subject to other complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers, investors or other third parties, as well as legal and regulatory reviews, challenges, investigations and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required at the relevant balance sheet date. In some cases it will not be possible to form a view, for example because the facts are unclear or because further time is needed properly to assess the merits of the case, and no provisions are held in relation to such matters. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows.

COMPETITIVE ENVIRONMENT

The Group provides financial services to individual and business customers, predominantly in the UK but also overseas. The main business activities of the Group are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

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

The markets for UK financial services, and the other markets within which the Group operates, are competitive, and management expects such competition to continue or intensify in response to competitor behaviour, including non-traditional competitors, consumer demand, technological changes such as the growth of digital banking, and the impact of regulatory actions and other factors.

See Risk Factors – Business and Economic Risks – The Group's businesses are conducted in competitive environments, with increased competition scrutiny, and the Group's financial performance depends upon management's ability to respond effectively to competitive pressures.

See Regulation – Competition Regulation.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

TABLE OF CONTENTS

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OVERVIEW AND TREND INFORMATION

GIVEN THE GROUP'S UK FOCUS, ITS FINANCIAL PERFORMANCE IS INEXTRICABLY LINKED TO THE PERFORMANCE OF THE UK ECONOMY AND ITS REGULATORY AND COMPETITIVE ENVIRONMENT

UK ECONOMIC TRENDS

RESILIENCE IN THE FACE OF A FRAGILE GLOBAL ECONOMY

Initial estimates indicate that the UK economy grew by 2.2 per cent in 2015, close to its 25-year average, at a time when global growth slowed. UK economic growth was the second strongest of the G7 countries, only marginally behind the US. Eurozone growth improved during 2015, back to its 25-year average, but at 1.5 per cent it remains significantly slower than the UK.

Leadership of global growth is shifting back to developed economies as they emerge from a period of private sector debt reduction, government cuts and tax increases. The slowdown in emerging markets as their credit cycle turns is pushing inflation down across the world as their currencies and commodity prices fall. UK inflation has hovered close to zero throughout 2015, and as a result, consumers' inflation-adjusted incomes have increased, ending a seven year period in which they had been broadly flat. That has boosted consumer spending growth to an eight year high in 2015, and helped push unemployment down to pre-crisis levels.

Low inflation and risks from the slowdown in emerging markets are complicating central banks' setting of interest rates. The US increased rates in December 2015 for the first time since 2006, much later than had been expected at the start of the year. And the UK hasn't yet raised rates, contrary to consensus expectations at the start of 2015 of two increases during that year. Low interest rates, along with limited supply, have boosted property prices with UK house prices up 10 per cent during 2015, surpassing their 2007 peak, and commercial property prices up 7.8 per cent.

MARKET GROWTH

Growth in the markets in which the Group operates has improved but in aggregate remains much weaker than pre-crisis. Mortgage volumes for house purchases rose 4.7 per cent to a post-crisis high, and their value rose by 10.7 per cent, pushing growth in balances up from 1.6 per cent in 2014 to 2.6 per cent in 2015, its strongest since 2008. Growth in consumer unsecured borrowing balances rose from 4.1 per cent in 2014 to 6.0 per cent in 2015, the strongest since 2005. Small and medium-sized companies (SMEs) have started to increase borrowing from banks again in 2015 for the first time since 2008, while companies' deposits continued to

grow rapidly, up 11.5 per cent in 2015 after an average of 9.3 per cent across 2013-14. Consumer deposits growth fell back slightly from 4.3 per cent in 2014 to 3.8 per cent in 2015, but this was mainly due to the government's launch of pensioner bonds.

MARGIN PRESSURE

Competition and the delay in Bank Rate increases are keeping banks' margins under pressure. The spread between average lending and deposit rates has held fairly flat in 2015 close to its pre-crisis level, having improved from the very low level of 2011-12 when wholesale funding costs were exceptionally high. Lending rates have fallen to a record low in 2015, and whilst deposit rates have fallen during the year they are still higher than short term financial-market rates, opposite to pre-crisis. Mortgage pricing has been particularly aggressive in 2015, with spreads on new loans over market funding costs falling around 50 basis points through the year.

LOW LEVEL IMPAIRMENT

Improving indebtedness, along with the continued low interest rate environment, is continuing to reduce impairments which are below expected through-the-cycle levels. The share of highly indebted consumers has fallen further in 2015, and consumers' concerns over their level of debt and mortgage payments are back to pre-crisis lows. Personal and corporate insolvency rates are low, both around half their 2009-10 peaks. Rising property prices have also sharply reduced potential losses from defaults on property lending.

OUTLOOK FOR 2016

Despite challenges from slowing emerging markets and rising US interest rates, the most likely outlook for the UK in 2016 is another year similar to 2015. Consensus expectations are for gdp growth of 2.2 per cent, CPI inflation rising to 1.1 per cent by the end of the year, house prices up 5 per cent, and another year without a rise in Bank Rate. As the recovery matures, borrowing is rising and domestic consumption will be the primary driver of economic growth. Lending has been subdued for five years and corporate and household balance sheets have strengthened, so that credit has room to grow without threatening macroeconomic stability. Low inflation will keep real household incomes growing, sustaining economic growth despite headwinds from the elevated level of sterling, weak manufacturing activity, tightening benefit payments and uncertainty over the future of the UK's membership of the EU.

There are, however, risks to those expectations, stemming from the deflationary impact of the slowdown in emerging markets, the associated recent volatility in financial markets that might weaken consumer and business confidence; and the referendum on UK membership of the EU which, if the vote is to leave, may create a period of uncertainty and impact companies' investment plans. Crystallisation of any of these risks could impact the UK economy, which in turn would have a negative impact on the Group's income, funding costs and impairment charges.

GROWTH IN THE GROUP'S MARKETS

(yearly % change in UK market balances)

13

CRITICAL ACCOUNTING POLICIES

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

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

FUTURE ACCOUNTING DEVELOPMENTS

Future developments in relation to the Group's IFRS reporting are discussed in note 57 to the financial statements.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RESULTS OF OPERATIONS – 2015, 2014 AND 2013

SUMMARY

	2015 £m	2014 £m	2013 £m
Net interest income	11,318	10,660	7,338
Other income	11,832	19,232	30,647
Total income	23,150	29,892	37,985
Insurance claims	(5,729)	(13,493)	(19,507)
Total income, net of insurance claims	17,421	16,399	18,478
Operating expenses	(15,387)	(13,885)	(15,322)
Trading surplus	2,034	2,514	3,156
Impairment	(390)	(752)	(2,741)
Profit before tax	1,644	1,762	415
Taxation	(688)	(263)	(1,217)
Profit (loss) for the year	956	1,499	(802)
Profit (loss) attributable to ordinary shareholders	466	1,125	(838)
Profit attributable to other equity holders[1]	394	287	–
Profit (loss) attributable to equity holders	860	1,412	(838)
Profit attributable to non-controlling interests	96	87	36
Profit (loss) for the year	956	1,499	(802)

[1] The profit after tax attributable to other equity holders of £394 million (2014: £287 million; 2013: £nil) is partly offset in reserves by a tax credit attributable to ordinary shareholders of £80 million (2014: £62 million; 2013: £nil).

2015 COMPARED WITH 2014

During the year ended 31 December 2015, the Group recorded a profit before tax of £1,644 million compared with a profit before tax in 2014 of £1,762 million. The result in 2015 included provisions in respect of redress to customers relating to both past sales of Payment Protection Insurance and other matters of £4,837 million compared to a charge of £3,125 million in the year ended 31 December 2014; 2014 also included a past service pension credit of £822 million and a loss of £1,362 million in relation to the exchange and repurchase of Enhanced Capital Notes, neither of which were repeated in 2015. Excluding these items from both years, profit before tax was £1,054 million, or 19 per cent, higher at £6,481 million in the year ended 31 December 2015 compared to £5,427 million in the previous year, reflecting a significant reduction in expenditure in relation to the Group's Simplification programme and lower impairment charges.

The comparison of results for 2015 to 2014 is also impacted by the sale of TSB Banking Group plc (TSB), which ceased to be consolidated in March 2015, with the sale of the Group's remaining holding becoming unconditional on

30 June 2015. The Group recognised a net loss of £660 million in 2015, relating to both the disposal of its shareholding and commitments under agreements entered into with TSB (see also note 55 on page F-104).

Total income decreased by £6,742 million, or 23 per cent, to £23,150 million in 2015 compared with £29,892 million in 2014, comprising a £7,400 million decrease in other income partly offset by an increase in net interest income.

Net interest income was £11,318 million in 2015; an increase of £658 million, or 6 per cent compared to £10,660 million in 2014. There was a positive impact of £358 million in 2015 from a decrease in the amounts payable to unit holders in those Open-Ended Investment Companies (OEICs) included in the consolidated results of the Group, particularly in relation to fixed income securities; the change in population of consolidated OEICs in 2015 compared to 2014 caused an increase of £27 million in this interest expense. After adjusting for this, net interest income was £300 million, or 3 per cent, higher at £11,562 million in 2015 compared to £11,262 million in 2014 reflecting an improvement in margin in the Group's banking operations, driven by a combination of lower deposit and wholesale funding costs, partly offset by continued pressure on asset prices. Average interest-earning assets fell as a result of the sale of TSB and the continued run down of the portfolio of assets which are outside of the Group's risk appetite.

Other income was £7,400 million, or 38 per cent, lower at £11,832 million in 2015 compared to £19,232 million in 2014. Fee and commission income was £407 million, or 11 per cent, lower at £3,252 million compared to £3,659 million in 2014. Fee and commission expense increased by £40 million, or 3 per cent, to £1,442 million compared with £1,402 million in 2014. The decrease in net fee and commission income largely reflects the disposals of TSB and Scottish Widows Investment Partnership. Net trading income decreased by £6,445 million, or 63 per cent, to £3,714 million in 2015 compared to £10,159 million in 2014; this decrease reflected a reduction of £6,146 million in gains on policyholder investments held within the insurance business as a result of market conditions over 2015 relative to those in 2014. The reduction in trading income within the insurance business was coupled with a small decrease of £266 million in the Group's other operations. Insurance premium income was £2,333 million, or 33 per cent, lower at £4,792 million in 2015 compared with £7,125 million in 2014; there was a decrease of £2,334 million in life insurance premiums and a £1 million increase in general insurance premiums. Premium income in 2015 has been reduced by a charge of £1,959 million relating to the recapture by a third party insurer of a portfolio of policies previously reassured with the Group; excluding this item life insurance premium income was £375 million, or 6 per cent, lower at £5,880 million in 2015 compared to £6,255 million in 2014. Other operating income was £1,825 million higher at £1,516 million in 2015 compared to a deficit of £309 million in 2014. Other operating income includes the results of liability management from which the Group incurred a loss of £28 million in 2015 compared to a loss of £1,386 million in 2014, which was principally in relation to exchange and repurchase transactions in respect of the Group's Enhanced Capital Notes. Excluding the impact of liability management activities, other operating income was £467 million, or 43 per cent, higher at £1,544 million in 2015 compared to £1,077 million in 2014; in part reflecting a reduction in the losses arising from the movement in the value of in-force insurance business.

Insurance claims expense was £7,764 million, or 58 per cent, lower at £5,729 million in 2015 compared to £13,493 million in 2014. The insurance claims expense in respect of life and pensions business was £7,804 million, or 59 per cent, lower at £5,359 million in 2015 compared to £13,163 million in 2014;

this decrease was matched by a similar decline in net trading income, reflecting the relative performance of policyholder investments. Insurance claims in respect of general insurance business were £40 million or 12 per cent, higher at £370 million in 2015 compared to £330 million in 2014.

Operating expenses increased by £1,502 million, or 11 per cent to £15,387 million in 2015 compared with £13,885 million in 2014; the main reasons for the increase being the £1,712 million increase in charges for redress payments to customers in respect of PPI and other conduct related matters from £3,125 million in 2014 to £4,837 million in 2015, a charge of £665 million in 2015 in relation to the disposal of TSB and a net past service pension credit of £822 million in 2014 which was not repeated in 2015. Excluding these items from both years, operating expenses were £1,697 million, or 15 per cent, lower at £9,885 million in 2015 compared to £11,582 million in 2014. On this basis staff costs were £890 million, or 16 per cent, lower at £4,677 million in 2015 compared with £5,567 million in 2014; annual pay rises being more than offset by the impact of headcount reductions resulting from business disposals and the Group's rationalisation programmes and a reduction in severance costs as this phase of the Simplification programme draws to a close. Premises and equipment costs were £176 million or 20 per cent, lower at £715 million in 2015 compared with £891 million in 2014. Other expenses, excluding the charges in respect of customer redress provisions and the charge relating to the TSB disposal, were £808 million, or 25 per cent, lower at £2,381 million in 2015 compared with £3,189 million in 2014 as a result of lower levels of technology spend, advertising and professional fees, in particular relating to Simplification and the costs of TSB separation in 2014. Depreciation and amortisation costs were £177 million, or 9 per cent, higher at £2,112 million in 2015 compared to £1,935 million in 2014.

Impairment losses decreased by £362 million, or 48 per cent, to £390 million in 2015 compared with £752 million in 2014. Impairment losses in respect of loans and advances to customers were £292 million, or 40 per cent, lower at £443 million in 2015 compared with £735 million in 2014. The overall performance of the portfolio reflects a significant reduction in lending which is outside of the Group's risk appetite and improvements in all divisions. The net charge has also benefited from significant provision releases but at lower levels than seen in 2014. There was a credit of £55 million in respect of undrawn commitments in 2015, compared to a charge of £10 million in 2014, a result of improvements in credit quality in a number of corporate relationships.

In 2015, the Group recorded a tax charge of £688 million compared to a tax charge of £263 million in 2014, an effective tax rate of 42 per cent, which was higher than the standard UK corporation tax rate of 20.25 per cent; principally as a result of the disallowance of a substantial proportion of the Group's charge in respect of PPI and other conduct risk issues. The tax charge of £263 million in 2014 arose on a profit before tax of £1,762 million; this tax charge reflected tax exempt gains on the sale of businesses.

On the balance sheet, total assets were £48,208 million, or 6 per cent, lower at £806,688 million at 31 December 2015 compared to £854,896 million at 31 December 2014, largely due to the disposal of TSB. Loans and advances to customers were £27,529 million, or 6 per cent, lower at £455,175 million at 31 December 2015 compared to £482,704 million at 31 December 2014, with £21,643 million of the reduction being due to the sale of TSB, the continued reduction in the portfolio of assets which are outside of the Group's risk appetite and a £5,148 million reduction in reverse repurchase agreement balances have more than offset growth in the UK consumer finance business. An increase of £7,925 million in cash and balances at central banks has been more than offset by an £11,395 million reduction in trading and other financial assets at fair value through profit or loss and a £6,661 million reduction in derivative assets. Total liabilities were £45,285 million, or 6 per cent, lower at £759,708 million at 31 December 2015 compared to £804,993 million at 31 December 2014, again largely due to the sale of TSB. Customer deposits were £28,741 million, or 6 per cent, lower at £418,326 million at 31 December 2015 compared to £447,067 million at 31 December 2014 with £24,625 million of the reduction being due to the sale of TSB. Decreases of £10,239 million in trading and other financial liabilities at fair value through profit or loss and £11,095 million in insurance and investment contract liabilities have been partly offset by increases of £6,038 million in deposits by banks and £5,823 million in debt securities in issue as the Group took advantage of favourable funding opportunities. Total equity was £2,923 million, or 6 per cent, lower at £46,980 million at 31 December 2015 compared to £49,903 million at 31 December 2014; this reflected the fact that retained profit for the year has been more than offset by negative reserve movements in respect of available-for-sale revaluation and cash flow hedging reserves, dividends paid and the adjustment to non-controlling interests on the deconsolidation of TSB.

The Group has maintained its capital position, with a common equity tier 1 (CET1) ratio of 12.8 per cent, (31 December 2014: 12.8 per cent) as the impact of the lower capital base (as a result of reduced levels of equity) has been offset by a reduction in risk-weighted assets.

Risk-weighted assets reduced by £16,986 million, or 7 per cent, to £222,747 million, at 31 December 2015 compared to £239,734 million at 31 December 2014, primarily driven by the sale of TSB, reductions in the portfolio of assets which are outside of the Group's risk appetite and continued improvements in credit quality offset by targeted lending growth.

The Group's liquidity position remains good, with liquidity coverage ratio (LCR) eligible assets of £123 billion. LCR eligible assets represent almost 5.7 times the Group's money-market funding with a maturity of less than one year and were in excess of total wholesale funding at 31 December 2015 thus providing a buffer in the event of market dislocation. The Group's LCR ratio already exceeds regulatory requirements and is greater than 100 per cent.

2014 COMPARED WITH 2013

During the year ended 31 December 2014, the Group recorded a profit before tax of £1,762 million compared with a profit before tax in 2013 of £415 million. The result in 2014 included provisions in respect of redress to customers relating to past sales of Payment Protection Insurance and other issues of £3,125 million compared to a charge of £3,455 million in the year ended 31 December 2013; and 2014 also includes a past service pension credit of £822 million, compared to a charge of £104 million in 2013. Excluding these items from both years, profit before tax was £91 million, or 2 per cent, higher at £4,065 million in the year ended 31 December 2014 compared to £3,974 million in the previous year.

Total income decreased by £8,093 million, or 21 per cent, to £29,892 million in 2014 compared with £37,985 million in 2013, comprising an £11,415 million decrease in other income partly offset by an increase of £3,322 million in net interest income.

Net interest income was £10,660 million in 2014; an increase of £3,322 million, or 45 per cent compared to £7,338 million in 2013. There was a positive impact of £2,489 million in 2014 from a decrease in the amounts payable to unit holders in those Open-Ended Investment Companies (OEICs) included in the consolidated results of the Group. After adjusting for this, net interest income was £833 million, or 8 per cent, higher at £11,262 million in 2014 compared to £10,429 million in 2013 reflecting the continued improvement in margins and loan growth in targeted customer segments,partly offset by the effect of disposals and the reduced portfolio of assets which are outside of the Group’s risk appetite. The net interest margin benefited from improved deposit pricing and lower funding costs, partly offset by continued pressure on asset prices.

Other income was £11,415 million, or 37 per cent, lower at £19,232 million in 2014 compared to £30,647 million in 2013. Fee and commission income was £460 million, or 11 per cent, lower at £3,659 million compared to £4,119 million in 2013. Fee and commission expense increased by £17 million, or 1 per cent, to £1,402 million compared with £1,385 million in 2013. The decrease in net fee and commission income largely reflects the impact of business disposals. Net trading income decreased by £6,308 million,or 38 per cent, to £10,159 million in 2014 compared to £16,467 million in 2013; this decrease reflected a reduction of £7,384 million in gains on policyholder investments held within the insurance business as a result of movements in financial markets. The reduction in trading income within the insurance business was partly offset by an increase of £1,076 million in the Group’s other operations, principally because of an improvement of £610 million in valuation gains on the equity conversion feature embedded in the Group’s Enhanced Capital Notes. Insurance premium income was £1,072 million, or 13 per cent, lower at £7,125 million in 2014 compared with £8,197 million in 2013; there was a decrease of £945 million in life insurance premiums and a £127 million decrease in general insurance premiums. Other operating income was £3,558 million lower at a deficit of £309 million in 2014 compared to £3,249 million in 2013. Other operating income includes gains and losses on disposal of available-for-sale financial assets which were £498 million, or 79 per cent, lower at £131 million in 2014 compared to £629 million in 2013 following the completion of the repositioning of the Group’s government bond portfolio. Other operating income also includes gains and losses on liability management from which the Group incurred a loss of £1,362 million in 2014 in relation to exchange and repurchase transactions in respect of its Enhanced Capital Notes. Excluding gains and losses on sale of available-for-sale financial assets and the impact of liability management activities,other operating income was £1,816 million lower at £946 million in 2014 compared to £2,762 million in 2013; income in 2013 included the gains of £540 million from the sales of shares in St James's Place and £538 million following the sale of the Group's portfolio of US Residential Mortgage-Backed Securities.

Insurance claims expense was £6,014 million, or 31 per cent, lower at £13,493 million in 2014 compared to £19,507 million in 2013. The insurance claims expense in respect of life and pensions business was £5,988 million, or 31 per cent, lower at £13,163 million in 2014 compared to £19,151 million in 2013; this decrease in claims was matched by a similar decline in net trading income, reflecting the relative performance of policyholder investments. Insurance claims in respect of general insurance business were £26 million, or 7 per cent, lower at £330 million in 2014 compared to £356 million in 2013.

Operating expenses decreased by £1,437 million, or 9 per cent to £13,885 million in 2014 compared with £15,322 million in 2013; the main reasons for the decrease being the £330 million reduction in charges for regulatory provisions from £3,455 million in 2013 to £3,125 million in 2014 and, a net past service pension credit of £822 million compared to a charge of £104 million in 2013. Excluding these items from both years, operating expenses were £181 million, or 2 per cent, lower at £11,582 million in 2014 compared to £11,763 million in 2013. On this basis staff costs were £170 million, or 3 per cent, lower at £5,567 million in 2014 compared with £5,737 million in 2013; annual pay rises being more than offset by the impact of headcount reductions resulting from business disposals and the Group's rationalisation programmes. Premises and equipment costs were £79 million, or 8 per cent, lower at £891 million in 2014 compared with £970 million in 2013. Other expenses excluding the charges in respect of payment protection insurance and other regulatory provisions were £73 million, or 2 per cent, higher at £3,189 million in 2014 compared with £3,116 million in 2013. Depreciation and amortisation costs were £5 million lower at £1,935 million in 2014 compared to £1,940 million in 2013.

Impairment losses decreased by £1,989 million, or 73 per cent, to £752 million in 2014 compared with £2,741 million in 2013. Impairment losses in respect of loans and advances to customers were £1,990 million, or 73 per cent, lower at £735 million in 2014 compared with £2,725 million in 2013. The overall performance of the portfolio reflects a significant reduction in lending which is outside of the Group's risk appetite and improvements in all divisions. The improvements reflect lower levels of new impairment as a result of effective risk management, improving economic conditions and the continued low interest rate environment. The net charge has also benefited from significant provision releases but at lower levels than seen in 2013. The impairment charge in respect of debt securities classified as loans and receivables was a charge of £2 million in 2014 compared to a charge of £1 million in 2013 and the impairment charge in respect of available-for-sale financial assets was £10 million lower at £5 million in 2014 compared to £15 million in 2013.

In 2014, the Group recorded a tax charge of £263 million compared to a tax charge of £1,217 million in 2013. The tax charge in 2014 was £116 million lower than the charge that would arise at the standard UK corporation tax rate of 21.5 per cent; principally as a result of a tax exempt gains on sales of businesses and a lower deferred tax liability in respect of the value of in-force assets for the life business partially offset by the effect of non-deductible expenses. The tax charge of £1,217 million in 2013 arose on a profit before tax of £415 million; this tax charge reflected a

£594 million charge arising from the reduction in the corporation tax rate, a £348 million write-off of deferred tax assets following the sale of the Group's Australian operations and a £251 million policyholder tax charge.

17

On the balance sheet, total assets were £12,516 million, or 1 per cent, higher at £854,896 million at 31 December 2014 compared to £842,380 million at 31 December 2013. Loans and advances to customers were £10,248 million, or 2 per cent, lower at £482,704 million at 31 December 2014 compared to £492,952 million at 31 December 2013 as the impact of focused growth in mortgages, unsecured personal lending and the small to medium-sized businesses sector has been more than offset by the continuing reduction in the portfolio of assets which are outside of the Group's credit risk appetite, including the disposal of tranches of lending in Ireland. Available-for-sale financial assets were £12,517 million, or 28 per cent, higher at £56,493 million at 31 December 2014 compared to £43,976 million at 31 December 2013 as the Group continues to build up its holding of high quality government and other securities for liquidity purposes. Trading assets were £11,144 million higher at £48,494 million as a result of an increase in reverse repo activity. Deposits by banks were £3,095 million, or 22 per cent, lower at £10,887 million at 31 December 2014 compared to £13,982 million at 31 December 2013 and debt securities in issue were £10,869 million, or 12 per cent, lower at £76,233 million at 31 December 2014 compared to £87,102 million at 31 December 2013 as the Group reduced its reliance on wholesale funding; however, customer deposits was £7,600 million, or 2 per cent, higher at £447,067 million at 31 December 2014 compared to £439,467 million at 31 December 2013 following growth in relationship deposits. Total equity was £10,567 million, or 27 per cent, higher at £49,903 million at 31 December 2014 compared to £39,336 million at 31 December 2013; this reflected the issue of £5,355 million of other equity instruments, retained profit and positive movements in cash flow hedging and available-for-sale reserves.

The Group continued to strengthen its capital position, with a common equity tier 1 (CET1) ratio of 12.8 per cent, driven by a combination of retained profit, further dividends from the Insurance business, changes to and improved valuations of the Group's defined benefit pension arrangements, and a reduction in risk-weighted assets. The positive effect of these items was partly offset by the impact of the recommended dividend of 0.75 pence per share.

Risk-weighted assets reduced in the year, to £239,734 million, primarily due to asset reductions in the portfolio of assets which are outside of the Group's risk appetite, active portfolio management in Commercial Banking and improvements in economic conditions.

The Group's liquidity position remained strong, with primary liquid assets of £109.3 billion (31 December 2013: £89.3 billion). Primary liquid assets represented almost six times the Group's money-market funding with a maturity of less than one year, and just under three times the Group's total short-term wholesale funding, in turn providing a substantial buffer in the event of market dislocation. In addition to primary liquid assets, the Group had significant secondary liquidity holdings of £99.2 billion (31 December 2013: £105.4 billion). Total liquid assets represented approximately five times the Group's short-term wholesale funding with primary liquid assets broadly equivalent to total wholesale funding.

NET INTEREST INCOME

	2015	2014	2013
Net interest income £m	11,318	10,660	7,338
Average interest-earning assets £m	614,917	634,910	661,793
Average rates:			
Gross yield on interest-earning assets %[1]	2.86	3.03	3.20
Interest spread %[2]	1.67	1.52	0.88
Net interest margin %[3]	1.84	1.68	1.11

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

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

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

2015 COMPARED WITH 2014

Net interest income was £11,318 million in 2015 an increase of £658 million, or 6 per cent, compared to £10,660 million in 2014. Net interest income in 2015 includes a charge of £244 million in respect of amounts payable to unitholders in consolidated Open-Ended Investment Companies compared to a charge in 2014 of £602 million; the change in population of consolidated OEICs in 2015 compared to 2014 caused an increase of £27 million in this interest expense. After adjusting for this, net interest income was £300 million, or 3 per cent, higher at £11,562 million in 2015 compared to £11,262 million in 2014.

Average interest-earning assets were £19,993 million, or 3 per cent, lower at £614,917 million in 2015 compared to £634,910 million in 2014. The reduction reflected the sale of TSB (leading to a year-on-year reduction of £17,309 million) and the continuing run-off of assets which are outside of the Group’s risk appetite.

Average interest-earning assets in Retail were £1,766 million lower at £315,801 million in 2015 compared to £317,567 million in 2014 and average interest-earning assets in Commercial Banking were £3,854 million lower at £89,299 million in 2015 compared to £93,153 million in 2014. Average interest-earning assets across the rest of the

Group were £14,373 million, or 6 per cent, lower at £209,817 million in 2015 compared to £224,190 million in 2014. The main driver for this reduction being the decrease of £17,309 million resulting from the sale of TSB and in the portfolio of assets which are outside of the Group's risk appetite, partly offset by growth in Consumer Finance and in non-relationship balances.

The net interest margin was 16 basis points higher at 1.84 per cent in 2015 compared to 1.68 per cent in 2014, however adjusting net interest income for the amounts allocated to unitholders in Open-Ended Investment Companies, the net interest margin was 11 basis points higher at 1.88 per cent in 2015 compared to 1.77 per cent in 2014. Margins in Retail increased, driven by improved deposit margin and mix, more than offsetting reduced lending rates; however margins in Consumer Finance were down due to the acquisition of lower risk but lower margin new business and the impact of the planned reduction in deposits in line with Group's funding strategy. Margins on relationship lending and similar interest-earning assets in Commercial Banking increased due to disciplined pricing on new lending and deposits, with a reduction in wholesale funding costs led by continued progress in attracting high quality deposits.

2014 COMPARED WITH 2013

Net interest income was £10,660 million in 2014 an increase of £3,322 million, or 45 per cent, compared to £7,338 million in 2013. Net interest income in 2014 includes a charge of £602 million in respect of amounts payable to unitholders in consolidated Open-Ended Investment Companies compared to a charge in 2013 of £3,091 million. After adjusting for this, net interest income was £833 million, or 8 per cent, higher at £11,262 million in 2014 compared to £10,429 million in 2013.

Average interest-earning assets were £26,883 million, or 4 per cent, lower at £634,910 million in 2014 compared to £661,793 million in 2013. The reduction reflected the continuing run-off of assets which were outside of the Group's risk appetite, including business disposals, more than offsetting the impact of focused new lending.

Average interest-earning assets in Retail were £1,371 million higher at £317,567 million in 2014 compared to £316,196 million in 2013 and average interest-earning assets in Commercial Banking were £207 million lower at £93,153 million in 2014 compared to £93,360 million in 2013. Average interest-earning assets across the rest of the Group were £28,047 million, or 11 per cent lower at £224,190 million in 2014 compared to £252,237 million in 2013. The main driver for this reduction was the continuing run-down of the portfolio of assets which are outside of the Group's risk appetite, average interest-earning assets in respect of which were £27,711 million at 48 per cent lower at £29,921 million in 2014 compared to £57,632 million in 2013.

The net interest margin was 57 basis points higher at 1.68 per cent in 2014 compared to 1.11 per cent in 2013, however adjusting net interest income for the amounts paid to unitholders in Open-Ended Investment Companies, the net interest margin was 19 basis points higher at 1.77 per cent in 2014 compared to 1.58 per cent in 2013. Margins in Retail improved, driven by further improvements in deposit mix, more than offsetting reduced lending rates however margins in Consumer Finance fell as a result of business growth being focused on higher quality, but lower margin, lending on the new vehicle market and credit card balances, more than offsetting favourable deposit repricing. Margins on relationship lending and similar interest-earning assets in Commercial Banking improved as a result of disciplined pricing of new lending, deposit repricing and a reduction in funding costs.

19

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OTHER INCOME

	2015 £m	2014 £m	2013 £m
Fee and commission income:			
Current account fees	804	918	973
Credit and debit card fees	918	1,050	984
Other	1,530	1,691	2,162
	3,252	3,659	4,119
Fee and commission expense	(1,442)	(1,402)	(1,385)
Net fee and commission income	1,810	2,257	2,734
Net trading income	3,714	10,159	16,467
Insurance premium income	4,792	7,125	8,197
Gains on sale of available-for-sale financial assets	51	131	629
Liability management	(28)	(1,386)	(142)
Other	1,493	946	2,762
Other operating income	1,516	(309)	3,249
Total other income	11,832	19,232	30,647

2015 COMPARED WITH 2014

Other income was £7,400 million, or 38 per cent, lower at £11,832 million in 2015 compared to £19,232 million in 2014.

Fee and commission income was £407 million, or 11 per cent, lower at £3,252 million in 2015 compared with £3,659 million in 2014. Current account fees were £114 million, or 12 per cent, lower at £804 million in 2015 compared to £918 million in 2014, with £75 million of the reduction being a result of the sale of TSB. A decrease of £132 million, or 13 per cent, in credit and debit card fees from £1,050 million in 2014 to £918 million in 2015 resulted from the sale of TSB (£51 million of the decrease) and reduced interchange income due to changes in regulation. Other fees and commissions receivable were £161 million, or 10 per cent lower at £1,530 million in 2015 compared with £1,691 million in 2014; again partly reflecting the sale of TSB and also Scottish Widows Investment Partnership in 2014.

Fee and commission expense was £40 million, or 3 per cent, higher at £1,442 million in 2015 compared to £1,402 million in 2014; despite a £63 million decrease as a result of the sale of TSB and Scottish Widows Investment Partnership; the underlying increase reflects increased levels of fees payable in respect of transactions in Commercial Banking and for asset management services in Insurance.

Net trading income was £6,445 million, or 63 per cent, lower at £3,714 million in 2015 compared with £10,159 million in 2014. Net trading income within the insurance businesses was £6,146 million, or 69 per cent, lower at £2,774 million in 2015 compared to £8,920 million in 2014, which reflects lower levels of returns on policyholder investments as a result of market conditions over 2015 relative in those in 2014. However this decrease, along with the decrease in long-term insurance premium income, was largely offset by the decrease in insurance claims expense and the £358 million decrease in the amounts payable to unit holders in those Open-Ended Investment Companies consolidated into the Group's results within net interest income. Net trading income within the Group's banking activities was £299 million, or 24 per cent, lower at £940 million in 2015 compared to £1,239 million in 2014; in particular this decrease reflected a charge of £101 million for the movement in fair value of the equity conversion feature of the Group's Enhanced Capital Notes, compared to a gain of £401 million in the year ended 31 December 2014.

Insurance premium income was £4,792 million in 2015 compared with £7,125 million in 2014; a decrease of £2,333 million, or 33 per cent. Premium income in 2015 has been reduced by a charge of £1,959 million relating to the recapture by a third party insurer of a portfolio of policies previously reassured with the Group. Excluding this item earned premiums in respect of the Group's long-term life and pensions business were £375 million, or 6 per cent, lower at £5,880 million in 2015 compared to £6,255 million in 2014 with the impact of regulatory and market change more than offsetting income from the new bulk annuities business. General insurance earned premiums were little changed, just £1 million higher at £871 million in 2015 compared with £870 million in 2014 reflecting competitive market conditions and the run-off of products closed to new customers.

Other operating income was £1,825 million higher at £1,516 million in 2015 compared to a deficit of £309 million in 2014. In April 2014, the Group had completed exchange offers with holders of certain series of its Enhanced Capital Notes (ECNs) to exchange the ECNs for new Additional Tier 1 (AT1) securities and a tender offer to eligible retail holders outside the United States to sell their Sterling-denominated ECNs for cash; a loss of £1,362 million was recognised in relation to these exchange and tender transactions in the year ended 31 December 2014. Excluding this item, other operating income was £463 million, or 44 per cent, higher at £1,516 million in 2015 compared to £1,053 million in 2014; this reflected a £266 million improvement in the movement in value of in-force insurance business and a £39 million increase in operating lease rental income.

2014 COMPARED WITH 2013

Other income was £11,415 million, or 37 per cent, lower at £19,232 million in 2014 compared to £30,647 million in 2013.

Fee and commission income was £460 million, or 11 per cent, lower at £3,659 million in 2014 compared with £4,119 million in 2013. Current account fees were £55 million, or 6 per cent, lower at £918 million in 2014 compared to £973 million in 2013. An increase of £66 million, or 7 per cent, in credit and debit card fees from £984 million in 2013 to £1,050 million in 2014 resulted from increased customer activity and merchanting charges. Other fees and commissions receivable were £471 million, or 22 per cent lower at £1,691 million in 2014 compared with £2,162 million in 2013; this reduction principally reflects the disposal of St James's Place plc in March 2013 and the sale of Scottish Widows Investment Partnership during the first half of 2014.

Fee and commission expense was £17 million, or 1 per cent, higher at £1,402 million in 2014 compared to £1,385 million in 2013.

Net trading income was £6,308 million, or 38 per cent, lower at £10,159 million in 2014 compared with £16,467 million in 2013. Net trading income within the insurance businesses was £7,384 million,or 45 per cent, lower at £8,920 million in 2014 compared to £16,304 million in 2013, which reflects relatively lower returns on policyholder investments. However this decrease, along with the decrease in long-term insurance premium income, was largely offset

20

by the decrease in insurance claims expense and the £2,489 million decrease in the amounts payable to unit holders in those Open-Ended Investment Companies consolidated into the Group's results within net interest income. Net trading income within the Group's banking activities was £1,076 million higher at £1,239 million in 2014 compared to £163 million in 2013. The principal reason for this was a £610 million improvement in the mark-to-market movement in the embedded derivative related to the Group's Enhanced Capital Notes from a loss of £209 million in 2013 to a gain of £401million in 2014; there was also an improvement in gains recognised on interest rate derivatives and foreign exchange contracts in the banking book not mitigated through hedge accounting.

Insurance premium income was £7,125 million in 2014 compared with £8,197 million in 2013; a decrease of £1,072 million, or 13 per cent. Earned premiums in respect of the Group's long-term life and pensions business were £945 million, or 13 per cent, lower at £6,255 million in 2014 compared to £7,200 million in 2013 following changes in the pensions and annuities markets and lower protection sales through branches. General insurance earned premiums were £127 million, or 13 per cent, lower at £870 million in 2014 compared with £997 million in 2013 due to competitive market conditions.

Other operating income was £3,558 million lower at a deficit of £309 million in 2014 compared to £3,249 million in 2013. In April 2014, the Group completed concurrent Sterling, Euro and Dollar exchange offers with holders of certain series of its Enhanced Capital Notes (ECNs) to exchange the ECNs for new Additional Tier 1 (AT1) securities. In addition, the Group completed a tender offer to eligible retail holders outside the United States to sell their Sterling-denominated ECNs for cash. The exchange offers completed with the equivalent of £4.0 billion of Sterling and Euro ECNs and approximately US$1.6 billion of US Dollar ECNs being exchanged for approximately £5.35 billion of AT1 securities. The retail tender offer completed with approximately £58.5 million of ECNs being repurchased for cash. A loss of £1,362 million has been recognised in relation to these exchange and tender transactions in the year ended 31 December 2014. During 2013 the Group incurred liability management losses of £142 million, following a planned exit from repurchase agreement facilities and redemption of a tranche of covered bonds.

During 2013, the Group had recognised a gain of £540 million following the sale of its shareholding in St. James's Place plc and gains of £538 million on the sale of a portfolio of US residential mortgage-backed securities partly offset by a loss of £256 million on the sale of the Group's Spanish retail banking operations and a loss of £382 million related to the sale of the Group's German life assurance business. In 2014 there was a gain of £128 million on the sale of Scottish Widows Investment Partnership which completed during the year.

Other operating income also includes gains and losses on sale of available-for-sale financial assets, which were £498 million, or 79 per cent, lower at £131 million in 2014 compared to £629 million in 2013; of this £787 million in 2013 related to the sale of government securities following the repositioning of the Group's government bond portfolio which substantially completed in the first half of 2013.

operating and financial review and prospects

OPERATING EXPENSES

	2015	2014	2013
	£m	£m	£m
Administrative expenses:			
Staff:			
Salaries	**2,808**	3,178	3,331
Performance-based compensation	**409**	390	473
Social security costs	**349**	398	385
Pensions and other post-retirement benefit schemes:			
Past service credits and curtailment gains	**–**	(822)	104
Other	**548**	596	654
	548	(226)	758
Restructuring costs	**104**	264	111
Other staff costs	**459**	741	783
	4,677	4,745	5,841
Premises and equipment:			
Rent and rates	**368**	424	467
Repairs and maintenance	**173**	221	178
Other	**174**	246	325
	715	891	970
Other expenses:			
Communications and data processing	**893**	1,118	1,169
Advertising and promotion	**253**	336	313
Professional fees	**262**	481	425
UK bank levy	**270**	237	238
TSB disposal	**665**	–	–
Other	**703**	1,017	971
	3,046	3,189	3,116
Depreciation and amortisation:			
Depreciation of tangible fixed assets	**1,534**	1,391	1,374
Amortisation of acquired value of in-force non-participating investment contracts	**41**	43	54
Amortisation of other intangible assets	**537**	501	512
	2,112	1,935	1,940
Total operating expenses, excluding regulatory provisions	**10,550**	10,760	11,867
Regulatory provisions:			
Payment protection insurance provision	**4,000**	2,200	3,050
Other regulatory provisions	**837**	925	405
	4,837	3,125	3,455
Total operating expenses	**15,387**	13,885	15,322
Cost:income ratio (%)[1]	**88.3**	84.7	82.9

[1] Total operating expenses divided by total income, net of insurance claims.

2015 COMPARED WITH 2014

Operating expenses increased by £1,502 million, or 11 per cent, to £15,387 million in 2015 compared with £13,885 million in 2014. This increase principally reflected the fact that 2014 included a past service pension credit of £822 million and 2015 includes a regulatory provisions charge of £4,837 million, which was £1,712 million, or 54 per cent, higher than the charge of £3,125 million in 2014.

The past service pension credit of £822 million in 2014 followed the Group's decision, announced on 11 March 2014 to reduce the cap on increases in pensionable pay used in calculating the pension benefit to nil with effect from 2 April 2014.

Despite the past service pension credit in 2014, staff costs were £68 million, or 1 per cent, lower in 2015 at £4,677 million compared to £4,745 million in 2014. Excluding the pension credit, staff costs were £890 million, or 16 per cent, lower at £4,677 million in 2015 compared to £5,567 million in 2014 reflecting, in particular, the impact of business disposals and a significant reduction in expenditure in relation to the Group's Simplification programme. As a result, salaries were £370 million, or 12 per cent, lower at £2,808 million in 2015 compared with £3,178 million in 2014; pension costs, excluding the past service pension credit from 2014, were £48 million, or 8 per cent, lower at £548 million in 2015 compared to £596 million in 2014; social security costs were £49 million, or 12 per cent, lower at £349 million in 2015 compared with £398 million in 2014; staff restructuring costs were £160 million, or 61 per cent, lower at £104 million in 2015 compared with £264 million in 2014; and other staff costs were £282 million, or 38 per cent, lower at £459 million in 2015 compared with £741 million in 2014, in particular due to lower levels of agency staff costs in relation to the Simplification programme.

Premises and equipment costs were £176 million, or 20 per cent, lower at £715 million in 2015 compared to £891 million in 2014, again reflecting business disposals and reduced Simplification expenditure. Rent and rates was £56 million, or 13 per cent, lower at £368 million in 2015 compared to £424 million in 2014; repairs and maintenance costs were £48 million, or 22 per cent, lower at £173 million in 2015 compared to £221 million in 2014, in part due to a lower level of dilapidation provisions on vacation of properties in 2015 than in 2014; and other premises and equipment costs decreased by £72 million, or 29 per cent, from £246 million in 2014 to £174 million in 2015, reflecting lower levels of losses on sale of equipment and a reduced level of activity in the property portfolio.

Other expenses, excluding the regulatory provisions charges, were £143 million, or 4 per cent, lower at £3,046 million in 2015 compared with £3,189 million in 2014. Communications and data processing costs were £225 million, or 20 per cent, lower at £893 million in 2015 compared with £1,118 million in 2014 as a result of a significant reduction in Simplification spend on systems and technology; professional fees were £219 million, or 46 per cent, lower at £262 million in 2015 compared to £481 million in 2014, reflecting both the reduced Simplification spend and a lower level of professional fees in respect of TSB; and advertising and promotion costs were £83 million, or 25 per cent, lower at £253 million in 2015 compared with £336 million in 2014 due to spend in relation to TSB in 2014. The cost of the Bank levy was £33 million, or 14 per cent, higher at £270 million in 2015 compared to £237 million in 2014, as a result of the increase in rate with effect from 1 April 2015. In 2015 the Group incurred a charge of £665 million relating to the disposal of TSB, reflecting the net costs of the Transitional Service Agreement between Lloyds and TSB and the contribution to be provided by Lloyds to TSB in moving to alternative IT provision. Other costs were £314 million, or 31 per cent, lower at £703 million in 2015 compared with £1,017 million in 2014.

Depreciation and amortisation costs were £177 million, or 9 per cent, higher at £2,112 million in 2015 compared with £1,935 million in 2014. Charges for the depreciation of tangible fixed assets were £143 million, or 10 per cent, higher at £1,534 million in 2015 compared to £1,391 million in 2014, in line with increased asset balances. The charge for the amortisation of acquired value of in-force non-participating investment contracts was £2 million, or 5 per cent, lower at £41 million in 2015 compared to £43 million in 2014. The charge for the amortisation of other intangible assets was £36 million, or 7 per cent, higher at £537 million in 2015 compared to £501 million in 2014, reflecting increased capitalised software balances.

The Group incurred a regulatory provisions charge in operating expenses of £4,837 million in 2015 compared to £3,125 million in 2014 of which £4,000 million (2014: £2,200 million) related to payment protection insurance. For further details see note 39 to the financial statements.

2014 COMPARED WITH 2013

Operating expenses decreased by £1,437 million, or 9 per cent, to £13,885 million in 2014 compared with £15,322 million in 2013. This decrease principally reflected a past service pension credit of £822 million, compared to a charge of £104 million in 2013 and the reduced regulatory provisions charge of £3,125 million in 2014, which was £330 million, or 10 per cent, lower than the charge of £3,455 million in 2013.

The past service pension credit of £822 million in 2014 followed the Group's announcement on 11 March 2014 to freeze pensionable pay with effect from 2 April 2014. The effect of this change was to reduce the Group's retirement benefit obligations recognised on the balance sheet by £843 million with a corresponding curtailment gain recognised in the income statement. This has been partly offset by a charge of £21 million following changes to pension arrangements for staff within the TSB business.

As a result of the past service pension credit, staff costs were £1,096 million, or 19 per cent, lower in 2014 at £4,745 million compared to £5,841 million in 2013. Excluding this, staff costs were lower by £170 million, or 3 per cent, at £5,567 million in 2014 compared to £5,737 million in 2013. Salaries were £153 million, or 5 per cent, lower at £3,178 million in 2014 compared with £3,331 million in 2013 as the impact of annual pay rises was more than offset by staff reductions, in part due to business disposals. Pension costs, excluding the past service pension items, were £58 million, or 9 per cent, lower at £596 million in 2014 compared to £654 million in 2013 primarily due to lower current service costs. Social security costs were £13 million, or 3 per cent, higher at £398 million in 2014 compared with £385 million in 2013. Staff restructuring costs were £153 million, higher at £264 million in 2014 compared with £111 million in 2013 reflecting a number of initiatives in the year, and other staff costs were £42 million, or 5 per cent, lower at £741 million in 2014 compared with £783 million in 2013.

Premises and equipment costs were £79 million, or 8 per cent, lower at £891 million in 2014 compared to £970 million in 2013. Rent and rates was £43 million, or 9 per cent, lower at £424 million in 2014 compared to £467 million in 2013 as the Group continues to rationalise its property portfolio, in part through business disposals. Repairs and maintenance costs were £43 million, or 24 per cent, higher at £221 million in 2014 compared to £178 million in 2013 in part reflecting increased dilapidation charges on a·number of properties; other premises and equipment costs decreased by £79 million,or 24 per cent, from £325 million in 2013 to £246 million in 2014, partly due to reduced charges in relation to the Group's Simplification programme.

Other expenses excluding the regulatory provisions charges, were £73 million, or 2 per cent, higher at £3,189 million in 2014 compared with £3,116 million in 2013. Communications and data processing costs were £51 million, or 4 per cent, lower at £1,118 million in 2014 compared with £1,169 million in 2013 due to the high level of costs supporting the TSB separation in 2013; professional fees were £56 million, or 13 per cent, higher at £481 million in 2014 compared to £425 million in 2013, in part due to charges in relation to the restructuring of the staff remuneration package and the rationalisation of the Group's overseas presence; and advertising and promotion costs were £23 million, or 7 per cent, higher at £336 million in 2014 compared with £313 million in 2013 due to the promotion of the TSB brand. Other costs were £46 million, or 5 per cent, higher at £1,017 million in 2014 compared with £971 million in 2013.

Depreciation and amortisation costs were £5 million, lower at £1,935 million in 2014 compared with £1,940 million in 2013. Charges for the depreciation of tangible fixed assets were £17 million, or 1 per cent, higher at £1,391 million in 2014 compared to £1,374 million in 2013, in line with increased asset balances. The charge for the amortisation of acquired value of in-force non-participating investment contracts was £11 million, or 20 per cent, lower at £43 million in 2014 compared to £54 million in 2013 following the sale of St James's Place plc in March 2013. The charge for the amortisation of other intangible assets was £11 million, or 2 per cent, lower at £501 million in 2014 compared to £512 million in 2013, partly as certain core deposit intangibles have become fully amortised.

The Group incurred a regulatory provisions charge of £3,125 million in 2014 compared to £3,455 million in 2013 of which £2,200 million (2013: £3,050 million) related to payment protection insurance. For further details see note 40 to the financial statements.

IMPAIRMENT

	2015	2014	2013
	£m	£m	£m
Impairment losses on loans and receivables:			
Loans and advances to customers	**443**	735	2,725
Debt securities classified as loans and receivables	**(2)**	2	1
Total impairment losses on loans and receivables	**441**	737	2,726
Impairment of available-for-sale financial assets	**4**	5	15
Other credit risk provisions	**(55)**	10	–
Total impairment charged to the income statement	**390**	752	2,741

2015 COMPARED WITH 2014

Impairment losses decreased by £362 million, or 48 per cent, to £390 million in 2015 compared to £752 million in 2014, largely due to reduced charges in relation to the portfolio of assets which are outside of the Group's risk appetite.

The impairment charge in respect of loans and advances to customers was £292 million, or 40 per cent, lower at £443 million in 2015 compared to £735 million in 2014. In Retail, a reduced impairment charge reflected continued low risk underwriting discipline, strong portfolio management and a favourable credit environment with low unemployment, increasing house prices and continued low interest rates. The improvement in Commercial Banking was driven by lower levels of new impairment as a result of effective risk management, improving UK economic conditions and the continued low interest rate environment; as well as provision releases, but at lower levels than seen during 2014. The Consumer Finance impairment charge reduced, driven by a continued underlying improvement in portfolio quality, supported by an increased level of write-backs from the sale of recoveries assets in the credit card portfolio compared to 2014 due to favourable market conditions. The impairment charge relating to assets which are outside of the Group's risk appetite reduced significantly, reflecting the Group's ongoing exit from these positions.

The impairment charge in respect of debt securities classified as loans and receivables was a credit of £2 million in 2015 compared to a charge of £2 million in 2014. The impairment charge in respect of available-for-sale financial assets was £1 million, or 20 per cent, lower at £4 million in 2015 compared to £5 million in 2014; and there was a credit of £55 million (2014: charge of £10 million) in respect of other credit risk provisions as a result of improved credit quality in a number of corporate relationships.

2014 COMPARED WITH 2013

Impairment losses decreased by £1,989 million, or 73 per cent, to £752 million in 2014 compared to £2,741 million in 2013 with a significant reduction in the portfolio of assets which are outside of the Group's risk appetite and improvements in all Divisions. The improvements reflect lower levels of new impairment as a result of effective risk management, improving economic conditions and the continued low interest rate environment. The net charge has also benefited from significant provision releases but at lower levels than seen in 2013.

The impairment charge in respect of loans and advances to customers was £1,990 million, or 73 per cent, lower at £735 million compared to £2,725 million in 2013. In Retail, the impairment charge on unsecured lending reduced in line with lower impaired loan and arrears balances, in part reflecting the sale of a tranche of recoveries balances, and coverage in the secured book improved. The charge in Commercial Banking reduced as a result of the higher quality of recent new lending, the improving economy and continuing low interest rates, and provision releases as the Division progresses with its strategy of building a low-risk commercial bank. The Consumer Finance impairment charge was lower as a result of improving portfolio quality and the Division also had a benefit from the sale of recoveries balances. The impairment charge relating to assets which are outside of the Group's risk appetite fell substantially following successful run-down of the portfolio, and in particular the sale of the majority of the Group's impaired mortgage assets in Ireland.

The impairment charge in respect of debt securities classified as loans and receivables was £2 million in 2014 compared to £1 million in 2013. The impairment charge in respect of available-for-sale financial assets was £10 million, or 67 per cent, lower at £5 million in 2014 compared to £15 million in 2013; and there was a charge of £10 million (2013: £nil) in respect of undrawn commitments.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

TAXATION

	2015	2014	2013
	£m	£m	£m
UK corporation tax:			
Current tax on profits for the year	**(485)**	(162)	(226)
Adjustments in respect of prior years	**(90)**	213	(205)
	(575)	51	(431)
Foreign tax:			
Current tax on profits for the year	**(24)**	(39)	(60)
Adjustments in respect of prior years	**27**	3	26
	3	(36)	(34)
Current tax credit (charge)	**(572)**	15	(465)
Deferred tax	**(116)**	(278)	(752)
Taxation charge	**(688)**	(263)	(1,217)

2015 COMPARED WITH 2014

In 2015, a tax charge of £688 million arose on the profit before tax of £1,644 million and in 2014 a tax charge of £263 million arose on the profit before tax of £1,762 million. The statutory corporation tax rates were 20.25 per cent for 2015 and 21.5 per cent for 2014.

The tax charge for the 2015 represented an effective tax rate of 42 per cent. The effective tax rate was higher than the UK corporation tax rate largely due to the introduction in 2015 of restrictions on the deductibility of conduct related provisions which resulted in an additional tax charge of £459 million. Adjusting for this charge, the effective tax rate would have been 14 per cent reflecting non-taxable and relieved gains and a number of positive one-off items.

The low tax charge in 2014 was driven by tax exempt gains on sales of businesses and a lower deferred tax liability in respect of the value of in-force assets in the life business.

2014 COMPARED WITH 2013

In 2014, a tax charge of £263 million arose on the profit before tax of £1,762 million and in 2013 a tax charge of £1,217 million arose on the profit before tax of £415 million. The statutory corporation tax rates were 21.5 per cent for 2014 and 23.25 per cent for 2013.

The tax charge for the 2014 represented an effective tax rate of 15 per cent. The effective tax rate was lower than the UK corporation tax rate largely as a result of tax exempt gains on sales of businesses and a lower deferred tax liability in respect of the value of in-force assets for the life business partially offset by the effect of non-deductible expenses.

The high tax charge in 2013 was driven by the write down of deferred tax assets following the changes in corporation tax rates and the sale of the Australian business.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LINE OF BUSINESS INFORMATION

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

The Group Executive Committee, which is the chief operating decision maker for the Group, reviews the Group's internal reporting based around these segments (which reflect the Group's organisational and management structures) in order to assess performance and allocate resources.

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 and the performance assessment includes a consideration of each segment's net interest revenue; consequently the total interest income and expense for all reportable segments is presented on a net basis. The internal reporting is on an underlying profit before tax basis. The Group Executive Committee believes that this basis better represents the underlying performance of the Group. IFRS 8 requires that the Group presents its segmental profit before tax on the basis reviewed by the chief operating decision maker that is most consistent with the measurement principles used in measuring the Group's statutory profit before tax. Accordingly, the Group presents its segmental underlying basis profit before tax in note 4 to the financial statements.

The aggregate total of the underlying basis segmental results constitutes a non-GAAP measure as defined in the United States Securities and Exchange Commission's Regulation G. Management uses aggregate underlying profit before tax, a non-GAAP measure, as a measure of performance and believes that it provides important information for investors because it is a comparable representation of the Group's performance. Profit before tax is the comparable GAAP measure to aggregate underlying profit before tax. The table below sets out the reconciliation of this non-GAAP measure to its comparable GAAP measure.

The Group's activities are organised into four financial reporting segments: Retail; Commercial Banking; Consumer Finance and Insurance.

Comparisons of results on a historical consolidated statutory basis are distorted by a number of items. In order to provide more meaningful and relevant comparatives, the results of the Group and divisions are presented on an 'underlying' basis. The following items are excluded in arriving at underlying profit:

– the amortisation of purchased intangible assets and the unwind of acquisition-related fair value adjustments arising from the HBOS acquisition;

– the effects of certain asset sales, the impact of liability management actions and the volatility relating to the Group's own debt and hedging arrangements as well as that arising in the insurance businesses and insurance gross up;

– Simplification costs, which for 2015 are limited to severance costs relating to the programme announced in October 2014. Costs in 2014 and 2013 included severance, IT and business costs relating to the programme started in 2011;

– TSB build and dual running costs and the loss relating to the TSB sale;

– payment protection insurance provision and other conduct provisions; and

– certain past service pensions charges and credits in respect of the Group's defined benefit pension arrangements.

Readers should be aware that the underlying basis has been presented for comparative purposes only and is not intended to provide proforma information or show the results of the Group as if the acquisition of HBOS had taken place at an earlier date.

The results of the businesses are set out below on the underlying basis:

	2015	2014	2013
	£m	£m	£m
Retail	**3,514**	3,228	3,015
Commercial Banking	**2,431**	2,206	1,890
Consumer Finance	**1,005**	1,010	965
Insurance	**962**	922	1,088
Other	**200**	390	(792)
Underlying profit before tax	**8,112**	7,756	6,166

26

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Reconciliation of underlying profit to statutory profit (loss) before tax for the year

	Note	**2015 £m**	2014 £m	2013 £m
Profit before tax – Underlying basis		**8,112**	7,756	6,166
Asset sales	1	**54**	138	(687)
Sale of government securities	2	**–**	–	787
Liability management	3	**(28)**	(1,386)	(142)
Own debt volatility	4	**26**	398	(221)
Other volatile items	5	**(129)**	(112)	(457)
Volatility arising in insurance businesses	6	**(105)**	(228)	668
Fair value unwind	8	**(192)**	(529)	(228)
Simplification costs and TSB build and dual running costs	9	**(255)**	(1,524)	(1,517)
Charge relating to TSB disposal	10	**(660)**	–	–
Payment protection insurance provision	11	**(4,000)**	(2,200)	(3,050)
Other conduct provisions	12	**(837)**	(925)	(405)
Past service pension credit (charge)	13	**–**	710	(104)
Amortisation of purchased intangibles	14	**(342)**	(336)	(395)
Profit before tax – Statutory		**1,644**	1,762	415

1. Asset sales

Asset sales comprise the gains and losses on asset disposals (2015: gains of £54 million; 2014: gains of £138 million; 2013: losses of £687 million), principally of assets which were outside of the Group's risk appetite.

2. Sale of government securities

These reflected gains on bond sales (2015: £nil; 2014: £nil; 2013: £787 million) as the Group took the opportunity afforded by the continuing low interest rate environment to reposition its holdings of available-for-sale government securities.

3. Liability management

In April 2014, the Group completed concurrent Sterling, Euro and Dollar exchange offers with holders of certain series of its Enhanced Capital Notes (ECNs) to exchange the ECNs for new Additional Tier 1 (AT1) securities. In addition the Group completed a tender offer to eligible retail holders outside the United States to sell their Sterling-denominated ECNs for cash. The exchange offers completed with the equivalent of £5.0 billion of ECNs being exchanged for the equivalent of £5.35 billion of AT1 securities, before issue costs. The retail tender offer completed with approximately £58.5 million of ECNs being repurchased for cash. A loss of £1,362 million was recognised in relation to these exchange and tender transactions in the year ended 31 December 2014.

Losses of £28 million (2014: losses of £24 million; 2013: losses of £142 million) arose on other transactions undertaken as part of the Group's management of wholesale funding and capital. The liability management losses were included in other income.

4. Own debt volatility

Own debt volatility includes a loss of £101 million (2014: gain of £401 million; 2013: loss of £209 million) relating to the change in fair value of the equity conversion feature of the Enhanced Capital Notes, which principally reflects the ongoing amortisation of the value of the conversion feature over its life. Own debt volatility also includes a £114 million gain (2014: gain of £33 million; 2013: gain of £41 million) relating to the change in fair value of the small proportion of the Group's wholesale funding which was designated at fair value at inception.

5. Other volatile items

Other volatile items include the change in fair value of interest rate derivatives and foreign exchange hedges in the banking book not mitigated through hedge accounting. A charge of £99 million was included in 2015 (2014: charge of £138 million; 2013: charge of £489 million). Also included in 2015 was a negative net derivative valuation adjustment of £30 million (2014: credit of £26 million; 2013: credit of £32 million), reflecting movements in the market implied credit risk associated with customer derivative balances.

6. Volatility arising in insurance businesses

The Group's statutory result before tax is affected by insurance volatility, caused by movements in financial markets, and policyholder interests volatility.

In 2015, the Group's statutory result before tax included negative insurance and policyholder interests volatility totalling £105 million compared to negative volatility of £228 million in 2014 and positive volatility of £668 million in 2013.

Volatility comprises the following:

	2015	2014	2013
	£m	£m	£m
Insurance volatility	**(303)**	(219)	218
Policyholder interests volatility	**87**	17	564
Insurance hedging arrangements	**111**	(26)	(114)
Total	**(105)**	(228)	668

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

The most significant limitations associated with excluding volatility from the underlying basis results are:

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

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

Management compensates for the limitations above by:

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

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

Insurance volatility

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

The expected gross investment returns used to determine the underlying profit of the business are based on prevailing market rates and published research into historical investment return differentials for the range of assets held. Where appropriate, rates are updated throughout the year to reflect changing market conditions and changes in the asset mix. In 2015 the basis for calculating these expected returns has been enhanced to reflect an average of the 15 year swap rate over the preceding 12 months and rates were updated throughout the year to reflect changing market conditions. The negative insurance volatility during 2015 of £303 million primarily reflects lower equity returns than expected, widening credit spreads and low returns on cash investments.

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.

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 result is, therefore, to either increase or decrease profit before tax with a related change in the tax charge. Timing and measurement differences exist between provisions for tax and charges made to policyholders. Consistent with the expected 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. In 2015, the statutory results before tax included a credit to other income which relates to policyholder interests volatility totalling £87 million (2014: £17 million) reflecting offsetting movements in equity, bond and gilt returns.

Insurance hedging arrangements

The Group purchased put option contracts in 2015 to protect against deterioration in equity market conditions and the consequent negative impact on the value of in-force business on the Group balance sheet. These were financed by selling some upside potential from equity market movements. A gain of £111 million was recognised in relation to these contracts in 2015.

7. Insurance gross-up

The Group's insurance businesses' income statements include income and expenditure which are attributable to the policyholders of the Group's long-term assurance funds. These items have no impact in total upon the profit attributable to equity shareholders and, in order to provide a clearer representation of the underlying trends within the business, these items are shown net on a separate line. These policyholder amounts relate principally to returns on policyholder investments (within net interest income and net trading income) and insurance premiums receivable, together with a matching amount within the insurance claims expense representing the allocation of these items to policyholders.

8. Fair value unwind

The statutory (IFRS) results include the impact of the acquisition-related fair value adjustments arising from the acquisition of HBOS in 2009; these adjustments affect a number of line items.

The principal financial effects of the fair value unwind are to reflect the effective interest rates applicable at the date of acquisition, on assets and liabilities that were acquired at values that differed from their original book value, and to recognise the reversal of credit and liquidity risk adjustments as underlying instruments mature or become impaired. Generally, this leads to higher interest expense as the value of HBOS's own debt accretes to par and a lower impairment charge reflecting the impact of acquisition balance sheet valuation adjustments.

9. Simplification costs and TSB build and dual-running costs

Simplification programme costs in 2015 were £170 million (2014: £966 million; 2013: £830 million) relating to the next phase of simplification announced in October 2014. This had delivered annual run-rate cost savings of £373 million by 31 December 2015. The costs in 2014 and 2013 related to phase 1 of the simplification programme which was completed in 2014.

During 2015, the Group completed the European Commission (EC) mandated business disposal of TSB. TSB costs in the year ended 31 December 2015 totalled £85 million (2014: £558 million; 2013: £687 million) relating to dual-running costs. The dual-running costs include the costs of TSB's standalone treasury, finance, human resources and other head office functions.

10. Charge relating to TSB disposal

On 20 March 2015 the Group announced that it had agreed to sell a 9.99 per cent interest in TSB Banking Group plc (TSB) to Banco de Sabadell S.A. (Banco Sabadell) and that it had entered into an irrevocable undertaking to accept Banco Sabadell's recommended cash offer in respect of its remaining 40.01 per cent interest in TSB. The offer by Banco Sabadell was conditional upon, amongst other things, regulatory approval.

The sale of the 9.99 per cent interest completed on 24 March 2015, reducing the Group's holding in TSB to 40.01 per cent; this sale led to a loss of control and the deconsolidation of TSB. The Group's residual investment in 40.01 per cent of TSB was then recorded at fair value, as an asset held for sale. The Group recognised a loss of £660 million reflecting the net costs of the Transitional Service Agreement between Lloyds and TSB, the contribution to be provided by Lloyds to TSB in moving to alternative IT provision and the net result on sale of the 9.99 per cent interest and fair valuation of the residual investment.

The Group announced on 30 June 2015 that all relevant regulatory clearances for the sale of its remaining 40.01 per cent holding in TSB had been received and that the sale was therefore unconditional in all respects; the proceeds were received on 10 July 2015.

11. Payment protection insurance (PPI) provision

The Group increased the provision for PPI costs by a further £4,000 million in 2015, bringing the total amount provided to £16,025 million. This included an additional £2,100 million in the fourth quarter, largely to reflect the impact of its interpretation of the proposals contained within the Financial Conduct Authority's (FCA) consultation paper regarding a potential time bar and the Plevin case. As at 31 December 2015, £3,458 million or 22 per cent of the total provision, remained unutilised with approximately £2,950 million relating to reactive complaints and associated administration costs.

The volume of reactive PPI complaints has continued to fall, with an 8 per cent reduction in 2015 compared with 2014, to approximately 8,000 complaints per week. Whilst direct customer complaint levels fell 30 per cent year-on-year, those from Claims Management Companies (CMCs) have remained broadly stable and as a result, CMCs now account for over 70 per cent of complaints.

Assuming current FCA proposals are implemented and an average of approximately 10,000 complaints per week, including those related to Plevin, the outstanding provision should be sufficient to cover all future PPI related complaints and associated administration costs through to mid-2018.

Weekly complaint trends could vary significantly throughout this period, given they are likely to be impacted by a number of factors including the potential impact of the FCA's proposed communication campaign as well as changes in the regulation of CMCs.

12. Other conduct provisions

In 2015, the Group incurred a charge of £837 million, of which £302 million was recognised in the fourth quarter relating to a number of non-material items including packaged bank accounts and a number of other product rectifications primarily in Retail, Insurance and Commercial Banking. Within the full year charge, £720 million of provisions related to potential claims and remediation in respect of products sold through the branch network and continuing investigation of matters highlighted through industry wide regulatory reviews, as well as legacy product sales and historical systems and controls such as those governing legacy incentive schemes. This includes a full year charge of £225 million in respect of complaints relating to packaged bank accounts. The full year charge also included the previously announced settlement of £117 million that the Group reached with the FCA with regard to aspects of its PPI complaint handling process during the period March 2012 to May 2013.

13. Past service pension credit (charge)

On 11 March 2014 the Group announced a change to its defined benefit pension arrangements, revising the existing cap on the increases in pensionable pay used in calculating the pension benefit, from 2 per cent to nil with effect from 2 April 2014. The effect of this change was to reduce the Group's retirement benefit obligations recognised on the balance sheet by £843 million with a corresponding curtailment gain recognised in the income statement. This was partly offset by a charge of £133 million relating to the cost of other changes to the pay, benefits and reward offered to employees to give a net credit of £710 million recognised in 2014.

In 2013 the Group recorded a charge of £104 million as a result of changes to early retirement and commutation factors in two of its principal defined benefit schemes.

14. Amortisation of purchased intangibles

The Group incurred a charge for the amortisation of intangible assets, recognised on the acquisition of HBOS in 2009, of £342 million (2014: £336 million; 2013: £395 million).

29

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

DIVISIONAL RESULTS

RETAIL

Retail offers a broad range of financial service products, including current accounts, savings, personal loans and mortgages, to UK personal customers, including Wealth and small business customers. It is also a distributor of insurance, protection and credit cards, and a range of long-term savings and investment products. Its aim is to be the best bank for customers in the UK, by building deep and enduring relationships that deliver real value to customers, and by providing them with greater choice and flexibility. It will maintain its multi-brand and multi-channel strategy, and continue to simplify the business and provide more transparent products, helping to improve service levels and reduce conduct risks.

	2015	2014	2013
	£m	£m	£m
Net interest income	7,397	7,079	6,500
Other income	1,122	1,212	1,435
Total income	8,519	8,291	7,935
Operating expenses	(4,573)	(4,464)	(4,160)
Impairment	(432)	(599)	(760)
Underlying profit	3,514	3,228	3,015

2015 COMPARED WITH 2014

Underlying profit increased by £286 million, or 9 per cent to £3,514 million in 2015 compared to £3,228 million in 2014, driven by improved margins and reduced impairments.

Net interest income increased £318 million, or 4 per cent, to £7,397 million in 2015 compared to £7,079 million in 2014. Margin performance was strong, increasing 11bps to 2.40 per cent in 2015 compared to 2.29 per cent in 2014, driven by improved deposit mix and margin, more than offsetting reduced lending rates.

Other income decreased £90 million, or 7 per cent, to £1,122 million in 2015 compared to £1,212 million in 2014, driven by current account transaction related income and regulatory changes, in particular, impacting the Wealth business.

Operating expenses increased £109 million, 2 per cent, to £4,573 million in 2015 compared to £4,464 million in 2014. The increase reflects continued business investment and simplification to improve customer experiences and enable staff numbers to be reduced by 7 per cent in 2015.

Impairment reduced by £167 million, or 28 per cent, to £432 million in 2015 compared to £599 million in 2014, driven by continued low risk underwriting discipline, strong portfolio management and a favourable credit environment.

2014 COMPARED WITH 2013

Underlying profit increased by £213 million, or 7 per cent to £3,228 million in 2014 compared to £3,015 million in 2013, driven by improved margins and reduced impairments.

Net interest income increased £579 million, or 9 per cent, to £7,079 million in 2014 compared to £6,500 million in 2013. Margin performance was strong, increasing 20 basis points to 2.29 per cent in 2014 compared to 2.09 per cent in 2013, driven by improved deposit mix and margin, more than offsetting reduced lending rates.

Other income decreased £223 million, or 16 per cent, to £1,212 million in 2014 compared to £1,435 million in 2013, as a result of lower other operating income from protection sales partly due to fewer advised sales roles in branches. Lower Wealth other operating income following the Retail Distribution Review.

Total costs increased £304 million, 7 per cent, to £4,464 million in 2014 compared to £4,160 million in 2013, driven by higher indirect costs previously absorbed within TSB and depreciation costs associated with ongoing investment in the business.

Impairment reduced £161 million, or 21 per cent, to £599 million in 2014 compared to £760 million in 2013, driven by lower write-offs and impaired loans in the unsecured book. Secured coverage strengthened to 37 per cent, resulting in a 13 per cent increase to the impairment charge.

COMMERCIAL BANKING

Commercial Banking has been supporting British business for 250 years. It has a client-led, low risk, capital efficient strategy, helping UK-based clients and international clients with a link to the UK. Through its four client facing divisions – SME, Mid Markets, Global Corporates and Financial Institutions – it provides clients with a range of products and services such as lending, transactional banking, working capital management, risk management, debt capital markets services, as well as access to private equity through Lloyds Development Capital.

	2015	2014	2013
	£m	£m	£m
Net interest income	2,510	2,480	2,113
Other income	2,066	1,956	2,259
Total income	4,576	4,436	4,372
Operating expenses	(2,167)	(2,147)	(2,084)
Impairment	22	(83)	(398)
Underlying profit	2,431	2,206	1,890

2015 COMPARED WITH 2014

Commercial Banking underlying profit increased by £225 million, or 10 per cent, to £2,431 million in 2015 compared to £2,206 million in 2014 due to lower impairments and increased total underlying income partially offset by higher operating costs.

Net interest income increased by £30 million, or 1 per cent, to £2,510 million in 2015 compared to £2,480 million in 2014 driven by reduced funding costs and higher net interest margin due to disciplined new lending and an increase in deposits.

Other income increased by £110 million, or 6 per cent, to £2,066 million in 2015 compared to £1,956 million in 2014 driven by refinancing support provided to Global Corporate clients and increases in Mid Markets.

Operating expenses increased by £20 million, or 1 per cent, to £2,167 million in 2015 compared to £2,147 million in 2014.

Impairments improved by £105 million to a £22 million release in 2015 compared to an £83 million charge in 2014 reflecting lower gross charges and a number of write-backs and releases.

2014 COMPARED WITH 2013

Commercial Banking underlying profit increased by £316 million, or 17 per cent, to £2,206 million in 2014 compared to £1,890 million in 2013 due to lower impairments and increased net interest income, partially offset by reduced other income and increased operating expenses.

Net interest income increased by £367 million, or 17 per cent, to £2,480 million in 2014 compared to £2,113 million in 2013 driven by reduced funding costs and net interest margin expansion as a result of disciplined pricing of new business.

Other income decreased by £303 million, or 13 per cent, to £1,956 million in 2014 compared to £2,259 million in 2013 reflecting reduced client activity in Debt Capital Markets and Financial Markets in addition to lower revaluation gains within Lloyds Development Capital.

Operating expenses increased by £63 million, or 3 per cent, to £2,147 million in 2014 compared to £2,084 million in 2013 as a result of continued investment in developing product capabilities.

Impairments decreased by £315 million, or 79 per cent, to £83 million in 2014 compared to £398 million in 2013 reflecting lower gross charges, and improved credit quality.

CONSUMER FINANCE

Consumer Finance provides a range of products including motor finance, credit cards, and European mortgages and deposit taking, aiming to deliver sustainable growth within risk appetite. Motor Finance seeks to achieve this through improving customer service by building digital capability and continuing to create innovative propositions. Credit Cards aims to attract customers through better use of Group customer relationships and insight, underpinned by improvements to customer experience.

	2015	2014	2013
	£m	£m	£m
Net interest income	**1,287**	1,290	1,333
Other income	**1,358**	1,364	1,359
Total income	**2,645**	2,654	2,692
Operating expenses	**(1,488)**	(1,429)	(1,384)
Impairment	**(152)**	(215)	(343)
Underlying profit	**1,005**	1,010	965

2015 COMPARED WITH 2014

Underlying profit was £1,005 million in 2015 compared to £1,010 million in 2014 with growth in better quality but lower margin lending resulting in lower income but lower impairments, offset by increased cost of investment in growth initiatives.

Total income decreased by £9 million to £2,645 million in 2015 compared to £2,654 million in 2014.

Net interest margin decreased by 55 basis points to 5.94 per cent, contributing to a small reduction in net interest income to £1,287 million in 2015 compared to £1,290 million in 2014. Net interest margin was down due to the acquisition of lower risk but lower margin new business, an increased proportion of Cards interest free balance transfer balances and the impact of the planned reduction in deposits in line with the Group's balance sheet funding strategy.

Other income reduced by £6 million to £1,358 million in 2015 compared to £1,364 million in 2014, as higher income from growing the Lex Autolease fleet was offset by the impact of lower interchange income in Cards following the recent EU ruling.

Operating expenses increased by £59 million, or 4 per cent, to £1,488 million in 2015 compared to £1,429 million in 2014 as operating cost savings were offset by continued investment in growth initiatives and increased operating lease depreciation as a result of growth in the Lex Autolease fleet.

The impairment charge reduced by £63 million, or 29 per cent, to £152 million in 2015 compared to £215 million in 2014. This has been driven by a continued underlying improvement in portfolio quality and supported by the sale of recoveries assets in the Credit Cards portfolio. The asset quality ratio improved by 37 basis points.

2014 COMPARED WITH 2013

Underlying profit increased by £45 million to £1,010 million in 2014 compared to £965 million in 2013 primarily due to a reduction of £128 million in impairment charges across the portfolio and growth in total income from Asset Finance partly offset by a fall in total income from Credit Cards and investments for future growth in the businesses.

Total income decreased by £38 million to £2,654 million in 2014 compared to £2,692 million in 2013.

Net interest margin decreased by 45 basis points to 6.49 per cent, resulting in a 3 per cent reduction in net interest income to £1,290 million in 2014 compared to £1,333 million in 2013. New business growth and deposit repricing have been offset by a change in the composition of the portfolio with an increase in higher quality, lower margin lending to the new vehicle market and the impact of the current year's strategic focus on growing the volume of new credit cards. Consistent with the strategy of acquiring high quality new business, the asset quality ratio improved by 71 basis points.

Other income increased by £5 million to £1,364 million in 2014 compared to £1,359 million in 2013 as a result of the growth strategy.

Operating expenses increased by £45 million, or 3 per cent, to £1,429 million in 2014 compared to £1,384 million in 2013 driven by investment in growth initiatives and increased operating lease depreciation as a result of growth in the Lex Autolease fleet, offset by cost savings and increased gains from end of life lease asset sales. In 2014 a further £45 million was invested in improving propositions and customers' digital experience.

The impairment charge reduced by £128 million, or 37 per cent, to £215 million in 2014 compared to £343 million in 2013. This has been driven by a continued underlying improvement of portfolio quality supported by the sale of recoveries assets in the Credit Cards and Asset Finance portfolios.

INSURANCE

Insurance provides a broad range of long term savings, retirement and protection products to retail and corporate customers, either direct or through intermediary networks or through the Group's banking branches .

Life, Pensions and Investments

The Life, Pensions and Investments business provides long-term savings, retirement solutions and protection products primarily distributed through intermediaries and direct channels of Scottish Widows.

General Insurance

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

	2015	2014	2013
	£m	£m	£m
Net interest expense	(163)	(131)	(107)
Other income	1,827	1,725	1,864
Total income, net of insurance claims	1,664	1,594	1,757
Operating expenses	(702)	(672)	(669)
Underlying profit	962	922	1,088

2015 COMPARED WITH 2014

Underlying profit from insurance was £40 million, or 4 per cent higher at £962 million compared to £922 million in 2014. The increase was driven by bulk annuity deals and the net benefit from a number of assumption updates, partly offset by increased costs reflecting significant investment spend, adverse economics, and reduced general insurance income.

Net interest expense increased by £32 million, or 24 per cent, to £163 million from £131 million in 2014 due to holding increased debt whilst a tranche of subordinated debt was re-financed.

Other income increased by £102 million, or 6 per cent, to £1,827 million from £1,725 million in 2014. The increase was driven by bulk annuity deals and the net benefit from a number of assumption updates, partly offset by adverse economics and reduced general insurance income.

2014 COMPARED WITH 2013

Underlying profit from insurance was £166 million, or 15 per cent, lower at £922 million compared to £1,088 million in 2013. This was impacted by the cost of structural changes in the corporate pensions book, primarily the cap on pension charges and lower life new business and general insurance premiums offset by improved economics and an increase in yields on assets backing annuity business as a result of the strategy to invest in long-term, low risk, higher yielding assets.

Net interest expense increased by £24 million, or 22 per cent, to £131 million from £107 million in 2013, primarily due to higher intra group charges.

Other income decreased by £139 million, or 7 per cent, to £1,725 million from £1,864 million in 2013. This was impacted by lower new business, reduced general insurance income and structural changes in the corporate pensions book, offset by benefits arising from the strategy of acquiring attractive, higher yielding assets to back the annuities business, improved economics and lower weather related claims.

Operating expenses of £672 million increased by £3 million from £669 million in 2013 where increased investment in strategic initiatives has been funded by a reduction in the underlying cost base.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

UNDERLYING PROFIT BY PRODUCT GROUP

	2015						2014	2013
	Pensions & investments £m	**Protection & retirement £m**	**Bulk annuities £m**	**General insurance £m**	**Other £m**	**Total £m**	Total £m	Total £m
New business income	**168**	**33**	**125**	**–**	**–**	**326**	268	423
Existing business income	**630**	**122**	**–**	**–**	**28**	**780**	882	795
Long-term investment strategy	**–**	**73**	**102**	**–**	**–**	**175**	160	118
Assumption changes and experience variances	**(208)**	**240**	**30**	**–**	**(2)**	**60**	(134)	(48)
General insurance income net of claims	**–**	**–**	**–**	**323**	**–**	**323**	418	469
Total income	**590**	**468**	**257**	**323**	**26**	**1,664**	1,594	1,757
Total costs	**(414)**	**(133)**	**(10)**	**(145)**	**–**	**(702)**	(672)	(669)
Underlying profit 2015	**176**	**335**	**247**	**178**	**26**	**962**	922	1,088
Underlying profit 2014	236	344	–	274	68	922		

2015 COMPARED WITH 2014

New business income increased by £58 million to £326 million with the primary driver being the new bulk annuity business. This was offset by a reduction in Protection income, following the removal of face-to-face advice in branch standalone protection sales and reduced annuity income following the introduction of Pensions Freedoms in 2015. Corporate pension income remained robust despite lower sales following the auto enrolment driven increases in 2014.

The £102 million fall in existing business income reflects a reduction in the expected rate of return used to calculate life and pensions income. The rate of return is largely set by reference to an average 15 year swap rate (2.57 per cent in 2015 and 3.48 per cent in 2014).

Long-term investment strategy includes the benefit from the successful acquisition of a further £1.4 billion of higher yielding assets to match long duration annuity liabilities.

Assumption changes and experience variances include an adverse impact of £208 million in Pensions and Investments as a result of the strengthening of lapse assumptions on the pensions book to allow for the impact of the recent pension reforms. This was more than offset by the £240 million of benefit recognised within Protection and Retirement, primarily as a result of changes to assumptions on longevity. These longevity changes reflect both experience in the annuity portfolio and the adoption of a new industry model reflecting an updated view of future life expectancy.

General Insurance income net of claims has fallen by £95 million. This reflects the run-off of products closed to new customers, the impact of becoming a sole underwriter of the home insurance business (which has resulted in a short term reduction from the loss of commission recognised upfront) and the impact of adverse weather. The anticipated launch in early 2016 of a more flexible Home product is expected to lead to an improvement in general insurance sales going forward.

Total costs were £30 million higher, reflecting significant investment spend as part of an ongoing programme of growth and simplification initiatives. In 2015 this included the launch of Protection to IFAs and the bulk annuities business alongside the Part VII transfer as well as a significant regulatory change agenda in particular to support pensions freedoms and transition to Solvency II. Excluding investment related expenditure, underlying costs fell by 3 per cent during 2015 reflecting ongoing operational efficiencies.

2014 COMPARED WITH 2013

New business income reduced by £155 million to £268 million driven by a reduction in pensions new business income due to lower volumes relative to the spike in 2013 sales (as Retail Distribution Review sales completed). In calculating new business income on auto-enrolment schemes, allowance has been made for low initial contribution levels and does not include future automatic increases in contribution levels. These increases will be reported in future years. In addition protection and retirement new business income has reduced following the 2014 Budget announcement which led to industry wide reductions in annuities volumes following changes to the freedoms consumers have in accessing their pension savings.

Existing business income has increased by £87 million reflecting improved economics benefiting the life and pensions business.

2014 underlying profit in the protection and annuities business included a benefit of £277 million, largely from investing in higher yielding assets to match long duration liabilities and benefits from assumption changes. This was offset by a charge of £219 million in the pensions and investments business driven primarily by assumption changes within the existing book including actions being taken to prepare for the structural changes arising from the Department for Work and Pensions' announcement which introduced a cap on pension charges. These changes to corporate pensions will ensure that future new business is less capital intensive.

General Insurance underlying profit has fallen by £35 million, due to the continued run off of legacy books and the impact of storms in the first quarter, offset by good prior year experience. During the year, underwriting of the home insurance business was brought in-house, ensuring delivery of a first class service to all customers and continued sustainable growth in the underwritten customer base.

OTHER

Other comprises Run-off, the results of TSB up until loss of control in March 2015 and Central items.

Run-off

Run-off includes assets classified as outside the Group's risk appetite and the results and gains on sale relating to businesses disposed in 2013 and 2014.

	2015 £m	2014 £m	2013 £m
Net interest income	**(88)**	(116)	138
Other income	**145**	451	1,266
Total income	**57**	335	1,404
Operating expenses	**(164)**	(308)	(726)
Impairment	**(8)**	(203)	(1,389)
Underlying loss	**(115)**	(176)	(711)

2015 COMPARED WITH 2014

The underlying loss of £115 million was £61 million lower than the loss of £176 million in 2014 as a result of both lower operating expenses and lower impairment charges as the run-off portfolios were managed down.

The reduction in total income from £335 million in 2014 to £57 million in 2015 was due to the sale of Scottish Widows Investment Partnership during 2014 and the continued reduction in run-off assets.

Operating costs were £164 million, down £144 million as a result of business disposals in 2014.

The reduction in the impairment charge from £203 million in 2014 to £8 million in 2015 reflects the continued progress in managing down the run-off portfolios.

2014 COMPARED WITH 2013

Underlying loss of £176 million was £535 million lower than the loss of £711 million in 2013 largely as a result of the reduction in impairment charges as the run-off portfolios were managed down.

Total income was £335 million, down £1,069 million or 76 per cent from £1,404 million in 2013 reflecting the disposal of businesses during 2013 and the reduction in run-off assets. 2013 included £662 million of income relating to St James's Place which was sold in the year.

Operating expenses were £308 million, £418 million or 58 per cent lower than 2013 as a result of business disposals during 2013.

TSB

TSB is a separately listed multi-channel retail banking business with branches in England, Wales and Scotland. It serves retail and small business customers; providing a full range of retail banking products.

As explained in note 55 to the financial statements, the Group sold its controlling interest in TSB in March 2015 and ceased to consolidate TSB's results at that point.

	2015 £m	2014 £m	2013 £m
Net interest income	**192**	786	615
Other income	**31**	140	163
Total income	**223**	926	778
Operating expenses	**(86)**	(370)	(563)
Impairment	**(19)**	(98)	(109)
Underlying profit	**118**	458	106

TSB results are shown on a Lloyds Banking Group reporting basis. The costs of TSB's head office functions are excluded from underlying profit.

2015 COMPARED WITH 2014

Underlying profit was £340 million, or 74 per cent, lower at £118 million in 2015 compared to £458 million in 2014; this principally reflects the fact that TSB was only consolidated for three months in 2015, compared to a full year in 2014.

Total income was £703 million, or 76 per cent, lower at £223 million in 2015 compared to £926 million in 2014; operating expenses were £284 million, or 77 per cent, lower at £86 million in 2015 compared to £370 million in 2014; and the impairment charge was £79 million, or 81 per cent, lower at £19 million in 2015 compared to £98 million in 2014.

2014 COMPARED WITH 2013

Underlying profit was £458 million, up £352 million compared to £106 million in 2013 as a result of higher income and reduced costs.

Total income was £926 million, up £148 million or 19 per cent compared to £778 million in 2013 driven by improved net interest income. This was largely due to a reduction in funding costs following the creation of TSB as a separate stand alone bank.

Operating expenses were £370 million, down £193 million or 34 per cent compared to £563 million in 2013. This was largely explained by the change in the basis of cost allocation to TSB following the creation of TSB as a separate stand alone bank.

OTHER (continued)

Central items

Central Items includes income and expenses not recharged to the divisions. These largely comprise residual income from the Group's processes to allocate funding and liquidity costs to the divisions and the charge for payments to the Group's charitable foundations.

	2015 **£m**	2014 £m	2013 £m
Total income	**176**	132	(133)
Operating expenses	**19**	(22)	(49)
Impairment release (charge)	**2**	(2)	(5)
Underlying profit (loss)	**197**	108	(187)

2015 COMPARED WITH 2014

Underlying profit was £197 million in 2015, £89 million higher than the £108 million profit in 2014.

Total income was £176 million, £44 million higher than 2014 as it included a full year benefit in net interest income from the exchange of the Enhanced Capital Notes in 2014.

Operating costs were a credit of £19 million compared with a charge of £22 million in 2014 and represent the residual amount after allocations to the divisions.

There was a net release of impairment of £2 million compared with a charge of £2 million in 2014.

2014 COMPARED WITH 2013

Underlying profit was £108 million in 2014, £295 million higher than the £187 million loss in 2013.

Total income was £265 million higher at £132 million in 2014, compared to negative income of £133 million in 2013 mainly as a result of the favourable impact on net interest income of the exchange of approximately £5 billion of the Group's Enhanced Capital Notes for Additional Tier 1 securities and structural interest rate hedging activities.

Operating expenses were £27 million, or 55 per cent, lower at £22 million in 2014 compared to £49 million in 2013.

The impairment charge was £3 million, or 60 per cent, lower at £2 million in 2014 compared to £5 million in 2013.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

AVERAGE BALANCE SHEET AND NET INTEREST INCOME

	2015 Average balance £m	**Interest income £m**	**Yield %**	2014 Average balance £m	Interest income £m	Yield %	2013 Average balance £m	Interest income £m	Yield %
Assets									
Loans and receivables:									
Loans and advances to banks	**94,543**	**397**	**0.42**	78,762	406	0.52	102,190	457	0.45
Loans and advances to customers	**464,012**	**16,256**	**3.50**	504,246	17,806	3.53	518,734	19,928	3.84
Debt securities	**2,139**	**40**	**1.87**	1,633	42	2.57	2,102	32	1.52
Available-for-sale financial assets	**40,967**	**725**	**1.77**	50,269	957	1.90	38,767	746	1.92
Held-to-maturity investments	**13,256**	**197**	**1.49**	–	–	–	–	–	–
Total interest-earning assets of banking book	**614,917**	**17,615**	**2.86**	634,910	19,211	3.03	661,793	21,163	3.20
Total interest-earning trading securities and other financial assets at fair value through profit or loss	**87,583**	**1,955**	**2.23**	82,018	1,993	2.43	68,763	2,076	3.02
Total interest-earning assets	**702,500**	**19,570**	**2.79**	716,928	21,204	2.96	730,556	23,239	3.18
Allowance for impairment losses on loans and receivables	**(4,729)**			(10,051)			(14,381)		
Non-interest earning assets	**145,224**			158,584			175,228		
Total average assets and interest income	**842,995**	**19,570**	**2.32**	865,461	21,204	2.45	891,403	23,239	2.61

	2015 Average interest earning assets £m	**Net interest income £m**	**Net interest margin %**	2014 Average interest earning assets £m	Net interest income £m	Net interest margin %	2013 Average interest earning assets £m	Net interest income £m	Net interest margin %
Average interest-earning assets and net interest income:									
Banking business	**614,917**	**11,318**	**1.84**	634,910	10,660	1.68	661,793	7,338	1.11
	87,583	**1,205**	**1.38**	82,018	1,464	1.78	68,763	1,757	2.56

Trading securities and other financial assets at fair value through profit or loss	**702,500**	**12,523**	**1.78**	716,928	12,124	1.69	730,556	9,095	1.24

37

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

	2015 Average balance £m	**Interest expense £m**	**Cost %**	2014 Average balance £m	Interest expense £m	Cost %	2013 Average balance £m	Interest expense £m	Cost %
Liabilities and shareholders' funds									
Deposits by banks	**10,442**	**43**	**0.41**	11,604	86	0.74	19,845	129	0.65
Customer deposits	**380,137**	**3,299**	**0.87**	416,651	4,781	1.15	397,881	6,119	1.54
Liabilities to banks and customers under sale and repurchase agreements	**5,960**	**34**	**0.57**	2,104	55	2.61	6,515	79	1.21
Debt securities in issue	**85,462**	**586**	**0.69**	88,289	552	0.63	111,264	1,451	1.30
Amounts payable to unitholders in consolidated open-ended investment vehicles	**21,059**	**244**	**1.16**	18,620	602	3.23	25,585	3,091	12.08
Subordinated liabilities	**24,975**	**2,091**	**8.37**	29,332	2,475	8.44	34,486	2,956	8.57
Total interest-bearing liabilities of banking book	**528,035**	**6,297**	**1.19**	566,600	8,551	1.51	595,576	13,825	2.32
Total interest-bearing liabilities of trading book	**61,560**	**750**	**1.22**	54,980	529	0.96	37,760	319	0.84
Total interest-bearing liabilities	**589,595**	**7,047**	**1.20**	621,580	9,080	1.46	633,336	14,144	2.23
Interest-free liabilities									
Non-interest bearing customer accounts	**45,294**			42,049			35,994		
Other interest-free liabilities	**158,852**			157,824			178,836		
Non-controlling interests and shareholders' funds	**49,254**			44,008			43,237		
Total average liabilities and interest expense	**842,995**	**7,047**	**0.84**	**865,461**	9,080	1.05	891,403	14,144	1.59

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

Following the reduction in the Group's non-UK activities, an analysis between domestic and foreign operations is not provided.

CHANGES IN NET INTEREST INCOME – VOLUME AND RATE ANALYSIS

The following table allocates changes in net interest income between volume and rate for 2015 compared with 2014 and for 2014 compared with 2013. Where variances have arisen from both changes in volume and rate these are allocated to volume.

	2015 compared with 2014 Increase/(decrease)			2014 compared with 2013 Increase/(decrease)		
	Total change £m	**Volume £m**	**Rate £m**	Total change £m	Volume £m	Rate £m
Interest receivable and similar income						
Loans and receivables:						
Loans and advances to banks	**(9)**	**66**	**(75)**	(51)	(122)	71
Loans and advances to customers	**(1,550)**	**(1,408)**	**(142)**	(2,122)	(511)	(1,611)
Debt securities	**(2)**	**9**	**(11)**	10	(12)	22
Available-for-sale financial assets	**(232)**	**(165)**	**(67)**	211	219	(8)
Held-to-maturity investments	**197**	**–**	**197**	–	–	–
Total banking book interest receivable and similar income	**(1,596)**	**(1,498)**	**(98)**	(1,952)	(426)	(1,526)
Total interest receivable and similar income on trading securities and other financial assets at fair value through profit or loss	**(38)**	**124**	**(162)**	(83)	322	(405)
Total interest receivable and similar income	**(1,634)**	**(1,374)**	**(260)**	(2,035)	(104)	(1,931)
Interest payable						
Deposits by banks	**(43)**	**(5)**	**(38)**	(43)	(61)	18
Customer deposits	**(1,481)**	**(318)**	**(1,163)**	(1,338)	216	(1,554)
Liabilities to banks and customers under sale and repurchase agreements	**(21)**	**22**	**(43)**	(24)	(115)	91
Debt securities in issue	**34**	**(20)**	**54**	(899)	(145)	(754)
Amounts payable to unitholders in consolidated open-ended investment vehicles	**(358)**	**28**	**(386)**	(2,489)	(225)	(2,264)
Subordinated liabilities	**(384)**	**(365)**	**(19)**	(481)	(435)	(46)
Total banking book interest payable	**(2,253)**	**(653)**	**(1,600)**	(5,274)	(753)	(4,521)
Total interest payable on trading and other liabilities at fair value through profit or loss	**221**	**80**	**141**	210	165	45
Total interest payable	**(2,032)**	**(573)**	**(1,459)**	(5,064)	(588)	(4,476)

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RISK OVERVIEW

EFFECTIVE RISK MANAGEMENT, GOVERNANCE AND CONTROL

How we manage risk is a fundamental part of our strategy. We operate as a simple, low risk, UK focused, retail and commercial bank with a culture founded on a prudent through the cycle appetite for risk.

Our approach to risk is founded on an effective control framework and a strong risk management culture which guides how our employees approach their work, the way they behave and the decisions they make. Risk appetite, defined as the amount and type of risk that we are prepared to seek, accept or tolerate, works in tandem with our strategy and is approved by the Board. Our risk appetite is then embedded within policies, authorities and limits across the Group.

RISK AS A STRATEGIC DIFFERENTIATOR

Group strategy and risk appetite are developed together to ensure one informs the other and creates a strategy that delivers on becoming the best bank for our customers whilst helping Britain prosper and creating sustainable growth over time.

Risks are identified, managed and mitigated using our Risk Management Framework (see page 41). The principal risks we face, which could significantly impact the delivery of our strategy, are discussed on pages 42 to 45.

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

Sustainable growth

Embedding a risk culture that ensures proactive support and constructive challenge takes place across the business in order to deliver sustainable growth.

Prudent approach to risk

Implementing a prudent approach to risk appetite across the Group, aligned to the embedding of a strong risk culture, driven both from the top and across the wider business, ensures we operate within risk appetite.

Strong control framework

The Group's Risk Management Framework (RMF) acts as the foundation for the delivery of effective risk control and ensures that the Group risk appetite is adhered to.

Effective risk analysis, management and reporting

Close monitoring and stringent reporting to all levels of management and the Board ensures appetite limits are maintained and are subject to stressed analysis at a risk type and portfolio level.

Business focus and accountability

Effective risk management is a key focus and is included in key performance measures against which individual business units are assessed. The business areas in the first line are accountable for risk but with oversight from a strong and importantly, independent, Second Line Risk Division.

ACHIEVEMENTS IN 2015

We have continued our strategic journey and created a foundation to deliver our objectives, through reacting to changing customer behaviour, maintaining our strong capital position and increasing dividend payments, whilst continuing to adapt to the ever changing regulatory environment. Close and collaborative working across the Group within risk culture and appetite has supported key risk-related deliverables in the year. These included:

Conduct

Deploying a consistent and relentless approach under the Group conduct strategy to ensure we deliver customer needs with an open and transparent culture.

Credit rating

In recognition of the delivery of the Group's strategy, the three main credit rating agencies have either reaffirmed or upgraded our credit rating in the year.

State aid commitments

We have satisfied all material structural and behavioural commitments following the successful carve-out and disposal of TSB with respect to the State Aid commitments agreed with the European Commission under the State Aid regime in 2009. We are therefore no longer subject to restrictive behavioural commitments including the constraint on acquisitions, but continue to be bound by two remaining limited ancillary commitments which means that we remain subject to supervision by the European Commission with respect to these commitments until they cease to have effect on or before June 2017. Our strong risk management has assisted in the government's continued sell-down of shares to a holding which is approximately 9 per cent.

Capital strength

We have maintained our strong capital position through a combination of increased underlying profit and lower risk-weighted assets, partially offset by PPI and other conduct charges, which enabled the Group to pay both an interim dividend at half year and to recommend the payment of both a full year ordinary dividend and a special dividend whilst maintaining strong capital ratios. In 2015 the Group participated in the UK-wide concurrent stress testing run by the Bank of England, comfortably exceeding both the capital and leverage minimum thresholds set.

Impairments

Through effective risk management our impairment charge has fallen to £568 million, while the impairment ratio fell to 0.14 per cent. Reduction in run-off assets and the sustained improvement in asset quality across the Group reflects our robust risk management framework which is ingrained across the entire business, as detailed on page 41.

RISK GOVERNANCE

The Board approves the Group's overall RMF and sets risk appetite, both of which are designed to ensure that we manage our risks in the right way to achieve our agreed strategic objectives. It has a dedicated risk committee of non-executive directors who keep the design and performance of the Group's RMF under close and regular scrutiny, and interact closely with the executive risk management committee operating at Group Executive Committee level. The Board and senior management encourage a culture of transparency and openness to ensure that issues are escalated promptly to them where required.

The Board approved RMF and risk appetite are put into effect using an enterprise-wide framework which applies to every area of the business and covers all types of risk. The framework is designed to ensure we follow a consistent approach to risk management and reporting throughout the Group, so that all risks are fully understood and managed in relation to our agreed risk appetite. It includes our policies, procedures, controls and reporting.

A high level structure is shown in the diagram below.

The framework is periodically reviewed, updated and approved by the Board to reflect any changes in the nature of our business and external regulations, law, corporate governance and industry best practice. This helps us to ensure we continue to meet our responsibilities to our customers, shareholders and regulators. Our risk appetite and the policy framework define clear parameters within which our business units must operate in order to deliver the best outcome for customers and stakeholders.

The Board delegates authorities for risk management through the Group Chief Executive and the management hierarchy to individuals, an approach which is consistent with the focus of the Senior Managers and Certification Regime (SM&CR) on the principle of individual accountability. At a senior level, executives are supported in their decision-making by a committee-based governance structure. The concept of individual accountability for risk management is embedded in the RMF and culture at every level, and guides the way all employees approach their work, behave and make decisions. An important element of the framework is the maintenance of strong internal controls which are owned and operated by individual business areas. The Group's risk governance arrangements will support the effective implementation of the requirements of the SM&CR which comes into force in 2016.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

THE MOST SIGNIFICANT RISKS WE FACE WHICH COULD IMPACT THE DELIVERY OF OUR STRATEGY, TOGETHER WITH KEY MITIGATING ACTIONS, ARE OUTLINED BELOW.

This year we have added two new principal risks:

– Insurance risk, reflecting that we are increasing our exposure to longevity risk, following our entry into the bulk annuity market in 2015; and

– Governance risk, given increasing societal and regulatory focus on governance arrangements.

All risks have the potential to impact our strategic priorities and the summary below illustrates the most predominant strategic priority impacted by the principal risks and uncertainties detailed.

PRINCIPAL RISKS

Credit risk

The risk that customers to whom we have lent money or other counterparties with whom we have contracted, fail to meet their financial obligations, resulting in loss to the Group.

Adverse changes in the economic and market environment we operate in or the credit quality and/or behaviour of our customers and counterparties could reduce the value of our assets and potentially increase our write downs and allowances for impairment losses, adversely impacting profitability.

Example:

– Whilst we have a deep understanding of credit risks across our commercial, mortgage and other portfolios; a changing economic environment, e.g. interest rate rises, can impact on customer affordability and therefore our performance.

KEY MITIGATING ACTIONS

– Credit policy, incorporating prudent lending criteria, aligned with Board approved risk appetite, to effectively manage risk.

– Robust risk assessment and credit sanctioning, with clearly defined levels of authority to ensure we lend appropriately and responsibly.

– Extensive and thorough credit processes and controls to ensure effective risk identification, management and oversight.

– Effective, well-established governance process supported by independent credit risk assurance.

– Early identification of signs of stress leading to prompt action in engaging the customer.

Regulatory and legal risk

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

Examples:

– Increased regulatory oversight and Prudential regulatory requirements.

– Increased legislative requirements, such as ring-fencing legislation.

– The Legal, Regulatory and Mandatory Change Committee ensures we develop plans for delivery of all legal and regulatory changes and tracks their progress. Groupwide projects implemented to address significant impacts.

– Continued investment in people, processes, training and IT to assess impact and help meet our legal and regulatory commitments.

– Engage with regulatory authorities and relevant industry bodies on forthcoming regulatory changes, market reviews and Competition and Markets Authority investigations.

Conduct risk

Conduct risk can arise from a number of areas including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customers' expectations; and exhibiting behaviours which do not meet market or regulatory standards.

Example:

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

– Customer focused conduct strategy implemented to ensure customers are at the heart of everything we do.

– Product approval, review processes and outcome testing supported by conduct management information.

– Clear customer accountabilities for colleagues, with rewards driven by customer-centric metrics.

– Learning from past mistakes through root cause analysis of crystallised issues.

Operational risk

We face significant operational risks which may result in financial loss, disruption or damage to our reputation. These include the availability, resilience and security of our core IT systems and the potential for failings in our customer processes.

Examples:

– A resilient IT environment is critical to providing reliable services to customers and enabling sustainable growth.

– Continual review of our IT environment to ensure that systems and processes can effectively support the delivery of services to customers.

– Addressing the observations and associated resilience risks raised in the Independent IT Resilience Review (2013), with independent verification of progress on an annual basis.

– The dynamic threat posed by cyber risk and the potential for external attacks on the integrity of electronic data or the availability of systems.

– Investing in enhanced cyber controls to protect against external threats to the confidentiality or integrity of electronic data, or the availability of systems. Responding to findings from third party industry testing.

– Focused action on strategy to attract, retain and develop high calibre people.

People risk

Key people risks include the risk that we fail to lead responsibly in an increasing competitive marketplace, particularly with the introduction of the SM&CR in 2016. This may dissuade capable individuals from taking up senior positions within the industry.

Example:

– Lack of colleague capacity and capability could impact the achievement of business objectives. Additional colleague stretch (including increased dependency on key staff) could result in a loss of expertise.

– Maintain compliance with legal and regulatory requirements relating to the SM&CR, embedding compliant and appropriate colleague behaviours.

– Continued focus on our culture, delivering initiatives which reinforce behaviours to generate the best long-term outcomes for customers and colleagues.

– Maintain organisational people capability and capacity levels in response to increasing volumes of organisational and external market changes.

KEY RISK INDICATORS	ALIGNMENT TO STRATEGIC PRIORITIES AND FUTURE FOCUS
Impairment charge Impaired assets	**Delivering sustainable growth** We have a UK customer focused, low risk, conservative and well balanced credit portfolio, managed through the economic cycle and supported by strong credit portfolio management. Credit risk decisions are consistent, fair and responsible, taking account of customers' circumstances. We support sustainable growth and meet our targets in the Helping Britain Prosper Plan while staying within prudent risk appetite. Impairments remain below long term levels and are expected to normalise over time. Emerging credit risks that have the potential to increase impairment include the global and UK economic environment as it can impact customer and counterparties' affordability.
Legal, regulatory and mandatory investment spend	**Delivering sustainable growth** We are committed to operating sustainably and responsibly, and commit significant resource and expense to ensure we meet our legal and regulatory obligations. We respond as appropriate to impending legislation and regulation and associated consultations and participate in industry bodies. We continue to be subject to significant ongoing and new legislation, regulation and court proceedings, with numerous developments in each of these areas.
FCA reportable complaints per 1,000 accounts (excl. PPI)[1]	**Creating the best customer experience** As we transform and simplify our business, minimising conduct risk is critical to achieving our strategic goals and meeting market and regulatory standards. Our customer focused conduct strategy forms the foundation of our vision to be the best bank for customers, allowing us to create the best customer experience through learning from past mistakes.
1 This key risk indicator is also a key performance indicator (KPI).	
Availability of core systems	**Creating the best customer experience** We recognise the role that resilient technology plays in enabling us to create the best customer experience, and in maintaining banking services and trust across the wider industry. As such, the availability, resilience and security of our IT systems remains a key focus.

Our Cyber Programme continues to focus on improving the Groupwide cyber security controls and we regularly assess our cyber control environment, through both internal and third party testing.

Creating the best customer experience

We continue to focus on developing colleagues, their capabilities and skills in order to create the best customer experience and to respond quickly to the rapidly evolving change in customers' decision making.

Best bank for customers index

The current regulatory regime presents some far reaching people implications in terms of personal accountability and remuneration arrangements. This coincides with the ongoing challenge of maintaining colleague capacity and capability to deliver our change agenda.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

PRINCIPAL RISKS

Insurance risk

Key insurance risks within the Insurance business are longevity, persistency and property insurance. Longevity risk is expected to increase with the 2015 entry into the bulk annuity market. Longevity is also the key insurance risk in the Group's Defined Benefit Pension Schemes.

Examples:
Increases in life expectancy (longevity) beyond current assumptions will increase the cost of annuities and pension scheme benefits.

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

Capital risk

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

Example:

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

Funding and liquidity risk

The risk that we have insufficient financial resources to meet our commitments as they fall due, or can only secure them at excessive cost.

KEY MITIGATING ACTIONS

– Insurance processes on underwriting, claims management, pricing and product design seek to control exposure to these risks. A team of longevity and bulk pricing experts has been built to support the new bulk annuity proposition.

– The merits of longevity risk transfer and hedging solutions are regularly reviewed for both the Insurance business and the Group's Defined Benefit Pension Schemes.

– Property insurance exposure to accumulations of risk and possible catastrophes is mitigated by a broad reinsurance programme.

– A comprehensive capital management framework that sets and monitors capital risk appetite using a number of key metrics.

– Close monitoring of capital and leverage ratios to ensure we meet current and future regulatory requirements.

– Comprehensive stress testing analysis to evidence sufficient levels of capital adequacy under various adverse scenarios.

– Accumulation of retained profits and managing dividend policy appropriately.

– Holding a large portfolio of unencumbered LCR eligible liquid assets to meet cash and collateral outflows and regulatory requirements and maintaining a further large pool of secondary assets that can be used to access central bank liquidity facilities.

Example:

– Our funding and liquidity position is supported by a significant and stable customer deposit base. A deterioration in either the Group's or the UK's credit rating, or a sudden and significant withdrawal of customer deposits, would adversely impact our funding and liquidity position.

Governance risk

Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from the SM&CR in force from March 2016 and the requirement to improve the resolvability of the Group and to ring-fence core UK financial services and activities from January 2019.

Example:

– Non-compliance with or breaches of ring-fencing, resolution and SM&CR requirements will result in legal and regulatory consequences.

Market risk

The risk that our capital or earnings profile is affected by adverse market rates, in particular interest rates and credit spreads in the Banking business and equity and credit spreads in the Insurance business and the Group's Defined Benefit Pension Schemes.

Examples:

– Earnings are impacted by our ability to forecast and model customer behaviour accurately and establish appropriate hedging strategies.

– The Insurance business is exposed indirectly to equity and credit markets through the value of future management charges on policyholder funds. Credit spread risk within the Insurance business primarily arises from bonds and loans used to back

– Undertaking daily monitoring against a number of market and Group-specific early warning indicators and regular stress tests.

– Maintaining a contingency funding plan detailing management actions and strategies available in stressed conditions.

– Our response to the SM&CR is managed through a programme with work streams addressing each of the major components.

– A programme is in place to address the requirements of ring-fencing and resolution and we are in close and regular contact with regulators to develop plans for our anticipated operating and legal structures.

– Our aim is to ensure that evolving risk and governance arrangements continue to be appropriate across the range of business in the Group in order to comply with regulatory objectives.

– Structural hedge programmes have been implemented to manage liability margins and margin compression, and the Group's exposure to Bank Base Rate.

– Equity and credit spread risks are inherent within Insurance products and are closely monitored to ensure they remain within risk appetite. Where appropriate, asset liability matching is undertaken to mitigate risk.

– The allocation to credit assets has been increased and equity holdings reduced within the Group's Defined Benefit Pension Schemes. A hedging programme is also in place to minimise exposure to nominal rates/inflation.

annuities. Credit spreads affect the value of the Group's Defined Benefit Pension Schemes' liabilities.

– Stress and scenario testing of Group risk exposures.

KEY RISK INDICATORS	**ALIGNMENT TO STRATEGIC PRIORITIES AND FUTURE FOCUS**
Insurance (Life and Pensions) present value of new business premiums **Insurance (General Insurance) gross written premiums**	**Creating the best customer experience** We are committed to meeting the changing needs of customers by working to provide a range of insurance products via multiple channels. The focus is on creating the best customer experience by helping customers protect themselves today whilst preparing for a secure financial future. Strategic growth initiatives within Insurance are developed and managed in line with a defined risk appetite, aligned to the Group risk appetite and strategy.
Common equity tier 1 ratio[1] **Leverage ratio** 1 This key risk indicator is also a key performance indicator (KPI). 2 Ratios are post interim and recommended full year dividends and adjusted, reflecting dividend paid by Insurance in February 2016 in respect of 2015 earnings.	**Delivering sustainable growth** Ensuring we hold an appropriate level of capital to maintain financial resilience and marketconfidence, underpins our strategic objectives of supporting the UK economy and delivering sustainable growth. Looking ahead, the Basel Committee is continuing to review aspects of the regulatory capital framework, and the Bank of England has consulted on its approach for setting minimum requirements for own funds and eligible liabilities. There is a risk that these could lead to higher capital requirements than we have anticipated in our strategic plans.
Regulatory liquidity	**Delivering sustainable growth** We maintain a strong funding position in line with our low risk strategy. Our funding position has been significantly strengthened in recent years

and our loan to deposit ratio remains within the target range.

Loan to deposit ratio

Liquid assets are broadly equivalent to our total wholesale funding and thus provide a substantial buffer in the event of continued market dislocation.

There is a risk that our options to fund our balance sheet are reduced in future, or that the cost of funding may increase which could impact our performance versus our strategic plans.

3 Individual liquidity adequacy standards eligible primary liquid assets.

Becoming simpler and more efficient

Ring-fencing requirements ensure we become simpler and continue to create the best customer experience, through providing further protection to core Retail and SME deposits, provide transparency on our operations and facilitate the options available in resolution.

N/A

Resolution requirements are aimed at reducing the probability of failure and its impact on customers should we fail through continuity of critical banking services, helping rebuild trust in the financial services sector.

We already have a strong culture of ownership and accountability, and compliance with the SM&CR will enable us to further strengthen our ability to clearly demonstrate the responsibilities of Senior Managers and how these are discharged.

Delivering sustainable growth

We manage our exposure to movements in market rates throughout the year, leading us to promote low volatility earnings and offer a comprehensive customer proposition with market risk hedging strategies to support strategic aims, including delivering sustainable growth.

Pension surplus

Mitigating actions are implemented to reduce the impact of market movements, resulting in a stable capital position. This allows us to more efficiently utilise available capital resources to deliver sustainable growth.

By reducing the volatility in the Group's Defined Benefit Pension Schemes through hedging in 2014, we have taken a conservative approach to risk in line with our strategy.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RISK MANAGEMENT

Risk management is at the heart of our strategy to become the best bank for customers.

Our mission is to support the business in delivering sustainable growth. This is achieved through informed risk decision making and superior risk and capital management, supported by a consistent risk-focused culture.

The risk overview (pages 40 to 45) provides a summary of risk management within the Group. It highlights the important role of risk as a strategic differentiator, risk achievements in 2015 and priorities for 2016 along with a brief overview of the Group's risk governance structure and the principal risks faced by the Group and key mitigating actions.

This full risk management section provides a more in-depth picture of how risk is managed within the Group, detailing the Group's emerging risks, approach to stress testing, risk governance, committee structure, appetite for risk (pages 46 to 54) and a full analysis of the primary risk drivers (pages 55 to 120) – the framework by which risks are identified, managed, mitigated and monitored.

Each risk driver is described and managed using the following standard headings: definition, appetite, exposures, measurement, mitigation and monitoring.

THE GROUP'S APPROACH TO RISK

The Group operates a prudent approach to risk with rigorous management controls to support sustainable business growth and minimise losses. Through a strong and independent risk function (Risk Division) a robust control framework is maintained to identify and escalate emerging risks to support sustainable business growth within risk appetite and through good risk reward decision making.

RISK CULTURE

The Board ensures that senior management implements risk policies and risk appetites that either limit or, where appropriate, prohibit activities, relationships and situations that could be detrimental to the Group's risk profile.

As part of a conservative business model that embodies a risk culture founded on a prudent approach to managing risk, the Group refreshed its Codes of Business and Personal Responsibility in 2015 reinforcing its approach where colleagues are accountable for the risks they take and where the needs of customers are paramount.

The focus remains on building and sustaining long-term relationships with customers cognisant of the economic climate.

RISK APPETITE

– Defined as 'the amount and type of risk that the Group is prepared to seek, accept or tolerate.'

– The Group's strategy operates in tandem with its high level risk appetite which is supported by more detailed metrics and limits. An updated Risk Appetite Statement was approved by the Board in 2015. This incorporated challenge and recommendations from the Board Risk Committee and is fully aligned with Group strategy.

– Risk appetite is embedded within principles, policies, authorities and limits across the Group and continues to evolve to reflect external market developments and composition of the Group.

– Performance is optimised by allowing business units to operate within approved risk appetite and limits.

GOVERNANCE AND CONTROL

– The Group's approach to risk is founded on a robust control framework and a strong risk management culture which are the foundation for the delivery of effective risk management and guide the way all employees approach their work, behave and make decisions.

– Governance is maintained through delegation of authority from the Board down to individuals through the management hierarchy. Senior executives are supported by a committee-based structure which is designed to ensure open challenge and support effective decision making.

–

The Group's risk appetite, principles, policies, procedures, controls and reporting are regularly reviewed and updated where needed to ensure they remain fully in line with regulations, law, corporate governance and industry good-practice.

– The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by both the Board and senior management.

– Board-level engagement, coupled with the direct involvement of senior management in Groupwide risk issues at Group Executive Committee level, ensures that escalated issues are promptly addressed and remediation plans are initiated where required.

– Line management is directly accountable for identifying and managing risks in their individual businesses, ensuring that business decisions strike an appropriate balance between risk and reward consistent with the Group's risk appetite.

– Clear responsibilities and accountabilities for risk are defined across the Group through a Three Lines of Defence model which ensures effective independent oversight and assurance in respect of key decisions.

RISK DECISION MAKING AND REPORTING

– Taking risks which are well understood, consistent with strategy and with appropriate return is a key driver of shareholder value.

– Risk analysis and reporting supports the identification of opportunities as well as risks.

- An aggregate view of the Group's overall risk profile, key risks and management actions, and performance against risk appetite, is reported to and discussed monthly at the Group Risk Committee (and a subset at the Group Asset and Liability Committee), with regular reporting to the Board Risk Committee and the Board.
- Rigorous stress testing exercises are carried out to assess the impact of a range of adverse scenarios with different probabilities and severities to inform strategic planning.

– The Chief Risk Officer regularly informs the Board Risk Committee (BRC) of the aggregate risk profile and as a member of the Board, has direct access to the Chairman and members of BRC.

46

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.1: **Exposure to risk arising from the business activities of the Group**

The table below provides a high level guide to how the Group's business activities are reflected in its risk measures and balance sheet.

	Lloyds Banking Group						
	Retail	Commercial Banking	Consumer Finance	Run-off	Central Items[1]	Insurance[2]	Total
Division	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Risk-weighted assets (RWAs)							
– Credit risk[3]	**48.8**	**83.4**	**17.6**	**10.0**	**12.7**	**–**	**172.5**
– Counterparty credit risk[3]	**–**	**9.1**	**–**	**–**	**0.6**	**–**	**9.7**
– Operational risk	**17.1**	**6.3**	**2.5**	**0.2**	**–**	**–**	**26.1**
– Market risk	**–**	**3.7**	**–**	**–**	**0.1**	**–**	**3.8**
Total (excluding threshold)	**65.9**	**102.5**	**20.1**	**10.2**	**13.4**	**–**	**212.1**
– Threshold[4]	**–**	**–**	**–**	**–**	**10.6**	**–**	**10.6**
Total	**65.9**	**102.5**	**20.1**	**10.2**	**24.0**	**–**	**222.7**

1 Central items include assets held outside the main operating divisions, including exposures relating to Group Corporate Treasury which holds the Group's liquidity portfolio, and Group Operations.

2 As a separate regulated business, Insurance maintains its own regulatory solvency requirements, including appropriate management buffers, and reports directly to Insurance Board. Insurance does not hold any RWAs, as its assets are removed from the Banking Group's regulatory capital calculations. However, part of the Group's investment in Insurance is included in the calculation of Threshold RWAs, subject to the CRD IV rules, while the remainder is taken as a capital deduction.

3 Exposures relating to the default fund of a central counterparty and credit valuation adjustments are included in Credit Risk and Counterparty Credit Risk respectively for the purposes of this table.

4 Threshold is presented on a fully loaded CRD IV basis. Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of deducted from CET1 capital. Significant investments primarily arise from the investment in the Group's Insurance business.

PRINCIPAL RISKS

The Group's principal risks are shown in the risk overview (pages 40 to 45). The Group's emerging risks are shown overleaf. Full analysis of the Group's risk drivers is on pages 55 to 120.

47

EMERGING RISKS

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

These risks are considered alongside the Group's operating plan.

Risk	Key mitigating actions
Regulatory and legal change: The pace and volume of regulatory and legal change and developments including: competition; pensions; capital requirements; payments; accounting standards changes; Senior Managers and Certification Regime (SM&CR); and consumer protection laws, all have the potential to impact the delivery of our strategic objectives.	– Continue to implement our conduct strategy ensuring the customer is at the heart of our business planning whilst working closely with regulatory authorities and industry bodies to ensure that the Group can identify and respond to the evolving regulatory landscape. – Programmes in place to deliver SM&CR by March 2016 implementation and ring-fencing and resolution by January 2019.
Low interest rate environment: Continuation of the present low interest rate environment has the potential to negatively impact the delivery of the Group's strategic and operational objectives. As a result there may be a requirement to review our cost and investment priorities.	– Regular reviews and updates to strategic milestones provide opportunity to reposition and reprioritise to minimise and negate potential impacts.
Response to market changes (agility): The dynamic nature of external influences has the potential to impact the delivery of the strategy and risk profile of the Group. As technology advances, the typical banking model is evolving, and as such, operational complexity has the potential to restrict the Group's speed of response.	– Organisational and behavioural effectiveness is reviewed through regular Group Strategic Reviews, ensuring the continued drive for simplicity and efficiency, and the building of new capabilities to support sustainable growth. – Sustained and continuing investment in digital capability and customer channels with our plans progressively updated to reflect market trends and customer behaviour.
Conduct risk: In a low growth environment we cannot compromise on our Conduct Strategy for revenue growth. Further provisions for legacy issues may be required if issues emerge which require remediation.	– Rigorous implementation of our conduct strategy with customer needs at the centre rather than a product driven model. – Programmes in place to deliver redress to customers with Groupwide rectification governance in place to enhance effectiveness. –

Data integrity, IT and cyber: Cyber remains an evolving threat to the Group and its strategic objectives. Increased digital interconnectivity across the Group, its customers and suppliers has the potential to heighten our vulnerability to cyber-attacks, which could disrupt service for customers, and cause financial loss and reputational damage.	– Delivery of the Group cyber control framework, aligned to industry-recognised cyber security framework, and continued investment in the Group's Cyber Programme to ensure integrity of key systems and processes remains a priority. – Resilience programmes in place to protect the integrity and availability of the Group's systems and mitigate the impacts of cyber-attacks.
Market liquidity: Financial markets continue to exhibit signs of a lack of liquidity and potential impacts include the speed at which structural hedging can be undertaken and relevant asset portfolio liquidated.	– Market liquidity is reviewed on a regular basis through specific committees which approve funding plans, based on detailed analysis to ensure regulatory compliance and future liquidity requirements are satisfied.
Ring-fencing and resolution: UK ring-fencing legislation, regulation and rules impact the Group's business and operating model and could impact the ability to, and cost of, serving customers effectively to a greater extent than current assumptions, with potential changes in the competitive landscape and changes to customer and market behaviour.	– Engagement with relevant governmental and regulatory bodies and other agencies to deliver compliance by January 2019. – Business model design will optimise delivery of the full range of services to ring-fenced Bank customers through the provision of certain propositions from Group entities outside the ring-fence.
Leveraging data: Increasing regulatory scrutiny under EU Data Protection Regulation may limit the extent to which customer data can be used to support the Group in achieving its strategic objectives.	– Assessment of the possible impacts of legislation is ongoing and the Group expects to deliver enhanced systems to fulfil related regulatory requirements. – Chief Data Officer reviewing Groupwide operating model and aligning the Group's appetite appropriately.
UK political uncertainty: An EU in-out referendum has been called for the 23 June 2016. In the event that the referendum outcome determines an exit from the EU, there may be an impact on UK trade, the domestic economy and inward investment and, in the short term, the potential for market volatility.	– The Group will monitor and assess the potential impacts on an on-going basis, manage exposures according to its current risk appetite and continue to review our existing contingency plans for market volatility before and after the referendum.
Geopolitical shocks: Current uncertainties could further impede the global economic recovery and adjustment from a period of ultra-accommodative monetary policy. Events in China, Russia and the Middle-East, as well as terrorist activity, have the potential to trigger changes in market risk pricing which could lead to rising funding costs.	– Current risk appetite criteria limits single counterparty bank and non-bank exposures complemented by a UK-focused strategy. – The Group's Financial Stability Forum is in place to develop and maintain the Group's Stability Response Plan, whilst also acting as a Rapid Reaction Group, meeting when external crises occur.

48

CAPITAL STRESS TESTING

OVERVIEW

Stress testing is recognised as a key risk management tool within the Group by the Board, senior management, the businesses and the Risk and Finance functions. Stress testing is fully embedded in the planning process of the Group as a key activity in medium term planning. Senior management is actively involved in stress testing activities via a strict governance process.

The Group uses scenario stress testing to:

- Assess its strategic plans to adverse economic conditions and understand key vulnerabilities of the Group.
- Assess results against Board risk appetite to ensure the Group is managed within its risk parameters, allowing senior management and the Board to adjust strategies if the plan does not meet risk appetite in a stressed scenario. At the same time, the results of the stress tests will also inform the setting of risk appetite by assessing the underlying risks under stress conditions.
- Drive the development of potential actions and contingency plans to mitigate the impact of adverse scenarios. Stress testing also links directly to the Group's Recovery Planning process.
- Support the Internal Capital Adequacy Assessment Process (ICAAP) by demonstrating capital adequacy, and meet the requirements of regulatory stress tests that are used to inform the setting of the Group's PRA buffer (see Capital Risk on pages 111 to 116).
- Meet the required standards and the information needs of internal and external stakeholders, including regulators.

REGULATORY STRESS TESTS

During 2015, the Group was subject to the UK-wide concurrent stress test run by the Bank of England. As announced in December, the Group comfortably exceeded the capital thresholds set by the regulator and was not required to take any action as a result of this test.

INTERNAL STRESS TESTS

At least on an annual basis, the Group conducts a detailed macroeconomic stress test of the operating plan, which is supplemented with higher-level refreshes if necessary. The exercise aims to highlight the key vulnerabilities of the Group to adverse changes in the economic environment, and to ensure that there are adequate financial resources in the event of a downturn. The internal stress test includes different economic scenarios, both in terms of severity and focus (for example exploring the impacts of both low and high interest rate environments).

REVERSE STRESS TESTING

Reverse stress testing is used to explore the vulnerabilities of the Group's strategies and plans to extreme adverse events that would cause the business to fail, in order to facilitate contingency planning. The scenarios used are those that would cause the Group to be unable to carry on its business activities. Where reverse stress testing reveals plausible scenarios with an unacceptably high risk when considered against the Group's risk appetite, the Group will adopt measures to prevent or mitigate that risk, which are then reflected in strategic plans.

OTHER STRESS TESTING ACTIVITY

The Group's stress testing programme also involves undertaking assessment of operational risk scenarios, liquidity scenarios, market risk sensitivities and business specific scenarios (see the principal risks on pages 55 to 120 for further information on risk specific stress testing). If required, ad hoc stress testing exercises are also undertaken to assess emerging risks, as well as in response to regulatory requests. This wide ranging programme provides a comprehensive view of the potential impacts arising from the risks to which the Group is exposed and reflects the nature, scale and complexity of the Group.

METHODOLOGY

The stress tests at all levels must comply with all regulatory requirements, achieved through comprehensive construction of macroeconomic scenarios and a rigorous divisional, functional and executive review and challenge process, supported by analysis and insight into impacts on customers and business drivers.

The Chief Economist's Office develops the internal macroeconomic scenarios used by the Group, based on key uncertainties for the Group's economic outlook. A wide set of economic parameter assumptions is constructed, with over 150 metrics provided such as Gross Domestic Product, Base Rate, unemployment, property indices, insolvencies and corporate failures to facilitate modelling of scenarios across the Group. Where an external scenario is provided, as was the case with the UK-wide concurrent Bank of England stress exercise, the Chief Economist's Office broadens the externally supplied parameters to the level of detail required by the Group.

The engagement of all required Risk and control areas is built into the preparation process, so that the appropriate analysis of each risk driver's impact upon the business plans is understood and documented. The methodologies and modelling approach used for stress testing ensure that a clear link is shown between the macroeconomic scenarios, the business drivers for each area and the resultant stress testing outputs. All material assumptions used in modelling are documented and justified, with a clearly communicated review and sign-off process. Modelling is supported by expert judgement and is subject to the Group Model Governance Policy.

Below is an overview of the principal output responsibilities by team:

– Finance teams in the business prepare and review finance related stress testing results including, but not limited to, income, margins, costs, lending and deposit volumes.

– Credit risk and market risk teams prepare and review risk-related stress outputs, including, but not limited to, impairment charges, risk-weighted assets, expected loss and trading losses.

– The Group Corporate Treasury team reviews the stress outputs and evaluates the impact upon the Group's Capital and Funding Plan.

– The Central Finance and Tax teams consolidate the Group position and assess the tax and regulatory capital impacts.

– The Group Financial Risk team provides oversight of the Finance and Risk stress submissions as well as the consolidated Group position and capital ratios, and produces analysis packs for the Group's senior committees.

49

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

GOVERNANCE

Clear accountabilities and responsibilities for stress testing are assigned to senior management and the Risk and Finance functions throughout the Group. This is formalised through the Group Business Planning and Stress Testing Policy and Procedures, which are reviewed at least annually.

The Group Financial Risk Committee (GFRC), chaired by the Chief Risk Officer and attended by the Chief Finance Officer and other senior Risk and Finance colleagues, is the Committee that has primary responsibility for overseeing the development and execution of the Group's stress tests.

The review and challenge of the detailed stress forecasts, the key assumptions behind these, and the methodology used to translate the economic assumptions into stressed outputs are finalised by the divisional Finance Director's, appropriate Risk Director's and Managing Director's sign-off. The outputs are then presented to GFRC, Group Risk Committee/Group Executive Committee and Board Risk Committee for Group-level executive review and challenge, before being approved by the Board.

HOW RISK IS MANAGED IN LLOYDS BANKING GROUP

The Group's Risk Management Framework (RMF) (see risk overview, page 41) is structured around the following nine components which meet and align with the industry-accepted internal control framework issued by the Committee of Sponsoring Organisations of the Treadway Commission. The RMF provides the Group with an effective mechanism for developing and embedding risk policies and risk management strategies which are aligned with the risks faced by its businesses. It also seeks to facilitate effective communication on these matters across the Group.

Role of the Board and senior management – key responsibilities of the Board and senior management include:

– setting risk appetite and approval of the RMF;

– approval of Groupwide risk principles and policies;

– the cascade of delegated authority (for example to Board sub-committees and the Group Chief Executive); and

– effective oversight over risk management consistent with the risk appetite.

RISK APPETITE

- Risk appetite is defined within the Group as 'the amount and type of risk that the Group is prepared to seek, accept or tolerate'.

- Risk appetite is documented in a Board Risk Appetite Statement reviewed by the Board Risk Committee and approved annually by the Board. The Board Risk Appetite is aligned to the Risk Appetite Framework, and in turn the RMF and Group Risk Principles. An updated Board Risk Appetite Statement was approved by the Board in 2015.

- The Board metrics are supported by more detailed sub-Board appetite functional risk metrics and sub-Board appetite divisional risk metrics.

- The Group's strategy operates in tandem with the Board Risk Appetite and business planning is undertaken with a view to meeting the requirements of the Board Risk Appetite.

- Risk appetite is embedded within principles, policies, authorities and limits across the Group and continues to evolve to reflect external market developments and composition of the Group.

- The Board Risk Committee is responsible for overseeing the development, implementation and maintenance of the Group's overall risk management framework and its risk appetite, to ensure they are in line with emerging regulatory, corporate governance and industry best practice.

Accountabilities under the Risk Appetite Framework are apportioned as follows:

Board:

- Approves the type and level of risk the Group is prepared to accept and the boundaries within which management must operate when setting strategy and executing the business plan.

- Holds the Group Chief Executive and other Senior Executives accountable for the integrity of the Board Risk Appetite Statement.

- Reviews and approves reporting against the Board Risk Appetite Statement.

- Ensure executive remuneration is aligned with risk appetite adherence.

Group Chief Executive and Group Executive Committee members (GEC):

- Ensure that the Board Risk Appetite Statement is developed in collaboration with the Chief Risk Officer and is fully embedded in the business.

- Ensure resources and processes are in place to support the Board Risk Appetite framework.

- Are accountable for the integrity of the Board Risk Appetite Statement, including the timely identification and escalation of breaches and for developing mitigating actions.
- Ensure risk appetite is fully embedded across strategy, planning, decision-making processes and remuneration.
- Monitor compliance with Board Risk Appetite.

Group Chief Risk Officer:

- Develops the Board Risk Appetite Statement in collaboration with the Group Chief Executive and other GEC members.
- Obtains the Board's support and approval of the Board Risk Appetite Statement.
- Oversees that the metrics are fully embedded by the business and reported on a monthly basis.
- Ensures breaches are identified, escalated and appropriate mitigating action is taken by the business.

50

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Risk appetite is embedded across the Group in the following ways:

- Communication – Board Risk Appetite metrics developed and agreed with business and operational teams. In addition Board Risk Appetite cascaded down into more detailed metrics and limits within Functional and Divisional sub-Board Risk Appetite Statements along with additional supporting metrics which should be used to drive local decision making and behaviours.
- Policies – Group policies are aligned with Risk Appetite Statement.
- Reporting – Performance against Board Risk Appetite metrics reported to Divisional, Functional, and Group Risk Committees and the BRC and Board.
- Performance Management – Group and Divisional Scorecards include adherence to risk appetite as a general measure and include more detailed risk appetite measures which are pertinent for that area of the Group.
- Key Decision Making – Strategy operates in tandem with risk appetite and the Group's annual Operating Plan is developed within the boundaries set by risk appetite.

Governance frameworks – the Policy framework is founded on Board-approved key principles for the overall management of risk in the organisation, which are aligned with Group strategy and risk appetite and based on a current and comprehensive risk profile that identifies all material risks to the organisation. The principles are underpinned by a hierarchy of policies which define mandatory requirements for risk management and control which are consistently implemented across the Group. The risk committee governance framework is outlined below.

Three Lines of Defence model – the RMF is implemented through a 'Three Lines of Defence' model which defines clear responsibilities and accountabilities and ensures effective independent oversight and assurance activities take place covering key decisions.

- Business lines (first line) have primary responsibility for risk decisions, identifying, measuring, monitoring and controlling risks within their areas of accountability. They are required to establish effective governance, and control frameworks for their business to be compliant with Group Policy requirements, to maintain appropriate risk management skills, mechanisms and toolkits, and to act within Group risk appetite parameters set and approved by the Board.
- Risk Division (second line) is a centralised function providing oversight and independent constructive challenge to the effectiveness of risk decisions taken by business management, providing proactive advice and guidance, reviewing challenging and reporting on the risk profile of the Group and ensuring that mitigating actions are appropriate.
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Group Audit (third line) provides independent, objective assurance and consulting activity designed to add value and improve the organisation's operations. It helps the Group accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. 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 the Risk Division and the business, and seeks to ensure objective challenge to the effectiveness of the risk governance framework.

Mandate of the Risk Division – the objective of Risk Division is to provide both proactive advice and constructive challenge to the business. It also has a key role in promoting the implementation of a strategic approach to risk management reflecting the risk appetite and RMF agreed by the Board that encompasses:

– embedded effective risk management processes;

– transparent focused risk monitoring and reporting;

– provision of expert and high quality advice and guidance to the Board, executives and management on strategic issues and horizon scanning including pending regulatory changes; and

– a constructive dialogue with the first line through provision of advice, development of common methodologies, understanding, education, training, and development of new tools.

Risk Division, headed by the Chief Risk Officer, consists of six risk directors and their specialist teams. These teams provide oversight and independent challenge to business management and support senior management and the Board with independent reporting on risks and opportunities. Risk directors, responsible for each risk type, 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.

The Chief Risk Officer is accountable for developing and leading an industry-wide recognised Risk function that adds value to the Group by:

– providing a regular comprehensive view of the Group's risk profile, key risks both current and emerging, and management actions;

– (with input from the business areas and Risk Division) proposing Group risk appetite to the Board for approval, and overseeing performance of the Group against risk appetite;

– developing an effective RMF which meets regulatory requirements for approval by the Board, and overseeing execution and compliance; and

– challenging management on emerging risks and providing expert risk and control advice to help management maintain an effective risk and control framework.

The Risk Directors:

- provide independent advice, oversight and challenge to the business;
- design, develop and maintain policies, specific functional risk type frameworks and guidance to ensure alignment with business imperatives and regulatory requirements;
- establish and maintain appropriate governance structures, culture, oversight and monitoring arrangements which ensure robust and efficient compliance with relevant risk-type risk appetites and policies;
- lead regulatory liaison on behalf of the Group including horizon scanning and regulatory development for their risk type; and
- propose risk appetite and oversight of the associated risk profile across the Group.

51

Risk identification, measurement and control – the process for risk identification, measurement and control is integrated into the overall framework for risk governance. Risk identification processes are forward looking to ensure emerging risks are identified. Risks are captured in comprehensive risk logs/registers, and measured using robust and consistent quantification methodologies. The measurement of risks includes the application of stress testing and scenario analysis, and considers whether relevant controls are in place before risks are incurred.

Risk monitoring, aggregation and reporting – identified risks are logged and reported on a monthly basis or as frequently as necessary to the appropriate committee. The extent of the risk is compared to the overall risk appetite as well as specific limits or triggers. When thresholds are breached, committee minutes are clear on the actions and timeframes required to resolve the breach and bring risk within given tolerances. There is a clear process for escalation of risks and risk events.

All business areas complete a Control Effectiveness Review annually, reviewing the effectiveness of their internal controls and putting in place a programme of enhancements where appropriate. Executives from each business area and each GEC member challenge and certify the accuracy of their assessment. This key process is overseen and independently challenged by Policy Owners, Risk Division and Group Audit, and reported to the Board.

Culture – supporting the formal frameworks of the RMF is the underlying culture, or shared behaviours and values, which sets out in clear terms what constitutes good behaviour and good practice. In order to effectively manage risk across the organisation, the functions encompassed within the Three Lines of Defence have a clear understanding of risk appetite, business strategy and an understanding of (and commitment to) the role they play in delivering it. A number of levers are used to reinforce the risk culture, including tone from the top, clear accountabilities, effective communication and challenge and an appropriately aligned performance incentive and structure.

Resources and capabilities – appropriate mechanisms are in place to avoid over-reliance on key personnel or system/technical expertise within the Group. Adequate resources are in place to serve customers both under normal working conditions and in times of stress, and monitoring procedures are in place to ensure that the level of available resource can be increased if required. Colleagues undertake appropriate training to ensure they have the skills and knowledge necessary to enable them to deliver fair outcomes for customers, being mindful of the Group's Conduct Strategy, Customer Treatment Policy/Standards and Financial Conduct Authority requirements.

There is ongoing investment in risk systems and models alongside the Group's investment in customer and product systems and processes. This drives improvements in risk data quality, aggregation and reporting leading to effective and efficient risk decisions.

RISK GOVERNANCE

The risk governance structure below is integral to effective risk management across the Group. Risk Division is appropriately represented on key committees to ensure that risk management is discussed in these meetings. This structure outlines the flow and escalation of risk information and reporting from business areas and Risk Division to GEC and Board. Conversely, strategic direction and guidance is cascaded down from the Board and GEC.

Company Secretariat support senior and Board level committees, and support the Chairs in agenda planning. This gives a further line of escalation outside the Three Lines of Defence.

Table 1.2: **Risk governance structure**

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

BOARD, EXECUTIVE AND RISK COMMITTEES

The Group's risk governance structure (see table 1.2) strengthens risk evaluation and management, while also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

Assisted by the Board Risk and Audit Committees, the Board approves the Group's overall governance, risk and control frameworks and risk appetite. Refer to the Corporate Governance section on pages 156 to 182, for further information on Board committees.

The divisional/functional risk committees review and recommend divisional/functional risk appetite and monitor local risk profile and adherence to appetite.

Insurance, which is subject to separate regulation, has its own Board and governance structure. The Insurance Board, assisted by a Risk Oversight Committee and Audit Committee, approves the governance, risk and control frameworks for the Insurance business and the Insurance business risk appetite, ensuring it aligns with the Group's framework and risk appetite.

Table 1.3: **Executive and Risk Committees**

The Group Chief Executive is supported by the following:

Committees	**Risk focus**
Group Executive Committee (GEC)	Supports the Group Chief Executive in exercising his authority in relation to material matters having strategic, cross-business area or Groupwide implications.
Group Risk Committee (GRC)	Reviews and recommends the Group's risk appetite and governance, risk and control frameworks, material Group policies and the allocation of risk appetite. The committee also regularly reviews risk exposures and risk/ reward returns and approves material risk models.
Group Asset and Liability Committee (GALCO)	Responsible for the strategic management of the Group's assets and liabilities and the profit and loss implications of balance sheet management actions. It is also responsible for the risk management framework for market risk, liquidity risk, capital risk and earnings volatility.
Group Customer First Committee (GCFC)	Provides a Groupwide perspective on the progress of Group's, Divisions' and Functions' implementation of initiatives which enhance the delivery of customer outcomes and customer trust, and set and promote the appropriate tone from the top to fulfil the Group's

	vision to become the Best Bank for Customers and Help Britain Prosper.
Group Product Governance Committee	Provides strategic and senior oversight over design, launch and management of products including new product approval, periodic product reviews and management of risk in the back book.
Executive Compensation Committee	Provides governance and oversight for Groupwide remuneration matters and policies.
Pensions Committee	Supports the Chief Financial Officer in relation to Group pension arrangements.

The Group Risk Committee is supplemented by the following committees to ensure effective oversight of risk management:

Credit Risk Committees	Responsible for the development and effectiveness of the relevant credit risk management framework, clear description of the Group's credit risk appetite, setting of credit policy, and compliance with regulatory credit requirements.
Group Market Risk Committee (GMRC)	Monitors and reviews the Group's aggregate market risk exposures and concentrations and provides a proactive and robust challenge around business activities giving rise to market risks.
Group Conduct, Compliance and Operational Risk Committee	Responsible for monitoring breaches, material events and risk issues and conducting deep dive assessments on specific Conduct, Compliance or Operational Risk subjects to inform corrective action along with the sharing of information and best practice.
Group Financial Crime Committee	Reviews and challenges the management of financial crime risk including the overall strategy and performance and engagement with financial crime authorities. 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.
Group Financial Risk Committee	Responsible for reviewing, challenging and recommending to GEC/GRC, the Group Individual Liquidity Adequacy Assessment and Internal Capital Adequacy Assessment Process submissions, the Group Recovery Plan, and the annual stress testing of the Group's operating plan, PRA and EBA stress tests, and any other analysis as required.
Group Model Governance Committee	Responsible for setting the framework and standards for model governance across the Group, including establishing appropriate levels of delegated authority and principles underlying the Group's risk modelling framework, specifically regarding consistency of approach across business units and risk types. It approves risk models other than material models which are approved by GRC.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

FULL ANALYSIS OF RISK DRIVERS

The Group's risk framework covers all types of risk which affect the Group and could impact on the achievement of its strategic objectives. A detailed description of each category is provided below.

PRIMARY RISK DRIVERS

Credit risk[1]	**Conduct risk**[1]	**Market risk**[1]	**Operational risk**[1]	**Funding and liquidity risk**[1]	**Capital risk**[1]	**Regulatory and legal risk**[1]	**Insurance risk**[1]	**People risk**[1]	**Financial reporting risk**	**Governance risk**[1]
Page 56	Page 93	Page 94	Page 101	Page 103	Page 111	Page 117	Page 117	Page 118	Page 119	Page 120

[1] The Group considers these to be principal risks. See risk overview pages 42 to 45 for further details.

SECONDARY RISK DRIVERS

Portfolio concentration risk	Customer risk	Interest rate risk	Regulatory and legal process	Funding risk	Capital sufficiency	Compliance risk	Longevity risk	Resourcing	Financial and prudential regulatory reporting
Counterparty credit risk	Product risk	Equity risk	Client money/ fiduciary obligations	Liquidity risk	Capital efficiency	Competition risk	Mortality risk	Performance and reward	Tax reporting and complianc
Country risk	Product distribution/ advice risk	Foreign exchange risk	Conduct process			Legal risk	Morbidity risk	Culture and engagement	Pillar 3 disclosure
Collateral management risk		Credit spread risk	Financial crime				Customer behaviour risk (including persistency risk)	Talent and succession	Financial delegated
		Inflation risk						Learning	
		Property risk						Wellbeing	
								Legal and	

Alternative	Fraud	Property	regulatory	authorities
assets risk	People	insurance risk	(people)	
Basis risk	process	Expenses risk		
Commodity risk	Sourcing			
	Service provision			
	Physical			
	security and health and safety			
	Information and			
	cyber security			
	IT systems			
	Change			
	Business			
	process			
	Financial			
	reporting			
	process			
	Governance			
	process			
	Risk process			
	Operational resilience			

The Group considers both reputational and financial impact in the course of managing all its risks and therefore does not classify reputational impact as a separate risk driver.

CREDIT RISK

DEFINITION

The risk that customers to whom we have lent money or other counterparties with whom we have contracted, fail to meet their financial obligations (both on and off balance sheet), resulting in loss to the Group.

RISK APPETITE

Credit risk appetite is described and reported on a monthly basis through a suite of Board metrics derived from credit portfolio performance measures. The Board metrics are supported by more detailed sub-Board appetite metrics at Divisional and Business level and by a comprehensive suite of credit risk appetite statements, credit policies, sector caps, and product and country limits to manage concentration risk and exposures within the Group's approved risk appetite. The metrics cover but are not limited to geographic concentration, single name customer concentration, product exposure, Loan to Value ratios (LTVs), higher risk sector concentration, limit utilisation, leveraged exposure, equity exposure, affordability and the obligor quality of new to bank lending.

Credit risk appetite statements and credit policies are regularly reviewed to ensure that the metrics continue to reflect the Group's risk appetite appropriately. For further information on risk appetite, refer to page 46.

EXPOSURES

The principal sources of credit risk within the Group arise from loans and advances, contingent liabilities, commitments, debt securities and derivatives to customers, financial institutions and sovereigns. The credit risk exposures of the Group are set out in note 53 on page F-91. Credit risk exposures are categorised as 'retail', arising primarily in the Retail, Consumer Finance and Run-off divisions, and some small and medium sized enterprises (SMEs) and 'corporate' (including corporates, banks, financial institutions, sovereigns and larger SMEs) arising primarily in the Commercial Banking, Run-off and Insurance divisions and Group Corporate Treasury (GCT).

In terms of loans and advances, (for example loans and overdrafts) and contingent liabilities (for example credit instruments such as guarantees and standby, documentary and commercial letters of credit), credit risk arises both from amounts advanced and commitments to extend credit to a customer or bank as required within documentation. 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 without notice and the creditworthiness of customers is monitored regularly. Most commercial term commitments to extend credit are contingent upon customers maintaining specific credit standards, which together with the creditworthiness of customers are monitored regularly.

Credit risk also arises from debt securities and derivatives. The total notional principal amount of interest rate, exchange rate, credit derivative and other contracts outstanding at 31 December 2015 is shown on page 65. 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 53 on page F-90.

Credit risk exposures in the Insurance business largely result from holding bond and loan assets in the shareholder funds (including the annuity portfolio) and from exposure to reinsurers.

The investments held in the Group's defined benefit pension schemes also expose the Group to credit risk. Note 31 on page F-46 provides further information on the defined benefit schemes' assets and liabilities.

Loans and advances, contingent liabilities, commitments, debt securities and derivatives also expose the Group to refinance risk. Refinance risk is the possibility that an outstanding exposure cannot be repaid at its contractual maturity date. If the Group does not wish to refinance the exposure then there is refinance risk if the obligor is unable to repay by securing alternative finance. This may be because the borrower is in financial difficulty, or because the terms required to refinance are outside acceptable appetite at the time. Refinance risk exposures are managed in accordance with the Group's existing credit risk policies, processes and controls, and are not considered to be material given the Group's prudent and through the cycle credit risk appetite. Where heightened refinance risk exists (such as in Commercial Banking's Business Support Unit (BSU) or the Run-off book) exposures are minimised through intensive account management and would be impaired and/or forborne where appropriate.

MEASUREMENT

In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Group reflects three components:

(i) the 'probability of default' 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').

For regulatory capital purposes the Group's rating systems assess probability of default and if appropriate, exposure at default and loss given default, in order to derive an expected loss. If not appropriate, regulatory prescribed exposure at default and loss given default values are used in order to derive Risk-Weighted Assets (RWAs) and regulatory Expected Loss (EL). 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. Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the regulatory expected loss models. Note 2(H) on page F-15 provides details of the Group's approach to the impairment of financial assets.

The obligor quality measurement of both retail and commercial counterparties is largely based on the outcomes of credit risk (probability of default – PD) models. The Group operates a number of different regulatory rating models, typically developed internally using statistical analysis and management judgement – retail models rely more on the former, commercial models include more of the latter, especially in the larger corporate and more specialised lending portfolios. Internal data is supplemented with external data in model development, where appropriate.

The models vary, inter alia, in the extent to which they are 'point in time' versus 'through the cycle'. The models are subject to rigorous validation and oversight/governance including, where appropriate, benchmarking to external information.

In commercial portfolios the PD models segment counterparties into a number of rating grades, with each grade representing a defined range of default probabilities, and there are a number of different model rating scales. Counterparties/exposures migrate between rating grades if the assessment of the PD changes. The modelled PDs 'map' through local scales to a single Corporate (non-retail) Master Scale comprising of 19 non-default ratings. Together with four default ratings the Corporate Master Scale forms the basis on which internal reporting is completed.

In the principal retail portfolios, exposure at default and loss given default models are also in use. For regulatory reporting purposes, counterparties are also segmented into a number of rating grades, each representing a defined range of default probabilities and exposures migrate between rating grades if the assessment of the counterparty probability of default changes. The Retail Master scale comprises 13 non-default ratings and 1 default rating.

MITIGATION

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

Prudent, through the cycle credit principles, risk policies and appetite statements: The independent Risk Division sets out the credit principles, risk policies and risk appetite statements. Principles and policies are reviewed regularly, and any changes are subject to a review and approval process. Policies and risk appetite statements, where appropriate, are supported by procedures, which provide a disciplined and focused benchmark for credit decisions. Risk oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes, and test the adequacy of credit risk infrastructure and governance processes throughout the Group, which includes tracking portfolio performance against an agreed set of key appetite tolerances. Oversight and reviews are also undertaken by Group Audit and Credit Risk Assurance.

Strong rating systems and controls: The Group has established an independent team in the Risk Division 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 and owned by the Risk Division. The designated model owner takes responsibility for ensuring the validation of the rating systems, supported and challenged by an independent specialist Group function.

Limitations on concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite as well as individual, customer and bank limit guidelines. Credit policies and appetite statements are aligned to the Group's risk appetite and restricts exposure to higher risk countries and more vulnerable sectors and segments. Note 18 on page F-38 provides an analysis of loans and advances to customers by industry (for commercial customers) and product (for retail customers). Exposures are monitored to prevent an excessive concentration of risk and single name concentrations. These concentration risk controls are not necessarily in the form of a maximum limit on exposure, but may instead require new business in concentrated sectors to fulfil additional certain minimum policy and/or guideline requirements. The Group's large exposures are detailed to the Board and reported in accordance with regulatory reporting requirements.

Robust country risk management: The Board sets country risk appetite. Within this, country limits are authorised by the country risk appetite committee, 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.

Specialist expertise: Credit quality is managed and controlled by a number of specialist units within Risk Division providing, for example: intensive management and control (see Intensive care of customers in financial difficulty); security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector specific expertise; and legal services applicable to the particular market place and product range offered by the business.

Stress testing and scenario analysis: The Group's credit portfolios are also subjected to regular stress testing, with stress scenario assessments run at various levels of the organisation. Exercises focused on individual divisions and portfolios are performed in addition to the Group led and regulatory stress tests. For further information on the stress testing process, methodology and governance refer to page 49.

Frequent and robust credit risk oversight and assurance: Undertaken by independent Credit Risk Assurance functions operating within Retail and Consumer Credit Risk and Commercial Banking which are part of the Group's second line of defence. Its primary objective is to provide reasonable and independent oversight that credit risk is being managed with appropriate and effective controls.

Group Audit performs the third line of credit risk assurance. A specialist team within Group Audit, comprising experienced credit professionals, is in place to carry out independent risk based internal control audits, providing an assessment of the effectiveness of internal credit controls, credit risk classification and the raising of impairment provisions. These audits cover the diverse range of the Group's businesses and activities, and include both 'standard' risk based audits and reviews as well as bespoke assignments to respond to any emerging risks or regulatory requirement. The work of Group Audit therefore continues to provide executive, senior management and Board Audit Committee with assurance on effectiveness of credit risk controls, as well as appropriateness of impairments.

Additional mitigation for Retail and Consumer Finance customers

The Group uses a variety of lending criteria when assessing applications for mortgages and unsecured lending. The general approval process uses credit acceptance scorecards and involves a review of an applicant's previous credit history using information held by Credit Reference Agencies (CRA). The Group also assesses the affordability of the borrower under a stressed interest rate scenario. In addition, the Group has in place quantitative limits such as product maximum limits, the level of borrowing to income and the ratio of borrowing to collateral. Some of these limits relate to internal approval levels and others are hard limits above which the Group will reject the application. The Group also has certain criteria that are applicable to specific products such as for applications for a mortgage on a property that is to be let by the applicant, Retail and Consumer Finance affordability assessments are compliant with relevant regulatory conduct guidelines.

For UK mortgages, the Group's policy is to reject all standard applications with a Loan to Value (LTV) greater than 90 per cent. Applications with a LTV up to 95 per cent are permitted for certain schemes, for example the UK government's Help to Buy scheme. For mainstream mortgages the Group has maximum per cent LTV limits which depend upon the loan size. These limits are currently:

Table 1.4: **UK mainstream loan to value analysis**

Loan size From	**To**	**Maximum LTV**
£1	£570,000	95%
£570,001	£750,000	90%
£750,001	£1,000,000	85%
£1,000,001	£2,000,000	80%
£2,000,001	£5,000,000	70%

For mainstream mortgages greater than £5,000,000 the maximum LTV is 50 per cent. Buy-to-let mortgages are limited to a maximum of £1,000,000 and 75 per cent LTV. All mortgage applications above £500,000 are subject to manual underwriting.

57

The Group's approach to underwriting applications for unsecured products ensures that lending is affordable and sustainable. The Group takes reasonable steps to validate information used in the assessment of a customer's income and expenditure. The Group rejects any application for an unsecured lending product where a customer is registered as bankrupt or insolvent, or has a County Court Judgment in excess of £1,000 registered at a CRA used by the Group. In addition, the Group rejects any applicant with total unsecured debt greater than £50,000 registered at the CRA; policy rules are also in place to provide additional scrutiny to applications where an applicant's total unsecured debt-to-income ratio greater than 100 per cent.

Where credit acceptance scorecards are used, Risk Division reviews model effectiveness, while new models and model changes are referred by them to the appropriate Model Governance Committees for approval. All changes are approved in accordance with the governance framework set by the Group Model Governance Committee.

Additional mitigation for Commercial customers

Individual credit assessment and independent sanction of customer and bank limits: with the exception of small exposures to SME customers where relationship managers have limited delegated sanctioning authority, credit risk in commercial customer portfolios are subject to sanction by the independent Risk Division, which considers the strengths and weaknesses of individual transactions, the balance of risk and reward, and how credit risk aligns to the Group's risk appetite. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities and limit guidelines. Approval requirements for each decision are based on a number of factors including 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 and customer underwriting is generally the same as that for assets intended to be held to maturity. All underwriting must be sanctioned via credit limits.

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 against agreed confidence intervals. Aggregate facility levels by counterparty are set and limit breaches are subject to escalation procedures.

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

Collateral

The principal collateral types for loans and advances, contingent liabilities and derivatives with commercial and bank counterparties/customers are:

– properties;

– charges over business assets such as premises, inventory and accounts receivables;

– financial instruments such as debt securities;

– vehicles;

– cash; and

– guarantees received from third parties.

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

Collateral held as security for financial assets other than loans and advances is determined by the nature of the underlying exposure. Debt securities, including treasury and other bills, are generally unsecured, with the exception of asset-backed securities and similar instruments such as covered bonds, which are secured by portfolios of financial assets. Collateral is generally not held against loans and advances to financial institutions, 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. Derivative transactions with wholesale counterparties are typically collateralised under a Credit Support Annex (CSA) in conjunction with the ISDA Master Agreement. Derivative transactions with non-bank customers are not usually supported by a CSA.

No collateral is held in respect of retail credit card or unsecured personal lending. For non-mortgage retail lending to small businesses, collateral may include second charges over residential property and the assignment of life cover.

It is policy that commercial lending decisions must be based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. The types of collateral taken and the requirement for which collateral is required at origination is dependent upon the credit quality, size and structure of the borrower. For non-retail exposures, the Group will often require the collateral to include a first charge over land and buildings owned and occupied by the business, a mortgage debenture over the company's undertaking and one or more of its assets, and key man insurance. The Group maintains policies setting out acceptable collateral, maximum LTV ratios and other criteria to be considered when reviewing an application. The decision as to whether or not collateral is required will be based upon the nature of the transaction and the credit worthiness of the customer/counterparty. Other than for project finance, object finance and income producing real estate where charges over the subject assets are a basic requirement, the provision of collateral will not determine the outcome of an application. Notwithstanding this, the fundamental business proposition must evidence the ability of the business to generate funds from normal business sources to repay a customer/counterparty's financial commitment.

The extent to which collateral values are actively managed will depend on the credit quality and other circumstances of the obligor and type of underlying transaction. Although lending decisions are based on expected cash flows, any collateral provided may impact the pricing and other terms of a loan or facility granted. This will have a financial impact on the amount of net interest income recognised and on internal loss given default estimates that contribute to the determination of asset quality and returns.

Collateral values are rigorously assessed at the time of loan origination. It is the Group's policy that collateral should always be realistically valued by an appropriately qualified source, independent of both the credit decision process and the customer, at the time of borrowing. Collateral values are reviewed on a regular basis and will vary according to the type of lending and collateral involved. For residential mortgages, the Group adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of the collateral when estimating credit losses. In order to minimise the credit loss, the Group may seek additional collateral from the counterparty as soon as early warning signs 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.

Credit policies are in place to avoid correlation or wrong way risk. Under the repo policies, the issuer of the collateral and the repo counterparty should be neither the same nor connected. The same rule applies for derivatives under collateral policies. The Risk Division has the necessary discretion to extend this rule to other cases where there is significant correlation. Countries with a rating equivalent to AA- and above may be considered to have no adverse correlation between the counterparty domiciled in the country and that country of risk (issuer of securities).

Refer to note 53 for further information on collateral.

Master netting agreements

Where it is appropriate and likely to be effective, the Group seeks to enter into master netting agreements. Although master netting agreements do not generally result in an offset of balance sheet assets and liabilities for accounting purposes, as transactions are usually settled on a gross basis, 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 this is the net position of all trades under the master netting agreement.

Other credit risk transfers

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

MONITORING

In conjunction with Risk Division, businesses identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed and monitored in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by senior management. Risk Division in turn produces an aggregated review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the Divisional Risk Committees, Group Risk Committee and the Board Risk Committee.

The performance of all rating models is monitored on a regular basis, in order to 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 the monitoring identifies material exceptions or deviations from expected outcomes, these will be escalated in accordance with the governance framework set by the Group Model Governance Committee.

Intensive care of customers in financial difficulty

The Group operates a number of treatments to assist borrowers who are experiencing financial stress. The material elements of these treatments through which the Group has granted a concession, whether temporarily or permanently, are set out below.

Retail and Consumer Finance customers

The Group's aim in offering forbearance and other assistance to retail customers in financial distress is to benefit both the customer and the Group by discharging the Group's regulatory and social responsibilities to support its customers and act in their best long-term interests and by bringing customer facilities back into a sustainable position which, for residential mortgages, also means keeping customers in their homes. The Group offers a range of tools and assistance to support retail customers who are encountering financial difficulties. Cases are managed on an individual basis, with the circumstances of each customer considered separately and the action taken judged as being affordable and sustainable for the customer. Operationally, the provision and review of such assistance is controlled through the application of an appropriate policy framework, controls around the execution of policy, regular review of the different treatments to confirm that they remain appropriate, monitoring of customers' performance and the level of payments received, and management visibility of the nature and extent of assistance provided and the associated risk.

Assistance is provided through trained colleagues in branches and dedicated telephony units, and via online guidance material. For those customers requiring more intensive help, assistance is provided through dedicated support units where tailored repayment programmes can be agreed. Customers are actively supported and referred to free money advice agencies when they have multiple credit facilities, including those at other lenders that require restructuring. Within the Collections and Recoveries functions, the sharing of best practice and alignment of policies across the Group has helped to drive more effective customer outcomes and achieve operational efficiencies.

The specific tools available to assist customers vary by product and the customer's status. In defining the treatments offered to customers who have experienced financial distress, the Group distinguishes between the following categories:

- Reduced payment arrangements: a temporary arrangement for customers in financial distress where arrears accrue at the contractual payment, for example short-term arrangements to pay.

– Term extensions: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment.

– Repair: a permanent account change used to repair a customer's position when they have emerged from financial difficulty, for example capitalisation of arrears.

CUSTOMERS RECEIVING SUPPORT FROM UK GOVERNMENT SPONSORED PROGRAMMES

To assist customers in financial distress, the Group also participates in, or benefits from, the following UK government sponsored programmes for households:

– Income Support for Mortgage Interest – This is a government medium term 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. All decisions regarding an individual's eligibility and any amounts payable under the scheme rest solely with the government. Payments are made directly to the Group by the Department of Work and Pensions.

– Mortgage Rescue Schemes – This is a 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. Government sponsored Mortgage Rescue Scheme (MRS) options are currently available in Wales and Scotland (in Scotland the MRS option is called the Home Owner’s Support Fund). No MRS options are available in Northern Ireland although one may be launched by the government in the future. In England, the government ceased funding and closed its MRS option in the second quarter of 2015.

The Group assesses whether a loan benefiting from a UK government sponsored programme is impaired using the same accounting policies and practices as it does for loans not benefiting from such a programme. There is no direct impact on the impairment status of a loan benefiting from the Mortgage Rescue schemes, as these schemes involve the purchase, and eventual sale, of the property. The loans included within the Income Support for Mortgage Interest scheme may be impaired, in accordance with the normal definition of impairment.

The Income Support for Mortgage Interest scheme remains the most successful of the government backed schemes. It is the longest-running, is the most widely known and provides both the customer and the Group with an assurance as to the maintenance of at least two years’ worth of interest payments. The Group estimates that customers representing approximately £2.2 billion of its mortgage exposures are receiving this benefit. This includes those who are also receiving other treatments for financial difficulty.

FORBEARANCE IDENTIFICATION, CLASSIFICATION AND MEASUREMENT

The Group classifies a retail account as forborne at the time a customer in financial difficulty is granted a concession. Accounts are classified as forborne only for the period of time which the exposure is known to be, or may still be, in financial difficulty. Where temporary forbearance is granted, exit criteria are applied to include accounts until they are known to no longer be in financial difficulty. Details of the exit criteria are shown in the analysis on page 61. Where the treatment involves a permanent change to the contractual basis of the customer’s account such as a capitalisation of arrears or term extension, the Group classifies the balance as forborne for a period of 24 months, after which no distinction is made between these accounts and others where no change has been made.

Those forborne loans which fall below individual assessment limits are grouped with other assets of similar characteristics and assessed collectively for impairment in accordance with the Group impairment policy detailed in note 2(H). The Group’s approach is to ensure that provisioning models, supported by management judgement, appropriately reflect the underlying loss risk of exposures. The performance and output of models are monitored and challenged on an ongoing basis, in line with the Group’s model governance policies.

CUSTOMERS IN FINANCIAL DIFFICULTY RECEIVING SUPPORT UNDER OTHER SCHEMES

The Group measures the success of a forbearance scheme based upon the proportion of customers performing (less than or equal to three months in arrears) over the 24 months following the exit from a forbearance treatment. For temporary treatments, 79 per cent of customers accepting reduced payment arrangements are performing. For permanent treatments, 82 per cent of customers who have accepted capitalisations of arrears and 84 per cent of customers who have accepted term extensions are performing.

Commercial customers

Early identification, control and monitoring are key in order to support the customer and protect the Group. With the exception of small exposures in SME all non-retail exposures in the Commercial Banking and Run-off divisions are reviewed at least annually by the independent Risk Division (and more frequently where required). As part of the Group's established Credit Risk Classification system, every exposure in the good book is categorised as either 'good' or 'watchlist'. This complements the Group's risk rating tools and is designed to identify and highlight portfolio levels of asset quality as well as individual problem credits. All watchlist names are reviewed by the business and Risk Division regularly, and the classification is updated if required. This process seeks to ensure that relationship managers act promptly to identify, and highlight to senior management those customers who have the possibility to become higher risk in the future.

Those customers deemed higher risk where there is cause for concern over future repayment capability or where there is a risk of impairment will lead to the customer being transferred to the Business Support Unit (BSU) at an early stage. The over-arching aim of the BSU is to provide support and work consensually with each customer to try and resolve the issues, to restore the business to a financially viable position and thereby bring about a business turnaround. This may involve a combination of restructuring, work out strategies and other types of forbearance.

BSU case officers manage non-retail distressed assets in Commercial Banking and Run-off divisions, and are part of the independent Risk Division. They are highly experienced and operate in a closely controlled and monitored environment, including regular oversight and close scrutiny by senior management.

A detailed assessment is undertaken for cases in BSU to assist in reducing and minimising risk exposure and to also highlight potential strategic options. A range of information is required to fully appraise and understand the customer's business, cashflow (and therefore debt serviceability) and will involve the Group, in addition to using its own internal sector experts, engaging professional advisers to perform asset valuations, strategic reviews and where applicable, independent business reviews. The assessment may also involve:

– critically assessing customer's ability to successfully manage the business effectively in a distressed situation where turnaround is required;

– analysis of market sector factors, i.e. products, customers, suppliers, pricing and margin issues;

– performance review of operational areas that should be considered in terms of current effectiveness and efficiency and scope for improvements;

– financial analysis to model plans and factor in potential sensitivities, vulnerabilities and upsides; and

– determining the most appropriate corporate and capital structure suitable for the work-out strategy concerned.

The above assessment, monitoring and control processes continue throughout the period the case is managed within the BSU. All the analysis performed around cash flows is used to determine appropriate impairment provisions.

The level of Commercial Banking division BSU gross lending to customers reduced from £5.0 billion to £4.2 billion between 31 December 2014 and 31 December 2015. The net reduction of £0.8 billion in BSU managed lending in Commercial Banking was driven by returns to mainstream, disposals, write-offs and repayments.

The Group's accounting policy for loan renegotiations is set out in note 2(H) on page F-16. Income statement information set out in the credit risk tables is on an underlying basis (see page 26).

FORBEARANCE

A key factor in determining whether the Group treats a commercial customer as forborne is the granting of a concession to a borrower who experiences, or is believed to be about to experience, financial difficulty and which is outside the Group's current risk appetite. Where a concession is granted to a customer that is not in financial difficulty or the risk profile is considered within the Group's current risk appetite, the concession would not be considered

60

to be an act of forbearance. The Group does not believe forbearance reporting is appropriate for derivatives, available for sale assets and the trading book where assets are marked to market daily.

The Group recognises that forbearance alone is not necessarily an indicator of impaired status, but it is a trigger for the review of the customer's credit profile. If there is any concern over the future cash flows and/or the Group incurring a loss, then forborne loans will be classified as impaired in accordance with the Group's impairment policy. All impaired loans, including recoveries portfolios, are reported as forborne.

Recovery can sometimes be through improvement in market or economic conditions, or the customer may benefit from access to alternative sources of liquidity, such as an equity injection. These can be especially relevant in real estate or other asset backed transactions where a fire sale of assets in a weak market may be unattractive.

Depending on circumstances and when operated within robust parameters and controls, the Group believes forbearance can help support the customer in the short to medium-term. The Group expects to have unimpaired forborne assets within its portfolios, where default has been avoided, or when no longer considered impaired, although the majority of these cases will be managed in the BSU, where more intensive management and monitoring is available.

Unimpaired forborne assets are included in calculating the overall collective unidentified impairment provision, which uses the historical observed default rate and loss emergence period of the relevant portfolio as a whole as part of its calculation.

Whilst the material portfolios have been reviewed for forbearance, some non-retail loans and advances in Commercial Banking and Run-Off divisions have not been reviewed on the basis that the level of unimpaired forbearance is relatively immaterial, or because the concept of forbearance is not relevant.

TYPES OF FORBEARANCE

The Group's strategy and offer of forbearance is largely dependent on the individual situation and early identification, control and monitoring are key to supporting the customer and protecting the Group. Concessions are often provided to help the customer with their day to day liquidity and working capital. A number of options are available to the Group where a customer is facing financial difficulty, and each case is treated depending on its own specific circumstances.

For commercial customers, the Group currently looks at forbearance concessions including changes to:

- Contractual payment terms (for example loan maturity extensions, or changes to capital and/or interest servicing arrangements, including capital repayment holidays or conversion to interest only terms); and
- Non-payment contractual terms (for example covenant amendments or waivers) where the concession enables default to be avoided.

The main types of forbearance concessions to commercial customers in financial difficulty are set out below:

- Covenants: This includes temporary and permanent waivers, amendment or resetting of non-payment contractual covenants (including LTV and interest cover). The granting of this type of concession in itself would not result in the loan being classified as impaired and the customer is kept under review in the event that further forbearance is necessary;
- Extensions/Alterations: This includes extension and/or alteration of repayment terms to a level outside of market or the Group's risk appetite due to the customer's inability to make existing contractual repayment terms; amendments to an interest rate to a level considered outside of market or the Group's risk appetite, or other amendments such as changes to capital and/or interest servicing arrangements including capital repayment holidays or conversion to interest only terms; and
- Multiple type of forbearance (a combination of the above two).

FORBEARANCE IDENTIFICATION, CLASSIFICATION AND MEASUREMENT

All non-retail loans and advances on the watchlist are further categorised depending on the current and expected credit risk attaching to the customer and the transaction. All watchlist names are reviewed by the business and independent Risk function regularly, and the classification is updated if required.

Any event that causes concern over future payments is likely to result in the customer being assessed for impairment and, if required, an impairment allowance recognised. If impairment is identified, the customer is immediately transferred to BSU (if not already managed there) and the lending will be treated as impaired.

All of a customer's impaired loans are treated as forborne as they are considered as having been (or will be) granted some form of forbearance. Most impaired loans and advances exist only in the BSU within Commercial Banking division, and Run-off division.

A portfolio approach is taken for SME customers with exposures below £1 million managed in BSU. All customers with exposures below £1 million are reported as forborne whilst they are managed by SME BSU (whether impaired or unimpaired).

All reviews performed in the good book, BSU within Commercial Banking or in the Run-off division include analysis of latest financial information, a consideration of the market and sector the customer operates in, performance against plan and revised terms and conditions granted as part of the forbearance concession.

EXIT FROM FORBEARANCE

A customer where forbearance has been granted will remain treated and recorded as forborne until it evidences acceptable performance over a period of time. This period will depend on a number of factors such as whether the customer is trading in line with its revised plan, it is operating within the new terms and conditions (including observation to revised covenants and contractual payments), its financial performance is stable or improving, and there are no undue concerns over its future performance. As a minimum, this cure period is currently expected to be at least 12 months following a forbearance event.

The exception to this 12 month minimum period is where a permanent structural cure is made (for example, an injection of new collateral security or a partial repayment of debt to restore an LTV back to within a covenant). In this case, the customer may exit forbearance once the permanent cure has been made.

However, notwithstanding this, the overriding requirement for exit from forbearance in all cases is that the customer is not impaired and the reason for the forbearance event is no longer present.

Upon exit from forbearance the customer may be returned to the mainstream good classification. It is important to note that such a decision can be made only by the independent Risk Division.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

THE GROUP CREDIT RISK PORTFOLIO IN 2015

Significant reduction in impairments and impaired assets

- Excluding TSB, the impairment charge decreased by 48 per cent to £568 million in 2015 compared to £1,102 million in 2014. The impairment charge is lower across all divisions and benefited from provision releases, but at lower levels than seen during 2014.

- The reduction reflects lower levels of new impairment as a result of effective risk management, a favourable credit environment, improving UK economic conditions and continued low interest rates.

- The asset quality ratio (impairment charge as a percentage of average loans and advances to customers) improved to 0.14 per cent compared to 0.23 per cent during 2014.

- At the Group Strategic Update in October 2014, we outlined that although it would be lower between 2015 to 2017, we expect the Group asset quality ratio to be c.40 basis points through the economic cycle.

- In 2016, the Group expects to benefit from its continued disciplined approach to the management of credit and the resilient UK economy. Write-backs and provision releases, however, are expected to be at a lower level and as a result, the Group expects the asset quality ratio for the 2016 full year to be around 20 basis points.

- Impaired loans as a percentage of closing loans and advances reduced to 2.1 per cent at 31 December 2015, from 2.9 per cent at 31 December 2014 driven by reductions within the continuing and run-off portfolios, including the sale of Irish commercial loans during the third quarter. Provisions as a percentage of impaired loans reduced from 56.4 per cent to 46.1 per cent reflecting the disposal of highly covered assets during the year.

- Retail division impairment provisions as a percentage of impaired loans have increased to 40.4 per cent from 38.8 per cent at 31 December 2014, with Secured increasing by 0.5 percentage points to 37.5 per cent. Consumer Finance division impairment provisions as a percentage of impaired loans have increased to 72.8 per cent from 70.5 per cent at 31 December 2014, with Credit Cards increasing by 5.3 percentage points to 81.8 per cent and Asset Finance UK decreasing by 2.8 percentage points to 67.2 per cent.

Low risk culture and prudent risk appetite

- The Group is delivering sustainable lending growth by maintaining its lower risk origination discipline and underwriting standards, despite terms and conditions in some of the Group's markets being impacted by increased competition. The overall quality of the portfolio has improved over the last 12 months.

- Credit performance of the UK Retail secured portfolio has been good, with improvements in LTVs, arrears, impaired loans and impairment charge on both Mainstream and Buy-to-let portfolios. Loans and advances to mainstream customers were broadly flat during the year at £227.3 billion with the Buy-to-let portfolio growing by 4 per cent to £55.6 billion. The closed specialist portfolio has continued to run-off, reducing by 10 per cent to £19.5 billion.

– The Group's UK Direct Real Estate gross lending (defined internally as exposure which is directly supported by cash flows from property activities) at 31 December 2015 in Commercial Banking, Wealth (within Retail division) and Run-off divisions was £19.5 billion (31 December 2014: gross £21.6 billion). The portfolio continues to reduce significantly, and the higher risk Run-off element of the book has reduced from gross £3.3 billion to gross £1.1 billion during 2015. The remaining gross lending of £18.4 billion (31 December 2014: £18.3 billion) is the lower risk element in Commercial Banking and Wealth, where the Group continues to write new business within conservative risk appetite parameters.

– Our Commercial Banking portfolios continue to benefit from our robust focus on credit at origination and our through the cycle risk appetite.

– Sector concentrations within the lending portfolios are closely monitored and controlled, with mitigating actions taken. Sector and product caps limit exposure to certain higher risk sectors and asset classes.

– The Group's extensive and thorough credit processes and controls ensure effective risk management, including early identification and management of potential concern customers and counterparties.

Re-shaping of the group is substantially complete

– The run-off portfolio has materially reduced through de-risking and the strategic desire to exit the residual portfolio still remains. There was a 38 per cent reduction in gross loans and advances in 2015 to £11,422 million (31 December 2014: £18,316 million).

– Run-off net external assets have reduced from £16,857 million to £12,154 million during 2015. The portfolio now represents only 2.3 per cent of the overall Group's loans and advances (31 December 2014: 3.0 per cent).

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.5: **Group impairment charge**

	2015						
	Loans and advances to customers £m	**Debt securities classified as loans and receivables £m**	**Available-for-sale financial assets £m**	**Other credit risk provisions £m**	**Total £m**	2014 £m	Change %
Retail	**432**	**–**	**–**	**–**	**432**	599	28
Commercial Banking	**9**	**–**	**–**	**(31)**	**(22)**	83	
Consumer Finance	**152**	**–**	**–**	**–**	**152**	215	29
Run-off	**28**	**(2)**	**4**	**(22)**	**8**	203	96
Central items	**–**	**–**	**–**	**(2)**	**(2)**	2	
Total impairment charge excluding TSB	**621**	**(2)**	**4**	**(55)**	**568**	1,102	48
TSB					**–**	98	
Total impairment charge					**568**	1,200	53
Impairment charge as a % of average advances[1]					**0.14%**	0.23%	(9)bps

1 Excludes TSB.

Table 1.6: **Movement in gross impaired loans**

	2015						2014
	Retail £m	**Commercial Banking £m**	**Consumer Finance £m**	**Run-off £m**	**TSB £m**	**Total £m**	Total £m
At 1 January	**4,927**	**3,241**	**720**	**5,215**	**205**	**14,308**	32,259
Classified as impaired during the year	**2,008**	**631**	**179**	**583**	**–**	**3,401**	4,825
Transferred to not impaired during the year	**(1,080)**	**(146)**	**(72)**	**(60)**	**–**	**(1,358)**	(4,526)
Repayments	**(831)**	**(693)**	**(68)**	**(137)**	**–**	**(1,729)**	(3,075)
Amounts written off	**(523)**	**(225)**	**(107)**	**(648)**	**–**	**(1,503)**	(7,004)
Impact of disposal of business and asset sales	**(3)**	**(48)**	**(55)**	**(3,092)**	**(205)**	**(3,403)**	(7,288)
Exchange and other movements	**(4)**	**(232)**	**(54)**	**164**	**–**	**(126)**	(883)
At 31 December	**4,494**	**2,528**	**543**	**2,025**	**–**	**9,590**	14,308

63

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.7: **Group impaired loans and provisions**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as % of closing advances %	Impairment provisions[1] £m	Impairment provision as % of impaired loans[2] %
At 31 December 2015					
Retail	**316,036**	**4,494**	**1.4**	**1,670**	**40.4**
Commercial Banking	**102,435**	**2,528**	**2.5**	**1,087**	**43.0**
Consumer Finance	**23,938**	**543**	**2.3**	**265**	**72.8**
Run-off	**11,422**	**2,025**	**17.7**	**1,150**	**56.8**
TSB					
Reverse repos and other items[3]	**5,798**	**–**		**–**	
Total gross lending	**459,629**	**9,590**	**2.1**	**4,172**	**46.1**
Impairment provisions	**(4,172)**				
Fair value adjustments[4]	**(282)**				
Total Group	**455,175**				
At 31 December 2014					
Retail	317,347	4,927	1.6	1,734	38.8
Commercial Banking	102,459	3,241	3.2	1,594	49.2
Consumer Finance	21,273	720	3.4	309	70.5
Run-off	18,316	5,215	28.5	3,927	75.3
TSB	21,729	205	0.9	88	42.9
Reverse repos and other items[3]	9,635				
Total gross lending	490,759	14,308	2.9	7,652	56.4
Impairment provisions	(7,652)				
Fair value adjustments[4]	(403)				
Total Group	482,704				

1 Impairment provisions include collective unidentified impairment provisions.

2 Impairment provisions as a percentage of impaired loans are calculated excluding Retail and Consumer Finance loans in recoveries (31 December 2015: £335 million in Retail Loans and Overdrafts, £28 million in Retail other and £179 million in Consumer Finance credit cards; 31 December 2014: £437 million in Retail loans and overdrafts, £26 million in Retail other and £282 million in Consumer Finance Credit Cards).

3 Includes £5.7 billion (31 December 2014: £4.4 billion) of lower risk loans sold by Commercial Banking and Retail to Insurance to back annuitant liabilities.

4 The fair value adjustments relating to loans and advances were made on the acquisition of HBOS to reflect the fair value of the acquired assets and took into account both the expected losses and market liquidity at the date of acquisition. The unwind relating to future impairment losses requires management judgement to assess whether the losses incurred in the current period were expected at the date of the acquisition and assessing whether the remaining losses expected at the date of the acquisition will still be incurred. The element relating to market liquidity unwinds to the income statement over the estimated expected lives of the related assets (until 2014 for commercial loans and 2018 for retail loans) although if an asset is written-off or suffers previously unexpected impairment then this

element of the fair value will no longer be considered a timing difference (liquidity) but permanent (impairment). The fair value unwind in respect of impairment losses incurred was £97 million for the period ended 31 December 2015 (31 December 2014: £251 million). The fair value unwind in respect of loans and advances is expected to continue to decrease in future years as fixed-rate periods on mortgages expire, loans are repaid or written-off, and will reduce to zero over time.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.8: **Derivative credit risk exposures**

	2015				2014		
		Traded over the counter				Traded over the counter	
	Traded on recognised exchanges £m	**Settled by central counterparties £m**	**Not settled by central counterparties £m**	**Total £m**	Traded on recognised exchanges £m	Settled by central counterparties £m	Not settled by central counterpartie £m
Notional balances							
Foreign exchange	6,568	–	383,722	390,290	–	–	456,215
Interest rate	31,128	3,598,307	791,351	4,420,786	82,201	5,768,373	972,531
Equity and other	4,837	–	9,337	14,174	4,808	–	10,034
Credit	–	–	4,566	4,566	–	–	18,063
Total	42,533	3,598,307	1,188,976	4,829,816	87,009	5,768,373	1,456,843
Fair values							
Assets		103	28,811			127	35,322
Liabilities		(131)	(26,149)			(117)	(32,988
Net asset		(28)	2,662			10	2,334

The total notional principle amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2015 and 31 December 2014 is shown in the table above. The notional principle 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 53 on page F-90.

RETAIL

- The impairment charge was £432 million in 2015, a decrease of 28 per cent against 2014. The decrease reflects continued low risk underwriting discipline, strong portfolio management and a favourable credit environment with low unemployment, increasing house prices and continued low interest rates.

- The impairment charge, as a percentage of average loans and advances to customers, improved to 14 basis points in 2015 from 19 basis points in 2014.

- Impaired loans decreased by £433 million to £4,494 million, which represented 1.4 per cent of closing loans and advances to customers at 31 December 2015 (31 December 2014: 1.6 per cent).

Retail Division Impairment coverage has increased to 40.4 per cent from 38.8 per cent at the end of 2014, with Secured coverage increasing 0.5 per cent to 37.5 per cent.

Table 1.9: **Retail impairment charge**

	2015	2014	Change
	£m	£m	%
Secured	98	281	65
Loans and overdrafts	311	279	(11)
Wealth	2	8	75
Retail Business Banking	21	31	32
Total impairment charge	432	599	28
Impairment charge as a % of average advances	0.14%	0.19%	(5)bps

65

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.10: **Retail impaired loans and provisions**

	Loans and advances to customers £m	**Impaired loans £m**	**Impaired loans as a % of closing advances %**	**Impairment provisions[1] £m**	**Impairment provisions as a % of impaired loans[2] %**
At 31 December 2015					
Secured	302,413	3,818	1.3	1,431	37.5
Loans and overdrafts:					
Collections		243		197	81.8
Recoveries[3]		335		–	–
	9,917	578	5.8	197	81.1
Wealth	2,811	55	2.0	23	41.8
Retail Business Banking:					
Collections		15		19	
Recoveries[3]		28		–	
	895	43	4.8	19	126.7
Total gross lending	316,036	4,494	1.4	1,670	40.4
Impairment provisions	(1,670)				
Fair value adjustments	(273)				
Total	314,093				
At 31 December 2014					
Secured	303,121	3,911	1.3	1,446	37.0
Loans and overdrafts:					
Collections		258		220	85.3
Recoveries[3]		437		–	–
	10,395	695	6.7	220	85.3
Wealth	2,962	270	9.1	40	14.8
Retail Business Banking:					
Collections		25		28	
Recoveries[3]		26		–	
	869	51	5.9	28	112.0
Total gross lending	317,347	4,927	1.6	1,734	38.8
Impairment provisions	(1,734)				
Fair value adjustments	(392)				
Total	315,221				

1 Impairment provisions include collective unidentified impairment provisions.
2 Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.
3 Recoveries assets are written down to the present value of future expected cash flows on these assets.

SECURED

– The impairment charge was £98 million, a decrease of 65 per cent against 2014. The impairment charge as a percentage of average loans and advances to customers, improved to 3 basis points from 9 basis points in 2014.

– Loans and advances to Mainstream customers were broadly flat during the year at £227.3 billion with the Buy-to-let portfolio growing by 4 per cent to £55.6 billion. The closed Specialist portfolio has continued to run-off, reducing by 10 per cent to £19.5 billion.

– Impaired loans reduced by £93 million in 2015 to £3,818 million at 31 December 2015 with reductions in both the Mainstream and Buy-to-let portfolios. Impairment provisions as a percentage of impaired loans increased to 37.5 per cent from 37.0 per cent at 31 December 2014.

– The value of mortgages greater than three months in arrears (excluding repossessions) decreased by £439 million to £5,905 million at 31 December 2015 (31 December 2014: £6,344 million), with reductions in both the Mainstream and Buy-to-let portfolios.

– The average indexed loan to value (LTV) of the residential mortgage portfolio at 31 December 2015 decreased to 46.1 per cent compared with 49.2 per cent at 31 December 2014. The percentage of closing loans and advances with an indexed LTV in excess of 100 per cent decreased to 1.1 per cent at 31 December 2015, compared with 2.2 per cent at 31 December 2014.

– The average LTV for new residential mortgages written in 2015 was 64.7 per cent compared with 64.8 per cent for 2014.

LOANS AND OVERDRAFTS

– The impairment charge was £311 million, an increase of 11 per cent against 2014.

– The impairment charge as a percentage of average loans and advances to customers, increased to 3.0 per cent in 2015 from 2.6 per cent in 2014.

– Impaired loans reduced by £117 million in 2015 to £578 million representing 5.8 per cent of closing loans and advances to customers, compared with 6.7 per cent at 31 December 2014.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.11: **Retail secured and unsecured loans and advances to customers**

	At 31 Dec 2015 £m	At 31 Dec 2014 £m
Secured:		
Mainstream	227,267	228,176
Buy-to-let	55,598	53,322
Specialist[1]	19,548	21,623
	302,413	303,121
Loans and overdrafts:		
Loans	7,889	8,204
Overdrafts	2,028	2,191
	9,917	10,395
Wealth	2,811	2,962
Retail Business Banking	895	869
Total gross lending	316,036	317,347

1 Specialist lending has been closed to new business since 2009.

Table 1.12: **Mortgages greater than three months in arrears (excluding repossessions)**

	Number of cases		Total mortgage accounts %		**Value of loans[1]**		Total mortgage balances %	
	2015 cases	2014 cases	2015 %	2014 %	2015 £m	2014 £m	2015 %	2014 %
Mainstream	34,850	37,849	1.6	1.7	3,803	4,102	1.7	1.8
Buy-to-let	5,021	5,077	1.0	1.1	626	658	1.1	1.2
Specialist	8,777	9,429	6.4	6.3	1,476	1,584	7.6	7.3
Total	48,648	52,355	1.7	1.8	5,905	6,344	2.0	2.1

1 Value of loans represents total gross book value of mortgages more than three months in arrears.

The stock of repossessions decreased to 654 cases at 31 December 2015 compared to 1,740 cases at 31 December 2014.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.13: **Period end and average LTVs across the Retail mortgage portfolios**

	Mainstream %	Buy-to-let %	Specialist %	Total %	Unimpaired %	Impaired %
At 31 December 2015						
Less than 60%	52.2	45.4	43.7	50.4	50.7	30.9
60% to 70%	19.1	26.8	19.7	20.6	20.6	17.5
70% to 80%	15.5	15.0	15.5	15.4	15.4	16.9
80% to 90%	9.0	8.0	11.6	9.0	8.9	13.3
90% to 100%	3.2	3.9	5.5	3.5	3.4	9.5
Greater than 100%	1.0	0.9	4.0	1.1	1.0	11.9
Total	100.0	100.0	100.0	100.0	100.0	100.0
Outstanding loan value (£m)	227,267	55,598	19,548	302,413	298,595	3,818
Average loan to value:[1]						
Stock of residential mortgages	43.6	56.3	53.3	46.1		
New residential lending	65.2	63.0	**n/a**	64.7		
Impaired mortgages	55.6	74.6	66.8	60.0		
At 31 December 2014						
Less than 60%	44.6	32.4	31.4	41.5	41.7	22.5
60% to 70%	19.9	27.3	19.5	21.2	21.3	15.3
70% to 80%	18.5	21.8	19.8	19.2	19.2	17.8
80% to 90%	10.6	9.4	14.9	10.7	10.6	16.7
90% to 100%	4.5	6.8	8.7	5.2	5.2	11.9
Greater than 100%	1.9	2.3	5.7	2.2	2.0	15.8
Total	100.0	100.0	100.0	100.0	100.0	100.0
Outstanding loan value (£m)	228,176	53,322	21,623	303,121	299,210	3,911
Average Loan to value:[1]						
Stock of residential mortgages	46.3	61.3	59.2	49.2		
New residential lending	65.3	62.7	n/a	64.8		
Impaired mortgages	60.1	81.0	72.6	64.9		

1 Average loan to value is calculated as total loans and advances as a percentage of the indexed total collateral of these loans and advances.

INTEREST-ONLY MORTGAGES

The Group provides interest-only mortgages to customers, whereby payments of interest only are made for the term of the mortgage, with the customer responsible for repaying the principal outstanding at the end of the loan term.

Retail has reduced its exposure to owner occupier interest-only mortgages throughout 2015. New owner occupier interest only mortgages are limited to a maximum loan to value of 75 per cent, with a verifiable repayment vehicle sufficient to repay the loan. Interest-only mortgages represented 0.1 per cent of new residential mortgages in 2015 (0.1 per cent in 2014).

Table 1.14: **Analysis of owner occupier interest-only mortgages**

	2015	2014
Interest-only balances (£m)[1]	81,558	90,649
Impaired Loans (£m)	2,071	2,012
Interest-only balances as a % of owner occupier balances	33.9	37.2
Average loan to value (%)	46.6	51.0

1 In addition the Group has Buy-to-let interest only balances of £49,751 million (2014: £47,761 million) and certain other interest only balances of £3,705 million (2014: £4,153 million).

For existing interest-only mortgages, a contact strategy is in place throughout the term of the mortgage to ensure that customers are aware of their obligations to repay the principal upon maturity of the loan. The weighted-average term to maturity of the interest-only balances included in the table above is 11 years; the profile of owner occupier interest-only maturities is shown below.

Table 1.15: **Analysis of owner occupier interest-only mortgages maturities**

	1 Year £bn	2-5 Years £bn	6-10 Years £bn	> 11 Years £bn
Value of loans as at 31 December 2015[1]	2.0	9.1	14.5	45.2
Value of loans as at 31 December 2014[1]	1.8	9.2	14.6	52.7

1 Excludes mortgage accounts which consist of partial interest only and partial capital repayment.

68

Treatment strategies exist to help customers who may not be able to fully repay the principal balance at maturity. Of the owner occupier interest only mortgages that have missed the payment of principal at the end of term, balances of £1,313 million remain at 31 December 2015 (£1,117 million at 31 December 2014). The average indexed loan to value of these accounts is 28.0 per cent at 31 December 2015 (28.7 per cent at 31 December 2014). Of these accounts, 9.1 per cent are impaired (8.4 per cent at 31 December 2014).

FORBORNE LOANS

At 31 December 2015, UK secured loans and advances currently or recently subject to forbearance were 1.0 per cent (31 December 2014: 1.4 per cent) of total UK secured loans and advances. The reduction in forbearance is due to the overall improvement of credit quality of the portfolio. Loans and overdrafts currently or recently subject to forbearance were 1.5 per cent (31 December 2014: 1.6 per cent) of total loans and overdrafts.

Further analysis of the forborne loan balances is set out below:

Table 1.16: **UK retail forborne loans and advances (audited)**

	Total loans and advances which are forborne[1]		**Total forborne loans and advances which are impaired**[1]		**Impairment provisions as % of loans and advances which are forborne**[1]	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 %	2014 %
UK secured lending:						
Temporary forbearance arrangements						
Reduced contractual monthly payment[2]	–	146	–	29	–	6.0
Reduced payment arrangements[3]	414	552	41	69	4.2	3.4
	414	698	41	98	4.2	4.0
Permanent treatments						
Repair and term extensions[4]	2,688	3,696	132	168	4.2	3.5
Total	3,102	4,394	173	266	4.2	3.5
Loans and overdrafts[5]**:**	147	162	119	139	40.0	39.4

1 Includes accounts where the customer is currently benefiting from a forbearance treatment or the treatment has recently ended.

2 Includes temporary interest-only arrangements and short-term payment holidays granted in collections where the customer is currently benefiting from the treatment and where the concession has ended within the previous six months (temporary interest-only) and previous 12 months (short-term payment holidays).

3 Includes customers who had an arrangement to pay less than the contractual amount at 31 December or where an arrangement ended within the previous three months.

4 Includes capitalisation of arrears and term extensions which commenced during the previous 24 months and where the borrowers remain as customers at 31 December.

5 Includes temporary treatments where the customer is currently benefiting from the change or the treatment has ended within the previous six months. Permanent changes which commenced during the last 24 months for existing customers as at 31 December are also included.

UK secured forborne loans and advances have reduced by £1,292 million in 2015 to £3,102 million, driven primarily by an improvement in the underlying quality of the portfolio, with a greater value exiting forbearance than entering. Loans and Overdrafts forborne loans and advances have reduced by £15 million in 2015.

Further analysis of the movements in UK retail lending forborne loans and advances during the year is as follows:

Table 1.17: **Movement in UK retail forborne loans and advances (audited)**

	2015		2014	
	Secured lending £m	Loans and Overdrafts lending £m	Secured lending £m	Loans and Overdrafts lending £m
At 1 January	4,394	162	6,153	191
Classified as forborne during the year	1,290	69	1,805	123
Written-off/sold	(25)	(55)	(93)	(77)
Good exit from forbearance	(2,252)	(25)	(2,957)	(35)
Redeemed or repaid	(263)	(6)	(462)	(10)
Exchange and other movements	(42)	2	(52)	(30)
At 31 December	3,102	147	4,394	162

69

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

COMMERCIAL BANKING

- There was a net impairment release of £22 million in 2015, compared to a charge of £83 million in 2014. This has been driven by lower levels of new impairment as a result of effective risk management, improving UK economic conditions and the continued low interest rate environment; as well as write backs and provision releases, but at lower levels than seen during 2014.

- The credit quality of the portfolio and new business remains good. Surplus market liquidity continues to lead to some relaxation of credit conditions in the marketplace, although the Group remains disciplined within its low risk appetite approach.

- Impaired loans reduced by 22 per cent to £2,528 million at 31 December 2015 compared with 31 December 2014 (£3,241 million) and as a percentage of closing loans and advances reduced to 2.5 per cent from 3.2 per cent at 31 December 2014.

- Impairment provisions reduced to £1,087 million at 31 December 2015 (December 2014: £1,594 million) and includes collective unidentified impairment provisions of £229 million (31 December 2014: £338 million). Provisions as a percentage of impaired loans reduced from 49.2 per cent to 43.0 per cent, predominantly due to the change in the mix of impaired assets during 2015, with newly impaired connections having lower coverage levels compared to the portfolio average. The decrease is also partly due to the reduction in the collective unidentified impairment provisions fund during the year as a result of improved conditions.

- The Group expects to benefit from its continued disciplined approach to the management of credit, and sustained UK economic growth. Nevertheless, market volatility and the uncertain global economic outlook such as the continued slowdown in Chinese economic growth and the fall in commodity prices may impact the Commercial portfolios.

- The Group manages and limits exposure to certain sectors and asset classes, and closely monitors credit quality, sector and single name concentrations. This together with our conservative through the cycle risk appetite approach, means our portfolios are well positioned.

Table 1.18: **Commercial Banking impairment charge**

	2015 £m	2014 £m	Change %
SME	(22)	15	
Other	–	68	
Total impairment (release)/charge	(22)	83	
Impairment charge as a % of average advances[1]	0.01%	0.08%	(7)bps

1 In respect of loans and advances to customers.

Table 1.19: **Commercial Banking impaired loans and provisions**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	**Impairment provisions[1] £m**	Impairment provisions as a % of impaired loans %
At 31 December 2015					
SME	29,393	1,149	3.9	213	18.5
Other	73,042	1,379	1.9	874	63.4
Total gross lending	102,435	2,528	2.5	1,087	43.0
Reverse repos	–				
Impairment provisions	(1,087)				
Total	101,348				
At 31 December 2014					
SME	28,256	1,546	5.5	398	25.7
Other	74,203	1,695	2.3	1,196	70.6
Total gross lending	102,459	3,241	3.2	1,594	49.2
Reverse repos	5,145				
Impairment provisions	(1,594)				
Total	106,010				

1 Impairment provisions include collective unidentified impairment provisions.

70

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

SME

- The SME Banking portfolio continues to grow within prudent credit risk appetite parameters.
- Portfolio credit quality has remained stable or improved across all key metrics.
- There was a net impairment release of £22 million compared to a net charge of £15 million in 2014 with lower new impairment offset by writebacks and releases.

OTHER COMMERCIAL BANKING

- Other Commercial Banking comprises £73,042 million of gross loans and advances to customers in Mid Markets, Global Corporates and Financial Institutions.
- In the Mid Markets portfolio, credit quality has remained stable. The portfolio is focused on UK businesses and dependent on the performance of the domestic economy and to some extent, the global economy. The oil and gas services element of the portfolio has been reviewed given ongoing low oil prices and this review has not revealed any material concerns with portfolio quality at this time.
- The Global Corporate business continues to have a predominance of investment grade clients, primarily UK based. As a result of this profile, allied to our conservative risk appetite, our portfolio remains of good quality despite the current global economic headwinds particularly relating to the energy and mining sectors. We continue to monitor the portfolio closely to ensure there is no material deterioration.
- The real estate business within the Group's Mid Markets and Global Corporate portfolio is focused on clients operating in the UK commercial property market ranging in size from medium sized private real estate entities up to publicly listed property companies. The market for UK real estate has been buoyant and credit quality remains good with minimal impairments/stressed loans. All asset classes are attracting investment but, recognising this is a cyclical sector, appropriate caps are in place to control exposure and business propositions continue to be written in line with prudent risk appetite with conservative LTV, strong quality of income and proven management teams.
- Financial Institutions serves predominantly investment grade counterparties with whom relationships are either client focused or held to support the Group's funding, liquidity or general hedging requirements.
- Trading exposures continue to be predominantly short-term and/or collateralised with inter-bank activity mainly undertaken with acceptable investment grade counterparties.
- The Group continues to adopt a conservative stance across the Eurozone maintaining close portfolio scrutiny and oversight particularly given the current macro environment and horizon risks.

Commercial Banking UK Direct Real Estate LTV analysis

- The Group classifies Direct Real Estate as exposure which is directly supported by cash flows from property activities (as opposed to trading activities such as hotels, care homes and housebuilders).
- The Group manages its exposures to Direct Real Estate across a number of different coverage segments.
- Approximately 70 per cent of loans and advances to UK Direct Real Estate relate to commercial real estate with the remainder residential real estate.
- The Group makes use of a variety of methodologies to assess the value of property collateral, where external valuations are not available. These include use of market indices, models and subject matter expert judgement.
- The LTV profile of the UK Direct Real Estate portfolio in Commercial Banking continues to improve.

Table 1.20: **LTV – UK Direct Real Estate**

	At 31 December 2015[1]				At 31 December 2014[1]			
	Unimpaired £m	**Impaired £m**	**Total £m**	%	Unimpaired £m	Impaired £m	Total £m	%
UK exposures >£5 million								
Less than 60%	4,989	72	5,061	63.7	3,985	52	4,037	47.8
60% to 70%	1,547	6	1,553	19.5	1,644	62	1,706	20.2
70% to 80%	610	13	623	7.9	964	17	981	11.6
80% to 100%	75	36	111	1.4	66	211	277	3.3
100% to 120%	–	8	8	0.1	–	–	–	–
120% to 140%	–	–	–	–	130	6	136	1.6
Greater than 140%	5	100	105	1.3	–	95	95	1.1
Unsecured	487	–	487	6.1	1,222	–	1,222	14.4
	7,713	235	7,948	100.0	8,011	443	8,454	100.0
UK exposures <£5 million	9,656	508	10,164		8,833	644	9,477	
Total	17,369	743	18,112		16,844	1,087	17,931	

1 Exposures exclude £0.3 billion (31 December 2014: £0.4 billion) of gross UK Direct Real Estate lending in Wealth (within Retail division) and £1.1 billion (31 December 2014: £3.3 billion) of UK Direct Real Estate lending in Run-off. Also excludes Social Housing and Housebuilder lending.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

FORBORNE LOANS

Commercial Banking forbearance

At 31 December 2015, £3,514 million (31 December 2014: £5,137 million) of total loans and advances were forborne of which £2,528 million (31 December 2014: £3,241 million) were impaired. Impairment provisions as a percentage of forborne loans and advances decreased marginally from 31.0 per cent at 31 December 2014 to 30.9 per cent at 31 December 2015.

Table 1.21: **Commercial Banking forborne loans and advances (audited)**

	Total loans and advances which are forborne		Impairment provisions as % of loans and advances which are forborne	
	2015 £m	2014 £m	2015 %	2014 %
Impaired	2,528	3,241	43.0	49.2
Unimpaired	986	1,896	–	–
Total	3,514	5,137	30.9	31.0

All impaired assets are considered forborne.

Impaired loans and advances

The movements in Commercial Banking impaired forborne loans and advances were as follows:

Table 1.22: **Movement in Commercial Banking impaired forborne loans and advances (audited)**

	2015 £m	2014 £m

At 1 January	3,241	5,047
Classified as impaired during the year:		
Exposures >£5m	505	775
Exposures <£5m	126	188
	631	963
Transferred to unimpaired:		
Exposures >£5m but still reported as forborne	(15)	(268)
Exposures >£5m no longer reported as forborne	(20)	–
Exposures <£5m	(111)	(477)
	(146)	(745)
Written-off	(225)	(719)
Asset disposal/sales of impaired assets	(48)	(357)
Drawdowns/repayments	(693)	(732)
Exchange and other movements	(232)	(216)
At 31 December	2,528	3,241

Unimpaired loans and advances

Unimpaired forborne loans and advances were £986 million at 31 December 2015 (31 December 2014: £1,896 million).

The table below sets out the largest unimpaired forborne loans and advances to Commercial Banking customers (exposures over £5 million) as at 31 December 2015 by type of forbearance:

Table 1.23: **Commercial Banking unimpaired forborne loans and advances (audited)**

	31 December 2015 £m	31 December 2014 £m
Exposures >£5 million:		
Covenants	310	1,018
Extensions/alterations	350	426
Multiple	9	6
	669	1,450
Exposures < £5 million	317	446
Total	986	1,896

72

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.24: **Movement in Commercial Banking unimpaired forborne loans and advances >£5m[1] (audited)**

	31 December 2015 £m	31 December 2014 £m
At 1 January	1,450	1,654
Classified as impaired during the year	(141)	(147)
Cured no longer forborne	(655)	(1,004)
Classified as forborne during the year	156	709
Transferred from impaired but still reported as forborne[2]	15	743
Asset disposal/sales	–	(451)
Net drawdowns/repayments	(153)	(6)
Exchange and other movements	(3)	(48)
At 31 December	669	1,450

1 Balances exclude intra-year movements.

2 2014 included £475 million in respect of two loans transferred from Run-off.

CONSUMER FINANCE

– The impairment charge reduced by 29 per cent to £152 million from £215 million in 2014. The reduction was driven by a continued underlying improvement of portfolio quality supported by an increased level of write-backs from the sale of recoveries assets in the Credit Cards portfolio.

– Impairment provisions as a percentage of impaired loans have increased to 72.8 per cent from 70.5 per cent at 31 December 2014, with Credit Cards increasing by 5.3 percentage points to 81.8 per cent and Asset Finance UK decreasing by 2.8 percentage points to 67.2 per cent.

– Loans and advances increased by £2,665 million to £23,938 million during 2015. The growth was achieved in both Asset Finance UK and Credit Cards portfolio with no relaxation in risk appetite and underwriting standards. Impaired loans decreased by £177 million in 2015 to £543 million which represented 2.3 per cent of closing loans and advances to customers (31 December 2014: 3.4 per cent).

Table 1.25: **Consumer Finance impairment charge**

	2015 £m	2014 £m	Change %
Credit Cards	129	186	31
Asset Finance UK	22	30	27
Asset Finance Europe	1	(1)	
Total impairment charge	152	215	29
Impairment charge as a % of average advances	0.68%	1.05%	(37) bps

73

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.26: **Consumer Finance impaired loans and provisions**

	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	**Impairment provisions[1] £m**	**Impairment provisions as a % of impaired loans[2] %**
At 31 December 2015					
Credit Cards:					
Collections		187		153	81.8
Recoveries[3]		179		–	
	9,425	366	3.9	153	81.8
Asset Finance UK	9,582	134	1.4	90	67.2
Asset Finance Europe	4,931	43	0.9	22	51.2
	14,513	177	1.2	112	63.3
	23,938	543	2.3	265	72.8
Impairment provisions	(265)				
Fair value adjustments	(9)				
Total	23,664				
At 31 December 2014					
Credit Cards:					
Collections		217		166	76.5
Recoveries[3]		282		–	
	9,119	499	5.5	166	76.5
Asset Finance UK	7,204	160	2.2	112	70.0
Asset Finance Europe	4,950	61	1.2	31	50.8
	12,154	221	1.8	143	64.7
	21,273	720	3.4	309	70.5
Impairment provisions	(309)				
Fair value adjustments	(30)				
Total	20,934				

1 Impairment provisions include collective unidentified impairment provisions.
2 Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.
3 Recoveries assets are written down to the present value of expected cash flows on these assets.

FORBORNE LOANS

At 31 December 2015, Consumer Credit Card loans and advances currently or recently subject to forbearance were 2.4 per cent (31 December 2014: 2.6 per cent) of total Consumer Credit Card loans and advances. At 31 December 2015, Asset Finance UK Retail loans and advances on open portfolios currently or recently subject to forbearance were 1.4 per cent (31 December 2014: 2.1 per cent) of total Asset Finance UK Retail loans and advances. Further analysis of the forborne loans and advances is set out below:

Table 1.27: **Consumer Finance forborne loans and advances (audited)**

	Total loans and advances which are forborne[1]		**Total forborne loans and advances which are impaired[1]**		**Impairment provisions as % of loans and advances which are forborne[1]**	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 %	2014 %
Consumer Credit Cards[2]	225	234	120	140	26.8	29.1
Asset Finance UK Retail[2]	100	109	51	53	25.5	20.5

1 Includes accounts where the customer is currently benefiting from a forbearance treatment or the treatment recently ended.

2 Includes temporary treatments where the customer is currently benefiting from the change or the treatment has ended within the last six months. Permanent changes which commenced during the last 24 months for existing customers as at 31 December are also included.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Consumer Credit Cards and Asset Finance UK Retail forborne loans have reduced in 2015 by £9 million and £9 million respectively, driven primarily by improvements in the underlying quality of the portfolios. The movements in forborne loans and advances during the year were as follows:

Table 1.28: **Movement in Consumer Finance forborne loans and advances (audited)**

	2015 Consumer credit cards £m	Asset Finance £m	2014 Consumer credit cards £m	Asset Finance £m
At 1 January	234	109	326	149
Classified as forborne during the year	108	61	128	56
Written off/sold	(48)	(14)	(93)	(25)
Good exit from forbearance	(36)	(17)	(92)	(19)
Redeemed or repaid	(9)	(19)	(14)	(26)
Exchange and other movements	(24)	(20)	(21)	(26)
At 31 December	225	100	234	109

RUN-OFF

- With the exception of a small residual book (£37 million of which £5 million is impaired), the Irish Wholesale book (which contained the Commercial Real Estate portfolio), is now effectively exited following completion of the divestment announced on 30 July 2015. The Ireland Retail portfolio has reduced from £4,464 million at 31 December 2014 to £4,040 million at 31 December 2015.

- The Corporate real estate and other corporate portfolio has continued to reduce significantly ahead of expectations. Net loans and advances reduced by £1,908 million, from £3,036 million to £1,128 million for 2015.

- Net loans and advances for the specialist finance asset based run-off portfolio stood at £4,001 million at 31 December 2015 (gross £4,190 million), and include Ship Finance, Aircraft Finance and Infrastructure, with around half of the remaining lending in the lower risk leasing sector. Including the reducing Treasury Asset Legacy investment portfolio, and operating losses, total net external assets reduced to £5,552 million at 31 December 2015 (gross £5,742 million).

- Ireland retail loans and advances with an indexed LTV in excess of 100 per cent decreased to £1,269 million (31.4 per cent) at 31 December 2015, compared with £1,737 million (38.9 per cent) at 31 December 2014. Of this amount £71 million were impaired (31 December 2014: £78 million).

Table 1.29: **Run-off impairment charge**

	2015 £m	2014 £m	Change %
Ireland retail	(5)	(6)	(17)
Ireland commercial real estate	11	67	84
Ireland corporate	61	247	75
Corporate real estate and other corporate	21	(28)	
Specialist finance	(45)	22	
Other	(35)	(99)	(65)
Total	8	203	96
Impairment charge as a % of average advances[1]	0.20%	0.64%	(44)bps

1 In respect of loans and advances to customers.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Table 1.30: **Run-off impaired loans and provisions**

	Advances to customers £m	**Impaired loans £m**	**Impaired loans as a % of closing advances %**	**Impairment provisions £m**	**Impairment provisions as a % of impaired loans %**
At 31 December 2015					
Ireland retail	4,040	132	3.3	120	90.9
Ireland commercial real estate	8	5	62.5	–	
Ireland corporate	29	–		–	
Corporate real estate and other corporate	1,873	1,410	75.3	745	52.8
Specialist finance	4,190	361	8.6	189	52.4
Other	1,282	117	9.1	96	82.1
	11,422	2,025	17.7	1,150	56.8
Impairment provisions	(1,150)				
Fair value adjustments	–				
Total	10,272				
At 31 December 2014					
Ireland retail	4,464	120	2.7	141	117.5
Ireland commercial real estate	1,797	1,659	92.3	1,385	83.5
Ireland corporate	1,639	1,393	85.0	1,095	78.6
Corporate real estate and other corporate	3,947	1,548	39.2	911	58.9
Specialist finance	4,835	364	7.5	254	69.8
Other	1,634	131	8.0	141	107.6
	18,316	5,215	28.5	3,927	75.3
Impairment provisions	(3,927)				
Fair value adjustments	19				
Total	14,408				

FORBORNE LOANS

RUN-OFF IRELAND RETAIL LENDING

At 31 December 2015, £169 million or 4.2 per cent (31 December 2014: £280 million or 6.3 per cent) of Irish retail secured loans and advances were subject to current or recent forbearance. Of this amount £26 million (31 December 2014: £41 million) were impaired.

RUN-OFF CORPORATE REAL ESTATE, OTHER CORPORATE AND SPECIALIST FINANCE

At 31 December 2015 £1,780 million (31 December 2014: £1,998 million) of total loans and advances were forborne of which £1,771 million (31 December 2014: £1,912 million) were impaired. Impairment provisions as a percentage of forborne loans and advances decreased from 58.3 per cent at 31 December 2014 to 52.5 per cent at 31 December 2015.

Unimpaired forborne loans and advances were £9 million at 31 December 2015 (31 December 2014: £86 million).

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Impaired loans and advances

The movements in Run-off corporate real estate, other corporate and Specialist Finance impaired forborne loans and advances were as follows:

Table 1.31: **Movement in Run-off corporate real estate, other corporate and Specialist Finance impaired forborne loans and advances (audited)**

	2015 £m	2014 £m
At 1 January	**1,912**	9,499
Classified as impaired during the year:		
Exposures >£5m	**414**	557
Exposures <£5m	**11**	46
	425	603
Transferred to unimpaired but still reported as forborne during the year:		
Exposures >£5m[1]	**(13)**	(961)
Exposures <£5m	**(11)**	(12)
	(24)	(973)
Write offs	**(238)**	(2,565)
Asset disposal/sales of impaired assets	**(763)**	(4,363)
Drawdowns/repayments	**(19)**	(248)
Exchange and other movements	**478**	(41)
At 31 December	**1,771**	1,912

1 2014 included £475 million in respect of two loans classified as impaired during the year and subsequently transferred to Commercial Banking.

Run-off Ireland commercial real estate and corporate

All loans and advances (whether impaired or unimpaired) are treated as forborne. At 31 December 2015, £37 million (31 December 2014: £3,436 million) of total loans and advances were forborne of which £5 million (31 December 2014: £3,052 million) were impaired. Impairment provisions as a percentage of forborne loans and advances decreased from 72.2 per cent at 31 December 2014 to nil at 31 December 2015.

The movements in forborne loans and advances were:

Table 1.32: **Movement in Run-off: Ireland commercial real estate and corporate forborne loans and advances (audited)**

	2015	**2014**
	£m	**£m**
At 1 January	**3,436**	9,430
Write-offs	**(419)**	(2,589)
Asset disposal/sales	**(2,563)**	(1,444)
Drawdowns/repayments	**(99)**	(1,413)
Exchange and other movements	**(318)**	(548)
At 31 December	**37**	3,436

Eurozone exposures

The following section summarises the Group's direct exposure to Eurozone countries at 31 December 2015. The exposures comprise on-balance sheet exposures based on their balance sheet carrying values and off-balance sheet exposures, and are based on the country of domicile of the counterparty unless otherwise indicated.

The Group manages its exposures to individual countries through authorised country limits which take into account economic, financial, political and social factors. In addition, the Group manages its direct risks to the selected countries by establishing and monitoring risk limits for individual banks, financial institutions, corporates and individuals.

Identified indirect exposure information, where available is also taken into account when setting limits and determining credit risk appetite for individual counterparties. This forms part of the Group's credit analysis undertaken at least annually for counterparty and sector reviews, with interim updates performed as necessary. Interim updates would usually be triggered by specific credit events such as rating downgrades, sovereign events or other developments such as spread widening. Examples of indirect risk which have been identified, where information is available, are: European Banking groups with lending and other exposures to certain Eurozone Countries; corporate customers with operations or significant trade in certain European jurisdictions; major travel operators known to operate in certain Eurozone Countries; and international banks with custodian operations based in certain European locations.

The Group Financial Stability Forum (GFSF) monitors developments within the Eurozone, carries out stress testing through detailed scenario analysis and completes appropriate due diligence on the Group's exposures.

The GFSF has carried out a number of scenario analyses and rehearsals to test the Group's resilience in the event of further instability in certain Eurozone countries. The Group has developed and refined pre-determined action plans that would be executed in such scenarios. The plans set out governance requirements and responsibilities for the key actions which would be carried out and cover risk areas such as payments, liquidity and capital, communications, suppliers and systems, legal, credit, delivery channels and products, employees and the impact on customers.

Exposures to Eurozone countries are detailed in the following tables and are based on balance sheet exposures, net of provisions. Derivative balances are included within exposures to financial institutions or corporates, as appropriate, at fair value adjusted for master netting agreements at obligor level

77

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

and net of cash collateral in line with legal agreements. Exposures in respect of reverse repurchase agreements are included on a gross IFRS basis and are disclosed based on the counterparty rather than the collateral (repos and stock lending are excluded); reverse repurchase exposures are not, therefore, reduced as a result of collateral held. Reverse repurchase exposures to Institutional funds secured by UK Gilts are excluded from all Eurozone exposures as detailed in the footnotes. Exposures to central clearing counterparties are shown net.

For multi-country asset backed securities exposures, the Group has reported exposures based on the largest country exposure. The country of exposure for asset backed securities is based on the location of the underlying assets which are predominantly residential mortgages not on the domicile of the issuer.

For Insurance, the Group has reported shareholder exposures i.e. where the Group is directly exposed to risk of loss. These shareholder exposures relate to direct investments where the issuer is resident in the named Eurozone country and the credit rating is consistent with the tight credit criteria defined under the appropriate investment mandate. Insurance also has interests in two funds domiciled in Ireland (Global Liquidity Fund and the Investment Cash Fund) where, in line with the investment mandates, cash is invested in short term financial instruments. For these funds, the exposure is analysed on a look through basis to the country risk of the obligors of the underlying assets rather than treating the insurance holding in the funds as exposure to Ireland.

EXPOSURES TO SELECTED EUROZONE COUNTRIES

The Group continues to have minimal exposure, in aggregate, which could be considered to be direct recourse to the sovereign risk of the selected countries.

Table 1.33: **Selected Eurozone exposures**

	Sovereign debt								
	Direct sovereign exposures £m	**Cash at central banks £m**	**Financial institutions Banks £m**	**Other[1] £m**	**Asset backed securities £m**	**Corporate £m**	**Personal £m**	**Insurance assets £m**	**Total £m**
At 31 December 2015									
Ireland	**–**	**–**	**748**	**445**	**87**	**731**	**3,921**	**–**	**5,932**
Spain	**–**	**–**	**77**	**102**	**–**	**870**	**39**	**9**	**1,097**
Portugal	**–**	**–**	**7**	**–**	**–**	**86**	**6**	**–**	**99**
Italy	**–**	**–**	**32**	**–**	**–**	**51**	**–**	**73**	**156**

Greece	**–**	**–**	**–**	**–**	**–**	**1**	**–**	**–**	**1**
	–	**–**	**864**	**547**	**87**	**1,739**	**3,966**	**82**	**7,285**
At 31 December 2014									
Ireland	–	–	359	–	115	1,672	4,325	–	6,471
Spain	–	–	57	116	–	1,160	49	13	1,395
Portugal	–	–	9	5	–	133	6	–	153
Italy	–	–	354	5	–	93	–	34	486
Greece	–	–	–	–	–	3	–	–	3
	–	–	779	126	115	3,061	4,380	47	8,508

1 Excludes reverse repurchase exposure to Institutional funds domiciled in Ireland secured by UK gilts of £11,267 million (2014: £10,456 million) on a gross basis.

In addition to the exposures detailed in table 1.33, the Group has the following exposures to sovereigns, financial institutions, asset backed securities, corporates and personal customers in the following Eurozone countries:

78

Table 1.34: **Other Eurozone exposures**

	Sovereign debt								
	Direct sovereign exposures £m	**Cash at central banks £m**	**Financial institutions Banks £m**	**Other[1] £m**	**Asset backed securities £m**	**Corporate £m**	**Personal £m**	**Insurance assets £m**	**Total £m**
At 31 December 2015									
Netherlands	**281**	**11,515**	**328**	**164**	**37**	**1,275**	**4,863**	**428**	**18,891**
France	**173**	**–**	**1,809**	**216**	**98**	**1,953**	**64**	**953**	**5,266**
Germany	**151**	**97**	**888**	**21**	**66**	**1,924**	**177**	**573**	**3,897**
Luxembourg	**–**	**–**	**74**	**1,178**	**618**	**1,614**	**–**	**36**	**3,520**
Belgium	**20**	**–**	**830**	**1**	**–**	**298**	**–**	**51**	**1,200**
Austria	**–**	**–**	**3**	**–**	**–**	**280**	**–**	**–**	**283**
All other Eurozone countries	**15**	**–**	**400**	**–**	**–**	**62**	**–**	**80**	**557**
	640	**11,612**	**4,332**	**1,580**	**819**	**7,406**	**5,104**	**2,121**	**33,614**
At 31 December 2014									
Netherlands	320	5,611	597	129	307	1,682	4,888	432	13,966
France	245	–	3,198	1,435	134	2,453	73	1,069	8,607
Germany	181	133	806	1,180	339	1,729	32	877	5,277
Luxembourg	–	–	8	799	74	2,241	–	11	3,133
Belgium	75	–	906	2	–	404	–	27	1,414
Austria	311	–	913	–	–	163	–	–	1,387
All other Eurozone countries	116	–	449	–	–	64	–	94	723
	1,248	5,744	6,877	3,545	854	8,736	4,993	2,510	34,507

1 Excludes reverse repurchase exposure to Institutional funds secured by UK gilts of £1,955 million (2014: £1,455 million) on a gross basis.

ENVIRONMENTAL RISK MANAGEMENT

The Group ensures appropriate management of the environmental impact of its lending activities. The Groupwide credit risk principles require all credit risk to be incurred with due regard to environmental legislation and the Group's Code of Business Responsibility.

Within Commercial Banking, an electronic environmental risk screening system has been the primary mechanism for assessing environmental risk in lending transactions. This system provides screening of location specific and sector based risks that may be present in a transaction. Identified risk results in the transaction referred to the Group's expert in-house environmental risk team for further review and assessment, as outlined below. Where required, the Group's panel of environmental consultants provide additional expert support.

The Group provides colleague training in environmental risk management as part of the standard suite of credit risk courses. Supporting this training, a range of online resource is available to colleagues and includes environmental risk theory, procedural guidance, and information on environmental legislation and sector-specific environmental impacts.

The Group has been a signatory to the Equator Principles since 2006 and has adopted and applied the expanded scope of Equator Principles III. The Equator Principles support the Group's approach to assessing and managing environmental and social issues in Project Finance, Project-Related Corporate loans and Bridge loans. Further information is contained within the Group's Responsible Business Review (http://www.lloydsbankinggroup.com/our-group/responsible-business/our-approach/managing-risk/).

Table 1.35: **Environmental risk management approach**

79

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LOAN PORTFOLIO

In the following tables, where lending and the related impairment allowances are analysed between domestic and international, the classification as domestic or international is based on the location of the office recording the transaction, except for certain lending of the international business booked in London including the Group's lending in Ireland which, following the merger of Bank of Scotland (Ireland) Limited into Bank of Scotland plc, is held on the balance sheet of Bank of Scotland plc in the UK but is reported as international.

ANALYSIS OF LOANS AND ADVANCES TO BANKS AND CUSTOMERS

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

	2015 £m	**2014 £m**	**2013 £m**	**2012 £m**	**2011 £m**
Loans and advances to banks	**25,117**	26,155	25,365	32,760	32,620
Loans and advances to customers:					
Mortgages	**312,877**	333,318	335,611	337,879	348,210
Other personal lending	**20,579**	23,123	23,230	28,334	30,014
Agriculture, forestry and fishing	**6,924**	6,586	6,051	5,531	5,198
Energy and water supply	**3,247**	3,853	4,414	3,321	4,013
Manufacturing	**5,953**	6,000	7,650	8,530	10,061
Construction	**4,952**	6,425	7,024	7,526	9,722
Transport, distribution and hotels	**13,526**	15,112	22,294	26,568	32,882
Postal and telecommunications	**2,563**	2,624	2,364	1,397	1,896
Financial, business and other services	**43,072**	44,979	42,478	48,729	64,046
Property companies	**32,228**	36,682	44,277	52,388	64,752
Lease financing	**2,751**	3,013	4,435	6,477	7,800
Hire purchase	**9,536**	7,403	5,090	5,334	5,776
Total loans	**483,325**	515,273	530,283	564,774	616,990
Allowance for impairment losses	**(3,033)**	(6,414)	(11,966)	(15,253)	(18,746)
Total loans and advances net of allowance for impairment losses	**480,292**	508,859	518,317	549,521	598,244

Following the reduction in the Group's non-UK activities, an analysis between domestic and foreign operations is not provided for 2013 or later years. The analysis of loans and advances at 31 December 2012 and 2011 between domestic and international offices is as follows:

	2012 £m	2011 £m
Domestic		
Loans and advances to banks	32,073	31,852
Loans and advances to customers:		
Mortgages	322,687	331,715
Other personal lending	26,119	28,244
Agriculture, forestry and fishing	5,482	5,010
Energy and water supply	1,773	1,689
Manufacturing	7,246	8,055
Construction	6,481	7,885
Transport, distribution and hotels	22,205	27,232
Postal and telecommunications	1,239	1,491
Financial, business and other services	44,155	56,721
Property companies	43,683	49,561
Lease financing	5,306	6,792
Hire purchase	4,970	5,237
Total loans	523,419	561,484
Allowance for impairment losses	(7,076)	(8,025)
Total loans and advances net of allowance for impairment losses	516,343	553,459

80

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

	2012 £m	2011 £m
Foreign		
Loans and advances to banks	687	768
Loans and advances to customers:		
Mortgages	15,192	16,495
Other personal lending	2,215	1,770
Agriculture, forestry and fishing	49	188
Energy and water supply	1,548	2,324
Manufacturing	1,284	2,006
Construction	1,045	1,837
Transport, distribution and hotels	4,363	5,650
Postal and telecommunications	158	405
Financial, business and other services	4,574	7,325
Property companies	8,705	15,191
Lease financing	1,171	1,008
Hire purchase	364	539
Total loans	41,355	55,506
Allowance for impairment losses	(8,177)	(10,721)
Total loans and advances net of allowance for impairment losses	33,178	44,785

	2012 £m	2011 £m
Total		
Loans and advances to banks	32,760	32,620
Loans and advances to customers:		
Mortgages	337,879	348,210
Other personal lending	28,334	30,014
Agriculture, forestry and fishing	5,531	5,198
Energy and water supply	3,321	4,013
Manufacturing	8,530	10,061
Construction	7,526	9,722
Transport, distribution and hotels	26,568	32,882
Postal and telecommunications	1,397	1,896
Financial, business and other services	48,729	64,046
Property companies	52,388	64,752
Lease financing	6,477	7,800
Hire purchase	5,334	5,776
Total loans	564,774	616,990
Allowance for impairment losses	(15,253)	(18,746)
Total loans and advances net of allowance for impairment losses	549,521	598,244

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

SUMMARY OF LOAN LOSS EXPERIENCE

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

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Balance at beginning of year	**6,414**	11,966	15,253	18,746	18,393
Exchange and other adjustments	**(246)**	(410)	291	(380)	(369)
Disposal of businesses	**(82)**	–	(176)	–	–
Advances written off:					
Loans and advances to customers:					
Mortgages	**(71)**	(87)	(601)	(133)	(86)
Other personal lending	**(853)**	(1,329)	(1,437)	(2,267)	(2,617)
Agriculture, forestry and fishing	**(1)**	(8)	(11)	(45)	(11)
Energy and water supply	**(73)**	–	(102)	(77)	(48)
Manufacturing	**(126)**	(59)	(130)	(226)	(137)
Construction	**(21)**	(157)	(84)	(654)	(92)
Transport, distribution and hotels	**(728)**	(1,119)	(798)	(458)	(329)
Postal and telecommunications	**(11)**	–	(14)	(7)	(1)
Financial, business and other services	**(604)**	(946)	(1,030)	(1,071)	(1,120)
Property companies	**(1,648)**	(2,669)	(1,891)	(3,554)	(2,630)
Lease financing	**(31)**	(4)	(10)	(75)	(224)
Hire purchase	**(37)**	(54)	(121)	(130)	(192)
Loans and advances to banks	**–**	–	(3)	(10)	(6)
Total advances written off	**(4,204)**	(6,432)	(6,232)	(8,707)	(7,493)
Recoveries of advances written off:					
Loans and advances to customers:					
Mortgages	**35**	18	28	53	26
Other personal lending	**366**	600	408	757	326
Energy and water supply	**5**	–	–	–	–
Manufacturing	**–**	–	–	–	–
Construction	**–**	–	–	–	–
Transport, distribution and hotels	**63**	–	–	1	1
Financial, business and other services	**193**	–	–	–	–
Property companies	**101**	–	–	4	–
Lease financing	**–**	–	–	2	–
Hire purchase	**1**	63	20	26	68
Total recoveries of advances written off	**764**	681	456	843	421
Total net advances written off	**(3,440)**	(5,751)	(5,776)	(7,864)	(7,072)

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Effect of unwinding of discount recognised through interest income	**(56)**	(126)	(351)	(374)	(226)
Allowances for impairment losses charged against income for the year:					
Loans and advances to customers:					
Mortgages	**33**	(138)	224	278	444
Other personal lending	**437**	536	920	881	1,669
Agriculture, forestry and fishing	**1**	2	–	54	27
Energy and water supply	**35**	28	95	71	105
Manufacturing	**23**	(4)	31	236	206
Construction	**13**	(81)	66	326	350
Transport, distribution and hotels	**(88)**	198	421	649	884
Postal and telecommunications	**(2)**	6	(3)	8	15
Financial, business and other services	**77**	179	552	824	1,464
Property companies	**(140)**	40	457	1,725	2,776
Lease financing	**31**	(1)	(26)	26	60
Hire purchase	**23**	(30)	(12)	47	20
Loans and advances to banks	**–**	–	–	–	–
Total allowances for impairment losses charged against income for the year	**443**	735	2,725	5,125	8,020
Total balance at end of year	**3,033**	6,414	11,966	15,253	18,746
Ratio of net write-offs during the year to average loans outstanding during the year	**0.8%**	1.1%	1.1%	1.4%	1.2%

The Group's impairment allowances in respect of loans and advances to banks and customers decreased by £3,381 million, or 53 per cent, from £6,414 million at 31 December 2014 to £3,033 million at 31 December 2015. This decrease resulted from a charge to the income statement of £443 million being more than offset by net advances written off of £3,440 million (advances written off of £4,204 million less recoveries £764 million). A further decrease of £82 million followed the disposal of the Group's interest in TSB Banking Group plc. The reduction in the charge to the income statement of £292 million, or 40 per cent, from £735 million in 2014 to £443 million in 2015 reflects lower charges in all Divisions, particularly in Retail and in respect of the portfolio of assets which are outside of the Group's risk appetite, reflecting the continuing run-off of such assets, in particular exposures in Ireland. By category of lending, the most significant elements of the charge to the income statement were a charge of £437 million in respect of other personal lending and a charge of £77 million in respect of financial business and other services, together with credits of £88 million in relation to transport, distribution and hotels and £140 million in respect of property companies. Of the net advances written off of £3,440 million, £487 million related to other personal lending, £665 million related to transport, distribution and hotels and £1,547 million to property companies.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Following the reduction in the Group's non-UK activities, an analysis between domestic and foreign operations is not provided for 2013 or later years. The analysis of movements in the allowance for impairment losses on loans and advances to banks and customers for the years ended 31 December 2012 and 2011 between domestic and international offices is as follows:

Domestic	2012 £m	2011 £m
Balance at beginning of year	8,025	9,786
Exchange and other adjustments	(24)	68
Advances written off:		
Loans and advances to customers:		
Mortgages	(96)	(56)
Other personal lending	(2,258)	(2,605)
Agriculture, forestry and fishing	(11)	(8)
Energy and water supply	(68)	(48)
Manufacturing	(75)	(105)
Construction	(477)	(38)
Transport, distribution and hotels	(140)	(247)
Postal and telecommunications	(1)	(1)
Financial, business and other services	(919)	(894)
Property companies	(528)	(1,594)
Lease financing	(74)	(120)
Hire purchase	(129)	(57)
Loans and advances to banks	(10)	(6)
Total advances written off	(4,786)	(5,779)
Recoveries of advances written off:		
Loans and advances to customers:		
Mortgages	53	26
Other personal lending	751	326
Agriculture, forestry and fishing	–	–
Energy and water supply	–	–
Manufacturing	–	–
Construction	–	–
Transport, distribution and hotels	1	1
Postal and telecommunications	–	–
Financial, business and other services	–	–
Property companies	–	–
Lease financing	2	–
Hire purchase	26	68
Total recoveries of advances written off	833	421
Total net advances written off	(3,953)	(5,358)

84

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Domestic	2012 £m	2011 £m
Effect of unwinding of discount recognised through interest income	(405)	(406)
Allowances for impairment losses charged against income for the year:		
Loans and advances to customers:		
Mortgages	32	24
Other personal lending	1,121	1,670
Agriculture, forestry and fishing	15	19
Energy and water supply	77	130
Manufacturing	81	110
Construction	221	168
Transport, distribution and hotels	289	298
Postal and telecommunications	–	(8)
Financial, business and other services	734	1,188
Property companies	776	287
Lease financing	37	48
Hire purchase	50	1
Loans and advances to banks	–	–
Total allowances for impairment losses charged against income for the year	3,433	3,935
Total balance at end of year – Domestic	7,076	8,025

Foreign	2012 £m	2011 £m
Balance at beginning of year	10,721	8,607
Exchange and other adjustments	(356)	(437)
Advances written off:		
Loans and advances to customers:		
Mortgages	(37)	(30)
Other personal lending	(9)	(12)
Agriculture, forestry and fishing	(34)	(3)
Energy and water supply	(9)	–
Manufacturing	(151)	(32)
Construction	(177)	(54)
Transport, distribution and hotels	(318)	(82)
Postal and telecommunications	(6)	–
Financial, business and other services	(152)	(226)
Property companies	(3,026)	(1,036)
Lease financing	(1)	(104)
Hire purchase	(1)	(135)
Loans and advances to banks	–	–
Total advances written off	(3,921)	(1,714)
Recoveries of advances written off:		
Loans and advances to customers:		
Mortgages	–	–
Other personal lending	6	–
Agriculture, forestry and fishing	–	–
Energy and water supply	–	–

Manufacturing	–	–
Construction	–	–
Transport, distribution and hotels	–	–
Postal and telecommunications	–	–
Financial, business and other services	–	–
Property companies	4	–
Hire purchase	–	–
Total recoveries of advances written off	10	–
Total net advances written off	(3,911)	(1,714)

85

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Foreign	2012 £m	2011 £m
Effect of unwinding of discount recognised through interest income	31	180
Allowances for impairment losses charged against income for the year:		
Loans and advances to customers:		
Mortgages	246	420
Other personal lending	(240)	(1)
Agriculture, forestry and fishing	39	8
Energy and water supply	(6)	(25)
Manufacturing	155	96
Construction	105	182
Transport, distribution and hotels	360	586
Postal and telecommunications	8	23
Financial, business and other services	90	276
Property companies	949	2,489
Lease financing	(11)	12
Hire purchase	(3)	19
Loans and advances to banks	–	–
Total allowances for impairment losses charged against income for the year	1,692	4,085
Total balance at end of year – Foreign	8,177	10,721

Total	2012 £m	2011 £m
Balance at beginning of year	18,746	18,393
Exchange and other adjustments	(380)	(369)
Advances written off:		
Loans and advances to customers:		
Mortgages	(133)	(86)
Other personal lending	(2,267)	(2,617)
Agriculture, forestry and fishing	(45)	(11)
Energy and water supply	(77)	(48)
Manufacturing	(226)	(137)
Construction	(654)	(92)
Transport, distribution and hotels	(458)	(329)
Postal and telecommunications	(7)	(1)
Financial, business and other services	(1,071)	(1,120)
Property companies	(3,554)	(2,630)
Lease financing	(75)	(224)
Hire purchase	(130)	(192)
Loans and advances to banks	(10)	(6)
Total advances written off	(8,707)	(7,493)
Recoveries of advances written off:		
Loans and advances to customers:		
Mortgages	53	26
Other personal lending	757	326
Energy and water supply	–	–
Manufacturing	–	–

Construction	–	–
Transport, distribution and hotels	1	1
Financial, business and other services	–	–
Property companies	4	–
Lease financing	2	–
Hire purchase	26	68
Total recoveries of advances written off	843	421
Total net advances written off	(7,864)	(7,072)

86

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Total	2012 £m	2011 £m
Effect of unwinding of discount recognised through interest income	(374)	(226)
Allowances for impairment losses charged against income for the year:		
Loans and advances to customers:		
Mortgages	278	444
Other personal lending	881	1,669
Agriculture, forestry and fishing	54	27
Energy and water supply	71	105
Manufacturing	236	206
Construction	326	350
Transport, distribution and hotels	649	884
Postal and telecommunications	8	15
Financial, business and other services	824	1,464
Property companies	1,725	2,776
Lease financing	26	60
Hire purchase	47	20
Loans and advances to banks	–	–
Total allowances for impairment losses charged against income for the year	5,125	8,020
Total balance at end of year – Total	15,253	18,746

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

	2015 Allowance £m	2015 Percentage of loans in each category to total loans %	2014 Allowance £m	2014 Percentage of loans in each category to total loans %	2013 Allowance £m	2013 Percentage of loans in each category to total loans %	2012 Allowance £m	2012 Percentage of loans in each category to total loans %	2011 Allo £m
Balance at year end applicable to:									
Loans and advances to banks	–	5.2	–	5.1	–	4.8	3	5.8	14
Loans and advances to customers:									
Mortgages	479	64.7	460	64.7	657	63.5	1,113	60.0	948
Other personal lending	388	4.3	607	4.5	919	4.4	1,147	5.0	1,89
Agriculture, forestry and fishing	15	1.4	18	1.3	38	1.1	67	1.0	51
Energy and water supply	20	0.7	61	0.7	149	0.8	191	0.6	165

Manufacturing	70	1.2	179	1.2	296	1.4	337	1.5	475
Construction	165	1.0	158	1.3	395	1.3	504	1.3	898
Transport, distribution and hotels	219	2.8	1,051	2.9	1,954	4.2	2,162	4.7	2,11
Postal and telecommunications	4	0.5	17	0.5	11	0.4	40	0.2	62
Financial, business and other services	811	8.9	1,225	8.7	2,293	8.0	2,764	8.6	3,07
Property companies	790	6.7	2,553	7.1	5,145	8.3	6,664	9.3	8,71
Lease financing	–	0.6	1	0.6	6	0.8	33	1.1	92
Hire purchase	72	2.0	84	1.4	103	1.0	228	0.9	244
Total balance at year end	3,033	100.0	6,414	100.0	11,966	100.0	15,253	100.0	18,7

87

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Following the reduction in the Group's non-UK activities, an analysis between domestic and foreign operations is not provided for 2013 or later years. The analysis of the coverage of the allowance for loan losses at 31 December 2012 and 2011 between domestic and international offices is as follows:

2012	Domestic Allowance £m	Percentage of loans in each category to total loans %	Foreign Allowance £m	Percentage of loans in each category to total loans %	Total Allowance £m	Percentage of loans in each category to total loans %
Balance at year end applicable to:						
Loans and advances to banks	3	6.1	–	1.7	3	5.8
Loans and advances to customers:						
Mortgages	106	62.0	1,007	36.8	1,113	60.0
Other personal lending	1,064	5.0	83	5.4	1,147	5.0
Agriculture, forestry and fishing	57	1.0	10	0.1	67	1.0
Energy and water supply	177	0.3	14	3.7	191	0.6
Manufacturing	194	1.4	143	3.1	337	1.5
Construction	215	1.2	289	2.5	504	1.3
Transport, distribution and hotels	715	4.2	1,447	10.6	2,162	4.7
Postal and telecommunications	10	0.2	30	0.4	40	0.2
Financial, business and other services	2,008	8.4	756	11.1	2,764	8.6
Property companies	2,307	8.3	4,357	21.0	6,664	9.3
Lease financing	14	1.0	19	2.8	33	1.1
Hire purchase	206	0.9	22	0.8	228	0.9
Total	7,076	100.0	8,177	100.0	15,253	100.0

2011	Domestic Allowance £m	Percentage of loans in each category to total loans %	Foreign Allowance £m	Percentage of loans in each category to total loans %	Total Allowance £m	Percentage of loans in each category to total loans %
Balance at year end applicable to:						
Loans and advances to banks	14	5.7	–	1.4	14	5.3
Loans and advances to customers:						
Mortgages	123	59.1	825	29.7	948	56.4
Other personal lending	1,555	5.0	340	3.2	1,895	4.9
Agriculture, forestry and fishing	39	0.9	12	0.3	51	0.8
Energy and water supply	137	0.3	28	4.2	165	0.7
Manufacturing	318	1.4	157	3.6	475	1.6
Construction	531	1.4	367	3.3	898	1.6
Transport, distribution and hotels	668	4.9	1,449	10.2	2,117	5.3
Postal and telecommunications	35	0.3	27	0.7	62	0.3

Financial, business and other services	2,172	10.1	903	13.2	3,075	10.4
Property companies	2,153	8.8	6,557	27.4	8,710	10.5
Lease financing	63	1.2	29	1.8	92	1.3
Hire purchase	217	0.9	27	1.0	244	0.9
Total	8,025	100.0	10,721	100.0	18,746	100.0

88

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RISK ELEMENTS IN THE LOAN PORTFOLIO

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

NON-PERFORMING LENDING

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

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

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

		Loans and advances to customers				
(audited)	**Loans and advances to banks £m**	**Retail – mortgages £m**	**Retail – other £m**	**Commercial £m**	**Total £m**	**Loans and advances designated at fair value through profit or loss £m**
31 December 2015						
Neither past due nor impaired	25,006	302,063	38,886	100,001	440,950	33,174
Past due but not impaired	111	8,233	393	463	9,089	–
Impaired – no provision required	–	732	690	1,092	2,514	–
– provision held	–	3,269	911	2,896	7,076	–
Gross	25,117	314,297	40,880	104,452	459,629	33,174
31 December 2014						

Neither past due nor impaired	26,003	320,324	37,886	106,768	464,978	36,725
Past due but not impaired	152	10,311	674	488	11,473	–
Impaired – no provision required	–	578	938	847	2,363	–
– provision held	–	3,766	1,109	7,070	11,945	–
Gross	26,155	334,979	40,607	115,173	490,759	36,725
31 December 2013						
Neither past due nor impaired	25,219	318,668	36,789	107,764	463,221	29,443
Past due but not impaired	146	12,329	580	786	13,695	–
Impaired – no provision required	–	637	1,284	1,824	3,745	–
– provision held	–	6,229	1,456	20,829	28,514	–
Gross	25,365	337,863	40,109	131,203	509,175	29,443
31 December 2012						
Neither past due nor impaired	32,726	319,613	41,223	117,152	477,988	14,551
Past due but not impaired	31	12,880	922	1,527	15,329	–
Impaired – no provision required	–	741	1,530	1,504	3,775	–
– provision held	3	7,391	2,124	33,003	42,518	–
Gross	32,760	340,625	45,799	153,186	539,610	14,551
31 December 2011						
Neither past due nor impaired	32,494	330,727	41,448	146,655	518,830	11,121
Past due but not impaired	15	12,742	1,093	2,509	16,344	–
Impaired – no provision required	6	1,364	1,604	3,544	6,512	–
– provision held	105	6,701	2,940	44,116	53,757	–
Gross	32,620	351,534	47,085	196,824	595,443	11,121

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

89

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

(audited)	Loans and advances to banks £m	Loans and advances to customers Retail – mortgages £m	Retail – other £m	Commercial £m	Total £m	Loans and advances designated at fair value through profit or loss £m
31 December 2015						
0-30 days	111	4,066	276	248	4,590	–
30-60 days	–	1,732	81	100	1,913	–
60-90 days	–	1,065	9	52	1,126	–
90-180 days	–	1,370	8	19	1,397	–
Over 180 days	–	–	19	44	63	–
Total	111	8,233	393	463	9,089	–
31 December 2014						
0-30 days	152	4,854	453	198	5,505	–
30-60 days	–	2,309	110	51	2,470	–
60-90 days	–	1,427	90	139	1,656	–
90-180 days	–	1,721	5	38	1,764	–
Over 180 days	–	–	16	62	78	–
Total	152	10,311	674	488	11,473	–
31 December 2013						
0-30 days	146	5,596	489	347	6,432	–
30-60 days	–	2,639	87	102	2,828	–
60-90 days	–	1,734	4	57	1,795	–