LLOYDS BANKING GROUP

ANNUAL REPORT AND ACCOUNTS 2008

CREATING THE UK'S LEADING FINANCIAL SERVICES PROVIDER

This publication contains the 2008 report and accounts for Lloyds Banking Group plc (formerly Lloyds TSB Group plc).

HBOS plc was acquired by Lloyds Banking Group plc on 16 January 2009 and, accordingly, is dealt with in the accounts only as a post balance sheet event (see note 52, page 181). The 2008 report and accounts for HBOS plc therefore do not form part of this publication.

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PRESENTATION OF INFORMATION

In order to provide a more comparable representation of underlying business performance in certain commentaries in the Overview and Business Review, insurance and policyholder interests volatility have been separately analysed for the Group's insurance businesses. Further information on these items is shown on pages 34 and 35. In addition, a provision in respect of certain historic US dollar payments, a provision in respect of the Financial Services Compensation Scheme levy and goodwill impairment in 2008, and the profit on the sale of businesses, the results of discontinued businesses and the settlement of overdraft claims in 2007 have been separately analysed in the Group's results. A reconciliation of this continuing businesses basis of presentation to the statutory profit is shown on page 1. Certain commentaries also separately analyse the impact of market dislocation from the results for both years.

FORWARD LOOKING STATEMENTS

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

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

Factors that could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by Lloyds Banking Group or on Lloyds Banking Group's behalf include, but are not limited to, general economic conditions in the UK and internationally; inflation, deflation, policies of the Bank of England and other G7 central banks and interest rate, exchange rate, market and monetary fluctuations; changing demographic developments including consumer spending, saving and borrowing habits, technological changes, natural and other disasters, adverse weather, terrorist acts and other acts of war or hostility and responses to those acts; changes in laws, regulations, taxation, Government policies or accounting standards or practices and similar contingencies outside Lloyds Banking Group's control; the ability to derive cost savings and other benefits as well as mitigate exposures from the acquisition and integration of HBOS; inadequate or failed internal or external processes, people and systems; exposure to regulatory scrutiny, legal proceedings or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the ability to secure new customers and develop more business from existing customers; the degree of borrower credit quality; the ability to achieve value-creating mergers and/or acquisitions at the appropriate time and prices and the success of Lloyds Banking Group in managing the risks of the foregoing.

Lloyds Banking Group may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds Banking Group annual review, half-year announcement, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group to third parties, including financial analysts. The forward looking statements contained in this annual report are made as of the date hereof, and Lloyds Banking Group undertakes no obligation to update any of its forward looking statements.

VIEW OUR ANNUAL REPORT ONLINE

A full version of our Annual Report and Accounts and information relating to Lloyds Banking Group is available at www.lloydsbankinggroup.com

GROUP PROFILE

OUR GROUP

Lloyds Banking Group is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers.

Lloyds Banking Group was formed in January 2009 following the acquisition of HBOS and our main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision. The new Group also operates an international banking business with a global footprint in 40 countries.

The Group is the largest UK retail bank and has a large and diversified customer base. Services are offered through a number of well recognised brands including Lloyds TSB, Halifax, Bank of Scotland, Scottish Widows, Clerical Medical and Cheltenham & Gloucester, and via a unique distribution capability comprising the largest branch network in the UK and intermediary channels.

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

2008 HIGHLIGHTS

Statutory profit before tax reduced by 80 per cent to £807 million. A resilient underlying business performance was offset by the impact of market dislocation and adverse volatility relating to the Group's insurance businesses.

A resilient business performance. Profit before tax, on a continuing businesses basis, totalled £2,426 million, a decrease of 35 per cent which reflected the impact of £1,270 million of market dislocation and higher impairment levels.

Robust income performance. Income, excluding market dislocation, grew by nine per cent reflecting strong revenue growth from the Group's relationship banking businesses. On a statutory basis, income was eight per cent lower at £9,872 million.

Excellent cost management. The Group's cost:income ratio, excluding market dislocation, improved by 1.1 percentage points to 47.0 per cent.

In a difficult economic environment, asset quality remains satisfactory. Impairment losses increased by 68 per cent to £3,012 million, reflecting the impact of market dislocation, the slowdown in the UK economic environment and the impact of the falling house price index.

Robust capital ratio and a strong liquidity and funding position maintained throughout the recent turbulence in global financial markets.

OUR VISION

To be recognised as the best financial services organisation in the UK by customers, colleagues and shareholders.

OUR STRATEGY

Our corporate strategy supports this vision and is focused upon:

Building strong customer franchises that are based on deep customer relationships

– Extending reach and depth of customer relationships
– Enhancing product capabilities to build competitive advantage

Building a high performance organisation

– Improving processing efficiency
– Applying our more prudent 'through the cycle' approach to risk to the enlarged Group
– Working capital harder
– Delivering flawlessly for the customer

Managing our most valuable resource, our people

GROUP RESULTS SUMMARY

	2008 £m	2007 £m
Net interest income	7,709	6,022
Other income	521	11,777
Total income	8,230	17,799
Insurance claims	2,859	(6,917)
Total income, net of insurance claims	11,089	10,882
Operating expenses	(5,651)	(5,330)
Trading surplus	5,438	5,552
Impairment	(3,012)	(1,796)
Profit before tax – continuing businesses*	2,426	3,756
Volatility		
– Insurance	(746)	(277)
– Policyholder interests	(471)	(222)
Discontinued businesses	–	162
Profit on sale of businesses	–	657
Provision in respect of certain historic US dollar payments	(180)	–
Provision for Financial Services Compensation Scheme levy	(122)	–
Goodwill impairment	(100)	–
Settlement of overdraft claims	–	(76)
Profit before tax – statutory	807	4,000

*Excluding volatility, a provision in respect of certain historic US dollar payments, a provision for the Financial Services Compensation Scheme levy, goodwill impairment and, in 2007, results of discontinued businesses, profit on sale of businesses and the settlement of overdraft claims.

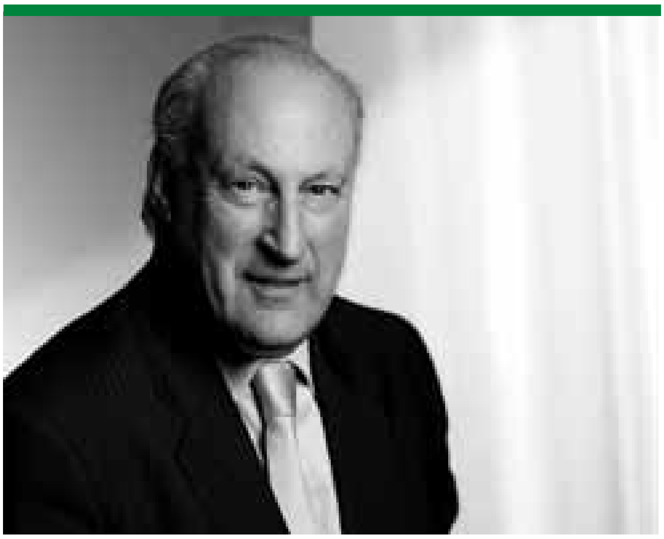
CHAIRMAN'S STATEMENT

Sir Victor Blank

2008 was a very difficult and challenging year for the banking industry, both in the UK and overseas. Asset values fell significantly in many developed markets. Wholesale funding contracted in a dramatic fashion as the expansionary credit conditions that had prevailed for some time ended abruptly. The UK Government had to intervene in the banking system by providing capital and liquidity where the markets had failed. In short, markets and economies behaved in ways which, I think it is fair to say, we have not seen in living memory.

At times of great economic and financial uncertainty, many apparently settled ideas come under great scrutiny. There is no doubt that there is a great deal of rethinking going on now and a new banking system will emerge both in this country and elsewhere in the coming years. Some certainties continue to prevail, however. For us, our emphasis on our relationship with our customers will remain very much at the core of how we do things as a business. Indeed, we believe this emphasis on customer relationships was a great asset to us last year and it will be at the core of how we develop our enlarged business in the future.

2008 was also, of course, the year when Lloyds TSB announced it was acquiring HBOS plc; the transaction was subsequently completed on 16 January 2009. It is this transaction to which I will now devote most of my attention in this review. I will also cover a number of other important issues, however, which I know shareholders would like me to discuss. They include the state sponsored banking recapitalisation last autumn and more recent significant Government measures, our dividend policy, our obligations to society, our corporate governance and the outlook for your company.



THE HBOS TRANSACTION

Lloyds TSB and HBOS had, on a number of occasions over the years, discussed the possibility of a combination. It was only the unique circumstances of last autumn, however, that enabled this transaction to happen. When we decided to acquire HBOS, we were doing so at a time when the economy was already deteriorating with the prospect of further declines to come. We were very mindful of the difficult economic backdrop to this transaction. We were also very aware, however, of the compelling logic of this transaction, including the substantial market positions we would secure and the significant synergies that would be generated. In short, we see the deal as being strategically imperative for us. The size and scale of the new group is very significant indeed and it offers opportunities for growth for the future which a stand-alone Lloyds TSB might not have been in a position to deliver to the same degree. Our senior management team, given its track record and strength in depth, is very well placed to exploit these opportunities on behalf of all our shareholders.

We believe that the HBOS transaction will prove to be very successful for our shareholders and our other stakeholders as well. Lloyds Banking Group is now the largest financial services franchise in the UK with a range of leading market positions in important product lines, such as savings, current accounts, mortgages, insurance and long-term savings. We are also a leading player in the Small and Medium Enterprise (SME) and wholesale banking sectors. The Group clearly has a very significant retail banking footprint and, with approximately 3,000 branches, is present in more UK locations than any other financial institution. We will also have the benefit of substantial synergies.

There is no doubt that the immediate outlook is challenging as indeed it is for most other banks in the UK and overseas. Lloyds TSB's trading performance in 2008 was by no means immune from the continued turbulence in the global financial markets which contributed to the decline in profit before tax to £807 million. HBOS was adversely affected by the challenging market conditions, a sharp decline in asset values and the dramatic contraction in the wholesale markets. Taking all these factors together, HBOS recorded a loss of £10.8 billion. Against this backdrop, it is unsurprising that questions have been asked about the HBOS transaction. I think it is important to remember, as I have already mentioned, that we purchased HBOS when the economic downturn was already well underway. In short, the opportunity to acquire HBOS only came about in the middle of great economic adversity and in conditions which are unlikely to be repeated.

In purchasing HBOS we acquired £17.9 billion of net asset value for £7.7 billion so, as a board, we remain very much convinced that this is the right transaction for your company. The short-term outlook is indeed difficult. Your board believes, however, that the earnings potential of Lloyds Banking Group will be significant in the longer term.

THE ROLE OF GOVERNMENT

A great deal has been said in recent months about the nature of the Government's involvement with the banking sector. We believe that most of the Government's initiatives have been positive and well considered. In particular, we very much welcome the Government's interventions to stabilise the banking system, provide liquidity and to encourage more lending. The dramatic unfolding of events across the world following the collapse of Lehman's meant that the Government needed to take swift and decisive action. It did so. That is why, despite Lloyds TSB's relative strength, in October 2008 we, together with other UK banks, were required by the UK Government to strengthen capital ratios as part of an industry wide initiative to reduce the systemic risk in the UK banking system. This led to us raising an additional £5.5 billion in capital, (£4.5 billion in ordinary shares and £1 billion in preference shares). HBOS were also required under the recapitalisation scheme to raise £11.5 billion, (£8.5 billion in ordinary shares and £3 billion in preference shares). The UK Government, as part of the capital raising process, has now become a 43.4 per cent shareholder in the Group.

DIVIDEND

As part of the HM Treasury recapitalisation scheme, the Group was required to suspend the payment of cash dividends to ordinary shareholders until the HM Treasury preference shares issued as part of the scheme are repaid. In the meantime, however, as we indicated in our shareholder circular last year, the board has approved a capitalisation issue of one for 40 ordinary shares held.

OUR ROLE IN SOCIETY

At a time when there is a great deal of public debate about the role of the banking system, I think it is important to reflect on the contribution that banks, and Lloyds Banking Group in particular, make to our society. Our company is the largest provider of social banking accounts in the UK. We provide four million of these accounts and are proud of the way in which we help our low income customers to access the banking system and, where appropriate, move up to a full service current account. We also have a substantial community investment programme through activities within the Company as well as the four Lloyds TSB Foundations. Our overall community investment programme is now somewhere in the region of £100 million a year and is, as a result, one of the most significant contributions by any major corporate to UK society. We are determined to continue to play an important role in the many communities in which we operate up and down the country.

Turning to broader societal issues, a great deal has been said in recent months about the role of bonuses in the banking system. We recognise the legitimate public interest in this subject. We have worked closely with the Government to devise a bonus system which is fair to our colleagues and sensitive to the wider needs of society as a whole. We do think that a necessary process is now underway to reassess the way in which some incentives in the banking system were structured and awarded – typically in areas in which we don't have a great deal of involvement. Specifically, we are very much a retail and commercial banking business with very little in the way of investment banking activity. We also recognise how important it is to align bonus and remuneration schemes with the interests of our shareholders, something we believe we have done over the years. From our perspective, it is particularly important that we retain our best talent both in the UK and overseas and we believe that it is an important factor that should also be taken into account when designing total reward systems.

OUR CORPORATE GOVERNANCE

We are committed to ensuring that the Group has a robust governance structure in place. Good corporate governance matters even more now than ever before. As we integrate HBOS we are now moving quickly to common governance standards. I believe this is important as there is a clear link between high quality governance and shareholder value creation.

During the year, we have continued the board's renewal process with the appointment of three new non-executive directors, each of whom brings a wealth of experience to the board. They are Carolyn McCall, Sir David Manning and Martin Scicluna and brief biographical details can be found on pages 66 and 67. In addition, Tim Ryan and Tony Watson will join us on 1 March and 2 April 2009, respectively. These appointments ensure that your board has a broad range of skills and senior experience, qualities which I believe are even more important now than they might have been before the economic turmoil began.

In October, Tim Tookey was appointed our new group finance director following Helen Weir's move from this role to become group executive director, UK Retail Banking after Terri Dial's decision to leave the Group. Mike Fairey, deputy group chief executive, retired in June following a 17 year career with the Group. On behalf of the board, I would like to thank Mike for his invaluable contribution to the Group over such a long period of time and wish Terri well in her new career.

OUTLOOK

The unprecedented market conditions which I sketched out at the start of this review have continued into 2009. At the same time, the economy is continuing to deteriorate; the debating point now is how deep the recession will be and how long will it take for it to end. One thing is certain – we are facing a prolonged period of economic difficulty for many households and companies up and down the country. As a bank with a strong focus on customer relationships, we are committed to helping our customers wherever possible to manage their way through these challenging times.

We know the short-term outlook for the enlarged Group is challenging. Whenever economic conditions do begin to normalise, however, we believe your company will be in a very strong position to reap the benefits. Our strong franchise across the whole range of product lines will enable us to do just that. In the meantime, our imperative is to manage your business as effectively as possible on your behalf during these challenging times. I believe we have the right people to do so.

One of the most important ways in which leading businesses differentiate themselves from their peers is through the quality of their people. I have no doubt that we at Lloyds Banking Group are very fortunate in having many of the best people in our industry working for us. The last 12 months, however, have been exceptionally difficult for many of our customers and colleagues alike. The unprecedented levels of market turbulence have meant that my colleagues have spent a great deal of time helping customers to understand what is happening and providing them with the necessary reassurance. The job that our colleagues do for our customers is very valuable and highly valued by us. I would therefore like to take this opportunity to thank them on our behalf for their outstanding contribution in 2008.

Sir Victor Blank
Chairman
26 February 2009

GROUP CHIEF EXECUTIVE'S REVIEW

J Eric Daniels

This has been an extraordinary year, by any measure and, as many commentators have observed, we are in the most severe global downturn since the 1930s. It was triggered by problems in the US housing market, spread to the financial services industry and has now moved on to the broader economy. The UK has been profoundly impacted by the crisis and, as a bank that primarily does its business in the UK, Lloyds TSB has felt the impact. In a year when many financial institutions declared losses, Lloyds TSB did deliver profits, albeit lower than in previous years and I am very aware that, as with the rest of the industry, there has been a sharp reduction in our share price. The year also brought opportunities, and we began the process to acquire the HBOS business, which is probably the most far reaching event in our 243 year history.

Over the past five years, I have reported on our progress towards the aspiration of building the UK's best bank and our approach to developing deep, long-lasting customer relationships. Banking is fundamentally a risk business, and early on we took the decision to manage risk on a 'through the cycle' basis. This means the business will be less impacted by the extreme points in the cycle and that we can continue to support our customers through the changes in the economic climate. As a result, our rate of growth in earnings in prior periods did not always match those of our competitors but the quality of our earnings has been demonstrated in this past year.

In my review this year, I will cover three areas; first, the strategic rationale for the transaction and the benefits it will bring, second, the performance of Lloyds TSB in 2008, and third the outlook for Lloyds Banking Group.

THE HBOS ACQUISITION

Throughout the year, it became clear that there were a number of institutions facing significant challenges, both here in the UK and overseas. During the summer months there was a further collapse in confidence in the wholesale markets and, for all but the strongest, the pressures of funding reached crisis proportions. Lloyds TSB had pursued a very successful relationship-focused strategy that had delivered good results for all our stakeholders, and we were continuing to perform relatively well. However, as the financial crisis gathered pace and a number of competitors recognised that they could not survive on a standalone basis, it became clear that the industry would begin to consolidate around a smaller number of larger players. It was against this backdrop that we decided to revisit our earlier strategic thinking regarding HBOS.

The opportunity to acquire HBOS was considered against our other strategic options, and before deciding to proceed the board considered a number of alternatives which included continuing with our existing organic growth strategy, acquiring parts of HBOS and alternate acquisitions. After a thorough review, the board decided that the HBOS acquisition would offer the highest value-creating strategy for our shareholders and we announced the transaction on 18 September 2008.

We are acquiring £17.9 billion of tangible net asset value with consideration valued at £7.7 billion, even taking into account the losses HBOS announced for 2008. All in, we have acquired a franchise that brings extensive distribution, a large customer base, good people and excellent brands. HBOS had developed a number of specialist businesses that brought greater returns at greater risk, and these did not fit the Lloyds TSB risk appetite. We recognised this in our due diligence and this was reflected in the price we agreed to pay. We are buying the business in the down part of the economic cycle, at a significant discount to book value, which increases the likelihood of value creation, and we paid in shares rather than cash which in some part insulated the Lloyds TSB shareholders from market risk.

The transaction allows us immediately to gain scale in a consolidating market, and it profoundly changes the long-term trajectory for the Group. The acquisition allows us to occupy leading positions in current accounts, retail savings and insurance, mortgages and personal lending, and will also provide substantial scale in our corporate and commercial businesses; something that would not have been possible through organic growth alone. There will clearly be revenue synergies arising from the acquisition, as we take the best of the relationship development skills from each business and apply them across the enlarged Group. Whilst these synergies are real, and we will report on them in future periods, they are always more difficult to measure and so we have not included any value for these benefits.

The transaction is essentially an in-market deal, which have historically proven to be amongst the most successful, given they allow greater cost synergies to be captured. We are targeting annualised savings in excess of £1.5 billion in 2011, which represents some 14 per cent of the combined cost base. Work is already underway, with early synergies starting to come from procurement benefits and the more efficient management of the property portfolio. Over £100 million of cost efficiencies have been identified immediately from ceasing projects that will no longer be required in the enlarged Group. Clearly, there will be some staffing reductions resulting from the broad range of programmes we will initiate, but we anticipate that we can accommodate the majority of any reductions through natural staff turnover or limited voluntary redundancy programmes.

The combination of the two businesses provides a strong platform for us to pursue our customer focused growth strategy, built around acquiring relationships and then deepening them. The scale we have now achieved will also allow us to be more efficient and to better leverage future investments.

Whilst it is still relatively early days in terms of the transaction, we have made considerable progress, with the senior 500 executives being appointed to run the new Group and we will quickly integrate the businesses. We are identifying those businesses that are priorities for future investment, those where we are adjusting the risk policies to reflect the current environment and those that will require significant change to meet our return hurdles and risk appetite. This is allowing us to focus on developing and growing those core business areas that fit with our relationship-based, lower-risk model, whilst we squarely address the issues that affect the higher-risk portfolios.

In evaluating the HBOS portfolios last year, we had taken a more conservative forecast than the HBOS internal estimates, recognising they were subject to greater volatility in an economic downturn. Once we took control of HBOS in January, we analysed the portfolios in granular detail, updated our diligence and have begun to apply the Lloyds TSB operating model across the enlarged business. As we began to apply our more conservative provisioning methodologies to their portfolios, and took account of the economic deterioration in the final quarter of the year, the expected losses in that final quarter increased and were finally set at a level £1.6 billion higher than our initial estimate of £8 billion. Whilst this figure is higher than our earlier estimates, it does reflect the size and nature of the HBOS portfolios and the scale of the change in the economic environment.

In line with our plans, we have completed substantial further work to analyse the portfolios. We understand the challenges faced by these portfolios and are taking the necessary actions; for instance, we have reviewed the major exposures in key lines, identified the significant concentrations, revised the credit criteria for key products and withdrawn from certain business lines.

We are prudently managing the capital base, as has been a hallmark of Lloyds TSB. The enlarged Group retains a robust capital position, with an adjusted pro forma core tier 1 capital ratio of 6.4 per cent as of 31 December 2008, which means we are well placed to withstand the impact of any slowdown in the economy.

THE LLOYDS TSB GROUP PERFORMANCE IN 2008

Let me now reflect on the performance of the Lloyds TSB Group in 2008. Whilst all the headlines this past year have been about the economy, the financial crisis and, for us, the HBOS transaction, it is easy to overlook the fact that the Group and our businesses have performed satisfactorily, delivering positive earnings despite the most difficult operating environment in many years.

Our results for the year show a decline in earnings, and on a statutory basis the Group's profit before tax fell by 80 per cent to £807 million. However, I believe a more appropriate way to view the results is to look at our performance on a continuing business basis, and taking this approach the Group profit before tax was £2,426 million, a reduction of 35 per cent.

On a continuing business basis we saw income rise by 2 per cent, as the ongoing market dislocation impacted on an otherwise good performance. Costs rose by 5 per cent, reflecting good cost control in our day-to-day operations which allowed us to further invest in our plans to support the growth of the franchise, with additional relationship staff and improvements to our systems and product range. Impairments were up 68 per cent, reflecting the general slowdown in the economy and a number of specific losses related to the financial crisis and economic downturn.

I would have liked to have delivered an even stronger performance for our shareholders, but in the context of the environment and when many organisations will be reporting losses, I do feel this is a reasonable out-turn. We again used the year well, strengthening the overall business franchise, with an improvement in efficiency, increases in market share, higher customer advocacy scores and we also added to the depth and experience of the management team. Our focus on developing strong franchises continues to offer a strong and sustainable platform for our future growth.

In building our business model, over this period, we have used a balanced scorecard approach throughout the organisation to measure our progress. The balanced scorecard contains five sections: financial performance, franchise growth, customer satisfaction, risk management and people development. As a result of managing each section of the scorecard assiduously, and focusing on a balanced approach to growth, your company was well positioned as the financial crisis struck the industry.

DIVIDEND

As part of the HM Treasury recapitalisation scheme, the Group was required to suspend the payment of cash dividends to ordinary shareholders until the HM Treasury preference shares issued as part of the scheme are repaid. In the meantime, however, as we indicated in our shareholder circular last year, the board has approved a capitalisation issue of one for 40 ordinary shares held.

SUPPORTING OUR CUSTOMERS

There has been considerable comment about the performance of the financial services sector this last year and, in particular, support for customers seeking mortgages and the owners of small businesses. I am very proud of the way your company has maintained its support to customers, in line with our relationship-based strategy. Using Bank of England data for the year to December 2008, our lending to individuals grew by 10.7 per cent against the industry average of 5.4 per cent, whilst our lending to private non-financial corporates grew by 22.2 per cent against the industry average of 3.7 per cent. The commitment to our customers is critical to our business strategy, and will continue to be so in 2009.

OUTLOOK

Against a backdrop of recession and an ongoing global financial crisis, we expect 2009 to be another challenging year. Our revenues will be less impacted than many other institutions, as we have a much lower reliance on transactional income, but we will nevertheless be affected by factors such as lower margins driven by lower interest rates and the accounting impact of replacing our single premium payment protection insurance product with a new monthly premium product, as well as the general slowdown in the economy.

We will continue to manage expenses tightly, as you have come to expect of us, but we will incur some additional costs in order to realise the synergies we have announced. Impairments will continue to run at high levels, especially in the higher risk parts of the legacy HBOS portfolios.

Despite the outlook for 2009 being tough, we will use this year to make significant progress in our strategy and to build the UK's leading financial services company. Given the relationship nature of our business, the markets in which we operate, the focus on what I describe as the fundamentals of banking and the return to the more appropriate pricing of risk all play to our strengths and will support our longer-term growth. We are now focused on the integration of the two businesses, which will allow us to offer unparalleled choice and service to our customers, create the platform for the next stage of our growth and provide long-term value for our shareholders.

SUMMARY

Our key businesses have continued to grow, attracting new customers, improving the service to our customers and building our market share. As the crisis continued to impact the UK banking industry, we acquired HBOS in a deal that brought greater stability to the UK banking system and which has allowed Lloyds TSB to rapidly advance its strategic priorities.

The success of this organisation is built on the wonderful contributions of our thousands of colleagues, and I am very grateful for all they have achieved this last year in serving our customers and executing our plans. It is this consistent level of performance over the last few years which left us so well placed. The next year will be challenging but I am very confident we will make further substantial progress in building our business, as we begin to establish the UK's leading financial services company.

J Eric Daniels
Group Chief Executive
26 February 2009

GROUP CHIEF EXECUTIVE'S Q&A

ISSUE: **THE CHALLENGING MARKETPLACE**

THE GLOBAL FINANCIAL CRISIS THAT HAS RAGED OVER THE LAST 18 MONTHS HAS LED TO THE DEMISE OF MANY FINANCIAL SERVICES COMPANIES AROUND THE WORLD.
HOW HAS THE CRISIS AFFECTED THE GROUP?

Clearly the last 18 months have seen unprecedented change for the worldwide financial services sector and the UK sector has been no different. Within the UK we have seen the nationalisation of Northern Rock, the acquisition of Alliance & Leicester, the break up of Bradford & Bingley and the recapitalisation of the UK banking sector.

Lloyds Banking Group has not been immune from the market dislocation as even the safest banks like Lloyds TSB with strong capital bases and limited exposure to risky assets have been impacted. Like many other financial institutions the Lloyds TSB Corporate Markets business has been significantly affected by the market dislocation; however the relationship focus of our strategy has meant that the impact on the Group's profit before tax was comparatively limited at £1,270 million in 2008. Although significant in absolute terms, this remains relatively low compared to many of our global peers.

Importantly in the current turbulent markets, the enlarged Group has a robust capital position, continues to fund at competitive prices and has diverse funding capabilities. The Group continues to offer security through its relative credit strength and our strong credit ratings are representative of this position. The board remains convinced that the combination of Lloyds TSB and HBOS will bring long-term benefits for our shareholders.

The unprecedented turmoil in the global financial markets has also had a significant impact on bank share prices, many of which have fallen considerably. It is not easy to offer simple explanations as to why the stock market has marked down bank share prices to such a degree in recent months but clearly there are a number of factors at play including the current view of, and future projections for, the UK economy and its impact on future asset write downs and impairments. It is also undoubtedly the case that there is currently a great deal of nervousness in the markets which is reflected in volatile bank share prices.

We are living through difficult times but Lloyds Banking Group remains a strong institution focused on building deeper relationships with our customers and delivering long-term shareholder value.

ISSUE: **THE HBOS ACQUISITION**

THE ACQUISITION OF HBOS HAS CREATED THE UK'S LEADING FINANCIAL SERVICES GROUP.
HOW WILL THIS INFLUENCE THE GROUP'S STRATEGY?

The strategy for the new Lloyds Banking Group will be similar to that successfully adopted by Lloyds TSB. We will continue to implement our 'through the cycle' customer relationship based approach. The new enlarged entity has significant scale advantage and both organisations enjoy a terrific reputation for managing efficiency. We will adopt the more conservative Lloyds TSB risk disciplines, which have served us well, and we will embed them across the combined business. We will also maintain the economic profit disciplines we use to allocate capital efficiently. At the same time, we will continue to invest in people and systems to serve our customers better and we will look to set customer and staff satisfaction standards that are unparalleled in the market.

The Lloyds TSB management team has a strong track record of delivery built up over the last five years as we have consistently executed against our strategy to attract more customers to our franchise business, to deepen relationships with these customers over time, to deliver sustainable cost and productivity improvements in our operations and to make the most effective use of all our resources. These skills will all remain important for Lloyds Banking Group.

The acquisition of HBOS provides a unique strategic opportunity to create the best financial services business in the United Kingdom. The combination of Lloyds TSB and HBOS creates a new stronger organisation and helps support the stability of the UK financial system. We are bringing together two of the most efficient customer franchises in the country and providing an unrivalled distribution network for our customers. The information advantage from the large customer base is a real differentiating edge, and the size of our operations gives us a clear opportunity for better productivity. We are targeting benefits in excess of £1.5 billion per annum through cost synergies, or some 14 per cent of the enlarged Group's cost base, by 2011. The enlarged Group has the capital strength and diverse funding capabilities which will enable us better to meet the current industry challenges and continue to lend to and support our customers. Despite our relative strength, the shape of the financial services markets is changing all the time and we will continue to operate in highly vibrant and competitive markets.

We believe we have a great case for value creation in the long-term, through building the largest financial services company in the UK, with the attendant benefits of a strong market position and large scale. All in, we believe this is a unique opportunity to create the UK's leading financial services company.

ISSUE: THE GOVERNMENT SHAREHOLDING

AS A RESULT OF THE RECAPITALISATION OF THE BANKING SECTOR AND THE ASSOCIATED PLACING AND OPEN OFFER, THE GOVERNMENT NOW HOLDS A SIGNIFICANT STAKE IN THE ENLARGED LLOYDS BANKING GROUP.
WHAT ARE THE IMPLICATIONS OF THIS AND HOW DOES THE GOVERNMENT'S SHARE OWNERSHIP IMPACT THE GROUP'S BUSINESS GOING FORWARD?

The Government's recapitalisation of the banking sector in October 2008 was necessary to restore confidence and stability to the financial services sector at that time, and although they now hold a significant stake in the organisation we are comfortable that the Government's investment was the right way of achieving that capital increase for our company.

It is important to note that the board believes that HM Treasury will act as a value-oriented shareholder with regard to the strategic development of the Group and the Government has stressed the importance of institutional and individual investors as well as HM Treasury.

A number of specific requirements stem from Government ownership which primarily relate to corporate governance and lending, as outlined below. Dividend restrictions, as outlined below, have been introduced due to the presence of the Government preference shares.

LENDING

We have a commitment to maintain the availability and active marketing of competitively priced mortgage lending and lending to Small and Medium Enterprises (SMEs) but do not expect any impact on our lending policies or on our conduct of business. As a major lender in the UK economy focused on developing enduring relationships with our customers, we recognise that our success is based on a commitment to helping our customers throughout the economic cycle. We are able to do this because we have a robust capital position.

We remained open for business last year and grew our lending prudently. Lending to SMEs grew by 20 per cent at Lloyds TSB in 2008 and over 100,000 small businesses chose to bank with Lloyds TSB last year. Both Lloyds TSB and HBOS also launched charters setting out the practical steps they will take to support small businesses through the economic downturn. In addition, on the retail side, we are the biggest mortgage provider in the first time buyer market and more basic banking customers bank with Lloyds Banking Group than any other bank.

CORPORATE GOVERNANCE

The Government are also keen to see an enlarged board and we are appointing two new independent non-executive directors, in consultation with HM Treasury (see page 66). It is important to note that the new directors will have precisely the same role and responsibilities as any other director on the board.

DIVIDEND

As part of the HM Treasury recapitalisation scheme, the Group was required to suspend the payment of cash dividends to ordinary shareholders until the HM Treasury preference shares issued as part of the scheme are repaid. In the meantime however, as we indicated in our shareholder circular last year, the board has approved a capitalisation issue of one for 40 ordinary shares held.

ISSUE: RISK MANAGEMENT

LLOYDS TSB HAS TRADITIONALLY BEEN PERCEIVED AS HAVING A CONSERVATIVE RISK PROFILE.
DOES THE HBOS ACQUISITION SIGNAL ANY CHANGE IN THE GROUP'S RISK APPETITE?

No, Lloyds TSB has clearly demonstrated a strong track record of delivery with a prudent risk appetite and the new Lloyds Banking Group has no intention of changing this successful approach.

Lloyds Banking Group will continue to take a prudent approach to risk management and our philosophy remains to take a 'through the cycle' relationship based approach to lending. We are committed to this relationship approach, are focused on the needs of our customers and recognise that we have a role to play in helping our customers through the economic downturn, particularly when they face financial difficulty. The new Group has already exited a number of non core areas in which HBOS previously participated and will continue to assess participation in business areas on a conservative basis.

Our conservative approach to managing the Group's risk has meant that we remain well positioned to capture growth opportunities at a time when others have pulled back from the market. As a result, we have been able to capture market share in a number of key areas without impacting the overall quality of business.

MARKETPLACE TRENDS

THE ECONOMY AND OUR MARKETS

Coming into 2008, the UK economy had enjoyed 60 consecutive quarters of sustained expansion. Inflation remained very low during that time, helped by globalisation and the emergence of low cost economies as suppliers to the developed world.

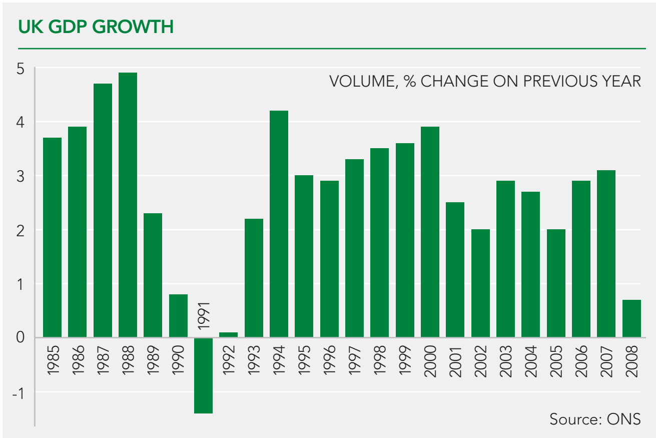
Muted global inflation enabled central banks everywhere, including in the UK, to meet inflation objectives whilst maintaining interest rates at very low levels by historical standards. In this environment, UK real household incomes had grown strongly, as had corporate profits, and asset markets had boomed, notably housing. As in the US economy, low interest rates, low inflation, a booming housing market and high real income growth encouraged sustained high levels of consumer spending. Savings rates had fallen to very low levels and household debt had grown faster than income.

We had anticipated that this benign environment was unlikely to last, and had as a result positioned our business to avoid riskier parts of the lending market and to focus on the likely longer-term rebound of savings. However, it was unclear what the trigger might be for the change in the economic environment and the readjustment by consumers towards lower borrowing and higher savings.

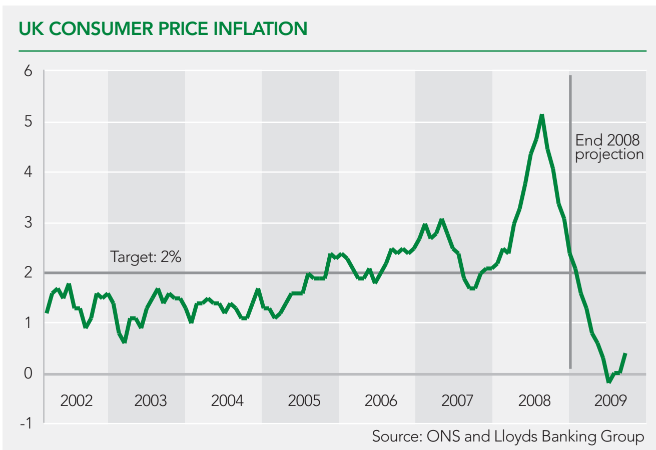
The initial cause of the readjustment was a gradual rise in interest rates globally as the extremely rapid growth of the newly industrialising economies greatly increased demand for raw materials and sharply higher commodity prices caused inflation to surge. The current financial crisis started in August 2007, with growing evidence that weakness in US sub-prime lending due to higher interest rates was affecting the value of securitised assets held on the balance sheets of financial institutions globally. But by the start of 2008 this had not affected the global economy materially. However, the outlook for the global, and UK, economy deteriorated significantly during last year.

THE ECONOMY IN 2008

At the start of 2008, the consensus view was that the UK economy would grow by around 1.8 per cent on 2007. But as consumers' spending power was squeezed by higher inflation and interest rates, and as consumer and business confidence collapsed, the consensus forecast gradually drifted downwards. The first full year figures for 2008 Gross Domestic Product (GDP) growth, released in late January 2009 showed a final outcome of 0.7 per cent, with the second half showing negative growth. The last quarter of 2008 was particularly weak, due in large part to sharply lower manufacturing output, both in the UK and globally, as consumers cut spending on non-essentials, businesses cancelled investments and retailers reduced stocks. So far the slowdown owes more to lower business investment and weaker manufacturing and construction than it does to the consumer. Whilst spending had been strong in the preceding period, and savings rates had fallen to very low levels, there was not such an obvious consumer boom as had been the case prior to the 1990s recession.



By the end of last year, house prices were down 16 per cent on a year earlier, using the Halifax measure. That decline had improved affordability, with the ratio of house prices to average earnings having fallen from a peak of 5.8 in July 2007 to an estimated 4.4 by December 2008, but still above its long term average of 4.0.



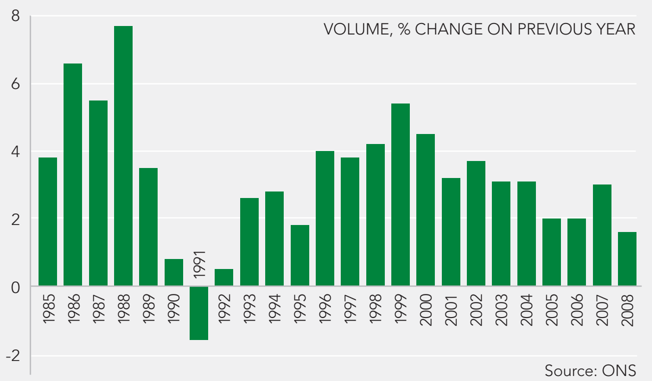
Compared to the last recession, average household finances do not yet seem to be under the same pressure, perhaps because the preceding consumer boom had not been so strong but also because interest rates have fallen faster and further. The percentage of mortgagors reporting payment problems is around half the levels seen in the early 1990s.

Other indicators of households' financial distress, such as mortgage arrears and repossessions, are at low levels compared with the early 1990s. However, in late 2008 unemployment levels were rising at a faster rate than at a similar point during the early 1990s, with companies seemingly responding more quickly to worsening economic conditions this time around.

The deterioration of economic prospects globally, combined with the initial impact of the financial crisis, has triggered a period of balance sheet adjustment by banks and other financial services companies, by non-bank companies and by individuals. Spreads in wholesale financial markets, on which many banks rely to fund their lending, widened sharply, with negative consequences for the availability and cost of credit for the broader economy. Balance sheet adjustment and high funding costs could, if left unchecked, make the global downturn even steeper and more damaging. Governments worldwide have responded by expansionary budget policy changes, by injecting capital into banks and by providing guarantees and other forms of support for wholesale funding markets.

Central banks have also responded – by sharply lowering the interest rates they control and by expanding their balance sheets to support financial markets. As a result, by early 2009, spreads in many financial markets had started to shrink, though remaining well above pre-crisis levels.

UK CONSUMER SPENDING GROWTH



IMPACT ON OUR MARKETS

During the long upturn that preceded the recession, consumer and corporate borrowing had grown at a strong pace, boosted by booming asset prices and seemingly low levels of risk. Savings growth had been modest by comparison. The recession will see a significant change in that pattern, as households and businesses adjust to the new world. The first signs of that change are evident already.

Against the backdrop of a weakening economy, most major UK banking product markets slowed in 2008. With house prices falling throughout last year, and with some banks withdrawing, mortgage lending growth slowed. By late 2008, growth in mortgage balances outstanding was down to below 4 per cent, and approvals for new mortgages were around 75 per cent below the level of a year earlier. However, those banks, like Lloyds TSB, who were still active in the market, were continuing to experience stronger growth due to the withdrawal of other lenders. Unsecured personal lending growth also moderated, although balances outstanding on credit cards grew more strongly, suggesting that financial pressures on households were reducing the number paying off credit card outstandings in full each month.

The slowdown in both mortgages and unsecured lending is due to both demand and supply factors. A worsening economic outlook and falling house prices have depressed consumer confidence and curbed demand for both secured and unsecured borrowing. On the supply side, weak capital and funding positions have caused the withdrawal of some lenders from the market. Combined with increased perception of risk and falling asset values, this has restricted the aggregate supply of credit. However, the relative strength of Lloyds TSB's capital and funding position, and our relationship-based approach, has enabled us to continue to grow our lending, thereby increasing our share of new lending.

In commercial and corporate banking markets, lending growth has also slowed. Again this is due to both supply and demand factors. The withdrawal of some banks from active participation in the market has reduced the aggregate supply of credit, and the increased cost of wholesale funding has raised the cost of finance. At the same time, cutbacks in investment – in reaction to a worsening economic outlook – have enabled many companies to cut their financing needs, although the reduced availability of trade credit plus tighter margins has weakened the cash flow of some. Weaker cash flow also helps to explain why corporate deposit growth turned negative in 2008. Shrinking corporate deposits, plus slowing household deposit growth has required those banks still growing their balance sheets to rely more heavily on wholesale funding.

THE OUTLOOK

The slowdown during the second half of 2008 means that the economy is now technically in recession (defined as a period of at least two consecutive quarters of negative growth). 2009 is likely to see that recession deepen. Views on 2009 economic prospects have also changed radically during the last year. At the start of 2008, the consensus forecast was that the UK economy would grow by 2 per cent in 2009. By early 2009, the consensus was for a fall of more than 2 per cent.

Against such an economic environment, we expect growth in our main markets to slow further during 2009, again driven by a mixture of demand and supply factors. Net mortgage lending may well turn negative in 2009 as house prices continue to fall. Unsecured lending will slow further as consumer spending on non-essentials is reduced. Savings growth will also be slow as pressures on household finances offset a desire to save more in an uncertain environment. Growth in commercial and corporate lending is expected to weaken as companies reduce investment spending further, and corporate deposit growth will remain weak. Given weak deposit growth by both households and firms, banks in aggregate will continue to rely on wholesale markets to fund net new lending. The likely continued high cost of wholesale funding, relative to base rates, will constrain banks' ability to support the economy through credit growth.

Unemployment will continue to rise, although the extent of that rise is uncertain, depending for instance on how much companies have reacted more quickly on layoffs in this recession than they did last time round. By the end of this year the housing market is expected to bottom out as affordability improves further. It is likely that further house price falls in 2009, combined with growth in average earnings, will reduce the ratio of house prices to average earnings to below the long term average. And very low interest rates, combined with lower house prices, should make borrowing to buy a house more affordable than at almost any time during the last 30 years.

By 2010, our scenarios all project the gradual restoration of growth, as growing confidence that the worst is over feeds through into a weak recovery in consumer spending and business investment, lower spreads in financial markets and a levelling off for asset prices. This will be reflected in some strengthening of growth in our main markets.

SUMMARY OF GROUP RESULTS

OUR STRATEGY

The strategy for the enlarged Group remains to grow the business through developing long-term customer relationships and building our customer franchise. All our businesses are focused on extending the reach and depth of our customer relationships, whilst enhancing product capabilities to build competitive advantage. The prudent Lloyds TSB 'through the cycle' approach to risk will apply to the enlarged Group and will be increasingly important as we strive to improve our processing efficiency and make our working capital work harder. Executing the strategy effectively will only be possible if we manage our most valuable resource, our people, well. By successfully delivering these objectives we are likely to achieve our vision of being the best financial services provider in the United Kingdom.

The focus for the Group remains within the UK and our position was significantly strengthened through the acquisition of HBOS in January 2009. The effective integration of the two businesses will be a significant challenge over the next few years, but the combination of the two businesses provides a real opportunity to create the UK's leading financial services organisation.

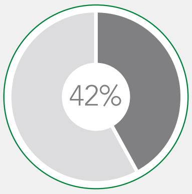
During 2008 there were three primary operating divisions: UK Retail Banking; Insurance and Investments; and Wholesale and International Banking. The key product markets in which they participate and relative contribution to the Group is presented below and a more detailed analysis of their strategy, business and performance is outlined within the Business Review. Following the acquisition of HBOS these divisions will be restructured with elements from some existing businesses coming together to form another division. The new Wealth and International division has been created to focus on Wealth Management, Asset Management and International Banking.

OUR DIVISIONS

DIVISION OVERVIEW — **CONTRIBUTION TO GROUP***

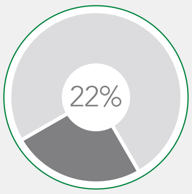
UK RETAIL BANKING

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



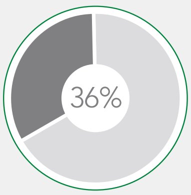
INSURANCE AND INVESTMENTS

- Life assurance, pensions and investments
- General Insurance
- Asset Management



WHOLESALE AND INTERNATIONAL BANKING

- Corporate Markets
- Commercial Banking
- Asset Finance
- International Banking



*Before impact of market dislocation and excluding volatility, a provision in respect of certain historic US dollar payments, a provision for the Financial Services Compensation Scheme levy and Goodwilll impairment. Also excludes central group items.

KEY HIGHLIGHTS

Statutory profit before tax reduced by 80 per cent to £807 million. A resilient underlying business performance was offset by the impact of market dislocation and adverse volatility relating to the Group's insurance businesses.

A resilient business performance. Profit before tax, on a continuing businesses basis, totalled £2,426 million, a decrease of 35 per cent which reflected the impact of £1,270 million of market dislocation and higher impairment levels.

Robust income performance. Income, excluding market dislocation, grew by nine per cent reflecting strong revenue growth from the Group's relationship banking businesses. On a statutory basis, income was eight per cent lower at £9,872 million.

Excellent cost management. The Group's cost:income ratio, excluding market dislocation, improved by 1.1 percentage points to 47.0 per cent.

In a difficult economic environment, asset quality remains satisfactory. Impairment losses increased by 68 per cent to £3,012 million, reflecting the impact of market dislocation, the slowdown in the UK economic environment and the impact of the falling house price index.

Strong liquidity and funding position maintained throughout the recent turbulence in global financial markets.

Robust capital ratios. Adjusting the year end capital ratios for the Government's recapitalisation of UK banks, completed in January 2009, and the estimated impact of the acquisition of HBOS, the enlarged Lloyds Banking Group's pro forma core tier 1 capital ratio stands at 6.4 per cent, the tier 1 ratio at 9.8 per cent and the total capital ratio at 12.5 per cent.

PROFIT ANALYSIS BY DIVISION

	2008 £m	2007† £m	Change %
UK Retail Banking	**1,793**	1,720	4
Insurance and Investments	**911**	748	22
Wholesale and International Banking			
– Before impact of market dislocation	**1,544**	1,580	
– Impact of market dislocation	**(1,270)**	(280)	
	274	1,300	(79)
Central group items	**(552)**	(12)	
Profit before tax†† – continuing businesses	**2,426**	3,756	(35)
Volatility			
– Insurance	**(746)**	(277)	
– Policyholder interests	**(471)**	(222)	
Discontinued businesses	**–**	162	
Profit on sale of businesses	**–**	657	
Provision in respect of certain historic US dollar payments, provision for Financial Services Compensation Scheme levy and goodwill Impairment	**(402)**	–	
Settlement of overdraft claims	**–**	(76)	
Profit before tax – statutory	**807**	4,000	(80)
Earnings per share	**14.3p**	58.3p	(75)

† Restated, see page 17.

†† Excluding volatility, a provision in respect of certain historic US dollar payments, a provision for the Financial Services Compensation Scheme levy, goodwill impairment; and, in 2007, results of discontinued businesses, profit on sale of businesses and the settlement of overdraft claims.

GROUP KEY PERFORMANCE INDICATORS – FINANCIAL

STATUTORY PROFIT BEFORE TAX (£m)

(80%)

	£m
2006	4,248
2007	4,000
2008	**807**

EARNINGS PER SHARE† (pence)

(39%)

	pence
2006	45.3
2007	48.6
2008	**29.7**

PROFIT BEFORE TAX† (£m)

(35%)

	£m
2006	3,588
2007	3,756
2008	**2,426**

RETURN ON EQUITY† (%)

	%
2006	24.4
2007	24.3
2008	**15.8**

INCOME AND COST GROWTH 2008† (%)

	%
Income	**2**
Costs	**6**

TOTAL SHAREHOLDER RETURN (%)

	%
2006	24.8
2007	(12.1)
2008	**(70.7)**

ECONOMIC PROFIT† (£m)

(58%)

	£m
2006	1,604
2007	1,725
2008	**731**

DIVIDEND (pence)

(68%)

	pence
2006	34.2
2007	35.9
2008	**11.4**

GROUP KEY PERFORMANCE INDICATORS – NON-FINANCIAL

ENGAGEMENT INDEX†† (%)

	%
2006	74.5
2007	75.3
2008	**78.3**

NET PROMOTER SCORE†††

2007	(4.3)
2008	**5.5**

† Excluding volatility, a provision in respect of certain historic US dollar payments, a provision for the Financial Services Compensation Scheme levy, goodwill impairment; and, in 2007, results of discontinued businesses, profit on sale of businesses and the settlement of overdraft claims; and, in 2006, the pension scheme related credit.

†† Read more in Our People section (page 40).

††† Read more in Corporate Responsibility section (page 37).

SUMMARY OF GROUP RESULTS continued

During 2008, the Group delivered a resilient core business performance against the backdrop of significant turbulence in global financial markets and a marked slowdown in the UK economic environment. Statutory profit attributable to equity shareholders however decreased by 75 per cent to £819 million and earnings per share decreased by 75 per cent to 14.3p, reflecting the impact of market dislocation, insurance volatility, caused by lower equity markets and wider credit spreads in fixed income markets, and a significant increase in impairment levels. Profit before tax fell by 80 per cent to £807 million.

To enable meaningful comparisons to be made with 2007, the income statement commentaries below are on a continuing businesses basis (see 'Presentation of information' on contents page).

BUILDING STRONG CUSTOMER RELATIONSHIPS

The Group's strategy is to build strong customer franchises and we have continued to extend the reach and depth of our customer relationships, achieving good sales growth, whilst also improving productivity and efficiency. As a result, the Group's core relationship businesses have continued to perform well, growing market share in many key areas.

Like many other financial institutions, the Group's Corporate Markets business has been significantly affected by the ongoing impact of market dislocation; however, the relationship focus of our strategy and conservative risk management approach has meant that the impact on the Group's profit before tax was limited to £1,270 million during 2008 (£925 million reduction in income; £345 million increase in impairment). In the extremely challenging and turbulent operating environment in global financial markets, this compares favourably to the impact on many other major financial services companies. The market dislocation largely reflects the impact of continuing mark-to-market adjustments in certain legacy trading portfolios, resulting from the marketwide repricing of liquidity and credit, together with the write-down of a number of Asset Backed Securities. Notably, even after fully absorbing this impact, the Wholesale and International Banking division delivered profit before tax of £274 million.

The Group continues to maintain a strong funding and liquidity profile and has continued to obtain funding at market leading rates, with the overall margin impact of funding the Group's balance sheet remaining broadly unchanged. The Group has benefited from improvements in a number of individual product margins, particularly in new mortgages and corporate lending, however the lower interest rate environment in the second half of the year has led to increased pressure on deposit spreads.

CONTINUED MOMENTUM THROUGHOUT THE BUSINESS

Profit before tax, excluding the impact of market dislocation, decreased by £340 million, or eight per cent, to £3,696 million, as good relationship banking and insurance business momentum was offset by a significant increase in levels of impairment. On this basis and adjusting for insurance grossing, revenue growth of eight per cent exceeded cost growth of five per cent.

GOOD INCOME GROWTH

Overall income growth of eight per cent, excluding the impact of market dislocation and insurance grossing adjustments, reflected continued good progress in delivering our divisional strategies. We have increased income from both new and existing customers, with strong growth in both assets and liabilities leading to higher net interest income, as well as an increase in fee-related income.

Group net interest income, excluding insurance grossing, increased by £1,457 million, or 26 per cent, to £7,058 million. Over the last 12 months, total assets increased by 23 per cent to £436 billion, with a 16 per cent increase in loans and advances to customers, reflecting strong levels of customer lending growth in Commercial Banking, Corporate Markets and mortgages. Customer deposits increased by nine per cent to £171 billion, supported by good growth in savings balances in the retail bank, where bank savings increased by 12 per cent and wealth management balances by 20 per cent. Customer deposits in our Corporate Markets, Commercial and International businesses increased by 15 per cent.

The net interest margin from our banking businesses was unchanged at 2.78 per cent, as improved product margins offset an adverse mix effect. Overall product margins were 12 basis points higher, reflecting stronger new business product margins in the mortgage and corporate businesses. Stronger growth in finer margin corporate and mortgage lending than in the wider margin unsecured consumer lending contributed to the negative mix effect which offset the increase in product margins.

Other income, net of insurance claims and excluding insurance grossing, decreased by £1,290 million, or 25 per cent, to £3,952 million, largely reflecting the impact of market dislocation. In the retail bank, higher fees and commissions receivable as a result of good growth in added value current accounts and card services were offset by lower creditor insurance commissions and the impact of changes in product design leading to a greater proportion of earnings being recognised as net interest income rather than fee income. In addition, good levels of growth were achieved in fee based product sales to commercial banking customers.

STRONG COST MANAGEMENT

The Group continues to invest in improving processing efficiency, resulting in continued tight control over day-to-day operating costs. During 2008, operating expenses increased by five per cent to £5,582 million excluding the insurance grossing adjustment. Over the last 12 months, staff numbers increased by 678 (one per cent) to 58,756, as investment in higher levels of customer facing staff more than offset further efficiency improvements in back-office processing centres. These improvements in operational effectiveness have resulted in a further reduction in the Group cost:income ratio, excluding market dislocation, from 48.1 per cent to 47.0 per cent. The Group's programme of productivity initiatives has continued to deliver significant benefits, improving underlying cost efficiency and creating greater headroom for further investment in the business. During 2008, the Group exceeded its expected net cost benefits target of £250 million in 2008 by delivering a total of £311 million net cost benefits from the programme.

ASSET QUALITY

In UK Retail Banking, impairment losses increased by £248 million, or 20 per cent, to £1,472 million, particularly reflecting the impact of lower house prices on the mortgage impairment charge. In terms of unsecured lending, our asset quality remains satisfactory. However, in the context of the uncertain UK economic environment and the potential for increased consumer arrears and insolvencies, we are continuing to enhance our underwriting, collections and fraud prevention procedures.

Mortgage credit quality remains good although the slowdown in economic activity and rising unemployment in the UK has led to arrears rising by 44 per cent over the last 12 months, a trend that is expected to continue. The fall in the house price index during the year has led to an increase of approximately £150 million in the secured impairment charge. Looking forward, our view is for a further fall of similar magnitude in house prices during 2009.

The Wholesale and International Banking charge for impairment losses increased significantly by £936 million to £1,508 million, including a £345 million impairment charge relating to the impact of market dislocation during 2008. The remaining charge reflects an increase in the level of impairments as a result of the economic slowdown in the UK and the impact of a number of high profile financial services company collapses.

Overall, impairment losses increased by 68 per cent to £3,012 million. Our impairment charge on loans and advances expressed as a percentage of average lending was 1.13 per cent, excluding the impact of market dislocation, compared to 0.82 per cent in 2007 (also excluding the impact of the 2007 Finance Act). Impaired assets increased by 64 per cent to £8,700 million and now represent 3.5 per cent of total lending, up from 2.5 per cent at 31 December 2007.

EXPOSURE TO ASSETS AFFECTED BY CURRENT CAPITAL MARKETS UNCERTAINTIES

The Group's relationship focused business model means our Corporate Markets business has limited exposure to assets affected by current capital markets uncertainties. During 2008 the Group has successfully taken steps to reduce and restructure these exposures and the related risk and it is anticipated that this process will continue in 2009.

Following the amendment to International Accounting Standards (IAS) 39, the Group has reclassified certain assets for which there is no longer an active market and which are now being managed as lending. Assets totalling £2,993 million previously classified as held for trading (measured at fair value through profit and loss) were transferred to loans and advances with effect from 1 July 2008 and a further £437 million of assets previously classified as available for sale (measured at fair value with changes taken to equity) were transferred to loans and advances with effect from 1 November 2008. If these reclassifications had not been made, the Group's income statement for 2008 would have included additional losses of £406 million.

INSURANCE VOLATILITY

A large proportion of the investments held by the Group's insurance business are invested in assets which are expected to be held on a long-term basis and which are inherently subject to short-term investment market fluctuations. Whilst it is expected that those investments will provide enhanced returns over the longer term, the single year impact of investment market volatility can be significant. In 2008, a decline in equity and property markets and a widening of credit spreads in fixed income markets contributed to adverse volatility of £746 million, after adjusting for the effect of illiquidity premia within the annuity business. This principally reflects a reduction in the market consistent valuation of the annuity portfolio, driven by the continued widening of corporate bond spreads in 2008, and lower expected future shareholder income from contracts where the underlying policyholder investments are in equities.

SUMMARY OF GROUP RESULTS continued

PROVISION RELATING TO CERTAIN HISTORIC US DOLLAR PAYMENTS

In January 2009, the Group announced that it had reached a settlement with both the US Department of Justice and the New York County District Attorney's Office in relation to a previously disclosed investigation involving those agencies into certain historic US dollar payment practices by Lloyds TSB. The Group disclosed in its interim results for the first half of 2008 that it was in discussions regarding a resolution of the investigation and that it had provided £180 million in respect of this matter. The provision was hedged into US dollars at the time and fully covers the settlement amount announced in January 2009. The Group is continuing discussions with the Office of Foreign Assets Control (OFAC) regarding the terms of the resolution of its investigation. OFAC has confirmed to the Group that the amount paid to the US Department of Justice and the New York County District Attorney's Office will be credited towards satisfying any penalty it imposes. The Group does not currently believe that any additional liability requiring provision will arise following the conclusion of the discussions with OFAC. The Group does not anticipate any further enforcement actions as to these issues.

PROVISION FOR FINANCIAL SERVICES COMPENSATION SCHEME LEVY

The recent arrangements put in place to protect the depositors of Bradford & Bingley and other failed deposit taking institutions involving the Financial Services Compensation Scheme (FSCS) will result in a significant increase in the levies made by the FSCS on the industry. The Group has made a provision of £122 million in its 2008 accounts in respect of its current obligation for the estimated interest cost on the FSCS borrowings. Going forward further provisions in respect of these costs are likely to be necessary until the borrowings are repaid. The ultimate cost to the industry, which will also include the cost of any compensation payments made by the FSCS and if necessary the cost of meeting any shortfall after recoveries on the borrowings entered into by the FSCS, remains uncertain although it may be significant.

GOODWILL IMPAIRMENT

During the year, the basis of goodwill allocation in parts of our Asset Finance business has been changed to treat the consumer finance business as a single cash generating unit encompassing the motor and personal finance operations which provide direct and point of sale finance. The markets in which these units operate have been affected by the UK economic downturn, which has been characterised by falling demand and increasing arrears at this point of the cycle. This, together with uncertainties over the likely short term macroeconomic environment, has resulted in a reassessment of the carrying value of the consumer finance cash generating unit and the recognition of a goodwill impairment charge of £100 million at 31 December 2008.

TAXATION

The Group's tax for 2008 was a credit of £38 million. This primarily reflects a significant policyholder interests related tax credit offsetting in full the charge for policyholder interests included in the Group's profit before tax.

ROBUST CAPITAL POSITION

At the end of December 2008, the Group's capital ratios remained robust with a total capital ratio on a Basel II basis of 11.2 per cent, a tier 1 ratio of 8.0 per cent and a core tier 1 ratio of 5.6 per cent. In September 2008, the Group completed the placing of 284.4 million ordinary shares at a price of 270 pence per share, raising approximately £760 million. Over the last 12 months, risk-weighted assets increased by 20 per cent to £170 billion, reflecting the growth in our Corporate Markets and mortgage businesses, as well as the impact of exchange rate movements which represented 8 percentage points of the increase.

Scottish Widows remains strongly capitalised and, at the end of December 2008, the working capital ratio of the Scottish Widows Long Term Fund was an estimated 21.6 per cent. During 2008 a regular dividend of £0.2 billion was paid to the Group, bringing the total capital repatriation since the beginning of 2005 to over £3.8 billion. As at 31 December 2008, the estimated Insurance Groups Directive (IGD) capital surplus was £0.8 billion, with additional surplus within the Long Term fund totalling an estimated £1.5 billion. This IGD surplus would be unchanged in the event of a 40 per cent reduction in equity markets from the 31 December 2008 position.

MAINTAINING A STRONG LIQUIDITY AND FUNDING POSITION

The current turbulence in global capital markets has been a severe examination of the banking system's capacity to absorb sudden significant changes in the funding and liquidity environment, and individual institutions have faced varying, but significant, degrees of stress. Throughout this period, the Group has maintained a strong liquidity position which is supported by our strong and stable retail and corporate deposit base. Both retail and corporate deposit inflows have been robust and the Group continues to benefit from its diversity of funding sources. The Group's wholesale funding base has proved to be resilient, supporting the Group's balance sheet growth with an increased level of longer term funding (greater than one year).

New initiatives introduced during the course of 2008 by The Bank of England and HM Treasury to facilitate banks' access to senior funding include the Special Liquidity Scheme and Credit Guarantee Scheme, respectively. The Group welcomed these initiatives and, like many of its peers, continues to make use of them for term funding. Going forward, where markets permit and it is economic to do so, the Group expects to reduce this utilisation and further develop and diversify its unguaranteed funding programmes.

Following completion of the HBOS acquisition in January 2009, all of the major rating agencies have updated their ratings for the enlarged Group. Each agency has issued the Group the highest possible short-term rating, and a long-term deposit rating in the 'double A' range. This provides the Group with a strong overall suite of credit ratings.

ACQUISITION OF HBOS

In September 2008, Lloyds TSB and HBOS announced that they had reached agreement on the terms of a recommended acquisition by Lloyds TSB of HBOS, creating a compelling opportunity to accelerate Lloyds TSB's strategy and create the UK's leading financial services group. In October 2008, both Lloyds TSB and HBOS announced that they intended to participate in a co-ordinated package of capital and funding measures for the UK banking sector being implemented by HM Treasury. This led to Lloyds TSB's participation in the raising of £5.5 billion new capital (consisting of £4.5 billion in ordinary shares and £1 billion in preference shares). In addition, HBOS participated in the raising of £11.5 billion (consisting of £8.5 billion in ordinary shares and £3 billion in preference shares). Both of these capital raisings and the HBOS acquisition were completed in January 2009. The Group's board believes that its participation in the Government funding proposal provided the capital necessary to complete the acquisition in a timely fashion, with certainty and on terms that were the best available in current market conditions. The board believes that HM Treasury, which is now a 43.4 per cent shareholder of the Group, will act as a value-oriented shareholder with regard to the strategic development of the Group.

Following the completion of the acquisition and the capital raisings in January 2009, the proforma adjusted capital ratios for Lloyds Banking Group, at 31 December 2008, were 6.4 per cent for core tier 1, 9.8 per cent for tier 1 capital and 12.5 per cent for total capital. The proforma adjusted net tangible asset value of the enlarged Group totalled an estimated £29.5 billion, equivalent to 179p per share.

A CHALLENGING OUTLOOK

2008 has been an immensely challenging period for all banks, and the assets on the enlarged Group's balance sheet have shown increasing signs of stress during the year. Whilst our risk management and business support culture is strong, the continuing economic deterioration in the UK will make 2009 another difficult year. We currently expect retail impairment levels to rise significantly in 2009, largely reflecting the expected increase in unemployment levels in the UK and the impact of further house price falls. Corporate impairment levels are expected to remain at the high levels seen during 2008, whilst Treasury asset and investment portfolio write-downs are expected to be significantly lower. Overall, before the recognition of negative goodwill, we expect the enlarged Group to report a loss for 2009.

Tim Tookey
Group Finance Director
26 February 2009

SUMMARY OF GROUP RESULTS continued

SUMMARISED SEGMENTAL ANALYSIS

2008	UK Retail Banking £m	Insurance and Investments** £m	Wholesale and International Banking £m	Central group items £m	Group excluding insurance gross up £m	Insurance gross up** £m	Group £m
Net interest income	4,110	(62)	3,303	(293)	7,058	651	7,709
Other income	1,766	1,749	829	(199)	4,145	(3,624)	521
Total income	5,876	1,687	4,132	(492)	11,203	(2,973)	8,230
Insurance claims	–	(193)	–	–	(193)	3,052	2,859
Total income, net of insurance claims	5,876	1,494	4,132	(492)	11,010	79	11,089
Operating expenses	(2,611)	(591)	(2,350)	(30)	(5,582)	(69)	(5,651)
Trading surplus (deficit)	3,265	903	1,782	(522)	5,428	10	5,438
Impairment	(1,472)	(2)	(1,508)	(30)	(3,012)	–	(3,012)
Profit (loss) before tax*	1,793	901	274	(552)	2,416	10	2,426
Volatility							
– Insurance	–	(746)	–	–	(746)	–	(746)
– Policyholder interests	–	–	–	–	-	(471)	(471)
Provision in respect of certain historic US dollar payments	–	–	(180)	–	(180)	–	(180)
Provision for Financial Services Compensation Scheme levy	(119)	(3)	–	–	(122)	–	(122)
Goodwill impairment	–	–	(100)	–	(100)	–	(100)
Profit (loss) before tax	1,674	152	(6)	(552)	1,268	(461)	807

*Excluding volatility, a provision in respect of certain historic US dollar payments, the Financial Services Compensation Scheme levy and goodwill impairment.

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

In the year ended 31 December 2008, the contribution from central group items was a negative £552 million compared to a negative contribution of £12 million in 2007. The result in 2008 has been significantly affected by the impact of yield curve volatility on the fair value of derivatives entered into for risk management purposes, after taking into account the effect of hedge accounting adjustments. In addition, there were increased central costs that were not recharged to the divisions in connection with professional advice received during the year and an impairment charge in respect of an available-for-sale investment.

SUMMARISED SEGMENTAL ANALYSIS continued

2007†	UK Retail Banking £m	Insurance and Investments** £m	Wholesale and International Banking £m	Central group items £m	Group excluding insurance gross up £m	Insurance gross up** £m	Group £m
Net interest income	3,695	(106)	2,380	(368)	5,601	421	6,022
Other income	1,797	1,741	1,644	362	5,544	6,233	11,777
Total income	5,492	1,635	4,024	(6)	11,145	6,654	17,799
Insurance claims	–	(302)	–	–	(302)	(6,615)	(6,917)
Total income, net of insurance claims	5,492	1,333	4,024	(6)	10,843	39	10,882
Operating expenses	(2,548)	(611)	(2,152)	(6)	(5,317)	(13)	(5,330)
Trading surplus (deficit)	2,944	722	1,872	(12)	5,526	26	5,552
Impairment	(1,224)	–	(572)	–	(1,796)	–	(1,796)
Profit (loss) before tax*	1,720	722	1,300	(12)	3,730	26	3,756
Volatility							
– Insurance	–	(277)	–	–	(277)	–	(277)
– Policyholder interests	–	–	–	–	–	(222)	(222)
Discontinued businesses	–	145	28	–	173	(11)	162
Profit on sale of businesses	–	272	385	–	657	–	657
Settlement of overdraft claims	(76)	–	–	–	(76)	–	(76)
Profit (loss) before tax	1,644	862	1,713	(12)	4,207	(207)	4,000

*Excluding volatility, results of discontinued businesses, profit on sale of businesses and the settlement of overdraft claims.

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

† Segmental analyses for 2007 have been restated as explained in note 4 on page 114.

DIVISIONAL RESULTS:
UK RETAIL BANKING

OUR BUSINESS

During 2008, UK Retail Banking provided a wide range of banking and financial services through our diversified, proprietary distribution network and highly recognised and well-regarded brands (Lloyds TSB, Cheltenham & Gloucester and Scottish Widows) to some 16 million personal customers through over 1,950 branches across the UK. At the end of 2008 Lloyds TSB had the UK's largest personal current account base with over 12 million current account customers, had the largest number of internet banking customers in the UK and operated 11 call centres, all in the UK, taking over 70 million calls per year. In 2008 Lloyds TSB was voted by Reader's Digest the most trusted bank in Britain for the eighth year running.

Following the acquisition of HBOS, the new 'Retail' division now includes the HBOS branch operations and is the largest retail bank in the UK. The Group is now the UK's leading provider of current accounts, savings, personal loans, credit cards and mortgages and has the largest branch network in the UK, with approximately 3,000 branches, and one of the largest fee free ATM networks in the UK with around 6,800 cash machines.

The new 'Retail' division has approximately 30 million customers. In addition to being the largest provider of current accounts in the UK with approximately 22 million current account customers, we are also the largest provider of social banking providing over four million basic bank or social banking accounts in the UK.

The new 'Retail' division operates a multi brand strategy with a range of highly recognised and well regarded brands including Lloyds TSB, Halifax, Bank of Scotland and Cheltenham & Gloucester.

Following the acquisition, the wealth management business is being transferred to the new 'Wealth and International' division.

NO 1 FOR UK CURRENT ACCOUNTS

Lloyds TSB took on over 1 million new customers for the second year in a row, maintaining the position of No 1 UK Current Account provider (GfK Financial Research Survey 'FRS' data). This success has been driven by launching innovative new products and services, such as Vantage and Control accounts and the market leading mobile banking services.

KEY HIGHLIGHTS

Good profit performance, against a backdrop of slowing economic activity. Profit before tax increased by four per cent to £1,793 million.

Strong income momentum maintained, up seven per cent, supported by overall sales growth of seven per cent.

Good growth in deposits resulted in a five per cent increase in overall deposit balances, with 12 per cent growth in bank savings, and 20 per cent growth in wealth management deposits.

Excellent market share of net new mortgage lending, at 27.5 per cent. Mortgage balances outstanding increased by 11 per cent to £112.9 billion.

Improved net interest margin, nine basis points higher than in 2007, reflecting improved key product margins, particularly in unsecured personal lending and new mortgages.

Continued effective cost management, with a clear focus on investing to improve service quality and processing efficiency. Operating expenses increased by only 2 per cent and there was an improvement in the cost:income ratio to 44.4 per cent.

Strong trading surplus performance, up 11 per cent to £3,265 million.

The quality of new lending continues to be good, reflecting continued strong credit criteria, although the fall in the house price index over the last 12 months has led to an increase of approximately £150 million in the secured impairment charge during the year. We currently expect retail impairment levels to rise significantly in 2009, largely reflecting the expected increase in unemployment levels in the UK and the impact of further house price falls.

DIVISIONAL PERFORMANCE

Continuing business

	2008 £m	2007† £m	Change %
Net interest income	**4,110**	3,695	11
Other income	**1,766**	1,797	(2)
Total income	**5,876**	5,492	7
Operating expenses	**(2,611)**	(2,548)	(2)
Trading surplus	**3,265**	2,944	11
Impairment	**(1,472)**	(1,224)	(20)
Profit before tax	**1,793**	1,720	4
Cost:income ratio	**44.4%**	46.4%	
	31 December 2008 £bn	31 December 2007 £bn	Change %
Total assets	**127.5**	115.0	11
Risk-weighted assets	**49.6**	44.8	11
Customer deposits	**85.9**	82.1	5

† Restated, see page 17.

OUR STRATEGY

'Retail's' strategic goal is to create Britain's best retail bank. This will be achieved by building deeper relationships with our customers through providing products that they need, at prices they can afford, as well as delivering a high quality service. At the same time, we will seek to improve the management of our costs and capital by continuing to apply a prudent approach to risk.

A major focus in the implementation of this strategy will be upon 'putting the relationship back into banking'. We will, through deeper customer insight, offer customers first class products backed by an effective and efficient service as well as strengthening our relationships which, in turn, will generate new sales. This is backed by our extensive multi channel distribution network providing our customers with a wide range of choice and added convenience. We will drive down operating costs by improving efficiency in our processes and effectively managing risk across the bank.

The integration of HBOS will give us additional opportunities to provide products and services to all of our customers whilst carefully managing risk and delivering cost synergies.

KEY PERFORMANCE INDICATORS

PROFIT BEFORE TAX† (£m)

4%

	£m
2006	1,549
2007	1,720
2008	**1,793**

CUSTOMER DEPOSITS (£bn)

5%

	£bn
2006	75.7
2007	82.1
2008	**85.9**

INCOME† (£m)

7%

	£m
2006	5,263
2007	5,492
2008	**5,876**

GROUP UK MORTGAGE BALANCES (£bn)

11%

	£bn
2006	95.3
2007	102
2008	**112.9**

INCOME AND COST GROWTH 2008†† (%)

	%
Income	7
Costs	2

NET PROMOTER SCORE

2007	(4.3)
2008	**5.5**

† The 2007 figures have been restated (see page 17). The 2006 figures are as originally published.
†† Excluding the settlement of overdraft claims and the Financial Services Compensation Scheme levy.

ONE IN FOUR NET NEW MORTGAGES

In 2008, Lloyds TSB achieved its best-ever performance in mortgages, by providing one in four net new mortgages in the UK last year (total completed mortgage business less redemptions and repayments), demonstrating Lloyds TSB remains very much open to new mortgage business and to supporting customers through difficult economic times.

SUCCESSFUL YEAR FOR SAVINGS AND PERSONAL LOANS

2008 was the most successful year ever for savings and personal loans. Savings balances grew by £5 billion with over two million accounts opened, 28 per cent higher than 2007. A really impressive performance given the market uncertainty and low interest rate environment. Lloyds TSB continues to be the number one provider of personal loans (CACI data).

DIVISIONAL RESULTS
UK RETAIL BANKING continued

By making its customers central to its strategy, UK Retail Banking continued to make substantial progress in each of its key strategic priorities: growing income from its existing customer base; expanding its customer franchise; and improving productivity and efficiency. In each of these areas, a key focus has been on sales of recurring income products, such as current accounts and savings products which, combined with higher lending related income, has supported the strong rate of revenue growth. This has been achieved whilst continuing to operate our lending principles in a responsible manner, by maintaining lending criteria appropriate to the position in the economic cycle, by working with our customers who are experiencing financial difficulties and by ensuring we pass on base rate cuts to our Standard Variable Rate mortgage customers.

Profit before tax from UK Retail Banking increased by £73 million, or four per cent, to £1,793 million, reflecting strong levels of franchise growth and effective cost management which offset the higher impairment charge. Total income increased by £384 million, or seven per cent, whilst operating expenses remained well controlled, increasing by two per cent. The trading surplus increased by 11 per cent to £3,265 million.

GROWING INCOME FROM THE CUSTOMER BASE

The retail bank has continued to make good progress, delivering strong product sales growth and revenue momentum, notwithstanding the challenging UK economic environment. Overall sales increased by seven per cent, with improvements over a broad range of products and through our wide variety of distribution channels. Both the internet and telephone banking channels performed strongly with sales growth of 29 per cent and 19 per cent respectively. Our continued good sales growth has been driven by strong sales of personal loans, bank savings and wealth management products. Our market share of new business in these key product areas has continued to increase, as the retail bank has successfully leveraged the benefit of the Group's strong brand and balance sheet to support increasing customer sales.

Customer deposits have increased by five per cent during the year, with particularly strong progress in growing our relationship focused bank savings and wealth management deposit balances, with increases of 12 per cent and 20 per cent respectively. The retail bank opened over two million new savings accounts during 2008.

	31 December 2008 £m	31 December 2007 £m	Change %
Current account and savings balances			
Bank savings	**46,941**	41,976	12
C&G deposits	**12,433**	14,861	(16)
Wealth management	**5,910**	4,939	20
UK Retail Banking savings	**65,284**	61,776	6
Current accounts	**20,642**	20,305	2
Total customer deposits	**85,926**	82,081	5

Over the last 12 months, the Group has made significant progress in building its mortgage business, in a mortgage market that has slowed considerably. The Group continues to focus on those segments of the prime mortgage market where value can be created whilst taking a conservative approach to credit risk. The Group continues to manage for value, targeting growth in profitable new business rather than overall market share. This approach, together with a recent uplift in interest spreads, has led to new business net interest margins strengthening over the last 12 months.

EXPANDING THE CUSTOMER FRANCHISE

In addition to the strong growth in product sales from existing customers, the Group has continued to make progress in expanding its customer franchise. The retail bank opened over one million new current accounts during the year, with a strong performance from the Group's range of added value current accounts with enhanced product features.

Despite tightened credit criteria and a slowdown in consumer demand, we have maintained our market leading position in personal loans, growing our market share of the unsecured personal loans market whilst remaining primarily focused on lending to our current account customer base. Unsecured consumer credit balances increased by six per cent, with personal loan balances outstanding at 31 December 2008 up nine per cent at £12.2 billion, whilst credit card balances were stable at £6.6 billion.

The demand for the Lloyds TSB Airmiles Duo credit card account has continued to be strong, with 1.4 million customers now signed up to use the account. Duo customers tend to be higher quality, more transactional customers. As a result, Lloyds TSB has maintained its position as a UK market leader in new credit card issuance during 2008, and has maintained an estimated new business market share of 13 per cent. In addition, Lloyds TSB was the leading consumer debit card issuer in the UK during the year.

The Group's market share of gross new mortgage lending increased to 10.8 per cent (2007: 8.1 per cent), as the Group continued to maintain its substantial presence in the UK mortgage market. Overall, new lending in the UK mortgage market fell by 29 per cent to £258 billion (2007: £363 billion) however the Group's gross new mortgage lending in 2008 fell by only five per cent to £27.8 billion (2007: £29.4 billion). The higher market share of gross mortgage lending, in conjunction with a reduction in the Group's share of mortgage redemptions, has led to a significant increase in our market share of net new lending to 27.5 per cent, which partly reflects the withdrawal of a number of competitors from the UK mortgage market. Group mortgage balances outstanding increased by 11 per cent to £112.9 billion.

Wealth management continues to make good progress with its expansion plans to deliver an enhanced wealth management offer comprising private banking, open architecture portfolio management, retirement planning, insurance and estate planning services. New funds under management increased by 22 per cent, investment portfolio cases grew by 16 per cent and wealth management banking deposits increased by 20 per cent. During a period when the FTSE 100 index fell by 31 per cent, investment portfolio funds under management decreased by 11 per cent and this led to an overall reduction of three per cent in total customer assets.

IMPROVING PRODUCTIVITY AND EFFICIENCY

We have continued to benefit from the recent investment in reducing the levels of administration and processing work carried out in branches. This has enabled us to further increase our focus on meeting the needs of our customers and has supported improved productivity in the branch network sales effort. These improvements have supported a further improvement in the retail banking cost:income ratio to 44.4 per cent, from 46.4 per cent last year. Average sales by staff in the branch network have shown good growth on the levels achieved in 2007.

Telephone banking has continued to improve the quality of the service which it provides to customers, allowing us to focus on better meeting the needs of our customers whilst also improving efficiency.

ARREARS PERFORMANCE REMAINS SATISFACTORY

Impairment losses on loans and advances were 20 per cent higher at £1,472 million, particularly reflecting the impact of lower house values on the mortgage impairment charge. The impairment charge as a percentage of average lending was higher at 1.22 per cent, compared to 1.10 per cent in 2007. Over 99 per cent of new personal loans and 90 per cent of new credit cards sold during 2008 were to existing customers. The level of arrears in the credit card and personal loan portfolios increased by 26 per cent and 15 per cent respectively reflecting the impact of the slowdown in the UK economic environment.

In terms of unsecured lending, our arrears performance remains satisfactory. However, in the context of the uncertain UK economic environment and the potential for increased consumer arrears and insolvencies, we are continuing to enhance our underwriting, collections and fraud prevention procedures. We currently expect retail impairment levels to rise significantly in 2009, largely reflecting the expected increase in unemployment levels in the UK and the impact of further house price falls.

Mortgage credit quality remains good although the slowdown in economic activity and rising unemployment in the UK has led to arrears rising by 44 per cent over the last 12 months. This compares to a rise of 72 per cent in Council of Mortgage Lenders (CML) industry averages in the 12 months to 31 December 2008. The fall in the house price index over the last 12 months has however led to an increase of approximately £150 million in the secured impairment charge during the year. Looking forward, our view is for a further fall of similar magnitude in house price index during 2009.

In Cheltenham & Gloucester, the average indexed loan-to-value ratio on the mortgage portfolio was 56 per cent, and the average loan-to-value ratio for new mortgages and further advances written during 2008 was 63 per cent. At 31 December 2008, 15 per cent of balances had an indexed loan-to-value ratio in excess of 100 per cent reflecting the significant fall in house prices during the year. Compared to the CML industry averages at 31 December 2008, UK Retail Banking had less than half the industry average for properties in possession and new repossessions as a percentage of total cases in 2008. In addition, arrears in the Group's buy-to-let portfolio represent only a small fraction of our prime portfolio and CML industry averages. We extensively stress-test our lending to changes in macroeconomic conditions and we remain confident in the quality of our mortgage portfolio.

DIVISIONAL RESULTS: INSURANCE AND INVESTMENTS

OUR BUSINESS

The Insurance and Investments division offered life assurance, pensions and investment products, general insurance and fund management services during 2008. These products were delivered through a number of brands including Scottish Widows, Lloyds TSB General Insurance and Scottish Widows Investment Partnership.

The Scottish Widows brand was the main brand for new sales of Lloyds TSB Group's life, pension, Open Ended Investment Companies (OEICs) and other long-term savings products in 2008. Scottish Widows was voted Best Individual Pensions Provider by IFAs and was voted the most trusted choice for pensions amongst UK consumers in 2008.

Lloyds TSB General Insurance was the leading distributor of home insurance in Britain, with products distributed through Lloyds TSB branches and strategic corporate partners.

Scottish Widows Investment Partnership (SWIP) managed funds for Lloyds TSB Group's retail life, pensions, and investment products. Other key clients covered both the retail and institutional segments, with SWIP occupying a top three position in terms of Retail funds under management. Retail and Institutional SWIP had £83 billion of funds under management at the end of 2008.

Following the acquisition of HBOS, the Insurance and Investments division has been renamed 'Insurance' and now includes the Clerical Medical and HBOS General Insurance businesses which were previously part of the HBOS Insurance and Investments division. The investment management business, Scottish Widows Investment Partnership, is being transferred to the new Wealth and International division.

Lloyds Banking Group is now the major bancassurance provider in the UK and provides a full range of equity based long-term savings and investment products.

KEY HIGHLIGHTS

Strong profit performance. Profit before tax increased by 22 per cent to £911 million.

Good income growth and strong cost management. Income increased by three per cent, whilst operating expenses decreased by three per cent.

Robust sales performance, in a challenging market environment resulting in an increase in estimated market share. Scottish Widows' bancassurance sales increased by four per cent, whilst sales through the Independent Financial Adviser (IFA) distribution channel decreased by eight per cent.

Continued high returns. On a European Embedded Value (EEV) basis, the post-tax return on embedded value remained high at 11.4 per cent. New business margins remained resilient at 2.9 per cent.

Strong profit performance in General Insurance. Profits more than doubled in 2008 reflecting the absence of the severe weather related claims experienced in 2007, good increases in home insurance income and more efficient claims processing.

Resilient performance by Scottish Widows Investment Partnership, as profit before tax increased against the backdrop of a significant reduction in equity market levels.

DIVISIONAL PERFORMANCE

Continuing businesses

	2008 £m	2007† £m	Change %
Net interest income	**(62)**	(106)	42
Other income	**1,749**	1,741	–
Total income	**1,687**	1,635	3
Insurance claims	**(193)**	(302)	36
Total income, net of insurance claims	**1,494**	1,333	12
Operating expenses	**(591)**	(611)	3
Impairment	**(2)**	–	
Profit before tax, excluding insurance gross	**901**	722	25
Insurance grossing adjustment (page 16)	**10**	26	(62)
Profit before tax	**911**	748	22
Profit before tax analysis			
Life, pensions and OEICs	**635**	597	6
General Insurance	**234**	110	113
Scottish Widows Investment Partnership	**42**	41	2
Profit before tax	**911**	748	22
Present value of new business premiums (PVNBP)	**10,094**	10,424	(3)
PVNBP new business margin (EEV basis) total	**2.9%**	3.1%	
Post-tax return on embedded value (EEV basis)	**11.4%**	10.7%	

† Restated, see page 17.

OUR STRATEGY

The strategic priorities for the new 'Insurance' division are:

– Delivering profitable, market-led product propositions
– Increasing the proportion of business sold through the Lloyds Banking Group franchise whilst profitably growing independent financial adviser (IFA) sales
– Leveraging scale into new channels
– Improving service and operational efficiency
– Managing risk effectively and optimising capital management
– Attracting, developing and retaining the best people

Within the life assurance operations this will be achieved by developing strong and enduring relationships, developing market-led propositions and being easy to do business with. Scottish Widows' products are distributed through the Lloyds TSB channels, independent financial advisers and other intermediaries, whilst Clerical Medical products are distributed through the HBOS channels, independent financial advisers and other intermediaries.

The General Insurance operations are targeting growing share in their chosen customer segments, developing key insurance partnerships, improving margins by better customer management and improving service and efficiency.

KEY PERFORMANCE INDICATORS

PROFIT BEFORE TAX†

£m

22%

NEW BUSINESS SALES (PVNBP)

£m

(3%)

RETURN ON EMBEDDED VALUE*

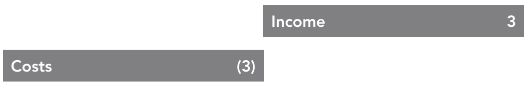
%

NEW BUSINESS MARGINS (PVNBP)†

%

INCOME AND COST GROWTH 2008◆†

%



†The 2007 figures have been restated (see page 17). The 2006 figures are as originally published.
*EEV basis.
◆Excluding volatility and insurance grossing.

MOST TRUSTED CHOICE

Scottish Widows was voted most trusted choice for pensions in an independent survey. (IPSOS, February 2008)

BEST HOME INSURANCE WEBSITE

Assessed against 550 different criteria and measured according to 1,000 insurance customer feedback responses, www.lloydstsbinsurance.co.uk has been ranked as the best Home Insurance website for the second year in succession by Global Reviews 2008. (November 2008)

DIVISIONAL RESULTS
INSURANCE AND INVESTMENTS continued

SCOTTISH WIDOWS LIFE, PENSIONS AND OEICs

Profit before tax, excluding volatility, increased by £38 million, or six per cent, to £635 million.

Life and pensions new business profit, on an IFRS basis and excluding volatility, increased by 46 per cent to £238 million, reflecting a higher volume of protection business and the development of an investment bond product which has resulted in a higher proportion of the new business written containing insurance features, which is therefore accounted for on an embedded value basis. Existing business profit decreased by 12 per cent, to £363 million, as an increase in expected profits from the existing business was more than offset by the adverse impact of changes in assumptions, principally reflecting an increase in long-term lapse assumptions.

During 2008, Scottish Widows has continued to make good progress in its key business priorities: to maximise bancassurance success; to profitably grow IFA sales; to improve service and operational efficiency; and to optimise capital management.

MAXIMISING BANCASSURANCE SUCCESS

During 2008, the value of Scottish Widows' bancassurance new business premiums increased by four per cent, building on the success of the simplified product range for distribution through the Lloyds TSB branch network, commercial banking and wealth management channels. Sales of OEICs through the wealth segment were particularly strong, offsetting a reduction in volumes through the mass market segment, where a reduction in the sales of equity-backed OEICs has been partly offset by strong sales of capital protected savings products. Sales of protection products also increased significantly reflecting the benefit of product enhancements during the year.

IFA SALES

Sales through the IFA distribution channel decreased by eight per cent, reflecting the general contraction in sales in the IFA market. Scottish Widows' participation in the IFA market remains focused on achieving financial returns which meet the Company's internal targets. Sales performance was strong in corporate pensions where an increase in volumes of 19 per cent was achieved whilst maintaining satisfactory margins and returns. Within individual pensions, sales of the Retirement Account, a capital efficient product with a more transparent charging structure, increased by 75 per cent benefiting from product enhancements introduced during the year. Sales of investment bonds reduced by 56 per cent, partly driven by changes in Capital Gains Tax regulations, but also reflecting the Company's unwillingness to participate in markets which do not generate an economic return.

IMPROVING SERVICE AND OPERATIONAL EFFICIENCY

The business has made further improvements in service and operational efficiencies, and the benefits can be seen in a further reduction of three per cent in operating expenses, notwithstanding ongoing investment in product and distribution enhancements. In addition, the strength of Scottish Widows' product and service proposition was recognised through an increased number of industry awards and ratings in 2008; the Company was voted best personal pensions provider, achieved two '5 star' service awards and was rated highly for its strong e-commerce platform.

OPTIMISING CAPITAL MANAGEMENT

The capital position of Scottish Widows has remained robust despite recent market turbulence. Scottish Widows' approach to capital management, including its investments and hedging strategy, has been successful in mitigating the impact of market shocks on its current capital base. Additionally, Scottish Widows' capital management strategy is designed to generate sufficient free cash flow to fund new business and maintain dividend flow to the Group. Accordingly, Scottish Widows continues to focus on improving the capital efficiency of its products and identifying further opportunities to improve its capital position. The post-tax return on embedded value, on an EEV basis, increased to 11.4 per cent, partly reflecting a lower value of in-force business resulting from recent falls in investment markets. During 2008, £0.2 billion of capital was paid to the Group via the regular annual dividend payment, giving a total capital repatriation of over £3.8 billion since the beginning of 2005.

PRESENT VALUE OF NEW BUSINESS PREMIUMS (PVNBP)

	2008 £m	2007 £m	Change %
Life and pensions:			
Protection	**317**	275	15
Creditor	**680**	685	(1)
Savings and Investments	**437**	913	(52)
Individual pensions	**2,125**	2,073	3
Corporate and other pensions	**2,482**	2,141	16
Retirement income	**939**	1,044	(10)
Managed fund business	**217**	486	(55)
Life and pensions	**7,197**	7,617	(6)
OEICs	**2,897**	2,807	3
Life, pensions and OEICs	**10,094**	10,424	(3)
Single premium business	**7,346**	8,375	(12)
Regular premium business	**2,748**	2,049	34
Life, pensions and OEICs	**10,094**	10,424	(3)
Bancassurance	**4,247**	4,096	4
Independent financial advisers	**5,367**	5,817	(8)
Direct	**480**	511	(6)
Life, pensions and OEICs	**10,094**	10,424	(3)

RESULTS ON A EUROPEAN EMBEDDED VALUE (EEV) BASIS

In addition to reporting under IFRS, the Group, as in previous reporting periods, provides supplementary financial reporting for Scottish Widows on an EEV basis.

CONTINUING BUSINESSES*

	2008 Life, pensions and OEICs £m	2007 Life, pensions and OEICs £m	Change %
New business profit	**295**	326	(10)
Existing business			
– Expected return	**321**	296	
– Experience variances	**52**	41	
– Assumption changes	**4**	(32)	
	377	305	24
Expected return on shareholders' net assets	**146**	166	(12)
Profit before tax, adjusted for capital repatriation*	**818**	797	3
Impact of capital repatriation to Group	**–**	21	
Profit before tax*	**818**	818	–
New business margin (PVNBP)	**2.9%**	3.1%	
Embedded value (period end) – continuing businesses	**£4,932m**	£5,365m	
Post-tax return on embedded value*	**11.4%**	10.7%	

*Excluding volatility and other items (page 26).

Adjusting for the impact of capital repatriation to Group, EEV profit before tax from the Group's life, pensions and OEICs business increased by three per cent to £818 million in challenging market conditions.

New business profit fell by £31 million, or 10 per cent, to £295 million and the overall new business margin reduced to 2.9 per cent, from 3.1 per cent last year, primarily reflecting higher commission payable on OEIC products. In difficult trading conditions, life and pensions new business profit remained satisfactory with a continued focus on improving product profitability resulting in the new business margin increasing to 3.6 per cent (page 27).

Existing business profit increased by 24 per cent to £377 million. Expected return increased to £321 million driven by an increase in expected income from our annuity portfolio. The net impact of experience variances in both years is broadly comparable and reflects adverse lapse experience being more than offset by other favourable experience. The net impact of assumption changes in the current year is not significant and reflects a charge from more pessimistic lapse assumptions in life and pensions business which is broadly offset by favourable lapse assumptions in OEICs and other modelling changes. The expected return on shareholders' net assets decreased by £20 million as a result of a lower volume of free assets, driven by lower investment markets.

Overall the post-tax return on embedded value increased to 11.4 per cent.

SCOTTISH WIDOWS INVESTMENT PARTNERSHIP

Profit before tax from Scottish Widows Investment Partnership (SWIP) increased to £42 million (2007: £41 million). The adverse impact on income of volatile equity and bond markets was more than offset by strong cost management. With the FTSE All-Share Index falling to levels not seen since 2003, SWIP's assets under management decreased by £14.6 billion to £83.0 billion.

MOVEMENTS IN FUNDS UNDER MANAGEMENT

The following table highlights the movement in retail and institutional funds under management.

	2008 £bn	2007 £bn
Opening funds under management	**102.7**	105.7
Movement in retail funds		
Premiums	**11.2**	11.7
Claims	**(4.3)**	(4.8)
Surrenders	**(5.7)**	(6.4)
Net inflow of business	**1.2**	0.5
Investment return, expenses and commission	**(12.5)**	2.4
Net movement	**(11.3)**	2.9
Movement in institutional funds		
Lloyds TSB pension schemes	**–**	(5.7)
Other institutional funds	**(0.8)**	(0.6)
Investment return, expenses and commission	**(2.5)**	1.3
Net movement	**(3.3)**	(5.0)
Proceeds from sale of Abbey Life	**–**	1.0
Dividends and surplus capital repatriation	**(0.2)**	(1.9)
Closing funds under management	**87.9**	102.7
Managed by SWIP	**83.0**	97.6
Managed by third parties	**4.9**	5.1
Closing funds under management	**87.9**	102.7

Including assets under management within our UK Wealth Management and International Private Banking businesses, groupwide funds under management decreased by 10 per cent to £109 billion.

DIVISIONAL RESULTS continued
INSURANCE AND INVESTMENTS continued

EUROPEAN EMBEDDED VALUE REPORTING – RESULTS FOR YEAR ENDED 31 DECEMBER 2008

This section provides further details of the Scottish Widows EEV financial information.

COMPOSITION OF EEV BALANCE SHEET

	31 December 2008 £m	31 December 2007 £m
Value of in-force business (certainty equivalent)	**2,360**	2,779
Value of financial options and guarantees	**(90)**	(53)
Cost of capital	**(90)**	(178)
Non-market risk	**(57)**	(61)
Total value of in-force business	**2,123**	2,487
Shareholders' net assets	**2,809**	2,878
Total EEV of covered business	**4,932**	5,365

RECONCILIATION OF OPENING EEV BALANCE SHEET TO CLOSING EEV BALANCE SHEET ON COVERED BUSINESS

	Shareholders' net assets £m	Value of in-force business £m	Total £m
As at 1 January 2007	3,572	2,841	6,413
Total profit after tax			
– Continuing businesses	580	102	682
– Discontinued businesses	81	5	86
Profit on disposal of Abbey Life (EEV basis)			
– Sale proceeds	985	–	985
– Assets disposed	(474)	(461)	(935)
	511	(461)	50
Dividends	(1,866)	–	(1,866)
As at 31 December 2007	2,878	2,487	5,365
Total profit (loss) after tax	**151**	**(364)**	**(213)**
Dividends	**(220)**	**–**	**(220)**
As at 31 December 2008	**2,809**	**2,123**	**4,932**

ANALYSIS OF SHAREHOLDERS' NET ASSETS ON AN EEV BASIS ON COVERED BUSINESS

	Required capital £m	Free surplus £m	Shareholders' net assets £m
As at 1 January 2007	2,207	1,365	3,572
Total profit (loss) after tax			
– Continuing businesses	(214)	794	580
– Discontinued businesses	(24)	105	81
Dividends	–	(1,866)	(1,866)
Disposal of Abbey Life (EEV basis)	(232)	743	511
As at 31 December 2007	**1,737**	**1,141**	**2,878**
Total (loss) profit after tax	**(823)**	**974**	**151**
Dividends	**–**	**(220)**	**(220)**
As at 31 December 2008	**914**	**1,895**	**2,809**

SUMMARY INCOME STATEMENT ON AN EEV BASIS – CONTINUING BUSINESSES

	2008 £m	2007 £m
New business profit	**295**	326
Existing business profit		
– Expected return	**321**	296
– Experience variances	**52**	41
– Assumption changes	**4**	(32)
	377	305
Expected return on shareholders' net assets	**146**	187
Profit before tax, excluding volatility and other items*	**818**	818
Volatility	**(1,176)**	(287)
Other items*	**60**	58
Total (loss) profit before tax	**(298)**	589
Taxation	**85**	(29)
Impact of corporation tax rate change	**–**	122
Total (loss) profit after tax – continuing businesses	**(213)**	682

*Other items represent amounts not considered attributable to the underlying performance of the business.

BREAKDOWN OF INCOME STATEMENT BETWEEN LIFE AND PENSIONS, AND OEICs – CONTINUING BUSINESSES

	Life and pensions £m	OEICs £m	Total £m
2008			
New business profit	**258**	**37**	**295**
Existing business			
– Expected return	**254**	**67**	**321**
– Experience variances	**40**	**12**	**52**
– Assumption changes	**(48)**	**52**	**4**
	246	**131**	**377**
Expected return on shareholders' net assets	**138**	**8**	**146**
Profit before tax*	**642**	**176**	**818**
New business margin (PVNBP)	**3.6%**	**1.3%**	**2.9%**
Post-tax return on embedded value*			**11.4%**
2007			
New business profit	270	56	326
Existing business			
– Expected return	245	51	296
– Experience variances	(2)	43	41
– Assumption changes	(92)	60	(32)
	151	154	305
Expected return on shareholders' net assets	179	8	187
Profit before tax*	600	218	818
New business margin (PVNBP)	3.5%	2.0%	3.1%
Post-tax return on embedded value*			10.7%

*Excluding volatility and other items.

DIVISIONAL RESULTS continued
INSURANCE AND INVESTMENTS continued

ECONOMIC ASSUMPTIONS

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

The valuation of the Group's annuity business has been affected by the recent upheaval in the capital markets which has caused a significant widening in corporate bond spreads. Based on available market analysis, an element of this widening in corporate bond spreads has been assessed as arising from an increase in the illiquidity premium. As a result, in 2008 the value of the in-force business asset for annuity business has been calculated after taking into account an estimate of the market premium for illiquidity derived using a portfolio of investment grade bonds with similar cash flow characteristics as the annuity liabilities.

For 2008, the risk-free rate assumed in valuing the non-annuity in-force business is the 15 year UK gilt yield. The risk free rate assumed in valuing the in-force asset for the annuity business is presented as a single risk-free rate to allow easier comparison to the rate used for other business. That single risk-free rate has been derived to give the equivalent value to the annuity book, had that book been valued using the UK gilt yield curve increased to reflect the illiquidity premium described above. The risk-free rate used in valuing financial options and guarantees is defined as the spot yield derived from the UK gilt yield curve, in line with Scottish Widows' FSA realistic balance sheet assumptions. The table below shows the range of resulting yields and other key assumptions.

	31 December 2008 %	31 December 2007 %
Risk-free rate (value of in-force non-annuity business)	**3.74**	4.65
Risk-free rate (value of in-force annuity business)	**5.22**	4.65
Risk-free rate (financial options and guarantees)	**1.11 to 4.24**	4.28 to 4.81
Retail price inflation	**2.75**	3.28
Expense inflation	**3.50**	4.18

NON-ECONOMIC ASSUMPTIONS

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

For OEIC business, recent lapse assumption experience has been collected over a period that has predominantly coincided with favourable investment conditions. Management have used a best estimate of the long-term lapse assumption which is higher than indicated by this experience. In management's view, the approach and lapse assumption are both reasonable.

NON-MARKET RISK

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

SENSITIVITY ANALYSIS

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

	Impact on EEV £m	Impact on new business profit before tax £m
2008 EEV/new business profit before tax		
100 basis points reduction in risk-free rate[1]	186	6
10 per cent reduction in market values of equity assets[2]	(170)	n/a
10 per cent reduction in market values of property assets[3]	(25)	n/a
10 per cent reduction in expenses[4]	84	31
10 per cent reduction in lapses[5]	70	17
5 per cent reduction in annuitant mortality[6]	(56)	(2)
5 per cent reduction in mortality and morbidity (excluding annuitants)[7]	23	4
100 basis points increase in equity and property returns[8]	nil	nil
25 basis points increase in corporate bond spreads[9]	(59)	(4)
25 basis points decrease in illiquidity premium[10]	(97)	n/a

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

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

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

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

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

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

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

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

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

[10] This sensitivity shows the impact of a 25 basis point reduction in the allowance for illiquidity premia. It assumes that the overall corporate bond spreads are unchanged and hence market values are unchanged. Government bond yields and the risk-free rate are both assumed to be unchanged.

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

GENERAL INSURANCE

Profit before tax from our general insurance operations increased by £124 million, to £234 million, reflecting a £109 million reduction in claims due to the absence of the severe weather related claims experienced in 2007 and the continued benefits from ongoing investment in our claims processes.

Net operating income increased by £22 million, reflecting good increases in new and renewal home insurance premium income. New business premium income increased by nine per cent and continued investment in our pricing and business retention capabilities delivered four per cent growth in renewal earned premiums.

	2008 £m	2007† £m	Change %
Home insurance			
Underwriting income (net of reinsurance)	**441**	418	6
Commission receivable	**50**	50	
Commission payable	**(78)**	(77)	(1)
	413	391	6
Creditor insurance			
Underwriting income (net of reinsurance)	**163**	164	(1)
Commission receivable	**428**	510	(16)
Commission payable	**(494)**	(574)	14
	97	100	(3)
Other			
Underwriting income (net of reinsurance)	**8**	9	(11)
Commission receivable	**71**	88	(19)
Commission payable	**(33)**	(41)	20
Other	**32**	19	68
	78	75	4
Net operating income	**588**	566	4
Claims paid on insurance contracts (net of reinsurance)	**(193)**	(302)	36
Operating income, net of claims	**395**	264	50
Operating expenses	**(161)**	(154)	(5)
Profit before tax	**234**	110	113
Claims ratio	**30%**	49%	
Combined ratio	**76%**	93%	

† Restated, see page 17. Within the above analysis, profit share receivable has been allocated across product groups, whereas it was previously allocated to other. Comparative figures have been restated accordingly.

Claims were £109 million lower, principally reflecting the absence of severe weather related claims experienced last year, which more than offset an increase of £15 million in payment protection insurance unemployment claims. Adjusting for the severe weather related claims, the claims ratio improved from 31 per cent to 30 per cent, reflecting continued benefits from ongoing investment in our claims processes and further efficiencies from improved process management.

General Insurance continues to make good progress against its key strategic initiatives:

GROWING SHARE IN OUR CHOSEN CUSTOMER SEGMENTS

Growth in total home insurance sales developed good momentum during 2008, with sales through the branch network increasing by nine per cent, supported by a positive customer reaction to our 5 Star Defaqto Rated home insurance product and strong claims service proposition.

DEVELOPING KEY INSURANCE PARTNERSHIPS

General Insurance continues to invest in the development of its Corporate Partnership distribution arrangements. New partnerships with Resolution Life, Reader's Digest, Budget and Post Office Financial Services are expected to underpin further profit delivery over future years.

IMPROVING EFFICIENCY AND SERVICE

Investment in our claims processes continues to deliver improved service and efficiency, with a reduction in property claims ratios and recognition of our customer service teams at the European Call Centre Awards.

An ongoing review of our advertising expenditure and the introduction of further improvements to the targeting of promotional activity have led to further efficiencies, and the cost per product sale improving by 13 per cent.

We have also continued to focus on making our key processes easier for our customers to use. For the second year in succession our website www.lloydstsbinsurance.co.uk has been ranked as the best home insurance website by worldwide benchmarking organisation, Global Reviews. In addition, in October 2008 Defaqto recognised LloydsTSBCompare.com as the best car insurance price comparison site.

DIVISIONAL RESULTS: WHOLESALE AND INTERNATIONAL BANKING

OUR BUSINESS

During 2008, our businesses within the Wholesale and International Banking arena covered a broad scope, serving thousands of customers, ranging from start-ups and small enterprises to large organisations and global corporations.

Combining the respective strengths of some 3,000 people in Corporate Banking and Products & Markets, Corporate Markets plays an integral role in leveraging and expanding the customer franchise and building deep, long-lasting relationships with around 26,000 corporate customers and was awarded jointly with Commercial Banking the 'Real Finance/CBI FDs' Excellence Awards - Bank of the Year' for the fourth year running.

Commercial Banking is a growing business with some 6,000 people serving nearly one million customers across the UK from one-person start-ups to large, established enterprises. Lloyds TSB has increased its lending to SMEs by nearly 20 per cent in 2008.

We also participate in specialist markets with a range of solutions including personal and international expatriate and private banking, motor and leisure finance and auto leasing.

Following the acquisition of HBOS, the Wholesale and International Banking division has been renamed 'Wholesale'. The Group's international businesses, with the exception of corporate in North America (including Canada), will form part of the new Wealth and International division.

The new 'Wholesale' division operates a multi brand strategy primarily through the Lloyds TSB and Bank of Scotland brands but also trades through a number of more specialist brands including Lloyds TSB Development Capital and Black Horse.

KEY HIGHLIGHTS

Resilient profit performance despite the turbulence in global financial markets. The division remained profitable even after absorbing the increased impact of its exposure to assets affected by current capital markets uncertainties and a significant rise in corporate impairments. The impact of recent market dislocation, however, has been to reduce profit before tax in 2008 by £1,270 million (2007: £280 million), to £274 million.

Continued strong relationship banking momentum. Excluding the impact of market dislocation, profit before tax decreased by two per cent, to £1,544 million, reflecting good levels of core business momentum which were offset by a significant increase in corporate impairment levels reflecting the challenging economic environment and additional write-offs relating to a number of high profile financial services company collapses.

Strong progress in expanding our Corporate Markets franchise, with a 34 per cent increase in Corporate Markets income, excluding market dislocation, supported by an 85 per cent increase in cross-selling income. This was largely offset however by the significant rise in impairments.

Good franchise growth in Commercial Banking, with a further increase in our market share of higher value customers, supporting a seven per cent growth in income, which was partially offset by an £89 million increase in impairments.

Significant lending growth, as our Corporate Markets and Commercial Banking businesses continued to provide substantial support to our mid-corporate market and SME customers.

Our risk management remains strong with satisfactory asset quality, despite a rise of £936 million in impairment losses, largely as a result of the £253 million year-on-year impact of market dislocation, a number of high profile financial services company collapses and an increase in the level of impairments reflecting the economic slowdown in the UK.

DIVISIONAL PERFORMANCE

Continuing businesses

	2008 £m	2007† £m	Change %
Net interest income	3,303	2,380	39
Other income	829	1,644	(50)
Total income	4,132	4,024	3
Operating expenses	(2,350)	(2,152)	(9)
Trading surplus	1,782	1,872	(5)
Impairment	(1,508)	(572)	
Profit before tax	274	1,300	(79)
Cost:income ratio	56.9%	53.5%	
Cost:income ratio, excluding market dislocation	46.5%	51.1%	
Post-tax return on average risk-weighted assets	0.16%	1.14%	
	31 December 2008 £bn	31 December 2007 £bn	Change %
Total assets	238.8	163.3	46
Risk-weighted assets	115.7	92.8	25
Customer deposits	82.9	72.3	15

† Restated, see page 17.

OUR STRATEGY

The acquisition of the HBOS corporate and commercial customer base provides the new 'Wholesale' division with a significant and exciting opportunity to accelerate our relationship-led wholesale banking strategy.

Our strategic vision is to be recognised as the UK's leading, 'through the cycle', wholesale bank. As a relationship bank, we place our customers at the forefront of this vision and we strive to understand and meet their needs whilst maintaining satisfactory asset quality.

The way we manage our customer relationships is the vital ingredient which differentiates us from our competition.

Making 'Wholesale' a great place for our customers to bank remains our number one priority and we seek to achieve this by deepening and maintaining profitable customer relationships. Building insight into customer needs and providing them with a broad range of banking and capital markets solutions will enable us to become our customers' first choice so we prosper together.

KEY PERFORMANCE INDICATORS

PROFIT BEFORE TAX†*

(2%)

	£m
2006	1,640
2007	1,580
2008	**1,544**

GROWTH IN CROSS-SELLING INCOME

	%
2006	48
2007	42
2008	**85**

CORPORATE MARKETS PROFIT BEFORE TAX*

(1%)

	£m
2006	1,030
2007	1,010
2008	**1,002**

COMMERCIAL CUSTOMER LENDING BALANCES

20%

	£m
2006	14,943
2007	17,140
2008	**20,504**

INCOME AND COST GROWTH 2008†*

	%
Income	20
Costs	9

†The 2007 figures have been restated (see page 17). The 2006 figures are as originally published.
*Before impact of market dislocation.

CORPORATE BANK OF THE YEAR

Lloyds TSB (Commercial/Corporate Markets) won Bank of the Year for the fourth consecutive year, receiving great feedback for the quality of service and degree to which relationship managers understood the customers' business. (Real FD/CBI FDs' Excellence Awards, April 2008)

WINNER
THE FDs' EXCELLENCE AWARDS
2005 2006 2007 2008
Bank of the Year
Lloyds TSB

AWARDS FOR COMMERCIAL

Lloyds TSB (Commercial) won two awards in the 2008 National Association of Commercial Finance Brokers Awards, scooping Business Bank of the Year and Commercial Mortgage Provider of the Year. The winners were nominated by NACFB members in its annual survey. (December 2008)

NACFB 2008 AWARD WINNER

DIVISIONAL RESULTS continued
WHOLESALE AND INTERNATIONAL BANKING

In Wholesale and International Banking, the Group has continued to make progress in its strategy to develop the Group's strong corporate and small to medium business customer franchises, however the division has continued to be significantly affected by the impact of market dislocation and the increase in impairments relating to the deteriorating economic environment and a number of high profile financial services company collapses. In Corporate Markets, further good progress has been made in developing our relationship banking franchise supported by a strong cross-selling performance and in Commercial Banking, strong growth in business volumes, further customer franchise improvements and good progress in improving operational efficiency, were offset by the significant increase in impairment levels.

Overall, the division remained profitable, however profit before tax decreased by 79 per cent to £274 million, largely reflecting the £990 million reduction in profits, compared to last year, as a result of market dislocation. A strong revenue performance in our relationship banking businesses contributed to overall income growth, excluding the impact of market dislocation, of 20 per cent, driven by strong Corporate Markets and Commercial Banking income growth of 34 per cent and seven per cent respectively. This exceeded cost growth of nine per cent, which largely reflected further investment in building the Corporate Markets business, higher depreciation charges in Asset Finance and the impact of exchange rate movements. The cost:income ratio, excluding the impact of market dislocation, improved to 46.5 per cent, from 51.1 per cent last year.

The charge for impairment losses was £936 million higher at £1,508 million, as a result of an increase of £253 million in the impact of market dislocation, and a significant increase in the level of impairments reflecting the economic slowdown in the UK and the impact of a number of high profile financial services company collapses. Despite this increase in the impairment charge, we believe that we remain relatively well positioned to withstand the economic slowdown as a result of our prudent credit management policy over the last few years.

PROFIT BEFORE TAX BY BUSINESS UNIT

	2008 £m	2007† £m	Change %
Corporate Markets			
– Before impact of market dislocation	**1,002**	1,010	(1)
– Impact of market dislocation	**(1,270)**	(280)	
	(268)	730	
Commercial Banking	**454**	469	(3)
Asset Finance	**2**	39	(95)
International Banking	**149**	138	8
Other	**(63)**	(76)	
Profit before tax			
– Before market dislocation	**1,544**	1,580	(2)
– Market dislocation	**(1,270)**	(280)	
	274	1,300	(79)

† Restated, see page 17.

CORPORATE MARKETS

	2008 £m	2007† £m	Change %
Net interest income	**1,784**	982	82
Other income	**(316)**	620	
Total income	**1,468**	1,602	(8)
Operating expenses	**(691)**	(632)	(9)
Trading surplus	**777**	970	(20)
Impairment	**(1,045)**	(240)	
Profit before tax	**(268)**	730	

† Restated, see page 17.

In Corporate Markets, profit before tax fell by £998 million, compared to last year, reflecting a combination of the impact of market dislocation and a substantial increase in impairment charge. Excluding the impact of market dislocation, profit before tax decreased by £8 million. On this basis, income increased by 34 per cent, supported by strong growth in corporate lending and an 85 per cent increase in cross-selling income. This growth in cross-selling income has continued to be supported by the Group's ability to leverage its strong funding capabilities and obtain funding at market leading rates, which has enabled the Corporate Markets business to continue to grow during a difficult 2008. Throughout this period, Corporate Markets has continued to invest in building its product capabilities and has been fulfilling substantially increased customer demand for interest rate and currency derivative products. This has enabled the business to further deepen its customer relationships, with Corporate Banking the only UK bank lender to have a positive net promoter score (TNS survey) as well as being awarded with 'Real Finance/CBI FDs' Excellence Awards – Corporate Bank of the Year' for the fourth year running.

Operating expenses increased by nine per cent to £691 million, reflecting significant further investment in people to support the substantial business growth in our Corporate Markets relationship business. The substantial increase in the impairment charge reflects an increase in the level of impairments as a result of the economic slowdown in the UK, market dislocation and the impact of a number of high profile financial services company collapses during the second half of the year.

CREDIT MARKET POSITIONS IN CORPORATE MARKETS

The Group's high quality business model means that it has relatively limited exposure to assets affected by current capital markets uncertainties. The following table shows credit market positions in Corporate Markets, on both a gross and net basis.

CREDIT MARKET POSITIONS

	31 December 2008 Net exposure £m	31 December 2008 Gross exposure £m	2008 P&L impact £m	31 December 2007 Net exposure £m	31 December 2007 Gross exposure £m
Available-for-sale assets					
– ABS CDO	60	60	92	130	130
Loans and advances					
– ABS*	318	318	103	–	–
– ABS CDO**	128	128	–	–	–
– secondary loan trading*	310	310	15	–	–
– SIV capital notes	–	–	84	78	78
– SIV liquidity backup facilities	22	22	11	370	370
– investment grade bank bonds*	2,566	2,566	9	–	–
Financial instruments held at fair value through profit or loss					
– ABS					
– trading book*	–	–	97	474	474
– monoline hedged**	–	–	275	–	470
– major global bank cash collateralised	–	1,867	–	–	1,861
– secondary loan trading*	–	–	40	665	863
– other***	1,279	1,533	544	3,895	3,895
Market dislocation			1,270		

* Items reclassified from trading to loans and advances on 1 July 2008 in accordance with amendment to IAS 39.

** Restructured ABS CDO removing monoline wrap and recorded within loans and advances.

*** £2,265 million exposure was reclassified to loans and advances on 1 July 2008 in accordance with amendment to IAS 39.

COMMERCIAL BANKING

	2008 £m	2007† £m	Change %
Net interest income	968	908	7
Other income	463	429	8
Total income	1,431	1,337	7
Operating expenses	(789)	(769)	(3)
Trading surplus	642	568	13
Impairment	(188)	(99)	(90)
Profit before tax	454	469	(3)

† Restated, see page 17.

Profit before tax in Commercial Banking fell by £15 million, or three per cent, as strong growth in business volumes, growth in the Commercial Banking customer franchise and further improvements in operational efficiency and effectiveness, were more than offset by an £89 million increase in the impairment charge, primarily reflecting the impact of recent deterioration in the UK economy. Income increased by seven per cent to £1,431 million, reflecting disciplined growth in lending and deposit balances, and an increased focus on the more valuable higher turnover customer relationships which have substantially greater product needs. During 2008, Commercial Banking has continued to extend lending support throughout its customer franchise and, as a result, the Group's lending to SME customers increased by 20 per cent to £20.5 billion. Over the last 12 months, the Group has increased its market share of high value customers in the £0.5 to £2 million turnover range by 2 percentage points to 18 per cent, as a result of continuing to make good progress in attracting customers 'switching' from other financial services providers.

Costs were three per cent higher. Cost management remains a priority and the business is now starting to capture significant benefits from recent investments in improved IT infrastructure, allowing further improvement in relationship manager productivity. Asset quality in the Commercial Banking portfolios has remained satisfactory with 90 per cent of the portfolio supported by security, however the impairment charge rose by £89 million partly reflecting the impact of recent deterioration in the UK economy. The impairment charge as a percentage of average lending remained below one per cent in 2008.

ASSET FINANCE

	2008 £m	2007† £m	Change %
Net interest income	305	283	8
Other income	463	423	9
Total income	768	706	9
Operating expenses	(496)	(439)	(13)
Trading surplus	272	267	2
Impairment	(270)	(228)	(18)
Profit before tax	2	39	(95)

† Restated, see page 17.

Profit before tax in Asset Finance decreased by 95 per cent to £2 million reflecting the significant combined impacts of higher impairments and lower residual values in response to the deteriorating economic conditions. Income increased by £62 million, or nine per cent, as a result of continued margin improvement across the Black Horse consumer businesses and growth in Autolease, our contract hire fleet business. Costs increased by £57 million, or 13 per cent, largely reflecting the impact of higher operating lease depreciation on the enlarged Contract Hire Fleet and exceptional residual value losses, but were otherwise flat year-on-year reflecting tight cost management and discipline. The impairment charge increased by £42 million to £270 million reflecting the impact of the economic slowdown in the UK.

INTERNATIONAL BANKING

	2008 £m	2007† £m	Change %
Net interest income	245	201	22
Other income	201	179	12
Total income	446	380	17
Operating expenses	(291)	(244)	(19)
Trading surplus	155	136	14
Impairment	(6)	2	
Profit before tax	149	138	8

† Restated, see page 17.

Profit before tax in International Banking grew by eight per cent to £149 million reflecting strong income growth from meeting the needs of our customers, as the Group has increased its focus on growing its customer franchise in the increasingly global mobile affluent and high net worth wealth management market. Total income grew to £446 million, up 17 per cent (10 per cent excluding the impact of exchange rate movements), reflecting strong customer franchise growth, improved lending volumes at increased margins and strong growth in customer deposits. Costs increased by 19 per cent (nine per cent excluding the impact of exchange rate movements) reflecting increased investment in our target Private Banking and Expatriate Banking markets, and the trading surplus increased by 14 per cent.

CENTRAL GROUP ITEMS

The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly those disabled and disadvantaged, to play a fuller role in society. The Foundations receive 1 per cent of Lloyds Banking Group's pre-tax profit after adjusting for gains and losses on the disposal of businesses and pre-tax minority interests, averaged over three years, instead of a dividend on their shareholdings. In 2008, £27 million was accrued for payment to registered charities.

	2008 £m	2007 £m
Income	(492)	(6)
Operating expenses	(30)	(6)
Impairment	(30)	–
Loss before tax	(552)	(12)

In the year ended 31 December 2008, the contribution from Central group items was a negative £552 million compared to a negative contribution of £12 million in 2007. The result in 2008 has been significantly affected by the impact of yield curve volatility on the fair value of derivatives entered into for risk management purposes after taking into account the effect of hedge accounting adjustments. In addition, there were increased central costs that were not recharged to the divisions in connection with professional advice received during the year and an impairment charge in respect of an available-for-sale investment.

VOLATILITY

INSURANCE VOLATILITY

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

Changes in market variables also affect the realistic valuation of the guarantees and options embedded within products written in the Scottish Widows With Profits Fund, the value of the in-force business and the value of shareholders' funds. Fluctuations in these values caused by changes in market variables, including corporate bond spreads, are also included within insurance volatility.

The valuation of the Group's annuity business has been affected by the recent upheaval in the capital markets which has caused a significant widening in corporate bond spreads. Based on available market analysis, an element of this widening in corporate bond spreads has been assessed as arising from an increase in the illiquidity premium. Annuity contracts cannot be surrendered and have reasonably certain cashflows best matched by assets of equivalent maturity with similar liquidity characteristics. As a result, in 2008 the value of in-force business for the annuity business has been calculated after taking into account an estimate of 154 basis points for the market premium for illiquidity, which has been derived using a portfolio of investment grade bonds with similar cash flow characteristics as the annuity liabilities. The effect of this has been to increase the value of in-force business by £842 million as at 31 December 2008 with a similar increase in profit before tax. This amount is reported within volatility and does not therefore impact profit before tax on a continuing business basis.

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

	2009 %	2008 %	2007 %
Gilt yields (gross)	3.74	4.55	4.62
Equity returns (gross)	6.74	7.55	7.62
Dividend yield	3.00	3.00	3.00
Property return (gross)	6.74	7.55	7.62
Corporate bonds in unit linked and With Profit funds (gross)	4.34	5.15	5.22
Fixed interest investments backing annuity liabilities (gross)	5.87	5.56	5.09

During 2008, profit before tax included negative insurance volatility of £746 million, being a credit of £9 million to net interest income and a charge of £755 million to other income (2007: negative volatility of £277 million, being a credit of £7 million to net interest income and a charge of £284 million to other income).

This charge mainly reflects the significant falls in global equities markets during the year, which resulted in total returns some 33 percentage points lower than expected. These lower than expected returns reduced the value of in-force business held on the balance sheet. The impact of the widening corporate bond credit spreads more than offset the inclusion of an allowance for the illiquidity premium referred to above, and resulted in a net reduction in the value of the annuity portfolio. Lower equities and bond prices also affected the valuation of the Group's investments held within the funds attributable to the shareholder; there was no exposure to assets held at fair value through profit or loss valued using unobservable market inputs.

POLICYHOLDER INTERESTS VOLATILITY

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

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

During 2008, profit before tax included negative policyholder interests volatility of £471 million, being a charge to other income (2007: negative volatility of £222 million, being a charge to other income). In 2008, substantial policyholder tax losses have been generated as a result of a fall in property, bond and equity values. These losses reduce future policyholder tax liabilities and have led to a policyholder tax credit during the year.

REGULATION

In the UK and elsewhere, there is continuing political and regulatory scrutiny of financial services. The Competition Commission launched an investigation into the supply of Payment Protection Insurance (PPI) services (except store card PPI) to non-business customers in the UK. Various members of the Group underwrite PPI, while other members of the Group distribute PPI, by offering it for sale with various of the credit products which they supply. On 5 June 2008, the Competition Commission issued its provisional findings, to the effect that there are market features which prevent, restrict or distort competition in the supply of PPI to non-business customers, with an adverse effect on competition and with resulting detriments to consumers. Following consultation, the Commission published its final report on 29 January 2009 setting out its remedies. The remedies include a prohibition on the sale of PPI within seven days of the distributor's sale of credit, although the customer may initiate this after 24 hours, and a prohibition on a single premium product, together with wide information and reporting requirements. The Commission expects that the measures will come into force during 2010 (information remedies in April 2010 and other measures by October 2010). The adoption of statutory orders implementing the remedies could have a significant adverse impact on the level of sales and thus the revenue generation and profitability of the payment protection insurance products which the Group offers its customers. The ultimate impact will be determined by a number of factors including the extent to which it is able to mitigate the potentially adverse effects of such statutory changes through restructuring the payment protection products it offers its customers and developing alternative products or revenue streams. On 12 December 2008 the Group announced its commercial decision to sell only regular monthly premium PPI to its personal loan customers from January 2009.

On 1 July 2008, the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the Financial Services Authority (FSA) as an issue of wider implication. The Group and other industry members and trade associations have made submissions to the FSA regarding this referral. The matter was considered at the FSA Board meeting on 25 September 2008. The Group is working with industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints.

On 30 September 2008, the FSA published a statement arising from its ongoing thematic review of PPI sales. In the statement, which was directed at the industry generally, the FSA highlighted certain concerns and indicated that it was escalating its regulatory intervention and considering appropriate action to deal with ongoing non-compliant sales practices and to remedy non-compliant past sales. The FSA plans to publish an update on the third phase of the thematic work in the first quarter of 2009.

The UK Office of Fair Trading (OFT) is carrying out an investigation into certain current account charges which are also subject to a legal test case (see note 48). In addition, on 16 July 2008, the OFT published a market study report on personal current accounts. This was followed by a period of consultation until 31 October 2008, and the OFT is expected to release a summary of the responses received, and is aiming to publish a further report in 2009 which will contain recommendations for the banking industry.

The OFT is continuing its investigation into interchange fees set by card networks and paid to card issuers. This investigation is in parallel with the European Commission's own investigation into Visa cross-border interchange fees, the European Commission having issued its decision ordering MasterCard to set its cross-border interchange rate to zero by June 2008. This decision is now being appealed to the European Court of First Instance. Lloyds TSB Bank plc along with a number of other UK and European banks will intervene in the appeal supporting the MasterCard position.

At the same time the FSA, The Bank of England and Her Majesty's Treasury (HMT) are considering UK financial stability and depositor protection proposals. The Banking Act 2009 (the Act) came into force on 22 February 2009. The Act introduces a statutory objective of promoting financial stability for the Bank of England, working with HMT and the FSA. The Act also introduces a special resolution regime (SRR) in advance of a potential bank insoivency, which consists of three stabilisation tools: (i) private sector transfer; (ii) transfer to a 'bridge bank' established by the Bank of England; and (iii) temporary public ownership (nationalisation).

In May 2008, the UK implemented the EU Unfair Commercial Practices Directive through the Consumer Protection from Unfair Trading Regulations. In addition, a number of EU directives, including the Payment Services Directive and Consumer Credit Directive are currently being implemented in the UK. The EU is also considering regulatory proposals for, *inter alia*, Mortgage Credit, Deposit Guarantee Schemes, expanding the Single European Payments Area, conducting a Retail Financial Services Review, including Financial Inclusion issues and reviewing capital adequacy requirements for insurance companies (Solvency II).

CORPORATE RESPONSIBILITY

SUPPORTING BUSINESS STRATEGY

Lloyds Banking Group's strategy focuses on building deep, long-lasting relationships with our customers in order to deliver high quality, sustainable results over time. We believe that corporate responsibility, built around the creation of colleague motivation, customer satisfaction and brand loyalty, has a major part to play in supporting our business strategy.

Against the backdrop of unprecedented market turbulence, our reputation for effective risk management is widely recognised. In 2008, Lloyds TSB was rated the sixth safest bank in the world by Global Finance and awarded the Reader's Digest readers' most trusted UK bank or building society for the eighth year running. Our commitment to corporate responsibility helps promote trust in the brand and reinforces customer loyalty and advocacy.

Lloyds Banking Group is rooted in local communities throughout the UK and we take our responsibilities to those communities very seriously. By investing in the communities where we operate we not only create economic value but we also make a positive social contribution. Through the Lloyds TSB Foundations, over £37 million was distributed to local charities in 2008.

Our corporate vision is to be recognised as the best financial services organisation by customers, colleagues and shareholders. Our corporate responsibility strategy is to support that vision by creating value for all our stakeholders through:

– increased colleague engagement;
– increased customer satisfaction;
– more effective risk management.

Our approach to embedding corporate responsibilty management over recent years has, we believe, helped us achieve competitive advantage.

All colleagues have a balanced scorecard of objectives that takes account of a range of business drivers rather than just pure financial measures.

2012 LOCAL HEROES

Local Heroes is Lloyds TSB's first initiative to deliver its London 2012 vision of inspiring and supporting young people, businesses and communities across Britain. The programme recognises young sporting talent and provides funding support as they start out on their journey in performance sport with optimism and determination. Identifying 250 emerging young sportspeople each year in the run up to 2012 and beyond, Lloyds TSB Local Heroes is being delivered in partnership with SportsAid, a registered charity.

MANAGING CORPORATE RESPONSIBILITY

The board reviews overall corporate responsibility performance annually and the chairman receives a quarterly progress report. Individual issues are subject to board consideration throughout the year. The chairman has board-level responsibility for corporate responsibility. Our corporate responsibility steering group is chaired by the Group human resources director and comprises senior executives from all business divisions and relevant Group functions. The steering group meets quarterly to recommend strategy and provide direction.

Overall, the board is satisfied that the systems in place to manage corporate responsibility risks are effective and that the relevant risks have been assessed during 2008 and managed in compliance with relevant policies and procedures.

For several years, we have adopted the European Foundation for Quality Management's Corporate Responsibility Framework to help us align corporate responsibility with business strategy and also with individual balanced scorecard priorities. As part of the process we have a network of senior managers across all business divisions, through whom we conduct an annual self-assessment of our performance with independent oversight and assurance. This allows us to identify strengths and areas for improvement and to prioritise objectives and actions. It also provides a benchmark against which we can compare our performance both internally and externally.

During 2008, Lloyds Banking Group has led a European Commission-sponsored working group along with a number of other major European businesses, business schools, consultancies and non-governmental organisations, in developing a framework for improved communication of non-financial performance between business and investors.

The framework mirrors the priorities developed in Lloyds Banking Group in recent years with an emphasis on colleagues, customers and innovation, community and suppliers, the environment and corporate governance. It is subject to consultation and final proposals will be published in the first half of 2009 but we intend using the framework as the basis of our 2008 corporate responsibility report.

OUR CUSTOMERS

We want to build a great organisation, which is recognised for operating to high standards and is built on strong customer relationships. We want to be the bank recommended most by customers and staff. We have put in place the essential building blocks; providing excellent customer service from well-trained staff; appropriate products that meet real needs; treating customers appropriately at all times; and following ethical business practices to build a sustainable, profitable business.

CUSTOMER SATISFACTION

For seven years, we have measured our customers' satisfaction with the service they receive using our CARE Index. After extensive research and consideration we have decided to move from CARE to a new advocacy programme to help us achieve our vision. We will monitor our progress using a Net Promoter Score, which measures the customers' likelihood of recommending Lloyds Banking Group to a friend or colleague.

During 2008, we have introduced a number of initiatives aimed at increasing customer advocacy. These include: better and more direct information to branch managers on their teams' performance; net promoter scores built in to reward and recognition criteria; the mapping of customer experience across a wide range of our activities; quality assurance programmes in telephone banking; and identification of the most critical impacts on customer perception.

Around 2,000 customers are contacted monthly and their view of the bank measured. The percentage of those with the highest scores are set against those with the lowest to give the net promoter score*. Over 2008, the average score increased by 10 points.

In a poll of finance directors across the UK, Lloyds TSB Corporate Banking was voted 'Bank of the Year' for the fourth year running at the Real Finance/Confederation of British Industry FDs' Excellence Awards, in recognition of our quality of service and understanding of our customers' businesses.

RESPONSIBLE LENDING

We are committed to being a responsible lender. It is in our interest to help customers borrow only those amounts they can afford to repay. We have a responsible lending programme with internal management reporting and accountability. This approach is reflected in our mortgage lending where we have maintained a significant share of net new mortgage lending, whilst continuing to focus on the prime mortgage market with a prudent average loan to value.

Our colleagues are trained to offer the necessary advice and support to help customers manage their borrowing. Over 1,500 customer advisers have been specifically trained over the last year to counsel customers with concerns about their financial circumstances. We actively look at our customers' account behaviour and proactively contact those that show signs of pressure on their finances. We can then help them to find an appropriate solution through more effective budgeting or rescheduling their borrowing. We have a customer support unit that can deliver more intensive help and we also support independent money advice networks including the Money Advice Trust and Consumer Credit Counselling Service. Payments totalling more than £3.4 million were made in 2008.

COMBATING FINANCIAL CRIME

We take protecting our customers and their assets extremely seriously and continue to invest in activities to deter, detect and prevent fraud. These include transaction monitoring tools to identify suspicious account activity and procedures to verify customer transactions.

We also work to ensure our customers are aware of how to protect themselves including dedicating a section of our website to information on common internet fraud types, an annual fraud awareness campaign, support of industry education initiatives and through our sponsorship of the charity Crimestoppers.

PROMOTING FINANCIAL INCLUSION

Our share of customers belonging to the lowest income groups is higher than our normal market share, reflecting our commitment to greater financial inclusion. By the end of 2008, nearly 540,000 Cash Accounts have been opened for those customers who prefer a basic bank account or who do not meet our standard account opening criteria but are not undischarged bankrupts. We now also offer an added value account with enhanced customer features for customers prepared to pay a modest fee while retaining the simplicity of a basic bank account.

We have also been at the forefront of developing alternative forms of financial provision and support for those communities where mainstream financial services have traditionally been considered inappropriate or inaccessible. We have one of the largest UK high street networks and, through our partnership with the Post Office, our personal customers can access their banking through more than 12,500 local post offices.

We support community finance initiatives and loan and venture capital funds which offer funding to individuals and businesses in some of the most deprived areas in the UK. Lloyds Banking Group has currently committed £12 million to the community finance sector. Our Public and Community Sector team within Corporate Banking is one of the largest funders of the UK social housing sector with £8 billion committed in 2008.

Lloyds Banking Group welcomes and fully supports the FSA's initiatives to increase financial capability in the UK. We have seconded a senior executive to develop, launch and manage the financial capability in the workplace project, to deliver the parents' guide to money initiative and help develop the operational delivery capability within the FSA programmes. These two initiatives have provided educational material and training to over three million adults throughout the UK. Feedback from all parties has been very encouraging and these initiatives are helping to improve financial capability.

SMALL BUSINESS

Lloyds TSB Bank has nearly 600,000 small business customers. They are an important part of our business and we are committed in supporting them in current economic conditions while seeking opportunities to grow our position in the market. Total lending to small businesses increased by 20 per cent over 2008.

In November 2008, we issued a six-point charter of commitments to small business customers which promises that: future reductions in base rates over 2009 will be passed on in full; there will be no change in price or availability of overdrafts for customers operating within agreed terms; reasonable requests for short term finance will be agreed; overdraft limits or prices will only change if there is a material change in the customer's risk profile; lending rates will continue to be linked to base rate; and we will provide expert guidance and support for small firms.

A series of 120 advice seminars with Lloyds Banking Group specialists and independent experts, providing practical advice and support will take place around the UK in 2009. These will help forge closer relationships between our business customers and accountants and business support agencies. The Group also extended the opportunity for customers without adequate capital to borrow under the Government's Small Firms Loans Guarantee Scheme.

* See chart on page 11.

PARTNERSHIPS

Continuing to grow a successful business is the best way for Lloyds Banking Group to create value for all its stakeholders. As a major employer, finance provider and purchaser of goods and services we are an important contributor to both national and local economies.

THE COMMUNITY

In addition to our financial contribution, we recognise that it is in our long-term interest to help improve the social and commercial fabric of local communities where we operate. That is why we have one of the largest community investment programmes in the UK.

LLOYDS TSB FOUNDATIONS

The majority of Lloyds Banking Group's charitable giving is channelled through the four Lloyds TSB Foundations, which cover England and Wales, Scotland, Northern Ireland and the Channel Islands. Their mission is to improve the lives of disadvantaged people in local communities.

Through their shareholding in Lloyds Banking Group, the Lloyds TSB Foundations together received £37.1 million to support their work in 2008, bringing the total contributions since 1997 to over £360 million, making Lloyds Banking Group one of the largest charitable donors in the UK.

The Foundations recognise that their success as community and local funders depends on maintaining a presence in and actively engaging with communities. The England and Wales Foundation, for example, remains one of the few grant-makers with a significant regional presence and its regional structure enables the Foundation to respond directly and effectively to local needs.

The England and Wales Foundation has a particular focus on supporting charities that improve social and community involvement, improve life choices and chances and help disadvantaged people to be heard. In 2008, funding focused on areas of geographical deprivation and the needs of both individuals and multiple communities. Where possible, the Foundation used its size and presence to facilitate the voice of smaller groups within their local, regional and national networks.

The main grants programmes are designed to address essential community needs and in particular, to support small under-funded charities. 35 per cent of the charities supported by the England and Wales Foundation in 2008 had a total income of £100,000 or less and over 90 per cent had an income of £500,000 or less.

COLLEAGUE VOLUNTEERING AND FUNDRAISING

In addition to the Foundations' support for local community causes, thousands of our colleagues volunteer to help in their communities, raise funds for the Group's Charity of the Year or make direct donations to charity using the UK's Give As You Earn system. In 2008, the Foundations provided matched funding for nearly 41,000 hours of time volunteered by Lloyds Banking Group colleagues in the community and also matched over £937,000 funds raised by colleagues for charities.

Our Charity of the Year relationship with Barnardo's was extended to 18 months and ended on 30 June 2008. Over £1.8 million was raised for the Lloyds TSB and Barnardo's 'Securing Futures' partnership far exceeding the £1 million target. The money raised will provide thousands of vocational training and education places for some of the most vulnerable and disadvantaged young people across the UK to help them have a better start in life and a brighter future.

Our new Charity of the Year is the British Heart Foundation, the overwhelming choice among the thousands of staff who voted to choose their charity of the year. Recognising the value of longer-term relationships, we have extended our partnership with the British Heart Foundation to two years. We aim to raise at least £2 million to fund the appointment of 15 specialist heart nurses across the UK.

OUR LONDON 2012 PARTNERSHIP IN THE COMMUNITY

As the first Partner of the London 2012 Olympic Games and Paralympic Games, we are delighted at the record breaking successes of Team GB and Paralympics GB in Beijing. Our Partnership however, is not just about focusing on elite sport, and the action that will take place for 17 days in 2012.

Research amongst staff and customers showed a real interest in supporting young athletes in their local community and helping them share in the excitement of Britain's journey to 2012. Thus, the vision for our Partnership was created, to inspire and support young people, communities and businesses all over Britain on their journey to London 2012 and beyond.

For every Olympic or Paralympic medallist, there are thousands of genuine hopefuls without recognition or funding. Lloyds TSB Local Heroes has been set up to help more of those young hopefuls when they need it most.

There are currently 250 Local Heroes, representing aspiring Olympians and Paralympians from all walks of life, from all sporting disciplines, from all over Great Britain. The funding we provide helps them on their journey in a variety of ways, from travel costs and new equipment, to competition entry fees and nutritional support.

OUR SUPPLIERS

Our suppliers are important to us and we want to ensure that we treat them fairly and pay them on time. Our supplier relationships are governed by a strict Code of Purchasing Ethics that defines the way we do business. We have been working throughout 2008 to update our long-established supplier review process that allows us to consider our suppliers' social, ethical and environmental performance as part of the tendering process.

We have also been working with a number of other financial services companies to develop an industry wide corporate responsibility questionnaire which is available on-line and benefits suppliers who only have to complete one questionnaire for all participating financial services companies, as well as benefiting Lloyds Banking Group by providing comparable information across different suppliers.

PAYMENT OF SUPPLIERS

	2008	2007	2006	2005
Number of payments	**335,713**	320,579	344,422	379,613
Value (£bn)	**2.67**	2.20	2.29	2.16
Average time to pay (days)	**26.03**	28.78	29.72	27.01
Number/amount of compensation payments for late settlement	**No payments**	No payments	No payments	No payments

THE ENVIRONMENT

Lloyds Banking Group has a long-standing commitment to managing its environmental impacts. We first introduced an environmental policy in 1996 and followed this with an environmental management system that follows the ISO 14001 standard. We were also one of the first UK banks to develop an environmental risk assessment system for all our business lending. In 2007, we adopted the Equator Principles for project finance, a financial sector initiative aimed at improving the social and environmental impacts of major projects such as road building and power stations.

CLIMATE CHANGE

Climate change has been described by the UK Government as the greatest long-term challenge facing the world today. We recognise that businesses have a role to play in helping to address the risks of climate change. Measures to tackle climate change will have potential implications for regulation, taxation and public policy. As well as physical, financial and market risks posed by climate change, there are also significant potential opportunities.

While our direct carbon intensity is relatively low compared to other industry sectors, we still need to fully understand the potential financial impact of climate change on others that we may lend to or invest in, so that we can manage the risks and identify business opportunities.

In 2007, we set a stretching target to reduce our CO_2 emissions by 30 per cent by 2012 based on 2002 levels. We are very pleased to report that by the end of 2008 we have achieved a 31 per cent reduction in CO_2, meeting our target four years ahead of schedule. We identified specific projects and prioritised investment to deliver significant CO_2 reductions. We have also purchased renewable electricity and electricity from combined heat and power (CHP) sources, which have a lower carbon footprint than standard grid electricity.

During 2008, we have improved our systems for collecting car mileage information and energy consumption data. Using actual mileage and engine sizes rather than fleet averages gives a more accurate travel total. This, allied to a 40 per cent increase in teleconferencing to 422,000 meetings, has significantly reduced our travel related CO_2 emissions.

FUTURE ENVIRONMENTAL RISKS AND OPPORTUNITIES

We want to inspire Lloyds Banking Group colleagues to rise to the challenge of tackling climate change. We have put in place a structured communication programme including dedicated intranet site, regular staff magazine and news features, competitions and seminars. In 2008, we established a Group-wide sustainability network for colleagues at all levels to meet, share experiences and ideas and to help fulfil our commitment to reducing our environmental impact. Our staff have responded enthusiastically to our carbon reduction plans and are keen to help with their delivery.

Beyond managing our own immediate impact, Lloyds Banking Group can be part of the response to climate change by engaging customers and suppliers. Lloyds Banking Group provides finance to all sectors of industry and by understanding the risks and opportunities our customers face, we are better able to help them develop appropriate solutions.

Examples of initiatives we have taken include:

– leading the development of the smallbusinessjourney.com website to provide advice and guidance to small businesses on how they can reduce their environmental impact;

– provided guidance to vehicle fleet operators through Lloyds TSB Autolease to help them structure their fleet selection policies to promote more fuel-efficient vehicles; and,

– created an on-line guide to help customers taking out a car loan to select a model with lower CO_2 emissions.

GREENHOUSE GAS EMISSIONS

Tonnes CO_2	2008*	2007	2006	2002 Baseline
Property	**177,033**	180,526	181,086	198,950
Property renewable	**(19,037)**	(18,164)	(18,944)	n/a
Travel	**26,479**	30,474	29,705	26,333
Total	**184,475**	192,836	191,847	225,283
Combined heat and power	**(28,823)**	(31,635)	(30,945)	n/a
Net total	**155,652**	161,201	160,902	225,283

*In 2008 DEFRA introduced changes to the conversion factors to be used for calculating CO_2 emissions from energy consumption and travel. In addition, they introduced new guidelines for the treatment of 'renewable energy' in calculating total CO_2 emissions. The total CO_2 emissions reported above have been calculated using the old conversion factors to provide a more accurate like-for-like comparison against the baseline. Using the new guidelines, our total emissions for 2008 would increase to 245,385 tonnes. In 2009, a priority for Lloyds Banking Group will be to baseline our environmental impacts across the combined Group.

OUR PEOPLE

BUILDING LONG LASTING RELATIONSHIPS THROUGH PEOPLE

We are a business based on building strong and long lasting relationships through the efforts of our people. Colleagues are our most valuable resource. It is our colleagues who build long lasting relationships with our customers and, therefore, managing our colleagues effectively is fundamental to the success of the business and achieving our vision of being the best financial services organisation in the UK.

Creating a great place to work is a core priority to enable the Group to be recognised, both within the financial services sector, but also more generally in the UK employment market, as the best organisation to work for.

In creating a great place to work in this way, we believe we will attract the highest performing people to join us and secure the commitment of those who are the strongest performers and have the highest potential to stay.

We are building a high commitment, high performance organisation. We are clear about what we expect from our colleagues. Our values guide us in all our dealings with colleagues, customers and the wider community. In Lloyds Banking Group, our values are that we: take ownership; act wisely; make it simple; stretch ourselves; and succeed together.

COLLEAGUE ENGAGEMENT

We pride ourselves in our people and we commit to giving them the training and tools to develop themselves, and to develop the relationships they have with customers and colleagues throughout the Group. We believe that to create a high commitment, high performance organisation, we need to have high levels of colleague engagement. In order to do this, we listen to what our colleagues tell us and act on the results. The Group uses a comprehensive, confidential online engagement survey to help us to measure and assess current levels of colleague engagement across the organisation. Our Group Chief Executive personally agrees the content of our colleague engagement survey, demonstrating our commitment to and investment in understanding their views. Over the last three years, the overall engagement index has continued to rise and in 2008, the Group achieved a record response rate and an all-time high engagement index, which put us above both the financial services norm and the high performance norm for the UK. In addition, our approach to colleague engagement saw us recognised in The Sunday Times as 'One to Watch' within their annual Best Big Company survey and accreditation.

ENGAGEMENT INDEX*

	2008	2007	2006
Engagement index	**78.3**	75.3	74.5

*The engagement index is based on the result of a survey conducted quarterly, asking Lloyds TSB colleagues a series of questions which reflect both the drivers and outcome of engagement. The data captures the percentage of total responses received which were favourable for each question, combined into a simple average overall score. (See chart on page 11).

TALENT, RECRUITMENT AND RETENTION

Recruitment, retention and development of talented people continues to be one of the highest priorities for our leaders. Top performers are attracted to the Group because of our strong brand and values; together with top class development and career opportunities.

Developing our current colleagues and succession planning are vital in supporting our growth strategy. In Autumn 2008, an Organisational Capability Review was completed. As a result, we have strong succession and development plans for all our senior leaders across the Group and have collected qualitative data on our top 300 colleagues. We are retaining people for an average tenure across our business of 13 years.

We run a wide range of generalist and specialist development programmes to support career progression into management. In 2008, we recruited 125 people into our graduate trainee programme, offered 44 internships and 110 student placements. Following the launch of the new Graduate Programme for 2009, our focus is now on attracting top talent into the organisation who will become senior business leaders of the future. We have also introduced a 'customer facing' element to the main programme so that all our graduates gain core banking 'front-line' experience. We are consistently identified in The Times Top 100 organisations for graduate recruitment. We also ran numerous programmes across our more senior populations to develop our pipeline of leaders for the future.

We actively track and manage retention of our highest performers, retaining 96.7 per cent of top performers in 2008 (up from 96 per cent in 2007).

PERFORMANCE MANAGEMENT

Our business strategy is translated into the Group's balanced scorecard and this is aligned at each level of the organisation. This ensures colleagues understand how their personal objectives relate to the strategy and that their contribution is measured against a range of factors, including long term growth of the business; customer service; risk management and personal development, as well as financial success.

Through twice yearly formal reviews and feedback, all our people understand how their performance impacts on colleagues, customers and our overall business success. Together, these act as robust processes for differentiating high performance and addressing and managing underperformance.

REWARD AND RECOGNITION

Overall, we have taken a conservative approach to remuneration levels and we have differentiated reward for our high performing colleagues through a number of performance measures, including the management of risk and other balanced scorecard objectives.

For 2008 bonus awards, we have worked with the UKFI, (the body responsible for the government's shareholdings in UK banks) to undertake a review of our bonus arrangements. We are also undertaking an ongoing review for 2009.

Overall, through aligning reward to our balanced scorecard, our aim is to recognise performance against factors including how well our colleagues manage risk and therefore the long term health of the business. We have structured our reward arrangements with this in mind. We will continue to differentiate our reward for colleagues who fulfil our commitment to building relationships for the long-term.

TOTAL REWARD

We take a broader view on reward than financial benefits and our 2008 flexible benefits scheme enabled colleagues to select from a range of non-cash benefits including medical and life-assurance, additional pension, education vouchers, matched learning and childcare vouchers. In 2008, 68 per cent of colleagues participated in the scheme. In addition, in 2008, over 95 per cent of colleagues opted to participate in one of our various employee share plans. The vast majority of our colleagues are therefore shareholders and have a vested interest in our long term success.

During 2009, we will undertake a full review of our approach to total reward as part of the integration of Lloyds TSB and HBOS.

RECOGNITION

While our emphasis is on providing recognition through line management, we also formally recognise those who have exceeded expectations and pushed boundaries in areas such as colleague support, customer service and building community profile. One example of this is through our 'Making a Difference' awards, which in 2008 recognised the contribution of over 180 colleagues who made exceptional contributions to the business and the community last year.

LEARNING AND DEVELOPMENT

We remain committed to investing in the development of our colleagues so that they can deliver great customer service and results. Our learning and development focuses on the capability and skills needed for current roles as well as those we will need to be successful in the future.

Our line managers play a critical role in creating a positive learning environment, managing and supporting our colleagues to maximise development opportunities and embed learning to drive results. Developing and strengthening management capabilities remains a priority, along with personal learning plans built around the specific learning and future needs of our colleagues. Our business-focused learning programmes include critical business capabilities such as financial, risk and relationship management which enable us to support our customers effectively.

CORPORATE UNIVERSITY

We have one of the largest corporate universities in Europe, which delivers a range of business-focused learning programmes. In addition to internally developed content, the university continues to work with best-practice suppliers to develop and deliver learning. The availability of programmes carrying relevant external certification provides colleagues with performance benchmarks and portable qualifications. We also support a range of business focused and developmental professional qualifications.

A range of delivery media is used including highly successful on-line modules and face-to-face workshops to support skills development. In 2008 the university website, which is accessible from both the corporate intranet and Internet, received over 4.2 million visits (33 per cent increase on 2007) and over 780,000 on-line assessments were completed. The learning environment in our Group Learning Centre has also been upgraded to further enhance our ability to meet the changing development needs of our leaders and managers. We now deliver an average of 2.9 days formal learning per full time equivalent (FTE), an increase of 26 per cent on 2007.

TRAINING DAYS

	2008	2007	2006
Number of days formal learning per FTE	**2.9**	2.3	1.8

COMMUNICATIONS

The Group invests in a range of internal media, ensuring our colleagues are informed and involved. These include a company intranet, print publications, e-zines, audio and video. We have also recently introduced group-wide, monthly face-to-face communication briefings to all colleagues through their line managers.

EQUALITY AND DIVERSITY

Equality and diversity is not just about complying with equality legislation. We believe that it is vital for achieving competitive advantage. We need to be close to our customers and provide them with the right products and services. By attracting and retaining a diverse workforce, we will better understand the needs of all our customers and be able to build lasting relationships.

Over the last few years, we have been working to increase the number of women in management and senior management positions across the organisation. At the end of 2008, our group executive committee had one of the highest proportion of women for a FTSE 100 company, and 23.4 per cent of our senior managers were women.

We're also working to increase the representation of ethnic minorities in the workforce at every level. In 2008, Race for Opportunity* named us as top performer out of 85 organisations for our leading edge race programme. We became the first organisation in the campaign's history to be awarded Platinum status.

We continue to make significant progress with our disability and sexual orientation programmes. Our disability programme has been ranked first out of 116 organisations by the Employers' Forum on Disability and we maintained our sixth place ranking in Stonewall's† Index of the 100 best employers of lesbian, gay and bisexual people.

DIVERSITY

	2008	2007	2006
Women managers	**41.1%**	40.1%	38.5%
Women senior managers	**23.4%**	21.7%	20.9%
Ethnic minority managers††	**5.1%**	4.9%	4.3%
Ethnic minority senior managers††	**2.6%**	2.5%	1.9%
Disabled colleagues††	**1.9%**	2%	1.5%
Lesbian, gay and bisexual (LGB) colleagues††	**1.0%**	0.8%	0.2%

* Race for Opportunity (RfO) is a national business network of over 150 UK organisations from the private and public sectors working on race and diversity as a business imperative.

† Stonewall is a campaigning organisation that works to achieve equality and justice for lesbians, gay men and bisexual people.

†† Shows percentage of whole workforce although not all colleagues have supplied information on race, disability or sexual orientation.

WORK ENVIRONMENT

Our objective is to provide great facilities and a safe environment for colleagues and customers, in all our business locations.

Flexible working is increasingly important in the competitive workplace and we have created a balanced environment where we offer a multitude of flexible working practices including: reduced hours; variable hours; job sharing; compressed hours; term-time working and tele-working.

OUR APPROACH TO RISK

The Lloyds TSB approach to risk is founded on strong corporate governance practices whereby the board takes the lead in establishing the tone at the 'top' and approving professional standards and corporate values for itself, senior management and other colleagues. The board ensures that senior management implements strategic policies and procedures designed to promote professional behaviour and integrity. The board also ensures that senior management implements risk policies and risk appetites that prohibit and, where appropriate, limit activities, relationships, and situations, that might diminish the quality of corporate governance. All colleagues from the group chief executive down are assessed against a balanced scorecard that explicitly addresses their risk performance.

This board-level engagement, coupled with the direct involvement of senior management in group-wide risk issues at group executive committee level, ensures that issues are escalated on a timely basis and appropriate remediation plans are put in place. The interaction of the executive and non-executive governance structures relies upon a culture of transparency and openness that is encouraged by senior management. Key decisions are always taken by more than one person. Within Lloyds TSB there is a strong culture of command and control from the centre with short lines of communication between divisions and functions.

The group business risk committee and the group asset and liability committee are chaired by the group chief executive and include all members of the group executive committee. The aggregate groupwide risk profile and portfolio appetite are discussed at their respective monthly meetings. This is a key component of the Lloyds TSB approach to risk management and provides oversight on behalf of the board to line management in specific business areas and activities. It is supported by the chief risk officer being a full member of the group executive committee and reporting to the group chief executive with direct access to the chairman and the risk oversight committee.

Table 1.1 sets out the role of the second line of defence and in particular that of the risk oversight committee and its interaction with the chief risk officer, the group risk directors and the divisional risk officers. This structure which has been in place for a number of years, has evolved with the risk oversight committee reviewing regular reports on the Group's risk exposures as well as taking a keen interest in the adequacy and capability of resources within the risk functions.

Lloyds TSB has a conservative business model and risk culture. The focus has been and remains on building and maintaining long-term relationships with customers. This involves taking a 'through the cycle' view whereby the sustainability of a relationship through good and bad economic times is taken into account. The approach is supported by a 'through the cycle' approach to risk with strong central control and monitoring.

There is a matrix approach to risk management which includes group risk directors being responsible for individual risk types in aggregate across the Group and divisional risk officers being responsible for the aggregate risk profile within their respective divisions. The group risk directors and divisional risk officers all have a direct reporting line to the chief risk officer. This matrix approach enables the group executive committee members to fulfil their accountabilities for risk management and enables the chief risk officer to inform the risk oversight committee of the aggregate risk profile of the Group.

The paragraphs that follow set out the risk management policies, practices and structures that applied during the past year to Lloyds TSB Group plc. These policies, practices and structures were adopted by Lloyds Banking Group from the date of completion of the HBOS plc transaction.

RISK AS A STRATEGIC DIFFERENTIATOR

The Group seeks to optimise performance by allowing divisions and business units to operate within capital and risk parameters and the Group's policy framework. They must do so in a way which is consistent with realising the Group's strategy and meeting agreed business performance targets. The Group's approach to risk management seeks to ensure the business remains accountable for risk whilst also ensuring there is effective independent oversight.

The Group has continued to focus on enhancing its capabilities in providing both qualitative and quantitative data to the board on risks associated with strategic objectives and facilitating more informed and effective decision making. The Group's ability to take risks which are well understood and consistent with its strategy and plans, is a key driver of shareholder return.

The maintenance of a strong control framework remains a priority and is the foundation for the delivery of effective risk management. Risk analysis and reporting capabilities support the identification of opportunities as well as risks and provide an aggregate view of the overall risk portfolio. Risk mitigation strategies clearly aligned with responsibilities and timescales are monitored at group and divisional level. Risk continues to be a key component of routine management information reporting.

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

MARKET DISLOCATION

During 2008, the global dislocation in financial markets has resulted in exceptional instability and volatility impacting upon market and investor confidence which has been characterised by a marked reduction in liquidity. This crisis in the financial markets led the UK Government to inject liquidity into the financial system and to require (and participate in) recapitalisation of the banking sector to restore confidence to the market.

During October 2008, as part of the co-ordinated package of capital and funding measures for the UK banking sector, implemented by HM Treasury, the Group participated in the Government Funding Package and thereby facilitated access to the UK Government backed provision of liquidity.

There can be no assurance that the measures so far announced by the Government, will be sufficient to prevent any future strain on the Group's ability to meet its financial obligations as they fall due. The recovery of wholesale and capital markets will depend upon renewed confidence in the UK banking system particularly if market conditions revert to the reduced levels of wholesale market liquidity and the availability of traditional sources of funding become more limited.

The key dependencies on successfully funding the Group's balance sheet include the continued functioning of the money and capital markets at their current levels; the continued access of the Group to central bank and Government sponsored liquidity facilities, including issuance under HMT's credit guarantee scheme (CGS) and access to the Bank of England's various facilities; limited further deterioration in the Group's credit ratings; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or Government support schemes.

Based upon projections by management, which take into account the acquisition on the 16 January 2009 of HBOS plc, and assume the availability of the existing and announced Government Funding Package, the Group believes it has adequate resources to continue in business for the foreseeable future.

RESPONSES TO MARKET DISLOCATION AND BANKING CRISIS

During the market dislocation there has been even more rigorous focus on the governance, accountabilities and execution capabilities to ensure adherence to an even lower risk profile. It is part of the Lloyds TSB approach to learn from adverse situations – regardless of whether there has been any direct business impact. Accordingly, 'lessons learned' exercises form part of normal activity and have been carried out during this turbulent period. The Lloyds TSB risk culture has manifested itself in some clear and critical pre crunch wholesale and capital markets policy actions that served to limit exposure.

The Group has developed its credit, liquidity and market risk control frameworks. Particular focus has been placed on the control of credit spread risk, associated stress testing and modelling. The Group during the year has further strengthened its oversight of liquidity, funding, capital and asset liability management issues with the upgrading of membership of the group asset and liability committee. Membership consists of group executive committee members and the treasurer, and it is chaired by the chief executive. A senior asset and liability committee has been created to support the group asset and liability committee. There have also been a number of further developments to our liquidity control frameworks that have been instituted including further developments of stress testing. During the height of the crisis, daily meetings with the group chief executive were held to assess the Group's position which has held up well during the worst aspects of the market dislocation.

In respect of credit risk, Lloyds TSB has reduced exposure via timely exit or scaling back of positions. In wholesale and capital market exposure, the Group has restricted investment policy for the Lloyds TSB conduit 'Cancara' (for example: no CDOs of asset backed securities); restricted exposure to monolines and leveraged loans; reviewed liquidity risk appetite and enhanced liquidity reporting; reduced holdings of equities in the insurance companies; progressed its pension scheme de-risking strategy and tightened policy parameters for US sub-prime mortgages. Also, all exposures were sanctioned on the basis of Lloyds TSB being content to hold the risk to maturity. In retail banking, risk mitigation activities and a prudent lending stance were maintained in the context of the changing environment: tightening of maximum loan to value criteria on all mortgage books; withdrawal of higher risk mortgage products; tightening of credit card eligibility criteria and tightening of policy rules and scorecard cut offs across all retail portfolios.

Consistent with our 'through the cycle' approach, Lloyds TSB has a proactive and supportive approach to assist customers through difficult periods. We have also invested significantly in our highly successful collections and recoveries and business support units.

RISK GOVERNANCE STRUCTURES

The Group maintains a risk governance structure that is intended to strengthen risk evaluation and management, whilst also positioning the Group to manage the changing regulatory environment in an efficient and effective manner. This structure has been tried and tested by Lloyds TSB and will remain the same for Lloyds Banking Group. The risk governance structure for Lloyds TSB is shown in Table 1.1.

BOARD AND COMMITTEES

The board, assisted by its committees, the risk oversight committee, the group executive committee, and the group audit committee, approves the Group's overall risk management framework. The board also reviews the Group's aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board's appetite for risk. The role of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 70 to 72, and further key risk oversight roles are described below.

There is strong cross membership of non-executive directors between remuneration, audit and risk oversight committees.

The group executive committee, assisted by the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, whilst also reviewing the Group's aggregate risk exposures and concentrations of risk. The group executive committee's duties are described in greater detail on page 71. The group executive committee members are also members of the group business risk committee and the group asset and liability committee, both of which are chaired by the group chief executive. The group business risk committee is supported by the following:

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

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

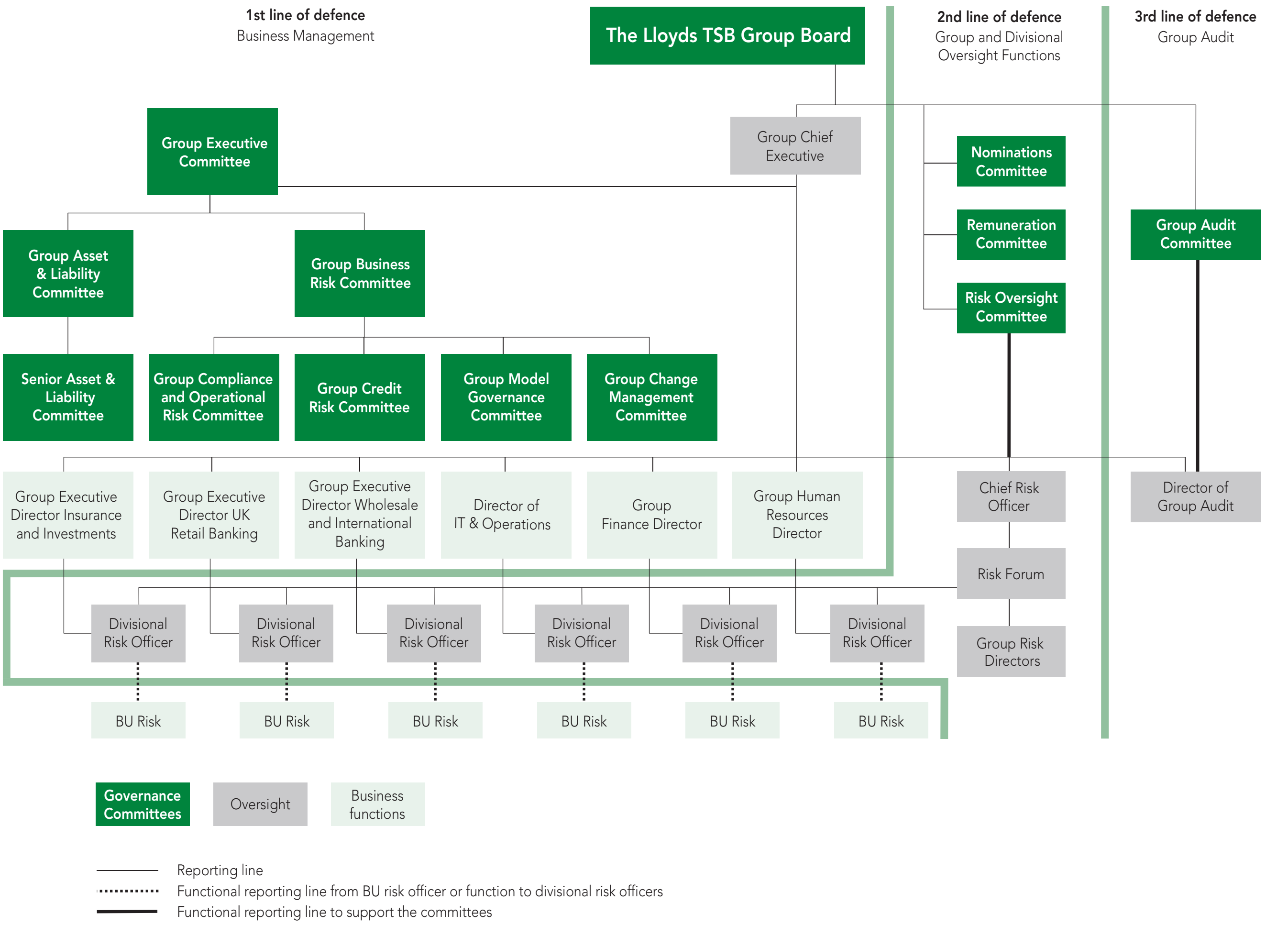
The **group model governance and approvals committee** is responsible for setting the control framework and standards for models across the Group, including establishing appropriate levels of delegated authority; the approval of models that are considered to be material to the Group (including credit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

The **group change management committee** is responsible for ensuring that the aggregate risks associated with the Group's project portfolio are identified, assessed and mitigated, thereby ensuring that the portfolio remains deliverable within an acceptable level of risk.

The **group asset and liability committee** is supported by the **senior asset and liability committee,** which is responsible for the review and escalation of issues of group level significance to the group asset and liability committee relating to 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.

Supporting the chief risk officer, the risk forum consists of the divisional risk officers and the group risk directors. The risk forum regularly reviews a summary of risks across the risk management spectrum to determine areas of focus for remedial action across the Group.

Table 1.1: RISK GOVERNANCE STRUCTURES



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

RISK MANAGEMENT OVERSIGHT

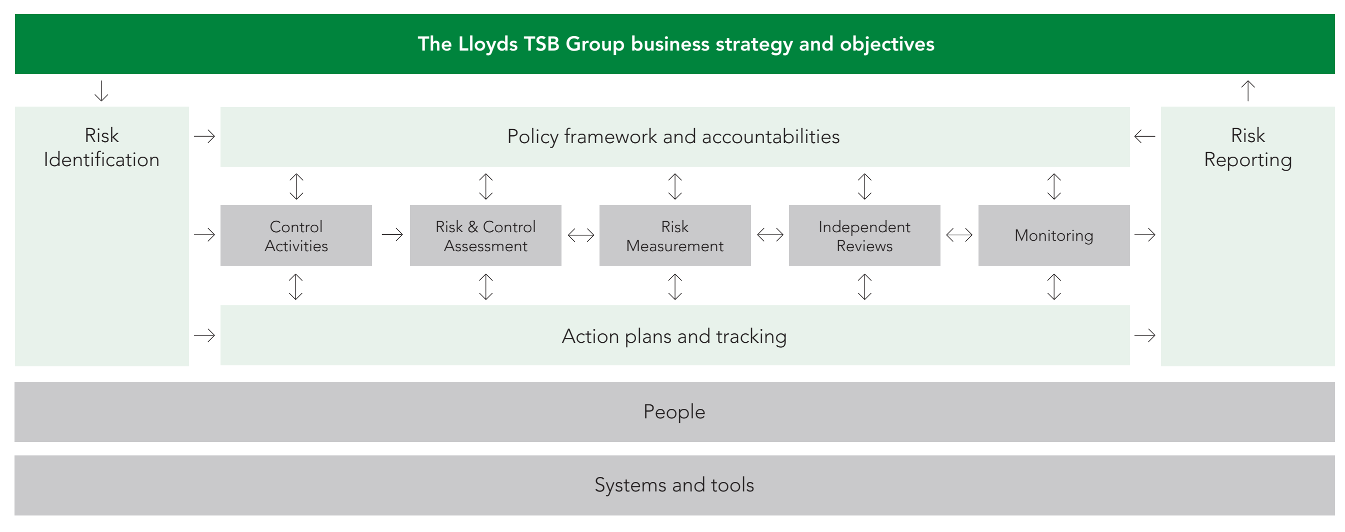
The chief risk officer, a member of the group executive committee and reporting directly to the group chief executive, oversees and promotes the development and implementation of a consistent group wide risk management framework. The chief risk officer, supported by the group risk department and the divisional risk officers, provides objective challenge to the Group's senior management. The chief risk officer also reports independently to the risk oversight committee (see page 72) that comprises non-executive directors and is chaired by the Group chairman.

Group risk directors are allocated responsibility for specific risk types and are responsible for ensuring the adequacy of risk resources as well as the oversight of the risk profile across the Group.

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

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

Table 1.2: RISK MANAGEMENT FRAMEWORK



BUSINESS RISK MANAGEMENT

Line management are directly accountable for the management of risks arising from the Group's business. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite. The senior executive team and the board receive regular briefings and guidance from the chief risk officer to ensure awareness of the overarching risk management framework and a clear understanding of their accountabilities for risk and internal control.

All business units, divisions and group functions complete a control self-assessment annually (described on page 73), reviewing the effectiveness of their internal controls and putting in place enhancements where appropriate. Managing directors and group executive directors certify the accuracy of their assessment.

Business risk management forms part of a tiered risk management model, as shown on page 44, with the divisional risk officers and group risk providing oversight and challenge, as described above, and the chief risk officer and group committees establishing the group-wide perspective.

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

RISK MANAGEMENT FRAMEWORK

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

The Group uses an enterprise-wide risk management framework for the identification, assessment, measurement and management of risk, designed to meet its customers' needs. It seeks to maximise value for shareholders over time by aligning risk management with the corporate strategy, assessing the impact of emerging risks from legislation, new technologies or the market, and developing risk tolerances and mitigating strategies. The framework seeks to strengthen the Group's ability to identify and assess risks; aggregate group wide risks and define the corporate risk appetite; develop solutions for reducing or transferring risk, where appropriate; and exploit risks to gain competitive advantage, thereby seeking to increase shareholder value. The principal elements of the risk management framework are shown in Table 1.2.

The risk management framework above comprises 10 interdependent activities which map to the components of the internal control-integrated framework issued by the committee of Sponsoring Organisations of the Treadway Commission (COSO).

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

The Lloyds TSB Group business strategy is used to determine the Group's high level risk principles and risk appetite measures and metrics for the primary risk drivers (see Table 1.3). A key focus has been to develop earnings volatility measures to complement existing capital measures for risk appetite. The risk appetite is proposed by the group chief executive and reviewed by various governance bodies including the group executive committee and the risk oversight committee. Responsibility for the approval of risk appetite rests with the board. The approved high level appetite and limits are delegated to individual group executive directors by the group chief executive.

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

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

Principles – high level principles for the six primary risk drivers

High level Group policy – policy for the main risk types aligned to the risk drivers

Detailed Group policy – detailed policy that applies across the Group

Divisional policy – local policy that specifically applies to a division

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

Table 1.3: RISK DRIVERS

Primary risk drivers	Business Risk	Credit Risk	Market Risk	Insurance Risk	Operational Risk	Financial Soundness
Detailed risk types	Strategy setting Execution of strategy	Retail Wholesale	Interest rate Foreign exchange Equity Credit spread	Mortality Longevity Morbidity Persistency Property Expenses Unemployment	Legal and regulatory Business process risk Financial crime risk Security risk People Change Governance Customer treatment	Capital Liquidity and funding Financial & prudential regulatory reporting Disclosure Tax

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

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

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

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

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

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

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

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

RISK DRIVERS

The Group's risk language is designed to capture the Group's principal risks referred to as the 'primary risk drivers'. A description of each risk, including definition, appetite, control and exposures, is included below. These are further broken down into 28 more granular risk types to enable more detailed review and facilitate appropriate reporting and monitoring, as set out in Table 1.3.

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

PRINCIPAL RISKS

At present the most significant risks faced by the Group are:

People risk: the Group's recent improvement to its people risk exposure, driven by leadership development and succession planning strategies, is now challenged by integration events and market disruption. External pressure on incentivisation in the banking industry increases the risk of losing specialist resources. The Group is addressing these pressures and taking the necessary steps to retain resources.

Credit risk: arising in the Retail and Wholesale and International Banking divisions and the Treasury function reflecting the risks inherent in the Group's lending activities. Over the last year the banking crisis has impacted the financial services industry resulting in high profile losses and writedowns. The deteriorating economic outlook, both in the UK and overseas, is also leading to significant rises in impairments. The Group is impacted by the economic downturn and a further worsening of the business environment could adversely impact earnings. This poses a major risk to the Group and its lending businesses in:

– Retail, where rising unemployment impacts the ability of customers to meet repayment dates on unsecured and secured lending and leads to a consequent increase in arrears. Additionally, the downturn in the housing market reduces collateral values for residential property and this impacts upon the profitability of secured lending.

– Wholesale, where companies are facing increasingly difficult conditions, resulting in corporate default levels rising and leading to increases in corporate impairment.

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

Liquidity and funding: arising in the banking business of the Group and impacting the Retail and Wholesale and International Banking divisions reflecting the risk that the Group is unable to attract and retain retail/wholesale deposits or issue debt securities. Like all major banks, the Group is dependent on confidence in the short and longer term wholesale funding markets; should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding and provide liquidity when necessary, it could impact its ability to fund its financial obligations. Throughout the market dislocation, the Group has maintained a robust liquidity position based on its significant retail and corporate deposit base and has funded strongly in the wholesale markets. Since completion of the HBOS transaction, the Group has been able to fund the Enlarged Group in the wholesale markets at rates comparable to the period prior to completion. In addition the Group has reinforced its strong funding position by actively participating in the support initiatives introduced by the Bank of England and HM Treasury. Prior to the year end 2008 additional liquidity resilience was built up to mitigate the potential for hightened liquidity risk faced by Lloyds TSB Group plc upon the acquisition of HBOS plc. The recent down grade by rating agencies has not had a material impact on the cost of short term wholesale funding.

Capital: during the year there was unprecedented turbulence in global financial markets which led to the UK Government taking action to stabilise the UK banking system. After discussion with HM Treasury on the additional capital required by the UK Government if the Group was to continue to have access to the Government backed provision of liquidity, the board decided it was in the best interests of shareholders for the Group to participate in the industry wide recapitalisation exercise which took place in October 2008. However, should the economic downturn worsen and consequently the Group sustain further sudden and significant shocks to its capital base, it could be necessary to raise additional capital to remain above the FSA's minimum target ratios. Any additional capital raised which was not taken up by existing shareholders would be dilutive to their earnings.

Market risk: In terms of potential impact on economic value, the principal market risks are a fall in equity markets reducing the value of assets in the Group's pension schemes and in the Insurance and Investments division, and exposure to a fall in real interest rates increasing the value of liabilities in the Group's pension schemes. In terms of potential impact on earnings, the principal market risks are exposure to a fall in equity markets reducing the value of assets in the Insurance and Investments division, and exposure to a widening of credit spreads reducing the value of assets in the Insurance and Investment division and in the Trading Book. Also, in the retail banking businesses, there is a potential impact on earnings arising from margin compression in a lower base rate environment. All risks are subject to regular review and mitigation activity via specific initiatives monitored by the group and senior asset and liability committees, including engagement with the pension scheme trustees.

Insurance risk: arising in Insurance and Investments division and the Group's pension schemes reflecting the exposure to increasing longevity of annuitants and pensioners. The main mitigation option open to the Group is to hedge the risk in the reinsurance or the capital markets and the Group actively monitors the attractiveness of potential opportunities in these markets.

Legal and regulatory risk: arising in all divisions and reflecting the legal and regulatory environment in which the Group operates and the volume and pace of change from within the UK and the rest of the world. This impacts the Group, both operationally in terms of cost of compliance with uncertainty about legal and regulatory expectations, and strategically through pressure on key earnings streams. The latter could potentially result in changes to business and pricing models, particularly in the UK retail and smaller business markets. Our business planning processes continue to reflect change to the legal and regulatory environment. Major current legal and regulatory reviews and proceedings are described on page 35. In addition, the Group faces risk where legal or regulatory proceedings are brought against it. Regardless of whether such claims have merit, the outcome of such proceedings is inherently uncertain and could result in financial loss.

Integration risk: A further risk arises as a result of the acquisition of HBOS plc by Lloyds TSB Group plc reflecting the risk that Lloyds Banking Group may fail to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or may incur unanticipated costs and losses associated with, the acquisition of HBOS plc. As a consequence Lloyds Banking Group results may suffer as a result of operational, financial, management and other integration risks. The Group has created an integration committee as a sub-committee to the group executive committee to oversee the integration process.

IMPACT OF LLOYDS TSB RISK MANAGEMENT PRACTICES ON HBOS

Following completion of the HBOS plc transaction, Lloyds Banking Group has moved swiftly to apply its risk management practices to the HBOS Group. As part of the completion process, we have amended Lloyds TSB Group high level policies so that they could be introduced for Lloyds Banking Group.

The way we manage risk is central to the success of Lloyds Banking Group. The board takes its responsibility for risk management very seriously and all of the Group's senior executives are actively involved in overseeing the risk profile for Lloyds Banking Group.

On the completion date the Lloyds TSB governance structure became the overriding governance structure for Lloyds Banking Group. This represented a change to the committee structures and delegated authorities for the heritage HBOS businesses. The major areas of change included material event escalation, sanctions, conflicts of interest, delegated authorities for expenditure and the credit sanctioning process where authorities were changed to align with those within the heritage Lloyds TSB Group plc businesses.

BUSINESS RISK

DEFINITION

Business risk is defined as the risk to economic profit in the Group's budget and over the medium-term plan arising from a sub optimal business strategy or the sub optimal implementation of the plan as agreed by the board of directors. In assessing business risk, consideration is given to internal and external factors.

RISK APPETITE

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

EXPOSURES

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

– internal factors: resource capability and availability, customer treatment, service level agreements, products and funding and the risk appetite of other risk categories; and

– external factors: economic, technological, political, social and ethical, environmental, legal and regulatory, market expectations, reputation and competitive behaviour.

MEASUREMENT

An annual business planning process is conducted at group and business unit level which includes a quantitative and qualitative assessment of the risks that could impact the Group's plans. Within the planning round, the Group conducts both scenario analysis and stress tests to assess risks to future earning streams. Over the last few years, the Group has made significant progress with embedding stress testing and scenario analysis into its risk management practice with the dual objectives of adding value to the business whilst also meeting regulatory requirements. The Group assesses a wide array of scenarios including economic recessions, regulatory action scenarios, pandemics and scenarios specific to the operations of each part of the business.

A common approach is applied across the Group to assess the creation of shareholder value. This is measured by economic profit (the profit attributable to shareholders, less a notional charge for the equity invested in the business). The focus on economic profit allows the Group to compare the returns being made on capital employed in each business on a consistent basis. During the year, as a result of the market dislocation and banking crisis, economic profit fell by £994 million to £731 million.

MITIGATION

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

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

MONITORING

The Group's strategy is reviewed and approved by the board. Regular reports are provided to the group executive committee and the board on the progress of the Group's key strategies and plans. Group risk conducts oversight to seek to ensure that business plans remain consistent with the Group's strategy.

CREDIT RISK

DEFINITION

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

RISK APPETITE

Credit risk appetite is expressed both in terms of credit risk economic equity and in terms of the impact of credit risk on earnings volatility.

Credit risk appetite is set by the board and is described and reported through a suite of metrics derived from a combination of accounting and credit portfolio model parameters which in turn use the various credit risk rating systems as inputs. These metrics are supplemented by a variety of policies, sector caps and limits to manage concentration risk at an acceptable level.

EXPOSURES

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. The credit risk exposures of the Group are set out in note 49 to the financial statements.

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

Credit risk can also arise from debt securities, derivatives and foreign exchange activities. Note 17 to the financial statements shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2008. 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 49 on page 168.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers.

MEASUREMENT

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

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

Each probability of default rating model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. Exposures migrate between classifications if the assessment of the obligor probability of default changes. Each rating system is required to map to a master scale, which supports the consolidation of credit risk information across portfolios through the adoption of a common rating scale. Given the differing risk profiles and credit rating considerations, the underlying risk reporting has been split into two distinct master scales, a retail master scale and a wholesale master scale. (Note 49 to the financial statements provides an analysis of the portfolio.)

The rating systems described above assess probability of default, exposure at default and loss given default, in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment (see note 20 to the consolidated financial statements on page 129). Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the expected loss model that is used for internal operational management and banking regulation purposes.

The Group's debt securities holdings, which are the subject of external agency ratings, are marked to market and independently checked by the middle office function within the products and markets business. Similarly, debt security investments within Scottish Widows are independently marked to market.

The Group also employs a statistically-based credit portfolio model, which models portfolio credit risk based on defaults and calculates the economic equity employed and credit value at risk for each portfolio.

MITIGATION

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

INTERNAL CONTROL

- Credit principles and policy: group risk sets out the Group credit principles and policy according to which credit risk is managed, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process. Divisional and business unit policy includes lending guidelines, which define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions. Credit policy also specifies maximum holding period limits for the credit trading portfolios.
- Counterparty limits: Limits are set against all types of exposure in a counterparty name, in accordance with an agreed methodology for each exposure type. This includes credit risk exposure on individual derivative transactions, which incorporates potential future exposures from market movements. Aggregate facility levels by counterparty are considered and limit breaches are subject to escalation procedures.
- Individual credit assessment and sanction: Credit risk in wholesale portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. The Group's credit risk appetite criteria for counterparty underwriting are the same as that for assets intended to be held over the period to maturity.
- Credit scoring: In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring). Divisional risk departments review scorecard effectiveness and approve changes, with material changes to scorecards that form part of a probability of default rating system subject to group risk approval.
- Controls over rating systems: The Group has established a robust and independent process built on a set of common minimum standards designed to challenge the discriminatory power of the systems, accuracy of calibration and ability to rate consistently over time and across obligors. The internal rating systems are developed and implemented by independent risk functions either in the business units or divisions with the business unit managing directors having ownership of the systems. They also take responsibility for ensuring the validation of the respective internal rating systems, supported and challenged by specialist functions in their respective division.
- Cross-border and cross-currency exposures: Country limits are authorised by Country Limits Panel and managed by a dedicated unit taking into account economic and political factors.
- Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines to reflect risk appetite. Credit policy is aligned to the Group's risk appetite and restricts exposure to certain high risk and more vulnerable sectors. Note 19 to the accounts provides an analysis of loans and advances to customers by industry (for wholesale) and product (for retail). Exposures are monitored to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. The Group's large exposures are reported in accordance with regulatory reporting requirements.
- Stress testing and scenario analysis: The credit portfolio is also subjected to stress-testing and scenario analysis, to simulate outcomes and calculate their associated impact. Events are modelled at a group wide level, at divisional and business unit level and by rating model and portfolio, for example, for a specific industry sector.
- Specialist expertise: Credit quality is maintained by specialist units providing, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business.

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

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

COLLATERAL

The principal collateral types for loans and advances are:

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

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

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

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

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

MASTER NETTING AGREEMENTS

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

OTHER CREDIT RISK TRANSFERS

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

MONITORING

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

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

MARKET RISK

DEFINITION

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

RISK APPETITE

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

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

EXPOSURES

The Group's banking activities expose it to the risk of adverse movements in interest rates, credit spreads, exchange rates and equity prices, with little or no exposure to commodity risk.

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

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

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

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

– The management of the With Profit Fund within Scottish Widows involves mismatching of assets and liabilities with the aim of generating a higher rate of return on assets to meet policyholders' expectations.

– Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of those assets.

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

– Surplus assets are held primarily in three portfolios: the surplus in the non-profit fund within the long term fund of Scottish Widows plc, assets in shareholder funds of life assurance companies and an investment portfolio within the general insurance business.

The Group's defined benefit staff pension schemes are exposed to significant risks from the constituent parts of their assets and from the present value of their liabilities, primarily equity and real interest rate risk. For further information on pension scheme assets and liabilities please refer to note 37.

MEASUREMENT

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

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

During the year the Group introduced group wide stress testing to measure exposure to credit spread widening across all businesses in response to the market dislocation that has impacted the observable inputs to asset pricing.

BANKING – TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 300 business days, the VaR for the years ended 31 December 2008 and 2007 based on the Group's global trading positions was as detailed in table 1.4.

The risk of loss measured by the VaR model is the potential loss in earnings. The total and average trading VaR does not assume any diversification benefit across the four risk types. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole. VaR numbers have increased during 2008 due to the significant rise in market volatility reflected in all the Group's VaR models across all markets.

TABLE 1.4: BANKING – TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	31 December 2008			
	Close £m	**Average £m**	**Maximum £m**	**Minimum £m**
Interest rate risk	**6.73**	**3.36**	**14.67**	**0.96**
Foreign exchange risk	**2.95**	**1.22**	**4.06**	**0.08**
Equity risk	**0.00**	**0.25**	**2.67**	**0.00**
Credit spread risk	**7.97**	**4.94**	**8.08**	**4.14**
Total VaR	**17.65**	**9.77**	**24.95**	**5.35**
	31 December 2007			
	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	1.63	2.20	4.66	1.27
Foreign exchange risk	0.08	0.23	0.53	0.04
Equity risk	0.00	0.29	3.02	0.00
Credit spread risk	4.21	3.60	8.30	2.06
Total VaR	5.92	6.32	11.00	4.28

BANKING – NON-TRADING

The estimated impact of an immediate 25 basis point increase in interest rates on economic value for the years ended 31 December 2008 and 2007 is shown below (in the 2007 accounts a 200 basis point increase was used). Economic value is defined as the present value of the non-trading portfolios concerned. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. No currency breakdown has been provided as most of the exposure is in pounds sterling. These calculations are made monthly using assumptions regarding the maturity of interest rate insensitive assets and liabilities. The portfolio is updated monthly to reflect any changes in the relationship between customer behaviour and the level of interest rates.

This is a risk based disclosure and the amounts below would be amortised in the income statement over the duration of the portfolio. During the year, management reviewed the basis of reporting banking non-trading to a value at risk measure to reflect better the internal measurement used to control this exposure. The decrease compared to the previous year is due to the impact on retail balances of significant cuts in base rate during the last few months of 2008. In view of the unprecedented low interest rate environment in 2009, the assumptions underlying this particular risk measure are under review and likely to change.

TABLE 1.5: BANKING – NON-TRADING

	31 December 2008 £m	31 December 2007 £m
Reduction in value	**(158)**	8

INSURANCE PORTFOLIOS

The Group's market risk exposure in respect of insurance activities described above is measured using European Embedded Value (EEV) as a proxy for economic value. The pre-tax sensitivity of EEV to standardised market stresses is shown below for the years ended 31 December 2008 and 2007. Foreign exchange risk arises predominantly from overseas equity holdings. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. Opening and closing numbers only have been provided as this data is not volatile or tracked on a daily basis.

TABLE 1.6: INSURANCE PORTFOLIOS

	31 December 2008 £m	31 December 2007 £m
Equity risk (impact of 10% fall pre-tax)	**(236)**	(248)
Interest rate risk (impact of 25 basis point reduction pre-tax)	**59**	58
Credit spread risk (impact of 25 basis point increase pre-tax)	**(82)**	(110)

MITIGATION

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

BANKING – NON-TRADING ACTIVITIES

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

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

INSURANCE ACTIVITIES

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

MONITORING

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

BANKING ACTIVITIES

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

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

INSURANCE ACTIVITIES

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

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

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

INSURANCE RISK

DEFINITION

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

RISK APPETITE

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

EXPOSURES

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

MEASUREMENT

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

Current and potential future insurance risk exposures are assessed and aggregated using risk measures based on 1-in-20 year stresses and other supporting measures where appropriate, for example those set out in Note 33.

MITIGATION

A key element of the control framework is the consideration of insurance risk by a suitable combination of high level committees/boards. For the life assurance businesses the key control body is the board of Scottish Widows Group Limited with the more significant risks also being subject to approval by the group executive committee and/or Lloyds TSB Group board. For the general insurance businesses the key control body is the Lloyds TSB General Insurance Limited board with the more significant risks again being subject to group executive committee and/or Lloyds TSB Group board approval. All Group staff pension schemes issues are covered by the group asset and liability committee and the group business risk committee.

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

Insurance risk is primarily controlled via the following processes:

– Underwriting (the process to ensure that new insurance proposals are properly assessed)
– Pricing-to-risk (new insurance proposals would usually be priced in accordance with the underwriting assessment)
– Claims management
– Product design
– Policy wording
– Product management
– The use of reinsurance or other risk mitigation techniques.

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

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

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

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

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

MONITORING

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

OPERATIONAL RISK

DEFINITION

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

There are a number of categories of operational risk:

LEGAL AND REGULATORY RISK

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

CUSTOMER TREATMENT RISK

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

BUSINESS PROCESS RISK

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

FINANCIAL CRIME RISK

The risk of reductions in earnings and/or value, through financial or reputational loss, associated with financial crime and failure to comply with related legal and regulatory obligations, these losses may include censure, fines or the cost of litigation.

PEOPLE RISK

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

CHANGE RISK

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

GOVERNANCE RISK

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

SECURITY RISK

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from theft of or damage to the Group's assets, the loss, corruption, misuse or theft of the Group's information assets or threats or actual harm to the Group's people.

RISK APPETITE

Operational risk appetite is defined as the quantum and composition of operational risk identified in the Group and the direction in which the Group wishes to manage it.

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

In setting operational risk appetite, the Group looks at both impact on solvency and the Group's reputation, including customer service requirements.

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

EXPOSURES

The main sources of operational risk within the Group relate to uncertainties created by the changing business, in particular the legal and regulatory environment in which financial firms operate both in the UK and overseas. As a result the most significant operational risk exposures are legal and regulatory.

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation with which the Group has to comply, along with new legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. Further uncertainties arise where regulations are principles-based without the regulator defining supporting minimum standards either for the benefit of the consumer or firms. This gives rise to both the risk of retrospection from any one regulator and also to the risk of differing interpretation by individual regulators.

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

MEASUREMENT

Throughout 2008, there was ongoing development of operational risk appetites and metrics to ensure both current and potential future operational risk exposures are understood in terms of both risk and reward potential.

The Group has a comprehensive and consistent operational risk management framework for the timely identification, measurement, monitoring and control of operational risk.

Integral to this operational risk management framework is a hybrid approach to calculating capital to support unexpected losses. The capital model calculations are driven by internal data which captures past losses, and forward looking scenarios which value potential future risk events. External industry-wide data is collected to help with validating scenarios.

The capital model outputs are used to determine the internal capital charge for the Group which is then allocated to the businesses within the Group. Following review and approval of the operational risk management framework and capital model, the FSA has granted the banking businesses within the Group an Advanced Measurement Approach (AMA) Waiver which recognises the embedding of the operational risk framework across Lloyds TSB Group plc. The waiver allowed the Group to calculate its own regulatory capital charge for operational risk from its capital model with effect from 1 January 2008.

The intention is to extend the same methodology to the insurance businesses within the Group where regulatory capital is currently determined under the ICA requirements.

MITIGATION

The Group's operational risk management framework consists of five key components:

- Identification of the key operational risks facing a business area.
- Evaluation of the effectiveness of the control framework covering each of the key risks to which the business area is exposed.
- Evaluation of the non-financial exposures (e.g. reputational risk) for each of the key risks to which the business area is exposed.
- For material risks identified, an estimate of the exposure to financial losses that could result within the coming financial year, together with an estimate of losses in a stressed environment.
- For material risks identified, an estimate of exposure to high impact, low frequency events through a scenario.

The Group purchases insurance to mitigate certain operational risk events.

MONITORING

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

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

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

FINANCIAL SOUNDNESS

DEFINITION

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

LIQUIDITY AND FUNDING

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

In recent months, the strain in the financial systems has increased substantially, leading to a significant tightening in market liquidity with the threat of a more marked deterioration in the global economic outlook and a consequent increase in recourse to liquidity schemes provided by central banks. Whilst various governments, including the UK Government, have taken substantial measures to ease the current crisis in liquidity, such as the measures announced in the UK on 8 October 2008 and 13 October 2008, there can be no assurance that these global measures will succeed in improving the funding and liquidity of the markets in which the major banks, including Lloyds Banking Group, operate.

Consistent with regulatory requirements, the Banking and Insurance parts of the Group manage their liquidity independently on a standalone basis. Liquidity for all UK based banking business is managed centrally. Liquidity for International banking entities are managed on a standalone basis Liquidity risk in the Insurance business is managed at business unit level and is not considered further in this section.

RISK APPETITE

Liquidity and funding risk appetite for the banking businesses is set by the board and reviewed on an annual basis. It is reported through various metrics that enable the Group to manage liquidity and funding constraints. The chief executive, assisted by the group asset and liability committee and its sub-committee the senior asset and liability committee, regularly reviews performance against risk appetite. The board reviews liquidity and funding risk on a quarterly basis.

EXPOSURE

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

MEASUREMENT

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

MITIGATION

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

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

The ability to deploy assets quickly, either through the repo market or through outright sale, is also an important source of liquidity for the Group's banking businesses. The Group holds sizeable balances of high grade marketable debt securities set out on page 172 of the financial statements which can be sold to provide, or used to secure, additional short term funding should the need arise from either market counterparties or central bank facilities (ECB, Federal Reserve, Bank of England). During the year the Group increased its stock of liquid assets by £47 billion to £63 billion (2007: £16 billion), which includes government securities, mortgage backed securities, corporate and other debt securities.

MONITORING

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

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

- Firstly, Lloyds Banking Group stress tests its potential cash flow mismatch position under various scenarios on an ongoing basis. The cash flow mismatch position considers on-balance sheet cash flows, commitments received and granted, and material derivative cash flows. Specifically, commitments granted include the pipeline of new business awaiting completion as well as other standby or revolving credit facilities. Behavioural adjustments are developed, evaluating how the cash flow position might change under each stress scenario to derive a stressed cash flow position. Scenarios cover both Lloyds Banking Group name specific and systemic difficulties. The scenarios and the assumptions are reviewed at least annually to gain assurance they continue to be relevant to the nature of the business.
- Secondly, the Group has a contingency funding plan embedded within the Group Liquidity Policy Statement which has been designed to identify emerging liquidity concerns at an early stage, so that mitigating actions can be taken to avoid a more serious crisis developing.

The information reviewed by the group executive committee, group asset and liability committee and senior asset and liability committee includes analysis set out in table 1.7.

TABLE 1.7: GROUP BALANCE SHEET

	31 December 2008 £bn	31 December 2007 £bn	2008 growth %
Assets			
Loans and advances to customers	242.7	209.8	15.7
Wholesale assets	72.5	57.7	25.6
Banking assets	315.2	267.5	17.8
Total assets	436.0	353.3	23.4
Liabilities			
Non-bank deposits	170.9	156.6	9.1
Wholesale funding*	141.4	105.1	34.5
Total Funding	312.3	261.7	19.3
Total liabilities and shareholders equity	436.0	353.3	23.4

*Excludes repos.

GROUP RETAIL AND WHOLESALE FUNDING MIX

Wholesale assets comprise balances arising from banking business and include loans and advances to banks, trading and other financial assets at fair value through profit and loss and available for sale assets. Non-bank deposits comprise balances arising from banking businesses and include customer accounts.

The group balance sheet has grown by 23.4 per cent during the year. The funding for this has been primarily raised in the wholesale markets with customer deposit growth of £14.4 billion.

Wholesale funding has been analysed between that monitored by the London Treasury operations and the Group's overseas Treasury operations. The wholesale funding shown excludes any repo activity.

The composition and quality of wholesale deposits are regularly reviewed by management and comprises deposits from corporates and government agencies that roll over on a regular basis and are reinvested.

TABLE 1.8: WHOLESALE FUNDING*

	As at 31 December 2008 £bn	As at 31 December 2008 %	As at 31 December 2007 £bn	As at 31 December 2007 %
Bank	27.9	8.9	28.6	10.9
Non-bank	48.7	15.6	39.5	15.1
Wholesale deposits	76.6	24.5	68.1	26.0
Certificates of deposit	27.9	8.9	11.3	4.3
Medium term notes	15.8	5.1	9.1	3.5
Commercial paper	19.9	6.4	17.6	6.7
Securitisation	9.8	3.1	13.3	5.1
Subordinated liabilities	15.9	5.1	11.9	4.5
London Treasury operations	165.9	53.1	131.3	50.1
Other Treasury operations	45.2	14.5	31.8	12.2
Total	211.1	67.6	163.1	62.3

*Table 1.8 excludes repo balances.

TABLE 1.9: RESIDUAL MATURITY OF LONDON TREASURY WHOLESALE FUNDING

	As at 31 December 2008 £bn	As at 31 December 2008 %	As at 31 December 2007 £bn	As at 31 December 2007 %
Less than one year	127.8	77.0	107.0	81.5
One to two years	5.7	3.5	5.0	3.8
Two to five years	18.1	10.9	11.1	8.5
More than five years	14.3	8.6	8.2	6.2
Total	165.9	100.0	131.3	100.0

Other Treasury operations include those businesses that are run on a standalone basis in jurisdictions outside London to support local banking businesses often in different time zones. The residual maturity profile of these operations is less than one year.

TABLE 1.10: RECONCILIATION OF AMOUNTS SHOWN ABOVE WITH THE STATUTORY BALANCE SHEET

2008	London Treasury Functions £bn	Other Treasury Functions £bn	Repos £bn	Other Retail £bn	Statutory Balance Sheet £bn
Non-bank (Customer deposits)	48.7	21.0	–	101.2	170.9
Deposits from banks	27.9	13.7	24.9	–	66.5
Debt securities in issue and trading and other liabilities at fair value through profit or loss	73.4	9.1	–	–	82.5
Subordinated liabilities	15.9	1.4	–	–	17.3
Total	165.9	45.2	24.9	101.2	337.2

2007	London Treasury Functions £bn	Other Treasury Functions £bn	Repos £bn	Other Retail £bn	Statutory Balance Sheet £bn
Non-bank (Customer deposits)	39.5	18.5	–	98.6	156.6
Deposits from banks	28.6	9.8	0.7	–	39.1
Debt securities in issue and trading and other liabilities at fair value through profit or loss	51.3	3.5	–	–	54.8
Subordinated liabilities	11.9	–	–	–	11.9
Total	131.3	31.8	0.7	98.6	262.4

CAPITAL

Capital risk is defined as the risk that the Group has insufficient capital to provide a sufficient resource to absorb predetermined levels of losses or that the capital structure is inefficient.

RISK APPETITE

Capital risk appetite is set by the board and reported through various metrics that enable the Group to manage capital constraints and shareholder expectations. The chief executive, assisted by the group asset and liability committee, regularly reviews performance against risk appetite. The board formally reviews capital risk on an annual basis.

EXPOSURE

A capital exposure arises where the Group has insufficient regulatory capital resources to support its strategic objectives and plans, and to meet external stakeholder requirements and expectations. The Group's capital management policy is focused on optimising value for shareholders.

MEASUREMENT

The Group's regulatory capital is divided into tiers defined by the European Community Banking Consolidation Directive as implemented in the UK by the Financial Services Authority's General Prudential Sourcebook. Tier 1 capital comprises mainly shareholders' equity, tier 1 capital instruments and minority interests, after deducting goodwill, other intangible assets and 50 per cent of the net excess of expected loss over accounting provisions and certain securitisation positions. During the year the FSA has defined core tier 1 capital. Accounting equity is adjusted in accordance with FSA requirements, particularly in respect of pensions and available-for sale assets. Tier 2 capital comprises qualifying subordinated debt after deducting 50 per cent of the excess of expected loss over accounting provisions, and certain securitisation positions. The amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. Total capital is reduced by deducting investments in subsidiaries and associates that are not consolidated for regulatory purposes. In the case of Lloyds TSB Group, this means that the net assets of its life assurance and general insurance businesses are excluded from its total regulatory capital.

A number of limits are imposed by the FSA on the proportion of the regulatory capital base that can be made up of subordinated debt and preferred securities. The unpredictable nature of movements in the value of the investments supporting the long-term assurance funds could cause the amount of qualifying tier 2 capital to be restricted because of falling tier 1 resources. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

The FSA sets Individual Capital Guidance (ICG) for each UK bank calibrated by references to its Capital Resources Requirement (CRR), broadly equivalent to 8 per cent of risk weighted assets and thus representing the capital required under Pillar 1 of the Basel II framework.

Also a key input into the FSA's ICG setting process (which addresses the requirements of Pillar 2 of the Basel II framework) is each bank's Internal Capital Adequacy Assessment Process. The FSA's approach is to monitor the available capital resources in relation to the ICG requirement. The Group has been given an ICG by the FSA and the board has also agreed a formal buffer to be maintained in addition to this requirement. Any breaches of the formal buffer must be notified to the FSA, together with proposed remedial action. No such notification has been made in 2008. The FSA has made it clear that each ICG remains a confidential matter between each bank and the FSA.

In the context of the current market conditions the FSA has made further statements to explain the approach it has taken to the capital framework these include core tier 1 and tier 1 targets under stressed conditions.

The Group has developed procedures meant to ensure that compliance with both current and potential future requirements are understood and that policies are aligned to its risk appetite.

In addition to the regulatory framework, the Group also operates an internal capital framework.

MITIGATION

The Group is also able to raise equity either via a rights issue, placing or an open offer. A share placing was undertaken in September and the board also announced in October a further placing and open offer to shareholders as part of its participation in the recapitalisation of the banking sector. The Group is able to raise funds by issuing subordinated liabilities. The cost and availability of subordinated liability finance are influenced by credit ratings. A reduction in these ratings could increase the cost and could reduce market access.

MONITORING

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group's budgeting and planning processes with updates of expected ratios reviewed regularly during the year by the Group asset and liability committee. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight. Regular reporting of actual and projected ratios is made to the senior asset and liability committee and to the group asset and liability committee.

CAPITAL RATIOS (BASEL II)

	31 December 2008 £m	31 December 2007 £m
Tier 1		
Share capital and reserves	9,573	12,663
Regulatory post-retirement benefit adjustments	435	704
Other items	(108)	–
Available-for-sale revaluation reserve and cash flow hedging reserve	2,997	402
Goodwill	(2,256)	(2,358)
Other deductions	(1,099)	(929)
Core tier 1 capital	9,542	10,482
Preference share capital	1,966	1,589
Innovative tier 1 capital instruments*	3,169	1,474
Less: restriction in amount eligible	(976)	–
Total tier 1 capital	13,701	13,545
Tier 2		
Undated loan capital	5,189	4,457
Dated loan capital	5,091	3,441
Innovative capital restricted from tier 1	976	–
Collectively assessed provisions	21	12
Available-for-sale revaluation reserve in respect of equities	8	12
Other deductions	(1,099)	(928)
Total tier 2 capital	10,186	6,994
Total tier 1 and tier 2 capital	23,887	20,539
Supervisory deductions		
Life and pensions businesses	(4,208)	(4,373)
Other deductions	(550)	(491)
Total supervisory deductions	(4,758)	(4,864)
Total capital	19,129	15,675
	£bn	£bn
Risk-weighted assets (unaudited)		
Credit risk	149.7	127.2
Market and counterparty risk	8.5	5.3
Operational risk	12.3	10.1
Total risk-weighted assets	170.5	142.6
Risk asset ratios (unaudited)		
Core tier 1	5.6%	7.4%
Tier 1	8.0%	9.5%
Total capital	11.2%	11.0%

*A firm is permitted to include innovative tier 1 capital in its tier 1 capital resources for the purposes of GENPRU1.2 (adequacy of financial resources) but is required to exclude these amounts from tier 1 for the purposes of meeting the main BIPRU firm Pillar 1 rules.

FINANCIAL AND PRUDENTIAL REGULATORY REPORTING, DISCLOSURE AND TAX

The risk of reputational damage, loss of investor confidence and/or financial loss arising from the adoption of inappropriate accounting policies, ineffective controls over financial, prudential regulatory and tax reporting and the failure to disclose information on a timely basis about the Group.

RISK APPETITE

The risk appetite is set by the board and reviewed on an annual basis. It includes the avoidance of the need for restatement of published financial and prudential regulatory data, public disclosures about the Groups financial, including tax, performance and its legal constitution.

EXPOSURE

Exposure represents the sufficiency of the Group's policies and procedures to maintain adequate books and records to support statutory, prudential and tax reporting, to present and detect financial reporting fraud and to manage the Group's tax exposure.

MITIGATION

The Group maintains a system of internal controls, which are designed to be consistently applied, and to provide a reasonable assurance that transactions are recorded and undertaken in accordance with delegated authorities that permit the preparation and disclosure of financial statements, prudential regulatory reporting and tax returns in accordance with International Financial Reporting Standards, statutory and regulatory requirements.

MONITORING

The Group has in place a disclosure committee whose responsibility is to review all significant disclosures made by the Group and to assist the group chief executive and group finance director fulfill their responsibilities under the Listing Rules and regulations emanating from the Sarbanes-Oxley Act of 2002. A programme of work is undertaken and designed to support an annual assessment of the effectiveness of internal controls over financial reporting, in accordance with the requirements of section 404 of the US Sarbanes-Oxley Act; it also has in place an assurance mechanism over its prudential regulatory reporting; additionally, monitoring activities are designed to identify and maintain tax liabilities and to assess emerging regulation and legislation.

LIFE ASSURANCE BUSINESSES

At 31 December 2008, the principal subsidiary involved in the Group's life assurance operations was Scottish Widows plc (Scottish Widows), which holds the only large With Profit Fund managed by Lloyds Banking Group.

BASIS OF DETERMINING REGULATORY CAPITAL OF THE LIFE ASSURANCE BUSINESSES

AVAILABLE CAPITAL RESOURCES

Available capital resources represent the excess of assets over liabilities calculated in accordance with detailed regulatory rules issued by the FSA. Different rules apply depending on the nature of the fund, as detailed below.

Statutory basis. Assets are generally valued on a basis consistent with that used for accounting purposes (with the exception that, in certain cases, the value attributed to assets is limited) and which follows a market value approach where possible. Liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses and mortality. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets in accordance with the FSA rules. Other assumptions are based on recent actual experience, supplemented by industry information where appropriate. The assessment of liabilities does not include future bonuses for with-profits policies that are at the discretion of management, but does include a value for policyholder options likely to be exercised.

'Realistic' basis. The FSA requires each life assurance company which contains a With Profit Fund in excess of £500 million, including Scottish Widows, to carry out a 'realistic' valuation of that fund. The word 'realistic' in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology.

The valuation of with-profits assets in a with-profits fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in a with-profits fund (a relatively small amount of business in the case of Scottish Widows), it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

The realistic valuation of liabilities is carried out using a stochastic simulation model which values liabilities on a basis consistent with tradable market option contracts (a 'market-consistent' basis). The model takes account of policyholder behaviour on a best-estimate basis and includes an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities. Further details regarding the stochastic simulation model are given in the section entitled 'Options and guarantees' on page 64.

REGULATORY CAPITAL REQUIREMENTS

Each life assurance company must retain sufficient capital to meet the regulatory capital requirements mandated by the FSA; the basis of calculating the regulatory capital requirement is given below. Except for Scottish Widows, the regulatory capital requirement is a combination of amounts held in respect of actuarial reserves, sums at risk and maintenance expenses (the Long-Term Insurance Capital Requirement) and amounts required to cover various stress tests. The regulatory capital requirement is deducted from the available capital resources to give 'statutory excess capital'.

For Scottish Widows, no amount is required to cover the impact of stress tests on the actuarial reserves. However, a further test is required in respect of the With Profit Fund, which compares the level of 'realistic excess capital' to the 'statutory excess capital' of the With Profit Fund. In circumstances where the 'realistic excess capital' position is less than 'statutory excess capital', the Company is required to hold additional capital to cover the shortfall, but only to the extent it exceeds the value, calculated in a prescribed way, of internal transfers from the With Profit Fund. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component. The 'realistic excess capital' is calculated as the difference between realistic assets and realistic liabilities of the With Profit Fund with a further deduction to cover various stress tests.

The determination of realistic liabilities of the With Profit Fund in respect of Scottish Widows includes the value of internal transfers expected to be made from the With Profit Fund to the Non-Participating Fund of Scottish Widows. These internal transfers include charges on policies where the associated costs are borne by the Non-Participating Fund. The With-Profits Insurance Capital Component is reduced by the value, calculated in the stress test scenario, of these internal transfers, but only to the extent that credit has not been taken for the value of these charges in deriving actuarial reserves for the Non-Participating Fund.

CAPITAL STATEMENT

The following table provides more detail regarding the sources of capital in the life assurance business. The figures quoted are based on management's current expectations pending completion of the annual financial return to the FSA. The figures allow for an anticipated transfer of £110 million from the Long Term Fund to the Shareholder Fund as at 31 December 2008.

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2008					
Assets attributable to the shareholder held outside the long-term funds	–	–	–	862	862
Assets attributable to the shareholder held within the long-term funds	–	2,562	2,562	–	2,562
Total shareholders' funds	–	2,562	2,562	862	3,424
Adjustments onto a regulatory basis:					
Life assurance business					
Unallocated surplus within insurance business	293	–	293	–	293
Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities	–	(708)	(708)	(581)	(1,289)
Adjustment to include estimated 'realistic' liabilities payable to the shareholder	(406)	–	(406)	–	(406)
Adjustment to replace 'realistic' liabilities with statutory liabilities	811	–	811	–	811
Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With Profit Fund	(49)	–	(49)	–	(49)
Qualifying loan capital	–	–	–	604	604
Available capital resources	**649**	**1,854**	**2,503**	**885**	**3,388**

The figures shown above for available capital resources within the insurance business relate to Scottish Widows plc only. The estimated total additional resources relating to the other life assurance subsidiaries within the Group as at 31 December 2008 are £310 million.

The comparative position as at 31 December 2007 was as follows (again, relating to Scottish Widows plc only):

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2007					
Assets attributable to the shareholder held outside the long-term funds	–	–	–	956	956
Assets attributable to the shareholder held within the long-term funds	–	2,343	2,343	–	2,343
Total shareholders' funds	–	2,343	2,343	956	3,299
Adjustments onto a regulatory basis:					
Life assurance business					
Unallocated surplus within insurance business	569	–	569	–	569
Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities	–	(435)	(435)	(602)	(1,037)
Adjustment to include estimated 'realistic' liabilities payable to the shareholder	(634)	–	(634)	–	(634)
Adjustment to replace 'realistic' liabilities with statutory liabilities	3,695	–	3,695	–	3,695
Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With Profit Fund	(23)	–	(23)	–	(23)
Qualifying loan capital	–	–	–	541	541
Available capital resources	3,607	1,908	5,515	895	6,410

FORMAL INTRA-GROUP CAPITAL ARRANGEMENTS

Scottish Widows has a formal arrangement with one of its subsidiary undertakings, Scottish Widows Unit Funds Limited, whereby the subsidiary company can draw down capital from Scottish Widows to finance new business which is reinsured from the parent to its subsidiary. Scottish Widows has also provided subordinated loans to its fellow group undertaking Scottish Widows Bank plc.

CONSTRAINTS OVER AVAILABLE CAPITAL RESOURCES

Scottish Widows was created following the demutualisation of Scottish Widows Fund and Life Assurance Society in 2000. The terms of the demutualisation are governed by a Court-approved Scheme of Transfer (the 'Scheme') which, inter alia, created a With Profit Fund and a Non-Participating Fund and established protected capital support for the with-profits policyholders in existence at the date of demutualisation. Much of that capital support is held in the Non-Participating Fund and, as such, the capital held in that fund is subject to the constraints noted below.

Requirement to maintain a Support Account: The Scheme requires the maintenance of a 'Support Account' within the Non-Participating Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Participating Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account in assessing the realistic value of assets available to the With Profit Fund. At 31 December 2008, the estimated value of surplus admissible assets in the Non-Participating Fund was £1,854 million (31 December 2007: £1,908 million) and the estimated value of the Support Account was £200 million (31 December 2007: £827 million).

Further Support Account: The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Participating Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Participating Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2008, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £3,603 million (31 December 2007: £4,026 million) and the estimated combined value of the Support Account and Further Support Account was £2,584 million (31 December 2007: £2,834 million).

Other restrictions in the Non-Participating Fund: In addition to the policies which existed at the date of demutualisation, the With Profit Fund includes policies which have been written since that date. As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2008 is £162 million (31 December 2007: £183 million). Scottish Widows has obtained from the FSA permission to include the value of this support in assessing the realistic value of assets available to the With Profit Fund. There is a further test requiring that no amounts can be transferred from the Non-Participating Fund of Scottish Widows unless there are sufficient assets within the Long Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

MOVEMENTS IN REGULATORY CAPITAL

The movements in Scottish Widows plc's available capital resources can be analysed as follows:

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2007	3,607	1,908	5,515	895	6,410
Changes in assumptions used to measure life assurance liabilities	**15**	**(29)**	**(14)**	**–**	**(14)**
Dividends and capital transfers	**–**	**(110)**	**(110)**	**(110)**	**(220)**
Changes in regulatory requirements	**–**	**–**	**–**	**–**	**–**
New business and other factors	**(2,973)**	**85**	**(2,888)**	**100**	**(2,788)**
As at 31 December 2008	**649**	**1,854**	**2,503**	**885**	**3,388**

The primary reasons for the movement in total available capital resources during the year are as follows:

WITH PROFIT FUND

Available capital in the With Profit Fund has decreased from £3,607 million at 31 December 2007 to an estimated £649 million at 31 December 2008. The key driver is investment market performance.

NON-PARTICIPATING FUND

Available capital in the Non-Participating Fund has decreased from £1,908 million at 31 December 2007 to an estimated £1,854 million at 31 December 2008. This is primarily a result of the anticipated transfer from the Non-Participating Fund to the Shareholder Fund at the year end of £110 million, and market movements offset by the return generated from the business.

SHAREHOLDER FUND

During 2008, dividends of £220 million were paid.

FINANCIAL INFORMATION CALCULATED ON A 'REALISTIC' BASIS

The estimated financial position of the With Profit Fund of Scottish Widows at 31 December 2008, calculated on a 'realistic' basis, is given in the following table, in the form reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the estimated 'realistic' financial position of the Long Term Fund of Scottish Widows as a whole, which consists of both the With Profit Fund and the Non-Participating Fund.

	31 December 2008		31 December 2007	
	With Profit Fund £m	**Long Term Fund £m**	With Profit Fund £m	Long Term Fund £m
Realistic value of assets of fund	**13,155**	**16,665**	16,793	21,005
Support arrangement assets	**362**	**–**	1,010	–
Realistic value of assets available to the fund	**13,517**	**16,665**	17,803	21,005
Realistic value of liabilities of fund	**(13,268)**	**(13,062)**	(16,858)	(16,979)
Working capital for fund	**249**	**3,603**	945	4,026
Working capital ratio for fund	**1.8%**	**21.6%**	5.3%	19.2%

The financial information calculated on a 'realistic' basis reconciles to the capital statement as follows:

	31 December 2008		31 December 2007	
	With Profit Fund £m	Long Term Fund £m	With Profit Fund £m	Long Term Fund £m
Available regulatory capital	**649**	**2,503**	3,607	5,515
Support arrangement assets	**362**	**–**	1,010	–
Adjustments to replace statutory liabilities with 'realistic' liabilities	**(811)**	**(779)**	(3,695)	(3,575)
Adjustments to include the value of future profits recognised in respect of Non-Participating business written in the With Profit Fund	**49**	**49**	23	23
Recognition of future profits allowable for 'realistic' capital purposes	**–**	**1,830**	–	2,063
	249	**3,603**	945	4,026

Analysis of policyholder liabilities in respect of the Group's life assurance business:

	Scottish Widows plc With Profit Fund (in accordance with FRS 27) £m	Other long-term funds £m	Total life business £m
As at 31 December 2008			
With Profit Fund liabilities	**13,293**	**–**	**13,293**
Unit-linked business (excluding that accounted for as investment contracts)	**–**	**11,480**	**11,480**
Other life assurance business	**–**	**8,364**	**8,364**
Insurance and participating investment contract liabilities	**13,293**	**19,844**	**33,137**
Non-participating investment contract liabilities	**–**	**14,243**	**14,243**
Total policyholder liabilities	**13,293**	**34,087**	**47,380**

	Scottish Widows plc With Profit Fund (in accordance with FRS 27) £m	Other long-term funds £m	Total life business £m
As at 31 December 2007			
With Profit Fund liabilities	16,404	–	16,404
Unit-linked business (excluding that accounted for as investment contracts)	–	14,282	14,282
Other life assurance business	–	6,714	6,714
Insurance and participating investment contract liabilities	16,404	20,996	37,400
Non-participating investment contract liabilities	–	18,197	18,197
Total policyholder liabilities	16,404	39,193	55,597

CAPITAL SENSITIVITIES

SHAREHOLDERS' FUNDS

Shareholders' funds outside the long-term business fund, other than those used to match regulatory requirements, are mainly invested in assets that are less sensitive to market conditions.

WITH PROFIT FUND

The with-profits realistic liabilities and the available capital for the With Profit Fund are sensitive to both market conditions and changes to a number of non-economic assumptions that affect the valuation of the liabilities of the fund. The available capital resources (and capital requirements) are sensitive to the level of the stock market, with the position worsening at low stock market levels as a result of the guarantees to policyholders increasing in value. However, the exposure to guaranteed annuity options increases under rising stock market levels. An increase in the level of equity volatility implied by the market cost of equity put options also increases the market consistent value of the options given to policyholders and worsens the capital position.

The most critical non-economic assumptions are the level of take-up of options inherent in the contracts (higher take-up rates are more onerous), mortality rates (lower mortality rates are generally more onerous) and lapses prior to dates at which a guarantee would apply (lower lapse rates are generally more onerous where guarantees are in the money). The sensitivity of the capital position and capital requirements of the With Profit Fund is partly mitigated by the actions that can be taken by management.

OTHER LONG-TERM FUNDS

Outside the With Profit Fund, assets backing actuarial reserves in respect of policyholder liabilities are invested so that the values of the assets and liabilities are broadly matched. The most critical non-economic assumptions are mortality rates in respect of annuity business written (lower mortality rates are more onerous). Reinsurance arrangements are in place to reduce the Group's exposure to deteriorating mortality rates in respect of life assurance contracts. In addition, poor cost control would gradually depreciate the available capital and lead to an increase in the valuation of the liabilities (through an increased allowance for future costs).

Assets held in excess of those backing actuarial reserves are invested across a range of investment categories including fixed interest securities, equities, properties and cash. The mix of investments is determined in line with the policy of Lloyds Banking Group to minimise the working capital (defined as available capital less minimum required capital) required to ensure all capital requirements continue to be met under a range of stress tests.

OPTIONS AND GUARANTEES

The Group has sold insurance products that contain options and guarantees, both within the With Profit Fund and in other funds.

OPTIONS AND GUARANTEES WITHIN THE WITH PROFIT FUND

The most significant options and guarantees provided from within the With Profit Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies.

For those policies written pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With Profit Fund of Scottish Widows called the Additional Account which is available, *inter alia*, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2008 of £2.0 billion (2007: £1.7 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

As noted above, under the realistic capital regime of the FSA, the liabilities of the With Profit Fund are valued using a market-consistent stochastic simulation model. This model is used in order to place a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are:

- Risk-free yield. The risk-free yield is defined as spot yields derived from the UK gilt yield curve.
- Investment volatility. The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2008, the 10 year equity-implied at-the-money assumption was set at 34.6 per cent (31 December 2007: 25.5 per cent). The assumption for property volatility was 15 per cent (31 December 2007: 15 per cent). The volatility of interest rates has been calibrated to the implied volatility of swaptions which was broadly 16 per cent (31 December 2007: 11 per cent).

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take-up rates and assumptions regarding persistency (both of which are based on recent actual experience and include an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

OPTIONS AND GUARANTEES OUTSIDE THE WITH PROFIT FUND OF SCOTTISH WIDOWS

Certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £65 million (31 December 2007: £65 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £3 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £11 million.

FIVE YEAR FINANCIAL SUMMARY

The financial information set out in the table below has been derived from the annual report and accounts of Lloyds Banking Group plc for each of the past four years. 2005 was the first year in which the annual report and accounts were prepared under International Financial Reporting Standards (IFRS). 2004 figures have been derived from the comparative information disclosed in the 2005 annual report and accounts. Under IFRS, accounting standards dealing with financial instruments (IAS 32 and IAS 39) and insurance (IFRS 4 and FRS 27) were applied only from 1 January 2005. To aid comparison, IFRS balance sheet data is presented as at 1 January 2005 rather than 31 December 2004; the 2004 IFRS income statement data is not comparable to the data for the other years presented. The financial statements for each of the years presented have been audited by PricewaterhouseCoopers LLP, independent auditors.

	2008	2007	2006	2005	2004
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**9,872**	10,706	11,104	10,540	9,661
Operating expenses	**(6,053)**	(5,567)	(5,301)	(5,471)	(5,297)
Trading surplus	**3,819**	5,139	5,803	5,069	4,364
Impairment	**(3,012)**	(1,796)	(1,555)	(1,299)	(866)
Profit before tax	**807**	4,000	4,248	3,820	3,477
Profit for the year	**845**	3,321	2,907	2,555	2,459
Profit for the year attributable to equity shareholders	**819**	3,289	2,803	2,493	2,392
Total dividend for the year[1]	**648**	2,026	1,927	1,915	1,914
	31 December 2008	31 December 2007	31 December 2006	31 December 2005	1 January 2005
Balance sheet data (£m)					
Share capital	**1,513**	1,432	1,429	1,420	1,419
Shareholders' equity	**9,393**	12,141	11,155	10,195	9,489
Net asset value per ordinary share	**155p**	212p	195p	180p	167p
Customer accounts	**170,938**	156,555	139,342	131,070	126,349
Subordinated liabilities	**17,256**	11,958	12,072	12,402	11,211
Loans and advances to customers	**242,735**	209,814	188,285	174,944	161,162
Total assets	**436,033**	353,346	343,598	309,754	292,854
	2008	2007	2006	2005	2004
Share information					
Basic earnings per ordinary share	**14.3p**	58.3p	49.9p	44.6p	42.8p
Diluted earnings per ordinary share	**14.2p**	57.9p	49.5p	44.2p	42.5p
Total dividend per ordinary share[1]	**11.4p**	35.9p	34.2p	34.2p	34.2p
Market price (year end)	**126.0p**	472.0p	571.5p	488.5p	473p
Number of shareholders (thousands)	**824**	814	870	920	953
Number of ordinary shares in issue (millions)[2]	**5,973**	5,648	5,638	5,603	5,596
	2008	2007	2006	2005	2004
Financial ratios (%)[3]					
Dividend payout ratio	**79.1**	61.6	68.7	76.8	80.0
Post-tax return on average shareholders' equity	**7.4**	28.2	26.6	25.6	22.8
Cost:income ratio[4]	**61.3**	52.0	47.7	51.9	54.8
	31 December 2008	31 December 2007	31 December 2006	31 December 2005	1 January 2005
Capital ratios (%)[5]					
Total capital	**11.2**	11.0	10.7	10.9	10.1
Tier 1 capital	**8.0**	8.1	8.2	7.9	8.2

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

[2] This figure excludes 79 million limited voting ordinary shares.

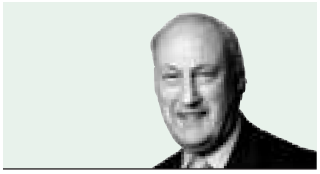
[3] Averages are calculated on a monthly basis from the consolidated financial data of Lloyds Banking Group.

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

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

THE BOARD

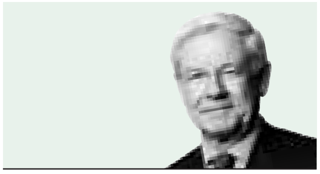
NON-EXECUTIVE DIRECTORS



Sir Victor Blank
Chairman

Chairman of the nomination and risk oversight committees and a member of the remuneration committee

Joined the board in 2006 as deputy chairman and became chairman in May 2006. Former partner in Clifford-Turner (now Clifford Chance) from 1969 to 1981 and chairman and chief executive of Charterhouse until 1997. Director of The Royal Bank of Scotland from 1985 to 1993 and of GUS from 1993 to 2006 (chairman from 2000). Chairman of Trinity Mirror from 1999 to 2006. A member of the Financial Reporting Council from 2002 to 2007 and a member of the Council of Oxford University from 2000 to 2007. A senior adviser to the Texas Pacific Group and appointed by the Prime Minister as a Business ambassador. Chairs two charities, WellBeing of Women and UJS Hillel, as well as the Council of University College School. Aged 66



Wolfgang C G Berndt
Independent director

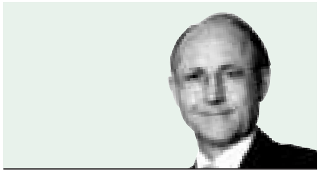
Member of the nomination committee and chairman of the remuneration committee

Joined the board in 2003. Joined Procter and Gamble in 1967 and held a number of senior and general management appointments in Europe, South America and North America, before retiring in 2001. A non-executive director of Cadbury, GfK AG and MIBA AG. Aged 66

Ewan Brown CBE FRSE
Senior Independent director
(retiring at the AGM in 2009)

Member of the audit and risk oversight committees

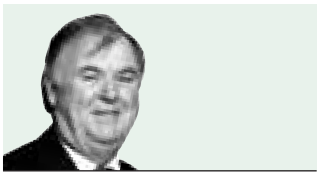
Joined the board in 1999 and was chairman of Lloyds TSB Scotland until May 2008. Joined Noble Grossart in 1969 and was an executive director of that company until December 2003. A non-executive director of Noble Grossart and Stagecoach Group, chairman of Creative Scotland 2009, senior governor of the Court of the University of St Andrews and vice chairman of the Edinburgh International Festival. A former chairman of tie and non-executive director of John Wood Group. Aged 66



Jan P du Plessis
Independent director

Chairman of the audit committee and a member of the nomination and risk oversight committees

Joined the board in 2005. Chairman of British American Tobacco. Held a number of senior and general management appointments in Rembrandt Group from 1981, before joining Compagnie Financière Richemont as group finance director in 1988, a position he held until 2004. A non-executive director of Rio Tinto and Marks and Spencer Group. A former chairman of RHM from 2005 to 2007 and group finance director of Rothmans International from 1990 to 1995. Aged 55



Sir Julian Horn-Smith
Independent director

Member of the nomination, remuneration and risk oversight committees

Joined the board in 2005. Held a number of senior and general management appointments in Vodafone from 1984 to 2006 including a directorship of that company from 1996 and deputy chief executive officer from 2005. Previously held positions in Rediffusion from 1972 to 1978, Philips from 1978 to 1982 and Mars GB from 1982 to 1984. A non-executive director of Digicel Group, a member of the Altimo International advisory board and a senior adviser to UBS in relation to the global telecommunications sector. A former chairman of The Sage Group. Aged 60

Lord Leitch
Independent director

Member of the audit, nomination and risk oversight committees

Joined the board in 2005. Appointed chairman of Scottish Widows in 2007. Held a number of senior and general management appointments in Allied Dunbar, Eagle Star and Threadneedle Asset Management before the merger of Zurich Group and British American Tobacco's financial services businesses in 1998. Subsequently served as chairman and chief executive officer of Zurich Financial Services United Kingdom, Ireland, Southern Africa and Asia Pacific, until his retirement in 2004. Chairman of the Government's Review of Skills (published in December 2006) and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster. Former chairman of the National Employment Panel. Aged 61

Sir David Manning GCMG CVO
Independent director

Member of the nomination, remuneration and risk oversight committees

Joined the board on 1 May 2008. Entered the Foreign and Commonwealth Office in 1972 and held senior appointments, including HM ambassador to Israel between 1995 and 1998, foreign policy adviser to the Prime Minister from 2001 to 2003 and HM ambassador to the USA from 2003 to 2007. A non-executive director of BG Group and Lockheed Martin UK Holdings. Aged 59

Carolyn J McCall OBE
Independent director

Member of the remuneration committee

Joined the board on 1 October 2008. Appointed group chief executive of Guardian Media Group in 2006 having joined that organisation in 1986 and held a number of senior and general management appointments before becoming a director in 2000. Chair of Opportunity Now and a director of Business in the Community. Aged 47

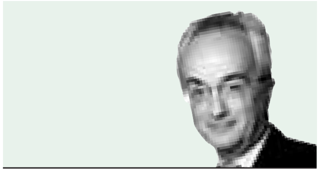
NON-EXECUTIVE DIRECTORS JOINING THE BOARD

T Timothy Ryan, Jr
Independent director and member of the audit and risk oversight committees (from 1 March 2009)

President and chief executive of the Securities Industry and Financial Markets Association. Held a number of senior appointments in JP Morgan Chase from 1993 to 2008 including vice chairman, financial institutions and governments, from 2005. A director of the US-Japan Foundation and the International Foundation of Electoral Systems and a member of the Global Markets Advisory Committee for the National Intelligence Council. A former director in the Office of Thrift Supervision, US Department of the Treasury and Koram Bank. Aged 63

Anthony Watson CBE
Independent director
(from 2 April 2009)

Previously chief executive of Hermes Pensions Management. Held a number of senior appointments in AMP Asset Management from 1991 to 1998. Retiring as chairman of the Strategic Investment Board (Northern Ireland) at the end of March 2009. A non-executive director of Hammerson, Vodafone and Witan Investment Trust and chairman of Marks and Spencer Pension Trust, Asian Infrastructure Fund and Lincoln's Inn investment committee. A former chairman of MEPC and a former member of the Financial Reporting Council. Aged 63

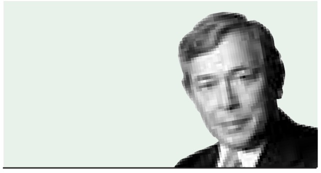


Philip N Green
Independent director

Member of the audit and remuneration committees

Joined the board in May 2007. Appointed chief executive of United Utilities in 2006. Former chief executive of Royal P&O Nedlloyd from 2003 to 2005. Previously held senior positions in DHL from 1990 to 1999, becoming chief operating officer for Europe and Africa in 1994, and the Reuters Group from 1999 to 2003, becoming chief operating officer in 2001. A director of Business in the Community and the UK Commission for Employment and Skills. A trustee of the Philharmonia Orchestra. Aged 55

EXECUTIVE DIRECTORS

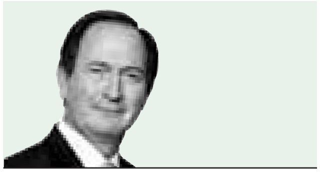


J Eric Daniels
Group Chief Executive

Joined the board in 2001 as group executive director, UK retail banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. A non-executive director of BT Group. Aged 57

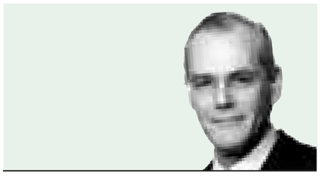
Archie G Kane
Group Executive Director
Insurance

Joined the Group in 1986 and held a number of senior and general management appointments before being appointed to the board in 2000, as group executive director, IT and operations. Appointed group executive director, insurance and investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. Chairman of the Association of British Insurers and a member of the Chancellor's Financial Services Global Competitiveness Group, The Takeover Panel and the Chancellor's Insurance Industry Working Group. Aged 56



G Truett Tate
Group Executive Director
Wholesale

Joined the Group in 2003 as managing director, corporate banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. A non-executive director of BritishAmerican Business Inc. A member of the fund-raising board of the National Society for the Prevention of Cruelty to Children, a director of Business in the Community and a director and trustee of In Kind Direct. Aged 58



Martin A Scicluna
Independent director

Member of the audit and risk oversight committees

Joined the board on 1 September 2008. Chairman of Deloitte UK from 1995 to 2007 and a member of the board from 1991 to 2007. Joined the firm in 1973 and was a partner from 1982 until he retired in 2008. A member of the board of directors of Deloitte Touche Tohmatsu from 1999 to 2007. A non-executive director of Great Portland Estates. A member of the council of Leeds University and a governor of Berkhamsted School. Aged 58

Tim J W Tookey
Group Finance Director

Joined the Group in 2006 as deputy group finance director, before being appointed acting group finance director in April 2008. Appointed to the board in October 2008 as group finance director. Previously finance director for the UK and Europe at Prudential from 2002 to 2006 and group finance director of Heath Lambert Group from 1996 to 2002. Prior to that, he spent 11 years at KPMG. Aged 46

Helen A Weir CBE
Group Executive Director
Retail

Joined the board in 2004 as group finance director. Appointed as group executive director, UK retail banking in April 2008. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q from 1997, having joined that company in 1995, and held a senior position at McKinsey & Co from 1990 to 1995. Began her career at Unilever in 1983. A non-executive director of Royal Mail Holdings. A member of the Said Business School Advisory Board and a former member of the Accounting Standards Board. Aged 46

Harry F Baines
Company Secretary and General Counsel

DIRECTORS' REPORT

RESULTS AND DIVIDENDS

The consolidated income statement shows a profit attributable to equity shareholders for the year ended 31 December 2008 of £819 million.

An interim dividend of 11.4p per ordinary share was paid on 1 October 2008. This dividend absorbed £648 million.

PRINCIPAL ACTIVITIES, BUSINESS REVIEW, FUTURE DEVELOPMENTS AND FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company is a holding company and its subsidiary undertakings provide a wide range of banking and financial services through branches and offices in the UK and overseas. A review of the development and performance of the business during the financial year and an indication of the likely future developments are given on pages 2 to 64. Key performance indicators are shown on page 11. Information regarding the financial risk management objectives and policies of the Company and its subsidiary undertakings, in relation to the use of financial instruments, is given on pages 42 to 64 and in note 49 on pages 165 to 177.

GROUP STRUCTURE

On 16 January 2009, Lloyds TSB Group plc changed its name to Lloyds Banking Group plc, following the acquisition of HBOS plc.

POST BALANCE SHEET EVENTS

Details are given in note 52 on page 181.

DIRECTORS

Biographical details of directors are shown on pages 66 and 67. Particulars of their emoluments and interests in shares in the Company are given on pages 74 to 95.

Ms T A Dial and Mr M E Fairey left the board on 18 April 2008 and 30 June 2008, respectively. Mr Ewan Brown will retire at the annual general meeting in 2009.

Sir David Manning joined the board on 1 May 2008.

Mr M A Scicluna, Ms C J McCall and Mr T J W Tookey joined the board on 1 September 2008, 1 October 2008 and 30 October 2008, respectively, and Mr T T Ryan and Mr Anthony Watson have been appointed directors from 1 March 2009 and 2 April 2009, respectively. In accordance with the articles of association, they offer themselves for election at the annual general meeting.

Sir Victor Blank, Mr A G Kane and Lord Leitch retire at the annual general meeting and offer themselves for re-election.

DIRECTORS' INDEMNITIES

The directors, including two former directors who left during the year, have entered into individual contracts of indemnity with the Company which constituted 'qualifying third party indemnity provisions' and 'qualifying pension scheme indemnity provisions' for the purposes of the Companies Act 2006. These contracts were in force during the whole of the financial year or from the date of appointment in respect of the four directors who joined the board in 2008. The contracts remain in force and are available for inspection at the Company's registered office.

SHARE CAPITAL

Information about share capital is shown in note 41 on pages 152 to 154; in note 6 of the parent company accounts, included within this document, on page 187; in the corporate governance report on pages 70 to 73; and in the directors' remuneration report on pages 74 to 95.

It is intended to issue ordinary shares by way of a capitalisation issue in May 2009, at the rate of one share for every 40 shares held.

CHANGE OF CONTROL

The Company is party to significant contracts that are subject to change of control provisions in the event of a takeover bid as follows:

The Company is party to a deed of covenant with each of the four Lloyds TSB Foundations (the 'Foundations') which hold limited voting shares in the Company (the limited voting shares are further described in note 41 on page 153). Under the terms of the deeds of covenant, the Company makes an annual payment to each of the Foundations. In the event of a successful offer for more than 50 per cent of the issued ordinary share capital of the Company, each limited voting share would convert to an ordinary share under the terms of the Company's articles of association. The payment obligation under the deeds of covenant would come to an end one year following the conversion of the limited voting shares.

EMPLOYEES

Lloyds Banking Group is committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief.

In the UK, Lloyds Banking Group belongs to the major employer groups campaigning for equality for the above groups of staff, including Employers' Forum on Disability, Employers' Forum on Age, Stonewall and the Race for Opportunity. Our involvement with these organisations enables us to identify and implement best practice for our staff.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds Banking Group.

DONATIONS

The income statement includes a charge for charitable donations totalling £29,603,000 in 2008 (2007: £37,463,000), including £28,997,000 (2007: £37,183,000) which will be paid under the deeds of covenant to the four Lloyds TSB Foundations during 2009.

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Company follows 'The Better Payment Practice Code' published by the Department of Business, Enterprise and Regulatory Reform (BERR), regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the BERR as shown on page 191.

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is 23. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2008 bears to the aggregate of the amounts invoiced by suppliers during the year.

DIRECTORS' RESPONSIBILITY STATEMENT

Each of the current directors, whose names and functions are shown on pages 66 and 67 of this annual report, confirms that, to the best of his or her knowledge:

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and Group; and
- the management report contained in the business review includes a fair review of the development and performance of the business and the position of the Company and Group, together with a description of the principal risks and uncertainties they face.

AUDITORS AND AUDIT INFORMATION

Each person who is a director at the date of approval of this report confirms that, so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditors and authorising the audit committee to set their remuneration will be proposed at the annual general meeting.

On behalf of the board

Harry F Baines
Company Secretary and General Counsel
26 February 2009

CORPORATE GOVERNANCE

COMPLIANCE WITH THE COMBINED CODE

The board is committed to ensuring that the Group has a robust governance structure in place. That has been uppermost in directors' minds when applying the principles contained in section 1 of the 2006 combined code on corporate governance issued by the Financial Reporting Council. The Group has complied with the provisions of the code and has done so throughout the year regarding the provisions where the requirements are of a continuing nature.

THE BOARD AND ITS COMMITTEES

The Group is led by the board comprising executive and non-executive directors with wide experience. The appointment of directors is considered by the board and, following the provisions in the articles of association, they must stand for election by the shareholders at the first annual general meeting following their appointment and must retire, and may stand for re-election by the shareholders, at least every three years. Independent non-executive directors are appointed for three-year renewable terms, which may, in accordance with the articles of association, be terminated without notice or payment of compensation.

The board usually meets at least nine times a year. It has a programme designed to enable the directors regularly to review corporate strategy and the operations and results of the businesses and discharge their duties within a framework of prudent and effective controls relating to the assessing and managing of risk.

The roles of the chairman, the group chief executive and the board and its governance arrangements, including the schedule of matters specifically reserved to the board for decision, are reviewed annually. The matters reserved to the board for decision include the approval of the annual report and accounts and any other financial statements; the payment of dividends; the long term objectives of the Group; the strategies necessary to achieve these objectives; the Group's budgets and plans; significant capital expenditure items; significant investments and disposals; the basis of allocation of capital within the Group; the organisation structure of the Group; the arrangements for ensuring that the Group manages risks effectively; any significant change in accounting policies or practices; the appointment of the Company's main professional advisers and their fees; and the appointment of senior executives within the organisation and related succession planning.

According to the articles of association, the business and affairs of the Company are managed by the directors, who have delegated to management the power to make decisions on operational matters, including those relating to credit, liquidity and market risk, within an agreed framework.

All directors have access to the services of the company secretary, and independent professional advice is available to the directors at the Group's expense, where they judge it necessary to discharge their duties as directors.

During the year, Dr Tracy Long, of Boardroom Review, conducted a formal evaluation of the performance of the board, its committees and individual directors. Directors were invited to comment, through questionnaires and interviews, and Dr Long's report was subsequently reviewed and discussed by the board. Where areas for improvement were identified, action has been agreed.

The chairman's performance was evaluated by the non-executive directors, taking account of the views of executive directors. This appraisal was discussed at a meeting of the non-executive directors, led by the senior independent director, without the chairman being present.

The remuneration committee reviewed the performance of the chairman, the group chief executive and the other group executive directors, when considering their remuneration arrangements. The nomination committee reviewed the performance of all the directors and the independence of non-executive directors. Like all board committees, the nomination committee and remuneration committee report to the board on their deliberations, including the results of the performance and independence evaluations.

The chairman has a private discussion at least once a year with every director on a wide range of issues affecting the Group, including any matters which the directors, individually, wish to raise.

There is an induction programme for all new directors, which is tailored to their specific requirements and includes visits to individual businesses and meetings with senior management. Major shareholders are also offered the opportunity to meet new non-executive directors. Additional training and updates on particular issues are arranged as appropriate.

DIRECTORS' CONFLICTS OF INTEREST

The board, as permitted by the Group's articles of association, has authorised all potential conflicts of interest declared by individual directors. Decisions regarding these conflicts of interest could only be taken by directors who had no interest in the matter. In taking the decision, the directors acted in a way they considered, in good faith, would be most likely to promote the Company's success. The directors had the ability to impose conditions, if thought appropriate, when granting authorisation. Any authorities given will be reviewed at least every 15 months. No director is permitted to vote on any resolution or matter where he or she has an actual or potential conflict of interest.

MEETINGS WITH SHAREHOLDERS

In order to develop an understanding of the views of major shareholders, the board receives regular reports from the group finance director and the director of investor relations.

The chairman, the group chief executive and the group finance director also have meetings with representatives of major shareholders and the senior independent director also attends some of these meetings. In addition, all directors are invited to attend investment analysts' and stockbrokers' briefings on the financial results.

All shareholders are encouraged to attend and participate in the Group's annual general meeting.

Each resolution considered at the annual general meeting in May 2008 and the general meeting in November 2008 was decided on a poll. Votes representing approximately 50 per cent of the total number of shares in issue were cast at both meetings and each resolution was passed by a substantial majority. Details of the poll results were announced following the meetings and displayed on our website, www.lloydsbankinggroup.com. They are available from the company secretary.

The resolutions to be considered at the annual general meeting in 2009 will also be decided on a poll. Details of the results will be announced following the meeting and will be displayed on our website, www.lloydsbankinggroup.com. They will also be available from the company secretary.

AUDIT COMMITTEE

The audit committee comprises Mr du Plessis (chairman), Mr Brown, Mr Green, Lord Leitch, Mr Ryan (from 1 March 2009) and Mr Scicluna. The committee's terms of reference are available from the company secretary and are displayed on our website, www.lloydsbankinggroup.com.

During the year, the audit committee received reports from, and held discussions with, management and the auditors. In discharging its duties, the committee has approved the auditors' terms of engagement, including their remuneration and, in discussion with them, has assessed their independence and objectivity (more information about which is given in note 11 to the consolidated financial statements, in relation to the procedure for approving fees for audit and non-audit work) and recommended their re-appointment at the annual general meeting. The committee also reviewed the financial statements published in the name of the board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; the scope of the work of the group audit department, reports from that department and the adequacy of its resources; the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations (more information about which is given in the note about internal control on page 73); the results of the external audit and its cost effectiveness; and reports from the external auditors on audit planning and their findings on accounting and internal control systems. Procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence have been established by the committee. The committee also had a meeting with the auditors, without executives present, and a meeting with the group audit director alone.

CHAIRMAN'S COMMITTEE

The chairman's committee, comprising the chairman and the group chief executive, meets to assist the chairman in preparing for board meetings.

The committee exercises specific powers delegated to it by the board from time to time.

GROUP EXECUTIVE COMMITTEE

The group executive committee, comprising the group chief executive, the group executive directors, the wealth and international director, the chief risk officer, the group human resources director, the group integration director and the director of group operations, meets to assist the group chief executive in performing his duties. Specifically, the committee considers the development and implementation of strategy, operational plans, policies and budgets; the monitoring of operating and financial performance; the assessment and control of risk; the prioritisation and allocation of resources; and the monitoring of competitive forces in each area of operation. The committee, assisted by its sub-committees, the group business risk and group asset and liability committees, also supports the group chief executive in endeavouring to ensure the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and in reviewing the Group's aggregate risk exposures and concentrations of risk.

The committee exercises specific powers delegated to it by the board from time to time. To comply with the Company's articles of association, only committee members who are also directors of the Company participate in the exercising of any powers delegated by the board.

NOMINATION COMMITTEE

The nomination committee, comprising Sir Victor Blank (chairman), Dr Berndt, Mr du Plessis, Sir Julian Horn-Smith, Lord Leitch and Sir David Manning, reviews the structure, size and composition of the board, taking into account the skills, knowledge and experience of directors and considers and makes recommendations to the board on potential candidates for appointment as directors. The committee also makes recommendations to the board concerning the re-appointment of any independent non-executive director by the board at the conclusion of his or her specified term; the re-election of any director by the shareholders under the retirement provisions of the articles of association; any matters relating to the continuation in office of a director; and the appointment of any director to executive or other office in the Company, although the chairman of the Company would not chair the committee when it was dealing with the appointment of a successor to the chairmanship of the Company.

During the year, in accordance with the plans for the orderly succession for appointments to the board, the committee recommended the appointment of one executive director and three non-executive directors. In that regard, detailed role specifications were drawn up, external search consultants were engaged and candidates were interviewed by committee members and other directors.

In addition, the directors agreed with the committee's recommendation that Mr Brown be asked to remain on the board until the annual general meeting in 2009. This would enable the Group to continue to benefit from his wide experience and maintain an appropriate balance of skills and experience on the board, as part of the plans for orderly succession for appointments. His continuing membership of the audit committee and understanding of the Group's activities was particularly helpful to the new chairman of that committee. Mr Brown remains the senior independent director until he is succeeded at the conclusion of the annual general meeting by Lord Leitch. The board considered the matter very carefully and concluded that both Mr Brown and Lord Leitch were independent in character and there were no relationships or circumstances which were likely to affect, or could appear to affect, their judgement.

CORPORATE GOVERNANCE continued

The committee's terms of reference are available from the company secretary and are displayed on our website, www.lloydsbankinggroup.com.

REMUNERATION COMMITTEE

Information about the remuneration committee's membership and work is given in the directors' remuneration report on pages 74 to 95 and its terms of reference are available from the company secretary and are displayed on the Company's website, www.lloydsbankinggroup.com.

RISK OVERSIGHT COMMITTEE

The risk oversight committee comprises Sir Victor Blank (chairman), Mr Brown, Mr du Plessis, Sir Julian Horn-Smith, Lord Leitch, Sir David Manning, Mr Ryan (from 1 March 2009) and Mr Scicluna. All non-executive directors are also invited to attend meetings if they wish. The risk oversight committee's duties include overseeing the development, implementation and maintenance of the Group's overall risk management framework, and its risk appetite, strategy, principles and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The committee also oversees the Group's risk exposures; facilitates the involvement of non-executive directors in risk issues and aids their understanding of these issues; oversees adherence to Group risk policies and standards and considers any material amendments to them; and reviews the work of the group risk division.

ATTENDANCE AT MEETINGS

The attendance of directors at board meetings and at meetings of the audit, nomination, remuneration and risk oversight committees during 2008 were as follows:

	Board	Audit Committee	Nomination Committee	Remuneration Committee	Risk Oversight Committee
Number of meetings during the year	18	6	7	9	5
Current directors who served during 2008					
W C G Berndt	16		7	9	
Sir Victor Blank	18		7	8	5
Ewan Brown	17	6			5
J E Daniels	18				
J P du Plessis[1]	17	6	6		2 (max 3)
P N Green	15	5		7	
Sir Julian Horn-Smith	18		7	9	5
A G Kane	17				
Lord Leitch	17	6	7		5
Sir David Manning[2]	10 (max 15)		4 (max 4)	6 (max 7)	2 (max 3)
C J McCall[3]	5 (max 7)				
M A Scicluna[4]	11 (max 11)	2			1 (max 1)
G T Tate	18				
T J W Tookey[5]	3 (max 3)				
H A Weir	18				
Former directors who served during 2008					
T A Dial[6]	2				
M E Fairey[7]	4				

[1] Appointed to the risk oversight committee from 8 May 2008.
[2] Appointed to the board, nomination, remuneration and risk oversight committees on 1 May 2008.
[3] Appointed to the board on 1 October 2008.
[4] Appointed to the board, audit and risk oversight committees on 1 September 2008.
[5] Appointed to the board on 30 October 2008.
[6] Left the board on 18 April 2008.
[7] Left the board on 30 June 2008.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the consolidated and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. The directors consider that in preparing the financial statements on pages 97 to 190 the Company and the Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The directors have responsibility for ensuring that the Company and the Group keep proper accounting records which disclose with reasonable accuracy the financial position of the Company and the Group and which enable them to ensure that the financial statements and the directors' remuneration report comply with the Companies Act 1985 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and the Group and to prevent and detect fraud and other irregularities.

A copy of the financial statements of the Company is placed on our website, www.lloydsbankinggroup.com. The directors are responsible for the maintenance and integrity of statutory and audited information on the Company's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INTERNAL CONTROL

The board of directors is responsible for the establishment and review of Lloyds Banking Group's system of internal control, which is designed to ensure effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. It should be noted, however, that such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. In establishing and reviewing the system of internal control, the directors have regard to the nature and extent of relevant risks, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The directors and senior management are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of published policies and procedures and regular management briefings. A requirement to comply with internal control risk policies is a key component of individual staff objectives expressed in the balanced scorecard. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. In addition, there is an annual control self assessment exercise whereby the key businesses and head office functions review specific controls and attest to the accuracy of their assessments. The assessment covers all enterprise-wide risk management categories and is in accordance with the principles of the combined code. As in previous years, this exercise was completed for the year ended 31 December 2008. All returns have been satisfactorily completed and appropriately certified.

The effectiveness of the internal control system is reviewed regularly by the board and the audit committee, which also receives reports of reviews undertaken around Lloyds Banking Group by group risk and group audit. The audit committee receives reports from the Company's auditors, PricewaterhouseCoopers LLP (which include details of significant internal control matters that they have identified), and has a discussion with the auditors at least once a year without executives present, to ensure that there are no unresolved issues of concern.

GOING CONCERN

The going concern of the Company and the Group is dependent on successfully funding their respective balance sheets and maintaining adequate levels of capital. In order to satisfy themselves that the Company and the Group have adequate resources to continue to operate for the foreseeable future, the directors have considered a number of key dependencies as discussed in note 1 on page 102. Having considered projections of the Group's capital and funding position, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

DIRECTORS' REMUNERATION REPORT

This is a report made by the board of Lloyds Banking Group plc, on the recommendation of the remuneration committee. It covers the current and proposed components of the remuneration policy and details the remuneration for each serving director during 2008.

CONTENT OF REMUNERATION REPORT

– Statement from remuneration committee chairman
– Remuneration decisions for 2008/9 key highlights
– Governance and risk management, including the role, membership and advisers to the committee
– Directors' remuneration policy
– Remuneration for 2009
– Remuneration for 2008
– Dilution limits
– Pensions
– Service agreements
– External appointments
– Performance graph
– Audited information

STATEMENT FROM WOLFGANG BERNDT

CHAIRMAN OF THE REMUNERATION COMMITTEE

It is my privilege once again to introduce the board's report on remuneration policy and practice.

INTRODUCTION

2008 was a year of unprecedented change and turmoil in financial services, in reality probably one of the most dramatic years that the sector has ever been through. The erosion of trust in the financial system, triggered by high profile failures both here and abroad, led to a change in business circumstances that no bank could escape. The problems in the financial sector have fed into the real economy and we now face a severe recession. This has understandably led to public anger and to questions being raised about the role of banks in the financial crisis.

Deciding how executives should be paid in these extraordinary circumstances has been an immensely difficult task. We know that many of our stakeholders will want to understand how we came to our decisions. For this reason, we have adopted a different approach to this year's remuneration report. In addition to the normal information provided, much of which is required by regulations, we have decided to set out the principles underlying our remuneration philosophy. We have also decided to describe how the committee came to the decisions it did during the year in more detail than would be normal. Given the current environment, we believe that our shareholders, customers, employees, and regulators are entitled to this information. We hope that in whatever capacity you are reading this report, you find it helpful.

A PRUDENT REMUNERATION POLICY

For some years now we have adopted a strategy based on building long-term relationships with our customers and through managing our business decisions based on our assessment of how they will perform through an entire economic cycle. This strategy is inherently long-term and requires a prudent approach to managing risk. It resulted in Lloyds TSB avoiding many of the more high-risk lending areas and funding strategies, even though this could have led to higher profits in the short-term during the boom years.

Like many other banks, we have been unable to avoid the problems created by the sharp decline in the willingness of banks to lend to each other and by the recession in the UK and many other countries around the world. In addition we recognise that while the acquisition of HBOS creates significant opportunities for Lloyds Banking Group, in the short term it has created a number of challenges and the need to participate in the Government recapitalisation programme. However, we remain an inherently prudent and well-managed bank, and will be in a very strong position to continue to serve our customers and shareholders in the future.

Historically our prudent business strategy has also been reflected in our approach to remuneration. Overall, we have taken a conservative approach to remuneration levels. We have typically positioned our base salaries and incentive levels at or below the levels offered by our direct competitors or by other UK companies of a similar size. The termination provisions within our contracts are among the toughest in the FTSE 100, ensuring no payment for failure.

We have used targets in our incentive plans that encourage the prudent management of risk. The economic profit measure that we use takes account of the capital we need to generate our profits, and the risk of the business we are undertaking. For a given level of profit, higher risk will result in lower levels of annual incentive payout for our executives. Economic profit is measured on the performance of our business (and in particular default rates on loans) through an entire economic cycle. This discourages management from taking short-term risks that will have adverse long-term consequences. As a result we have been able to avoid the riskier types of lending or the less prudent funding strategies that were the downfall of some other UK banks.

Our annual incentive plan also reflects the fact that you cannot run a successful bank by entirely focusing on financial performance. The plan includes measures relating to how well we serve our customers, how committed and engaged our employees are, the success with which we are growing our franchise, and how we are managing risk. These are factors that have a direct and measurable impact on the future success of our business.

This combination of financial and non-financial annual incentive targets encapsulated in a balanced scorecard reinforces to all of our executives the importance of doing business for the long-term in a way that is sustainable. This reflects our commitment to basing our business on building long-term relationships.

GOVERNMENT RECAPITALISATION

In October last year Lloyds TSB participated in a recapitalisation programme launched by the UK Government to ensure the stability of the UK banking system. Details of this arrangement are included in the Chairman's statement.

Participation in this programme has clearly impacted on our remuneration approach as well as our commitment to comply with the Financial Service Authority's (FSA) principles on remuneration. In light of a review of the Group's remuneration polices earlier in 2008 and following consultation with the FSA in October, we developed an approach which is aligned to these principles. Our approach is currently under further detailed review and any subsequent changes will be made as required to ensure our compliance with the FSA's draft Code of Practice.

Although we believe that our approach to remuneration has served the business well, we recognise that we are now operating in an entirely different environment for banks. This will be reflected in the changes we are making to our remuneration approach.

In line with our prudent approach to remuneration we had already announced that for 2009 there would be no salary increases for the board and at their own request the executive directors would not be awarded any bonus for 2008. In addition long-term incentive awards for 2009 have been reduced by 175 per cent of salary.

FUTURE REMUNERATION DESIGN

During 2009 we will be undertaking a further review of our remuneration policy and practices. The committee intends to undertake this review mindful of the requirements of our shareholders and regulators whilst doing the utmost to ensure that we are not competitively disadvantaged against the market with respect to our approach to remuneration going forward; particularly our ability to attract and retain the best talent for the future of the Group.

There are clearly many things to be learned by all banks from the current crisis. One of the areas receiving a lot of attention is the whole area of remuneration and risk management. During the year the committee reviewed an analysis of Lloyds TSB incentive schemes and the extent to which they support sound risk-management, and are aligned with customer and shareholder interests. This was started in the first half of the year, pre-dating the HBOS acquisition and the Financial Services Authority's project looking at remuneration in the banking sector.

The committee believes that we have an approach to remuneration aligned with our business strategy that remains sound in its fundamental principles. We do not believe that remuneration led to adverse behaviour at Lloyds TSB. Indeed we believe that our prudent approach to remuneration helped us to avoid many of the problems experienced by a number of our competitors. However, we are not complacent. We recognise that there are areas where our remuneration arrangements can be improved. We have studied the developments in the industry and the recommendations put forward by regulators and industry commentators. We are adopting many of these recommendations in our remuneration for 2009 and beyond. We are committed to rolling out these remuneration practices across the Lloyds Banking Group.

CONCLUSION

Our past approach to remuneration has been well received by shareholders and a key focus for the committee and the management team is to maintain that positive relationship. We have therefore consulted extensively with shareholders in relation to all of our 2008 and 2009 remuneration decisions.

One key challenge that the committee has been grappling with has been how best to motivate and incentivise the management team of the Lloyds Banking Group to undertake the huge task ahead, while recognising that we are operating in a very difficult environment for banks generally. We recognise the extreme scrutiny that remuneration in the financial services sector is attracting and the current sentiment of shareholders. At the same time, the Board strongly believes that we have the executive management team required to take on the complexity of issues that the integration of HBOS will bring. The retention of this team is central to the future success of the bank and it is important that they are paid in a fair and responsible way.

The remuneration committee unanimously recommends that you vote to approve the remuneration report at the 2009 Annual General Meeting.

Dr Wolfgang Berndt
Chairman, remuneration committee

REMUNERATION DECISIONS FOR 2008/2009 KEY HIGHLIGHTS

In 2009, our remuneration package will continue to have the same main elements as for 2008:

– base salary
– annual incentive
– long-term incentive plan

In addition, executive directors participate in pension arrangements and receive benefits such as life assurance and medical insurance.

The following key decisions have been made for 2008/2009 remuneration:

– at their own request, the executive directors will not be awarded any bonus for 2008
– base salaries for executive directors frozen at 2008 levels
– reduced the maximum level of incentives from 2008 levels by 175 per cent of salary
– strengthened the role for non-financial measures, introducing a balanced scorecard into the long-term incentive plan focused on the HBOS integration
– increased the role of risk-adjusted economic profit, by introducing it as a measure in the long-term incentive plan, in addition to its current use in the annual incentive
– changed the annual incentive plan so that the payment is deferred over three years, and subject to claw-back if the performance on which the incentive is based is found not to be sustainable
– determined that, from April 2012, executive directors will no longer participate in the final salary pension plan

The approximate make-up of the main components of our new package for executive directors on an expected value basis is shown below.

Long-term incentive	33%	Based on a combination of performance targets comprising economic profit, earnings per share, synergy savings, and non-financial measures relating to the success of the integration	**Paid in shares after three years**
Short-term incentive	33%	Based half on financial measures and half on a balanced scorecard of non-financial measures	**Deferred and paid in tranches over three years subject to clawback**
Salary	33%	Based on role, market competitiveness, and performance	**Paid in cash**

The package is designed to encourage a long-term and risk-based focus:

– Salary is a significant proportion of the total package, avoiding excessive leverage
– All incentives will be paid on a deferred basis over three years
– Deferred annual incentive is subject to claw-back, i.e. is not paid if performance on which the incentive is based is found to be unsustainable
– A combination of financial and non-financial measures encourages a long-term focus
– Economic profit, which is a risk-adjusted profit measure, is a core financial target

We believe that these arrangements are well aligned with the Financial Services Authority's draft Code of Practice on Remuneration.

GOVERNANCE AND RISK MANAGEMENT

An essential component of our approach to remuneration is the governance process that underpins it. This ensures that our policy is robustly applied and risk is managed appropriately.

The remuneration committee reviews the remuneration policy for the top management group. The committee's role is to ensure that members of the executive management are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation.

The committee advises on major changes of employee benefits schemes and it also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount, currently £350,000.

All the independent non-executive directors are invited to attend meetings if they wish, and they receive the minutes and have the opportunity to comment and their views taken into account before the committee's decisions are implemented.

The committee's terms of reference are available from the company secretary and are displayed on the Group's website, www.lloydsbankinggroup.com.

The committee met on nine occasions during 2008, and the members were as follows:

– Dr Wolfgang Berndt (chairman)
– Sir Victor Blank
– Mr Philip Green
– Sir Julian Horn-Smith
– Sir David Manning (from 1 May 2008)

We welcomed Sir David Manning to the committee in May 2008, which was the only change to the committee membership during the year.

The committee retains independent consultants to provide advice on specific matters according to their particular expertise. Towers Perrin, Hewitt New Bridge Street and Kepler Associates were retained by the committee during 2008 to advise on various matters relating to executive remuneration. In addition, PricewaterhouseCoopers LLP (PwC) were also retained in 2008 specifically to support the committee with a one-off project to review executive remuneration arrangements in light of the acquisition of HBOS, given their particular expertise in relation to the remuneration aspects of transactions. In recognition that PwC are also the auditors to the Lloyds Banking Group and to mitigate any threat to audit independence, Kepler Associates continue to be retained as the remuneration committee's primary independent advisers, and were commissioned to provide comment on PwC's advice.

In addition to their advice on executive remuneration, during 2008 Towers Perrin also provided market remuneration data as well as other remuneration consulting services to the Group, Hewitt New Bridge Street provided pension consulting services and PwC were the Group's auditors.

During 2008, Alithos Limited continued to provide information on behalf of the committee for the testing of the total shareholder return (TSR) (calculated by reference to both dividends and growth in share price) performance conditions for the Group's long-term incentive schemes.

Mr Daniels, Mrs Risley (Group Human Resources Director), Mr Farley (Reward & Employment Policy Director) and Ms Kemp (HR Director, Total Reward) provided guidance to the committee (other than for their own remuneration).

The remuneration committee takes an interest in ensuring that appropriate remuneration and governance arrangements are in place throughout the organisation, with the Group functions providing an oversight role in the development of remuneration policy and practice below the senior executive population. In particular, divisional remuneration decisions are subject to independent oversight from the human resources function and the appointment and remuneration for risk officers in the divisions is reviewed in conjunction with the chief risk officer for the Group.

During 2008, the committee received a review of the Group's remuneration practices against a number of criteria including customer, shareholder alignment, conflict of interest and risk. This was prior to the review of practices requested by the Financial Services Authority (FSA) in October 2008. In general, the review found that there was good alignment between remuneration practices and the policy objectives. However, changes are being implemented to the practice in some areas of the business. In particular we had put in place for those employees in our Wholesale and International Banking division a bonus deferral plan appropriate to the roles they perform. As described above we have also implemented a deferral arrangement for senior executives, and have increased the use of our risk-adjusted economic profit measure in our incentive plans.

Following the FSA's approach to a number of major UK banks in October 2008, we submitted an analysis of our current remuneration policies against their proposed good practice criteria. The assessment showed a generally favourable comparison. We have met with representatives from the FSA and will continue to co-operate with them as they develop their updated guidance in 2009. Their draft Code of Conduct was published as this report was being finalised. Although we believe our approach is well aligned with the Code of Conduct, our approach will be subject to a further detailed review.

As a result of this review, and discussions with the FSA, we have identified some areas of governance where we will be implementing changes for the future, as part of our plan for integrating the Lloyds TSB and HBOS businesses:

- We will be enhancing the formal role of control functions in the oversight of remuneration. Input is already sought from the risk and finance functions into remuneration design and decisions. However, we believe that our governance would benefit from a more formalised role for control functions in our remuneration processes.
- We will be reviewing the oversight of divisional remuneration. Already we apply independent oversight of divisional remuneration from the Group's centre function. During the year, the group HR function, in conjunction with the risk function, undertook the group wide review of remuneration practices summarised above, and we will be reviewing the oversight processes and governance controls relating to divisions to identify areas where they can be further strengthened. Our particular emphasis will be on ensuring that the linkage between good risk practices and remuneration can be robustly demonstrated.
- Regulators have identified the remuneration of risk officers as one of their areas of interest. The decision on risk officer remuneration is already held at the Group's centre function. We will be reviewing the remuneration setting processes for all of our control functions to ensure that all potential conflicts of interest are identified and managed.

DIRECTORS' REMUNERATION POLICY

The Group's remuneration policy supports our business strategy, which is based on building long-term relationships with our customers and employees, and managing the financial consequences of our business decisions across the entire economic cycle. The policy is designed to ensure that cost effective packages are provided which attract and retain executive directors and senior management of the highest calibre and motivate them to perform to the highest standards. At the same time, the objective is to align individual rewards with the Group's performance, the interests of its shareholders, and a prudent approach to risk management. In this way we balance the requirements of our various stakeholders: customers, shareholders, employees, and regulators. We believe that this approach is in line with the Association of British Insurers best practice code on remuneration as well the draft Financial Services Authority's Code of Practice, as the policy seeks to reward long-term value creation whilst not encouraging excessive risk taking.

We summarise below how each of these policy objectives is met by our remuneration packages.

Policy objective	How achieved
Building long-term relationships	We build relationships with our customers and people rather than viewing them as counterparties in a money-making transaction and will be seeking to extend this philosphy across the integrated Group. This means that working for the Lloyds Banking Group should be about more than pay. While our relationships with our people means that we will pay them fairly and competitively, our pay is positioned conservatively against the market and we will not seek to be among the highest payers in the sector. In setting pay for executive directors, we take account of the terms and conditions applying to other employees of the Group. Our incentive measures are not just financial. Half of the annual incentive for executives is linked to a scorecard including how we performed against targets that measure how satisfied our customers are with us, and the extent to which our employees feel engaged with and committed to working for the Lloyds Banking Group, both of which are important foundations of a relationship-based strategy.
Managing the financial consequences of our business through the economic cycle	Economic profit is a key measure by which we manage our business. This measure takes into account the level of capital required to generate profits as well as the risks taken. The same level of profit generated at lower risk results in higher economic profit. Economic profit also measures risk based on an assessment of how business will perform through the economic cycle. Therefore, for example, in good times, when default rates on loans are low, we adjust the economic profit measure downwards based on a higher average expected default experience over the economic cycle. This encourages us to avoid business and funding strategies that are only profitable during boom times but turn bad in a recession. Economic profit plays a prominent role in our incentive plans for executives, a role which will be further enhanced in 2009, with its inclusion in the long-term incentive plan performance measures.
Aligning individual rewards with Group performance and shareholders	The majority of our executives' pay is linked to stretching performance targets through annual and long-term incentives. Performance measures on the annual incentive are directly aligned to the Group's financial and non-financial performance. Executives are aligned with shareholders through the long-term incentive plan, which pays out based on performance against Group targets over a three year period, and which is paid in shares to improve alignment with shareholders further. The combination of incentive plans is designed to enable executives to achieve pay levels within the top 25 per cent of comparable companies, provided that performance is also in the top 25 per cent. Executives are required to build up a holding in the Lloyds Banking Group shares of value equal to 1.5 times salary for executive directors (2 times salary for the group chief executive). They are expected to retain half of the net-of-tax proceeds of share plan pay-outs until they reach this target. Finally, we operate tough contract provisions whereby no executive has an entitlement to more than 12 months' notice, compensation on termination is limited to basic salary, and any compensation is paid monthly over 12 months and is mitigated if the executive gets another job. This approach avoids the risk of payment for failure. These requirements are among the toughest in the FTSE 100.

Policy objective	How achieved
A prudent approach to risk management	Economic profit measures profit relative to the risk taken to generate that profit. Its use in our incentive plans therefore encourages executives to take a prudent approach to risk. We also have non-financial measures of performance against risk objectives in the plan for executives, which enables a more rounded assessment of risk-taking behaviour to be made. For the 2009 incentive we have increased the alignment to long-term prudent risk management by introducing deferral. For executive directors and other senior executives, any cash incentive earned will be deferred and paid-out over three years. If the performance that led to the incentive is found to be unsustainable, then this deferred portion may be forfeited. We pay competitively but not excessively. Our prudent approach to positioning compensation means that we reduce the incentives where excessive risk may be taken for personal gain. This means that we do not attract employees with an extreme appetite for risk. We have a robust governance framework with an independent remuneration committee reviewing all compensation decisions. This robust approach to governance and review is cascaded through the organisation.
Cost effective packages to attract and retain executives	We aim to ensure that the totality of remuneration for executive directors is competitive against our benchmark groups. These groups are other major UK banks, and also the top 20 companies in the FTSE 100, reflecting practices in comparably sized large UK companies across all sectors. We aim to be competitively but conservatively positioned against the market. We aim to choose incentive plan targets that are directly linked to the business strategy and priorities. This not only ensures alignment with company performance, but also means that the targets are meaningful to executives and therefore motivating. This ensures that incentive packages are valued by executives and therefore cost effective.

REMUNERATION FOR 2009

The remuneration committee had already started a review of executive remuneration during 2008 prior to the announcement of the HBOS acquisition. This was in the light of concerns about the competitiveness of the package, which had led to the committee making long-term incentive awards of 375 per cent of salary in 2008, above the normal maximum of 300 per cent. The scope and context of this review was naturally altered by the acquisition of HBOS and by the rapidly evolving environment in the financial services sector.

The changes introduced as a result of this review are summarised below.

SUMMARY OF REMUNERATION ELEMENTS

The key remuneration elements for 2009 as a result of the review are summarised below. Each individual element is then described in more detail in the subsequent sub-sections.

Element	Level/design for 2009	Key purpose
Base salary	Set competitively relative to FTSE 20 and banking sector competitors No increase for 2009 compared with 2008	Meet essential commitments of executive Retention
Annual incentive	200 per cent of salary maximum (225 per cent for CEO), as for 2008 Based 50 per cent on Group financial targets relating to profit before tax and economic profit Based 50 per cent on balanced scorecard covering, customers, people, risk and build franchise Subject to deferral with the first tranche released in 2011	Alignment with Group performance Alignment with sound risk management Motivation of executives
Long-term incentive plan	200 per cent of salary maximum, 175 per cent of salary less than the maximum award level in 2008, split as follows: 120 per cent of salary Normal LTIP Award based: – 50 per cent on Earnings per Share – 50 per cent on Economic Profit 80 per cent of salary Integration Award based: – 50 per cent on financial synergy savings – 50 per cent on non-financial measures of the success of the HBOS integration	Alignment with shareholder interests Alignment with sound risk management Motivation and retention of executives

DIRECTORS' REMUNERATION REPORT continued

Element	Level/design for 2009	Key purpose
Pension	A mixture of final salary and defined contribution pension arrangements	Enable executives to build long-term retirement savings
	From April 2012, executive directors with final salary pensions will move to a defined contribution pension arrangement, with no compensation	Retention

Despite the significantly increased responsibilities of the executive directors, the maximum total pay opportunity for an executive director in 2009 is reduced by 175 per cent of salary from 2008.

GENERAL CONSIDERATIONS

When deciding the approach to take for remuneration in 2009, the remuneration committee considered a range of factors. In forming the Lloyds Banking Group, our senior executive team will be managing a combined business twice the size of Lloyds TSB, at the same time as integrating two highly complex businesses, one of which had a flawed business model. The balance sheet alone will be among the largest balance sheets in the world. There will be significant increases in workload and responsibilities. Shareholders, customers and tax-payers will want to ensure that the right team is in place, appropriately motivated and incentivised to take this bank forward, put appropriate risk management frameworks into HBOS, and deliver the value from the takeover. The terms on which senior executives have recently been appointed within the banking sector shows that shareholders remain convinced of the need to offer competitive compensation packages.

At the same time, the committee has been very aware of developments in the financial services sector and in relation to remuneration practices more widely. The committee reviewed trends in relation to base salary and incentives at other major financial firms globally, including those participating in Government funding programmes. The committee also considered the implications of the Financial Services Authority's draft code on remuneration. Finally the committee considered developments at the other UK and international banks, including the terms on which senior executives at banks were hired through the year (including executives departing from Lloyds TSB).

BASE SALARY

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by Towers Perrin) and then adjusted from 1 January of the following year. The remuneration committee confirmed during the 2008 review that the FTSE 20 was the most appropriate comparator group to use to benchmark overall competitiveness of the remuneration package whilst taking particular account of the remuneration practice of our direct competitors, namely the major UK banks. The FTSE 20 is regarded as providing a realistic and relevant comparison in terms of company size and complexity, as well as being a key market for talent.

However, in recognition of the current operating environment and in common with many of our peers, base salaries for 2009 remain unchanged from the salaries set for 2008. Basic salary increases for other employees across the Group will remain in line with any market movement, but will, in general be significantly lower than in previous years.

Name	J E Daniels	A G Kane	G T Tate	T J W Tookey	H A Weir
As at 1 January 2008	£1,035,000	£590,000	£640,000	£600,000*	£625,000

*With effect from appointment on 30 October 2008.

This approach has also been applied to the Chairman's salary and non-executive director fees for 2009 which remain unchanged from 2008.

ANNUAL INCENTIVE PLAN

The Lloyds TSB annual incentive plan already had many good features, such as the combination of financial and non-financial measures, which supported our prudent approach to managing risk. We are proposing to keep these features, while enhancing the operation of the plan in order to increase the alignment between risk and reward still further.

The remuneration committee has considered the preliminary guidance from the FSA relating to good practice criteria, and has reviewed emerging practice in other banks within the sector both in the UK and overseas. Although more than half of our total incentive opportunity was already deferred, through our long-term incentive plan, we have decided that the annual incentive for executive directors should be deferred also. Consistent with the aim of ensuring that short-term financial results are only achievable sustainably, the committee has decided that the incentive will be deferred and released in tranches over a three year period. The deferral will be on the same basis as for senior staff with the first tranche being released in June 2011. The deferred incentive will be subject to 100 per cent claw back if the performance that generated the incentive is found to be unsustainable.

The maximum annual incentive opportunity remains unchanged at 200 per cent (225 per cent for Mr Daniels) of basic salary for the achievement of exceptional performance targets.

The remuneration committee believes that the structure of the incentive – in particular the use of risk-adjusted and non-financial measures – has been highly successful in promoting a long-term focus within the senior management team. Introducing this deferral element further enhances these aspects of the plan.

LONG TERM INCENTIVE AWARD

The current LTIP rules allow for awards to be made of up to 400 per cent of base salary. Under normal circumstances awards are made of 300 per cent of salary with the additional 100 per cent available for circumstances that the remuneration committee deems to be exceptional. In 2008, awards were made of 375 per cent of base salary to the CEO and two of the executive directors for retention purposes, and in light of data reviewed by the committee which showed total remuneration to be behind median both for the FTSE 20, and the other major UK banks.

Further information viewed by the committee through 2008 continued to show that total remuneration for the executive directors was materially behind the median of our peer groups, even before allowing for the increased responsibilities of running the combined bank and the magnitude of the task of integrating the two businesses.

However, there is a strong overall focus on cost control within the business, and rapid changes within the industry make it difficult to assess what will, in future, be market competitive. Therefore, the committee has determined not to seek authority from shareholders to increase the LTIP award to the level required to achieve a market median value of remuneration. Instead, the committee has determined that for 2009 the grant level for executive directors should be set at 200 per cent of base salary.

This means that, in its totality, the maximum remuneration opportunity for executive directors in 2009 will be reduced by 175 per cent of salary from the maximum awarded to a director in 2008, despite a doubling in the size of the Group, and despite the challenges ahead in integrating the businesses to create the Lloyds Banking Group.

LONG-TERM INCENTIVE PERFORMANCE MEASURES

In reviewing measures, the remuneration committee has aimed to build on existing aspects of the remuneration policy that have been successful, with a focus on long-term performance, taking appropriate account of risk. At the same time, the committee has sought to develop arrangements that motivate executives to meet the near-term objectives of integrating the two businesses.

The setting of the definitive performance targets for 2009 will be completed in time for publication prior to the Annual General Meeting. The committee will continue to engage with shareholders during this time and will share the detail of the performance targets once they are finalised.

Performance targets will be set by reference to analysts' expectations, internal business plans, competitive performance assessments and probability modelling. Stretch performance will be equated to the remuneration committee's assessment of an upper quartile performance level or greater. Non-financial targets will be fully disclosed, and payments against them justified, in the year of vesting.

The detailed rationale for the proposed measures is set out below.

EARNINGS PER SHARE (APPLYING TO AWARD OF 60 PER CENT OF SALARY, BEING HALF THE REGULAR LTIP AWARD)

Earnings per share continues to be an important measure of our profitability and ability to generate cash at a point in time. The committee has therefore decided to retain this well-recognised measure in our incentive system.

ECONOMIC PROFIT (APPLYING TO AWARD OF 60 PER CENT OF SALARY, BEING HALF THE REGULAR LTIP AWARD)

Economic profit has been used as a performance measure within Lloyds TSB for a number of years. It has been very successful at introducing a long-term, risk-based approach to managing our business. Given the increasing focus now being placed on risk-adjusted measures by shareholders and regulators, adoption of this established measure into the LTIP is felt by the committee to be a further enhancement of the alignment between our remuneration and business strategy. Our economic profit measure is a through-the-cycle measure, which encourages prudent risk management of our portfolio, considering the impact of decisions over an entire economic cycle.

Economic profit replaces relative total shareholder return within the LTIP. The committee is of the view that at the current time, with extreme market volatility and the level of disruption in our peer group, TSR is not a robust performance measure. Moreover, the committee is concerned that relative TSR measures may not have been supportive of sound risk management policies during economic upswings. Indeed, such a measure can encourage a 'strategic herd mentality', with banks encouraged to take on more risk in order to improve the prospects of significantly out-performing their peers. Economic profit, by measuring risk-adjusted performance with targets reflecting the Company's specific risk appetite, is, in the view of the committee, a better incentive for sustainable performance.

The committee is aware that some shareholders favour relative TSR as a measure, and so will further consider its role for long-term incentive awards in 2010 and beyond during the review to be carried out later in 2009. However, it is the view of the committee that an economic profit measure is better aligned with the Financial Services Authority's draft Code of Practice criteria.

DIRECTORS' REMUNERATION REPORT continued

SYNERGY TARGETS (APPLYING TO AWARD OF 40 PER CENT OF SALARY, BEING 50 PER CENT OF THE INTEGRATION AWARD)

The Integration Award naturally includes a component relating to the achievement of our £1.5 billion synergy goal by the end of 2011. However, in order to demonstrate the credibility of our integration to the market, it is important that the trajectory of achieving the synergies, and the cost of achievement, are well balanced. Therefore, the synergy element will include targets for synergy savings in 2009 and 2010 (although awards will not ultimately vest until the end of 2011, and will be subject to an assessment by the remuneration committee at that point that the synergies have been achieved on a sustainable basis).

INTEGRATION BALANCED SCORECARD (APPLYING TO AWARD OF 40 PER CENT OF SALARY, BEING 50 PER CENT OF THE INTEGRATION AWARD)

The committee believes that an excessive focus on financial targets can potentially reward short-term actions that are detrimental to the long-term health of the business. For this reason a balanced scorecard has been operated in the annual incentive plan for a number of years, with great success. The committee has decided that this success should be built upon by measuring part of the 2009 LTIP on a long-term balanced scorecard of non-financial measures underpinning the success of the integration over 2009 to 2011. These measures will be grouped under the categories by which the integration is being managed:

– Risk
– Customer
– People
– Build business

These measures are distinct from the similarly named areas under the annual incentive plan. The annual incentive measures focus on excellence of performance in business as usual activities. The non-financial measures in the integration balanced scorecard are specific to the integration. There is a major change programme to be undertaken within HBOS, particularly in relation to systems and processes for measuring and managing risk. The integration balanced scorecard will be built around outperformance of this change agenda.

PENSION

In April 2012, all executive directors will transition to defined contribution pension arrangements with contributions of 25 per cent of base salary for the chief executive and other executive directors, with no compensation for ceasing final salary accrual.

FURTHER REVIEW OF EXECUTIVE REMUNERATION DURING 2009

The committee recognises that the above proposals for executive remuneration for 2009 are being made at a time of high uncertainty and great volatility, and therefore the committee has decided to undertake a further review of executive remuneration during 2009. This is to ensure that the overall positioning of remuneration remains appropriate when compared with the external market and ensures that the Lloyds Banking Group is able to attract and retain the high calibre of talent needed to lead the combined Group, while reflecting latest trends in the sector and any updated guidance from shareholders and regulators. The committee will continue to engage with shareholders during this review.

OTHER SHARE PLANS

The executive directors and the chairman are also eligible to participate in the Group's 'sharesave' scheme and the Group's 'shareplan'. These are 'all-employee' share schemes.

CHAIRMAN'S REMUNERATION

The chairman's remuneration comprises salary and benefits which are broadly similar to those extended to the executive directors. However, he does not participate in the annual bonus and long-term incentive arrangements, nor is he entitled to pension benefits.

The chairman's salary is reviewed annually, usually in December, taking into account performance and market information and then adjusted from 1 January of the following year. No adjustments will be made from 1 January 2009 and his salary remains unchanged at £640,000.

INDEPENDENT NON-EXECUTIVE DIRECTORS' FEES

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. To accommodate a potentially larger board following the acquisition of HBOS, a resolution was passed at the General Meeting on 19 November 2008 to increase this amount to £1 million. Directors may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the various responsibilities of a non-executive director's role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees from 1 January 2009 are unchanged and are listed below.

Board	£65,000
Audit committee chairmanship	£50,000
Audit committee membership	£20,000
Nomination committee membership	£5,000
Remuneration committee chairmanship	£30,000
Remuneration committee membership	£15,000
Risk oversight committee membership	£15,000

Independent non-executive directors who serve on the boards of subsidiary companies may also receive fees from the subsidiaries. The fees paid in 2008 to the current non-executive directors are shown in the table below:

REMUNERATION FOR 2008

2008 ANNUAL INCENTIVE SCHEME

The annual incentive scheme for executive directors is designed to reflect specific goals linked to the performance of the business.

Incentive awards for executive directors are based upon individual contribution and overall corporate results. Half of the incentive opportunity is driven by corporate performance based on the stretching budget relating to profit before tax and economic profit. The level of achievement against the targets for profit before tax and economic profit that results in the lower payout will determine the exent to which the target has been met. The other half of the incentive opportunity is determined by divisional achievement driven through individual performance. Individual targets relevant to improving overall business performance are contained in a balanced scorecard and are grouped under the following headings:

– Financial
– Franchise growth
– Customer service
– Risk
– People development

These targets are weighted differently for each of the executive directors, reflecting differing strategic priorities. The non-financial measures include key performance indicators relating to process efficiency, service quality and employee engagement.

The maximum annual incentive opportunity is 200 per cent (225 per cent for Mr Daniels) of basic salary for the achievement of exceptional performance targets. The maximum payment under the corporate half of the annual incentive is only available if exceptional performance is achieved against the stretching corporate budget. An amount equal to 50 per cent of this element of the incentive is available on the achievement of the stretching corporate budget. Failure to achieve at least 90 per cent of the stretching budget would result in no payment under the corporate half of the incentive.

In recognition of the current environment, the executive directors have elected not to receive any annual incentive in respect of 2008.

DIRECTORS' REMUNERATION REPORT continued

LONG-TERM INCENTIVE PLANS

2008 LONG-TERM INCENTIVE PLAN AWARDS

In 2008, following shareholder consultation, three directors were granted enhanced awards of 375 per cent of basic salary. This was to ensure that for these directors, where there was a concern about retention, we continued to provide a fully market competitive remuneration framework.

Details of the plan, including the specific performance conditions, can be found on page 93.

2008 NON-EXECUTIVE DIRECTORS' FEES (£)

	Lloyds TSB Group					LTSBS*	SW**	
	Board	Audit committee	Remuneration committee	Nomination committee	Risk oversight committee	Board	Board	**2008 Total fees**
W C G Berndt	65,000		30,000	5,000				**100,000**
Ewan Brown	65,000	30,568			15,000	11,568		**122,136**
J P du Plessis	65,000	39,432		5,000	9,715			**119,147**
P N Green	65,000	20,000	15,000					**100,000**
Sir Julian Horn-Smith	65,000		15,000	5,000	15,000			**100,000**
Lord Leitch	65,000	20,000		5,000	15,000		60,000	**165,000**
Sir David Manning	43,333		10,000	3,333	10,000			**66,666**
C J McCall	16,250							**16,250**
M A Scicluna	21,666	6,667			5,000			**33,333**

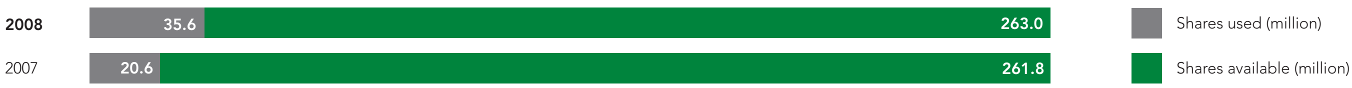
* Lloyds TSB Scotland plc.
** Scottish Widows Services Ltd.

DILUTION LIMITS

The following charts illustrate the shares available for the Group's share schemes.

ALL SCHEMES (10% IN ANY CONSECUTIVE 10 YEARS)

EXECUTIVE SCHEMES (5% IN ANY CONSECUTIVE 10 YEARS)



PENSIONS

Executive directors are either entitled to participate in the Group's defined benefit pension schemes (based on salary and length of service, with a maximum pension of two thirds of final salary), or the Group's defined contribution scheme (under which their pension entitlement will be based upon both employer and employee contributions). The defined benefit schemes are closed to new entrants on recruitment.

Pension accruals under the defined benefits scheme for Messrs Daniels and Kane will continue until April 2012. Thereafter they will have the opportunity to either participate in a defined contribution scheme or to receive a cash supplement with no compensation for ceasing final salary accrual. There is no entitlement to an immediate and unreduced pension should their employment be terminated before the normal date of retirement.

SERVICE AGREEMENTS

The Group's policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months' notice from the Group, but would be required to give six months' notice if they wished to leave. Executive directors normally retire at age 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65.

It is the Group's policy that where compensation on early termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured, and that bonus payments should relate to the period of actual service, rather than the full notice period, and will be determined on the basis of performance.

Any entitlements under the pension scheme or equity plans will be in accordance with the scheme rules on leaving.

	Notice to be given by the Company	Date of service agreement/letter of appointment
Sir Victor Blank	6 months	25 January 2006
J E Daniels	12 months	22 January 2009
A G Kane	12 months	23 January 2009
G T Tate	12 months	9 February 2009
T J W Tookey	12 months	26 January 2009
H A Weir	12 months	21 January 2009
Former directors who served during 2008		
T A Dial	12 months	23 May 2005
M E Fairey	12 months	28 August 1991

Independent non-executive directors do not have service agreements and their appointment may be terminated, in accordance with the articles of association, at any time without compensation.

EXTERNAL APPOINTMENTS

The Group recognises that executive directors may be invited to become non-executive directors of other companies and that these appointments may broaden their knowledge and experience, to the benefit of the Group. Fees are normally retained by the individual directors as the post entails personal responsibility.

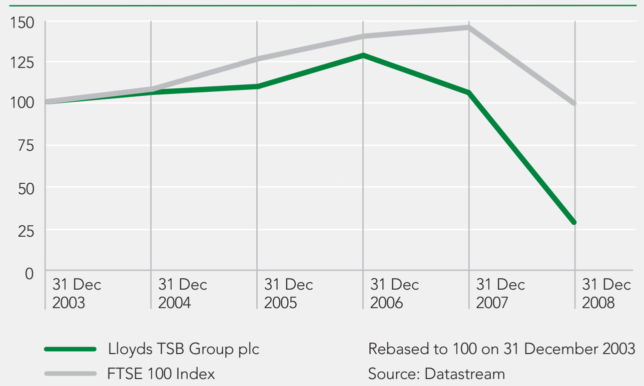
Executive directors are generally allowed to accept one non-executive directorship.

During 2008, Mr Daniels and Mrs Weir received fees of £54,718 and £42,500 respectively, which were retained by them, for serving as non-executive directors of other companies.

PERFORMANCE GRAPH

The graph below illustrates the performance of the Group measured by TSR against a 'broad equity market index' over the past five years. The Group has been a constituent of the FTSE 100 index throughout this five year period.

TOTAL SHAREHOLDER RETURN – FTSE 100 INDEX



DIRECTORS' EMOLUMENTS FOR 2008

	Salaries/ fees £000	Other benefits Cash £000[1]	Other benefits Non-cash £000[2]	Performance-related payments £000[3]	2008 Total £000	2007 Total £000
Current directors who served during 2008						
Executive directors						
J E Daniels	**1,035**	**108**	**8**	**–**	**1,151**	2,884
A G Kane	**590**	**22**	**23**	**–**	**635**	1,377
G T Tate	**640**	**25**	**24**	**–**	**689**	1,386
T J W Tookey (from 30.10.08)	**104**	**4**	**–**	**–**	**108**	
H A Weir	**625**	**95**	**22**	**–**	**742**	1,586
Non-executive directors						
Sir Victor Blank	**640**	**12**	**17**	**–**	**669**	661
W C G Berndt	**100**				**100**	90
Ewan Brown	**122**				**122**	151
J P du Plessis	**119**				**119**	80
P N Green	**100**				**100**	56
Sir Julian Horn-Smith	**100**				**100**	95
Lord Leitch	**165**				**165**	130
Sir David Manning (from 01.05.08)	**67**				**67**	
C J McCall (from 01.10.08)	**16**				**16**	
M A Scicluna (from 01.09.08)	**33**				**33**	
Former directors who served during 2008						
M E Fairey (until 30.6.08)	**315**	**18**	**4**	**–**	**337**	1,440
T A Dial (until 18.4.08)	**340**	**128**	**2**	**–**	**470**	1,995
Others						124
	5,111	**412**	**100**	**–**	**5,623**	12,055

Notes:

[1] The cash column under 'other benefits' includes flexible benefits payments (4 per cent of basic salary), the tax planning and education allowances for Mr Daniels, the housing allowance and pension scheme allowance for Ms Dial (paid until 30.6.08) , payments to certain directors who elect to take cash rather than a company car under the car scheme and the cash balance of a pension allowance for Mrs Weir. Sir Victor Blank has elected to take cash rather than a company car.

[2] The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance. It also includes the value of any matching shares which are received under the terms of Shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.

[3] The executive directors waived their entitlement to any bonus in respect of the 2008 performance. There will be no free shares award under Shareplan in respect of 2008.

AUDITED INFORMATION

WAIVED FEES

For the period 1 January – 30 June 2008, Mr Fairey waived fees payable to him as a director of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £5,000 (2007: £10,750 waived). For the period 1 July – 31 December 2008, Mr Fairey received fees payable to him as a director and chairman of the Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited which totalled £35,000.

Mr Brown waived fees payable to him as a director and chairman of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited for the period 1 January – 30 June 2008, which totalled £7,000 in 2008 (2007: £15,500 waived).

DIRECTORS' PENSIONS

The executive directors are currently members of one of the pension schemes provided by the Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined the Lloyds TSB Group after 1 June 1989 and are members of a defined benefit scheme have pensions provided on salary in excess of the earnings cap either through membership of a funded unapproved retirement benefits scheme (FURBS) or by an unfunded pension promise. Retirement pensions accrue at rates of between 1/60 and 1/30 of basic salary.

For those directors who are members of a defined pension scheme, pension will continue to accrue until 5 April 2012. On 6 April 2012, defined benefit pension accrual will cease and directors will be offered the option to participate in the defined contribution pension scheme in operation at that date. Alternatively, they may choose not to join the scheme and elect to receive a pension cash allowance.

Directors have a normal retirement age of 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65. In the event of death in service, a lump sum of four times salary is payable plus, for members of a defined benefit scheme, a spouse's pension of two-thirds of the member's prospective pension. On death in retirement, a spouse's pension of two-thirds of the member's pension is payable. The defined benefit schemes are non-contributory. Members of defined contribution schemes are required to contribute.

DEFINED CONTRIBUTION SCHEME MEMBERS

During the year to 31 December 2008 (from 30 October 2008 for Mr Tookey), the employer has made the following (£000) contributions to the defined contribution scheme:

G T Tate	128
T J W Tookey	23
H A Weir	56

DEFINED BENEFIT SCHEME MEMBERS

	Accrued pension at 31 December 2008 £000 (a)	Accrued pension at 31 December 2007 £000 (b)	Change in accrued pension £000 (a)-(b)	Transfer value at 31 December 2008 £000 (c)	Transfer value at 31 December 2007 £000 (d)	Change in transfer value £000 (c)-(d)	Additional pension earned to 31 December 2008 £000 (e)	Transfer value of the increase £000 (f)
J E Daniels	175	147	28	3,263	2,878	385	23	428
A G Kane	342	305	37	6,146	5,701	445	25	449
M E Fairey	339*	322	17	n/a	7,469	n/a	n/a	n/a

*Pension as at 30 June 2008 (i.e. normal retirement date).

The disclosures in columns (a) to (d) are as required by the Companies Act 1985 Schedule 7A.

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2008 and 2007, respectively.

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2008 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme. The basic method used to arrive at the factors has not changed during the year, although minor adjustments have been made following the introduction of new requirements applicable to transfer calculations effective from 2008.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2007 on the assumption that the director left service at that date.

Column (e) is the increase in pension built up during the year, recognising (i) the accrual rate for the additional service based on the pensionable salary in force at the year end, and (ii) where appropriate the effect of pay changes in 'real' (inflation adjusted) terms on the pension already earned at the start of the year.

Column (f) is the capital value of the pension in column (e).

The disclosures in columns (e) and (f) are as required by the UK Listing Authority listing rules. The requirements of the listing rules differ from those of the Companies Act. The listing rules require the additional pension earned over the year to be calculated as the difference between the pension accrued at the end of the financial year and the pension accrued at the start of the financial year less the increase in the pension earned over the year solely due to inflation. The transfer value in column (f) can differ significantly from the change in transfer value as required by the Companies Act because the additional pension accrued over the year calculated in accordance with the listing rules makes allowance for inflation, and the change in the transfer value required by the Companies Act will be significantly influenced by changes in the assumptions underlying the transfer value calculation at the beginning and end of the financial year.

Members of the Lloyds TSB Group's pension schemes have the option to pay additional voluntary contributions: neither the contributions nor the resulting benefits are included in the above table.

Major changes to the legislation governing the provision of pensions in the UK (known as pension simplification) came into effect in April 2006. Benefits from an approved pension scheme will be limited to the Lifetime Allowance, currently £1.65 million which is equivalent to an annual pension of £82,500. Any benefit in excess of this amount will incur a tax charge for the individual. The Group has agreed that if an executive director has benefits in excess of the Lifetime Allowance they may cease to accrue benefits in the Scheme and receive a salary supplement as an alternative. This will not cost the Group more than the current arrangements. The Group will not compensate any individual in respect of any increased tax liability arising from pension simplification. To date, the executive directors affected have elected to continue to accrue benefits in the approved scheme.

FORMER DIRECTORS WHO SERVED DURING 2008

Ms Dial elected to become a member of the pension scheme for life cover only.

Mr Fairey retired as at 30 June 2008 and took his non-approved benefit entitlement in the form of a lump sum in accordance with the scheme rules. A tax free amount of £4.523 million was paid from the FURBS, with a further taxable amount of £2.446 million made by the bank from provisions set aside. The total amount of £6.969 million covered the bank's liability to provide benefits in respect of salary in excess of the earnings cap.

DIRECTORS' INTERESTS

The interests, all beneficial, of those who were directors at 31 December 2008 in shares in Lloyds Banking Group were:

SHARES

	At 1 January 2008 (or later date of appointment)	At 31 December 2008	At 26 February* 2009
Executive directors			
J E Daniels	166,023	423,018	607,514
A G Kane	137,000	204,061	293,523
G T Tate	8,112	75,072	108,315
T J W Tookey	2,252	2,493	4,186
H A Weir	10,511	61,822	89,306
Non-executive directors			
Sir Victor Blank	200,000	301,199	433,528
W C G Berndt	170,000	170,000	243,899
Ewan Brown	4,677	95,074	136,402
J P du Plessis	10,000	50,000	71,735
P N Green	5,000	5,000	7,173
Sir Julian Horn-Smith	5,000	5,000	7,173
Lord Leitch	10,000	10,000	14,347
Sir David Manning	4,500	4,500	6,456
C J McCall	–	–	–
M A Scicluna	–	10,000	14,461

*The changes in beneficial interests between 31 December 2008 and 26 February 2009 related to applications made under the Placing and Open Offer, the Scheme of Arrangement relating to the acquisition of HBOS plc and 'partnership' and 'matching' shares acquired under the Lloyds TSB Group Shareplan.

INTERESTS IN SHARE OPTIONS

	At 1 January 2008 (or later date of appointment)	Granted during the year	Exercised during the year	Lapsed during the year	At 31 December 2008	Exercise price	Exercise periods From	To	Notes
J E Daniels	939,177			807,693	131,484	419.25p	18/3/2007	17/3/2014	d, f
	521,876			91,329	430,547	474.25p	17/3/2008	16/3/2015	e, f
	2,236			2,236		418p	1/6/2009	30/11/2009	a, n
		6,906			6,906	139p	1/1/2012	30/6/2012	a, h
A G Kane	50,000			50,000		880p	4/3/2001	3/3/2008	b, j
	27,000				27,000	887.5p	4/3/2002	3/3/2009	b, g
	64,786				64,786	549.5p	6/3/2003	5/3/2010	c, g
	11,841				11,841	615.5p	8/8/2003	7/8/2010	c, g
	34,759				34,759	655p	6/3/2004	5/3/2011	c, g
	5,783		5,783		–	284p	1/6/2008	30/11/2008	a, k
	523,255			450,000	73,255	419.25p	18/3/2007	17/3/2014	d, f
	300,474			52,583	247,891	474.25p	17/3/2008	16/3/2015	e, f
		6,906			6,906	139p	1/1/2012	30/6/2012	a, h
G T Tate	268,336			203,936	64,400	419.25p	18/3/2007	17/3/2014	d, f
	195,409			168,052	27,357	403p	12/8/2007	11/8/2014	d, f
	300,474			52,583	247,891	474.25p	17/3/2008	16/3/2015	e, f
	3,851			3,851		418p	1/6/2011	30/11/2011	a, n
		6,906			6,906	139p	1/1/2012	30/6/2012	a, h
T J W Tookey	2,798			2,798		343p	1/6/2011	30/11/2011	a, n
		6,906			6,906	139p	1/1/2012	30/6/2012	a, h
H A Weir	556,208			478,340	77,868	424.75p	29/4/2007	28/4/2014	d, f
	5,093			5,093		321p	1/11/2009	30/4/2010	a, n
	300,474			52,583	247,891	474.25p	17/3/2008	16/3/2015	e, f
		6,906			6,906	139p	1/1/2012	30/6/2012	a, h
Sir Victor Blank		4,897		4,897		343p	1/6/2013	30/11/2013	a, n
		6,906			6,906	139p	1/1/2012	30/6/2012	a, h
Other share plan									
T J W Tookey	35,305				35,305	(see page 95)	20/4/2009	19/10/2009	h

INTERESTS IN SHARE OPTIONS continued

	At 1 January 2008	Granted during the year	Exercised during the year	Lapsed during the year	At 31 December 2008	Exercise price	Exercise periods From	To	Notes
Former directors who served during 2008									
M E Fairey	48,000			**48,000**		859.5p	15/5/2001	14/5/2008	b, f, j
	57,000				**57,000**	817p	2/8/2002	1/8/2009	b, g
	85,896				**85,896**	549.5p	6/3/2003	5/3/2010	c, g
	10,931				**10,931**	615.5p	8/8/2003	7/8/2010	c, g
	42,884				**42,884**	655p	6/3/2004	5/3/2011	c, g
	555,992			**478,154**	**77,838**	419.25p	18/3/2007	17/3/2014	d, f
	344,754			**60,332**	**284,422**	474.25p	17/3/2008	16/3/2015	e, f
	1,789			**1,789†**		418p	1/6/2009	30/11/2009	a, h
T A Dial	464,134			**464,134**	0	474p	11/8/2008	10/8/2015	e, h, m
Other share plan									
T A Dial	242,825			**242,825**	–	(see page 95)	1/6/2008	30/11/2008	i

†Funds from this Sharesave option were repaid to Mr Fairey after he left the board.

Notes:

a) Sharesave.
b) Executive option granted between March 1998 and August 1999.
c) Executive option granted between March 2000 and March 2001.
d) Executive option granted between March 2004 and August 2004.
e) Executive options granted from March 2005.
f) Exercisable to the extent at which the performance condition vested.
g) Not exercisable as the performance conditions had not been met.
h) Not exercisable as the option has not been held for the period required by the relevant scheme.
i) Option lapsed on notice of resignation tendered prior to 31 May 2008.
j) Option lapsed as not exercised by 10th anniversary of date of grant.
k) Mr Kane exercised his 2003A Sharesave option on 7 August 2008. Market price on day of exercise was 318.75p. In that regard Mr Kane made a gain of £2,009.59.
l) Exercisable Sharesave option.
m) Lapsed on resignation.
n) Cancelled Sharesave option.

Mr Fairey retired from the Group on 30 June 2008.

Mr Tookey was appointed to the board on 30 October 2008.

Ms Dial resigned from the board on 18 April 2008 and left the Group on 30 June 2008.

The market price for a share in the Company at 1 January 2008 and 31 December 2008 was 467.5p and 126p, respectively. The range of prices between 1 January 2008 and 31 December 2008 was 118.5p to 483.1229p.

None of the other directors at 31 December 2008 had options to acquire shares in Lloyds TSB Group plc or its subsidiaries.

The following table contains information on the performance conditions for executive options granted since 1998. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Options granted	Performance conditions
March 1998 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the retail price index plus two percentage points for each complete year of the relevant period plus a further condition that the Company's ranking based on TSR over the relevant period should be in the top 50 companies of the FTSE 100.
March 2000 – March 2001	As for March 1998 – August 1999 except that there must have been growth in the earnings per share equal to the change in the retail price index plus three percentage points for each complete year of the relevant period.
March 2004 – August 2004	That the Company's ranking based on TSR over the relevant period against a comparator group (17 UK and international financial services companies including Lloyds TSB) must be at least ninth, when 14 per cent of the option will be exercisable. If the Company is ranked first in the group, then 100 per cent of the option will be exercisable and if ranked tenth or below the performance condition is not met. Options granted in 2004 became exercisable as the performance condition was met on the re-test. The performance condition vested at 24 per cent for Mr Tate's March option and at 14 per cent for all other options granted to executive directors during 2004.
March 2005 – August 2005	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds TSB) must be at least eighth, when 30 per cent of the option will be exercisable. If the Company is ranked first to fourth position in the group, then 100 per cent of the option will be exercisable and if ranked ninth or below, the performance condition is not met. Options granted in 2005 became exercisable as the performance condition was met when tested. The performance condition vested at 82.5 per cent for all options granted to executive directors.

LLOYDS TSB PERFORMANCE SHARE PLAN

Under the plan, executive directors were required to defer 50 per cent of their bonus awards in 2005 and 2006 into shares in the Company, known as bonus shares. The number of bonus shares awarded was calculated after the deduction of income tax and national insurance from the deferred element of the bonus.

The bonus shares are held on behalf of the executive for a period of three years before release.

Executives received a further award of 'performance shares' on the basis of two performance shares for each bonus share. The receipt of the performance shares is dependent on the satisfaction of a TSR performance condition measured over three financial years of the Company.

The following table details the number of bonus and performance shares released in respect of their 2004 bonus and the number of bonus and performance shares remaining under the plan relating to the 2005 bonus.

	Bonus shares			Performance shares					
	At 1 January 2008	Released 18 March 2008	At 31 December 2008	At 1 January 2008	Vested 10 April 2008	Lapsed 10 April 2008	At 31 December 2008	Award price	Bonus shares release date
J E Daniels	57,737	57,737		195,720	97,860	97,860		479p	18/3/2008
	50,944		50,944	172,694			172,694	566.10p	20/3/2009
A G Kane	22,171	22,171		75,156	37,578	37,578		479p	18/3/2008
	20,531		20,531	69,598			69,598	566.10p	20/3/2009
G T Tate	22,710	22,710		76,982	38,491	38,491		479p	18/3/2008
	27,358		27,358	92,738			92,738	566.10p	20/3/2009
H A Weir	16,628	16,628		56,366	28,183	28,183		479p	18/3/2008
	20,062		20,062	68,008			68,008	566.10p	20/3/2009
Former directors who served during 2008									
M E Fairey	31,901	31,901		108,140	54,070	54,070		479p	18/3/2008
	22,459*			76,134			76,134	566.10p	20/3/2009
T A Dial	16,909*		0	57,322**	n/a	n/a	0	566.10p	20/3/2009

*Bonus shares released in June 2008.
**Performance Shares lapsed on resignation.

The following table contains information on the performance conditions for performance shares. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Performance shares awarded	Performance conditions
March 2005 and March 2006	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds TSB) must be at least eighth for any shares to be received. If ranked ninth or below no shares would be received. The maximum of two performance shares for each bonus share will be awarded only if the Company is first in the comparator group; one performance share will be awarded for each bonus share if the Company is placed fifth; and one performance share for every two bonus shares if the Company is placed eighth. Between first and fifth positions and fifth and eighth positions a sliding scale will apply. Whilst income tax was deducted from the deferred bonus before the conversion to bonus shares, where a match of performance shares is justified, these shares will be awarded as if income tax had not been deducted. This maintains the original design of the plan prior to the issue of guidance from HM Revenue & Customs in December 2004. The performance condition attached to the March 2005 award was met, with Lloyds TSB ranked in fifth place. Bonus shares were released on 18 March 2008, with one performance share awarded for every bonus share. Performance shares were released on 10 April 2008.

LLOYDS TSB LONG-TERM INCENTIVE PLAN

The following are conditional share awards available under the plan. Further information regarding this plan can be found on page 81.

	At 1 January 2008	Awarded during the year	Lapsed during the year	At 31 December 2008	Year of vesting	Notes
J E Daniels	507,692			507,692	2009	
	534,322			534,322	2010	
		838,735		838,735	2011	b
A G Kane	288,460			288,460	2009	
	306,122			306,122	2010	
		413,309		413,309	2011	a
G T Tate	297,114			297,114	2009	
	333,951			333,951	2010	
		518,638		518,638	2011	b
T J W Tookey	54,258			54,258	2009	
	52,875			52,875	2010	
		71,220		71,220	2011	a
H A Weir	288,460			288,460	2009	
	320,037			320,037	2010	
		506,482		506,482	2011	b
Former directors who served during 2008						
M E Fairey	328,846			328,846	2009	
	333,951			333,951	2010	c
T A Dial	328,846		328,846	–	2009	d
	347,866		347,866	–	2010	d

Notes

a) share price for the award made 6 March 2008 was 428.25p.

b) share price for the award made 4 April 2008 was 462.75p.

c) Mr Fairey's LTIP awards will continue to vesting dates, but will be pro-rated depending on the number of months worked during each award. For the award made on 12 May 2006, this would be 30 months. For the award made on 8 March 2007, the half subject to the EPS performance condition would be over 18 months and the half subject to the TSR performance condition would be over 16 months.

d) Ms Dial's LTIP awards lapsed following her resignation from the Group.

The following table contains information on the performance conditions for awards made under the long-term incentive plan. The remuneration committee chose the relevant performance conditions because they were felt to be challenging, aligned to shareholders' interests and appropriate at the time.

LTIP award	Performance conditions
May 2006	For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the retail price index over the same period. If it is less than 3 per cent per annum, the EPS Award will lapse. If the increase is more than 3 but less than 6 per cent per annum, then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ended on 31 December 2008. For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for the Company's TSR to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where the Company's TSR is equal to median and vesting will occur on a straight line basis in between these points. Where the Company's TSR is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ended on 31 December 2008.
March 2007	For 50 per cent of the award (the 'EPS Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 1 January 2007 and ending on 31 December 2009. For the other 50 per cent of the award (the 'TSR Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 8 March 2007 (the date of award) and ending on 7 March 2010.
March and April 2008	For 50 per cent of the award (the 'EPS Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010. For the other 50 per cent of the award (the 'TSR Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 6 March 2008 (the date of the March award) and ending on 5 March 2011.

Alithos Limited provided information for the testing of the TSR performance conditions for the Company's long-term incentive schemes. EPS is the Group's normalised earnings per share as shown in the Group's report and accounts, subject to such adjustments as the remuneration committee regards as necessary for consistency.

OTHER SHARE PLAN

Lloyds TSB Group executive share plan 2005.

Ms Dial was the only participant in this plan where an option was granted to her, in June 2005, to acquire 242,825 ordinary shares in Lloyds TSB Group plc for a total price of £1. The option was not subject to any performance condition but would normally become exercisable only if she remained an employee, and had not given notice of resignation, on 31 May 2008. The option lapsed on notice of resignation tendered prior to 31 May 2008. Full details of the plan were set out in the 2005 annual report.

LLOYDS TSB GROUP EXECUTIVE SHARE PLAN 2003

Mr Tookey was granted an option under this plan to acquire 35,305 ordinary shares in Lloyds TSB Group plc. The option was not subject to any performance condition but would normally become exercisable only if he remains an employee, and has not given notice of resignation, on 19 April 2009.

In addition, on 26 March 2008 (prior to his appointment as an executive director), Mr Tookey was granted an award under the Lloyds TSB Executive Retention Plan 2006. The award is satisfied in cash only and, subject to continued employment, gives Mr Tookey the right to receive an amount equal to the value of 108,342 Lloyds Banking Group Shares on the date of vesting. The award vests as to 50 per cent on 26 March 2011 and 50 per cent on 26 March 2013. Mr Tookey has agreed to reinvest the cash proceeds into Lloyds Banking Group Shares. As an executive director, he is no longer eligible to be granted awards under this plan.

None of those who were directors at the end of the year had any other interest in the capital of Lloyds Banking Group plc or its subsidiaries.

The register of directors' interests, which is open to inspection, contains full particulars of directors' shareholdings and options to acquire shares in Lloyds Banking Group.

On behalf of the board

Harry F Baines
Company Secretary and General Counsel
26 February 2009

REPORT OF THE INDEPENDENT AUDITORS ON THE CONSOLIDATED FINANCIAL STATEMENTS

TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

We have audited the consolidated financial statements of Lloyds Banking Group plc for the year ended 31 December 2008 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes. These consolidated financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Lloyds Banking Group plc for the year ended 31 December 2008 and on the information in the directors' remuneration report that is described as having been audited.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the annual report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union are set out in the statement of directors' responsibilities on page 73.

Our responsibility is to audit the consolidated financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the consolidated financial statements give a true and fair view and whether the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the consolidated financial statements. The information given in the directors' report includes that specific information presented in the Overview and the Business Review that is cross referred from the principal activities, business review, future developments and financial risk management objectives and policies section of the directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the annual report and consider whether it is consistent with the audited consolidated financial statements. The other information comprises only the Overview, the unaudited part of the Business Review, the directors' report, the corporate governance disclosures, the unaudited part of the directors' remuneration report, the shareholder information and all the other information listed on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the consolidated financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the consolidated financial statements.

OPINION

In our opinion:

– the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its profit and cash flows for the year then ended;

– the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and

– the information given in the directors' report is consistent with the consolidated financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
26 February 2009

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2008

	Note	2008 £ million	2007 £ million
Interest and similar income		**17,569**	16,874
Interest and similar expense		**(9,851)**	(10,775)
Net interest income	5	**7,718**	6,099
Fee and commission income		**3,231**	3,224
Fee and commission expense		**(694)**	(600)
Net fee and commission income	6	**2,537**	2,624
Net trading income	7	**(9,186)**	3,123
Insurance premium income	8	**5,412**	5,430
Other operating income	9	**532**	952
Other income		**(705)**	12,129
Total income		**7,013**	18,228
Insurance claims	10	**2,859**	(7,522)
Total income, net of insurance claims		**9,872**	10,706
Operating expenses	11	**(6,053)**	(5,567)
Trading surplus		**3,819**	5,139
Impairment	12	**(3,012)**	(1,796)
Profit on sale of businesses	13	**–**	657
Profit before tax		**807**	4,000
Taxation	14	**38**	(679)
Profit for the year		**845**	3,321
Profit attributable to minority interests		**26**	32
Profit attributable to equity shareholders		**819**	3,289
Profit for the year		**845**	3,321
Basic earnings per share	15	**14.3p**	58.3p
Diluted earnings per share	15	**14.2p**	57.9p

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

CONSOLIDATED BALANCE SHEET
at 31 December 2008

	Note	2008 £ million	2007 £ million
Assets			
Cash and balances at central banks		5,008	4,330
Items in the course of collection from banks		946	1,242
Trading and other financial assets at fair value through profit or loss	16	45,064	57,911
Derivative financial instruments	17	28,884	8,659
Loans and advances to banks	18	40,758	34,845
Loans and advances to customers	19	242,735	209,814
Available-for-sale financial assets	21	55,707	20,196
Investment property	22	2,631	3,722
Goodwill	23	2,256	2,358
Value of in-force business	24	1,893	2,218
Other intangible assets	25	197	149
Tangible fixed assets	26	2,965	2,839
Current tax recoverable		300	–
Deferred tax assets	38	833	–
Other assets	27	5,856	5,063
Total assets		436,033	353,346

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

The directors approved the consolidated financial statements on 26 February 2009.

Sir Victor Blank
Chairman

J Eric Daniels
Group Chief Executive

Tim J W Tookey
Group Finance Director

CONSOLIDATED BALANCE SHEET
at 31 December 2008

Equity and liabilities	Note	2008 £ million	2007 £ million
Liabilities			
Deposits from banks	28	66,514	39,091
Customer accounts	29	170,938	156,555
Items in course of transmission to banks		508	668
Trading and other liabilities at fair value through profit or loss	30	6,754	3,206
Derivative financial instruments	17	26,892	7,582
Debt securities in issue	31	75,710	51,572
Liabilities arising from insurance contracts and participating investment contracts	32	33,792	38,063
Liabilities arising from non-participating investment contracts	34	14,243	18,197
Unallocated surplus within insurance businesses	35	270	554
Other liabilities	36	11,456	9,690
Retirement benefit obligations	37	1,771	2,144
Current tax liabilities		–	484
Deferred tax liabilities	38	–	948
Other provisions	39	230	209
Subordinated liabilities	40	17,256	11,958
Total liabilities		426,334	340,921
Equity			
Share capital	41	1,513	1,432
Share premium account	42	2,096	1,298
Other reserves	43	(2,476)	(60)
Retained profits	44	8,260	9,471
Shareholders' equity		9,393	12,141
Minority interests		306	284
Total equity		9,699	12,425
Total equity and liabilities		436,033	353,346

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

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Minority interests £ million	Total £ million
Balance at 1 January 2007	2,695	336	8,124	11,155	352	11,507
Movement in available-for-sale financial assets, net of tax:						
– change in fair value	–	(436)	–	(436)	–	(436)
– transferred to income statement in respect of disposals	–	(5)	–	(5)	–	(5)
– transferred to income statement in respect of impairment	–	49	–	49	–	49
– disposal of businesses	–	(6)	–	(6)	–	(6)
Movement in cash flow hedges, net of tax	–	(15)	–	(15)	–	(15)
Currency translation differences	–	17	–	17	(1)	16
Net income recognised directly in equity	–	(396)	–	(396)	(1)	(397)
Profit for the year	–	–	3,289	3,289	32	3,321
Total recognised income for 2007	–	(396)	3,289	2,893	31	2,924
Dividends	–	–	(1,957)	(1,957)	(19)	(1,976)
Purchase/sale of treasury shares	–	–	(1)	(1)	–	(1)
Employee share option schemes:						
– value of employee services	–	–	16	16	–	16
– proceeds from shares issued	35	–	–	35	–	35
Repayment of capital to minority shareholders	–	–	–	–	(80)	(80)
Balance at 31 December 2007	2,730	(60)	9,471	12,141	284	12,425
Movement in available-for-sale financial assets, net of tax:						
– change in fair value	**–**	**(2,059)**	**–**	**(2,059)**	**28**	**(2,031)**
– transferred to income statement in respect of disposals	**–**	**(19)**	**–**	**(19)**	**–**	**(19)**
– transferred to income statement in respect of impairment	**–**	**102**	**–**	**102**	**–**	**102**
– other transfers to income statement	**–**	**(66)**	**–**	**(66)**	**–**	**(66)**
Movement in cash flow hedges, net of tax	**–**	**(12)**	**–**	**(12)**	**–**	**(12)**
Currency translation differences	**–**	**(362)**	**–**	**(362)**	**–**	**(362)**
Net income recognised directly in equity	**–**	**(2,416)**	**–**	**(2,416)**	**28**	**(2,388)**
Profit for the year	**–**	**–**	**819**	**819**	**26**	**845**
Total recognised income for 2008	**–**	**(2,416)**	**819**	**(1,597)**	**54**	**(1,543)**
Dividends	**–**	**–**	**(2,042)**	**(2,042)**	**(29)**	**(2,071)**
Private placement of ordinary shares	**760**	**–**	**–**	**760**	**–**	**760**
Purchase/sale of treasury shares	**–**	**–**	**16**	**16**	**–**	**16**
Employee share option schemes:						
– value of employee services	**–**	**–**	**(4)**	**(4)**	**–**	**(4)**
– proceeds from shares issued	**119**	**–**	**–**	**119**	**–**	**119**
Repayment of capital to minority shareholders	**–**	**–**	**–**	**–**	**(3)**	**(3)**
Balance at 31 December 2008	**3,609**	**(2,476)**	**8,260**	**9,393**	**306**	**9,699**

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

CONSOLIDATED CASH FLOW STATEMENT

for the year ended 31 December 2008

	Note	2008 £ million	2007 £ million
Profit before tax		**807**	4,000
Adjustments for:			
Change in operating assets	50(A)	**(43,025)**	(16,982)
Change in operating liabilities	50(B)	**80,933**	21,541
Non-cash and other items	50(C)	**(4,064)**	2,784
Tax paid		**(810)**	(859)
Net cash provided by operating activities		**33,841**	10,484
Cash flows from investing activities			
Purchase of available-for-sale financial assets		**(144,680)**	(21,667)
Proceeds from sale and maturity of available-for-sale financial assets		**110,470**	19,468
Purchase of fixed assets		**(1,436)**	(1,334)
Proceeds from sale of fixed assets		**579**	982
Acquisition of businesses, net of cash acquired	50(F)	**(19)**	(8)
Disposal of businesses, net of cash disposed	50(G)	**–**	1,476
Net cash used in investing activities		**(35,086)**	(1,083)
Cash flows from financing activities			
Dividends paid to equity shareholders		**(2,042)**	(1,957)
Dividends paid to minority interests	50(E)	**(29)**	(19)
Interest paid on subordinated liabilities		**(771)**	(709)
Proceeds from issue of subordinated liabilities	50(E)	**3,021**	–
Proceeds from issue of ordinary shares	50(E)	**879**	35
Repayment of subordinated liabilities	50(E)	**(381)**	(300)
Repayment of capital to minority shareholders	50(E)	**(3)**	(80)
Net cash provided by (used in) financing activities		**674**	(3,030)
Effects of exchange rate changes on cash and cash equivalents		**1,440**	82
Change in cash and cash equivalents		**869**	6,453
Cash and cash equivalents at beginning of year		**31,891**	25,438
Cash and cash equivalents at end of year	50(D)	**32,760**	31,891

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 BASIS OF PREPARATION

During 2008, global financial markets experienced difficult conditions which have been characterised by a marked reduction in liquidity. As a consequence of this, Governments and central banks carried out a series of actions to address the lack of liquidity within their respective banking systems. In the UK these actions have included the introduction of the Bank of England's Special Liquidity Scheme whereby banks and building societies can exchange eligible securities for UK Treasury bills; and the creation of a credit guarantee scheme by HM Treasury, providing a Government guarantee for certain short and medium term senior debt securities issued by eligible banks. During 2008 the Group has made use of these measures in order to maintain and improve a stable funding position. The Group's management of liquidity and funding risks is described on pages 55 and 56.

In the context of this continued turbulence and uncertainty in the financial markets, combined with a deteriorating global economic outlook, the Group has also taken steps to strengthen its capital position (see note 52 for details of the preference and ordinary share capital issued by the Group in January 2009) in order to provide a buffer against further shocks arising from the financial systems and to ensure that it remains competitive.

There is a risk that, despite the substantial measures taken by Governments, further deterioration in the markets could occur. In addition the economic conditions in the UK are deteriorating more quickly than previously anticipated placing greater strain on the Group's capital resources. The key dependencies on successfully funding the Group's balance sheet include the continued functioning of the money and capital markets at their current levels; the continued access of the Group to central bank and Government sponsored liquidity facilities, including issuance under HM Treasury's credit guarantee scheme and access to the Bank of England's various facilities; limited further deterioration in the Group's credit ratings; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or Government support schemes.

Based upon projections prepared by management which take into account the acquisition on 16 January 2009 of HBOS plc together with the Group's current ability to fund in the market and the assumption that the announced Government sponsored schemes will continue to be available, the directors are satisfied that the Company and the Group have adequate resources to continue in business for the foreseeable future. Accordingly, the financial statements of the Company and the Group have been prepared on a going concern basis.

2 ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation, and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

The following IFRS pronouncements relevant to the Group have been adopted in these consolidated financial statements:

(i) IFRIC 11 IFRS 2 – Group and Treasury Share Transactions. This interpretation clarifies the application of IFRS 2 Share-based Payment to certain share-based payment arrangements involving own equity instruments and arrangements involving equity instruments of a parent entity. The application of this new interpretation has not had any impact for amounts recognised in these financial statements.

(ii) IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirement and their Interaction. This interpretation provides guidance on assessing the amount of a pension surplus that can be recognised as an asset and explains how a minimum funding requirement might either affect the availability of reductions in future contributions or give rise to a liability. The application of this new interpretation has not had any impact for amounts recognised in these financial statements.

(iii) Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures – Reclassification of Financial Assets. The amendment to IAS 39 permits reclassification of non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in certain circumstances and permits the transfer of a financial asset from the available-for-sale category to the loans and receivables category where that financial asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale) and where there is both the intention and ability to hold that financial asset for the foreseeable future. The amendment to IFRS 7 requires additional disclosures about the situations in which any such reclassification is made and the effects on the financial statements including details of the carrying amounts and fair values for all financial assets that have been reclassified until they are derecognised and the fair value gain or loss that would have been recognised in the income statement or equity, as appropriate, if the financial asset had not been reclassified. For eligible reclassifications made before 1 November 2008, these amendments became effective from 1 July 2008. Details of the financial assets reclassified in accordance with this amendment are set out in note 49.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2008 and which have not been applied in preparing these financial statements are given in note 51.

2 ACCOUNTING POLICIES continued

The Group's accounting policies are set out below.

(A) CONSOLIDATION

The assets, liabilities and results of Group undertakings (including special purpose entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include all entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Group undertakings are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Open Ended Investment Companies (OEICs) where the Group, through the Group's life funds, has a controlling interest are consolidated; the unitholders' interest is reported in other liabilities. Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

(B) GOODWILL

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets and contingent liabilities of the acquired entity at the date of acquisition. Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. At the date of disposal of a Group undertaking, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal except where it has been written off directly to reserves in the past.

(C) OTHER INTANGIBLE ASSETS

Other intangible assets comprise capitalised software enhancements and customer lists. Capitalised software enhancements are amortised over periods not exceeding five years, being their estimated useful lives, using the straight-line method. Customer lists are amortised over periods not exceeding 15 years, being their estimated useful lives, in line with the income expected to arise from those customers and are subject to annual reassessment. All other intangible assets are reviewed for impairment whenever events or any changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, it is written down immediately.

(D) REVENUE RECOGNITION

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Group including expected early redemptions and related penalties and premiums and discounts that are an integral part of the overall return as well as direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see J).

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retains no part of the loan package for itself or retains a part at the same effective interest rate for all interest-bearing financial instruments, including loans and advances, as for the other participants.

Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to life assurance and general insurance business are detailed below (see R).

(E) TRADING SECURITIES, OTHER FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS, AND AVAILABLE-FOR-SALE FINANCIAL ASSETS

Debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur.

2 ACCOUNTING POLICIES continued

Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur.

Financial assets and liabilities are designated as at fair value through profit or loss on acquisition in the following circumstances:

- When doing so results in more relevant information because either:
  - it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on different bases; or
  - the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy, with management information also prepared on this basis.
- Where the assets and liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Refer to note 3 (Critical accounting estimates and judgements: Valuation of financial instruments) and note 49 (Financial risk management: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

The Group is permitted to reclassify, at fair value at the date of transfer, non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the trading category if they are no longer held for the purpose of being sold or repurchased in the near term, as follows:

- if the financial assets would have met the definition of loans and receivables (but for the fact that they had to be classified as held for trading at initial recognition), they may be reclassified into loans and receivables where the Group has the intention and ability to hold the assets for the foreseeable future or until maturity;
- if the financial assets would not have met the definition of loans and receivables, they may be reclassified out of the held for trading category into available-for-sale financial assets in 'rare circumstances'.

Debt securities and equity shares, other than those classified as trading securities or at fair value through profit or loss, are classified as available-for-sale and recognised in the balance sheet at their fair value; available-for-sale investments are those intended to be held for an indeterminate period of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest calculated using the effective interest method is recognised in the income statement.

The Group is permitted to transfer, at fair value at the date of transfer, a financial asset from the available-for-sale category to the loans and receivables category where that asset would have met the definition of loans and receivables at the time of reclassification (if the financial asset had not been designated as available-for-sale) and where there is both the intention and ability to hold that financial asset for the foreseeable future. For assets transferred, gains or losses recognised in equity in respect of these assets as at the date of transfer are amortised to profit or loss over the remaining life of the asset using the effective interest method.

Purchases and sales of securities and other financial assets and liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset. Trading securities and other financial assets and liabilities at fair value through profit or loss are initially recognised at fair value. Available-for-sale financial assets are initially recognised at fair value inclusive of transaction costs. These financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

(F) LOANS AND ADVANCES TO BANKS AND CUSTOMERS

Loans and advances to banks and customers, including any eligible assets transferred into these categories out of the fair value through profit or loss or available-for-sale financial assets categories, are accounted for at amortised cost using the effective interest method, except those which the Group intends to sell in the near term and which are accounted for at fair value, with the gains and losses arising from changes in their fair value reflected in the income statement. Loans and advances are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs. Loans and advances are derecognised when the rights to receive cash flows from them have expired or where the Group has transferred substantially all risks and rewards of ownership.

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. Such financial assets continue to be recognised by the Group, together with a corresponding liability for the funding except in those cases where substantially all of the risks and rewards associated with the assets have been transferred or a significant proportion but not all of the risks and rewards have been transferred and the transferee has the ability to sell the assets when the assets are derecognised in full. If a fully proportional share of all, or of specifically identified, cash flows have been transferred, then that proportion of the assets is derecognised.

2 ACCOUNTING POLICIES continued

(G) SALE AND REPURCHASE AGREEMENTS

Securities sold subject to repurchase agreements ('repos') are recognised on the balance sheet where all of the risks and rewards are retained; the counterparty liability is included in deposits from banks or customer accounts, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Securities lent to counterparties are retained in the financial statements. Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability.

(H) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 3 (Critical accounting estimates and judgements: Valuation of financial instruments) and note 49 (Financial risk management: Fair values of financial assets and liabilities) for details of valuation techniques and significant inputs to valuation models.

Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. In accordance with IFRS 4, a policyholder's option to surrender an insurance contract for a fixed amount is not treated as an embedded derivative.

The method of recognising the movements in the fair value of the derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Derivatives may only be designated as hedges provided certain strict criteria are met. At the inception of a hedge its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship must be tested throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its objective the hedge relationship is terminated.

The Group designates certain derivatives as either: (1) hedges of the fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges); (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges); or (3) hedges of net investments in foreign operations (net investment hedges). These are accounted for as follows:

(1) FAIR VALUE HEDGES

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk; this also applies if the hedged asset is classified as an available-for-sale financial asset. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value attributable to the hedged risk are no longer recognised in the income statement; the adjustment that has been made to the carrying amount of a hedged item is amortised to the income statement over the period to maturity.

(2) CASH FLOW HEDGES

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(3) NET INVESTMENT HEDGES

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

(I) OFFSET

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(J) IMPAIRMENT OF FINANCIAL ASSETS

(1) ASSETS ACCOUNTED FOR AT AMORTISED COST

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

– Delinquency in contractual payments of principal and/or interest;

2 ACCOUNTING POLICIES continued

– Indications that the borrower or group of borrowers is experiencing significant financial difficulty;

– Restructuring of debt to reduce the burden on the borrower;

– Breach of loan covenants or conditions; and

– Initiation of bankruptcy or individual voluntary arrangement proceedings.

The estimated period between a loss occurring and its identification is determined by local management for each identified portfolio. In general, the periods used vary between two months and twelve months.

If there is objective evidence that an impairment loss has been incurred, an allowance is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate. For the Group's portfolios of smaller balance homogenous loans, such as the residential mortgage, personal lending and credit card portfolios, allowances are calculated for groups of assets taking into account historical cash flow experience. For the Group's other lending portfolios, allowances are established on a case-by-case basis. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

If there is no objective evidence of individual impairment the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Segmentation takes into account such factors as the type of asset, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the allowance is adjusted and the amount of the reversal is recognised in the income statement.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

(2) AVAILABLE-FOR-SALE FINANCIAL ASSETS

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for financial assets accounted for at amortised cost set out above, this assessment involves reviewing the current financial circumstances (including creditworthiness) and future prospects of the issuer assessing the future cash flows expected to be realised and, in the case of equity shares, considering whether there has been a significant or prolonged decline in the fair value of the asset below its cost. If an impairment loss has been incurred, the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that asset previously recognised, is removed from equity and recognised in the income statement. For impaired debt instruments, impairment losses are recognised in subsequent periods when it is determined that there has been a further negative impact on expected future cash flows; a reduction in fair value caused by general widening of credit spreads would not, of itself, result in additional impairment. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, an amount not greater than the original impairment loss is credited to the income statement; any excess is taken to the available-for-sale reserve. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(3) RENEGOTIATED LOANS

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans. In subsequent years, the asset is considered to be past due and disclosed only if further renegotiated.

(K) INVESTMENT PROPERTY

Property held for long-term rental yields and capital appreciation within the long-term assurance funds is classified as investment property. Investment property comprises freehold and long leasehold land and buildings and is carried in the balance sheet at fair value, being the open market value as determined in accordance with the guidance published by the Royal Institution of Chartered Surveyors. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices on less active markets. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair value are recorded in the income statement.

2 ACCOUNTING POLICIES continued

(L) TANGIBLE FIXED ASSETS

Tangible fixed assets are included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):

– Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease
– Leasehold improvements: shorter of 10 years or, if lease renewal is not likely, the remaining period of the lease

Equipment:

– Fixtures and furnishings: 10-20 years
– Other equipment and motor vehicles: 2-8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

(M) LEASES

(1) AS LESSEE

The leases entered into by the Group are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

(2) AS LESSOR

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee; all other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments is recognised as a receivable within loans and advances to banks and customers. Finance lease income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Operating lease assets are included within tangible fixed assets at cost and depreciated over their estimated useful lives, which equates to the lives of the leases, after taking into account anticipated residual values. Operating lease rental income is recognised on a straight line basis over the life of the lease.

The Group evaluates non-lease arrangements such as outsourcing and similar contracts to determine if they contain a lease which is then accounted for separately.

(N) BORROWINGS

Borrowings (which include deposits from banks, customer accounts, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

(O) PENSIONS AND OTHER POST-RETIREMENT BENEFITS

The Group operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method adjusted for unrecognised actuarial gains and losses. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Group's income statement includes the current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities ('the corridor approach'). In these circumstances the excess is charged or

2 ACCOUNTING POLICIES continued

credited to the income statement over the employees' expected average remaining working lives. Past service costs are charged immediately to the income statement, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

The Group's balance sheet includes the net surplus or deficit, being the fair value of scheme assets less the discounted value of scheme liabilities adjusted for the corridor. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The Group recognises the effect of material changes to the terms of its defined benefit pension plans which reduce future benefits as curtailments; gains and losses are recognised in the income statement when the curtailments occur.

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due.

(P) SHARE-BASED COMPENSATION

The Group operates a number of equity-settled, share-based compensation plans. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement over the remaining vesting period, together with a corresponding adjustment to equity.

(Q) TAXATION

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

For the Group's long-term assurance businesses, the tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on equity holders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

(R) INSURANCE

The Group undertakes both life assurance and general insurance business.

For accounting purposes the life assurance business issues three types of contract:

Insurance contracts – these contracts contain significant insurance risk, which the Group defines as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur.

Investment contracts containing a discretionary participation feature – these contracts do not contain significant insurance risk, but contain features which entitle the holder to receive, in addition to the guaranteed benefits, further amounts that are likely to be a significant proportion of the total benefits and the amount and timing of which is at the discretion of the Group and based upon the performance of specified assets. Contracts with a discretionary participation feature are referred to as participating investment contracts.

Non-participating investment contracts – these contracts do not contain significant insurance risk or a discretionary participation feature.

For accounting purposes the general insurance business only issues insurance contracts.

2 ACCOUNTING POLICIES continued

(1) LIFE ASSURANCE BUSINESS

(I) ACCOUNTING FOR INSURANCE AND PARTICIPATING INVESTMENT CONTRACTS

PREMIUMS AND CLAIMS

Premiums received in respect of insurance and participating investment contracts are recognised as revenue when due, except as detailed below in respect of unit-linked contracts.

Claims are recorded as an expense when they are incurred.

LIABILITIES

– Insurance or participating investment contracts in the Group's With Profit Fund

Liabilities of the Group's With Profit Fund, including guarantees and options embedded within products written by that fund, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime, except that projected transfers out of the fund into other Group funds are not treated as liabilities. Further details on the realistic capital regime are given on page 62.

– Insurance or participating investment contracts which are not unit-linked or in the Group's With Profit Fund

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain.

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

– Insurance or participating investment contracts which are unit-linked

Allocated premiums in respect of unit-linked contracts that are either insurance or participating investment contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals. The mortality charges deducted in each period from the policyholders as a group are considered adequate to cover the expected total death benefit claims in excess of the contract account balances in each period and hence no additional liability is established for these claims. Revenue consists of fees deducted for mortality, policy administration and surrender charges. Interest or changes in the unit prices credited to the account balances and excess benefit claims in excess of the account balances incurred in the period are charged as expenses in the income statement.

UNALLOCATED SURPLUS

Any amounts in the With Profit Fund not yet determined as being due to policyholders are recognised as an unallocated surplus which is shown separately from other liabilities.

VALUE OF IN-FORCE BUSINESS

The Group recognises as an asset the value of in-force business in respect of life insurance and participating investment contracts. The asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts written at the balance sheet date. This is determined after making appropriate assumptions about future economic conditions and other matters such as future mortality and persistency rates and includes allowances for both non-market risk and for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

(II) ACCOUNTING FOR NON-PARTICIPATING INVESTMENT CONTRACTS

All of the Group's non-participating investment contracts are unit-linked. These contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

Deposits and withdrawals are accounted for directly in the balance sheet as adjustments to the liability.

The Group receives investment management fees in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the instrument. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them on a straight-line basis over the estimated lives of the contracts.

Directly incremental commissions that vary with and are related to either securing new or renewing existing non-participating investment contracts are deferred; all other costs are recognised as expenses when incurred. This asset is subsequently amortised over the period of the provision of investment management services and is reviewed for impairment in circumstances where its carrying amount may not be recoverable. If the asset is greater than its recoverable amount it is written down immediately through expenses in the income statement.

2 ACCOUNTING POLICIES continued

(2) GENERAL INSURANCE BUSINESS

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date. Claims liabilities are not discounted.

(3) LIABILITY ADEQUACY TEST

At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities net of related deferred tax assets and acquired value of in-force business. In performing these tests current best estimates of discounted future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss by establishing a provision for losses arising from liability adequacy tests.

(4) REINSURANCE

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held. Insurance contracts entered into by the Group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract and are regularly reviewed for impairment. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

(S) FOREIGN CURRENCY TRANSLATION

The consolidated financial statements are presented in sterling, which is the Company's functional currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items measured at fair value are recognised in profit or loss, except for differences on available-for-sale non-monetary financial assets such as equity shares, which are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into sterling at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised directly in equity and included in profit or loss on its disposal.

(T) PROVISIONS

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(U) DIVIDENDS

Dividends on ordinary shares are recognised in equity in the period in which they are paid.

(V) CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, are discussed below.

IMPAIRMENT OF FINANCIAL ASSETS

LOAN IMPAIRMENT ALLOWANCES

The Group regularly reviews its loan portfolios to assess for impairment. Impairment allowances are established to recognise incurred impairment losses in its loan portfolios carried at amortised cost. In determining whether an impairment has occurred at the balance sheet date the Group considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows or their timings; such observable data includes information as to whether there has been an adverse change in the payment status of borrowers or changes in economic conditions that correlate with defaults on loan repayment obligations. Where this is the case, the impairment loss is the difference between the carrying value of the loan and the present value of the estimated future cash flows discounted at the loan's original effective interest rate.

At 31 December 2008 gross loans and advances to customers and banks totalled £287,220 million (2007: £247,067 million) against which impairment allowances of £3,727 million (2007: £2,408 million) had been made.

There are two components of the Group's loan impairment allowances: individual and collective. All impaired loans which exceed a certain threshold, principally within the Group's corporate banking business, are individually assessed for impairment having regard to expected future cash flows including those that could arise from the realisation of security. The determination of these allowances often requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer and the value of the security held, for which there may not be a readily accessible market. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment allowances and consequently these allowances can be subject to variation as time progresses and the circumstances of the customer become clearer.

Impairment allowances for portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis. Collective impairment allowances are calculated on a portfolio basis using formulae which take into account factors such as the length of time that the customer's account has been out of order, historical loss rates, the credit quality of the portfolios and the value of any security held, which is estimated, where appropriate, using indices such as house price indices. The variables used in the formulae are kept under regular review to ensure that as far as possible they reflect current economic circumstances; however changes in interest rates, unemployment levels and bankruptcy trends, particularly in the UK, could result in actual losses differing from reported impairment allowances.

Assumptions used in calculating provisions for loan impairment have been updated to reflect market conditions, including those in respect of house price inflation, forced sale discount and probability of borrower default. If average house prices were 12.5 per cent lower than those in place as at 31 December 2008, the house price index related impact on the impairment charge would be an increase of approximately £85 million.

IMPAIRMENT OF AVAILABLE-FOR-SALE FINANCIAL ASSETS

In determining whether an impairment loss has been incurred in respect of an available-for-sale financial asset, the Group performs an objective review of the current financial circumstances and future prospects of the issuer and, in the case of equity shares, considers whether there has been a significant or prolonged decline in the fair value of that asset below its cost. This consideration requires management judgement. Among factors considered by the Group is whether the decline in fair value is a result of a change in the quality of the asset or a downward movement in the market as a whole. An assessment is performed of the future cash flows expected to be realised from the asset, taking into account, where appropriate, the quality of underlying security and credit protection available. The reduction in the fair value of available-for-sale financial assets during the year was £2,721 million (2007: £483 million). Impairment losses in respect of available-for-sale financial assets transferred from reserves to the income statement totalled £130 million (2007: £70 million).

VALUATION OF FINANCIAL INSTRUMENTS

Trading securities, other financial assets and liabilities at fair value through profit or loss, derivatives and available-for-sale financial assets are stated at fair value. The fair value of these financial instruments is the amount for which an instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The fair values of financial instruments are determined by reference to unadjusted quoted prices in active markets where these are available. Where market prices are not available or are unreliable because of poor liquidity, fair values are determined using valuation techniques which, to the extent possible, use market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to similar instruments.

The Group uses widely recognised valuation models for determining the fair value of common and less complex financial instruments that use only observable market data. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over-the-counter derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and any uncertainty associated with determination of fair values. Availability of that observable information depends on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

Financial markets in certain financial instruments such as asset backed securities (ABS) and secondary loans, which were previously active and had been valued using market observable inputs in previous years, became inactive during 2008. The fair values of those assets are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data. For interest rate and foreign exchange option products and more complex option products, some or all of the inputs into the Group's valuation models may not be observable in the market and are derived from market prices or rates or are estimated based on market standard consensus data. The process of calculating the fair value of these instruments may necessitate the estimation of certain pricing parameters, assumptions or model characteristics. Management judgement and estimation are usually required when determining such matters as the expected cash flows on the financial instruments being valued, the probability of counterparty default, prepayment assumptions, and selection of appropriate discount rates.

The fair values of the Group's financial assets and liabilities are disclosed within note 49 on pages 175 to 177 together with an indication of the valuation technique used for each major asset or liability category, the inputs into valuation models that have the potential to significantly impact the value determined, the assumptions, if any, used for those inputs and the effects of applying reasonably possible alternative assumptions or, in the case of ABS within available-for-sale financial assets, a shift in credit spreads.

PENSIONS

The net liability recognised in the balance sheet at 31 December 2008 in respect of the Group's retirement benefit obligations was £1,771 million (2007: £2,144 million) of which £1,657 million (2007: £2,033 million) related to defined benefit pension schemes. This liability excludes actuarial losses of £267 million (2007: gains of £1,350 million) which the Group is permitted to leave unrecognised. The defined benefit pension schemes' gross deficit totalled £1,924 million (2007: £683 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

The schemes' liabilities are calculated using the projected unit credit method, which takes into account projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. The resulting estimated cash flows are discounted at a rate equivalent to the market yield at the balance sheet date on high quality bonds with a similar duration and currency to the schemes' liabilities. In order to estimate the future cash flows, a number of financial and non-financial assumptions are made by management, changes to which could have a material impact upon the overall deficit or the net cost recognised in the income statement.

Two important assumptions are the rate of inflation and the expected lifetime of the schemes' members. The assumed rate of inflation affects the rate at which salaries are projected to grow and therefore the size of the pension that employees receive upon retirement and also the rate at which pensions in payment increase. Over the longer term rates of inflation can vary significantly; at 31 December 2008 it was assumed that the rate of inflation would be 3.0 per cent per annum (2007: 3.3 per cent), although if this was increased by 0.2 per cent the overall deficit would increase by approximately £451 million and the annual cost by approximately £17 million. A reduction of 0.2 per cent would reduce the overall deficit by approximately £437 million and the annual cost by approximately £16 million.

The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience. An increase of one year in the expected lifetime of scheme members would increase the overall deficit by approximately £318 million and the annual cost by approximately £22 million; a reduction of one year would reduce the overall deficit by approximately £323 million and the annual cost by approximately £24 million.

The size of the overall deficit is also sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variations. At 31 December 2008 the discount rate used was 6.3 per cent (2007: 5.8 per cent); a reduction of 0.2 per cent would increase the overall deficit by approximately £469 million and the annual cost by approximately £7 million, while an increase of 0.2 per cent would reduce the net deficit by approximately £393 million and the annual cost by approximately £9 million.

GOODWILL

At 31 December 2008 the Group carried goodwill on its balance sheet totalling £2,256 million (2007: £2,358 million), substantially all of which relates to acquisitions made a number of years ago.

The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The impairment review is performed by projecting future cash flows, excluding finance and tax, based upon budgets and plans and making appropriate assumptions about rates of growth and discounting these using a rate that takes into account prevailing market interest rates and the risks inherent in the business. If the present value of the projected cash flows is less than the carrying value of the underlying net assets and related goodwill an impairment charge is required in the income statement. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or performance does not meet expectations which affects the amount and timing of future cash flows, goodwill may become impaired in future periods. Further details are given in note 23.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

INSURANCE

LIFE ASSURANCE BUSINESS

The Group carries in its balance sheet an asset representing the value of in-force business in respect of life insurance and participating investment contracts of £1,893 million at 31 December 2008 (2007: £2,218 million). This asset, which is presented gross of attributable tax, represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. This is determined after making appropriate assumptions about future economic conditions and other matters such as future mortality and persistency rates and includes allowances for both non-market risk and for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets.

The valuation of the Group's annuity business has been affected by the recent upheaval in the capital markets which has caused a significant widening in corporate bond spreads. Based on available market analysis, an element of this widening in corporate bond spreads has been assessed as arising from an increase in the illiquidity premium. Annuity contracts cannot be surrendered and have reasonably certain cash flows best matched by assets of equivalent maturity with similar liquidity characteristics. As a result, in 2008 the value of in-force business asset for annuity business has been calculated after taking into account an estimate of the market premium for illiquidity derived from market and other published sources using a portfolio of investment grade bonds with similar cash flow characteristics as the annuity liabilities. The effect of this has been to increase the value of in-force business by £842 million as at 31 December 2008 with a similar increase in profit before tax disclosed within other operating income. It is not practicable to estimate the effect of this change on the results of future periods.

The assumptions made to derive the discount rates and cash flows are inherently uncertain and changes could significantly affect the value attributed. The process for determining key assumptions that have been made at 31 December 2008 is detailed in notes 24 and 32.

At 31 December 2008 the Group also carried substantial liabilities to holders of life, pensions and investment contracts in its balance sheet. The methodology used to value the liabilities is described in note 2 (R) (1). Liabilities arising from insurance contracts and participating investment contracts were £21,518 million and £11,619 million respectively (2007: £22,526 million and £14,874 million) and those arising from non-participating investment contracts totalled £14,243 million (2007: £18,197 million). Elements of the liabilities require assumptions about future investment returns, future mortality rates and future policyholder behaviour. The impact on profit before tax of changes in key assumptions is detailed in note 33.

GENERAL INSURANCE BUSINESS

At 31 December 2008 the Group held a provision of £183 million (2007: £207 million) in respect of the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date.

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgement. An increase of 10 per cent in the cost of claims would result in the recognition of an additional loss of approximately £18 million. Similarly, an increase of 10 per cent in the ultimate number of such claims would lead to an additional loss of approximately £18 million; some relief would arise from reinsurance contracts held.

TAXATION

At 31 December 2008 the Group had a current tax asset of £300 million and a deferred tax asset of £833 million (2007: a current tax liability of £484 million and a deferred tax liability of £948 million). During 2008, the Group's net tax position has shifted from a liability of £1,432 million at 31 December 2007 to an asset of £1,133 million at 31 December 2008. While the Group has taken account of tax issues that are subject to ongoing discussion with HM Revenue & Customs and other tax authorities in recognising these assets a significant feature is the management judgement in determining the timing, forecasting and probability of them reversing. This involved a detailed review of profit and loss numbers for 2007 and 2008 to ensure any carry forward positions were optimised at 31 December 2008. The outcome of this exercise has been mapped into 2009 profit and loss estimates and beyond and supports the above assets.

Inherent in this exercise has been management's assessment of legal and professional advice, case law and other relevant guidance. The various risks are categorised and appropriate weightings applied in arriving at the numbers. Where the expected tax outcome of these tax risks is different from the amounts that were initially recorded, such differences will impact the current and deferred tax numbers in the period in which such determination is made.

4 SEGMENTAL ANALYSIS

The Group is a leading financial services group, whose businesses provide a wide range of banking and financial services predominantly in the UK.

At 31 December 2008 the Group's activities were organised into three segments: UK Retail Banking, Insurance and Investments and Wholesale and International Banking. Services provided by UK Retail Banking encompass the provision of banking and other financial services to personal customers, private banking and mortgages. Insurance and Investments offers life assurance, pensions and savings products, general insurance and asset management services. Wholesale and International Banking provides banking and related services for major UK and multinational companies, banks and financial institutions, and small and medium-sized UK businesses. It also provides asset finance to personal and corporate customers, manages the Group's activities in financial markets through its treasury function and provides banking and financial services in some overseas locations.

Under the Group's transfer pricing arrangements, inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds.

For those derivative contracts entered into by business units for risk management purposes, the business unit retains the amount that would have been recognised on an accrual accounting basis (an amount equal to the interest element of the next payment on the swap) and transfers the remainder of the fair value of the swap to the central group segment where the resulting accounting volatility is managed though the establishment of hedge accounting relationships. Any change in fair value of the hedged instrument attributable to the hedged risk is also recorded within the central group segment. This allocation of the fair value of the swap and change in fair value of the hedged instrument attributable to the hedged risk avoids accounting asymmetry in segmental results, records volatility where it is managed and provides a fair presentation of the segments' operating performance. It is the basis on which the segments are managed and measured internally and is the basis of the Group's internal segmental reporting to the board.

As part of its transition to Basel II on 1 January 2008, the Group has updated its capital and liquidity pricing methodology. The main difference in this approach is to allocate a greater share of certain funding costs, previously allocated to the Central group items segment, to individual divisions. To enable a meaningful period-on-period comparison, the segmental analysis for the year ended 31 December 2007 has been restated to reflect these changes.

	UK Retail Banking £m	General insurance £m	Life, pensions and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Inter-segment eliminations £m	Total £m
Year ended 31 December 2008								
Interest and similar income	9,437	25	1,048	1,073	10,561	1,742	(5,244)	17,569
Interest and similar expense	(5,327)	(19)	(456)	(475)	(7,258)	(2,035)	5,244	(9,851)
Net interest income	4,110	6	592	598	3,303	(293)	–	7,718
Other income (net of fee and commission expense)	1,766	579	(3,680)	(3,101)	829	(199)	–	(705)
Total income	5,876	585	(3,088)	(2,503)	4,132	(492)	–	7,013
Insurance claims	–	(193)	3,052	2,859	–	–	–	2,859
Total income, net of insurance claims	5,876	392	(36)	356	4,132	(492)	–	9,872
Operating expenses	(2,730)	(161)	(502)	(663)	(2,630)	(30)	–	(6,053)
Trading surplus (deficit)	3,146	231	(538)	(307)	1,502	(522)	–	3,819
Impairment	(1,472)	–	(2)	(2)	(1,508)	(30)	–	(3,012)
Profit (loss) before tax	1,674	231	(540)	(309)	(6)	(552)	–	807
External revenue	9,804	1,176	(2,130)	(954)	7,679	1,029	–	17,558
Inter-segment revenue	1,002	65	120	185	2,395	1,152	(4,734)	–
Segment revenue	10,806	1,241	(2,010)	(769)	10,074	2,181	(4,734)	17,558
External assets	127,502	1,123	65,426	66,549	238,832	3,150	–	436,033
Inter-segment assets	5,679	564	2,779	3,343	143,842	98,190	(251,054)	–
Total assets	133,181	1,687	68,205	69,892	382,674	101,340	(251,054)	436,033
External liabilities	97,929	904	56,509	57,413	249,149	21,843	–	426,334
Inter-segment liabilities	31,361	74	7,088	7,162	128,681	83,850	(251,054)	–
Total liabilities	129,290	978	63,597	64,575	377,830	105,693	(251,054)	426,334
Other segment items:								
Capital expenditure	167	9	227	236	837	196	–	1, 436
Depreciation and amortisation	215	16	34	50	421	–	–	686
Movement in value of in-force business	–	–	(325)	(325)	–	–	–	(325)
Impairment of goodwill	–	–	–	–	100	–	–	100
Defined benefit scheme charges	103	2	19	21	85	(45)	–	164

4 SEGMENTAL ANALYSIS continued

	UK Retail Banking £m	General insurance £m	Life, pensions and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Inter-segment eliminations £m	Total £m
Year ended 31 December 2007								
Interest and similar income	7,964	23	1,040	1,063	9,762	1,386	(3,301)	16,874
Interest and similar expense	(4,269)	(18)	(682)	(700)	(7,353)	(1,754)	3,301	(10,775)
Net interest income	3,695	5	358	363	2,409	(368)	–	6,099
Other income (net of fee and commission expense)	1,797	554	7,643	8,197	1,773	362	–	12,129
Total income	5,492	559	8,001	8,560	4,182	(6)	–	18,228
Insurance claims	–	(302)	(7,220)	(7,522)	–	–	–	(7,522)
Total income, net of insurance claims	5,492	257	781	1,038	4,182	(6)	–	10,706
Operating expenses	(2,624)	(154)	(501)	(655)	(2,282)	(6)	–	(5,567)
Trading surplus (deficit)	2,868	103	280	383	1,900	(12)	–	5,139
Impairment	(1,224)	–	–	–	(572)	–	–	(1,796)
Profit on sale of businesses	–	–	272	272	385	–	–	657
Profit (loss) before tax	1,644	103	552	655	1,713	(12)	–	4,000
External revenue	9,132	1,235	8,854	10,089	10,082	300	–	29,603
Inter-segment revenue	958	49	181	230	1,487	1,591	(4,266)	–
Segment revenue	10,090	1,284	9,035	10,319	11,569	1,891	(4,266)	29,603
External assets	115,012	1,164	72,213	73,377	163,294	1,663	–	353,346
Inter-segment assets	5,093	361	3,777	4,138	91,246	64,654	(165,131)	–
Total assets	120,105	1,525	75,990	77,515	254,540	66,317	(165,131)	353,346
External liabilities	96,166	870	65,304	66,174	162,376	16,205	–	340,921
Inter-segment liabilities	20,321	12	5,930	5,942	86,159	52,709	(165,131)	–
Total liabilities	116,487	882	71,234	72,116	248,535	68,914	(165,131)	340,921
Other segment items:								
Capital expenditure	80	11	452	463	613	178	–	1,334
Depreciation and amortisation	205	14	37	51	374	–	–	630
Movement in value of in-force business	–	–	(93)	(93)	–	–	–	(93)
Defined benefit scheme charges	114	3	26	29	92	(60)	–	175

As the activities of the Group are predominantly carried out in the UK, no geographical analysis is presented.

5 NET INTEREST INCOME

	Weighted average effective interest rate			
	2008 %	2007 %	**2008 £m**	2007 £m
Interest receivable:				
Loans and advances to customers	**6.31**	6.89	**13,855**	13,209
Loans and advances to banks	**4.63**	5.14	**1,861**	2,025
Lease and hire purchase receivables	**7.62**	6.34	**706**	602
Interest receivable on loans and receivables	**6.11**	6.58	**16,422**	15,836
Available-for-sale financial assets	**4.58**	4.83	**1,147**	1,038
Total interest receivable	**5.98**	6.44	**17,569**	16,874
Interest payable:				
Deposits from banks	**3.65**	5.00	**(1,540)**	(1,919)
Customer accounts	**3.27**	3.58	**(4,932)**	(5,085)
Debt securities in issue	**4.10**	5.08	**(2,227)**	(2,680)
Subordinated liabilities	**5.82**	5.65	**(896)**	(741)
Liabilities under sale and repurchase agreements	**4.45**	4.81	**(256)**	(155)
Interest payable on liabilities held at amortised cost	**3.67**	4.24	**(9,851)**	(10,580)
Other	**–**	4.28	**–**	(195)
Total interest payable	**3.61**	4.24	**(9,851)**	(10,775)
Net interest income			**7,718**	6,099

Included within interest receivable is £435 million (2007: £395 million) in respect of impaired financial assets. Net interest income also includes a charge of £16 million (2007: credit of £1 million) transferred from the cash flow hedging reserve (see note 43).

6 NET FEE AND COMMISSION INCOME

	2008 £m	2007 £m
Fee and commission income:		
Current accounts	**707**	693
Insurance broking	**549**	648
Credit and debit card fees	**581**	536
Trust and other fiduciary fees	**413**	362
Other	**981**	985
	3,231	3,224
Fee and commission expense	**(694)**	(600)
Net fee and commission income	**2,537**	2,624

As discussed in note 2(D), fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 5. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 7.

7 NET TRADING INCOME

	2008 £m	2007 £m
Foreign exchange translation gains	**66**	34
Gains on foreign exchange trading transactions	**75**	159
Total foreign exchange	**141**	193
Investment property losses (note 22)	**(1,058)**	(321)
Securities and other (losses) gains	**(8,269)**	3,251
Net trading income	**(9,186)**	3,123

Securities and other (losses) gains comprise net gains arising on assets and liabilities held at fair value through profit or loss and for trading as follows:

	2008 £m	2007 £m
Net income (expense) arising on assets held at fair value through profit or loss:		
Loans and advances to banks and customers	**20**	23
Debt securities	**918**	673
Equity shares	**(7,759)**	2,422
Total net (expense) income arising on assets held at fair value through profit or loss	**(6,821)**	3,118
Net expense arising on liabilities held at fair value through profit or loss – debt securities in issue	**(232)**	(153)
Total net (losses) gains arising on assets and liabilities held at fair value through profit or loss	**(7,053)**	2,965
Net (losses) gains on financial instruments held for trading	**(1,216)**	286
Securities and other (losses) gains	**(8,269)**	3,251

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

8 INSURANCE PREMIUM INCOME

	2008 £m	2007 £m
Life insurance		
Gross premiums	4,841	4,937
Ceded reinsurance premiums	(41)	(98)
Net earned premiums	4,800	4,839
Non-life insurance		
Gross premiums written	651	632
Ceded reinsurance premiums	(23)	(23)
Net premiums	628	609
Change in provision for unearned premiums	(16)	(18)
Net earned premiums	612	591
Total net earned premiums	5,412	5,430

Life insurance gross written premiums can be further analysed as follows:

	2008 £m	2007 £m
Life and pensions	4,182	4,233
Annuities	645	689
Other	14	15
Gross premiums	4,841	4,937

Non-life insurance gross written premiums can be further analysed as follows:

	2008 £m	2007 £m
Credit protection	203	212
Home	441	412
Health	7	8
	651	632

9 OTHER OPERATING INCOME

	2008 £m	2007 £m
Operating lease rental income	392	393
Rental income from investment property (note 22)	209	227
Other rents receivable	32	31
Gains less losses on disposal of available-for-sale financial assets (note 43)	19	5
Movement in value of in-force business (note 24)	(325)	(93)
Car dealership income	–	49
Other income	205	340
	532	952

10 INSURANCE CLAIMS

Insurance claims comprise:

	2008 £m	2007 £m
Life insurance and participating investment contracts		
Claims and surrenders:		
Gross	**(4,710)**	(5,432)
Reinsurers' share	**65**	73
	(4,645)	(5,359)
Change in liabilities:		
Gross	**7,364**	(1,955)
Reinsurers' share	**49**	(20)
	7,413	(1,975)
Change in unallocated surplus (note 35)	**284**	114
Total life insurance and participating investment contracts	**3,052**	(7,220)
Non-life insurance		
Claims and claims paid:		
Gross	**(219)**	(250)
Reinsurers' share	**7**	–
	(212)	(250)
Change in liabilities:		
Gross	**24**	(58)
Reinsurers' share	**(5)**	6
	19	(52)
Total non-life insurance	**(193)**	(302)
Total insurance claims credit (expense)	**2,859**	(7,522)
Life insurance gross claims can also be analysed as follows:		
Deaths	**(289)**	(296)
Maturities	**(1,888)**	(1,516)
Surrenders	**(1,960)**	(2,994)
Annuities	**(516)**	(568)
Other	**(57)**	(58)
	(4,710)	(5,432)

A non-life insurance claims development table is included in note 32.

11 OPERATING EXPENSES

	2008 £m	2007 £m
Salaries	2,183	2,127
Social security costs	176	167
Pensions and other post-retirement benefit schemes (note 37)	235	238
Other staff costs	337	372
Staff costs	2,931	2,904
Other administrative expenses:		
Operating lease rentals	265	250
Repairs and maintenance	151	154
Communications and data processing	455	462
Advertising	194	192
Professional fees	229	279
Provision in respect of certain historic US dollar payments (note 48)	180	–
Provision for Financial Services Compensation Scheme levy (note 48)	122	–
Settlement of overdraft claims	–	76
Other	740	620
	2,336	2,033
Depreciation of tangible fixed assets (note 26)	648	594
Amortisation of other intangible assets (note 25)	38	36
Goodwill impairment charge (note 23)	100	–
Total operating expenses	6,053	5,567

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2008	2007
UK	64,355	67,616
Overseas	2,118	1,937
	66,473	69,553

11 OPERATING EXPENSES continued

	2008 £m	2007 £m
Fees payable for the audit of the Company's current year annual report	**7.1**	6.8
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	**2.5**	2.5
Other services supplied pursuant to legislation	**3.0**	2.7
Total audit fees	**12.6**	12.0
Other services – audit related fees	**5.3**	1.1
Total audit and audit related fees	**17.9**	13.1
Services relating to taxation	**0.5**	0.7
Other non-audit fees:		
Services relating to corporate finance transactions	**0.4**	0.7
Other services	**0.7**	0.1
Total other non-audit fees	**1.1**	0.8
Total fees payable to the Company's auditors by the Group	**19.5**	14.6

During the year, the auditors also earned fees payable by entities outside the consolidated Lloyds Banking Group in respect of the following:

	2008 £m	2007 £m
Audits of Group pension schemes	**0.2**	0.2
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	**0.5**	0.4
Reviews of the financial position of corporate and other borrowers	**1.4**	2.8
Acquisition due diligence and other work performed in respect of potential venture capital investments	**1.0**	0.6

The following types of services are included in the categories listed above:

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings. Other services supplied pursuant to legislation relate primarily to the costs associated with the Sarbanes-Oxley Act audit requirements together with the cost of the audit of the Group's Form 20-F filing.

Audit related fees: This category includes fees in respect of services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements, for example acting as reporting accountants in respect of prospectuses and circulars required by the UKLA listing rules.

Services relating to taxation: This category includes tax compliance and tax advisory services.

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital transactions and other assurance and advisory services.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to the provision of advice on tax issues, assistance in transactions involving the acquisition and disposal of businesses and accounting advice. The auditors are not permitted to provide management consultancy services to the Group.

The Group has procedures that are designed to ensure auditor independence, including that fees for audit and non-audit services are approved in advance. This approval can be obtained either on an individual engagement basis or, for certain types of non-audit services, particularly those of a recurring nature, through the approval of a fee cap covering all engagements of that type provided the fee is below that cap. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant fee cap must be pre-approved by the audit committee on an individual engagement basis. On a quarterly basis, the audit committee receives a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

12 IMPAIRMENT

	2008 £m	2007 £m
Impairment losses on loans and advances (note 20)	**2,876**	1,721
Other credit risk provisions (note 39)	**6**	5
	2,882	1,726
Impairment of available-for-sale financial assets	**130**	70
Total impairment charged to the income statement	**3,012**	1,796

13 PROFIT ON SALE OF BUSINESSES

	2008 £m	2007 £m
Profit on sale of Lloyds TSB Registrars	**–**	407
Profit on sale of Abbey Life	**–**	272
Other, including adjustments in respect of businesses sold in earlier years	**–**	(22)
Profit on sale of businesses	**–**	657

During 2007 the Group completed the sale of the business and assets of Lloyds TSB Bank plc's company registration business, Lloyds TSB Registrars; the sale of Abbey Life Assurance Company Limited, a UK life operation which had been closed to new business since 2000; and the sale of The Dutton-Forshaw Group Limited, a medium-size car dealership. In addition, provision was made for payments under an indemnity given in relation to a business sold in an earlier year. The businesses sold in 2007 did not represent separate material lines of business and consequently they were not treated as discontinued operations.

14 TAXATION

(A) ANALYSIS OF CREDIT (CHARGE) FOR THE YEAR

	2008 £m	2007 £m
UK corporation tax:		
Current tax on profit for the year	**(667)**	(763)
Adjustments in respect of prior years	**(19)**	30
	(686)	(733)
Double taxation relief	**91**	60
	(595)	(673)
Foreign tax:		
Current tax on profit for the year	**(144)**	(98)
Adjustments in respect of prior years	**4**	3
	(140)	(95)
Current tax charge	**(735)**	(768)
Deferred tax (note 38)	**773**	89
Tax credit (charge)	**38**	(679)

As a result of the Finance Act 2007, the statutory rate of corporation tax in the UK was reduced from 30 per cent to 28 per cent with effect from 1 April 2008. Therefore the charge for tax on the profit for the year is based on a UK corporation tax rate of 28.5 per cent (2007: 30 per cent).

The Group, as a proxy for policyholders in the UK, is required to record taxes on investment income, gains and losses each year. Accordingly, the tax attributable to UK life insurance policyholder earnings is included in income tax expense. The tax credit attributable to policyholders was £471 million (2007: £243 million credit), including a prior year tax charge of £4 million (2007: tax charge of £5 million).

In addition to the income statement current tax charge, a total of £674 million of current tax has been credited to equity (2007: a total of £131 million credit to equity); a debit of £1 million (2007: a credit of £3 million) in respect of share based payments, a credit of £584 million (2007: a credit of £103 million) in respect of foreign exchange differences and a net credit of £91 million (2007: a net credit of £25 million) in respect of the revaluation of available-for-sale financial assets.

14 TAXATION continued

(B) FACTORS AFFECTING THE TAX CREDIT (CHARGE) FOR THE YEAR

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the tax credit (charge) for the year is given below:

	2008 £m	2007 £m
Profit before tax	**807**	4,000
Tax charge thereon at UK corporation tax rate of 28.5 per cent (2007: 30 per cent)	**(230)**	(1,200)
Factors affecting charge:		
Goodwill impairment	**(28)**	–
Disallowed and non-taxable items	**12**	(2)
Overseas tax rate differences	**(39)**	4
Gains exempted or covered by capital losses	**25**	274
Policyholder interests	**337**	173
UK corporation tax rate change	**–**	110
Other items	**(39)**	(38)
Tax on profit on ordinary activities	**38**	(679)
Effective rate	**(4.7%)**	17.0%

15 EARNINGS PER SHARE

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year, which has been calculated after deducting 5 million (2007: 5 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

	2008	2007
Profit attributable to equity shareholders	**£819m**	£3,289m
Weighted average number of ordinary shares in issue	**5,742m**	5,637m
Basic earnings per share	**14.3p**	58.3p

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has dilutive potential ordinary shares in respect of share options and awards granted to employees. The number of shares that could have been acquired at market price (determined as the average annual share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options and awards is determined; the residual bonus shares are added to the weighted average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

	2008	2007
Profit attributable to equity shareholders	**£819m**	£3,289m
Weighted average number of ordinary shares in issue	**5,742m**	5,637m
Adjustment for share options and awards	**39m**	46m
Weighted average number of ordinary shares for diluted earnings per share	**5,781m**	5,683m
Diluted earnings per share	**14.2p**	57.9p

The weighted average number of anti-dilutive share options and awards excluded from the calculation of diluted earnings per share was 59 million at 31 December 2008 (2007: 3 million).

As discussed in note 52, the Group issued 2,596,653,203 ordinary shares at 173.3p on 13 January 2009 and issued 7,775,694,993 ordinary shares as purchase consideration for the acquisition of 100 per cent of the ordinary share capital of HBOS plc on 16 January 2009.

16 TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2008 £m	2007 £m
Trading assets	857	4,663
Other financial assets at fair value through profit or loss	44,207	53,248
	45,064	57,911

These assets are comprised as follows:

	2008		2007	
	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to banks	–	–	29	1
Loans and advances to customers	283	325	756	403
Debt securities:				
Government securities	38	7,326	62	4,848
Other public sector securities	–	18	–	–
Bank and building society certificates of deposit	–	433	–	811
Mortgage backed securities	–	369	87	70
Other asset backed securities	–	1,342	122	1,805
Corporate and other debt securities	536	11,120	3,607	13,564
	574	20,608	3,878	21,098
Equity shares:				
Listed	–	16,569	–	23,598
Unlisted	–	6,705	–	8,148
	–	23,274	–	31,746
	857	44,207	4,663	53,248

At 31 December 2008 £44,046 million (2007: £55,729 million) of trading and other financial assets at fair value through profit or loss had a contractual residual maturity of greater than one year.

Other financial assets at fair value through profit or loss represent the following assets designated into that category:

(i) financial assets backing insurance contracts and investment contracts which are so designated because the related liabilities either have cash flows that are contractually based on the performance of the assets or are contracts whose measurement takes account of current market conditions and where significant measurement inconsistencies would otherwise arise;

(ii) certain loans and advances to customers which are economically hedged by interest rate derivatives which are not in hedge accounting relationships and where significant measurement inconsistencies would otherwise arise if the related derivatives were treated as trading liabilities and the loans and advances were carried at amortised cost; and

(iii) certain private equity investments that are managed, and evaluated, on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

The maximum exposure to credit risk at 31 December 2008 of the loans and advances to banks and customers designated at fair value through profit or loss was £325 million (2007: £404 million); the Group does not hold any credit derivatives or other instruments in mitigation of this risk. There was no significant movement in the fair value of these loans attributable to changes in credit risk; this is determined by reference to the publicly available credit ratings of the instruments involved.

The carrying value of assets that are subject to stock lending arrangements was £809 million at 31 December 2008 (2007: £1,450 million) all of which the secured party is permitted by contract or custom to sell or repledge.

The Group's Corporate Markets business has no direct exposure to US sub-prime ABS and limited indirect exposure through asset-backed security collateralised debt obligations (ABS CDOs). During 2008, the market value of Corporate Markets' holdings in ABS CDOs reduced and, as a result, there has been an income statement charge of £92 million (2007: £114 million). The Group's Corporate Markets business has no exposure to mezzanine ABS CDOs. In addition, there are £1,867 million (2007: £1,861 million) of ABS CDOs which remain fully cash collateralised by major global financial institutions.

16 TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS continued

At 31 December 2008, the Group's Corporate Markets business had fair value exposure to one monoline financial guarantor in the form of credit default swap (CDS) protection bought against a £256 million collateralised loan obligation (CLO) (2007: exposure to one monoline against a £198 million CLO and one monoline against a £467 million collateralised debt obligation). The exposure on this CDS was £10 million, following a £28 million adverse credit valuation adjustment. A restructuring of Corporate Markets' other monoline hedged ABS CDO during 2008 has eliminated any reliance on the financial guarantor and has resulted in a much improved risk profile (AA) on a reduced holding of £128 million, included in loans and advances. Credit valuation adjustments and restructuring costs related to the cancelled CDS in the amount of £275 million were recognised in the income statement.

At 31 December 2008, fair values of £956 million (2007: £1,570 million) of the Group's trading and other financial assets classified as fair value through profit or loss, held within the Corporate Markets business, were valued using unobservable inputs. These assets largely represent the Group's venture capital investments, for which values are determined using valuation techniques which follow British Venture Capital Association (BVCA) guidelines. In respect of these assets, during the year to 31 December 2008, a credit of £111 million (2007: credit of £51 million) was recognised in the income statement relating to the change in their fair values.

17 DERIVATIVE FINANCIAL INSTRUMENTS

The principal derivatives used by the Group are interest rate and exchange rate contracts; particular attention is paid to the liquidity of the markets and products in which the Group trades to ensure that there are no undue concentrations of activity and risk.

Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.

Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. As discussed in note 19, the Group also uses credit default swaps to securitise, in combination with external funding, £8,360 million (2007: £4,325 million) of corporate and commercial banking loans.

Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities, in the form of published indices on or before a specified future date.

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate.

At 31 December 2008, £578 million (2007: £14 million) of fair value liabilities were valued using unobservable inputs; a charge of £512 million (2007: charge of £14 million) was recognised in the income statement relating to the change in fair value. The effect of using reasonably possible favourable and adverse valuation assumptions would be to increase or decrease net trading income by up to £80 million respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

17 DERIVATIVE FINANCIAL INSTRUMENTS continued

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2008			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	157,572	5,788	4,102
Currency swaps	29,463	4,367	1,463
Options purchased	9,185	714	–
Options written	10,143	–	743
	206,363	10,869	6,308
Interest rate contracts:			
Interest rate swaps	368,176	11,797	12,639
Forward rate agreements	153,930	405	395
Options purchased	37,175	843	–
Options written	33,130	–	627
Futures	587	44	3
	592,998	13,089	13,664
Credit derivatives	32,495	4,257	2,670
Equity and other contracts	5,447	234	81
Total derivative assets/liabilities held for trading		28,449	22,723
Hedging			
Derivatives designated as fair value hedges:			
Interest rate swaps (including swap options)	37,243	434	1,665
Derivatives designated as cash flow hedges:			
Interest rate swaps	867	1	91
Derivatives designated as net investment hedges:			
Cross currency swaps	6,318	–	2,413
Total derivative assets/liabilities held for hedging		435	4,169
Total recognised derivative assets/liabilities		28,884	26,892

At 31 December 2008 £16,200 million of total recognised derivative assets and £15,215 million of total recognised derivative liabilities (2007: £3,573 million of assets and £4,112 million of liabilities) had a contractual residual maturity of greater than one year.

17 DERIVATIVE FINANCIAL INSTRUMENTS continued

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2007			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	150,450	1,759	1,285
Currency swaps	30,214	803	680
Options purchased	7,609	157	–
Options written	6,988	–	149
	195,261	2,719	2,114
Interest rate contracts:			
Interest rate swaps	332,361	2,765	3,250
Forward rate agreements	102,274	36	34
Options purchased	33,147	171	–
Options written	22,976	–	171
Futures	35,571	1	–
	526,329	2,973	3,455
Credit derivatives	63,444	1,838	1,057
Equity and other contracts	4,439	865	156
Total derivative assets/liabilities held for trading		8,395	6,782
Hedging			
Derivatives designated as fair value hedges:			
Interest rate swaps (including swap options)	50,734	263	460
Derivatives designated as cash flow hedges:			
Interest rate swaps	630	1	24
Derivatives designated as net investment hedges:			
Cross currency swaps	5,302	–	316
Total derivative assets/liabilities held for hedging		264	800
Total recognised derivative assets/liabilities		8,659	7,582

18 LOANS AND ADVANCES TO BANKS

	2008 £m	2007 £m
Lending to banks	**5,104**	5,892
Money market placements with banks	**35,812**	28,953
Total loans and advances to banks	**40,916**	34,845
Allowance for impairment losses (note 20)	**(158)**	–
	40,758	34,845

At 31 December 2008 £5,459 million (2007: £5,773 million) of loans and advances to banks had a contractual residual maturity of greater than one year.

The Group holds collateral with a fair value of £10,739 million (2007: £9,109 million), which it is permitted to sell or repledge, of which £5,492 million (2007: £8,482 million) was repledged or sold to third parties for periods not exceeding three months from the transfer.

19 LOANS AND ADVANCES TO CUSTOMERS

	2008 £m	2007 £m
Agriculture, forestry and fishing	**3,969**	3,226
Energy and water supply	**2,598**	2,102
Manufacturing	**12,057**	8,385
Construction	**3,016**	2,871
Transport, distribution and hotels	**14,664**	11,573
Postal and telecommunications	**1,060**	946
Property companies	**23,318**	17,576
Financial, business and other services	**35,746**	29,707
Personal:		
– Mortgages	**114,643**	102,739
– Other	**25,318**	22,988
Lease financing	**4,620**	4,686
Hire purchase	**5,295**	5,423
	246,304	212,222
Allowance for impairment losses (note 20)	**(3,569)**	(2,408)
	242,735	209,814

At 31 December 2008 £180,197 million (2007: £153,302 million) of loans and advances to customers had a contractual residual maturity of greater than one year.

Included in loans and advances to customers are £6,342 million (2007: £4,201 million) held in Cancara, the Group's hybrid Asset Backed Commercial Paper conduit (see note 21).

During 2008 the Group's Corporate Markets business wrote down the value of its structured investment vehicle (SIV) exposures by £95 million (2007: £22 million) and now has no residual exposure to SIV Capital Notes (2007: exposure of £78 million). Additionally, at 31 December 2008 the Group's Corporate Markets business had a commercial paper back up liquidity facility totalling £22 million (2007: £370 million).

The Group holds collateral with a fair value of £1,736 million (2007: £1,975 million), which it is permitted to sell or repledge, of which £366 million (2007: £1,818 million) was repledged or sold to third parties for periods not exceeding three months from the transfer.

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2008 £m	2007 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**542**	620
Later than 1 year and not later than 5 years	**1,779**	1,917
Later than 5 years	**5,639**	5,339
	7,960	7,876
Unearned future finance income on finance leases	**(3,038)**	(2,875)
Rentals received in advance	**(128)**	(131)
Commitments for expenditure in respect of equipment to be leased	**(174)**	(184)
Net investment in finance leases	**4,620**	4,686

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

	2008 £m	2007 £m
Not later than 1 year	**329**	340
Later than 1 year and not later than 5 years	**978**	1,004
Later than 5 years	**3,313**	3,342
	4,620	4,686

19 LOANS AND ADVANCES TO CUSTOMERS continued

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. During 2008 and 2007 no contingent rentals in respect of finance leases were recognised in the income statement. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £15 million (2007: £16 million). The unguaranteed residual values included in finance lease receivables were as follows:

	2008 £m	2007 £m
Not later than 1 year	1	–
Later than 1 year and not later than 5 years	29	7
Later than 5 years	3	11
Total	33	18

SECURITISATIONS

Loans and advances to customers include balances that have been securitised but not derecognised, comprising both residential mortgages and commercial banking loans, the carrying values of which are set out below together with any related liabilities. Residential mortgages are not derecognised because the Group remains exposed to the majority of the risk of any default in respect of them; commercial banking loans are not derecognised because the Group has not transferred the contractual rights to receive the cash flows from those loans nor has it assumed a contractual obligation to pay the cash flows from those loans to a third party.

Beneficial interests in certain residential mortgages have been transferred to special purpose entities which issue floating rate debt securities. Neither the Group nor any entities in the Group are obliged to support any losses that may be suffered by the note holders and do not intend to offer such support. The floating rate note holders only receive payments of interest and principal to the extent that the special purpose entities have received sufficient funds from the transferred mortgages and after certain expenses have been met. In the event of a deficiency, they have no recourse whatsoever to the Group.

At 31 December 2008 the total amount of residential mortgages subject to securitisation was £34,293 million (2007: £46,284 million) in respect of which external funding at the year end amounted to £9,824 million (2007: £12,403 million); external funding is shown in debt securities in issue (see note 31). The Group participates in the securitisation through the provision of administration and other services, the provision of interest rate and currency swaps and in the form of unsecured loan financing which is subordinate to the interests of the floating rate note holders.

A further £40,608 million of residential mortgages are subject to securitisation via a covered bond programme; the related bonds have been issued to Lloyds TSB Bank plc, and are available for use in connection with Lloyds TSB Bank plc's participation in the Bank of England's Special Liquidity Scheme.

In addition the Group has entered into a number of securitisations of elements of its corporate and commercial loan portfolio. The total value of loans so securitised was £8,360 million (2007: £4,325 million), utilising a combination of external funding totalling £226 million (2007: £98 million) and credit default swaps.

The external funding is shown in debt securities in issue (see note 31) and the credit default swaps are accounted for as derivatives (see note 17).

20 ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND ADVANCES

	Loans and advances to customers					
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances to banks £m	Total £m
Balance at 1 January 2007	42	1,918	233	2,193	1	2,194
Exchange and other adjustments	–	–	2	2	–	2
Advances written off	(25)	(1,439)	(78)	(1,542)	–	(1,542)
Recoveries of advances written off in previous years	2	133	2	137	–	137
Unwinding of discount	–	(101)	(3)	(104)	–	(104)
Charge (credit) to the income statement	18	1,518	186	1,722	(1)	1,721
At 31 December 2007	37	2,029	342	2,408	–	2,408
Exchange and other adjustments	–	–	43	43	–	43
Advances written off	(23)	(1,382)	(205)	(1,610)	–	(1,610)
Recoveries of advances written off in previous years	1	111	–	112	–	112
Unwinding of discount	–	(100)	(2)	(102)	–	(102)
Charge to the income statement	171	1,687	860	2,718	158	2,876
At 31 December 2008	186	2,345	1,038	3,569	158	3,727

20 ALLOWANCE FOR IMPAIRMENT LOSSES ON LOANS AND ADVANCES continued

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

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 2(J). All impaired loans which exceed a certain threshold, principally within the Group's corporate banking business, are individually assessed for impairment having regard to expected future cash flows including those that could arise from the realisation of security. Included in loans and advances to customers and to banks were loans and advances individually determined to be impaired whose gross amount before impairment allowances was £2,699 million (2007: £684 million) and in respect of which collateral with a fair value of £518 million (2007: £193 million) was held.

21 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2008			2007		
	Cancara £m	Other £m	Total £m	Cancara £m	Other £m	Total £m
Debt securities:						
Government securities	–	868	868	–	319	319
Other public sector securities	–	12	12	–	5	5
Bank and building society certificates of deposit	–	9,602	9,602	–	1,825	1,825
Mortgage backed securities	3,176	1,253	4,429	4,136	1,914	6,050
Other asset backed securities	853	4,103	4,956	1,015	3,056	4,071
Corporate and other debt securities	2,244	4,346	6,590	3,117	3,153	6,270
	6,273	20,184	26,457	8,268	10,272	18,540
Equity shares:						
Listed	–	3	3	–	1	1
Unlisted	–	38	38	–	28	28
	–	41	41	–	29	29
Treasury bills and other bills:						
Treasury bills and similar securities	–	2,402	2,402	–	1,608	1,608
Other bills	–	26,807	26,807	–	19	19
	–	29,209	29,209	–	1,627	1,627
	6,273	49,434	55,707	8,268	11,928	20,196

Cancara is the Group's hybrid Asset Backed Commercial Paper conduit. Total exposures in Cancara were £12,615 million (31 December 2007: £12,469 million) comprising the £6,273 million (31 December 2007: £8,268 million) of debt securities detailed above and £6,342 million (31 December 2007: £4,201 million) of loans and advances to customers (see note 19). Cancara, which is fully consolidated in the Group's accounts, is managed in a very conservative manner, which is demonstrated by the quality and ratings stability of its underlying asset portfolio. At 31 December 2008, the asset-backed securities in Cancara were 91.8 and 94.2 per cent (31 December 2007: 100 per cent) Aaa/AAA rated by Moody's and Standard & Poor's respectively, and there was no exposure either directly or indirectly to sub-prime US mortgages within Cancara's debt security portfolio. At 31 December 2008 loans and advances included no US sub-prime mortgage exposure (31 December 2007: £115 million).

The other asset-backed securities not in the Cancara conduit of £4,103 million (31 December 2007: £3,056 million) comprise £2,917 million (31 December 2007: £2,643 million) of US Government guaranteed student loan asset-backed securities and £1,186 million (31 December 2007: £413 million) of unhedged asset-backed security collateralised debt obligations.

At 31 December 2008 £15,627 million (2007: £15,265 million) of available-for-sale financial assets had a contractual residual maturity of greater than one year.

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in note 2(J). Included in available-for-sale assets at 31 December 2008 are debt securities individually determined to be impaired whose gross amount before impairment allowances was £282 million (2007: £75 million) and in respect of which no collateral was held. In addition, included in available-for-sale assets at 31 December 2008 are equity securities individually determined to be impaired whose gross amount before impairment allowances was £31 million (2007: nil).

22 INVESTMENT PROPERTY

	2008 £m	2007 £m
At 1 January	3,722	4,739
Exchange and other adjustments	66	5
Additions:		
Acquisitions of new properties	85	302
Additional expenditure on existing properties	116	181
Total additions	201	483
Disposals	(300)	(271)
Adjustments on deconsolidation of OEICs	–	(881)
Changes in fair value (note 7)	(1,058)	(321)
Disposal of businesses	–	(32)
At 31 December	2,631	3,722

The investment properties are valued at least annually at open-market value, by independent, professionally qualified valuers, who have recent experience in the location and categories of the investment properties being valued.

In addition, the following amounts have been recognised in the income statement:

	2008 £m	2007 £m
Rental income	209	227
Direct operating expenses arising from investment properties that generate rental income	29	24

Capital expenditure in respect of investment properties:

	2008 £m	2007 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	82	111

23 GOODWILL

	2008 £m	2007 £m
At 1 January	2,358	2,377
Exchange and other adjustments	(2)	–
Disposals	–	(19)
Impairment charge to the income statement	(100)	–
At 31 December	2,256	2,358
Cost*	2,362	2,364
Accumulated impairment losses	(106)	(6)
At 31 December	2,256	2,358

*For acquisitions made prior to 1 January 2004, the date of transition to IFRS, cost is included net of amounts amortised up to 31 December 2003.

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,256 million (2007: £2,358 million), £1,836 million (or 81 per cent of the total) has been allocated to Scottish Widows and £410 million (or 18 per cent of the total) to Asset Finance.

The recoverable amount of Scottish Widows has been based on a value in use calculation. The calculation uses projections of future cash flows based upon budgets and plans approved by management covering a five-year period, and a discount rate of 12 per cent (gross of tax). The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. Cash flows beyond the five-year period have been extrapolated using a steady 3 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

23 GOODWILL continued

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 15 per cent (gross of tax). The discount rate has been set at a premium over the Group's weighted average cost of capital to take into account the specific risk profile of the Asset Finance business. The cash flows for each of the businesses of Asset Finance beyond the five-year period are extrapolated using steady growth rates, in each case not exceeding 2.5 per cent nor the long-term average growth rates for the markets in which the respective businesses of Asset Finance participate.

During 2008, the basis of goodwill allocation and the related value in use calculation has been changed to treat the consumer finance business as a single cash generating unit encompassing the motor and personal finance operations which provide direct and point of sale finance; this reflects the strategic and operational interdependencies and shared market dynamics of these units. The markets in which these units operate have been affected by the UK economic downturn, which has been characterised by a fall off in demand and increasing arrears at this point of the cycle. This, together with continuing uncertainties over the likely short-term macroeconomic environment, has resulted in a reassessment of the carrying value of the consumer finance cash generating unit and the recognition of a goodwill impairment charge of £100 million at 31 December 2008.

24 VALUE OF IN-FORCE BUSINESS

The asset in the consolidated balance sheet and movement recognised in the income statement are as follows:

Gross value of in-force insurance and participating investment business

	2008 £m	2007 £m
At 1 January	**2,218**	2,723
Movements in the year:		
New business	**368**	264
Existing business:		
Expected return	**(112)**	(166)
Experience variances	**(46)**	(38)
Assumption changes	**(92)**	69
Economic variance	**(443)**	(222)
Movement in value of in-force business taken to income statement (note 9)	**(325)**	(93)
Disposal of business	**–**	(412)
At 31 December	**1,893**	2,218

This breakdown shows the movement in the value of in-force business only, and does not represent the full contribution that each item in the breakdown contributes to profit before tax, which would also contain changes in the other assets and liabilities of the relevant businesses. Economic variance is the element of earnings which is generated from changes to economic experience in the period and to assumptions over time. The presentation of economic variance includes the impact of financial market conditions being different at the end of the reporting period from those included in assumptions used to calculate new and existing business returns.

The principal features of the methodology and process used for determining key assumptions used in the calculation of the value of in-force business are set out below:

ECONOMIC ASSUMPTIONS

Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. In practice, to achieve the same result, where the cash flows are either independent of or move linearly with market movements, a method has been applied known as the 'certainty equivalent' approach whereby it is assumed that all assets earn the risk-free rate and all cash flows are discounted at the risk-free rate.

A market consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date. The risk free rate used for the value of financial options and guarantees is defined as the spot yield derived from the UK gilt yield curve in line with Scottish Widows' FSA realistic balance sheet assumptions.

The valuation of the Group's annuity business has been affected by the recent upheaval in the capital markets which has caused a significant widening in corporate bond spreads in 2008. Based on available market analysis, an element of this widening in corporate bond spreads has been assessed as arising from an increase in the illiquidity premium. Annuity contracts cannot be surrendered and have reasonably certain cash flows best matched by assets of equivalent maturity with similar liquidity characteristics. As a result, in 2008 the value of in-force business asset for annuity business has been calculated after taking into account an estimate of 154 basis points for the market premium for illiquidity, which has been derived from market and other published sources using a portfolio of investment grade bonds with similar cash flow characteristics as the annuity liabilities. The effect of this has been to increase the value of in-force business by £842 million as at 31 December 2008 with a similar increase in profit before tax. This is reflected as an economic variance in the table above, together with other market movements.

24 VALUE OF IN-FORCE BUSINESS continued

The risk free rate assumed in valuing the in-force asset for annuity business is presented as a single risk free rate to allow easier comparison to the rate used for other business. That single risk free rate has been derived to give the equivalent value to the annuity book, had the book been valued using the UK gilt yield curve increased to reflect the illiquidity premium as described above. For 2008, the risk-free rate assumed in valuing the in-force asset for non-annuity business is the 15-year gilt yield.

The table below shows the range of resulting yields and other key assumptions at 31 December:

	2008 %	2007 %
Risk-free rate (value of in-force non-annuity business)	**3.74**	4.65
Risk-free rate (value of in-force annuity business)	**5.22**	4.65
Risk-free rate (financial options and guarantees)	**1.11 to 4.24**	4.28 to 4.81
Retail price inflation	**2.75**	3.28
Expense inflation	**3.50**	4.18

NON-MARKET RISK

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the With Profit Fund there are asymmetries in the range of potential outcomes for which an explicit allowance is made.

NON-ECONOMIC ASSUMPTIONS

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

Further information about the effect of changes in key assumptions is given in note 32.

25 OTHER INTANGIBLE ASSETS

	Customer lists £m	Software enhancements £m	Total £m
Cost:			
At 1 January 2007	54	198	252
Additions	3	47	50
Disposals	–	(5)	(5)
At 31 December 2007	57	240	297
Additions	**6**	**80**	**86**
At 31 December 2008	**63**	**320**	**383**
Accumulated amortisation:			
At 1 January 2007	–	114	114
Charge for the year	5	31	36
Disposals	–	(2)	(2)
At 31 December 2007	5	143	148
Charge for the year	**7**	**31**	**38**
At 31 December 2008	**12**	**174**	**186**
Balance sheet amount at 31 December 2008	**51**	**146**	**197**
Balance sheet amount at 31 December 2007	52	97	149

Software enhancements principally comprise identifiable and directly associated internal staff and other costs.

26 TANGIBLE FIXED ASSETS

	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m
Cost:				
At 1 January 2007	1,488	2,849	2,866	7,203
Exchange and other adjustments	–	2	(24)	(22)
Adjustments on disposal of businesses	(53)	(89)	–	(142)
Adjustments on deconsolidation of subsidiaries	–	–	(1,015)	(1,015)
Additions	60	286	549	895
Disposals	(58)	(177)	(945)	(1,180)
At 31 December 2007	1,437	2,871	1,431	5,739
Exchange and other adjustments	**2**	**18**	**70**	**90**
Additions	**96**	**341**	**556**	**993**
Disposals	**(19)**	**(82)**	**(493)**	**(594)**
At 31 December 2008	**1,516**	**3,148**	**1,564**	**6,228**
Accumulated depreciation and impairment:				
At 1 January 2007	675	1,960	316	2,951
Exchange and other adjustments	–	2	(3)	(1)
Adjustments on disposal of businesses	(11)	(35)	–	(46)
Adjustments on deconsolidation of subsidiaries	–	–	(86)	(86)
Charge for the year	83	242	269	594
Disposals	(29)	(162)	(321)	(512)
At 31 December 2007	718	2,007	175	2,900
Exchange and other adjustments	**1**	**10**	**21**	**32**
Charge for the year	**81**	**254**	**313**	**648**
Disposals	**(11)**	**(63)**	**(243)**	**(317)**
At 31 December 2008	**789**	**2,208**	**266**	**3,263**
Balance sheet amount at 31 December 2008	**727**	**940**	**1,298**	**2,965**
Balance sheet amount at 31 December 2007	719	864	1,256	2,839

At 31 December the future minimum rentals receivable under non-cancellable operating leases were as follows:

	2008 £m	2007 £m
Receivable within 1 year	**294**	259
1 to 5 years	**320**	271
Over 5 years	**9**	9
	623	539

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2008 and 2007 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £102 million at 31 December 2008 (£113 million at 31 December 2007) is expected to be received under non-cancellable sub-leases of the Group's premises.

27 OTHER ASSETS

	2008 £m	2007 £m
Assets arising from reinsurance contracts held (note 32)	**385**	350
Deferred acquisition costs	**196**	212
Settlement balances	**751**	205
Other assets and prepayments	**4,524**	4,296
	5,856	5,063

At 31 December 2008 £1,833 million (2007: £1,781 million) of other assets had a contractual residual maturity of greater than one year.

Deferred acquisition costs:

	2008 £m	2007 £m
At 1 January	**212**	443
Acquisition costs deferred, net of amounts amortised to the income statement	**(16)**	(22)
Disposal of businesses and other adjustments	**–**	(209)
At 31 December	**196**	212

28 DEPOSITS FROM BANKS

The breakdown of deposits from banks between the domestic and international offices of the Group is set out below:

	2008 £m	2007 £m
Domestic:		
Non-interest bearing	**131**	101
Interest bearing	**58,471**	32,335
	58,602	32,436
International:		
Non-interest bearing	**23**	46
Interest bearing	**7,889**	6,609
	7,912	6,655
Deposits from banks	**66,514**	39,091

At 31 December 2008 £1,956 million (2007: £25 million) of deposits from banks had a contractual residual maturity of greater than one year.

Included in deposits from banks were deposits of £2,574 million (2007: £1,509 million) held as collateral, principally in relation to derivative contracts. The fair value of those deposits approximates the carrying amount.

29 CUSTOMER ACCOUNTS

	2008 £m	2007 £m
Non-interest bearing current accounts	**4,176**	3,807
Interest bearing current accounts	**47,109**	45,726
Savings and investment accounts	**76,144**	71,905
Other customer deposits	**43,509**	35,117
Customer accounts	**170,938**	156,555

29 CUSTOMER ACCOUNTS continued

The breakdown of customer accounts between the domestic and international offices of the Group is set out below:

	2008 £m	2007 £m
Domestic:		
Non-interest bearing	**3,530**	3,407
Interest bearing	**162,804**	149,412
	166,334	152,819
International:		
Non-interest bearing	**646**	400
Interest bearing	**3,958**	3,336
	4,604	3,736
Customer accounts	**170,938**	156,555

At 31 December 2008 £2,499 million (2007: £1,949 million) of customer accounts had a contractual residual maturity of greater than one year.

Included in customer accounts were deposits of £1,002 million (2007: £777 million) held as collateral, principally in relation to derivative contracts. The fair value of those deposits approximates the carrying amount.

30 TRADING AND OTHER LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	2008 £m	2007 £m
Liabilities held at fair value through profit or loss (debt securities)	**6,748**	3,107
Trading liabilities	**6**	99
Trading and other liabilities at fair value through profit or loss	**6,754**	3,206

At 31 December 2008 £6,525 million (2007: £2,032 million) of trading and other liabilities at fair value through profit or loss had a contractual residual maturity of greater than one year.

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2008 was £6,517 million, which was £231 million lower than the balance sheet carrying value (2007: £3,131 million, which was £24 million higher than the balance sheet carrying value). At 31 December 2008 there was a cumulative £44 million decrease in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of Lloyds TSB Bank plc, the issuing entity within the Group. Of the £44 million, £36 million arose in 2008 and £8 million arose in 2007.

Liabilities designated at fair value through profit or loss represent debt securities in issue which either contain substantive embedded derivatives which would otherwise need to be recognised and measured at fair value separately from the related debt securities, or which are accounted for at fair value to significantly reduce an accounting mismatch.

31 DEBT SECURITIES IN ISSUE

	2008 £m	2007 £m
Euro medium-term note programme	**9,178**	4,692
Other bonds and medium-term notes	**12,695**	14,497
Certificates of deposit issued	**33,207**	14,995
Commercial paper	**20,630**	17,388
Total debt securities in issue	**75,710**	51,572

At 31 December 2008 £16,120 million (2007: £18,604 million) of debt securities in issue had a contractual residual maturity of greater than one year.

Debt securities in issue at 31 December 2008 included £9,824 million (2007: £12,403 million) in respect of the securitisation of mortgages and £226 million (2007: £98 million) in respect of the securitisation of corporate and commercial banking loans (see note 19).

32 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS

	2008 £m	2007 £m
Insurance contract liabilities	**22,173**	23,189
Participating investment contract liabilities	**11,619**	14,874
	33,792	38,063

At 31 December 2008 £29,967 million (2007: £35,603 million) of liabilities arising from insurance contracts and participating investment contracts had a contractual residual maturity of greater than one year.

INSURANCE CONTRACT LIABILITIES

Insurance contract liabilities, substantially all of which relate to business written in the United Kingdom, are comprised as follows:

	2008			2007		
	Gross £m	**Reinsurance* £m**	**Net £m**	Gross £m	Reinsurance* £m	Net £m
Life insurance (see (1) below)	**21,518**	**(380)**	**21,138**	22,526	(340)	22,186
Non-life insurance (see (2) below):						
Unearned premiums	**472**	**–**	**472**	456	–	456
Claims outstanding	**183**	**(5)**	**178**	207	(10)	197
	655	**(5)**	**650**	663	(10)	653
	22,173	**(385)**	**21,788**	23,189	(350)	22,839

*Reinsurance balances receivable are reported within other assets (note 27).

(1) LIFE INSURANCE

The movement in life insurance contract liabilities over the year can be analysed as follows:

	Gross £m	Reinsurance £m	Net £m
At 1 January 2007	25,763	(425)	25,338
New business	2,428	(18)	2,410
Changes in existing business	(1,316)	15	(1,301)
Disposal of businesses	(4,349)	88	(4,261)
At 31 December 2007	22,526	(340)	22,186
New business	**2,915**	**(32)**	**2,883**
Changes in existing business	**(3,923)**	**(8)**	**(3,931)**
At 31 December 2008	**21,518**	**(380)**	**21,138**

The movement in liabilities arising from participating investment contracts may be analysed as follows:

	£m
At 1 January 2007	15,095
New business	491
Changes in existing business	(712)
At 31 December 2007	14,874
New business	**208**
Changes in existing business	**(3,463)**
At 31 December 2008	**11,619**

32 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

PROCESS FOR DETERMINING KEY ASSUMPTIONS

The process for determining the key assumptions for insurance contracts and participating investment contracts is set out below.

These policy liabilities can be split into With Profit Fund liabilities, accounted for using the FSA's realistic capital regime (realistic liabilities) and Non-Profit Fund liabilities, accounted for using a traditional prospective actuarial discounted cash flow methodology as described in the accounting policies.

WITH PROFIT FUND REALISTIC LIABILITIES

The Group's With Profit Fund contains life insurance contracts and participating investment contracts. The calculation of With Profit Fund realistic liabilities uses best estimate assumptions for mortality, persistency rates and expenses. These are calculated in a similar manner to those used for the value of in-force business as discussed in note 24. The persistency rates used for the realistic valuation of the With Profit Fund liabilities make an allowance for potential changes in future experience as the guarantees and options within with-profits contracts become more valuable under adverse market conditions.

Other key assumptions are:

INVESTMENT RETURNS AND DISCOUNT RATES

The realistic capital regime dictates that With Profit Fund liabilities are valued on a market-consistent basis. This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The With Profit Fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as the spot yield derived from the UK gilt yield curve.

GUARANTEED ANNUITY OPTION TAKE-UP RATES

The guaranteed annuity option take-up rates are set with regard to the Group's actual experience and make allowance for potential increases in take-up rates when the Guaranteed Annuity Options become more valuable to the policyholder.

INVESTMENT VOLATILITY

The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2008, the 10 year equity-implied at-the-money assumption was set at 34.6 per cent (31 December 2007: 25.5 per cent). The assumption for property volatility was 15 per cent (31 December 2007: 15 per cent), with swaption volatility of broadly 16 per cent (31 December 2007: broadly 11 per cent).

MORTALITY

The mortality assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this is significant, and relevant industry data otherwise.

LAPSE RATES

Lapse rates refer to the rate of policy termination and the rate at which policyholders stop paying regular premiums. These rates are based on a combination of historical experience and management's views on future experience taking into consideration potential changes in future experience that may result from guarantees and options becoming more valuable under adverse market conditions.

NON-PROFIT FUND LIABILITIES

Generally, assumptions used to value Non-Profit Fund liabilities are prudent in nature and therefore contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The key assumptions used in the measurement of Non-Profit Fund liabilities are:

INTEREST RATES

The rates used are derived in accordance with the FSA Rules. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the FSA Rules, including reductions made to the available yields to allow for default risk based upon the credit rating of each stock.

MORTALITY AND MORBIDITY

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and include a margin for adverse deviation.

32 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

LAPSE RATES

Lapse rates, set with regard to the Group's actual experience and with a margin for adverse deviation, are allowed for on some Non-Profit Fund contracts.

MAINTENANCE EXPENSES

Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviation. Explicit allowance is made for future expense inflation.

KEY CHANGES IN ASSUMPTIONS

During 2008, following a detailed review of the Group's current and expected experience, there has been a change in the key assumption in respect of lapse and paid-up rates. The impact of this change has been to decrease profit before tax by £143 million; this amount includes movements in liabilities and value of the in-force business in respect of insurance contracts and participating investment contracts.

(2) NON-LIFE INSURANCE

Gross non-life insurance contract liabilities are analysed by line of business as follows:

	2008 £m	2007 £m
Credit protection	**293**	274
Home	**359**	385
Health	**3**	4
	655	663

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. There has been no significant change in the assumptions and methodologies used for setting reserves.

The reserving methodology and associated assumptions are set out below:

The unearned premium reserve is determined on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of each contract.

Claims outstanding comprise those claims that have been notified and those that have been incurred but not reported. Claims incurred but not reported are determined based on the historical emergence of claims and their average cost. The notified claims element represents the best estimate of the cost of claims reported using projections and estimates based on historical experience.

The movements in non-life insurance contract liabilities and reinsurance assets over the year have been as follows:

	Gross £m	Reinsurance £m	Net £m
Provisions for unearned premiums			
At 1 January 2007	438	–	438
Increase in the year	632	(23)	609
Release in the year	(614)	23	(591)
At 31 December 2007	456	–	456
Increase in the year	**651**	**(23)**	**628**
Release in the year	**(635)**	**23**	**(612)**
At 31 December 2008	**472**	**–**	**472**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

32 LIABILITIES ARISING FROM INSURANCE CONTRACTS AND PARTICIPATING INVESTMENT CONTRACTS continued

These provisions represent the liability for short-term insurance contracts for which the Group's obligations are not expired at the year end.

	Gross £m	Reinsurance £m	Net £m
Claims and loss adjustment expenses			
Notified claims	127	(4)	123
Incurred but not reported	22	–	22
At 1 January 2007	149	(4)	145
Cash paid for claims settled in the year	(275)	–	(275)
Increase (decrease) in liabilities:			
Arising from current year claims	341	(9)	332
Arising from prior year claims	(8)	3	(5)
At 31 December 2007	207	(10)	197
Cash paid for claims settled in the year	**(245)**	**7**	**(238)**
Increase (decrease) in liabilities:			
Arising from current year claims	**221**	**–**	**221**
Arising from prior year claims	**–**	**(2)**	**(2)**
At 31 December 2008	**183**	**(5)**	**178**
Notified claims	**160**	**(5)**	**155**
Incurred but not reported	**23**	**–**	**23**
At 31 December 2008	**183**	**(5)**	**178**
Notified claims	188	(10)	178
Incurred but not reported	19	–	19
At 31 December 2007	207	(10)	197

NON-LIFE INSURANCE CLAIMS DEVELOPMENT TABLE

The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Group's estimate of total claims outstanding for each accident year has changed at successive year ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. The accident year basis is considered the most appropriate for the business written by the Group.

NON-LIFE INSURANCE ALL RISKS – GROSS

	2004 £m	2005 £m	2006 £m	2007 £m	**2008 £m**	**Total £m**
Accident year						
Estimate of ultimate claims costs:						
At end of accident year	227	211	208	317	**205**	**1,168**
One year later	209	207	206	311		
Two years later	207	204	204			
Three years later	206	202				
Four years later	206					
Current estimate of cumulative claims	206	202	204	311	**205**	**1,128**
Cumulative payments to date	(204)	(197)	(195)	(265)	**(99)**	**(960)**
Liability recognised in the balance sheet	2	5	9	46	**106**	**168**
Liability in respect of earlier years						**8**
Total liability included in the balance sheet						**176**

The liability of £176 million shown in the above table excludes £7 million of unallocated claims handling expenses.

33 LIFE INSURANCE SENSITIVITY ANALYSIS

The following table demonstrates the effect of changes in key assumptions on profit before tax and equity disclosed in these financial statements assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. These amounts include movements in assets, liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts. The impact is shown in one direction but can be assumed to be reasonably symmetrical.

	Change in variable	Increase (reduction) in profit before tax £m	Increase (reduction) in equity £m
Non-annuitant mortality[1]	5% reduction	31	22
Annuitant mortality[2]	5% reduction	(77)	(55)
Lapse rates[3]	10% reduction	38	28
Future maintenance and investment expenses[4]	10% reduction	70	50
Risk-free rate[5]	0.25% deduction	47	34
Guaranteed annuity option take up[6]	5% addition	(22)	(15)
Equity investment volatility[7]	1% addition	(7)	(5)
Widening of credit default spreads on corporate bonds[8]	0.25% addition	(82)	(59)
Decrease in illiquidity premia[9]	0.25% deduction	(134)	(97)

Assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and statutory reserving bases.

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

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

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

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

[5] This sensitivity shows the impact on the value of in-force business, financial options and guarantee costs, statutory reserves and asset values of reducing the risk-free rate by 25 basis points.

[6] This sensitivity shows the impact of a flat 5 per cent addition to the expected rate.

[7] This sensitivity shows the impact of a flat 1 per cent addition to the expected rate.

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

[9] This sensitivity shows the impact of a 25 basis point reduction in the allowance for illiquidity premia. It assumes the overall corporate bond spreads are unchanged and hence market values are unchanged. Government bond yields and the risk-free rate are both assumed to be unchanged.

34 LIABILITIES ARISING FROM NON-PARTICIPATING INVESTMENT CONTRACTS

The movement in liabilities arising from non-participating investment contracts may be analysed as follows:

	Gross £m	Reinsurance £m	Net £m
At 1 January 2007	24,370	(22)	24,348
New business	2,413	–	2,413
Changes in existing business	(1,303)	22	(1,281)
Disposal of businesses	(7,283)	–	(7,283)
At 31 December 2007	18,197	–	18,197
New business	**660**	**–**	**660**
Changes in existing business	**(4,614)**	**–**	**(4,614)**
At 31 December 2008	**14,243**	**–**	**14,243**

35 UNALLOCATED SURPLUS WITHIN INSURANCE BUSINESSES

The movement in the unallocated surplus within long-term insurance business over the year can be analysed as follows:

	2008 £m	2007 £m
At 1 January	**554**	683
Change in unallocated surplus recognised in the income statement (note 10)	**(284)**	(114)
Disposal of businesses	**–**	(15)
At 31 December	**270**	554

36 OTHER LIABILITIES

	2008 £m	2007 £m
Settlement balances	**891**	445
Unitholders' interest in Open Ended Investment Companies	**4,336**	3,441
Other creditors and accruals	**6,229**	5,804
Other liabilities	**11,456**	9,690

At 31 December 2008 £5,454 million (2007: £4,427 million) of other liabilities had a contractual residual maturity of greater than one year.

37 RETIREMENT BENEFIT OBLIGATIONS

	2008 £m	2007 £m
Charge to the income statement		
Defined benefit pension schemes	**157**	158
Other post-retirement benefit schemes	**7**	17
Total defined benefit schemes	**164**	175
Defined contribution pension schemes	**71**	63
	235	238

	2008 £m	2007 £m
Amounts recognised in the balance sheet		
Defined benefit pension schemes	**1,657**	2,033
Other post-retirement benefit schemes	**114**	111
	1,771	2,144

37 RETIREMENT BENEFIT OBLIGATIONS continued

PENSION SCHEMES

DEFINED BENEFIT SCHEMES

The Group has established a number of defined benefit pension schemes in the UK and overseas. The majority of the Group's employees are members of the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2. These schemes provide retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes is 50.

The latest full valuations of the two main schemes are being carried out as at 30 June 2008. The provisional results have been updated to 31 December 2008 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2008 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The Group's obligations in respect of its defined benefit schemes are funded. The Group currently expects to pay contributions of at least £525 million to its defined benefit schemes in 2009.

	2008 £m	2007 £m
Amount included in the balance sheet		
Present value of funded obligations	**15,617**	16,795
Fair value of scheme assets	**(13,693)**	(16,112)
	1,924	683
Unrecognised actuarial (losses) gains	**(267)**	1,350
Liability in the balance sheet	**1,657**	2,033

	2008 £m	2007 £m
Movements in the defined benefit obligation		
At 1 January	**16,795**	17,378
Current service cost	**258**	302
Interest cost	**957**	866
Actuarial gains	**(1,928)**	(971)
Benefits paid	**(597)**	(555)
Past service cost	**21**	25
Curtailments	**6**	–
Disposal of businesses	**–**	(262)
Exchange and other adjustments	**105**	12
At 31 December	**15,617**	16,795

	2008 £m	2007 £m
Changes in the fair value of scheme assets		
At 1 January	**16,112**	15,279
Expected return	**1,085**	1,035
Employer contributions	**541**	446
Actuarial (losses) gains	**(3,520)**	139
Benefits paid	**(597)**	(555)
Disposal of businesses	**–**	(244)
Exchange and other adjustments	**72**	12
At 31 December	**13,693**	16,112
Actual return on scheme assets	**(2,435)**	1,174

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

37 RETIREMENT BENEFIT OBLIGATIONS continued

ASSUMPTIONS

The principal actuarial and financial assumptions used in valuations of the defined benefit pension schemes were as follows:

	2008 %	2007 %
Discount rate	**6.30**	5.80
Rate of inflation	**3.00**	3.30
Rate of salary increases	**3.75**	4.00
Rate of increase for pensions in payment	**2.80**	3.10
	Years	Years
Life expectancy for member aged 60, on the valuation date:		
Men	**26.4**	25.9
Women	**27.2**	27.9
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**27.3**	27.1
Women	**28.1**	29.0

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 as at 31 December 2008 is assumed to live for, on average, 26.4 years for a male and 27.2 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

An analysis of the impact of a reasonable change in these assumptions is provided in note 3.

The expected return on scheme assets has been calculated using the following assumptions:

	2008 %	2007 %
Equities	**8.2**	8.0
Fixed interest gilts	**4.5**	4.6
Index linked gilts	**4.4**	4.2
Non-Government bonds	**6.0**	5.1
Property	**6.7**	6.5
Money market instruments and cash	**4.8**	3.9

The expected return on scheme assets in 2009 will be calculated using the following assumptions:

	2009 %
Equities and alternative assets	**8.4**
Fixed interest gilts	**3.7**
Index linked gilts	**4.0**
Non-Government bonds	**6.7**
Property	**6.4**
Money market instruments and cash	**3.8**

37 RETIREMENT BENEFIT OBLIGATIONS continued

Composition of scheme assets:

	2008 £m	2007 £m
Equities	**7,040**	8,537
Fixed interest gilts	**1,452**	2,041
Index linked gilts	**1,326**	1,433
Non-Government bonds	**1,721**	1,990
Property	**1,485**	1,666
Money market instruments, cash and other assets and liabilities	**669**	445
At 31 December	**13,693**	16,112

The assets of all the funded plans are held independently of the Group's assets in separate trustee administered funds.

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields at the balance sheet date at a term and credit rating broadly appropriate for the bonds held. Expected returns on equity and property investment are long-term rates based on the views of the plan's independent investment consultants. The expected return on equities allows for the different expected returns from the private equity, infrastructure and hedge fund investments held by some of the funded plans. Some of the funded plans also invest in certain money market instruments and the expected return on these investments has been assumed to be the same as cash.

Experience adjustments history (since the date of adoption of IAS 19):

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Present value of defined benefit obligation	**15,617**	16,795	17,378	17,320	14,866
Fair value of scheme assets	**(13,693)**	(16,112)	(15,279)	(14,026)	(11,648)
	1,924	683	2,099	3,294	3,218
Experience losses on scheme liabilities	**(39)**	(185)	(50)	(69)	(126)
Experience (losses) gains on scheme assets	**(3,520)**	139	314	1,538	361

The expense recognised in the income statement for the year ended 31 December comprises:

	2008 £m	2007 £m
Current service cost	**258**	302
Interest cost	**957**	866
Expected return on scheme assets	**(1,085)**	(1,035)
Curtailments	**6**	–
Past service cost	**21**	25
Total defined benefit pension expense	**157**	158

DEFINED CONTRIBUTION SCHEMES

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally the defined contribution sections of the Lloyds TSB Group Pension Schemes No's 1 and 2.

During the year ended 31 December 2008 the charge to the income statement in respect of these schemes was £71 million (2007: £63 million), representing the contributions payable by the employer in accordance with each scheme's rules.

OTHER POST-RETIREMENT BENEFIT SCHEMES

The Group operates a number of schemes which provide post-retirement healthcare benefits to certain employees, retired employees and their dependants. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependants) who retired prior to 1 January 1996. The Group has entered into an insurance contract to provide these benefits and a provision has been made for the estimated cost of future insurance premiums payable.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 30 June 2007; this valuation has been updated to 31 December 2008 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 7.50 per cent (2007: 7.43 per cent).

37 RETIREMENT BENEFIT OBLIGATIONS continued

Amount included in the balance sheet:

	2008 £m	2007 £m
Present value of unfunded obligations	**118**	123
Unrecognised actuarial losses	**(4)**	(12)
Liability in the balance sheet	**114**	111

Movements in the other post-retirement benefits obligation:

	2008 £m	2007 £m
At 1 January	**123**	110
Exchange and other adjustments	**2**	–
Actuarial (gain) loss	**(8)**	2
Insurance premiums paid	**(6)**	(6)
Charge for the year	**7**	17
At 31 December	**118**	123

38 DEFERRED TAX

The movement in the net deferred tax balance is as follows:

	2008 £m		2007 £m	
Liability at 1 January		**948**		1,416
Exchange and other adjustments		**4**		–
Disposals		**(98)**		(389)
Income statement (credit) charge:				
Due to change in UK corporation tax rate	**–**		(110)	
Other	**(773)**		21	
		(773)		(89)
Amount charged (credited) to equity:				
Available-for-sale financial assets (note 43)	**(566)**		(1)	
Net investment hedge (note 43)	**(358)**		–	
Cash flow hedges (note 43)	**(5)**		(6)	
Share based compensation	**15**		17	
		(914)		10
(Asset) liability at 31 December		**(833)**		948

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

	2008 £m	2007 £m
Accelerated capital allowances	**(318)**	(32)
Pensions and other post-retirement benefits	**104**	134
Investment reserve	**32**	(30)
Allowances for impairment losses	**(2)**	42
Unrealised gains	**(297)**	(91)
Tax on value of in-force business	**(193)**	(108)
Other temporary differences	**(99)**	(4)
	(773)	(89)

38 DEFERRED TAX continued

Deferred tax assets and liabilities are comprised as follows:

	2008 £m	2007 £m
Deferred tax assets:		
Pensions and other post-retirement benefits	**(496)**	(600)
Allowances for impairment losses	**(103)**	(101)
Other provisions	**(51)**	(15)
Derivatives	**(114)**	(178)
Available-for-sale asset revaluation	**(567)**	(1)
Tax losses carried forward	**(856)**	(409)
Other temporary differences	**(121)**	(168)
	(2,308)	(1,472)

	2008 £m	2007 £m
Deferred tax liabilities:		
Accelerated capital allowances	**561**	979
Investment reserve	**151**	119
Unrealised gains	**45**	342
Tax on value of in-force business	**459**	652
Other temporary differences	**259**	328
	1,475	2,420

DEFERRED TAX ASSETS

Deferred tax assets are recognised for tax losses and foreign tax credit carry forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable. Scottish Widows plc has recognised a deferred tax asset of £388 million and other Group companies have recognised deferred tax assets totalling £468 million in relation to tax losses carried forward. For all of these losses, after reviewing medium term profit forecasts, the Group considers that there will be sufficient profits in the future against which these losses will be offset.

Deferred tax assets of £252 million (2007: £33 million) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of Eligible Unrelieved Foreign Tax (EUFT) and other foreign tax credits carried forward as at 31 December 2008 of £60 million (2007: £104 million), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. EUFT can be carried forward indefinitely.

DEFERRED TAX LIABILITIES

Deferred tax liabilities have not been recognised for tax that may be payable if earnings of certain subsidiaries were remitted to the UK. Such amounts are either reinvested for the foreseeable future or can be remitted free of tax. Unremitted earnings totalled £1,196 million (2007: £928 million).

Future transfers from Scottish Widows plc's long-term business funds to its Shareholder Fund will be subject to a shareholder tax charge. Under IAS 12, no provision is required to be made to the extent that the timing of such transfers is under Scottish Widows plc's control. Accordingly, deferred tax liabilities of £90 million (2007: £90 million) have not been recognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

39 OTHER PROVISIONS

	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2008	29	43	137	209
Exchange and other adjustments	1	–	13	14
Provisions applied	(6)	(9)	(21)	(36)
Amortisation of discount	–	–	2	2
Charge for the year	6	–	35	41
At 31 December 2008	30	34	166	230

PROVISIONS FOR CONTINGENT LIABILITIES AND COMMITMENTS

Provisions are held in cases where the Group is irrevocably committed to advance additional funds, but where there is doubt as to the customer's ability to meet its repayment obligations.

CUSTOMER REMEDIATION PROVISIONS

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes have been found to be deficient. During 2008 management has reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and are satisfied that no additional charge is required. At 31 December 2008 the remaining provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester and underwritten by life assurance companies within the Group and also by third parties. The principal assumptions that are made in the assessment of the adequacy of the provision relate to the number of cases that are likely to require redress, taking into account any time barring, and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the remaining expenditure will be incurred within the next five years.

VACANT LEASEHOLD PROPERTY AND OTHER

Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income, compared to the head rent, and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on a biennial basis and will normally run off over the period of under-recovery of the leases concerned, currently averaging five years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

The Group also carries provisions in respect of its obligations relating to UIC Insurance Company Limited (UIC), which is in provisional liquidation. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a reinsurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate cost of settling the Group's exposure in respect of the insurance business of UIC and the timing remains uncertain. The provision held represents management's current best estimate of the cost after having regard to the financial condition of UIC and actuarial estimates of future claims.

40 SUBORDINATED LIABILITIES

	Note	2008 £m	2007 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)	d, g	**756**	471
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	a, b	**584**	593
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a, c	**824**	515
6% Non-cumulative Redeemable Preference Shares	o	**–**	–
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	d, m	**459**	335
7.875% Perpetual Capital Securities (€500 million)	d, f, p	**472**	–
7.875% Perpetual Capital Securities (US$1,250 million)	d, f, p	**921**	–
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	d, f, k	**512**	365
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	d, n	**248**	248
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	d, f, k	**720**	504
		5,496	3,031
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:	d, e		
Series 1 (US$750 million)		**515**	374
Series 2 (US$500 million)		**343**	249
Series 3 (US$600 million)		**412**	299
11¾% Perpetual Subordinated Bonds (£100 million)		**100**	100
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	d, k	**1,212**	915
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	d, e	**144**	110
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)	d, j	**409**	408
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million)	d, h	**536**	534
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)	d, l	**189**	111
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	d, j	**455**	449
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	d, j	**241**	238
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	d, j	**186**	188
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	d, j	**444**	444
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	d, j	**452**	450
		5,638	4,869

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

40 SUBORDINATED LIABILITIES continued

	Note	2008 £m	2007 £m
Dated subordinated liabilities			
5¼% Subordinated Notes 2008 (DM 750 million)		–	281
10⅝% Guaranteed Subordinated Loan Stock 2008 (£100 million)	i	–	100
9½% Subordinated Bonds 2009 (£100 million)		100	100
6¼% Subordinated Notes 2010 (€400 million)		404	302
12% Guaranteed Subordinated Bonds 2011 (£100 million)	i	100	100
9⅛% Subordinated Bonds 2011 (£150 million)		149	149
4¾% Subordinated Notes 2011 (€850 million)		836	609
5⅞% Subordinated Guaranteed Bonds 2014 (€750 million)		821	591
5⅞% Subordinated Notes 2014 (£150 million)		149	149
6⅝% Subordinated Notes 2015 (£350 million)		320	316
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	e	300	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	e	480	371
Subordinated Fixed to Floating Rate Notes due 2018 callable 2013 (€1,000 million)	k, p	992	–
Subordinated Fixed to Floating Rate Notes due 2020 callable 2015 (£750 million)	k, p	754	–
Subordinated Floating Rate Notes 2020 (€100 million)	e	96	73
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		309	305
9⅝% Subordinated Bonds 2023 (£300 million)		312	312
		6,122	4,058
Total subordinated liabilities		17,256	11,958

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer. The Group has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the period (2007: nil).

At 31 December 2008 £17,156 million (2007: £11,577 million) of subordinated liabilities had a contractual residual maturity of greater than one year.

a) Any repayment of preference shares would require prior notification to the Financial Services Authority. In certain circumstances, the shares may be mandatorily exchanged for qualifying non-innovative tier 1 securities. The Company may declare no dividend or a partial dividend on these preference shares. Dividends may be reduced if the distributable profits of the Company are insufficient to cover the payment in full of the dividends and also the payment in full of all other dividends on shares issued by the Company.

b) Dividends will accrue at a rate of 6.369 per cent per annum up to 24 August 2015, and, unless redeemed, at a rate reset quarterly equal to 1.28 per cent per annum above the London interbank offered rate for three-month sterling deposits thereafter. These preference shares can be redeemed at the option of the Company on 25 August 2015 or quarterly thereafter.

c) Dividends will accrue at a rate of 6.267 per cent per annum up to 13 November 2016 and, unless redeemed, at a rate reset quarterly equal to 1.035 per cent per annum above the London interbank offered rate for three-month sterling deposits thereafter. These preference shares can be redeemed at the option of the Company on 14 November 2016 or every 10 years thereafter.

d) In certain circumstances, these notes, bonds and securities would acquire the characteristics of preference share capital. Any repayments of undated subordinated liabilities would require prior notification to the Financial Services Authority. They are accounted for as liabilities since coupon payments are mandatory as a consequence of the terms of the 6 per cent Non-cumulative Redeemable Preference Shares.

e) These notes bear interest at rates fixed periodically in advance based on London interbank rates.

f) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds Banking Group plc can declare or pay a dividend until payments have been resumed. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares.

g) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds Banking Group plc can declare or pay a dividend until payments are resumed. Any deferred payments will be made good on redemption of the securities. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on any coupon date.

h) In certain circumstances the interest payments on these securities can be deferred although in this case Scottish Widows plc cannot declare or pay a dividend until any deferred payments have been made.

40 SUBORDINATED LIABILITIES continued

i) Issued by a group undertaking under the Company's subordinated guarantee.

j) At the callable date the coupon on these notes will be reset by reference to the applicable five year benchmark gilt rate.

k) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a floating rate.

l) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a margin of 1.60 per cent over the five year Yen swap rate.

m) These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a margin of 2.33 per cent over EURIBOR. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds Banking Group plc. Lloyds Banking Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

n) These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a margin of 3.50 per cent over a rate based on the yield of specified UK Government stock. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds Banking Group plc. Lloyds Banking Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

o) Since 2004, the Company has had in issue 400 6 per cent non-cumulative preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company.

p) Issued during 2008 to finance the general business of the Group.

Changes in the issued preference share capital of the Group during January 2009 are discussed in note 52.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

41 SHARE CAPITAL

			2008	2007
Authorised share capital				
Sterling:			£m	£m
6,911 million Ordinary shares of 25p each			1,728	1,728
79 million Limited voting ordinary shares of 25p each			20	20
175 million Preference shares of 25p each			44	44
			1,792	1,792
US dollars:			US$m	US$m
160 million Preference shares of 25 cents each			40	40
Euro:			€m	€m
160 million Preference shares of 25 cents each			40	40
Japanese yen:			¥m	¥m
50 million Preference shares of ¥25 each			1,250	1,250
	2008 Number of shares	2007 Number of shares	2008 £m	2007 £m
Issued and fully paid ordinary shares				
Ordinary shares of 25p each				
At 1 January	5,647,703,945	5,637,964,437	1,412	1,409
Private placement of ordinary shares	284,400,000	–	71	–
Issued under employee share schemes	40,751,724	9,739,508	10	3
At 31 December	5,972,855,669	5,647,703,945	1,493	1,412
Limited voting ordinary shares of 25p each				
At 1 January and 31 December	78,947,368	78,947,368	20	20
			1,513	1,432

SHARE CAPITAL AND CONTROL

There are no restrictions on the transfer of shares in the Company other than as set out in the articles of association and:

- certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws);
- pursuant to the UK Listing Authority's listing rules where directors and certain employees of the Company require the approval of the Company to deal in the Company's shares; and
- pursuant to the rules of some of the Company's employee share plans where certain restrictions may apply while the shares are subject to the plans.

Where, under an employee share plan operated by the Company, participants are the beneficial owners of shares but not the registered owners, the voting rights are normally exercised by the registered owner at the direction of the participant. All of the Company's share plans contain provisions relating to a change of control. Outstanding awards and options would normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions at that time.

In addition, the Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

Information regarding significant direct or indirect holdings of shares in the Company can be found on page 191.

The directors have authority to allot and issue ordinary and preference shares and to make market purchases of ordinary shares in accordance with the articles of association. The authority for the Company to purchase, in the market, 572,712,063 of its shares, representing some 10 per cent of the issued share capital, expires at the annual general meeting. Shareholders will be asked, at the annual general meeting, to give similar authorities.

In addition, the Company has authority to purchase, in the market, (i) the £1,000,000,000 fixed to floating non-cumulative callable preference shares issued by the Company to HM Treasury on 15 January 2009 pursuant to the preference share subscription agreement entered into with effect from 13 October 2008 by the Company and HM Treasury and (ii) the preference shares issued by the Company in exchange for the £3,000,000,000 fixed to floating non-cumulative callable preference shares issued by HBOS plc to HM Treasury on 15 January 2009 pursuant to the preference share subscription agreement entered into with effect from 13 October 2008 by HBOS plc and HM Treasury (together with the £1,000,000,000 HM Treasury preference shares, the Preference Shares) provided that (a) the maximum number of Preference Shares which may be purchased is 4,000,000 (b) the minimum price which may be paid for each Preference Share is 25 pence (exclusive of expenses) (c) the maximum price which may be paid for each Preference Share is an amount equal to 120 per cent of the liquidation preference of the Preference Share and (d) the authority expires 18 months after 19 November 2008 (except in relation to the purchase of Preference Shares the contracts for which are concluded before such expiry and which are executed wholly or partly after such expiry) unless such authority is renewed prior to that time.

41 SHARE CAPITAL continued

Subject to any rights or restrictions attached to any shares, on a show of hands at a general meeting of the Company every holder of shares present in person or by proxy and entitled to vote has one vote and on a poll every member present and entitled to vote has one vote for every share held. Further details regarding voting at the annual general meeting can be found in the notes to the notice of the annual general meeting.

ORDINARY SHARES

The holders of ordinary shares (excluding the limited voting ordinary shares), who held 98.7 per cent of the total share capital as at 31 December 2008, are entitled to receive the Company's report and accounts, attend, speak and vote at general meetings and appoint proxies to exercise voting rights. Holders of ordinary shares (excluding the limited voting ordinary shares) may also receive a dividend (subject to the provisions of the Company's articles of association) and on a winding up may share in the assets of the Company.

LIMITED VOTING ORDINARY SHARES

The limited voting ordinary shares are held by the Lloyds TSB Foundations (the Foundations). The holders of the limited voting ordinary shares, who held 1.3 per cent of the total share capital as at 31 December 2008, are entitled to receive copies of every circular or other document sent out by the Company to the holders of other ordinary shares. These shares carry no rights to dividends but rank pari passu with the ordinary shares in respect of other distributions and in the event of winding up. These shares do not have any right to vote at general meetings other than on resolutions concerning acquisitions or disposals of such importance that they require shareholder consent, or for the winding up of the Company, or for a variation in the class rights of the limited voting ordinary shares. In the event of an offer for more than 50 per cent of the issued ordinary share capital of the Company, each limited voting ordinary share will convert into an ordinary share and shall rank equally with the ordinary shares in all respects from the date of conversion. Lloyds Banking Group plc has entered into deeds of covenant with the Foundations, under the terms of which the Company makes annual donations to the Foundations equal, in total, to 1 per cent of the Group's pre-tax profits (after certain adjustments) averaged over three years. The deeds of covenant can be cancelled by the Company at nine years' notice. This donation is payable on or before the last day of February in each year (the payment date). In the event of conversion of the limited voting ordinary shares, the Foundations shall be entitled to receive a donation, on the same basis as set out above, on the payment date following conversion.

PRIVATE PLACEMENT OF ORDINARY SHARES DURING 2008

On 19 September 2008, the Company entered into a placing agreement whereby a total of 284,400,000 new ordinary shares of 25 pence each with an aggregate nominal value of £71,100,000 were placed with institutional investors at a price of 270 pence per share. The proceeds of the placing, after costs, were £760 million. The issue represented an increase of approximately 5 per cent in the issued share capital at the time. The capital was raised to allow Lloyds Banking Group to strengthen its capital and support the development of business strategies.

ISSUED AND FULLY PAID PREFERENCE SHARES

Since 2004, the Company has had in issue 400 6 per cent non-cumulative redeemable preference shares of 25 pence each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company. The holders of the 6 per cent non-cumulative redeemable preference shares held less than 0.1 per cent of the total share capital as at 31 December 2008. In accordance with IFRS, these shares are reported within liabilities.

In addition, during 2006 the Company issued 600,000 Fixed/Floating Rate Non-Cumulative Callable Preference Shares of 25 pence each with a liquidation preference of £1,000 per share and 1,000,000 Fixed/Floating Rate Non-Cumulative Callable Preference Shares of 25 cents each with a liquidation preference of US$1,000 per share. Both issues of preference shares are perpetual, although the two issues can be redeemed at the option of the Company on or after 25 August 2015 and 14 November 2016 respectively and carry the right to non-cumulative dividends which are fixed until those first redemption dates. The terms of these two issues of preference shares are such that the Company cannot declare and pay a dividend on any other junior class of share (including the mandatory dividend on the 400 6 per cent non-cumulative redeemable preference shares mentioned above) until the coupon has been paid on these preference shares. As the Company is effectively committed to the payment of a coupon on these shares they are classified as liabilities on the balance sheet in accordance with IFRS (see note 40). The holders of the fixed/floating rate non-cumulative callable preference shares, who held less than 0.1 per cent of the total share capital as at 31 December 2008, do not have the right to receive notice of, attend, speak or vote at any general meetings other than on resolutions relating to the variation or abrogation of any of the rights or restrictions attached to the preference shares or the winding up or dissolution of the Company or if, at the date of the notice of meeting, the dividend payable at the immediately preceding dividend payment date has failed to be declared and paid in full. Upon winding up, the fixed/floating rate non-cumulative callable preference shares shall rank equally with the most senior class of preference shares and any other class of shares which are expressed to rank equally.

Any repayment of the fixed/floating rate non-cumulative callable preference shares would require prior notification to the FSA. The sterling fixed/floating rate non-cumulative callable preference shares can be redeemed at the option of the Company on or after 25 August 2015; at this call date, dividends will be reset at a margin of 1.28 per cent over 3 month LIBOR. The US dollar fixed/floating rate non-cumulative callable preference shares can be redeemed at the option of the Company on or after 14 November 2016; at this call date, dividends will be reset at a margin of 1.035 per cent over 3 month LIBOR. In certain circumstances, the fixed/floating rate non-cumulative callable preference shares may be mandatorily exchanged for qualifying non-innovative tier 1 securities and in certain circumstances and subject to compliance with certain requirements, the fixed/floating rate non-cumulative callable preference shares may be redeemed by the Company at certain times in the event that the FSA makes a decision that the preference shares can no longer qualify as non-innovative tier 1 capital. The Company may declare no dividend or a partial dividend on these preference shares; notwithstanding this discretion, in certain circumstances, the dividends on the fixed/floating rate non-cumulative callable preference shares will be mandatorily payable if the preference shares cease to be eligible to qualify as regulatory capital and the Company is in

41 SHARE CAPITAL continued

compliance with relevant FSA regulations regarding capital adequacy. Dividends may be reduced if the distributable profits of the Company are insufficient to cover the payment in full of the dividends and also the payment in full of all other dividends on shares issued by the Company. These securities were issued during 2006 primarily to finance the development and expansion of the business of the Group.

CHANGES IN AUTHORISED AND ISSUED SHARE CAPITAL SINCE THE END OF THE YEAR

Increases in the authorised and issued share capital of the Company during January 2009 are discussed in note 52.

42 SHARE PREMIUM ACCOUNT

	2008 £m	2007 £m
At 1 January	1,298	1,266
Premium arising on private placement of ordinary shares (note 41)	689	–
Premium arising on issue of shares under share option schemes	109	32
At 31 December	2,096	1,298

43 OTHER RESERVES

	2008 £m	2007 £m
Other reserves comprise:		
Merger reserve	343	343
Revaluation reserve in respect of available-for-sale financial assets	(2,982)	(399)
Cash flow hedging reserve	(15)	(3)
Foreign currency translation reserve	178	(1)
	(2,476)	(60)

Movements in other reserves were as follows:

	2008 £m	2007 £m
Merger reserve		
At 1 January and 31 December	343	343

	2008 £m	2007 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	(399)	–
Exchange and other adjustments	(541)	(1)
Change in fair value of available-for-sale financial assets	(2,721)	(483)
Change in fair value attributable to minority interests	2	–
Deferred tax	566	1
Current tax	94	46
	(2,059)	(436)
Income statement transfers:		
Disposals (note 9)	(19)	(5)
Impairment	130	70
Current tax	(28)	(21)
	102	49
Other transfers	(91)	–
Current tax	25	–
	(66)	–
Disposal of businesses	–	(6)
At 31 December	(2,982)	(399)

43 OTHER RESERVES continued

	2008 £m	2007 £m
Cash flow hedging reserve		
At 1 January	**(3)**	12
Change in fair value of hedging derivatives	**(33)**	(20)
Deferred tax	**9**	6
	(24)	(14)
Income statement transfer (note 5)	**16**	(1)
Deferred tax	**(4)**	–
	12	(1)
At 31 December	**(15)**	(3)

	2008 £m	2007 £m
Foreign currency translation reserve		
At 1 January	**(1)**	(19)
Currency translation differences arising in the year	**2,533**	257
Foreign currency losses on net investment hedges	**(3,310)**	(342)
Amounts transferred to income statement in respect of hedge ineffectiveness	**14**	–
Current tax	**584**	103
Deferred tax	**358**	–
	(2,354)	(239)
At 31 December	**178**	(1)

44 RETAINED PROFITS

	2008 £m	2007 £m
At 1 January	**9,471**	8,124
Profit for the year	**819**	3,289
Dividends	**(2,042)**	(1,957)
Purchase/sale of treasury shares	**16**	(1)
Employee share option schemes – value of employee services	**(4)**	16
At 31 December	**8,260**	9,471

Retained profits are stated after deducting £40 million (2007: £75 million) representing 15 million (2007: 15 million) treasury shares held.

Value of employee services includes a credit of £12 million (2007: £30 million) reflecting the income statement charge in respect of SAYE and executive options, together with a related tax charge of £16 million (2007: tax charge £14 million). Purchase/sale of treasury shares includes a credit of £31 million (2007: £29 million) relating to the cost of other share scheme awards.

45 ORDINARY DIVIDENDS

	2008 Pence per share	2007 Pence per share	2008 £m	2007 £m
Final dividend for previous year paid during the current year	**24.7**	23.5	**1,394**	1,325
Interim dividend	**11.4**	11.2	**648**	632
	36.1	34.7	**2,042**	1,957

The directors do not propose to pay a final dividend (2007: 24.7 pence per share, which represented a total cost of £1,394 million).

Bank of New York Nominees Limited have waived the right to all dividends on Lloyds Banking Group plc shares that they hold (holding at 31 December 2008 and at 31 December 2007: 10 shares).

45 ORDINARY DIVIDENDS continued

In addition, the trustees of the following holdings of Lloyds Banking Group plc shares in relation to employee share schemes retain the right to receive dividends but chose to waive their entitlement to the dividends on those shares as indicated: the Lloyds TSB Group Shareplan (holding at 31 December 2008: 972,151 shares, at 31 December 2007: 931,478 shares, waived right to all dividends), the Lloyds TSB Group Employee Share Ownership Trust (holding at 31 December 2008: 1,442,116 shares, at 31 December 2007: 1,935,141 shares, waived right to all dividends), Lloyds TSB Group Holdings (Jersey) Limited (holding at 31 December 2008 and 31 December 2007: 41,801 shares, waived right to all but a nominal amount of 1 penny in total) and the Lloyds TSB Qualifying Employee Share Ownership Trust (holding at 31 December 2008 and 31 December 2007: 1,364 shares, waived right to all but a nominal amount of 1 penny in total).

46 SHARE BASED PAYMENTS

CHARGE TO THE INCOME STATEMENT

The charge to the income statement is set out below:

	2008 £m	2007 £m
Executive and SAYE schemes:		
Options granted in the year	8	6
Options granted in prior years	4	24
	12	30
Share incentive plan:		
Shares granted in the year	10	12
Shares granted in prior years	21	17
	31	29
	43	59

SHARE BASED PAYMENT SCHEME DETAILS

During the year ended 31 December 2008 the Group operated the following share based payment schemes, all of which are equity settled.

EXECUTIVE SCHEMES

The executive share option schemes were long-term incentive schemes available to certain senior executives of the Group, with grants usually made annually. Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options. The last grant of executive options was made in August 2005. These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary. Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5. Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied.

PERFORMANCE CONDITIONS FOR EXECUTIVE OPTIONS

FOR OPTIONS GRANTED UP TO MARCH 2001

Options granted	Performance conditions
March 1998 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period together with a further condition that Lloyds Banking Group plc's ranking based on total shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1998 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period.

In respect of options granted between March 1998 and March 2001, the relevant period for the performance conditions begins at the end of the financial year preceding the date of grant and will continue until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions are met. Once the conditions have been satisfied the options will remain exercisable without further conditions. If they are not satisfied by the tenth anniversary of the grant the option will lapse.

FOR OPTIONS GRANTED FROM AUGUST 2001 TO AUGUST 2004

The performance condition is linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds Banking Group plc.

46 SHARE BASED PAYMENTS continued

The performance condition is measured over a three year period commencing at the end of the financial year preceding the grant of the option and continuing until the end of the third subsequent year. If the performance condition is not then met, it will be measured at the end of the fourth financial year. If the condition has not then been met, the options will lapse.

To meet the performance conditions, the Group's ranking against the comparator group must be at least ninth. The full grant of options will only become exercisable if the Group is ranked first. A performance multiplier (of between nil and 100 per cent) will be applied below this level to calculate the number of shares in respect of which options granted to executive directors will become exercisable, and will be calculated on a sliding scale. If Lloyds Banking Group plc is ranked below median the options will not be exercisable.

Options granted to senior executives other than executive directors are not so highly leveraged and, as a result, different performance multipliers are applied to their options. For the majority of executives, options are granted with the performance condition but no performance multiplier.

Options granted in 2004 became exercisable as the performance condition was met on the re-test. The performance condition vested at 14 per cent for executive directors, 24 per cent for managing directors, and 100 per cent for all other executives.

FOR OPTIONS GRANTED IN 2005

The same conditions apply as for grants made up to August 2004, except that:

– the performance condition is linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc;
– if the performance condition has not been met at the end of the third subsequent year, the options will lapse; and
– the full grant of options becomes exercisable only if the Group is ranked in the top four places of the comparator group. A sliding scale applies between fourth and eighth positions. If Lloyds Banking Group is ranked below the median (ninth or below) the options will not be exercisable and will lapse.

Options granted in 2005 became exercisable as the performance condition was met when tested. The performance condition vested at 82.5 per cent for all options granted.

Movements in the number of share options outstanding under the Executive share option schemes during 2007 and 2008 are set out below:

	2008		2007	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**20,621,774**	**480.57**	32,459,593	459.84
Exercised	**(137,431)**	**419.25**	(267,650)	509.10
Forfeited	**(9,280,715)**	**470.02**	(11,570,169)	421.76
Outstanding at 31 December	**11,203,628**	**490.05**	20,621,774	480.57
Exercisable at 31 December	**9,132,197**	**453.77**	423,300	876.37

The weighted average share price at the time that the options were exercised during 2008 was 453.42 pence (2007: 574.39 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 5.1 years (2006: 6.2 years).

SAVE-AS-YOU-EARN SCHEMES

Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £250 per month and, at the expiry of a fixed term of three or five years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Group at a price equal to 80 per cent of the market price at the date the options were granted. Grants in periods up to 31 December 2001 also had options exercising after seven years.

Movements in the number of share options outstanding under the SAYE schemes are set out below:

	2008		2007	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**85,673,227**	**342.49**	90,220,144	335.94
Granted	**215,737,733**	**173.80**	10,759,688	432.00
Exercised	**(40,612,608)**	**290.77**	(9,473,792)	351.28
Forfeited	**(2,394,415)**	**388.11**	(3,447,524)	363.45
Cancelled	**(62,963,491)**	**373.21**	(1,822,417)	397.98
Expired	**(4,961,997)**	**311.47**	(562,872)	547.46
Outstanding at 31 December	**190,478,449**	**152.54**	85,673,227	342.49
Exercisable at 31 December	**3,157,524**	**332.12**	1,560,472	459.01

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

46 SHARE BASED PAYMENTS continued

The weighted average share price at the time that the options were exercised during 2008 was 370.29 pence (2007: 552.20 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 3.4 years (2007: 1.7 years).

The weighted average fair value of SAYE options granted during the year was £0.61 (2007: £1.07). The values for the SAYE options have been determined using a standard Black-Scholes model.

OTHER SHARE OPTION PLANS

LLOYDS TSB GROUP EXECUTIVE SHARE PLAN 2003

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees. Options granted to date under this scheme were granted specifically to facilitate recruitment. Options granted under this plan are not subject to any performance conditions.

	2008		2007	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**308,718**	**Nil**	357,123	Nil
Granted	**681,931**	**Nil**	214,444	Nil
Exercised	**(117,236)**	**Nil**	(203,170)	Nil
Forfeited	**(15,802)**	**Nil**	(59,679)	Nil
Outstanding at 31 December	**857,611**	**Nil**	308,718	Nil

The weighted average fair value of options granted in the year was £2.92 (2007: £5.27). The weighted average share price at the time that the options were exercised during 2008 was 291.04 pence (2007: 539.77 pence). No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 2.5 years (2007: 1.8 years).

LLOYDS TSB GROUP EXECUTIVE SHARE PLAN 2005

This plan was adopted by the Group in 2005, specifically to facilitate the recruitment of Ms Dial. Ms Dial was the only participant in the plan. Options granted under this plan were not subject to any performance conditions and would have normally become exercisable if Ms Dial remained as an employee, and had not given notice of resignation, on 31 May 2008. On 28 March 2008, the Group announced that Ms Dial had decided to leave the Group and, in accordance with the terms of the plan, the options lapsed.

	2008		2007	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	**242,825**	**Nil**	242,825	Nil
Lapsed	**(242,825)**	**Nil**	–	–
Outstanding at 31 December	**–**	**–**	242,825	Nil

The weighted average remaining contractual life of options outstanding at the end of 2007 was 0.9 years.

OTHER SHARE PLANS

LONG-TERM INCENTIVE PLAN

The Long-Term Incentive Plan introduced in 2006 is a long-term incentive scheme aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of the Group over a three year period. Awards are made within limits set by the rules of the plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary, in exceptional circumstances this may increase up to four times annual salary.

The performance conditions for awards made in May and August 2006 are as follows:

(i) For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Price Index over the same period. If it is less than 3 per cent per annum the EPS Award will lapse. If the increase is more than 3 per cent but less than 6 per cent per annum then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ended on 31 December 2008.

(ii) For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for the Group's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where the Group's total shareholder return is equal to median and vesting will occur on a straight line basis in between these points. Where the Group's total shareholder return is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ended on 31 December 2008.

46 SHARE BASED PAYMENTS continued

The performance conditions for awards made in March and August 2007 are as follows:

(i) For 50 per cent of the award (the 'EPS Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2007 and ending on 31 December 2009.

(ii) For the other 50 per cent of the award (the 'TSR Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 8 March 2007 (the date of the first award) and ending on 7 March 2010.

The performance conditions for awards made in March, April, August and September 2008 are as follows:

(i) For 50 per cent of the award (the EPS Award) – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010.

(ii) For the other 50 per cent of the award (the TSR Award) – the performance condition is as described for May 2006, except that the comparator group comprises of 13 companies, with the relevant performance period commencing on 6 March 2008 (the date of the first award) and ending on 5 March 2011.

	2008 Number of shares	2007 Number of shares
Outstanding at 1 January	13,209,081	5,788,108
Granted	10,519,609	7,884,787
Forfeited	(1,491,408)	(463,814)
Outstanding at 31 December	22,237,282	13,209,081

The fair value of the share awards granted in 2008 was £2.28 (2007: £3.13).

PERFORMANCE SHARE PLAN

Under the performance share plan, introduced during 2005, participating executives will be eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 and 2005 bonus. The maximum match will be two performance shares for each bonus share, awarded at the end of a three year period. The actual number of shares awarded will depend on the Group's total shareholder return performance measured over a three year period, compared to other companies in the comparator group. The maximum of two performance shares for each bonus share will be awarded only if the Group's total shareholder return performance places it first in the comparator group; one performance share for each bonus share will be granted if the Group is placed fifth; and one performance share for every two bonus shares if the Group is placed eighth (median). Between first and fifth position, and fifth and eighth position, sliding scales will apply. If the total shareholder return performance is below median, no performance shares will be awarded. There will be no retest. Whilst income tax is deducted from the bonus before deferral into the plan, where a match of performance shares is justified, these shares will be awarded as if income tax had not been deducted.

The performance condition attached to the March 2005 award was met, with the Group ranked in fifth place. Bonus shares were released on 18 March 2008, with one performance share granted for each bonus share. Performance shares were released on 10 April 2008.

	2008 Number of shares	2007 Number of shares
Outstanding at 1 January	1,767,594	1,849,102
Forfeited	(74,691)	(81,508)
Lapsed	(375,790)	–
Released	(375,789)	–
Outstanding at 31 December	941,324	1,767,594

The weighted average share price at the date the shares were released during 2008 was 446.13 pence.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

46 SHARE BASED PAYMENTS continued

The ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life and number of options outstanding for the option schemes were as follows:

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2008									
Exercise price range									
£0 to £1	**–**	**–**	**–**	**–**	**–**	**–**	**Nil**	**2.5**	**857,611**
£1 to £2	**–**	**–**	**–**	**139.00**	**3.5**	**178,932,603**	**–**	**–**	**–**
£2 to £3	**–**	**–**	**–**	**284.00**	**0.4**	**941,414**	**–**	**–**	**–**
£3 to £4	**–**	**–**	**–**	**344.75**	**1.9**	**7,366,320**	**–**	**–**	**–**
£4 to £5	**453.77**	**5.9**	**9,132,197**	**423.49**	**2.0**	**3,200,532**	**–**	**–**	**–**
£5 to £6	**551.25**	**1.2**	**741,905**	**588.50**	**0.3**	**37,580**	**–**	**–**	**–**
£6 to £7	**652.30**	**2.1**	**997,326**	**–**	**–**	**–**	**–**	**–**	**–**
£7 to £8	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
£8 to £9	**863.63**	**0.3**	**332,200**	**–**	**–**	**–**	**–**	**–**	**–**

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2007									
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	1.4	551,543
£2 to £3	–	–	–	284.00	0.9	42,651,925	–	–	–
£3 to £4	–	–	–	353.10	1.9	15,775,539	–	–	–
£4 to £5	449.34	6.8	17,898,897	424.23	2.9	26,525,262	–	–	–
£5 to £6	551.09	2.2	815,965	563.65	0.1	720,501	–	–	–
£6 to £7	652.47	3.1	1,114,912	–	–	–	–	–	–
£7 to £8	–	–	–	–	–	–	–	–	–
£8 to £9	871.54	0.7	792,000	–	–	–	–	–	–

The fair value calculations at 31 December 2008 for grants made in the year are based on the following assumptions:

	SAYE	Other option schemes	Other share plans
Risk-free interest rate	**3.14%**	**3.90%**	**4.04%**
Expected life	**3.2 years**	**2.9 years**	**3.0 years**
Expected volatility	**40%**	**29%**	**23%**
Expected dividend yield	**3.5%**	**7.3%**	**8.9%**
Weighted average share price	**£2.17**	**£3.67**	**£4.24**
Weighted average exercise price	**£1.74**	**Nil**	**Nil**
Expected forfeitures	**6%**	**4%**	**4%**

Expected volatility is a measure of the amount by which the Group's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in the Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

46 SHARE BASED PAYMENTS continued

SHARE INCENTIVE PLAN

FREE SHARES

An award of shares may be made annually to employees based on a percentage of each employee's salary in the preceding year up to a maximum of £3,000. The percentage is normally announced concurrently with the Group's annual results and the price of the shares awarded is announced at the time of award. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf. The award is subject to a non-market based condition: if an employee leaves the Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited (for awards made up to April 2005, only a portion of the shares would be forfeited: 75 per cent within one year of the award, 50 per cent within two years and 25 per cent within three years).

The number of shares awarded relating to free shares in 2008 was 8,862,823 (2007: 6,784,201), with an average fair value of £4.38 (2007: £5.82), based on the market price at the date of award.

MATCHING SHARES

The Group undertakes to match shares purchased by employees up to the value of £30 per month; these shares are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason or the accompanying partnership shares are sold within that time, 100 per cent of the matching shares are forfeited (or the portion relating to the shares sold).

The number of shares awarded relating to matching shares in 2008 was 4,475,264 (2007: 2,073,018), with an average fair value of £2.56 (2007: £5.49), based on market prices at the date of award.

47 RELATED PARTY TRANSACTIONS

KEY MANAGEMENT PERSONNEL

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the Group's key management personnel are the members of Lloyds Banking Group plc group executive committee together with its non-executive directors.

The table below details, on an aggregated basis, key management personnel compensation:

	2008 £m	2007 £m
Compensation		
Salaries and other short-term benefits	8	15
Post-employment benefits	1	4
Termination benefits	–	–
Share based payments	4	4
	13	23

In addition, Mr Fairey retired as at 30 June 2008 and received his non approved benefit entitlement in the form of a lump sum in accordance with the scheme rules. A tax free amount of £4,523,000 was paid from the FURBS, with a further taxable amount of £2,446,000 made by the Group from provisions set aside. The total amount of £6,969,000 covered the Group's liability to provide benefits in respect of salary in excess of the earnings cap.

	2008 million	2007 million
Share options		
At 1 January	7	11
Granted (including options of appointed directors)	–	–
Exercised/lapsed (including options of former directors)	(5)	(4)
At 31 December	2	7

	2008 million	2007 million
Share incentive plans		
At 1 January	6	4
Granted (including entitlements of appointed directors)	3	2
Exercised/lapsed (including entitlements of former directors)	(2)	–
At 31 December	7	6

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

47 RELATED PARTY TRANSACTIONS continued

The tables below detail, on an aggregated basis, balances outstanding at the year end and related income and expense, together with information relating to other transactions between the Group and its key management personnel:

	2008 £m	2007 £m
Loans		
At 1 January	**2**	2
Advanced	**2**	1
Repayments	**(1)**	(1)
At 31 December	**3**	2

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 2.14 per cent and 34.01 per cent in 2008 (2007: 4.95 per cent and 30.0 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2007: £nil).

	2008 £m	2007 £m
Deposits		
At 1 January	**5**	5
Placed	**27**	21
Withdrawn	**(26)**	(21)
At 31 December	**6**	5

Deposits placed by key management personnel attracted interest rates of up to 6.0 per cent (2007: 8.0 per cent).

At 31 December 2008, the Group did not provide any guarantees in respect of key management personnel (2007: £6,154 in respect of one director).

At 31 December 2008, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £3 million with eight directors and six connected persons (2007: £2 million with five directors and three connected persons).

SUBSIDIARIES

Details of the principal subsidiaries are given in note 8 to the parent company financial statements. In accordance with IAS 27, transactions and balances with subsidiaries have been eliminated on consolidation.

OTHER RELATED PARTY DISCLOSURES

At 31 December 2008, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £23 million (2007: £23 million).

The Group manages 105 (2007: 107) Open Ended Investment Companies (OEICs), and of these 47 (2007: 40) are consolidated. The Group invested £455 million (2007: £1,961 million) and redeemed £343 million (2007: £1,526 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £2,661 million (2007: £2,233 million) at 31 December. The Group earned fees of £206 million from the unconsolidated OEICs (2007: £200 million). The Company held no investments in OEICs at any time during 2007 or 2008.

The Group has a number of associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2008, these companies had total assets of approximately £5,838 million (2007: £3,184 million), total liabilities of approximately £5,780 million (2007: £3,182 million) and for the year ended 31 December 2008 had turnover of £2,088 million (2007: £2,136 million) and made a net loss of approximately £80 million (2007: net profit of £9 million). In addition, the Group has provided £825 million (2007: £609 million) of financing to these companies on which it received £46 million (2007: £23 million) of interest income in the year.

48 CONTINGENT LIABILITIES AND COMMITMENTS

LEGAL PROCEEDINGS

The Group has provided information relating to its review of historic US dollar payments involving countries, persons or entities subject to US economic sanctions administered by the Office of Foreign Assets Control (OFAC) to a number of authorities including OFAC, the US Department of Justice and the New York County District Attorney's Office which, along with other authorities, have been reported to be conducting a broader review of sanctions compliance by non-US financial institutions. At 31 December 2008, the discussions with those authorities had advanced towards resolution of their investigations and the Group held an accrual of £180 million in respect of this matter. On 9 January 2009, the Group announced that it had reached a settlement with both the US Department of Justice and the New York County District Attorney's Office in relation to their investigations. The settlement documentation contains details of the results of the investigations including the identification of certain activities

48 CONTINGENT LIABILITIES AND COMMITMENTS continued

relating to Iran, Sudan and Libya which the Group conducted during the relevant period. The provision made by the Group in respect of this matter during 2008 was hedged into US dollars at the time and fully covers the settlement amount. The Group is continuing discussions with OFAC regarding the terms of the resolution of its investigation. OFAC has confirmed to the Group that the amount paid to the US Department of Justice and the New York County District Attorney's Office will be credited towards satisfying any penalty it imposes. The Group does not currently believe that any additional liability requiring provision will arise following the conclusion of the discussions with OFAC. The Group does not anticipate any further enforcement actions as to these issues.

On 27 July 2007, following agreement between the OFT and a number of UK financial institutions, the OFT issued High Court legal proceedings against those institutions, including Lloyds TSB Bank plc, to determine the legal status and enforceability of certain of the charges applied to their personal customers in relation to requests for unplanned overdrafts. On 24 April 2008, the High Court determined, in relation to the current terms and conditions of those financial institutions (including Lloyds TSB Bank plc), that the relevant charges are not capable of amounting to penalties but that they are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999. On 23 May 2008, Lloyds TSB Bank plc, along with the other relevant financial institutions, was given permission to appeal the finding that unplanned overdraft charges are assessable for fairness. The appeal hearing commenced on 28 October 2008 and concluded on 5 November 2008. On 26 February 2009, the Court of Appeal dismissed the banks' appeal and held that the charges are assessable for fairness. The banks will now be applying to the House of Lords for permission to appeal this judgment.

A further hearing was held on 7 to 9 July 2008 to consider whether those financial institutions' historic terms and conditions are capable of being penalties, and to consider whether their historic terms are assessable for fairness. On 21 January 2009, the court confirmed that the relevant charges under Lloyds TSB Bank plc's historic terms and conditions are not capable of being penalties but are assessable for fairness, to the extent that the bank's contracts with customers included the applicable charging terms. The issue of whether the charges are actually fair will be determined at subsequent hearings. If various appeals are pursued, the proceedings may take a number of years to conclude.

Cases before the Financial Ombudsman Service and the County Courts are currently stayed pending the outcome of the legal proceedings initiated by the OFT. Lloyds Banking Group intends to continue to defend its position strongly. Accordingly, no provision in relation to the outcome of this litigation has been made. Depending on the High Court's determinations, a range of outcomes is possible, some of which could have a significant financial impact on the Group. The ultimate impact of the litigation on the Group can only be known at its conclusion.

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

THE FINANCIAL SERVICES COMPENSATION SCHEME

The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS has borrowings from HM Treasury to fund the compensation costs associated with the institutions that have failed in 2008 and will receive the receipts from asset sales, surplus cash flow and other recoveries from these institutions in the future.

The FSCS fulfils its obligations by raising management expenses levies, which include amounts to cover the interest on its borrowings, and compensation levies on the industry, each deposit-taking institution contributing in proportion to its share of total protected deposits.

In 2008, the Group has accrued £122 million in respect of its current obligation to meet management expenses levies.

If the FSCS does not receive sufficient funds from the failed institutions to repay HM Treasury in full, it will raise compensation levies. At this time, it is not possible to estimate the quantum or timing of any shortfall resulting from the cash flows received from the failed institutions and, accordingly, no provision for compensation levies, which could be significant, has been made in these financial statements.

CONTINGENT LIABILITIES AND COMMITMENTS ARISING FROM THE BANKING BUSINESS

Acceptances and endorsements arise where Lloyds Banking Group agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, where Lloyds Banking Group has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Performance bonds and other transaction-related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

Lloyds Banking Group's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held.

48 CONTINGENT LIABILITIES AND COMMITMENTS continued

	2008 £m	2007 £m
Contingent liabilities		
Acceptances and endorsements	49	40
Other:		
Other items serving as direct credit substitutes	1,870	1,095
Performance bonds and other transaction-related contingencies	2,850	2,429
	4,720	3,524
	4,769	3,564

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

	2008 £m	2007 £m
Commitments		
Documentary credits and other short-term trade-related transactions	319	306
Forward asset purchases and forward deposits placed	613	463
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	3,056	4,639
Other commitments	46,006	52,791
	49,062	57,430
1 year or over original maturity	31,761	32,165
	81,755	90,364

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £46,890 million (2007: £53,036 million) was irrevocable.

Included in commitments to lend above are not-yet-syndicated leveraged loan underwriting commitments which amounted to £931 million (2007: £1,158 million). All of the underlying assets are performing satisfactorily.

OPERATING LEASE COMMITMENTS

Where a Group company is the lessee the future minimum lease payments under non-cancellable premises operating leases are as follows:

	2008 £m	2007 £m
Not later than 1 year	216	212
Later than 1 year and not later than 5 years	647	677
Later than 5 years	774	764
	1,637	1,653

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments.

CAPITAL COMMITMENTS

Excluding commitments in respect of investment property (see note 22), capital expenditure contracted but not provided for at 31 December 2008 amounted to £92 million (2007: £102 million). Of this amount, £85 million (2007: £96 million) related to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

49 FINANCIAL RISK MANAGEMENT

As a bancassurer, financial instruments are fundamental to the Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the Group.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and foreign exchange risk; and liquidity risk. Information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk and the Group's management of capital can be found on pages 42 to 64. The following additional disclosures, which provide quantitative information about the risks within financial instruments held or issued by the Group, should be read in conjunction with that earlier information.

MEASUREMENT BASIS OF FINANCIAL ASSETS AND LIABILITIES

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

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2008								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	5,008	–	5,008
Items in the course of collection from banks	–	–	–	–	–	946	–	946
Trading and other financial assets at fair value through profit or loss	–	857	44,207	–	–	–	–	45,064
Derivative financial instruments	435	28,449	–	–	–	–	–	28,884
Loans and advances to banks	–	–	–	–	40,758	–	–	40,758
Loans and advances to customers	–	–	–	–	242,735	–	–	242,735
Available-for-sale financial assets	–	–	–	55,707	–	–	–	55,707
Total financial assets	435	29,306	44,207	55,707	283,493	5,954	–	419,102
Financial liabilities								
Deposits from banks	–	–	–	–	–	66,514	–	66,514
Customer accounts	–	–	–	–	–	170,938	–	170,938
Items in course of transmission to banks	–	–	–	–	–	508	–	508
Trading and other liabilities at fair value through profit or loss	–	6	6,748	–	–	–	–	6,754
Derivative financial instruments	4,169	22,723	–	–	–	–	–	26,892
Debt securities in issue	–	–	–	–	–	75,710	–	75,710
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	33,792	33,792
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	14,243	14,243
Unallocated surplus within insurance businesses	–	–	–	–	–	–	270	270
Subordinated liabilities	–	–	–	–	–	17,256	–	17,256
Total financial liabilities	4,169	22,729	6,748	–	–	330,926	48,305	412,877

49 FINANCIAL RISK MANAGEMENT continued

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2007								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	4,330	–	4,330
Items in the course of collection from banks	–	–	–	–	–	1,242	–	1,242
Trading and other financial assets at fair value through profit or loss	–	4,663	53,248	–	–	–	–	57,911
Derivative financial instruments	264	8,395	–	–	–	–	–	8,659
Loans and advances to banks	–	–	–	–	34,845	–	–	34,845
Loans and advances to customers	–	–	–	–	209,814	–	–	209,814
Available-for-sale financial assets	–	–	–	20,196	–	–	–	20,196
Total financial assets	264	13,058	53,248	20,196	244,659	5,572	–	336,997
Financial liabilities								
Deposits from banks	–	–	–	–	–	39,091	–	39,091
Customer accounts	–	–	–	–	–	156,555	–	156,555
Items in course of transmission to banks	–	–	–	–	–	668	–	668
Trading and other liabilities at fair value through profit or loss	–	99	3,107	–	–	–	–	3,206
Derivative financial instruments	800	6,782	–	–	–	–	–	7,582
Debt securities in issue	–	–	–	–	–	51,572	–	51,572
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	38,063	38,063
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	18,197	18,197
Unallocated surplus within insurance businesses	–	–	–	–	–	–	554	554
Subordinated liabilities	–	–	–	–	–	11,958	–	11,958
Total financial liabilities	800	6,881	3,107	–	–	259,844	56,814	327,446

RECLASSIFICATION OF FINANCIAL ASSETS

In accordance with the amendment to IAS 39 as disclosed in note 2, the Group reviewed the categorisation of its assets classified as held for trading and available-for-sale financial assets. On the basis that there was no longer an active market for some of those assets, which are therefore more appropriately managed as loans, the Group reclassified £2,993 million of assets classified as held for trading (measured at fair value through profit or loss immediately prior to reclassification) to loans and receivables with effect from 1 July 2008 and £437 million of assets classified as available-for-sale financial assets (measured at fair value through equity) to loans and receivables with effect from 1 November 2008. At the time of these transfers, the Group had the intention and ability to hold them for the foreseeable future or until maturity.

HELD FOR TRADING TO LOANS AND RECEIVABLES

In respect of the £2,993 million of assets transferred with effect from 1 July 2008, a loss of £172 million was recognised in the income statement for the six months to 30 June 2008 (year to 31 December 2007: £132 million) while they were classified as held for trading. If the assets had not been transferred and had been kept as held for trading, a loss of £347 million would have been recognised in the income statement for the six months to 31 December 2008 within net trading income.

Since their reclassification to loans and receivables, a net credit of £31 million has been recognised in the income statement for the six months to 31 December 2008 within net interest income and a charge of £158 million within impairment. The weighted average effective interest rate of the assets transferred was 6.3 per cent with expected recoverable cash flows of £3,524 million.

49 FINANCIAL RISK MANAGEMENT continued

AVAILABLE-FOR-SALE FINANCIAL ASSETS TO LOANS AND RECEIVABLES

In respect of the £437 million of assets transferred with effect from 1 November 2008, a negative valuation movement of £261 million, including exchange movements, was recognised in the revaluation reserve in respect of available-for-sale financial assets for the ten months to 31 October 2008 while they were classified as available-for-sale financial assets. If the assets had not been transferred and had been kept as available-for-sale financial assets £3 million would have been recognised in interest income and £209 million would have been recognised in impairment in the income statement for the two months to 31 December 2008.

Since their reclassification to loans and receivables, an amount of £3 million has been recognised in the income statement for the two months to 31 December 2008 within interest income and a further £23 million within impairment. The weighted average effective interest rate of the assets transferred was 10.9 per cent with expected recoverable cash flows of £837 million.

For the year ended 31 December 2007, a negative valuation movement of £34 million, including exchange movements, was recognised in the revaluation reserve in respect of available-for-sale financial assets and £32 million was recognised in interest income.

INTEREST RATE RISK

In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There are a relatively small volume of deposits whose rate is contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However a significant proportion of the Group's lending assets, for example personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio. At 31 December 2008 the aggregate notional principal of interest rate swaps designated as fair value hedges was £37,243 million (2007: £50,734 million) with a net fair value liability of £1,231 million (2007: £197 million) (see note 17). The losses on the hedging instruments were £584 million (2007: losses of £233 million). The gains on the hedged items attributable to the hedged risk were £426 million (2007: gains of £211 million).

In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next six years and the hedge accounting adjustments will be reported in the income statement as the cash flows arise. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2008 was £867 million (2007: £630 million) with a net fair value liability of £90 million (2007: £23 million) (see note 17). In 2008, there is no ineffectiveness recognised in the income statement that arises from cash flow hedges (2007: nil). There were no transactions for which cash flow hedge accounting had to be ceased in 2008 or 2007 as a result of the highly probable cash flows no longer being expected to occur.

CURRENCY RISK

Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to Wholesale and International Banking Market and Liquidity Risk. Associated VaR and the closing, average, maximum and minimum for 2007 and 2008 are disclosed on page 51.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to reserves.

The Group hedges part of the currency translation risk of the net investment in certain foreign operations using cross currency swaps. At 31 December 2008 the aggregate notional principal of these cross currency swaps was £6,318 million (2007: £5,302 million) with a net fair value liability of £2,413 million (2007: liability of £316 million) (see note 17) and they were designated on an after-tax basis as hedges of net investments in foreign operations. In 2008, ineffectiveness of £14 million before tax and £10 million after tax (2007: nil) was recognised in the income statement arising from net investment hedges.

The Group's main overseas operations are in the Americas, Asia and Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

49 FINANCIAL RISK MANAGEMENT continued

	2008 £m	2007 £m
Functional currency of Group operations		
Euro	**133**	95
US dollar	**(907)**	7
Swiss franc:		
Gross exposure	**2,784**	1,945
Net investment hedge	**(2,663)**	(1,875)
	121	70
Japanese yen:		
Gross exposure	**3,667**	2,148
Net investment hedge	**(3,645)**	(2,136)
	22	12
Other non-sterling	**296**	196
	(335)	380

CREDIT RISK

The Group's credit risk exposure arises predominantly in the United Kingdom and the European Union.

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

	2008 £m	2007 £m
Loans and advances to banks	**40,916**	34,845
Loans and advances to customers	**246,304**	212,222
Deposit amounts available for offset[1]	**(4,837)**	(6,206)
Impairment losses	**(3,727)**	(2,408)
	278,656	238,453
Available-for-sale debt securities and treasury and other bills	**55,666**	20,167
Trading and other financial assets at fair value through profit or loss	**21,790**	26,165
Derivative assets, before netting	**28,884**	8,659
Amounts available for offset under master netting arrangements[1]	**(10,598)**	(3,287)
	18,286	5,372
Assets arising from reinsurance contracts held	**385**	350
Financial guarantees	**10,382**	9,753
Irrevocable loan commitments and other credit-related contingencies[2]	**51,659**	56,600
Maximum credit risk exposure	**436,824**	356,860
Maximum credit risk exposure before offset items	**452,259**	366,353

[1] Deposit amounts available for offset and amounts available for offset under master netting arrangements do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

[2] See note 48 – Contingent liabilities and commitments for further information.

A general description of collateral held in respect of financial instruments is disclosed on page 50.

Loans and advances to banks – the Group may require collateral before entering into a credit commitment with another bank, depending on the type of the financial product and the counterparty involved, and netting agreements are obtained whenever possible and to the extent that such agreements are legally enforceable.

Available-for-sale debt securities, treasury and other bills, and trading and other financial assets at fair value through profit or loss – the credit quality of the Group's available-for-sale debt securities, treasury and other bills, and the majority of the Group's trading and other financial assets at fair value through profit or loss held is set out below. An analysis of trading and other financial assets at fair value through profit or loss

49 FINANCIAL RISK MANAGEMENT continued

is included in note 16 and a similar analysis for available-for-sale financial assets is included in note 21. The Group's non-participating investment contracts are all unit-linked. Movements in the fair values of trading and other financial assets at fair value through profit or loss which back those investment contracts, including movements arising from credit risk, are borne by the contract holders.

Derivative assets – the Group reduces exposure to credit risk by using master netting agreements and by obtaining cash collateral. An analysis of derivative assets is given in note 17. Of the net derivative assets of £18,286 million (2007 £5,372 million), cash collateral of £2,970 million (2007: £2,004 million) was held and a further £5,840 million was due from OECD banks (2007: £1,459 million).

Assets arising from reinsurance contracts held – of the assets arising from reinsurance contracts held at 31 December 2008 of £385 million (2007: £350 million), £380 million (2007: £341 million) were due from insurers with a credit rating of AA or above.

Financial guarantees – these represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards.

Reverse repo and repo transactions – for reverse repo transactions which are accounted for as collateralised loans, it is the Group's policy to seek collateral which is at least equal to the amount loaned. At 31 December 2008, the fair value of collateral accepted under reverse repo transactions that the Group is permitted by contract or custom to sell or repledge was £5,858 million (2007: £10,300 million). Of this, £5,855 million (2007: £10,299 million) was sold or repledged as at 31 December 2008. The fair value of collateral pledged in respect of repo transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to repledge was £5,734 million (2007: £768 million).

LOANS AND ADVANCES

	Loans and advances to customers				Loans and advances designated at fair value through profit or loss	Loans and advances to banks
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	£m	£m
31 December 2008						
Neither past due nor impaired	**110,148**	**33,571**	**89,208**	**232,927**	**608**	**40,741**
Past due but not impaired	**3,134**	**1,146**	**555**	**4,835**	**–**	**17**
Impaired – no provision required	**479**	**150**	**1,253**	**1,882**	**–**	**–**
– provision held	**882**	**4,327**	**1,451**	**6,660**	**–**	**158**
Gross	**114,643**	**39,194**	**92,467**	**246,304**	**608**	**40,916**
Allowance for impairment losses (note 20)	**(186)**	**(2,345)**	**(1,038)**	**(3,569)**	**–**	**(158)**
Net	**114,457**	**36,849**	**91,429**	**242,735**	**608**	**40,758**
31 December 2007						
Neither past due nor impaired	99,828	29,850	73,475	203,153	1,189	34,845
Past due but not impaired	2,153	966	639	3,758	–	–
Impaired – no provision required	415	100	293	808	–	–
– provision held	343	3,600	560	4,503	–	–
Gross	102,739	34,516	74,967	212,222	1,189	34,845
Allowance for impairment losses (note 20)	(37)	(2,029)	(342)	(2,408)	–	–
Net	102,702	32,487	74,625	209,814	1,189	34,845

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

49 FINANCIAL RISK MANAGEMENT continued

LOANS AND ADVANCES WHICH ARE NEITHER PAST DUE NOR IMPAIRED

	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m	Loans and advances to banks £m
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m		
31 December 2008						
Good quality	**109,437**	**21,251**	**50,718**		**129**	**40,295**
Satisfactory quality	**643**	**9,305**	**34,559**		**411**	**192**
Lower quality	**–**	**900**	**3,444**		**56**	**240**
Below standard, but not impaired	**68**	**2,115**	**487**		**12**	**14**
Total	**110,148**	**33,571**	**89,208**	**232,927**	**608**	**40,741**
31 December 2007						
Good quality	99,407	18,157	46,240		191	34,647
Satisfactory quality	378	8,964	25,013		670	190
Lower quality	1	665	2,034		327	7
Below standard, but not impaired	42	2,064	188		1	1
Total	99,828	29,850	73,475	203,153	1,189	34,845

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Wholesale lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models. Good quality lending includes the lower assessed default probabilities and all loans with low expected losses in the event of default, with other categories reflecting progressively higher risks and lower expected recoveries.

LOANS AND ADVANCES WHICH ARE PAST DUE BUT NOT IMPAIRED

	Loans and advances to customers				Loans and advances designated at fair value through profit or loss £m	Loans and advances to banks £m
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m		
31 December 2008						
0-30 days	**1,527**	**853**	**289**	**2,669**	**–**	**–**
30-60 days	**633**	**259**	**90**	**982**	**–**	**–**
60-90 days	**424**	**32**	**70**	**526**	**–**	**17**
90-180 days	**549**	**2**	**77**	**628**	**–**	**–**
Over 180 days	**1**	**–**	**29**	**30**	**–**	**–**
Total	**3,134**	**1,146**	**555**	**4,835**	**–**	**17**
Fair value of collateral held	**2,637**	**n/a**	**n/a**	**n/a**		
31 December 2007						
0-30 days	1,123	781	266	2,170	–	–
30-60 days	445	155	107	707	–	–
60-90 days	260	29	129	418	–	–
90-180 days	325	1	67	393	–	–
Over 180 days	–	–	70	70	–	–
Total	2,153	966	639	3,758	–	–
Fair value of collateral held	2,111	n/a	n/a	n/a		

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

49 FINANCIAL RISK MANAGEMENT continued

Collateral held against retail mortgage lending is principally comprised of residential properties; their fair value has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices, after making allowance for indexation error and dilapidations. The resulting valuation has been limited to the principal amount of the outstanding advance in order to provide a clearer representation of the Group's credit exposure.

Lending decisions are based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values for non-mortgage lending are assessed more rigorously at the time of loan origination or when taking enforcement action and may fluctuate, as in the case of floating charges, according to the level of assets held by the customer. Whilst collateral is reviewed on a regular basis in accordance with business unit credit policy, this varies according to the type of lending and collateral involved. It is therefore not practicable to estimate and aggregate current fair values of collateral for non-mortgage lending.

RENEGOTIATED LOANS AND ADVANCES

Loans and advances that were renegotiated during the year and that would otherwise have been past due or impaired at 31 December 2008 totalled £144 million (2007: £579 million).

REPOSSESSED COLLATERAL

	2008 £m	2007 £m
Residential property	221	73
Other	26	9
Total	247	82

The Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

LOAN TO VALUE RATIO OF MORTGAGE LENDING

	2008 £m	2007 £m
Analysis by loan to value ratio of the Group's residential mortgage lending which is neither past due nor impaired:		
Less than 70 per cent	55,040	66,716
70 per cent to 80 per cent	15,812	15,690
80 per cent to 90 per cent	15,954	12,102
Greater than 90 per cent	23,342	5,320
Total	110,148	99,828

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

49 FINANCIAL RISK MANAGEMENT continued

Debt securities, treasury and other bills – analysis by credit rating:

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2008							
Debt securities held at fair value through profit or loss							
Trading assets:							
Government securities	38	–	–	–	–	–	38
Corporate and other debt securities	76	187	38	68	87	80	536
Total held as trading assets	114	187	38	68	87	80	574
Other assets held at fair value through profit or loss:							
Government securities	7,025	45	138	1	–	117	7,326
Other public sector securities	–	–	–	–	–	18	18
Bank and building society certificates of deposit	96	337	–	–	–	–	433
Mortgage backed securities	207	108	23	16	–	15	369
Other asset backed securities	206	362	391	277	105	1	1,342
Corporate and other debt securities	3,194	864	2,911	2,142	599	1,410	11,120
Total held at fair value through profit or loss	10,842	1,903	3,501	2,504	791	1,641	21,182
Available-for-sale financial assets							
Debt securities:							
Government securities	851	–	1	–	–	16	868
Other public sector securities	–	–	–	–	–	12	12
Bank and building society certificates of deposit	–	9,418	166	–	18	–	9,602
Mortgage backed securities	4,388	6	21	–	14	–	4,429
Other asset backed securities	4,604	121	60	20	98	53	4,956
Corporate and other debt securities	4,111	1,424	304	71	113	567	6,590
Total debt securities	13,954	10,969	552	91	243	648	26,457
Treasury bills and other bills	26,858	2,351	–	–	–	–	29,209
Total held as available-for-sale assets	40,812	13,320	552	91	243	648	55,666

49 FINANCIAL RISK MANAGEMENT continued

	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
As at 31 December 2007							
Debt securities held at fair value through profit or loss							
Trading assets:							
Government securities	62	–	–	–	–	–	62
Mortgage backed securities	–	28	51	8	–	–	87
Other asset backed securities	–	15	61	38	3	5	122
Corporate and other debt securities	268	1,268	1,390	103	59	519	3,607
Total held as trading assets	330	1,311	1,502	149	62	524	3,878
Other assets held at fair value through profit or loss:							
Government securities	4,808	6	15	1	–	18	4,848
Bank and building society certificates of deposit	42	548	53	–	–	168	811
Mortgage backed securities	61	–	–	–	–	9	70
Other asset backed securities	1,367	214	153	71	–	–	1,805
Corporate and other debt securities	5,118	1,606	2,868	2,528	340	1,104	13,564
Total held at fair value through profit or loss	11,726	3,685	4,591	2,749	402	1,823	24,976
Available-for-sale financial assets							
Debt securities:							
Government securities	310	–	–	–	–	9	319
Other public sector securities	–	–	–	–	–	5	5
Bank and building society certificates of deposit	–	1,683	125	–	15	2	1,825
Mortgage backed securities	5,880	14	10	–	–	146	6,050
Other asset backed securities	3,895	37	27	–	–	112	4,071
Corporate and other debt securities	3,822	1,170	186	–	–	1,092	6,270
Total debt securities	13,907	2,904	348	–	15	1,366	18,540
Treasury bills and other bills	31	1,596	–	–	–	–	1,627
Total held as available-for-sale assets	13,938	4,500	348	–	15	1,366	20,167

There are no material amounts for debt securities, treasury and other bills which are past due but not impaired.

49 FINANCIAL RISK MANAGEMENT continued

LIQUIDITY RISK

The table below analyses financial instrument liabilities of the Group, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2008						
Deposits from banks	**49,620**	**13,617**	**1,480**	**1,986**	**5**	**66,708**
Customer accounts	**151,164**	**8,258**	**9,675**	**2,303**	**697**	**172,097**
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	**29,479**	**1,077**	**5,295**	**7,203**	**3,818**	**46,872**
Debt securities in issue	**24,381**	**26,944**	**9,192**	**13,643**	**3,489**	**77,649**
Liabilities arising from non-participating investment contracts	**14,243**	**–**	**–**	**–**	**–**	**14,243**
Subordinated liabilities	**34**	**130**	**563**	**5,382**	**20,516**	**26,625**
Total	**268,921**	**50,026**	**26,205**	**30,517**	**28,525**	**404,194**
As at 31 December 2007						
Deposits from banks	35,466	2,218	1,480	26	–	39,190
Customer accounts	144,213	4,800	7,578	2,002	447	159,040
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	10,286	2,176	3,607	1,589	1,851	19,509
Debt securities in issue	20,307	6,047	9,529	13,202	6,197	55,282
Liabilities arising from non-participating investment contracts	18,197	–	–	–	–	18,197
Subordinated liabilities	27	210	1,067	6,371	14,292	21,967
Total	228,496	15,451	23,261	23,190	22,787	313,185

Trading derivatives (other than those in the insurance companies) and trading liabilities are included in the up to 1 month column at their fair value. Liquidity risk on these items is not managed on the basis of contractual maturity as they are frequently settled on demand at fair value and therefore this is considered a better presentation of the Group's liquidity risk. Derivatives used in a hedging relationship are included according to their contractual maturity.

Cash flows for undated subordinated liabilities whose terms give the Group the option to redeem at a future date are included within the table on the basis that the Group will exercise its option to redeem.

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £412 million (2007: £223 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

Further information on the Group's liquidity exposures is provided on pages 55 and 56.

Liabilities arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	**1-3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
As at 31 December 2008	**340**	**927**	**2,626**	**7,030**	**22,869**	**33,792**
As at 31 December 2007	238	651	1,570	9,548	26,056	38,063

The following tables set out the amounts and residual maturities of Lloyds Banking Group's off balance sheet contingent liabilities and commitments.

49 FINANCIAL RISK MANAGEMENT continued

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2008					
Acceptances	**49**	**–**	**–**	**–**	**49**
Other contingent liabilities	**1,722**	**1,525**	**402**	**1,071**	**4,720**
Total contingent liabilities	**1,771**	**1,525**	**402**	**1,071**	**4,769**
Lending commitments	**54,155**	**15,029**	**8,014**	**3,625**	**80,823**
Other commitments	**572**	**181**	**80**	**99**	**932**
Total commitments	**54,727**	**15,210**	**8,094**	**3,724**	**81,755**
Total contingents and commitments	**56,498**	**16,735**	**8,496**	**4,795**	**86,524**

	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
31 December 2007					
Acceptances	39	1	–	–	40
Other contingent liabilities	1,441	1,032	255	796	3,524
Total contingent liabilities	1,480	1,033	255	796	3,564
Lending commitments	60,981	13,759	10,634	4,221	89,595
Other commitments	466	78	108	117	769
Total commitments	61,447	13,837	10,742	4,338	90,364
Total contingents and commitments	62,927	14,870	10,997	5,134	93,928

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments include financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been estimated using market prices for instruments held by the Group. Where market prices are not available, or are unreliable because of poor liquidity, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics either identical or similar to those of the instruments held by the Group. These estimation techniques are necessarily subjective in nature and involve several assumptions.

The fair values presented in the following table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that do not meet the definition of a financial instrument. These items include intangible assets, such as the value of the Group's branch network, the long-term relationships with depositors and credit card relationships; premises and equipment; and shareholders' equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

The valuation technique for each major category of financial instrument and, where valuation models are used, significant inputs into valuation models, are discussed below.

Where referred to within the major categories listed, the Group's use of lead manager quotes and market standard consensus pricing services are as described below:

Lead manager quotes for illiquid assets in the current markets do not represent binding levels and are validated for consistency across the same asset class and by reference to discounted cash flow models that use expected loss and discount assumptions.

Market standard consensus pricing services aggregate price and other market data inputs from leading participants in the relevant markets and provide average mid-level outputs adjusted to exclude prices that are clearly out of line with other prices observed; these levels do not represent binding quotes.

TRADING AND OTHER FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

The fair values of financial instruments quoted in active markets are based on quoted prices. The fair values of financial instruments that are not quoted in active markets are determined using valuation techniques including cash flow models which, to the extent practicable, use observable market inputs such as interest rate yield curves, equities and commodities prices, option volatilities and currency rates that are either directly

49 FINANCIAL RISK MANAGEMENT continued

observable or are implied from instrument prices. The fair values of bonds classified as trading assets are determined predominantly from lead manager quotes and, where these are not available, by reference to market standard consensus pricing services, broker quotes and other research data. Certain corporate bonds were valued using credit default swap (CDS) spreads and assumptions around the bond/CDS spread. The fair values of the Group's venture capital investments are determined using techniques which follow British Venture Capital Association (BVCA) guidelines.

The fair value movement on assets and liabilities held at fair value through profit or loss and gains in respect of instruments held for trading are disclosed in note 7.

At 31 December 2008, the Group had a portfolio of corporate bonds hedged by CDS. Prior to October 2008, the markets for both corporate bonds and CDS were relatively liquid and both sides of the above position were valued using market observable inputs. During October 2008 bid/offer spreads widened severely and, consequently, the cash market for corporate bonds became inactive. The above position is valued in part using assumptions around the bond/CDS spread. The effect of using reasonably possible alternative adverse assumptions for this valuation would reduce net trading income by up to £105 million.

DERIVATIVE FINANCIAL INSTRUMENTS

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

Interest rate swaps are valued using discounted cash flow models; the most significant inputs into those models are interest rate yield curves which are developed from publicly quoted rates. Foreign exchange derivatives that do not contain options are priced using rates available from publicly quoted sources. Credit derivatives, except for the items noted below, are valued using publicly available yield and CDS curves; the Group uses standard models with observable inputs. Less complex interest rate and foreign exchange option products are valued using volatility surfaces developed from publicly available interest rate cap, interest rate swaption and other option volatilities; option volatility skew information is derived from a market standard consensus pricing service. For more complex option products, the Group calibrates its models using observable at-the-money data; where necessary, the Group adjusts for out-of-the-money positions using a market standard consensus pricing service.

An analysis of derivatives including fair values by contract type is given in note 17.

At 31 December 2008, the Group had a senior synthetic position in a structured corporate collateralised debt obligation (CDO) that is valued in part using assumptions around recovery levels. The effect of using reasonably possible alternative favourable or adverse assumptions for recovery levels would increase or reduce net trading income by up to £80 million respectively.

At 31 December 2008, the Group had a credit valuation reserve on its derivative positions that is valued in part using assumptions around credit spreads and recovery risks. The effect of using reasonably possible alternative adverse combinations of assumptions for these risks would reduce net trading income by up to £70 million.

LOANS AND ADVANCES TO BANKS AND CUSTOMERS

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair values of asset backed securities (ABS) and secondary loans, which were previously within assets held for trading and were reclassified to loans and receivables (see page 166), are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

AVAILABLE-FOR-SALE FINANCIAL ASSETS

Listed securities are valued at current bid prices. Unlisted securities and other financial assets are valued based on discounted cash flows, market prices of similar instruments and other appropriate valuation techniques. The fair values of bonds classified as available-for-sale financial assets, including ABS, are determined predominantly from lead manager quotes and, where these are not available, by alternative techniques including reference to credit spreads on similar assets with the same obligor, market standard consensus pricing services, broker quotes and other research data.

At 31 December 2008, the Group's available-for-sale financial assets included ABS of £13,938 million. In respect of these assets, the effect of a 100 basis point shift in credit spreads would result in a pre-tax movement of £590 million which would be recognised, net of tax, in the revaluation reserve in respect of available-for-sale assets.

DEPOSITS FROM BANKS AND CUSTOMER ACCOUNTS

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits and customer accounts is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

49 FINANCIAL RISK MANAGEMENT continued

DEBT SECURITIES IN ISSUE AND SUBORDINATED LIABILITIES

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using quoted market prices.

TRADING AND OTHER LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

The fair values of financial instruments quoted in active markets are based on quoted prices. The fair values of financial instruments that are not quoted in active markets are determined using valuation techniques including cash flow models which, to the extent practicable, use observable market inputs such as interest rate yield curves, equities and commodities prices, option volatilities and currency rates that are either directly observable or are implied from instrument prices.

LIABILITIES ARISING FROM NON-PARTICIPATING INVESTMENT CONTRACTS

The value of the Group's non-participating investment contracts, all of which are unit-linked, is contractually linked to the fair values of financial assets within the Group's unitised investment funds and is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

FINANCIAL COMMITMENTS AND CONTINGENT LIABILITIES

Financial guarantees are valued on the basis of cash premiums receivable. The Group considers that it is not meaningful or practical to provide an estimate of the fair value of other contingent liabilities and financial commitments, given the lack of an established market, the diversity of fee structures and the difficulty of separating the value of the instruments from the value of the overall transaction. Therefore only financial guarantees are included in the following table.

	Carrying value 2008 £m	Carrying value 2007 £m	**Fair value 2008 £m**	Fair value 2007 £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	**45,064**	57,911	**45,064**	57,911
Derivative financial instruments	**28,884**	8,659	**28,884**	8,659
Loans and advances to banks	**40,758**	34,845	**40,425**	34,832
Loans and advances to customers	**242,735**	209,814	**237,079**	209,066
Available-for-sale financial assets	**55,707**	20,196	**55,707**	20,196
Financial liabilities				
Deposits from banks	**66,514**	39,091	**66,504**	39,063
Customer accounts	**170,938**	156,555	**171,119**	156,608
Trading and other liabilities at fair value through profit or loss	**6,754**	3,206	**6,754**	3,206
Derivative financial instruments	**26,892**	7,582	**26,892**	7,582
Debt securities in issue	**75,710**	51,572	**76,291**	51,312
Liabilities arising from non-participating investment contracts	**14,243**	18,197	**14,243**	18,197
Financial guarantees	**35**	26	**35**	26
Subordinated liabilities	**17,256**	11,958	**11,199**	12,128

50 CONSOLIDATED CASH FLOW STATEMENT

(A) CHANGE IN OPERATING ASSETS

	2008 £m	2007 £m
Change in loans and advances to banks	**(3,360)**	8,673
Change in loans and advances to customers	**(30,357)**	(20,796)
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	**(8,990)**	(4,348)
Change in other operating assets	**(318)**	(511)
Change in operating assets	**(43,025)**	(16,982)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

50 CONSOLIDATED CASH FLOW STATEMENT continued

(B) CHANGE IN OPERATING LIABILITIES

	2008 £m	2007 £m
Change in deposits from banks	**25,279**	2,136
Change in customer accounts	**13,088**	17,172
Change in debt securities in issue	**22,401**	(2,450)
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	**22,565**	3,840
Change in investment contract liabilities	**(3,061)**	(58)
Change in other operating liabilities	**661**	901
Change in operating liabilities	**80,933**	21,541

(C) NON-CASH AND OTHER ITEMS

	2008 £m	2007 £m
Depreciation and amortisation	**686**	630
Revaluation of investment property	**1,058**	321
Allowance for loan losses	**2,876**	1,721
Write-off of allowance for loan losses	**(1,498)**	(1,405)
Impairment of available-for-sale securities	**130**	70
Impairment of goodwill	**100**	–
Change in insurance contract liabilities	**(4,555)**	853
Customer remediation paid	**(9)**	(54)
Other provision movements	**16**	2
Net charge in respect of defined benefit schemes	**164**	175
Contributions to defined benefit schemes	**(547)**	(452)
Other non-cash items	**(3,371)**	870
Total non-cash items	**(4,950)**	2,731
Interest expense on subordinated liabilities	**896**	741
Profit on disposal of businesses	**–**	(657)
Other	**(10)**	(31)
Total other items	**886**	53
Non-cash and other items	**(4,064)**	2,784

(D) ANALYSIS OF CASH AND CASH EQUIVALENTS AS SHOWN IN THE BALANCE SHEET

	2008 £m	2007 £m
Cash and balances with central banks	**5,008**	4,330
Less: mandatory reserve deposits[1]	**(545)**	(338)
	4,463	3,992
Loans and advances to banks	**40,758**	34,845
Less: amounts with a maturity of three months or more	**(12,461)**	(6,946)
	28,297	27,899
Total cash and cash equivalents	**32,760**	31,891

[1] Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents at 31 December 2008 is £8,255 million (2007: £7,426 million) held within the Group's life funds, which is not immediately available for use in the business.

50 CONSOLIDATED CASH FLOW STATEMENT continued

(E) ANALYSIS OF CHANGES IN FINANCING DURING THE YEAR

	2008 £m	2007 £m
Share capital (including share premium account):		
At 1 January	**2,730**	2,695
Issue of share capital:		
Private placement	**760**	–
Other	**119**	35
At 31 December	**3,609**	2,730

	2008 £m	2007 £m
Minority interests:		
At 1 January	**284**	352
Exchange and other adjustments	**28**	(1)
Repayment of capital to minority shareholders	**(3)**	(80)
Minority share of profit after tax	**26**	32
Dividends to minority shareholders	**(29)**	(19)
At 31 December	**306**	284

	2008 £m	2007 £m
Subordinated liabilities:		
At 1 January	**11,958**	12,072
Exchange and other adjustments	**2,658**	186
Issue of subordinated liabilities	**3,021**	–
Repayments of subordinated liabilities	**(381)**	(300)
At 31 December	**17,256**	11,958

(F) ACQUISITION OF GROUP UNDERTAKINGS AND BUSINESSES

	2008 £m	2007 £m
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**19**	8

(G) DISPOSAL AND CLOSURE OF GROUP UNDERTAKINGS AND BUSINESSES

	2008 £m	2007 £m
Cash and balances at central banks	**–**	37
Trading and other financial assets at fair value through profit or loss	**–**	10,999
Loans and advances to banks	**–**	1,150
Value of in-force business	**–**	412
Liabilities arising from insurance contracts and participating investment contracts	**–**	(4,349)
Liabilities arising from non-participating investment contracts	**–**	(7,283)
Unallocated surplus within insurance businesses	**–**	(15)
Other net assets and liabilities	**–**	(95)
	–	856
Profit on sale of businesses	**–**	657
Cash and cash equivalents disposed of	**–**	(37)
Net cash inflow from disposals	**–**	1,476

51 FUTURE ACCOUNTING DEVELOPMENTS

The following pronouncements will be relevant to the Group but were not effective at 31 December 2008 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group, however, the initial view is that none of these pronouncements are expected to cause any material adjustments to reported numbers in the financial statements.

Pronouncement	Nature of change	Effective date
IFRIC 13 Customer Loyalty Programmes	Addresses accounting by entities who grant customer loyalty award credits to customers as part of sales transactions and which can be redeemed in the future for free or discounted goods or services.	Annual periods beginning on or after 1 July 2008.
IFRIC 16 Hedges of a Net Investment in a Foreign Operation[1]	Provides guidance on accounting for hedges of net investments in foreign operations in an entity's consolidated financial statements.	Annual periods beginning on or after 1 October 2008.
IAS 1 Presentation of Financial Statements	Revises the overall requirements for the presentation of financial statements, guidance for their structure and minimum content requirements. The revised standard requires the presentation of all non-owner changes in equity within a statement of comprehensive income.	Annual periods beginning on or after 1 January 2009.
IAS 23 Borrowing Costs	Requires interest and other costs incurred in connection with the borrowing of funds to be recognised as an expense except for those which are directly attributable to the acquisition, construction or production of assets that take a substantial period of time to get ready for their intended use or sale which must be capitalised as part of the cost of those assets.	Annual periods beginning on or after 1 January 2009.
IFRS 8 Operating Segments	Replaces IAS 14 Segment Reporting and requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally.	Annual periods beginning on or after 1 January 2009.
IFRS 2 Share-based Payment – Vesting Conditions and Cancellations	The amendment restricts the definition of vesting conditions to include only service conditions and performance conditions and deals with the accounting consequences of a failure to meet a condition other than a vesting condition including how to deal with cancellations by the counterparty and circumstances where neither the entity nor the counterparty is in a position to choose whether or not to meet a vesting condition.	Annual periods beginning on or after 1 January 2009.
Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation	The amendment requires some puttable financial instruments (being those which give the holder the right to put the instrument back to the issuer for cash or another financial asset) and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity.	Annual periods beginning on or after 1 January 2009.
Improvements to IFRSs	Sets out minor amendments to IFRS standards as part of annual improvements process.	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 January 2009.
Amendment to IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate	Removes the definition of the cost method and requires the presentation of dividends as income in the separate financial statements of the investor.	Annual periods beginning on or after 1 January 2009.
IFRS 3 Business Combinations[1, 2]	The revised standard continues to apply the acquisition method to business combinations, however, all payments to purchase a business are to be recorded at fair value at the acquisition date, some contingent payments are subsequently remeasured at fair value through income, goodwill may be calculated based on the parent's share of net assets or it may include goodwill related to the minority interest, and all transaction costs are expensed.	Annual periods beginning on or after 1 July 2009.
IAS 27 Consolidated and Separate Financial Statements[1, 2]	Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control; any remaining interest in an investee is re-measured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.	Annual periods beginning on or after 1 July 2009.

51 FUTURE ACCOUNTING DEVELOPMENTS continued

Pronouncement	Nature of change	Effective date
IFRIC 17 Distributions of Non-cash Assets to Owners[1, 2]	Provides accounting guidance for non-reciprocal distributions of non-cash assets to owners (and those in which owners may elect to receive a cash alternative).	Annual periods beginning on or after 1 July 2009.
Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items[1, 2]	Clarifies how the principles underlying hedge accounting should be applied in particular situations.	Annual periods beginning on or after 1 July 2009.

[1] At the date of this report, these pronouncements are awaiting EU endorsement.

[2] Subject to EU endorsement, the Group has not yet made a final decision as to whether it will apply these pronouncements in the 2009 financial statements.

52 POST BALANCE SHEET EVENTS

SHARE CAPITAL

On 19 November 2008, Lloyds Banking Group plc shareholders approved, subject to certain conditions, an increase in the Company's share capital by creating 14,911,908,221 new ordinary shares of 25 pence each, and creating 625,000,000 new preference shares of 25 pence each. These conditions were met in January 2009.

On 13 January 2009, the Group issued 2,596,653,203 ordinary shares at 173.3p, largely subscribed for by HM Treasury, raising a total of £4,500 million.

On 15 January 2009, the Company issued £1,000,000,000 12 per cent fixed to floating non-cumulative callable preference shares to HM Treasury pursuant to the preference share subscription agreement entered into with effect from 13 October 2008 by the Company and HM Treasury. These preference shares became fungible with the £3,000,000,000 12 per cent fixed to floating non-cumulative callable preference shares issued by the Company on 16 January 2009 (see below); under the terms of these preference shares, the payment of cash dividends to ordinary shareholders is not permitted until the preference shares are repaid.

So as to improve the position of HBOS preference shareholders following the acquisition of HBOS (see below), on 16 January 2009 the Group cancelled a number of HBOS preference share issuances in exchange for preference shares issued by Lloyds Banking Group plc. In this regard, the Company issued £299,987,729 9.25 per cent fixed rate non-cumulative preference shares, £99,999,942 9.75 per cent fixed rate non-cumulative preference shares, £186,190,532 6.475 per cent fixed rate non-cumulative preference shares, £745,431,000 6.0884 per cent fixed to floating rate non-cumulative callable preference shares, £334,951,000 6.3673 per cent fixed to floating non-cumulative callable preference shares, US$750,000,000 6.413 per cent fixed to floating rate non-cumulative callable preference shares, US$750,000,000 5.92 per cent fixed to floating rate non-cumulative callable preference shares, US$750,000,000 6.657 per cent fixed to floating rate non-cumulative callable preference shares and £3,000,000,000 12 per cent fixed to floating non-cumulative callable preference shares.

On 19 January 2009, the Company issued US$1,250,000,000 7.875 per cent non-cumulative callable preference shares and €500,000,000 7.875 per cent non-cumulative callable preference shares.

ACQUISITION

On 16 January 2009, the Group acquired 100 per cent of the ordinary share capital of HBOS plc, which together with its subsidiaries undertakes banking, insurance and other financial services related activities. Under the terms of the acquisition, HBOS shareholders received 0.605 Lloyds Banking Group shares for every 1 HBOS share.

The total fair value of the purchase consideration was £7,751 million, comprising 7,775,694,993 Lloyds Banking Group ordinary shares with a fair value of £7,651 million based on the closing price of 98.4p per ordinary share on 15 January 2009, the trading day immediately prior to completion, and directly attributable transaction costs of approximately £100 million.

Because of the limited time available between the acquisition and the approval of these financial statements, the Group is still in the process of establishing the fair value of the assets and liabilities acquired. The audited net assets of HBOS at 31 December 2008 as shown in the accounts were £13,499 million.

CAPITALISATION ISSUE

On 19 November 2008, the Company's shareholders approved, subject to certain conditions, a resolution authorising the board to capitalise an amount out of the Company's reserves and to apply such amount in paying up new Company shares. On 26 February 2009, the board approved a capitalisation issue of one for forty ordinary shares held.

NAME CHANGE

On 19 November 2008, the Company's shareholders approved, subject to certain conditions, a resolution changing the name of the Company to Lloyds Banking Group plc. These conditions were met and the Company changed its name on 16 January 2009.

53 APPROVAL OF FINANCIAL STATEMENTS

The consolidated financial statements were approved by the directors of Lloyds Banking Group plc on 26 February 2009.

REPORT OF THE INDEPENDENT AUDITORS ON THE PARENT COMPANY FINANCIAL STATEMENTS

TO THE MEMBERS OF LLOYDS BANKING GROUP PLC

We have audited the parent company financial statements of Lloyds Banking Group plc for the year ended 31 December 2008 which comprise the parent company balance sheet, the parent company statement of changes in equity, the parent company cash flow statement and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report on pages 74 to 95 that is described as having been audited.

We have reported separately on the consolidated financial statements of Lloyds Banking Group plc for the year ended 31 December 2008.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the parent company financial statements in accordance with applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union are set out in the statement of directors' responsibilities on page 73.

Our responsibility is to audit the parent company financial statements and the part of the directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the parent company financial statements. The information given in the directors' report includes that specific information presented in the Overview and the Business Review that is cross referred from the principal activities, business review, future developments and financial risk management objectives and policies section of the directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the chairman's statement, the group chief executive's review, the Business Review, the directors' report, the corporate governance disclosures, the unaudited part of the directors' remuneration report, the shareholder information and all other information listed on the contents page . We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements and the part of the directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements and the part of the directors' remuneration report to be audited.

OPINION

In our opinion:

– the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2008 and cash flows for the year then ended;
– the parent company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
– the information given in the directors' report is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
26 February 2009

PARENT COMPANY BALANCE SHEET

at 31 December 2008

	Note	2008 £ million	2007 £ million
Assets			
Non-current assets:			
Investment in subsidiaries	8	**5,589**	5,589
Loans to subsidiaries	8	**3,009**	2,820
Deferred tax assets	2	**–**	2
		8,598	8,411
Current assets:			
Derivative financial instruments		**1,297**	169
Other assets		**205**	165
Amounts due from subsidiaries	3	**216**	92
Cash and cash equivalents		**1,201**	58
		2,919	484
Total assets		**11,517**	8,895
Equity and liabilities			
Capital and reserves:			
Share capital	4	**1,513**	1,432
Share premium account	4	**2,096**	1,298
Retained profits	5	**2,147**	1,935
Total equity		**5,756**	4,665
Non-current liabilities:			
Subordinated liabilities	6	**2,875**	2,345
Debt securities in issue	7	**–**	50
		2,875	2,395
Debt securities in issue	7	**2,644**	1,694
Current tax liabilities		**116**	28
Derivative financial instruments		**–**	29
Other liabilities		**126**	84
		2,886	1,835
Total liabilities		**5,761**	4,230
Total equity and liabilities		**11,517**	8,895

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

The directors approved the parent company financial statements on 26 February 2009.

Sir Victor Blank
Chairman

J Eric Daniels
Group Chief Executive

Tim J W Tookey
Group Finance Director

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

	Share capital and premium £ million	Retained profits £ million	Total £ million
Balance at 1 January 2007	2,695	2,026	4,721
Profit for the year*	–	1,855	1,855
Dividends	–	(1,957)	(1,957)
Purchase/sale of treasury shares	–	(19)	(19)
Employee share option schemes:			
Value of employee services	–	30	30
Proceeds from shares issued	35	–	35
Balance at 31 December 2007	2,730	1,935	4,665
Profit for the year*	**–**	**2,256**	**2,256**
Dividends	**–**	**(2,042)**	**(2,042)**
Shares issued via private placement	**760**	**–**	**760**
Purchase/sale of treasury shares	**–**	**(14)**	**(14)**
Employee share option schemes:			
Value of employee services	**–**	**12**	**12**
Proceeds from shares issued	**119**	**–**	**119**
Balance at 31 December 2008	**3,609**	**2,147**	**5,756**

*No income statement has been shown for the parent company, as permitted by section 230 of the Companies Act 1985.

PARENT COMPANY CASH FLOW STATEMENT

for the year ended 31 December 2008

	2008 £ million	2007 £ million
Profit before tax	2,269	1,870
Dividend income	(2,294)	(1,957)
Fair value and exchange adjustments	(68)	10
Change in other assets	(166)	103
Change in other liabilities	42	(128)
Tax received (paid)	77	(32)
Net cash used in operating activities	**(140)**	**(134)**
Cash flows from investing activities		
Capital lending to subsidiaries	–	(1,111)
Cash flows from financing activities		
Dividends received from subsidiaries	2,294	1,957
Dividends paid to equity shareholders	(2,042)	(1,957)
Proceeds from issue of debt securities	1,896	1,770
Repayment of debt securities in issue	(1,744)	–
Proceeds from issue of ordinary shares via private placement	760	–
Proceeds from issue of other ordinary shares	119	35
Repayment of amounts due to subsidiaries	–	(1,715)
Net cash generated by financing activities	**1,283**	**90**
Change in cash and cash equivalents	1,143	(1,155)
Cash and cash equivalents at beginning of year	58	1,213
Cash and cash equivalents at end of year	**1,201**	**58**

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

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

The parent company has applied International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2008. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements; the Company has not taken advantage of this relaxation, and therefore there is no difference in application to the Company between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of all derivative contracts.

The accounting policies of the parent company are the same as those of the Group which are set out in note 2 to the consolidated financial statements, except that it has no policy in respect of consolidation and investments in subsidiaries are carried at historical cost, less any provisions for impairment.

2 DEFERRED TAX ASSETS

The movement in the net deferred tax assets is as follows:

	2008 £m	2007 £m
At 1 January	2	–
Income statement (charge) credit	(2)	2
At 31 December	–	2

The deferred tax assets relate to temporary differences.

3 AMOUNTS DUE FROM SUBSIDIARIES

These comprise short-term lending to subsidiaries, repayable on demand. The fair values of amounts owed by subsidiaries are equal to their carrying amounts. No provisions have been recognised in respect of amounts owed by subsidiaries.

4 SHARE CAPITAL AND SHARE PREMIUM

Details of the Company's share capital and share premium account are as set out in notes 41 and 42 to the consolidated financial statements.

5 RETAINED PROFITS

	£m
At 1 January 2007	2,026
Profit for the year	1,855
Dividends	(1,957)
Purchase/sale of treasury shares	(19)
Employee share option schemes: value of employee services	30
At 31 December 2007	1,935
Profit for the year	2,256
Dividends	(2,042)
Purchase/sale of treasury shares	(14)
Employee share option schemes: value of employee services	12
At 31 December 2008	2,147

Details of the Company's dividends are as set out in note 45 to the consolidated financial statements.

6 SUBORDINATED LIABILITIES

	2008 £m	2007 £m
Preferred securities		
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)†	**584**	593
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$ 1,000 million)†	**824**	515
6% Non-Cumulative Redeemable Preference Shares	**–**	–
Undated subordinated liabilities		
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)*	**497**	497
Dated subordinated liabilities		
9 1/8% Subordinated Bonds 2011 (£150 million)	**149**	149
5 7/8% Subordinated Guaranteed Bonds 2014 (€750 million)	**821**	591
	970	740
Total subordinated liabilities	**2,875**	2,345

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer.

† Further information regarding the fixed/floating rate non-cumulative callable preference shares can be found in note 40 to the consolidated financial statements.

* In certain circumstances, these bonds would acquire the characteristics of preference share capital. Any repayments of undated loan capital would require the prior consent of the Financial Services Authority. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of certain preference shares. At the callable date the coupon on these bonds will be reset by reference to the applicable five year benchmark gilt rate.

7 DEBT SECURITIES IN ISSUE

These comprise the US$100 million Thirteen-Month Extendible Short-Term Notes issued by the Company in May 2007 and the US$3,750 million Thirteen-Month Extendible Short-Term Notes issued by the Company in July 2008.

8 RELATED PARTY TRANSACTIONS

KEY MANAGEMENT PERSONNEL

The key management personnel of the Group and parent company are the same. The relevant disclosures are given in note 47 to the consolidated financial statements.

The Company has no employees (2007: nil).

As discussed in note 46 to the consolidated financial statements, the Group provides share based compensation to employees through a number of schemes; these are all in relation to shares in the Company and the cost of providing those benefits is recharged to the employing companies in the Group on a cash basis.

INVESTMENT IN SUBSIDIARIES

The Company's investment in subsidiaries is carried at cost: there has been no movement in the carrying value during the year and there has been no impairment of the Company's investment in subsidiaries.

NOTES TO THE PARENT COMPANY FINANCIAL STATEMENTS continued

8 RELATED PARTY TRANSACTIONS continued

The principal subsidiaries, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds Banking Group plc, are:

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds TSB Bank plc	England	100%	Banking and financial services
Lloyds TSB Commercial Finance Limited	England	100%†	Credit factoring
Lloyds TSB Leasing Limited	England	100%†	Financial leasing
Lloyds TSB Private Banking Limited	England	100%†	Private banking
The Agricultural Mortgage Corporation PLC	England	100%†	Long-term agricultural finance
Lloyds TSB Offshore Limited	Jersey	100%†	Banking and financial services
Lloyds TSB Scotland plc	Scotland	100%†	Banking and financial services
Lloyds TSB General Insurance Limited	England	100%†	General insurance
Scottish Widows Investment Partnership Group Limited	England	100%†	Investment management
Lloyds TSB Insurance Services Limited	England	100%†	Insurance broking
Lloyds TSB Asset Finance Division Limited	England	100%†	Consumer credit, leasing and related services
Black Horse Limited	England	100%†	Consumer credit, leasing and related services
Scottish Widows plc	Scotland	100%†	Life assurance
Scottish Widows Annuities Limited	Scotland	100%†	Life assurance

† Indirect interest.

The principal area of operation for each of the above subsidiaries is the United Kingdom and the Channel Islands, except as follows:

Lloyds TSB Bank plc operates principally in the UK but also through branches in Belgium, Dubai, Ecuador, France, Germany, Gibraltar, Hong Kong, Japan, Jersey, Luxembourg, Malaysia, Monaco, Netherlands, Singapore, Spain, Switzerland, Uruguay and the USA, and representative offices in China, Colombia, Guatemala and Paraguay.

None of the parent company's subsidiaries has experienced any significant restrictions in paying dividends or repaying loans and advances. All regulated banking and insurance subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make distributions.

Loans to subsidiaries:

	2008 £m	2007 £m
At 1 January	**2,820**	1,723
Exchange and other adjustments	**189**	(14)
Amounts advanced	**–**	1,111
At 31 December	**3,009**	2,820

In addition the parent company carried out all of its banking activities through its subsidiary, Lloyds TSB Bank plc (the Bank). At 31 December 2008, the parent company held deposits of £1,201 million with the Bank (2007: £58 million). Given the volume of transactions flowing through the account, it is not meaningful to provide gross inflow and outflow information. In addition, at 31 December 2008 the parent company had interest rate and currency swaps with the Bank with an aggregate notional principal amount of £4,567 million and a net positive fair value of £1,297 million (2007: notional principal amount of £4,032 million and a net positive fair value of £140 million), of which contracts with an aggregate notional principal amount of £1,870 million and a net positive fair value of £501 million (2007: notional principal amount of £4,032 million and a net positive fair value of £140 million) were designated as fair value hedges to manage the Company's issuance of subordinated liabilities and debt securities in issue.

Related party information in respect of other related party transactions is given in note 47 to the consolidated financial statements.

9 FINANCIAL INSTRUMENTS

MEASUREMENT BASIS OF FINANCIAL ASSETS AND LIABILITIES

The accounting policies in note 2 to the consolidated financial statements describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	**Held for trading at fair value through profit or loss £m**	**Loans and receivables £m**	**Held at amortised cost £m**	**Total £m**
As at 31 December 2008					
Financial assets:					
Cash and cash equivalents	**–**	**–**	**–**	**1,201**	**1,201**
Derivative financial instruments	**501**	**796**	**–**	**–**	**1,297**
Loans to subsidiaries	**–**	**–**	**3,009**	**–**	**3,009**
Amounts due from subsidiaries	**–**	**–**	**216**	**–**	**216**
Total financial assets	**501**	**796**	**3,225**	**1,201**	**5,723**
Financial liabilities:					
Debt securities in issue	**–**	**–**	**–**	**2,644**	**2,644**
Subordinated liabilities	**–**	**–**	**–**	**2,875**	**2,875**
Total financial liabilities	**–**	**–**	**–**	**5,519**	**5,519**

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Held for trading at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2007					
Financial assets:					
Cash and cash equivalents	–	–	–	58	58
Derivative financial instruments	169	–	–	–	169
Loans to subsidiaries	–	–	2,820	–	2,820
Amounts due from subsidiaries	–	–	92	–	92
Total financial assets	169	–	2,912	58	3,139
Financial liabilities:					
Derivative financial instruments	29	–	–	–	29
Debt securities in issue	–	–	–	1,744	1,744
Subordinated liabilities	–	–	–	2,345	2,345
Total financial liabilities	29	–	–	4,089	4,118

INTEREST RATE RISK AND CURRENCY RISK

The Company is exposed to interest rate risk and currency risk on its debt securities in issue and its subordinated debt.

As discussed in note 8, the Company has entered into interest rate and currency swaps with its subsidiary, Lloyds TSB Bank plc, to manage these risks.

CREDIT RISK

The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiary, Lloyds TSB Bank plc, and subsidiaries of that company.

9 FINANCIAL INSTRUMENTS continued

LIQUIDITY RISK

The table below analyses financial instrument liabilities of the Company, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date, balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2008						
Debt securities in issue	**75**	**12**	**2,601**	**–**	**–**	**2,688**
Subordinated liabilities	**14**	**28**	**125**	**789**	**2,529**	**3,485**
Total	**89**	**40**	**2,726**	**789**	**2,529**	**6,173**
As at 31 December 2007						
Derivative financial instruments	10	20	1,791	–	–	1,821
Debt securities in issue	8	15	1,740	50	–	1,813
Subordinated liabilities	11	21	97	516	3,195	3,840
Total	29	56	3,628	566	3,195	7,474

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £111 million (2007: £97 million) per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The valuation techniques for the Company's financial instruments are as discussed in note 49 to the consolidated financial statements.

	Carrying value 2008 £m	Carrying value 2007 £m	Fair value 2008 £m	Fair value 2007 £m
Financial assets:				
Cash and cash equivalents	**1,201**	58	**1,201**	58
Derivative financial instruments	**1,297**	169	**1,297**	169
Loans to subsidiaries	**3,009**	2,820	**2,139**	2,856
Amounts due from subsidiaries	**216**	92	**216**	92
Financial liabilities:				
Derivative financial instruments	**–**	29	**–**	29
Debt securities in issue	**2,644**	1,744	**2,644**	1,744
Subordinated liabilities	**2,875**	2,345	**1,563**	2,134

10 POST BALANCE SHEET EVENTS

Details of the Company's post balance sheet events are set out in note 52 to the consolidated financial statements.

11 APPROVAL OF THE FINANCIAL STATEMENTS AND OTHER INFORMATION

The parent company financial statements were approved by the directors of Lloyds Banking Group plc on 26 February 2009.

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 Henry Duncan House, 120 George Street, Edinburgh EH2 4LH, Scotland, and its principal executive offices in the UK are located at 25 Gresham Street, London EC2V 7HN.

SHAREHOLDER INFORMATION

ANALYSIS OF SHAREHOLDERS

at 31 December 2008	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 99	61,777	7.50	2.2	0.04
100 – 499	317,901	38.60	105.3	1.76
500 – 999	232,719	28.25	155.0	2.59
1,000 – 4,999	169,621	20.59	322.8	5.40
5,000 – 9,999	24,486	2.97	165.3	2.77
10,000 – 49,999	15,053	1.83	267.6	4.48
50,000 – 99,999	735	0.09	48.8	0.82
100,000 – 999,999	887	0.11	305.0	5.11
1,000,000 and over	493	0.06	4,600.9	77.03
	823,672	100.00	5,972.9	100.00

SUBSTANTIAL SHAREHOLDINGS

At the date of this report, notifications had been received that:
– AXA Investment Managers Limited had a direct interest of 0.79 per cent and an indirect interest of 2.7 per cent;
– Barclays PLC had an interest of 3.84 per cent;
– The Capital Group Companies, Inc had an interest of 4.86 per cent; and
– The Solicitor for the Affairs of Her Majesty's Treasury had a direct interest of 43.38 per cent

in the issued share capital with rights to vote in all circumstances at general meetings. No other notification has been received that anyone has an interest of 3 per cent or more in the issued ordinary share capital.

SHARE PRICE INFORMATION

In addition to listings in the financial pages of the press, the latest price of Lloyds Banking Group shares on the London Stock Exchange can be obtained by telephoning 09058 890 190.
Visit www.londonstockexchange.com for details.

SHARE DEALING FACILITIES

A full range of dealing services is available as follows:

– Internet dealing. Log on to www.lloydstsbsharedealing.com
– Telephone dealing. Call 0845 606 0560
– Internet and telephone dealing services are available between 8.00am and 4.30pm, Monday to Friday.

Details of any dealing costs are available when you log on to the share dealing website or when you call the above number.

AMERICAN DEPOSITARY RECEIPTS (ADRs)

Lloyds Banking Group shares are traded in the USA through an NYSE-listed sponsored ADR facility, with The Bank of New York Mellon as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4.

For details contact: The Bank of New York Mellon Shareowner Services, PO Box 358516, Pittsburgh, Pennsylvania 15252-8516.
Telephone: 877-353-1154 (US toll free), international callers: +1 201-680-6825. Alternatively visit www.bnymellon.com or email shrrelations@bnymellon.com

INDIVIDUAL SAVINGS ACCOUNTS (ISAs)

The Company provides a facility for investing in Lloyds Banking Group shares through an ISA. For details contact: Retail Investor Operations, Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2244.

CORPORATE RESPONSIBILITY

A copy of the Group's corporate responsibility report may be obtained by writing to Corporate Responsibility, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN. This information together with the Group's code of business conduct is also available on the Group's website www.lloydsbankinggroup.com

THE BETTER PAYMENT PRACTICE CODE

A copy of the code and information about it may be obtained from the BERR Publications Orderline 0845 015 0010, quoting ref URN 04/606. Alternatively, visit www.payontime.co.uk for details.

SHAREHOLDER ENQUIRIES

The Company's share register is maintained by Equiniti Limited. Contact them if you have enquiries about your Lloyds Banking Group shareholding, including those concerning the following matters:

– change of name or address
– loss of share certificate
– dividend information, including loss of dividend warrant or tax voucher.

Contact details for Equiniti Limited can be found on page 195.

Equiniti operates a web based enquiry and portfolio management service for you to receive shareholder communications electronically. In addition, you can change your address or bank details and register proxy appointments and voting instructions on your shareholding online. Visit www.shareview.co.uk for details.

Computershare Investor Services continue to maintain the register of Lloyds Banking Group shareholder account holders (formerly the HBOS shareholder account). If you have any queries please either write to Computershare Investor Services PLC, PO Box 1910, Bristol BS99 7DS or call 0870 702 0102 or visit www.computershare.com

Daytime calls Monday to Friday from BT landlines to 0870 numbers will cost no more than 6p a minute plus an 8p connection fee. Calls to 09058, 0871 and 0845 numbers are charged at 55p, 8p and 5p per minute, respectively, from a BT landline. The price of calls from mobiles and other networks may vary. The call prices we have quoted were correct in February 2009.

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FINANCIAL CALENDAR 2009

27 February	Results for 2008 announced
8 May	Record date for the capitalisation issue
11 May	Ex-date for the capitalisation issue and shares admitted to trading. CREST accounts credited
22 May	Latest date for the despatch of share certificates and Lloyds Banking Group shareholder account statements in respect of the capitalisation issue
5 August	Results for the half-year to 30 June 2009 announced

HEAD OFFICE

25 Gresham Street
London EC2V 7HN
Telephone +44 (0)20 7626 1500

REGISTERED OFFICE

Henry Duncan House
120 George Street
Edinburgh EH2 4LH
Registered in Scotland no 95000

INTERNET

www.lloydsbankinggroup.com

REGISTRAR

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA
Telephone 0871 384 2990
Textphone 0871 384 2255
Overseas +44 (0)121 415 7066
www.equiniti.com

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