Bank of Scotland plc

Annual Report and Accounts 2023

Member of Lloyds Banking Group

Contents

Strategic report

Principal activities
Bank of Scotland plc (the Bank) and its subsidiaries (together, the Group) provide a wide range of banking and financial services.

The Group's revenue is earned through interest and fees on a broad range of financial services products including current and savings accounts, personal loans, credit cards and mortgages within the retail market and loans and other products to commercial and corporate customers.

Business review
Income statement
The Group made a profit before tax for the year of £351 million, compared to £1,137 million in 2022, primarily as a result of lower net interest income which was partially offset by an impairment credit. The profit for the year was £335 million (2022: £1,066 million).

Total income was £3,391 million, a decrease of 31 per cent on 2022. Net interest income was £2,871 million, compared to £4,547 million for 2022. Higher funding costs on intra-group borrowing more than offset the benefits from UK Bank Rate increases.

Other income of £520 million was 35 per cent higher than 2022, driven by increases in both net fee and commission income and other operating income. Net fee and commission income for the year was £362 million compared to £280 million in 2022, reflecting higher credit and debit card fees as a result of increased customer activity. Other operating income in 2023 of £191 million was up £138 million as a result of gains from liability management exercises and income from the securitisation of legacy mortgages.

Operating expenses of £3,359 million were 6 per cent higher than in 2022, due to higher amortisation given increased strategic investment and an increase in internal recharges due to the effects of inflation. The Group recognised remediation costs of £89 million (2022: £91 million). There have been no further charges relating to HBOS Reading and the provision held continues to reflect the Group's best estimate of its full liability, albeit uncertainties remain.

Impairment of £319 million was a credit compared to a charge of £632 million in 2022. The decrease reflects the impact of a significant write-back following the repayment of debt from a single name client, as well as an impairment credit from modest revisions to the Group's economic outlook compared to the deterioration in economic outlook captured last year. Asset quality remains strong with credit performance across portfolios relatively stable and remaining broadly at, or favourable to pre-pandemic experience.

The Group recognised a tax expense of £16 million in the year, compared to £71 million in 2022.

The Group's post-tax return on average total assets decreased to 0.10 per cent compared to 0.34 per cent in the year ended 31 December 2022.

Balance sheet
The Group's balance sheet has remained broadly stable compared to 31 December 2022. Total assets of £322,430 million were up £2,189 million compared to £320,241 million at 31 December 2022. Financial assets at amortised cost were £2,483 million higher at £311,145 million compared to £308,662 million at 31 December 2022 with increases in debt securities of £1,696 million and balances due from fellow Lloyds Banking Group undertakings of £725 million. The marginal increase in loans and advances to customers of £54 million consists of growth in mortgages offset by the securitisation of £2.5 billion of legacy mortgage loans during the year.

Total liabilities of £305,831 million were up £1,636 million compared to £304,195 million at 31 December 2022 driven by increases in balances due to fellow Lloyds Banking Group undertakings of £3,811 million and an increase in debt securities in issue at amortised cost of £2,487 million as a result of senior unsecured notes and securitisation notes issued during the year. There was a reduction in customer deposits of £4,417 million in the year to £161,946 million. The reduction in the year included a decrease in current account balances from higher spend and a more competitive market, partly offset by growth in savings balances.

Total equity increased by £553 million to £16,599 million at 31 December 2023 from £16,046 million at 31 December 2022. The movement reflected attributable profit for the year and issuance of other equity instruments.

Capital
The Bank's common equity tier 1 (CET1) capital ratio reduced from 15.4 per cent at 31 December 2022 to 14.9 per cent at 31 December 2023. Profit for the year, including dividends received from subsidiaries, was more than offset by an increase in risk-weighted assets and a reduction in IFRS 9 transitional relief following the end of static relief and phased unwind of dynamic relief. The total capital ratio reduced from 21.0 per cent at 31 December 2022 to 20.4 per cent at 31 December 2023, reflecting the increase in risk-weighted assets, partially offset by the increase in CET1 capital and the issuance of a new AT1 capital instrument.

Risk-weighted assets increased by £7,170 million to £80,254 million at 31 December 2023 compared to £73,084 million at 31 December 2022. This includes the impact of Retail secured CRD IV model updates of £5 billion. Excluding this, lending, a modest uplift from credit and model calibrations, and increases in market risk and securitisation risk-weighted assets, the latter reflecting the increase in debt securities held, were partly offset by a reduction in operational risk and other movements.

The Bank's UK leverage ratio increased from 4.5 per cent at 31 December 2022 to 4.8 per cent at 31 December 2023, reflecting the increase in the total tier 1 capital position. This was partially offset by the increase in the leverage exposure measure following the increase in lending and debt securities held, net of a reduction in off-balance sheet items.

Capital position at 31 December 2023

The capital position of Bank of Scotland plc is presented on an unconsolidated basis. The Bank's capital position as at 31 December 2023 is set out below.

Capital resources of the Bank (audited)

	At 31 Dec 2023 £m	At 31 Dec 2022 £m
Common equity tier 1		
Shareholders' equity per balance sheet	**14,485**	13,704
Cash flow hedging reserve	**76**	65
Other adjustments[1]	**(1)**	133
	14,560	13,902
Less: deductions from common equity tier 1		
Goodwill and other intangible assets	**(703)**	(672)
Prudent valuation adjustment	**(45)**	(53)
Removal of defined benefit pension surplus	**(36)**	(33)
Significant investments	**–**	(54)
Deferred tax assets	**(1,810)**	(1,806)
Common equity tier 1 capital	**11,966**	11,284
Additional tier 1		
Additional tier 1 instruments	**2,550**	2,200
Total tier 1 capital	**14,516**	13,484
Tier 2		
Tier 2 instruments	**1,500**	1,500
Eligible provisions and other adjustments	**394**	346
Total tier 2 capital	**1,894**	1,846
Total capital resources	**16,410**	15,330
Risk-weighted assets of the Bank (unaudited)	**80,254**	73,084
Capital and leverage ratios of the Bank (unaudited)		
Common equity tier 1 capital ratio	**14.9%**	15.4%
Tier 1 capital ratio	**18.1%**	18.5%
Total capital ratio	**20.4%**	21.0%
UK leverage ratio	**4.8%**	4.5%

1 31 December 2022 includes an adjustment applied to reserves to reflect the application of the IFRS 9 transitional arrangements for capital. As at 31 December 2023, no relief existed under the IFRS 9 transitional arrangements and therefore no adjustment was applied to reserves.

Risk-weighted assets of the Bank (unaudited)

	At 31 Dec 2023 £m	At 31 Dec 2022 £m
Foundation Internal Ratings Based (IRB) Approach	**2,492**	2,605
Retail IRB Approach	**61,956**	53,771
Other IRB Approach[1]	**3,917**	3,863
IRB Approach	**68,365**	60,239
Standardised (STA) Approach[1]	**3,457**	4,307
Credit risk	**71,821**	64,546
Securitisation	**931**	463
Counterparty credit risk	**162**	191
Credit valuation adjustment risk	**72**	77
Operational risk	**6,799**	7,751
Market risk	**468**	56
Total risk-weighted assets	**80,254**	73,084
of which: threshold risk-weighted assets[2]	**3,205**	3,190

1 Threshold risk-weighted assets are included within Other IRB Approach and Standardised (STA) Approach.
2 Threshold risk-weighted assets reflect the element of significant investments and deferred tax assets that are permitted to be risk-weighted instead of being deducted from CET1 capital.

Future developments
Information about future developments is provided within the principal risks and uncertainties section below.

Section 172(1) Statement
This section (**pages 3 to 5**) is our Section 172(1) statement for the purposes of the Companies Act 2006 (the Act), describing how the directors have had regard to the matters set out in section 172(1) (a) to (f) of the Act when performing their duty to promote the success of the Bank under section 172. Further detail on key stakeholder interaction is also contained within the directors' report on **pages 8 to 12**.

The directors remain mindful in all their deliberations of the long-term consequences of their decisions, as well as the importance of maintaining a reputation for high standards of business conduct and the Board engaging with, and taking account of the views of, key stakeholders.

Key Stakeholder Engagement
The non-executive directors undertook tailored engagement via the Closer to Customers, Clients and Colleagues Programme allowing them to hear directly from key stakeholders, including customers and clients.

The programme was designed to help the directors better understand the important issues for our customers and clients, the role the Bank plays in supporting them and how the Bank is performing in that regard, helping to inform the directors' decision making.

A number of activities took place under the programme, which included meetings with customers and clients. The non-executive directors continue to find these sessions beneficial, providing valuable insight which helps in their consideration of the proposals reviewed by the Board during the year.

Further engagement by the Board with its stakeholders is described below, and examples of decision making by the Board which had particular stakeholder relevance can be found on **pages 4 to 5**.

Our Stakeholders
Customers and clients
The Bank's customer centric approach means the Board has an ongoing commitment to understanding and addressing customer and client needs, which remains central to achieving strategic ambitions.

Relevant engagement included:
- Non-executive directors attended events to provide deeper insight into the issues which customers and clients have faced during the year. These events included sessions on, amongst others, the challenges of running a small business, the issues faced by vulnerable customers, the pressures for customers dealing with financial difficulties, and the challenges of managing finances in retirement
- The Board also took the opportunity to meet with clients when visiting Group sites in Glasgow, Chester and Bristol
- Dedicated updates to the Board from across the organisation, which identified areas of customer and client concern and covered a range of internal and external performance measures; in addition, concerns relevant to customers and clients were identified for consideration in wider proposals put to the Board
- Regular updates to the Board giving insight into performance in delivering on customer and client related objectives and commitments, which assisted in determining where further action was required to meet these objectives
- The Chair and the Group Chief Executive attended customer and client engagement events across various regions of the UK, providing an important opportunity for customers and clients to raise their concerns directly with these Board members

Shareholders
The Bank is a wholly owned subsidiary within the Lloyds Banking Group group of companies. The directors ensure that the strategy, priorities, processes and practices of the Bank are fully aligned where required to those of Lloyds Banking Group, ensuring that the interests of Lloyds Banking Group plc as the Bank's ultimate sole shareholder are duly acknowledged. Further information in respect of the relationship of Lloyds Banking Group plc with its shareholders is included within the strategic report within the Lloyds Banking Group plc Annual Report and Accounts for 2023, available on the Lloyds Banking Group website.

Communities and environment
The Board places great importance on engagement and action to help the communities in which the Bank operates prosper, while helping to build a more sustainable and inclusive future.

Relevant engagement included:
- Updates on climate, environmental and social matters, covering all aspects of the Bank's business, where the Board reviewed progress made against its stated ambitions in these areas and agreed any further action it considered was required
- The Board continues to be supported in environmental matters by its Responsible Business Committee. The Committee considers stakeholder views on all matters relating to ambition to be a trusted, sustainable, inclusive and responsible business

Regulators and government
The Board continues to maintain strong and open relationships with the Bank's regulators and with government authorities, including key stakeholders such as the Financial Conduct Authority (FCA) the Prudential Regulation Authority (PRA), HM Treasury and HMRC.

Relevant engagement included:
- The Chair and individual directors, including Chairs of the Board's Committees, held continuing discussions with the FCA and PRA on a number of aspects relevant to the evolving regulatory agenda
- The Board reviewed updates on wider regulatory interaction, providing a view of key areas of focus and also progress made in addressing key regulatory priorities
- A meeting was held between the Board and the PRA in July to discuss the outcomes and progress of action relevant to the PRA's Periodic Summary Meeting letter
- The Chair and individual directors had a number of Continuous Assessment meetings with the PRA to discuss the Board's oversight of the Group, key risks and strategic priorities

Suppliers
The Bank has a number of partners it relies on for important aspects of our operations and customer service provision and the Board recognises the importance of these supplier relationships in achieving the Bank's wider ambitions.

Relevant engagement included:
- The Board's Audit Committee considered reports from Sourcing and Finance teams on the efficiency of supplier payment practices, including those relating to the Bank's key suppliers, ensuring our approach continued to meet wider industry standards
- The Board continued to oversee resilience in the supply chain, ensuring our most important supplier relationships were not impacted by potential material events
- The Board considered matters relating to ensuring continuity in the Bank's customer related print communication, throughout turbulence within the supply chain in the second half of the year

Key Decisions
Effective stakeholder engagement is fundamental to good governance. Stakeholder engagement takes place at all levels within the Bank and is an important part of how we are delivering on our purpose of Helping Britain Prosper. The Board continues to engage both directly and indirectly with many of its stakeholders. This engagement helps to provide a better understanding of stakeholders' points of view, and the impact the Bank has on their day-to-day lives. Read more about the engagement of Board members with stakeholders on **pages 3 and 4**.

The Board requires stakeholder implications to be considered by senior management in all proposals submitted to the Board, both within the papers and as part of the accompanying presentations. Senior management routinely provides the Board with details of stakeholder interaction and feedback through their regular business updates and in their interactions both inside and outside of the board room. Managing stakeholder interests also forms a key part of the Board's delegation of the day-to-day management of the business to senior management.

Throughout 2023 the Board's key stakeholders remained the same as they were in 2022. The directors remain mindful in all their deliberations of the long-term consequences of their decisions, as well as the importance of the Bank maintaining a reputation for high standards of business conduct and the Board engaging with, and taking account of the views of, key stakeholders.

The three key Board decisions outlined in this section (Cost of Living, Consumer Duty and Environmental Sustainability) evidence how the Board is engaged in key decisions.

Cost of Living
Customers & Clients, Communities & Environment
The rising cost of living, including high levels of inflation and higher interest rates, was a key area of concern for many customers and clients during 2023. The Board continued to consider the impacts upon these stakeholders, including the impacts on mortgage customers and clients with lending facilities and the action being taken to provide them with the necessary support.

Support to customers and clients has been driven by our purpose of Helping Britain Prosper and has evolved as the Board and the Bank have sought to better understand the varying impacts of the rise in the cost of living. The support provided included the offer of interest free overdraft facilities in certain circumstances, facilitating specialist third party support, and forbearance options.

The Board was keen that particular support be provided to our mortgage, business and corporate clients. There has been a number of tailored means of assistance developed accordingly, with the understanding that the right support will help these customers become more financially resilient in the long-term, which is good for the business. This included Lloyds Banking Group's participation in the Government-led Mortgage Charter, a sector-wide initiative to support those struggling with mortgage repayments.

The Board will continue to monitor the challenges which the rising cost of living causes our stakeholders as we continue to work with our regulators and our peers to ensure the most appropriate support can be provided to customers and clients.

Consumer Duty

Customers & Clients, Shareholder, Regulators & Government

The Board and its Board Risk Committee supported the Bank in working towards the introduction in July 2023 of the FCA's new Consumer Duty requirements. In doing so, the Board acknowledged the strong alignment between the Bank's purpose, values and existing customer-centric approach and the regulator's ambition to assist customers in achieving their financial objectives, while preventing customer harm.

The Board received several updates during the year on progress with meeting the regulator's requirements. This included reviewing the regulator's feedback and the steps taken by senior management in fully embedding the approach and ensuring improved customer outcomes.

The Board was mindful of the scale of the programme of work and the resulting risks to delivery and considered the approach to potential actions to mitigate those risks. The Board was pleased with the successful delivery of the initial stages of the programme. The Board also considered the approach which would be taken as the programme moves into its second implementation period ending in July 2024 and also the approach which would be taken to ensure that focus remains strong in this area as it transitions into 'business as usual', which will be supported by the Bank's strong focus on purpose. The Board will continue to be updated on progress prior to July 2024.

Environmental Sustainability

Communities & Environment, Customers & Clients, Shareholder

Building a more sustainable future is a core part of our purpose driven strategy and how we are Helping Britain Prosper. It is a key source of opportunity for the Bank as well as risk management.

As such, the Board has considered the importance of Lloyds Banking Group's commitments to net zero, including both our emissions reduction targets and Lloyds Banking Group's role as a member of the Net Zero Banking Alliance. The Board received regular updates on the progress made in all areas related to sustainability ambitions and has provided valuable challenge as we work towards meeting our commitments. The Board is keenly aware of the importance of our own release ambitions as we support our customers and our clients through their transitions to net zero and the vital link this represents to delivering on Lloyds Banking Group's climate ambitions. The Board has therefore encouraged further action to fully embed climate considerations into all of the Bank's decision making, recognising the breadth of the action which needs to be taken and the importance of moving from target setting to action at scale. This recognises that there are many growth opportunities in helping our customers and clients transition to a net zero economy, while future-proofing our balance sheet.

The Board has encouraged clarity in the role that all areas of the Group will take as we transition to net zero. This has included ensuring cross-Group capabilities are fully utilised and emphasising the importance which bold decision making will play. In doing so the Board recognises the particularly important role which financial services organisations will take in supporting low carbon ambitions, including in key areas such as the housing and transport markets.

The Board is very aware of the challenges and risks to delivering on our commitments and has considered these throughout the course of the year.

Principal risks and uncertainties
The significant risks faced by the Group are detailed below.

The Group has remained committed to maintaining support for its customers despite challenges with the rising cost of living and economic uncertainties in the global and domestic markets.

Observed credit performance remains resilient, despite the continued economic uncertainty, with only modest evidence of deterioration to date. The Group's loans and advances continue to be well positioned and heightened monitoring is in place to identify signs of affordability stress.

As part of the Group's strategy, there will be continuing investments in technology and infrastructure. The Group's operational resilience risks remain a key area of focus, particularly relating to cyber risk and supply chain management.

The Group has overseen the embedding of its operational risk and control framework during 2023 and its oversight of management of financial crime risks and consumer fraud.

Climate risk remains a key priority for the Group, with positive progress in 2023 and a commitment to continued focus in 2024.

The Group's principal risks and uncertainties are reviewed and reported regularly to the Board of Lloyds Banking Group in alignment with Lloyds Banking Group's enterprise risk management framework.

Capital risk
Capital risk is defined as the risk that an insufficient quantity or quality of capital is held to meet regulatory requirements or to support business strategy, an inefficient level of capital is held or that capital is inefficiently deployed across Lloyds Banking Group.

Change and execution risk
Change and execution risk is defined as the risk that, in delivering its change agenda, the Group fails to ensure compliance with laws and regulation, maintain effective customer service and availability, and/or operate within Lloyds Banking Group's risk appetite.

Climate risk
The Group defines climate risk as the risk that the Group experiences losses and/or reputational damage, either from the impacts of climate change and the transition to net zero (inbound) or as a result of the Group's response to tackling climate change (outbound)

Conduct risk
Conduct risk is defined as the risk of customer detriment across the customer lifecycle including: failures in product management, distribution and servicing activities; from other risks materialising, or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure, reputational damage or financial loss.

Credit risk
Credit risk is defined as the risk that parties with whom the Group has contracted fail to meet their financial obligations (both on and off-balance sheet).

Data risk
Data risk is defined as the risk of the Group failing to effectively govern, manage and protect its data throughout its lifecycle, including data processed by third parties, or failure to drive value from data; leading to unethical decision making, poor customer outcomes, loss of value to the Group and mistrust.

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

Market risk
Market risk is defined as the risk that the Group's capital or earnings profile is adversely affected by changes in market rates or prices, in particular interest rates and credit spreads.

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

Operational risk
Operational risk is defined as the risk of loss from inadequate or failed internal processes, people and systems, or from external events.

Operational resilience risk
Operational resilience risk is defined as the risk that the Group fails to design resilience into business operations including those that are outsourced, underlying infrastructure and controls (people, property, process, technology) so that it is able to withstand external or internal events which could impact the continuation of operations, and fails to respond in a way which meets customer and stakeholder expectations and needs when the continuity of operations is compromised.

People risk
People risk is defined as the risk that the Group fails to provide an appropriate colleague and customer-centric culture, supported by robust reward and wellbeing policies and processes; effective leadership to manage colleague resources; effective talent and succession management; and robust control to ensure all colleague-related requirements are met.

Regulatory and legal risk
Regulatory and legal risk is defined as the risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.

Strategic risk
Strategic risk is defined as the risk which results from: incorrect assumptions about internal or external operating environments, failure to understand the potential impact of strategic responses and business plans on existing risk types and failure to respond or the inappropriate strategic response to material changes in the external or internal operating environments.

Financial risk management objectives and policies

Information regarding the financial risk management objectives and policies of the Group, in relation to the use of financial instruments, is given in notes 13, 14 and 36 to the accounts. The Group's approach to risk management including risk policies, risk appetite, measurement bases and sensitivities, in particular for credit risk, market risk and liquidity risk, is aligned to those of Lloyds Banking Group plc, the Bank's ultimate parent. Further information can be found in the Lloyds Banking Group plc Annual Report and Accounts.

The Group maintains risk management systems and internal controls relating to the financial reporting processes designed to:

- ensure that accounting policies are appropriately and consistently applied;
- enable the calculation, preparation and reporting of financial outcomes in line with applicable standards; and
- ensure that disclosures are made on a timely basis in accordance with statutory and regulatory requirements.

The 2023 Strategic report has been approved by the Board of Directors.

On behalf of the Board

Robin Budenberg

Sir Robin Budenberg
Chair
Bank of Scotland plc
29 February 2024

Directors' report

Results
The consolidated income statement on **page 24** shows a statutory profit before tax for the year ended 31 December 2023 of £351 million (*year ended 31 December 2022: £1,137 million*).

Dividends
The Bank did not pay any interim dividends during the course of the year (2022: £nil). The directors have not recommended a final dividend for the year ended 31 December 2023 (2022: £nil).

Post balance sheet events
There were no material post balance sheet events.

Going concern
The going concern of the Bank 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 Bank and the Group have adequate resources to continue to operate for the foreseeable future, the directors have reviewed the Bank and the Group's operating plan and its funding and capital positions, including a consideration of the implications of climate change. The directors have also taken into account the impact of further stress scenarios.

Accordingly, the directors conclude that the Bank and the Group have adequate resources to continue in operational existence for a period of at least 12 months from the date of the approval of the financial statements and therefore it is appropriate to continue to adopt the going concern basis in preparing the accounts.

Corporate Governance Statement
In accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended by the Companies (Miscellaneous Reporting) Regulations 2018) (the Regulations), for the year ended 31 December 2023, the Bank has in its corporate governance arrangements applied the Wates Corporate Governance Principles for Large Private Companies (the Principles), which are available at **www.frc.org.uk**. The following section explains the Bank's approach to corporate governance, and its application of the Principles.

High standards of corporate governance are central to achieving the strategy which has been set for the Bank. To this end a Corporate Governance Framework is in place for Lloyds Banking Group plc, the Bank, Lloyds Bank plc and HBOS plc, with all four companies sharing a common approach to governance. The framework is designed to meet the specific needs of each company, setting the approach and standards in respect of the Bank's corporate governance practices, including addressing the matters set out in the Principles and the governance requirements of the operation of the Bank as part of Lloyds Banking Group's Ring-Fenced Bank.

This includes the matters reserved to the Board, and the matters the Board has chosen to delegate to management. Governance arrangements, including the Corporate Governance Framework, are reviewed at least annually to ensure they remain fit for purpose. The Board delegates further responsibilities to the Group Chief Executive, who is supported by the Group Executive Committee, the composition of which is detailed on **page 77** of the Lloyds Banking Group plc Annual Report and Accounts for 2023. The Corporate Governance Framework of the Bank further addresses the requirements of the Principles as discussed on **pages 8 to 9**.

Principle One – Purpose and Leadership
The Board is collectively responsible for the long term success of the Bank. It achieves this by agreeing the Bank's strategy, within the wider strategy of Lloyds Banking Group, and overseeing delivery against it. The Bank's strategy is discussed further in the Strategic Report. The Board also assumes responsibility for the management of the culture, values and wider standards of the Bank, within the equivalent standards set by Lloyds Banking Group. The Board's understanding of stakeholders' interests is central to these responsibilities and informs key aspects of Board decision making, as discussed within the statement on **pages 3 to 5**.

Acknowledging the needs of all stakeholders is fundamental to the way the Bank operates, as is maintaining the highest standards of business conduct, which is a vital part of the corporate culture. The Bank's approach is further influenced by our ambition to provide not only outstanding service to our customers, but also responding to the UK's social and economic issues. To this end, the Board plays a lead role in establishing, promoting, and monitoring the Bank's corporate culture and values, with the Corporate Governance Framework ensuring such matters receive the level of prominence in Board and Executive decision making which they require. The Bank's corporate culture and values align to those of Lloyds Banking Group, which are discussed in more detail within the Strategic and Directors' Reports of the Lloyds Banking Group plc Annual Report and Accounts for 2023.

Principle Two – Board Composition
The Bank is led by a Board comprising a non-executive Chair, independent non-executive directors and executive directors, further details of the directors can be found on **page 12**. The Board reviews its size and composition regularly and is committed to ensuring it has the right balance of skills and experience. The Board considers its current size and composition is appropriate to the Bank's circumstances. New appointments are made on merit, taking account of the specific skills and experience, independence and knowledge needed to ensure a rounded board and the diversity benefits each candidate can bring overall.

The Board is supported by its committees, the operation of which are discussed below, which make recommendations to the Board on matters delegated to them. Each committee has written terms of reference setting out its delegated responsibilities. Each committee comprises non-executive directors with appropriate skills and experience and is chaired by an experienced chair. The committee Chairs report to the Board at the next Board meeting. The Board undertakes an annual review of its effectiveness, which provides an opportunity to consider ways of identifying greater efficiencies, ways to maximise strengths and highlights areas of further development. An internally facilitated evaluation of the Board's effectiveness was undertaken during the course of the year, which concluded that the Board is continuing to operate effectively. Further information on conclusions of the evaluation can be found on **pages 90 to 91** of the Lloyds Banking Group plc Annual Report and Accounts for 2023.

Principle Three – Director Responsibilities
The directors assume ultimate responsibility for all matters, and along with senior management are committed to maintaining a robust control framework as the foundation for the delivery of good governance, including the effective management of delegation through the Corporate Governance Framework. Policies are also in place in relation to potential conflicts of interest which may arise. All directors have access to the services of the Company Secretary, and independent professional advice is available to the directors at the expense of Lloyds Banking Group, where they judge it necessary to discharge their duties as directors.

The Board is supported by its committees which make recommendations on matters delegated to them under the Corporate Governance Framework. The management of all committees is in keeping with the basis on which meetings of the Board are managed, with open debate, and adequate time for members to consider proposals which are put forward. The Chair of the Board and each Board committee assumes responsibility with support from the Company Secretary for the provision to each meeting of accurate and timely information.

Principle Four – Opportunity and Risk
The Board oversees the development and implementation of the Bank's strategy, within the context of the wider strategy of Lloyds Banking Group, which includes consideration of all strategic opportunities. The Board is also responsible for the long term sustainable success of the Bank, generating value for its shareholder and ensuring a positive contribution to society. The Board agrees the Bank's culture, purpose, values and strategy, within that of Lloyds Banking Group, and agrees the related standards of the Bank, again within the relevant standards of Lloyds Banking Group. Further specific aims and objectives of the Board are formalised within the Corporate Governance Framework, which also sets out the matters reserved for the Board.

Strong risk management is central to the strategy of the Bank, which along with a robust risk control framework acts as the foundation for the delivery of effective management of risk. The Board agrees the Bank's risk appetite and ensures the Bank manages risk effectively, delegating related authorities to individuals through the Corporate Governance Framework and the further management hierarchy. Board level engagement coupled with the direct involvement of senior management in risk issues ensures that escalated issues are promptly addressed, and remediation plans are initiated where required. The Bank's risk appetite, principles, policies, procedures, controls and reporting are managed in conjunction with those of Lloyds Banking Group, and as such are regularly reviewed to ensure they remain fully in line with regulations, law, corporate governance and industry best practice. The Bank's principal risks are discussed further on **page 6**.

Principle Five – Remuneration
The Remuneration Committee of the Board, in conjunction with the Remuneration Committee of Lloyds Banking Group (the Remuneration Committees), assume responsibility for the Bank's approach to remuneration. This includes reviewing and making recommendations on remuneration policy as relevant to the Bank, ranging from the remuneration of directors and members of the Executive to that of all other colleagues employed by the Bank. This includes colleagues where the regulators require the Bank to implement a specific approach to their remuneration, such as Senior Managers and other material risk takers. The activities of the Remuneration Committees extend to matters of remuneration relevant to subsidiaries of the Bank, where such subsidiary does not have its own remuneration committee.

Principle Six – Stakeholders
The Bank as part of Lloyds Banking Group operates under Lloyds Banking Group's wider approach to responsible business, which acknowledges that the Bank has a responsibility to help address the economic, social and environmental challenges which the UK faces, and as part of this understand the needs of the Bank's external stakeholders, including in the development and implementation of strategy.

Central to this is Lloyds Banking Group's and the Bank's purpose of Helping Britain Prosper. During the year the directors took a number of decisions with the Bank's purpose and specific stakeholder interest in mind, which are discussed further on **pages 3 to 5**.

In 2023 the Responsible Business Committee provided further oversight and support of Lloyds Banking Group's and the Bank's plans for embedding responsible business in the Bank's core purpose. The approach of the Board in respect of its key stakeholders is described further in a separate statement made in compliance with the Regulations on **pages 3 to 5**.

Directors
The names of the current directors are shown on **page 12**. There were no changes to the composition of the Board since 1 January 2023 up to the date of this report. Alan Dickinson and Lord Lupton have notified the Board that they do not intend to seek re-election at the 2024 annual general meeting of Lloyds Banking Group plc, and therefore will at this date retire as non-executive directors of the Bank. Nathan Bostock will be appointed as a non-executive director of the Bank with effect from 1 August 2024.

Directors' indemnities
The directors of the Bank have entered into individual deeds of indemnity with Lloyds Banking Group which constitute 'qualifying third party indemnity provisions' for the purposes of the Companies Act 2006. The deeds indemnify the directors to the maximum extent permitted by law and remain in force. The deeds were in force during the whole of the financial year. In addition, Lloyds Banking Group had appropriate Directors' and Officers' liability insurance cover in place throughout 2023. Deeds for existing directors are available for inspection at the Bank's registered office.

Lloyds Banking Group has also granted deeds of indemnity by deed poll and by way of entering into individual deeds, which constitute 'qualifying third party indemnity provisions' to the directors of the Group's subsidiary companies, including former directors who retired during the year, and to colleagues subject to the provisions of the Senior Managers and Certification Regime. Such deeds were in force during the financial year ended 31 December 2023 and remain in force as at the date of this report. Qualifying pension scheme indemnities have also been granted to the Trustees of Lloyds Banking Group's Pension Schemes, including those schemes relevant to the Bank, which were in force for the whole of the financial year and remain in force as at the date of this report.

Information required under DTR 7.2
Certain information is incorporated into this report by reference. Information about internal control and risk management systems relating to the financial reporting process can be found on **page 7**.

Information about share capital is shown in note 27 on **page 73**. The Bank is a wholly owned subsidiary of HBOS plc, which holds all of the Bank's issued ordinary share capital.

The directors manage the business of the Bank under the powers set out in the Companies Act 2006 and the Bank's articles of association, these powers include those in relation to the issue or buy back of the Bank's shares.

The appointment and retirement of directors is governed by the Bank's articles of association and the Companies Act 2006. The Bank's articles of association may only be amended by a special resolution of the shareholders in a general meeting.

Conflicts of interest
The Board has a comprehensive procedure for reviewing, and as permitted by the Companies Act 2006 and the Bank's articles of association, approving actual and potential conflicts of interest. Directors have a duty to notify the Chair and Company Secretary as soon as they become aware of actual or potential conflict situations. Changes to commitments of all directors are reported to the Board and a register of directors' interests is regularly reviewed and authorised by the Board to ensure the authorisation status remains appropriate.

Lord Lupton is a senior adviser to Greenhill Europe, an investment bank focused on providing financial advice on significant mergers, acquisitions, restructurings, financings and capital raising to corporations, partnerships, institutions and governments. The Board has authorised the potential conflicts and requires Lord Lupton to recuse himself from discussions, should the need arise.

Branches, future developments and financial risk management objectives and policies
The Bank provides a wide range of banking and financial services through branches and offices in the UK and overseas. Information regarding future developments and financial risk management objectives and policies of the Group in relation to the use of financial instruments that would otherwise be required to be disclosed in the directors' report, and which is incorporated into this report by reference, can be found in the strategic report.

Share capital
Information about share capital is shown in note 27 on **page 73**. This information is incorporated into this report by reference. The Bank did not repurchase any of its shares during 2023 (2022: none). There are no restrictions on the transfer of shares in the Bank 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.

Change of control
The Bank is not party to any significant agreements which take effect, alter or terminate upon a change of control of the Bank following a takeover bid. There are no agreements between the Bank and its directors or employees providing compensation for loss of office or employment that occurs because of a takeover bid.

Research and development activities
During the ordinary course of business the Bank develops new products and services within the business units.

Information incorporated by reference
The following additional information forms part of the directors' report, and is incorporated by reference.

Content		Pages
Disclosures required under the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008	*Statement of stakeholder engagement*	3 to 5

Significant contracts
Details of related party transactions are set out in note 31 on **pages 76 to 77**.

Streamlined Energy and Carbon Reporting
The Bank has taken advantage of the exemption from Streamlined Energy and Carbon Reporting (SECR) reporting requirements in its own directors' report as it is covered by the Lloyds Banking Group SECR report given in the Lloyds Banking Group plc 2023 Annual Report and Accounts, available at **www.lloydsbankinggroup.com/investors/financial-downloads.html**.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual 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 are required to prepare the Bank's and the Group's financial statements in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Bank and the Group, and of the profit or loss of the Bank and the Group for that period. In preparing these financial statements, the directors are required to properly select and apply accounting policies; present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; provide additional disclosures when compliance with the specific requirements in international accounting standards in conformity with the requirements of the Companies Act 2006 are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and make an assessment of the Bank's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Bank's transactions and disclose with reasonable accuracy at any time the financial position of the Bank and the Group, and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Bank and the Group, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. A copy of the financial statements is placed on the website **www.lloydsbankinggroup.com/investors/financial-downloads.html**. The directors are responsible for the maintenance and integrity of all information relating to the Bank on that website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the current directors who are in office as at the date of this report, and whose names and functions are listed on **page 12** of this annual report, confirm that, to the best of his or her knowledge:

- The Bank's and the Group's financial statements, which have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006 give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and the Group
- The management report contained in the strategic report and the directors' report includes a fair review of the development and performance of the business and the position of the Bank and the Group together with a description of the principal risks and uncertainties they face
- The Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for shareholders to assess the Bank's and the Group's position, performance, business model and strategy. The directors have also separately reviewed and approved the strategic report

Independent auditor and audit information

Each person who is a director at the date of approval of this report confirms that, so far as the director is aware, there is no relevant audit information of which the Bank's auditor is unaware and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Bank's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

On behalf of the Board

Kate Cheetham

Kate Cheetham
Company Secretary
29 February 2024

Bank of Scotland plc
Registered in Scotland
Company Number SC327000

Current directors

Executive directors:
Charlie Nunn Group *Chief Executive*
William Chalmers *Chief Financial Officer*

Non-executive directors:
Sir Robin Budenberg CBE *Chair*
Alan Dickinson *Deputy Chair*
Sarah Bentley
Brendan Gilligan
Nigel Hinshelwood *Senior Independent Director*
Sarah Legg
Lord Lupton CBE
Amanda Mackenzie LVO OBE
Harmeen Mehta
Cathy Turner
Scott Wheway
Catherine Woods

Forward looking statements

This document contains certain forward-looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Bank of Scotland plc together with its subsidiaries (the Group) and its current goals and expectations. Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward-looking statements. Words such as, without limitation, 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate', 'probability', 'goal', 'objective', 'deliver', 'endeavour', 'prospects', 'optimistic' and similar expressions or variations on these expressions are intended to identify forward-looking statements. These statements concern or may affect future matters, including but not limited to: projections or expectations of the Group's future financial position, including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; the Group's ESG targets and/or commitments; statements of plans, objectives or goals of the Group or its management and other statements that are not historical fact and statements of assumptions underlying such statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, targets, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward-looking statements include, but are not limited to: general economic and business conditions in the UK and internationally; acts of hostility or terrorism and responses to those acts, or other such events; geopolitical unpredictability; the war between Russia and Ukraine; the conflicts in the Middle East; the tensions between China and Taiwan; political instability including as a result of any UK general election; market related risks, trends and developments; changes in client and consumer behaviour and demand; exposure to counterparty risk; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Group's credit ratings; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; volatility in credit markets; volatility in the price of the Group's securities; tightening of monetary policy in jurisdictions in which the Group operates; natural pandemic and other disasters; risks concerning borrower and counterparty credit quality; longevity risks defined benefit pension schemes; changes in laws, regulations, practices and accounting standards or taxation; changes to regulatory capital or liquidity requirements and similar contingencies; the policies and actions of governmental or regulatory authorities or courts together with any resulting impact on the future structure of the Group; risks associated with the Group's compliance with a wide range of laws and regulations; assessment related to resolution planning requirements; risks related to regulatory actions which may be taken in the event of a bank or Group failure; exposure to legal, regulatory or competition proceedings, investigations or complaints; failure to comply with anti-money laundering, counter terrorist financing, anti-bribery and sanctions regulations; failure to prevent or detect any illegal or improper activities; operational risks including risks as a result of the failure of third party suppliers; conduct risk; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; technological failure; inadequate or failed internal or external processes or systems; risks relating to ESG matters, such as climate change (and achieving climate change ambitions) and decarbonisation, including the Group's ability along with the government and other stakeholders to measure, manage and mitigate the impacts of climate change effectively, and human rights issues; the impact of competitive conditions; failure to attract, retain and develop high calibre talent; the ability to achieve strategic objectives; the ability to derive cost savings and other benefits including, but without limitation, as a result of any acquisitions, disposals and other strategic transactions; inability to capture accurately the expected value from acquisitions; assumptions and estimates that form the basis of the Group's financial statements; and potential changes in dividend policy. A number of these influences and factors are beyond the control of the Group or any of the Group's immediate or ultimate parent entities (if applicable). Please refer to the latest Annual Report on Form 20-F filed by Lloyds Bank plc with the US Securities and Exchange Commission (the SEC), which is available on the SEC's website at www.sec.gov, for a discussion of certain factors and risks. Lloyds Banking Group plc may also make or disclose written and/or oral forward-looking statements in other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group plc to third parties, including financial analysts. Except as required by any applicable law or regulation, the forward-looking statements contained in this document are made as of today's date, and the Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document whether as a result of new information, future events or otherwise. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

Independent auditors' report to the members of the Bank of Scotland plc

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of Bank of Scotland plc (the 'Bank') and its subsidiaries (the 'Group' or 'BOS') give a true and fair view of the state of the Group's and of the Bank's affairs as at 31 December 2023 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB);
- the Bank financial statements have been properly prepared in accordance with United Kingdom adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise the:

Group	Bank
• Consolidated balance sheet as at 31 December 2023; • Consolidated income statement for the year then ended; • Consolidated statement of comprehensive income for the year then ended; • Consolidated statement of changes in equity for the year then ended; • Consolidated cash flow statement for the year then ended; and • Notes 1 to 38 to the financial statements, which include the accounting principles and policies.	• Balance sheet as at 31 December 2023; • Statement of changes in equity for the year then ended; • Cash flow statement for the year then ended; and • Notes 1 to 38 to the financial statements, which include the accounting principles and policies.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom adopted international accounting standards, and as regards the Bank financial statements, as applied in accordance with the provisions of the Companies Act 2006.

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditors' responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and the Bank for the year are disclosed in note 10 to the financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard to the Group or the Bank.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Expected credit losses ('ECL') (Group and Bank) • Regulatory and litigation matters (Group and Bank) • IT systems that impact financial reporting (Group and Bank) Our assessment of the level of risk for each of these areas have remained consistent with the prior year.
Materiality	Overall materiality used for the Group consolidated financial statements was £165 million, which was determined on the basis of net assets. Overall materiality used for the Bank financial statements was £165 million, which was determined on the basis of net assets and capped at Group materiality.
Scoping	Our audit scope covers 89 per cent of the Group's revenue, 91 per cent of the Group's profit before tax, 98 per cent of the Group's total assets and 97 per cent of the Group's total liabilities.

Our audit approach

We structured our approach to the audit to reflect how the Group is organised as well as ensuring it was both effective and risk focused. It can be summarised into the following key activities that we used to obtain sufficient audit evidence required to form our opinion on the Group and the Bank's financial statements:

- **Audit planning and risk assessment**

Our audit planning procedures considered the impact of internal and external factors affecting the Group's profitability and operations, key audit matters most relevant to the users of the financial statements, the appropriate scope of audit work performed as well as the expectations and requirements of the Group's investors and regulators.

In performing our audit risk assessments, we considered the impact of macroeconomic factors on the Group's key accounting judgements and sources of estimation uncertainty. The key factors considered in our risk assessments were:

- the impact of high interest rates, high inflation and cost of living pressures on the Group's ECL; and
- changes to the regulatory and litigation environment affecting the Group's financial reporting.

We obtained the knowledge and information required to inform our audit planning and risk assessment decision making through regular meetings with Group and divisional finance management and the extensive use of data and technology.

Independent auditors' report continued

- **Audit procedures undertaken at both Group and Bank level**

We performed audit procedures over the Group and Bank financial statements, including the consolidation of the Group's results, the preparation of the financial statements, regulatory and litigation matters as well as the Group's entity level and oversight controls relevant to financial reporting. The areas not covered by our audit scope are subject to analytical procedures to confirm our conclusion that there were no significant risks of material misstatement in the aggregated financial information;

- **Internal controls testing approach**

Our internal controls testing approach was informed by our scoping and risk assessment activities. We have assessed the Group's end-to-end financial reporting processes supporting all in-scope financial statement balances and identified relevant controls to test for these balances. This included the testing of general IT controls, process level controls and entity level controls at the Group level; and

- **The impact of climate change on our audit**

In planning our audit, we have considered the impact of climate change on the Group's operations and any subsequent impact on its financial statements. The Group sets out its assessment of the potential impact on **pages 6** of the Strategic report of the Annual Report.

In conjunction with our climate risk specialists, we have held discussions with the Group to understand their:
- process for identifying affected operations including the governance and controls over this process, and the subsequent effect on the financial reporting for the Group; and
- long-term strategy to respond to climate change risks and how this is factored into the Group's forecasts, considering publicly announced climate change commitments and any costs associated with the Group's net zero targets.

Our audit work has involved:
- evaluating climate as a factor in risk assessments for potentially affected balances;
- challenging the completeness of the physical and transition risks identified and considered in the Group's climate risk assessment and the conclusion that there continues to be no material impact of climate change risk on financial reporting;
- reviewing the Group's qualitative loan portfolio analysis, and challenging the key assumptions used by the Group with reference to our own understanding of the portfolios and publicly available documentation; and
- assessing disclosures in the Annual Report and challenging the consistency between the financial statements and the remainder of the Annual Report.

As part of our audit procedures we are required to read and consider these disclosures to consider whether they are materially inconsistent with the financial statements or knowledge obtained in the audit and we did not identify any material inconsistencies as a result of these procedures.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the Group's and the Bank's ability to continue to adopt the going concern basis of accounting included:

- using our knowledge of the Group and the Bank, the financial services industry, the financial services regulatory environment and the general economic environment including, macroeconomic pressures affecting the Group's operations to identify inherent risks in the business model and how such risks might affect the financial resources or ability to continue operations over the going concern period;
- evaluating the Group's strategic plans in light of the changing macroeconomic environment, short and longer term financial budgets, funding, liquidity and capital adequacy plans including internal stress tests;
- considering the Group's operational resilience;
- reading analyst reports, industry data, Bank of England reports and other external information to determine if it provided corroborative or contradictory evidence in relation to the Group's assumptions;
- reviewing correspondence and meeting with prudential and conduct regulators to assess whether there are any matters that may impact the going concern assessment; and
- evaluating the Group's disclosures on going concern against the requirements of IAS 1.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Group's and the Bank's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Expected credit losses (Group and Bank)	
Key audit matter description	**How the scope of our audit responded to the key audit matter**
Refer to notes 2, 11, 16, 17 and 36 in the financial statements	
The Group has recognised £2.4 billion of expected credit losses ('ECL') as at 31 December 2023. The determination of ECL consists of a number of assumptions that are inherently uncertain and require a high degree of complex and subjective auditor judgement, specialised skills and knowledge, and complex impairment modelling. Specifically, the impact of high interest rates and inflation, as well as the economic impact of the rising cost of living on the ECL have been particularly judgemental in the current economic environment. The key areas we identified as having the most significant level of management judgement were in respect of: • Multiple economic scenarios ('MES'); • Collectively assessed ECL; • Individually assessed ECL; and • ECL model adjustments.	
Multiple economic scenarios The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes. The Group's economics team develops the future economic scenarios. Firstly, a base case forecast is produced based on a set of conditioning assumptions, which are designed to reflect the Group's best view of future events. A full distribution of economic scenarios around this base case is produced using a Monte Carlo simulation and scenarios within that distribution are ranked using estimated relationships with industrywide historical loss data. In addition to the base case, three scenarios are derived from the distribution as averages of constituent modelled scenarios around the 15th, 75th and 95th percentiles of the distribution corresponding to an upside, a downside and a severe downside, respectively. The severe downside is then adjusted to incorporate non-modelled paths for inflation and interest rate assumptions. The upside, the base case and the downside scenarios are weighted at 30 per cent and the severe downside at 10 per cent. These four scenarios are then used as key assumptions in the determination of the ECL allowance. The development of these multiple economic scenarios is inherently uncertain, highly complex, and requires significant judgement. The principal consideration for our determination that the multiple economic scenarios is a key audit matter was the high degree of management judgement which required specialised auditor knowledge and a high degree of audit effort in areas such as evaluating the forward-looking information used by management, and the weighting applied.	We performed the following procedures: • Tested the controls over the generation of the multiple economic scenarios including those over the Group's governance processes to determine the base case, different scenarios and the weightings applied to each scenario; • Working with our internal economic specialists: – Challenged and evaluated economic forecasts in the base scenario such as the unemployment rate, House Price Index, inflation and forecasted interest rates, and Gross Domestic Product through comparison to independent economic outlooks, other external analyses and market data; – Challenged and evaluated the appropriateness of management's change in both the assumptions and the model; – Challenged and evaluated the appropriateness of the methodology applied to generate alternative macroeconomic scenarios, including associated weightings and assumptions within; – Independently replicated the multiple economic scenario model and compared the outputs of our independent model to the Group's output to test scenario generation; • Tested the completeness and accuracy of the data used by the model; • Performed a stand back assessment of the appropriateness of the weightings applied to each of the scenarios based on publicly available data; and • Evaluated the appropriateness of disclosures in respect of significant judgements and sources of estimation uncertainty including macroeconomic scenarios.

Key audit matter description	How the scope of our audit responded to the key audit matter
Collectively assessed ECL The ECL for the retail and commercial lending, except for individually assessed stage 3 commercial loans, is determined on a collective basis using impairment models. *These models use a number of significant judgements to* calculate a probability weighted estimate by applying a probability of default, exposure at default and a loss given default, taking account of collateral held or other loss mitigants, discounted using the effective interest rate. The key judgements and estimates in determining the ECL include: • modelling approach, modelling simplifications and judgements, and selection of modelling data; • behavioural lives for the retail lending; • credit risk ratings for the commercial lending, which are performed on a counterparty basis for larger exposures by a credit officer; and • the appropriate allocation of assets into the correct staging taking into account any significant deterioration in credit risk since inception of the loan.	We tested controls across the process to determine the ECL provisions including: • Model governance including model validation and monitoring; • *Model assumptions;* • The allocation of assets into stages, including those to determine the Credit Risk Rating in the commercial lending; and • Data accuracy and completeness. Working with our internal modelling specialists, our audit procedures over the key areas of estimation covered the following: • Model estimations, where we: – evaluated the appropriateness of the modelling approach and assumptions used; – independently replicated the models for all material portfolios and compared the outputs of our independent models to the Group's outputs; – assessed model performance by evaluating variations between observed data and model predictions; – developed an understanding and assessed model limitations and remedial actions; and – tested the completeness and accuracy of the data used in model execution and calibration. • Allocation of assets into stages, where we: – evaluated the appropriateness of quantitative and qualitative criteria used for allocation into IFRS 9 stages, including independently assessing the credit rating of loans in the commercial lending; – tested the appropriateness of the stage allocation for a sample of exposures; and – tested the data used by models in assigning IFRS 9 stages and evaluated the appropriateness of the model logic used.
Individually assessed ECL *For individual provision assessments of larger exposures in* stage 3 in the commercial lending, complex and subjective auditor judgement including specialised knowledge is required in evaluating the methodology, models and inputs that are inherently uncertain. The significant judgements in determining provisions are the: • completeness and appropriateness of the potential workout scenarios identified; • probability of default assigned to each identified potential workout scenarios; and • valuation assumptions used in determining the expected recovery strategies.	• *For expected credit losses assessed individually we have:* – selected senior team members with extensive IFRS 9 knowledge and expertise to design and lead the execution of ECL recognised in respect of these exposures; – tested the controls over the determination of individually assessed exposures including assumptions and inputs into workout and recovery scenarios, as well as valuation assumptions used; and – evaluated the appropriateness of workout and recovery scenarios including associated cash flows and consideration of climate risk.

Key audit matter description	How the scope of our audit responded to the key audit matter
ECL model adjustments Adjustments are made to models to address known model and data limitations, and emerging or non-modelled risks. The current economic environment, characterised by elevated cost of living pressures on borrowers and high inflation, has increased the uncertainty of credit losses. As a result, the amount and timing of adjustments recognised in the model to account for the impacts of the current economic environment are highly judgemental and inherently uncertain. These adjustments require specialist auditor judgement when evaluating the: • completeness of adjustments; and • methodology, models and inputs used in determining the relevant adjustments. Where impairment models do not incorporate all factors relevant to estimating the ECL, adjustments are made to address known model limitations and data limitations, emerging or non-modelled risks and the impact of economic uncertainty on different industry sectors. The measurement of judgements around model adjustments to evaluate the completeness of adjustments, methodology and model inputs for these adjustments is highly judgemental and inherently uncertain.	• In respect of the adjustment to models, we performed the following procedures in conjunction with our specialists: – tested the controls over the valuation of in-model and post-model adjustments; – evaluated the methodology, approach and assumptions in developing the adjustments, and evaluated the Group's selection of approach; – tested the completeness and accuracy of the data used in formulating the judgements; – performed a recalculation of adjustments; – evaluated the completeness of adjustments based on our understanding of both model and data limitations, including those related to cost of living and high inflation pressures; and – assessed the appropriateness of the disclosures and whether the disclosures appropriately address the uncertainty which exists in determining the ECL.

Key observations communicated to the Audit Committee

We are satisfied that the ECL provisions are reasonable and recognised in accordance with the requirements of IFRS 9. Appropriate methodologies using reasonable modelled assumptions were used in the calculations of the multiple economic scenarios, collectively assessed and in-model adjustments and post-model adjustments where they address model shortcomings. Overall ECL levels are reasonable compared to peer benchmarking information.

Regulatory and litigation matters (Group and Bank)

Key audit matter description	How the scope of our audit responded to the key audit matter
Refer to notes 2 and 25 in the financial statements	
The Group operates in an environment where it is subject to regulatory investigations, litigation and customer remediation, including allegations of fraud and misconduct. The Group is currently exposed to a number of regulatory and litigation matters. The Group's provision for these matters is £0.4 billion as at 31 December 2023. Significant judgement is required by the Group in determining whether, under IAS 37 'Provisions, Contingent Liabilities and Contingent Assets': • the amount recorded is representative of the Group's best estimate to settle the obligation based on the information available to the Group; and • any contingent liabilities and underlying significant estimation uncertainties are adequately disclosed.	We performed the following audit procedures: • Tested the Group's controls over the completeness of provisions, the review of the assessment of the provision against the requirements of IAS 37, the review of the appropriateness of judgements used to determine a 'best estimate' and the completeness and accuracy of data used in the process; • Evaluated the assessment of the provisions, associated probabilities, and potential outcomes in accordance with IAS 37; • Verified and evaluated whether the methodology, data and significant judgements and assumptions used in the valuation of the provisions are appropriate in the context of the applicable financial reporting framework; • Inspected correspondence and, where appropriate, made direct inquiry with the Group's regulators and internal and external legal counsel; • Where no provision was made, we critically evaluated the conclusion in the context of the requirements of IAS 37; and • Evaluated whether the disclosures made in the financial statements appropriately reflect the facts and key sources of estimation uncertainty.

Key observations communicated to the Audit Committee

While there is significant judgement required in estimating the timing and value of future settlements, we are satisfied that the approach to the recognition, estimation and disclosures of these provisions and contingent liabilities is consistent with the requirements of IFRS.

IT systems that impact financial reporting (Group and Bank)	
Key audit matter description	**How the scope of our audit responded to the key audit matter**
The Group's IT environment is inherently complex due to the number of systems it operates and its reliance on automated and IT dependent manual controls. Together, these support a broad range of banking and insurance products as well as the processing of the Group's significant volume of transactions, which impact all account balances. As such, IT systems within the Group form a critical component of the Group's financial reporting activities. Due to the significant reliance on IT systems, effective General IT Controls ('GITCs') are critical to allow reliance to be placed on the completeness and accuracy of financial data and the integrity of automated system functionality, such as system calculations. We identified the IT systems that impact financial reporting as a key audit matter because of the: • Pervasive reliance on complex technology that is integral to the operation of key business processes and financial reporting; • Reliance on technology which continues to develop in line with the business strategy, such as the increase in the use of automation across the Group and increasing reliance on third parties; and • Importance of the IT controls in maintaining an effective control environment. A key interdependency exists between the ability to rely on IT controls and the ability to rely on financial data, system configured automated controls and system reports. IT controls, in the context of our audit scope, primarily relate to privileged access at the infrastructure level, user access security at the application level and change control.	Our IT audit scope covered the Group's IT controls over information systems deemed relevant to the audit based on the financial data, system configured automated controls and/or key financial reports that reside within it. We used IT specialists to support our evaluation of the risks associated with IT in the following areas: • General IT Controls, including user access and change management controls; • Key financial reports and system configured automated controls; and • Cyber security risk assessment. Where deficiencies in the IT control environment were identified, our risk assessment procedures included an assessment of those deficiencies to determine the impact on our audit plan. Where relevant, the audit plan was adjusted to mitigate the unaddressed IT risk. Where we were able to identify and test appropriate mitigating controls over affected financial statement line items, our testing approach remained unchanged. In a limited number of areas, we adopted a non-controls reliance approach and we therefore performed additional substantive procedures.

Key observations communicated to the Audit Committee

We are satisfied that the Group's overall IT control environment appropriately supports the financial reporting process and control deficiencies identified in respect of privileged user access to IT infrastructure and in application user access management were mitigated by compensating business controls.

6. Our application of materiality

6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Bank financial statements
Materiality	£165 million (2022: £125 million)	£165 million (2022: £125 million)
Basis for determining materiality	We have determined net assets to be the most relevant benchmark to the users of the financial statements. The determined materiality represents 1.0 per cent of net assets.	The Bank materiality represents 1.0 per cent of net assets, and is capped at Group materiality.
Rationale for the benchmark applied	Given the importance of this measures to investors and users of the financial statements, we have used net assets as the benchmark for our determination of materiality given the volatility of income statement items during the course of 2023.	

6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Bank financial statements
Performance materiality	70 per cent of Group materiality – £115 million (2022: 70 per cent at £80 million)	70 per cent of Bank materiality – £115 million (2022: 70 per cent at £80 million)
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the following factors: a. The quality of the control environment and whether we were able to rely on controls; b. Degree of centralisation and commonality of controls and processes; c. The uncertain economic environment; d. The nature, volume and size of uncorrected misstatements arising in the previous audit; and e. The nature, volume and size of uncorrected misstatements that remain uncorrected in the current period.	

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £8 million (2022: £5 million), as well as any differences below this threshold, which in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. Other information

The other information comprises the information included in the Annual Report, other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information contained within the Annual Report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.	**We have nothing to report in this regard.**

We summarise below our work in relation to areas of the other information including those areas upon which we are specifically required to report:

	Our responsibility	Our report
Matters we are specifically required to report		
Strategic report and directors' report	Report whether they are consistent with the audited financial statements and are prepared in accordance with applicable legal requirements. Report if we have identified any material misstatements in either report in the light of the knowledge and understanding of the Group and of the Bank and their environment obtained in the course of the audit.	As set out in the section 'Opinions on other matters prescribed by the Companies Act 2006', in our opinion, based on the work undertaken in the course of the audit, the information in these reports is consistent with the audited financial statements and has been prepared in accordance with applicable legal requirements.
Principal risks (within the strategic report)	Review the confirmation and description in the light of the knowledge gathered during the audit, such as through considering the directors' processes to support the statements made, challenging the Group's key judgements and estimates, consideration of historical forecasting accuracy and evaluating macro-economic assumptions.	We have nothing material to report, add or draw attention to in respect of these matters.

8. Responsibilities of Directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Bank's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Bank or to cease operations, or have no realistic alternative but to do so.

9. Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at **www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditors' report.

10. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

Identifying and assessing potential risks related to irregularities

In identifying and assessing the risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- the Group's own assessment of the risks that irregularities may occur either as a result of fraud or error that was discussed by the Audit Committee on 20 February 2024;
- enquiring of management, in-house legal counsel, internal audit and the Audit Committee, including obtaining and reviewing supporting documentation, concerning the Group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- discussing among the engagement team including relevant internal specialists, including tax, valuations, pensions, IT and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud; and
- obtaining an understanding of the legal and regulatory frameworks that the Group operates in, focusing on those laws and regulations that had a direct effect on the financial statements, such as provisions of the UK Companies Act, pensions legislation and tax legislation or that had a fundamental effect on the operations of the Group, including regulation and supervisory requirements of the Prudential Regulation Authority, Financial Reporting Council and Financial Conduct Authority.

Audit response to risks identified

As a result of performing the above, we identified the Group's and Bank's determination of 'Expected credit losses' as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures in response to those key audit matters. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- inquiring of management, the Audit Committee and in-house and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and correspondence with regulators; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and
- evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including specialists and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

11. Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- The information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- The strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and of the Bank and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

12. Matters on which we are required to report by exception

Adequacy of explanations received and accounting records Under the Companies Act 2006 we are required to report to you if, in our opinion: • We have not received all the information and explanations we require for our audit; or • Adequate accounting records have not been kept by the Bank, or returns adequate for our audit have not been received from branches not visited by us; or • The Bank's financial statements are not in agreement with the accounting records and returns.	**We have nothing to report in respect of these matters.**
Directors' remuneration Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.	**We have nothing to report in respect of this matter.**

13. Other matters which we are required to address

Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by shareholders at its annual general meeting on 18 May 2023 to audit the financial statements of Lloyds Banking Group plc, including Bank of Scotland plc for the year ended 31 December 2023 and subsequent financial periods. The period of total uninterrupted engagement of the firm is accordingly three years.

Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

14. Use of our report

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

As required by the Financial Conduct Authority (FCA) Disclosure Guidance and Transparency Rule (DTR) 4.1.15R – DTR 4.1.18R, these financial statements will form part of the Electronic Format Annual Financial Report filed on the National Storage Mechanism of the FCA in accordance with DTR 4.1.15R – DTR 4.1.18R. This auditors' report provides no assurance over whether the Electronic Format Annual Financial Report has been prepared in compliance with DTR 4.1.15R – DTR 4.1.18R.

Michael Lloyd

Michael Lloyd (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
29 February 2024

Consolidated income statement
for the year ended 31 December

	Note	2023 £m	2022 £m
Interest income		**11,699**	8,189
Interest expense		**(8,828)**	(3,642)
Net interest income	4	**2,871**	4,547
Fee and commission income		**686**	590
Fee and commission expense		**(324)**	(310)
Net fee and commission income	5	**362**	280
Net trading (losses) income	6	**(33)**	51
Other operating income	7	**191**	53
Other income		**520**	384
Total income		**3,391**	4,931
Operating expenses	8	**(3,359)**	(3,162)
Impairment credit (charge)	11	**319**	(632)
Profit before tax		**351**	1,137
Tax expense	12	**(16)**	(71)
Profit for the year		**335**	1,066
Profit attributable to ordinary shareholders		**149**	944
Profit attributable to other equity holders		**186**	122
Profit for the year		**335**	1,066

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statement of comprehensive income

for the year ended 31 December

	2023 £m	2022 £m
Profit for the year	**335**	1,066
Other comprehensive income		
Items that will not subsequently be reclassified to profit or loss:		
Post-retirement defined benefit scheme remeasurements:		
Remeasurements before tax	**1**	(12)
Tax	**–**	6
	1	(6)
Items that may subsequently be reclassified to profit or loss:		
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income:		
Change in fair value	**–**	(36)
Income statement transfers in respect of disposals	**–**	15
Tax	**–**	7
	–	(14)
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**(7)**	11
Net income statement transfers	**(8)**	(11)
Tax	**4**	(2)
	(11)	(2)
Movements in foreign currency translation reserve:		
Transfers to income statement (tax: £nil)	**21**	–
Total other comprehensive income (loss) for the year, net of tax	**11**	(22)
Total comprehensive income for the year	**346**	1,044
Total comprehensive income attributable to ordinary shareholders	**160**	922
Total comprehensive income attributable to other equity holders	**186**	122
Total comprehensive income for the year	**346**	1,044

The accompanying notes are an integral part of the consolidated financial statements.

Balance sheets

at 31 December

	Note	The Group		The Bank	
		2023 £m	2022 £m	2023 £m	2022 £m
Assets					
Cash and balances at central banks		**3,009**	3,004	**3,009**	3,004
Financial assets at fair value through profit or loss	14	**266**	291	**111**	113
Derivative financial instruments	15	**2,850**	3,477	**2,850**	3,476
Loans and advances to banks		**206**	198	**180**	171
Loans and advances to customers	16	**292,470**	292,416	**286,187**	283,621
Debt securities		**1,696**	–	**1,696**	–
Due from fellow Lloyds Banking Group undertakings		**16,773**	16,048	**20,921**	22,999
Financial assets at amortised cost		**311,145**	308,662	**308,984**	306,791
Goodwill	19	**452**	452	**325**	325
Current tax recoverable		**1,024**	390	**1,096**	464
Deferred tax assets	12	**1,911**	1,944	**1,932**	1,979
Investment in subsidiary undertakings	20	**–**	–	**1,294**	1,313
Retirement benefit assets		**49**	47	**49**	47
Other assets[1]	21	**1,724**	1,974	**1,459**	1,640
Total assets		**322,430**	320,241	**321,109**	319,152
Liabilities					
Deposits from banks		**179**	195	**179**	195
Customer deposits		**161,946**	166,363	**161,946**	166,363
Repurchase agreements		**30,397**	30,210	**30,397**	30,210
Due to fellow Lloyds Banking Group undertakings		**95,098**	91,287	**94,394**	91,563
Financial liabilities at fair value through profit or loss	14	**23**	26	**–**	–
Derivative financial instruments	15	**4,428**	4,570	**4,297**	4,421
Notes in circulation		**1,392**	1,280	**1,392**	1,280
Debt securities in issue at amortised cost	23	**8,610**	6,123	**7,992**	5,376
Other liabilities[1]	24	**1,506**	1,570	**1,290**	1,345
Provisions	25	**720**	973	**655**	897
Subordinated liabilities	26	**1,532**	1,598	**1,532**	1,598
Total liabilities		**305,831**	304,195	**304,074**	303,248
Equity					
Share capital	27	**5,847**	5,847	**5,847**	5,847
Other reserves	28	**3,061**	3,051	**3,235**	3,238
Retained profits[2]	29	**5,133**	4,940	**5,403**	4,619
Ordinary shareholders' equity		**14,041**	13,838	**14,485**	13,704
Other equity instruments	30	**2,550**	2,200	**2,550**	2,200
Total equity excluding non-controlling interests		**16,591**	16,038	**17,035**	15,904
Non-controlling interests		**8**	8	**–**	–
Total equity		**16,599**	16,046	**17,035**	15,904
Total equity and liabilities		**322,430**	320,241	**321,109**	319,152

1 See note 1 regarding changes to presentation.
2 The Bank recorded a profit after tax for the year of £926 million (2022: £1,147 million).

No income statement or statement of comprehensive income has been shown for the parent company, as permitted by section 408 of the Companies Act 2006.

The accompanying notes are an integral part of the consolidated financial statements.

The directors approved the financial statements on 29 February 2024.

Sir Robin Budenberg
Chair

Charlie Nunn
Group Chief Executive

William Chalmers
Chief Financial Officer

Statements of changes in equity

for the year ended 31 December

The Group	Attributable to ordinary shareholders: Share capital £m	Other reserves £m	Retained profits £m	Total £m	Other equity instruments £m	Non-controlling interests £m	Total £m
At 1 January 2022	5,847	2,013	3,975	11,835	2,200	8	14,043
Comprehensive income							
Profit for the year	–	–	944	944	122	–	1,066
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(6)	(6)	–	–	(6)
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	–	(14)	–	(14)	–	–	(14)
Movements in cash flow hedging reserve, net of tax	–	(2)	–	(2)	–	–	(2)
Total other comprehensive loss	–	(16)	(6)	(22)	–	–	(22)
Total comprehensive (loss) income[1]	–	(16)	938	922	122	–	1,044
Transactions with owners							
Distributions on other equity instruments	–	–	–	–	(122)	–	(122)
Capital contributions received	–	1,054	46	1,100	–	–	1,100
Adjustment on transfer of subsidiary	–	–	(19)	(19)	–	–	(19)
Total transactions with owners	–	1,054	27	1,081	(122)	–	959
At 31 December 2022	5,847	3,051	4,940	13,838	2,200	8	16,046
Comprehensive income							
Profit for the year	**–**	**–**	**149**	**149**	**186**	**–**	**335**
Other comprehensive income							
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**1**	**1**	**–**	**–**	**1**
Movements in cash flow hedging reserve, net of tax	**–**	**(11)**	**–**	**(11)**	**–**	**–**	**(11)**
Movements in foreign currency translation reserve, net of tax	**–**	**21**	**–**	**21**	**–**	**–**	**21**
Total other comprehensive income	**–**	**10**	**1**	**11**	**–**	**–**	**11**
Total comprehensive income[1]	**–**	**10**	**150**	**160**	**186**	**–**	**346**
Transactions with owners							
Distributions on other equity instruments	**–**	**–**	**–**	**–**	**(186)**	**–**	**(186)**
Issue of other equity instruments (note 30)	**–**	**–**	**–**	**–**	**350**	**–**	**350**
Capital contributions received	**–**	**–**	**43**	**43**	**–**	**–**	**43**
Total transactions with owners	**–**	**–**	**43**	**43**	**164**	**–**	**207**
At 31 December 2023	**5,847**	**3,061**	**5,133**	**14,041**	**2,550**	**8**	**16,599**

1 Total comprehensive income attributable to owners of the parent was £346 million (2022: £1,044 million).

Further details of movements in the Group's share capital and reserves are provided in notes 27 to 30.

The accompanying notes are an integral part of the consolidated financial statements.

Statements of changes in equity continued

for the year ended 31 December

The Bank	Attributable to ordinary shareholders				Other equity instruments £m	Total £m
	Share capital £m	Other reserves £m	Retained profits £m	Total £m		
At 1 January 2022	5,847	2,025	3,554	11,426	2,200	13,626
Comprehensive income						
Profit for the year	–	–	1,025	1,025	122	1,147
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of tax	–	–	(6)	(6)	–	(6)
Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax	–	(14)	–	(14)	–	(14)
Movements in cash flow hedging reserve, net of tax	–	(2)	–	(2)	–	(2)
Total other comprehensive loss	–	(16)	(6)	(22)	–	(22)
Total comprehensive (loss) income[1,2]	–	(16)	1,019	1,003	122	1,125
Transactions with owners						
Distributions on other equity instruments	–	–	–	–	(122)	(122)
Capital contributions received	–	1,229	46	1,275	–	1,275
Total transactions with owners	–	1,229	46	1,275	(122)	1,153
At 31 December 2022	5,847	3,238	4,619	13,704	2,200	15,904
Comprehensive income						
Profit for the year	**–**	**–**	**740**	**740**	**186**	**926**
Other comprehensive income						
Post-retirement defined benefit scheme remeasurements, net of tax	**–**	**–**	**1**	**1**	**–**	**1**
Movements in cash flow hedging reserve, net of tax	**–**	**(11)**	**–**	**(11)**	**–**	**(11)**
Movements in foreign currency translation reserve, net of tax	**–**	**8**	**–**	**8**	**–**	**8**
Total other comprehensive (loss) income	**–**	**(3)**	**1**	**(2)**	**–**	**(2)**
Total comprehensive (loss) income[1,2]	**–**	**(3)**	**741**	**738**	**186**	**924**
Transactions with owners						
Distributions on other equity instruments	**–**	**–**	**–**	**–**	**(186)**	**(186)**
Issue of other equity instruments (note 30)	**–**	**–**	**–**	**–**	**350**	**350**
Capital contributions received	**–**	**–**	**43**	**43**	**–**	**43**
Total transactions with owners	**–**	**–**	**43**	**43**	**164**	**207**
At 31 December 2023	**5,847**	**3,235**	**5,403**	**14,485**	**2,550**	**17,035**

1 No income statement or statement of comprehensive income has been shown for the Bank, as permitted by section 408 of the Companies Act 2006.
2 Total comprehensive income attributable to owners of the parent was £924 million (2022: £1,125 million).

Further details of movements in the Bank's share capital and reserves are provided in notes 27 to 30.

The accompanying notes are an integral part of the consolidated financial statements.

Cash flow statements
for the year ended 31 December

	Note	The Group 2023 £m	The Group 2022 £m	The Bank 2023 £m	The Bank 2022 £m
Cash flows from operating activities					
Profit before tax		**351**	1,137	**901**	1,213
Adjustments for:					
Change in operating assets	37(A)	**(783)**	(5,619)	**(481)**	(6,488)
Change in operating liabilities	37(B)	**1,952**	2,454	**1,135**	3,169
Non-cash and other items	37(C)	**(620)**	660	**(1,434)**	478
Net tax paid		**(612)**	(318)	**(556)**	(208)
Net cash provided by (used in) operating activities		**288**	(1,686)	**(435)**	(1,836)
Cash flows from investing activities					
Proceeds from sale and maturity of financial assets		**–**	1,955	**–**	1,955
Dividends received from subsidiaries		**–**	–	**719**	126
Purchase of fixed assets		**(222)**	(158)	**(219)**	(158)
Proceeds from sale of fixed assets		**11**	–	**13**	–
Net cash (used in) provided by investing activities		**(211)**	1,797	**513**	1,923
Cash flows from financing activities					
Distributions on other equity instruments		**(186)**	(122)	**(186)**	(122)
Interest paid on subordinated liabilities		**(105)**	(58)	**(105)**	(58)
Proceeds from issue of other equity instruments		**350**	–	**350**	–
Repayment of subordinated liabilities		**(63)**	(44)	**(63)**	(44)
Net cash used in financing activities		**(4)**	(224)	**(4)**	(224)
Effect of exchange rate changes on cash and cash equivalents		**–**	–	**–**	(1)
Change in cash and cash equivalents		**73**	(113)	**74**	(138)
Cash and cash equivalents at beginning of year		**2,053**	2,166	**2,027**	2,165
Cash and cash equivalents at end of year	37(D)	**2,126**	2,053	**2,101**	2,027

The accompanying notes are an integral part of the consolidated financial statements.

Notes to the financial statements
for the year ended 31 December

Note 1: Basis of preparation
The consolidated financial statements of Bank of Scotland plc (the Bank) together with its subsidiary undertakings (the Group) have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006. The financial statements have also been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB).

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, financial assets measured at fair value through other comprehensive income, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts. The directors consider that it is appropriate to continue to adopt the going concern basis in preparing the financial statements. In reaching this assessment, the directors have considered the impact of climate change upon the Group's performance and projected funding and capital position. The directors have also taken into account the results from stress testing scenarios.

Except for accounting policies and methods of computation affected by the IAS 12 exception relating to the recognition and disclosure of the implication of certain potential deferred tax consequences, the Group's accounting policies are consistent with those applied by the Group in its financial statements for the year ended 31 December 2022 and there have been no changes in the Group's methods of computation. Following amendments to IAS 12 by the IASB (*International Tax Reform – Pillar Two Model Rules*, issued in May 2023) entities are not permitted to disclose information about deferred tax assets and liabilities related to the Organisation for Economic, Co-operation and Development's Pillar Two Model Rules, including any qualified domestic minimum top-up taxes. No changes arise to the Group's deferred tax assets or liabilities as a result of the Group having applied the relevant exception.

Presentational changes

The following changes have been made to the presentation of the Group and Bank's balance sheet to provide a more relevant analysis of the Group's and Bank's financial position:

- Items in the course of collection from banks are reported within other assets rather than separately on the face of the balance sheet
- Items in the course of transmission to banks are reported within other liabilities rather than separately on the face of the balance sheet

There has been no change in the basis of accounting for any of the underlying transactions. Comparatives for 2022 have been restated.

Operating segments

IFRS 8 *Operating Segments* requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally. The chief operating decision maker has been identified as the Group Executive Committee of Lloyds Banking Group. The Bank of Scotland Group is managed on an entity basis and not by segment. The Group Executive Committee does not assess the Bank of Scotland Group's performance and allocate resources across any segments, accordingly no segmental information is provided. A brief overview of the Group's sources of income is provided in the Business review. The ultimate parent undertaking, Lloyds Banking Group plc, produces consolidated accounts which set out the basis of the segments through which it manages performance and allocates resources across the consolidated Lloyds Banking Group.

Future accounting developments

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2024, including IFRS 16 *Lease Liability in a Sale and Leaseback*, IAS 1 *Non-current Liabilities with Covenants*, and IAS 1 *Classification of Liabilities as Current or Non-current*. These amendments are not expected to have a significant impact on the Group and have been endorsed for use in the UK.

Note 2: Accounting policies
The accounting policies are set out below. These accounting policies have been applied consistently.

(A) *Consolidation*
The assets, liabilities and results of Group undertakings (including structured entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include subsidiaries, associates and joint ventures. Details of the Group's subsidiaries and related undertakings are given on **pages 97 to 98**.

(1) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through the exercise of its power. This generally accompanies a shareholding of more than one half of the voting rights although in certain circumstances a holding of less than one half of the voting rights may still result in the ability of the Group to exercise control. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group reassesses whether or not it controls an entity if facts and circumstances indicate that there have been changes to any of the above elements. Subsidiaries are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases.

Structured entities are entities that are designed so that their activities are not governed by way of voting rights. In assessing whether the Group has power over such entities in which it has an interest, the Group considers factors such as the purpose and design of the entity; its practical ability to direct the relevant activities of the entity; the nature of the relationship with the entity; and the size of its exposure to the variability of returns of the entity.

Note 2: Accounting policies continued
The treatment of transactions with non-controlling interests depends on whether, as a result of the transaction, the Group loses control of the subsidiary. Changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions; any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent entity. Where the Group loses control of the subsidiary, at the date when control is lost the amount of any non-controlling interest in that former subsidiary is derecognised and any investment retained in the former subsidiary is remeasured to its fair value; the gain or loss that is recognised in profit or loss on the partial disposal of the subsidiary includes the gain or loss on the remeasurement of the retained interest.

Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

The acquisition method of accounting is used to account for business combinations by the Group. The consideration for the acquisition of a subsidiary is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred except those relating to the issuance of debt instruments (see (E)(4) below) or share capital (see (O) below). Identifiable assets acquired and liabilities assumed in a business combination are measured initially at their fair value at the acquisition date.

(2) Joint ventures and associates
Joint ventures are joint arrangements over which the Group has joint control with other parties and has rights to the net assets of the arrangements. Joint control is the contractually agreed sharing of control of an arrangement and only exists when decisions about the relevant activities require the unanimous consent of the parties sharing control. Associates are entities over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the entity, but is not control or joint control of those policies, and is generally achieved through holding between 20 per cent and 50 per cent of the voting share capital of the entity.

The Group utilises the venture capital exemption for investments where significant influence or joint control is present and the business unit operates as a venture capital business. These investments are designated on initial recognition at fair value through profit or loss. Otherwise, the Group's investments in joint ventures and associates are accounted for using the equity method of accounting.

(B) Goodwill
Goodwill arises on business combinations and represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities acquired. Where the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities of the acquired entity is greater than the cost of acquisition, the excess is recognised immediately in the income statement.

Goodwill is recognised as an asset at cost and is tested at least annually for impairment. For impairment testing, goodwill is allocated to the cash-generating unit (CGU) or groups of CGUs that are expected to benefit from the business combination. An impairment loss is recognised if the carrying amount of a CGU is determined to be greater than its recoverable amount. The recoverable amount of a CGU is the higher of its fair value less costs to sell and its value in use. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and this is not subsequently reversed. At the date of disposal of a subsidiary, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal.

(C) Other intangible assets
Intangible assets which have been determined to have a finite useful life are amortised on a straight-line basis over their estimated useful life as follows: up to 7 years for capitalised software; 10 to 15 years for brands and other intangible assets.

Intangible assets with finite useful lives are reviewed at each reporting date to assess whether there is any indication that they are impaired. If any such indication exists the recoverable amount of the asset is determined and in the event that the asset's carrying amount is greater than its recoverable amount, it is written down immediately.

(D) Revenue recognition
(1) Net interest income
Interest income and expense are recognised in the income statement using the effective interest method for all interest-bearing financial instruments, except for those classified at fair value through profit or loss. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument to the gross carrying amount of the financial asset (before adjusting for expected credit losses) or to the amortised cost of the financial liability, including early redemption fees, other fees, and premiums and discounts that are an integral part of the overall return. In the case of financial assets that are purchased or originated credit-impaired, the effective interest rate is the rate that discounts the estimated future cash flows to the amortised cost of the instrument. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account. Interest income from non-credit-impaired financial assets is recognised by applying the effective interest rate to the gross carrying amount of the asset; for credit-impaired financial assets, the effective interest rate is applied to the net carrying amount after deducting the allowance for expected credit losses. Impairment policies are set out in (H) below.

(2) Fee and commission income and expense
Fees and commissions receivable which are not an integral part of the effective interest rate are recognised as income as the Group fulfils its performance obligations. The Group's principal performance obligations arising from contracts with customers are in respect of value added current accounts, credit cards and debit cards. These fees are received, and the Group provides the service, monthly; the fees are recognised in income on this basis. The Group also receives certain fees in respect of its asset finance business where the performance obligations are typically fulfilled towards the end of the customer contract; these fees are recognised in income on this basis. Where it is unlikely that the loan commitments will be drawn, loan commitment fees are recognised in fee and commission income over the life of the facility, rather than as an adjustment to the effective interest rate for the lending expected to be drawn. Incremental costs incurred to generate fee and commission income are charged to fee and commission expense as they are incurred.

(3) Other
Dividend income is recognised when the right to receive payment is established.

Revenue recognition policies specific to trading income are set out in (E)(3) below; and those relating to leases are set out in (J)(1) below.

Note 2: Accounting policies continued

(E) Financial assets and liabilities

On initial recognition, financial assets are classified as measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss, depending on the Group's business model for managing those financial assets and whether the resultant cash flows represent solely payments of principal and interest. The Group assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. Financial assets with embedded derivatives are considered in their entirety when considering their cash flow characteristics. The Group reclassifies financial assets only when its business model for managing those assets changes. A reclassification will only take place when the change is significant to the Group's operations and will occur at a portfolio level and not for individual instruments; reclassifications are expected to be rare.

The Group initially recognises loans and advances, deposits, debt securities in issue and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of securities and other financial assets and trading liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset.

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when the Group has transferred its contractual right to receive the cash flows from the assets and either: substantially all of the risks and rewards of ownership have been transferred; or the Group has neither retained nor transferred substantially all of the risks and rewards, but has transferred control.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires.

(1) Financial instruments measured at amortised cost

Financial assets that are held to collect contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A basic lending arrangement results in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Where the contractual cash flows introduce exposure to risks or volatility unrelated to a basic lending arrangement such as changes in equity prices or commodity prices, the payments do not comprise solely principal and interest. Financial assets measured at amortised cost are predominantly loans and advances to customers and banks, reverse repurchase agreements and certain debt securities used by the Group to manage its liquidity. Loans and advances and reverse repurchase agreements are initially recognised when cash is advanced to the borrower at fair value inclusive of transaction costs. Interest income is accounted for using the effective interest method (see (D) above).

Financial liabilities are measured at amortised cost, except for trading liabilities and other financial liabilities designated at fair value through profit or loss on initial recognition which are held at fair value.

Where changes are made to the contractual cash flows of a financial asset or financial liability that are economically equivalent and arise as a direct consequence of interest rate benchmark reform, the Group updates the effective interest rate and does not recognise an immediate gain or loss.

(2) Financial assets measured at fair value through other comprehensive income

Financial assets that are held to collect contractual cash flows and for subsequent sale, where the assets' cash flows represent solely payments of principal and interest, are recognised in the balance sheet at their fair value, inclusive of transaction costs. Interest calculated using the effective interest method and foreign exchange gains and losses on assets denominated in foreign currencies are recognised in the income statement. All other gains and losses arising from changes in fair value are recognised directly in other comprehensive income, until the financial asset is either sold or matures, at which time, other than in respect of equity shares, the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement. The cumulative revaluation amount in respect of equity shares is transferred directly to retained profits. The Group recognises a charge for expected credit losses in the income statement (see (H) below). As the asset is measured at fair value, the charge does not adjust the carrying value of the asset, and this is reflected in other comprehensive income.

(3) Financial instruments measured at fair value through profit or loss

Financial assets are classified at fair value through profit or loss where they do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income or where they are designated at fair value through profit or loss to reduce an accounting mismatch. All derivatives are carried at fair value through profit or loss, other than those in effective cash flow and net investment hedging relationships. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Refer to note 14(2) (Financial instruments: Financial assets and liabilities carried at fair value) for details of valuation techniques and significant inputs to valuation models.

Derivatives embedded in a financial asset are not considered separately; the financial asset is considered in its entirety when determining whether its cash flows are solely payments of principal and interest. Derivatives embedded in financial liabilities 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.

Trading securities, which are debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains, do not meet these criteria and are also measured at fair value through profit or loss. Financial assets measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses together with interest coupons and dividend income are recognised in the income statement within net trading income.

Note 2: Accounting policies continued

Financial liabilities are measured at fair value through profit or loss where they are trading liabilities or where they are designated at fair value through profit or loss in order to reduce an accounting mismatch; where the liabilities are part of a group of liabilities (or assets and liabilities) which is managed, and its performance evaluated, on a fair value basis; or where the 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. Financial liabilities measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses are recognised in the income statement within net trading income in the period in which they occur.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices, respectively, which include the expected effects of potential changes to laws and regulations, risks associated with climate change and other factors. If the market is not active the Group establishes a fair value by using valuation techniques. The fair values of derivative financial instruments are adjusted where appropriate to reflect credit risk (via credit valuation adjustments (CVAs), debit valuation adjustments (DVAs) and funding valuation adjustments (FVAs)), market liquidity and other risks.

(4) Borrowings

Borrowings (which include deposits from banks, customer deposits, repurchase agreements, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense. Securities which carry a discretionary coupon and have no fixed maturity or redemption date are classified as other equity instruments. Interest payments on these securities are recognised as distributions from equity in the period in which they are paid. An exchange of financial liabilities on substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The difference between the carrying amount of a financial liability extinguished and the new financial liability is recognised in profit or loss together with any related costs or fees incurred.

When a financial liability is exchanged for an equity instrument, the new equity instrument is recognised at fair value and any difference between the carrying value of the liability and the fair value of the new equity instrument is recognised in profit or loss.

(5) Sale and repurchase agreements (including securities lending and borrowing)

Securities sold subject to repurchase agreements (repos) continue to be recognised on the balance sheet where substantially all of the risks and rewards are retained. Funds received for repos carried at fair value are included within trading liabilities. Conversely, securities purchased under agreements to resell (reverse repos), where the Group does not acquire substantially all of the risks and rewards of ownership, are measured at amortised cost or at fair value. Those measured at fair value are recognised within trading securities. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

Securities borrowing and lending transactions are typically secured; collateral takes the form of securities or cash advanced or received. Securities lent to counterparties are retained on the balance sheet. Securities borrowed are not recognised on the balance sheet, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability. Cash collateral given or received is treated as a loan and advance measured at amortised cost or customer deposit.

(F) Hedge accounting

As permitted by IFRS 9, the Group continues to apply the requirements of IAS 39 to its hedging relationships.

Changes in the fair value of all derivative instruments, other than those in effective cash flow and net investment hedging relationships, are recognised immediately in the income statement. As noted in (2) below, the change in fair value of a derivative in an effective cash flow hedging relationship is allocated between the income statement and other comprehensive income.

Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of such instruments. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item, the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship is tested both at inception and throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued. Note 15 provides details of the types of derivatives held by the Group and presents separately those designated in hedge relationships.

Where there is uncertainty arising from interest rate benchmark reform, the Group assumes that the interest rate benchmark on which the hedged cash flows and/or the hedged risk are based, or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform. The Group does not discontinue a hedging relationship during the period of uncertainty arising from the interest rate benchmark reform solely because the actual results of the hedge are not highly effective.

Where the contractual terms of a financial asset, financial liability or derivative are amended, on an economically equivalent basis, as a direct consequence of interest rate benchmark reform, the uncertainty arising from the reform is no longer present. In these circumstances, the Group amends the hedge documentation to reflect the changes required by the reform; these changes to the documentation do not in and of themselves result in the discontinuation of hedge accounting or require the designation of a new hedge relationship.

(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 a financial asset at fair value through other comprehensive income. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using the effective interest method over the period to maturity.

Note 2: Accounting policies continued

(F) Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(G) Offset

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of offset and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Cash collateral on exchange traded derivative transactions is presented gross unless the collateral cash flows are always settled net with the derivative cash flows. In certain situations, even though master netting agreements exist, the lack of management intention to settle on a net basis results in the financial assets and liabilities being reported gross on the balance sheet.

(H) Impairment of financial assets

The impairment charge in the income statement reflects the change in expected credit losses, including those arising from fraud. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets (other than equity investments) measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts. Expected credit losses are calculated as an unbiased and probability-weighted estimate using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Group at the point of default after taking into account the value of any collateral held, repayments, or other mitigants of loss and including the impact of discounting using the effective interest rate.

At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk since origination, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk since initial recognition are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit-impaired are allocated to Stage 3. Some Stage 3 assets, are subject to individual rather than collective assessment. Such cases are subject to a risk-based impairment sanctioning process, and these are reviewed and updated at least quarterly, or more frequently if there is a significant change in the credit profile. The collective assessment of impairment aggregates financial instruments with similar risk characteristics, such as whether the facility is revolving in nature or secured and the type of security held against financial assets.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. In determining whether there has been a significant increase in credit risk, the Group uses quantitative tests based on relative and absolute probability of default (PD) movements linked to internal credit ratings together with qualitative indicators such as watchlists and other indicators of historical delinquency, credit weakness or financial difficulty. The use of internal credit ratings and qualitative indicators ensures alignment between the assessment of staging and the Group's management of credit risk which utilises these internal metrics within distinct retail and commercial portfolio risk management practices. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. The use of a payment holiday in and of itself has not been judged to indicate a significant increase in credit risk, with the underlying long-term credit risk deemed to be driven by economic conditions and captured through the use of forward-looking models. These portfolio-level models are capturing the anticipated volume of increased defaults and therefore an appropriate assessment of staging and expected credit loss. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since initial recognition, the asset is transferred back to Stage 1.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit-impaired. Default is considered to have occurred when there is evidence that the customer is experiencing financial difficulty which is likely to affect significantly the ability to repay the amount due. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due which the Group now uses for all its products following changes to the definition of default for UK mortgages on 1 January 2022. In addition, other indicators of mortgage default are added including end-of-term payments on past due interest-only accounts and loans considered non-performing due to recent arrears or forbearance. The use of payment holidays is not considered to be an automatic trigger of regulatory default and therefore does not automatically trigger Stage 3. Days past due will also not accumulate on any accounts that have taken a payment holiday including those already past due.

In certain circumstances, the Group will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. In the latter circumstances, the loan will remain classified as either Stage 2 or Stage 3 until the credit risk has improved such that it no longer represents a significant increase since origination (for a return to Stage 1), or the loan is no longer credit-impaired (for a return to Stage 2). On renegotiation the gross carrying amount of the loan is recalculated as the present value of the renegotiated or modified contractual cash flows, which are discounted at the original effective interest rate. Renegotiation may also lead to the loan and associated allowance being derecognised and a new loan being recognised initially at fair value.

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement. For both secured and unsecured retail balances, the write-off takes place only once an extensive set of collections processes has been completed, or the status of the account reaches a point where policy dictates that continuing attempts to recover are no longer appropriate. For commercial lending, a write-off occurs if the loan facility with the customer is restructured, the asset is under administration and the only monies that can be received are the amounts estimated by the administrator, the underlying assets are disposed and a decision is made that no further settlement monies will be received, or external evidence (for example, third party valuations) is available that there has been an irreversible decline in expected cash flows.

Note 2: Accounting policies continued

(I) Property, plant and equipment

Property, plant and equipment (other than investment property) is included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows: the shorter of 50 years and the remaining period of the lease for freehold/long and short leasehold premises; the shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease for leasehold improvements; 10 to 20 years for fixtures and furnishings; and 2 to 8 years for other equipment and motor vehicles.

The assets' residual values and useful lives are reviewed and, if appropriate, revised 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 assessing the recoverable amount of assets the Group considers the effects of potential or actual changes in legislation, customer behaviour, climate-related risks and other factors on the asset's CGU. In the event that an asset's CGU carrying amount is determined to be greater than its recoverable amount the asset is written down immediately.

Investment property comprises freehold and long leasehold land and buildings that are held either to earn rental income or for capital accretion or both. In accordance with the guidance published by the Royal Institution of Chartered Surveyors, investment property is carried at fair value based on current prices for similar properties, adjusted for the specific characteristics of the property (such as location or condition). If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices in less active markets. These valuations are reviewed at least annually by independent professionally qualified valuers. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be valued at fair value.

(J) Leases

Under IFRS 16, a lessor is required to determine whether a lease is a finance or operating lease. A lessee is not required to make this determination.

(1) As lessor

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all of the risks and rewards of ownership to the lessee but not necessarily legal title. All other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments, together with any unguaranteed residual value, is recognised as a receivable, net of allowances for expected credit losses and residual value impairment, within loans and advances to banks and customers. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance lease income. Finance lease income is recognised in interest income over the term of the lease using the net investment method (before tax) so as to give a constant rate of return on the net investment in the lease. Unguaranteed residual values are reviewed regularly to identify any impairment.

Operating lease assets are included within other assets at cost and depreciated over their estimated useful lives. The depreciation charge is based on the asset's residual value and the life of the lease. 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.

(2) As lessee

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Assets and liabilities arising from a lease are initially measured on a present value basis. The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the Group's incremental borrowing rate appropriate for the right-of-use asset arising from the lease, and the liability recognised within other liabilities.

Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise IT equipment and small items of office furniture.

(K) Employee benefits

Short-term employee benefits, such as salaries, paid absences, performance-based cash awards and social security costs, are recognised over the period in which the employees provide the related services.

(1) Share-based compensation

Lloyds Banking Group operates a number of equity-settled, share-based compensation plans in respect of services received from certain of its employees. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model or a Monte Carlo simulation. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement, together with a corresponding adjustment to equity. Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period. Modifications are assessed at the date of modification and any incremental charges are charged to the income statement.

Note 2: Accounting policies continued

(L) Taxation

Tax expense comprises current and deferred tax. Current and deferred tax are charged or credited in the income statement except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period, outside the income statement (either in other comprehensive income, directly in equity, or through a business combination), in which case the tax appears in the same statement as the transaction that gave rise to it. The tax consequences of the Group's dividend payments (including distributions on other equity instruments), if any, are charged or credited to the statement in which the profit distributed originally arose.

Current tax is the amount of corporate income taxes expected to be payable or recoverable based on the profit for the period as adjusted for items that are not taxable or not deductible, and is calculated using tax rates and laws that were enacted or substantively enacted at the balance sheet date.

Current tax includes amounts provided in respect of uncertain tax positions when management expects that, upon examination of the uncertainty by His Majesty's Revenue and Customs (HMRC) or other relevant tax authority, it is more likely than not that an economic outflow will occur. Provisions reflect management's best estimate of the ultimate liability based on their interpretation of tax law, precedent and guidance, informed by external tax advice as necessary. Changes in facts and circumstances underlying these provisions are reassessed at each balance sheet date, and the provisions are remeasured as required to reflect current information.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the balance sheet date, and which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax liabilities are generally recognised for all taxable temporary differences but not recognised for taxable temporary differences arising on investments in subsidiaries where the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future. Deferred tax liabilities are not recognised on temporary differences that arise from goodwill which is not deductible for tax purposes.

Deferred tax assets are recognised to the extent it is probable that taxable profits will be available against which the deductible temporary differences can be utilised, and are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognised in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. Deferred tax is not discounted.

(M) Foreign currency translation

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). Foreign currency transactions are translated into the appropriate functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when recognised in other comprehensive income as qualifying cash flow or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items held at fair value through profit and loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets measured at fair value through other comprehensive income, such as equity shares, are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

The results and financial position of all Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows: the assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on the acquisition of a foreign entity, are translated into Sterling at foreign exchange rates ruling at the balance sheet date; and the income and expenses of foreign operations are translated into Sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions, in which case income and expenses are translated at the dates of the transactions.

Foreign exchange differences arising on the translation of a foreign operation are recognised in other comprehensive income and accumulated in a separate component of equity. On disposal or liquidation of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation is reclassified from equity and included in determining the profit or loss arising on disposal or liquidation.

(N) Provisions and contingent liabilities

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Provision is made for expected credit losses in respect of irrevocable undrawn loan commitments and financial guarantee contracts (see (H) above).

Note 2: Accounting policies continued

(O) Share capital

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds. Dividends paid on the Group's ordinary shares are recognised as a reduction in equity in the period in which they are paid.

(P) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory deposits held with central banks, mandatory deposits held with central banks in demand accounts and amounts due from banks with an original maturity of less than three months that are available to finance the Group's day-to-day operations.

(Q) Investment in subsidiaries

Investments in subsidiaries are carried at historical cost, less any provisions for impairment.

Note 3: Critical accounting judgements and key sources of estimation uncertainty

The preparation of the Group's financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In preparing the financial statements, the Group has considered the impact of climate-related risks on its financial position and performance. While the effects of climate change represent a source of uncertainty, the Group does not consider there to be a material impact on its judgements and estimates from the physical, transition and other climate-related risks in the short term.

The significant judgements, apart from those involving estimation, made by management in applying the Group's accounting policies in these financial statements (critical judgements) and the key sources of estimation uncertainty that may have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year (key sources of estimation uncertainty), which together are considered critical to the Group's results and financial position, are as follows:

- Uncertain tax positions (note 12)
- Fair value of financial instruments (note 14)
- Allowance for expected credit losses (note 17)
- Regulatory and legal provisions (note 25)

Note 4: Net interest income

	2023 £m	2022 £m
Interest income:		
Financial assets held at amortised cost	**11,699**	8,174
Financial assets at fair value through other comprehensive income	**–**	15
Total interest income[1]	**11,699**	8,189
Interest expense:		
Deposits from banks and customer deposits	**(6,787)**	(2,986)
Repurchase agreements	**(1,404)**	(440)
Debt securities in issue at amortised cost[2]	**(523)**	(146)
Lease liabilities	**(12)**	(13)
Subordinated liabilities	**(102)**	(57)
Total interest expense	**(8,828)**	(3,642)
Net interest income	**2,871**	4,547

1 Includes £32 million (2022: £28 million) in respect of interest income on finance lease receivables.
2 The impact of the Group's hedging arrangements is included on this line.

Net interest income also includes a credit of £8 million (2022: credit of £11 million) transferred from the cash flow hedging reserve (see note 28).

Note 5: Net fee and commission income

	2023 £m	2022 £m
Fee and commission income:		
Current accounts	**195**	199
Credit and debit card fees	**420**	341
Other	**71**	50
Total fee and commission income	**686**	590
Fee and commission expense	**(324)**	(310)
Net fee and commission income	**362**	280

Fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 4. 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 6.

In determining the disaggregation of fees and commissions the Group has considered how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors, including those that are impacted by climate-related factors. It has determined that the above disaggregation by product type provides useful information that does not aggregate items that have substantially different characteristics and is not too detailed.

At 31 December 2023, the Group held on its balance sheet £38 million (31 December 2022: £28 million) in respect of services provided to customers. There were no unsatisfied performance obligations at 31 December 2022 or 31 December 2023.

The most significant performance obligations undertaken by the Group are in respect of current accounts, the provision of other banking services for commercial customers and credit and debit card services.

In respect of current accounts, the Group receives fees for the provision of bank account and transaction services such as ATM services, fund transfers, overdraft facilities and other value-added offerings.

For commercial customers, alongside its provision of current accounts, the Group provides other corporate banking services including factoring and commitments to provide loan financing. Loan commitment fees are included in fees and commissions where the loan is not expected to be drawn down by the customer.

The Group receives interchange and merchant fees, together with fees for overseas use and cash advances, for provision of card services to cardholders and merchants.

Note 6: Net trading (losses) income

	2023 £m	2022 £m
Net (losses) gains on financial assets and liabilities at fair value through profit or loss:		
Net (losses) gains on financial instruments held for trading	**(88)**	42
Net gains (losses) on other financial instruments mandatorily held at fair value through profit or loss	**8**	(14)
	(80)	28
Foreign exchange	**48**	23
Investment property losses	**(1)**	–
Net trading (losses) income	**(33)**	51

Note 7: Other operating income

	2023 £m	2022 £m
Net gains (losses) on disposal of financial assets at fair value through other comprehensive income (note 28)	–	(15)
Liability management	**100**	11
Intercompany recharges and other	**91**	57
Total other operating income	**191**	53

Note 8: Operating expenses

	2023 £m	2022 £m
Staff costs:		
Salaries and social security costs[1]	**886**	903
Pensions and other retirement benefit schemes	**179**	181
	1,065	1,084
Premises and equipment costs	**200**	173
Depreciation and amortisation[2]	**274**	224
Other expenses:		
Regulatory and legal provisions (note 25)	**89**	91
Amounts payable to fellow Lloyds Banking Group undertakings and other	**1,731**	1,590
	1,820	1,681
Total operating expenses	**3,359**	3,162

1 Including social security costs of £84 million (2022: £89 million).
2 Including depreciation in respect of premises £44 million (2022: £47 million), equipment £29 million (2022: £35 million) and right-of-use assets £74 million (2022: £78 million).

Average headcount

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2023	2022
UK	**21,918**	23,173
Overseas	**388**	389
Total	**22,306**	23,562

The majority of the Group's staff are contractually employed by the Bank's parent company, HBOS plc.

Note 9: Share-based payments

During the year ended 31 December 2023 Lloyds Banking Group plc operated a number of share-based payment schemes for which employees of the Bank of Scotland Group were eligible and all of which are mainly equity settled. Details of all schemes operated by Lloyds Banking Group are set out below; these are managed and operated on a Lloyds Banking Group-wide basis. The amount charged to the Group's income statement in respect of Lloyds Banking Group share-based payment schemes, and which is included within staff costs (note 8), was £59 million (2022: £72 million).

During the year ended 31 December 2023 the Lloyds Banking Group operated the following share-based payment schemes, all of which are mainly equity settled.

Lloyds Banking Group Performance Share plan

The Lloyds Banking Group operates a Group Performance Share plan that is part equity settled. Bonuses in respect of employee service in 2023 have been recognised in the charge in line with the proportion of the deferral period completed.

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £500 per month and, at the expiry of a fixed term of three years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Lloyds Banking Group at a discounted price of no less than 90 per cent of the market price at the start of the invitation period.

Note 9: Share-based payments continued

Movements in the number of share options outstanding under the SAYE schemes are set out below:

	2023 Number of options	2023 Weighted average exercise price (pence)	2022 Number of options	2022 Weighted average exercise price (pence)
Outstanding at 1 January	**1,256,918,075**	**31.30**	1,180,563,291	30.63
Granted	**287,984,574**	**38.55**	217,611,519	39.38
Exercised	**(164,709,399)**	**38.55**	(23,359,526)	37.75
Forfeited	**(12,862,726)**	**31.78**	(20,961,259)	29.20
Cancelled	**(45,807,000)**	**37.65**	(47,687,607)	33.88
Expired	**(10,318,376)**	**38.25**	(49,248,343)	46.29
Outstanding at 31 December	**1,311,205,148**	**31.70**	1,256,918,075	31.30
Exercisable at 31 December	**410,368**	**39.87**	263,302	47.92

The weighted average share price at the time that the options were exercised during 2023 was £0.48 (2022: £0.49). The weighted average remaining contractual life of options outstanding at the end of the year was 1.58 years (2022: 1.88 years).

The weighted average fair value of SAYE options granted during 2023 was £0.09 (2022: £0.07). The fair values of the SAYE options have been determined using a standard Black-Scholes model.

Other share option plans

Executive Share Plans – buyout and retention awards

Share options may be granted to senior employees under the Lloyds Banking Group Executive Share Plan 2003, Lloyds Banking Group Executive Group Ownership Share Plan and Deferred Bonus Scheme 2021 specifically to facilitate recruitment (to compensate new recruits for any lost share awards), and also to make grants to key individuals for retention purposes. In some instances, grants may be made subject to individual performance conditions.

Participants are not entitled to any dividends paid during the vesting period.

	2023 Number of options	2023 Weighted average exercise price (pence)	2022 Number of options	2022 Weighted average exercise price (pence)
Outstanding at 1 January	**20,466,471**	**Nil**	14,032,762	Nil
Granted	**15,198,717**	**Nil**	10,278,224	Nil
Exercised	**(8,739,497)**	**Nil**	(3,333,322)	Nil
Vested	**(765,247)**	**Nil**	–	Nil
Forfeited	**(8,216)**	**Nil**	(33,409)	Nil
Lapsed	**(20,973)**	**Nil**	(477,784)	Nil
Outstanding at 31 December	**26,131,255**	**Nil**	20,466,471	Nil
Exercisable at 31 December	**1,148,770**	**Nil**	1,638,202	Nil

The weighted average fair value of options granted in the year was £0.41 (2022: £0.44). The fair values of options granted have been determined using a standard Black-Scholes model. The weighted average share price at the time that the options were exercised during 2023 was £0.46 (2022: £0.46). The weighted average remaining contractual life of options outstanding at the end of the year was 6.3 years (2022: 6.0 years).

Included in the above are awards to the Group Chief Executive.

William Chalmers joined the Group on 3 June 2019 and was appointed as Chief Financial Officer on 1 August 2019. He was granted deferred share awards over 4,086,632 shares, to replace unvested awards from his former employer, Morgan Stanley, that were forfeited as a result of him joining the Lloyds Banking Group. The final tranche was exercised in 2022 and no options were outstanding for 2023.

	2023 Number of shares	2022 Number of shares
Outstanding at 1 January	**–**	686,085
Exercised	**–**	(686,085)
Outstanding at 31 December	**–**	–

Note 9: Share-based payments continued

Charlie Nunn joined the Group on 16 August 2021 as Group Chief Executive. He was granted deferred share awards over 8,301,708 shares to replace unvested awards from his former employer, HSBC, that were forfeited as a result of him joining the Lloyds Banking Group.

	2023 Number of shares	2022 Number of shares
Outstanding at 1 January	**6,585,447**	7,444,787
Exercised	**(1,247,548)**	(859,340)
Outstanding at 31 December	**5,337,899**	6,585,447

Other share plans

Lloyds Banking Group Executive Group Ownership Share Plan

The plan, introduced in 2006, is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of the Lloyds Banking Group over a three-year period. Awards are made within limits set by the rules of the plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary. In exceptional circumstances this may increase to four times annual salary.

At the end of the performance period for the 2021 grant, the targets had not been fully met and therefore these awards vested in 2023 at a rate of 43.70 per cent.

The Executive Group Ownership awards were replaced by Long Term Share Plan awards in 2021.

	2023 Number of shares	2022 Number of shares
Outstanding at 1 January	**202,394,509**	350,873,627
Vested	**(66,555,435)**	(50,703,778)
Forfeited	**(96,034,781)**	(98,741,356)
Dividend award	**–**	966,016
Outstanding at 31 December	**39,804,293**	202,394,509

Lloyds Banking Group Long Term Share Plan

The plan, introduced in 2021, replaced the Lloyds Banking Group Executive Group Ownership Share Plan and is intended to provide alignment to the Group's aim of delivering sustainable returns to shareholders, supported by its values and behaviours.

The awards in respect of the 2021 grant are due to vest in 2024 at a rate of 100 per cent.

	2023 Number of shares	2022 Number of shares
Outstanding at 1 January	**171,947,743**	77,883,068
Granted	**108,551,439**	108,513,202
Forfeited	**(18,089,793)**	(14,448,527)
Outstanding at 31 December	**262,409,389**	171,947,743

The weighted average fair value of awards granted in the year was £0.42 (2022: £0.36).

Assumptions at 31 December 2023

The fair value calculations at 31 December 2023 for grants made in the year, using Black-Scholes models and Monte Carlo simulation, are based on the following assumptions:

	SAYE	Executive Share Plans	Long Term Share Plan
Weighted average risk-free interest rate	**4.52%**	**4.36%**	**3.71%**
Weighted average expected life	**3.3 years**	**1.9 years**	**3.6 years**
Weighted average expected volatility	**28%**	**30%**	**34%**
Weighted average expected dividend yield	**6.0%**	**6.0%**	**6.0%**
Weighted average share price	**£0.44**	**£0.46**	**£0.52**
Weighted average exercise price	**£0.39**	**Nil**	**Nil**

Expected volatility is a measure of the amount by which the Lloyds Banking 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 Lloyds Banking Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

Notes to the financial statements continued
for the year ended 31 December

Note 9: Share-based payments continued
Share Incentive Plans
Matching shares
The Lloyds Banking Group undertakes to match shares purchased by employees up to the value of £45 per month; these matching shares are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves within this three-year period for other than a 'good' reason, all of the matching shares are forfeited. Similarly, if the employees sell their purchased shares within three years, their matching shares are forfeited..

The number of shares awarded relating to matching shares in 2023 was 43,945,238 (2022: 43,378,504), with an average fair value of £0.46 (2022: £0.45), based on market prices at the date of award.

Fixed share awards
Fixed share awards were introduced in 2014 in order to ensure that total fixed remuneration is commensurate with role and to provide a competitive reward package for certain Lloyds Banking Group employees, with an appropriate balance of fixed and variable remuneration, in line with regulatory requirements. The fixed share awards are delivered in Lloyds Banking Group plc shares, and were initially released over five years with 20 per cent being released each year following the year of award. From June 2020, the fixed share awards are released over three years with one third being released each year following the year of award. The number of shares purchased in relation to fixed share awards in 2023 was 1,790,243 (2022: 7,261,080) with an average fair value of £0.46 (2022: £0.47) based on market prices at the date of the award.

The fixed share award is not subject to any performance conditions, performance adjustment or clawback. On an employee leaving the Lloyds Banking Group, there is no change to the timeline for which shares will become unrestricted.

Since the beginning of 2023 the number of recipients of these awards has been reduced to the executive directors only.

Free shares
An award of shares may be made annually to employees up to a maximum of £3,600. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition. If an employee leaves the Lloyds Banking Group within this three-year period for other than a 'good' reason, all of the shares awarded will be forfeited.

There have not been any awards made since 2021.

Note 10: Auditors' remuneration
Fees payable to the Bank's auditors are as follows:

	2023 £m	2022 £m
Fees payable for the:		
– the audit of the Bank's current year Annual Report	**3.7**	3.6
– the audits of the Bank's subsidiaries	**1.6**	0.3
– total audit fees in respect of the statutory audit of Group entities[1]	**5.3**	3.9
– services normally provided in connection with statutory and regulatory filings or engagements	**0.1**	0.2
Total audit fees[2]	**5.4**	4.1
Other audit-related fees[2]	**–**	0.2
All other fees[2]	**0.4**	–
Total non-audit services[3]	**0.4**	0.2
Total fees payable to the Bank's auditors by the Group	**5.8**	4.3

1 As defined by the Financial Reporting Council (FRC).
2 As defined by the Securities and Exchange Commission (SEC).
3 As defined by the SEC. Total non-audit services as defined by the FRC include all fees other than audit fees in respect of the statutory audit of Group entities. These fees totalled £0.5 million (2022: £0.4 million).

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 audit-related fees: This category includes fees in respect of services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements, for example acting as reporting accountants in respect of debt prospectuses required by the Listing Rules.

All other fees: This category includes other assurance services not related to the performance of the audit or review of the financial statements, for example, the review of controls operated by the Group on behalf of a third party. The auditors are not engaged to provide tax services.

It is the Group's policy to use the auditors only 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.

The Group has procedures that are designed to ensure auditor independence, including prohibiting certain non-audit services. All audit and non-audit assignments must be pre-approved by the Lloyds Banking Group Audit Committee on an individual engagement basis; for certain types of non-audit engagements where the fee is 'de minimis' the Lloyds Banking Group Audit Committee has pre-approved all assignments subject to confirmation by management. On a quarterly basis, the Lloyds Banking Group Audit Committee receives and reviews a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

Note 11: Impairment

Year ended 31 December 2023	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
In respect of:				
Loans and advances to customers	**101**	**(240)**	**(185)**	**(324)**
Due from fellow Lloyds Banking Group undertakings	**(8)**	**–**	**–**	**(8)**
Financial assets at amortised cost	**93**	**(240)**	**(185)**	**(332)**
Loan commitments and financial guarantees	**19**	**(5)**	**(1)**	**13**
Total impairment charge (credit)	**112**	**(245)**	**(186)**	**(319)**

Year ended 31 December 2022	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of:				
Loans and advances to customers	(169)	212	548	591
Due from fellow Lloyds Banking Group undertakings	11	–	–	11
Financial assets at amortised cost	(158)	212	548	602
Loan commitments and financial guarantees	3	27	–	30
Total impairment (credit) charge	(155)	239	548	632

Note 12: Tax

Analysis of tax expense for the year

	2023 £m	2022 £m
UK corporation tax:		
Current tax on profit for the year	**3**	(231)
Adjustments in respect of prior years	**18**	176
	21	(55)
Foreign tax:		
Current tax on profit for the year	**–**	–
Adjustments in respect of prior years	**–**	(1)
	–	(1)
Current tax credit (expense)	**21**	(56)
Deferred tax:		
Current year	**(37)**	(70)
Adjustments in respect of prior years	**–**	55
Deferred tax expense	**(37)**	(15)
Tax expense	**(16)**	(71)

Factors affecting the tax expense for the year

The UK corporation tax rate for the year was 23.5 per cent (2022: 19.0 per cent). The increase in applicable tax rate from 2022 relates to the change in statutory tax rate effective from 1 April 2023. An explanation of the relationship between tax expense and accounting profit is set out below.

	2023 £m	2022 £m
Profit before tax	**351**	1,137
UK corporation tax thereon	**(82)**	(216)
Impact of surcharge on banking profits	**(2)**	(87)
Non-deductible costs: conduct charges	**(13)**	(2)
Non-deductible costs: bank levy	**(13)**	(11)
Other non-deductible costs	**(17)**	(7)
Non-taxable income	**23**	1
Tax relief on coupons on other equity instruments	**44**	23
Tax-exempt gains on disposals	**26**	–
Remeasurement of deferred tax due to rate changes	**–**	(5)
Differences in overseas tax rates	**–**	3
Adjustments in respect of prior years	**18**	230
Tax expense	**(16)**	(71)

Note 12: Tax continued

Deferred tax

The Group's and the Bank's deferred tax assets and liabilities are as follows:

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Statutory position				
Deferred tax assets	**1,911**	1,944	**1,932**	1,979
Deferred tax liabilities	**–**	–	**–**	–
Net deferred tax asset at 31 December	**1,911**	1,944	**1,932**	1,979
Tax disclosure				
Deferred tax assets	**2,017**	2,063	**1,977**	2,020
Deferred tax liabilities	**(106)**	(119)	**(45)**	(41)
Net deferred tax asset at 31 December	**1,911**	1,944	**1,932**	1,979

The statutory position reflects the deferred tax assets and liabilities as disclosed in the consolidated and the Bank balance sheet and takes into account the ability of the Group and the Bank to net assets and liabilities where there is a legally enforceable right of offset. The tax disclosure of deferred tax assets and liabilities ties to the amounts outlined in the tables below which splits the deferred tax assets and liabilities by type, before such netting.

Movements in deferred tax assets and liabilities (before taking into consideration the offsetting of balances within the same taxing jurisdiction) can be summarised as follows:

The Group Deferred tax assets	**Tax losses £m**	**Property, plant and equipment £m**	**Provisions £m**	**Pension liabilities £m**	**Share-based payments £m**	**Derivatives £m**	**Other temporary differences £m**	**Total £m**
At 1 January 2022	1,827	103	90	–	4	28	30	2,082
Credit (charge) to the income statement	26	(27)	(14)	–	–	(7)	(24)	(46)
Credit to other comprehensive income	–	–	–	–	–	5	–	5
Acquisition	–	2	19	–	–	–	1	22
At 31 December 2022	1,853	78	95	–	4	26	7	2,063
Credit (charge) to the income statement	**4**	**(46)**	**(13)**	**5**	**1**	**–**	**(1)**	**(50)**
Credit to other comprehensive income	**–**	**–**	**–**	**–**	**–**	**4**	**–**	**4**
At 31 December 2023	**1,857**	**32**	**82**	**5**	**5**	**30**	**6**	**2,017**

The Group Deferred tax liabilities	**Capitalised software enhancements £m**	**Acquisition fair value £m**	**Pension assets £m**	**Derivatives £m**	**Asset revaluations[1] £m**	**Other temporary differences £m**	**Total £m**
At 1 January 2022	(20)	–	–	(1)	(7)	(47)	(75)
(Charge) credit to the income statement	8	4	(11)	–	7	23	31
Credit to other comprehensive income	–	–	6	–	–	–	6
Acquisition	–	(80)	–	–	–	–	(80)
Exchange and other adjustments	–	–	–	–	–	(1)	(1)
At 31 December 2022	(12)	(76)	(5)	(1)	–	(25)	(119)
(Charge) credit to the income statement	**4**	**16**	**(9)**	**1**	**–**	**1**	**13**
Credit to other comprehensive income	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Exchange and other adjustments	**–**	**–**	**–**	**–**	**–**	**–**	**–**
At 31 December 2023	**(8)**	**(60)**	**(14)**	**–**	**–**	**(24)**	**(106)**

1 Financial assets at fair value through other comprehensive income.

Note 12: Tax continued

The Bank Deferred tax assets	Tax losses £m	Property, plant and equipment £m	Provisions £m	Share-based payments £m	Pension liabilities £m	Derivatives £m	Other temporary differences £m	Total £m
At 1 January 2022	1,799	125	87	4	–	28	22	2,065
Credit (charge) to the income statement	25	(36)	(14)	–	–	–	(18)	(43)
Charge to other comprehensive income	–	–	–	–	–	(2)	–	(2)
At 31 December 2022	1,824	89	73	4	–	26	4	2,020
Credit (charge) to the income statement	**4**	**(47)**	**(9)**	**1**	**5**	**–**	**(1)**	**(47)**
Charge to other comprehensive income	**–**	**–**	**–**	**–**	**–**	**4**	**–**	**4**
At 31 December 2023	**1,828**	**42**	**64**	**5**	**5**	**30**	**3**	**1,977**

The Bank Deferred tax liabilities	Capitalised software enhancements £m	Pension assets £m	Asset revaluations[1] £m	Other temporary differences £m	Total £m
At 1 January 2022	(20)	–	(7)	(47)	(74)
(Charge) credit to the income statement	8	(11)	–	23	20
Credit to other comprehensive income	–	6	7	–	13
At 31 December 2022	(12)	(5)	–	(24)	(41)
(Charge) credit to the income statement	**4**	**(9)**	**–**	**1**	**(4)**
Credit to other comprehensive income	**–**	**–**	**–**	**–**	**–**
At 31 December 2023	**(8)**	**(14)**	**–**	**(23)**	**(45)**

1 Financial assets at fair value through other comprehensive income.

At 31 December 2023 the Group carried net deferred tax assets on its balance sheet of £1,911 million (2022: £1,944 million) and the Bank carried net deferred tax assets of £1,932 million (2022: £1,979 million) principally relating to tax losses carried forward.

Estimation of income taxes includes the assessment of recoverability of deferred tax assets. Deferred tax assets are only recognised to the extent that they are considered more likely than not to be recoverable based on existing tax laws and forecasts of future taxable profits against which the underlying tax deductions can be utilised. The Group has recognised a deferred tax asset of £1,857 million (2022: £1,853 million) and the Bank £1,828 million (2022: £1,824 million) in respect of trading losses carried forward. Substantially all of these losses have arisen in the Bank, and they will be utilised as taxable profits arise in future periods.

The Group's expectations of future UK taxable profits require management judgement, and take into account the Group's long-term financial and strategic plans and anticipated future tax-adjusting items. In making this assessment, account is taken of business plans, the Board-approved operating plan and the expected future economic outlook as set out in the strategic report, as well as the risks associated with future regulatory, climate-related and other change, in order to produce a base case forecast of future UK taxable profits. Under current law there is no expiry date for UK trading losses not yet utilised, and given the forecast of future profitability and the Group's commitment to the UK market, in management's judgement it is more likely than not that the value of the losses will be recovered by the Group while still operating as a going concern. Banking tax losses that arose before 1 April 2015 can only be used against 25 per cent of taxable profits arising after 1 April 2016, and they cannot be used to reduce the surcharge on banking profits. These restrictions in utilisation mean that the value of the deferred tax asset in respect of tax losses is only expected to be fully recovered by 2034 (2022: 2032) in the base case forecast. It is possible that future tax law changes could materially affect the timing of recovery and the value of these losses ultimately realised by the Group.

Deferred tax not recognised

Deferred tax assets of £24 million (2022: £29 million) for the Group and the Bank have not been recognised in respect of £97 million of UK tax losses and other temporary differences which can only be used to offset future capital gains. UK capital losses can be carried forward indefinitely.

No deferred tax has been recognised in respect of foreign trade losses where it is not more likely than not that we will be able to utilise them in future periods. Of the asset not recognised, £33 million for the Group and £nil for the Bank (2022: £37 million for the Group and £nil for the Bank) relates to losses that will expire if not used within 20 years, and £2 million for the Group and £nil for the Bank (2022: £2 million for the Group and £nil for the Bank) relates to losses with no expiry date.

As a result of parent company exemptions on dividends from subsidiaries and on capital gains on disposal there are no significant taxable temporary differences associated with investments in subsidiaries, branches, associates and joint arrangements.

Critical accounting judgements and key sources of estimation uncertainty

Critical judgement:	The Group believes that its interpretation of the tax rules on group relief are correct

The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013, HMRC informed the Group that its interpretation of the UK rules means that the group relief is not available. In 2020, HMRC concluded its enquiry into the matter and issued a closure notice. The Group's interpretation of the UK rules has not changed and hence it appealed to the First Tier Tax Tribunal, with a hearing having taken place in May 2023. If the final determination of the matter by the judicial process is that HMRC's position is correct, management believes that this would result in an increase in current tax liabilities of the Group of approximately £185 million (including interest). The Group, following conclusion of the hearing and having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

There are a number of other open matters on which the Group is in discussions with HMRC, none of which is expected to have a material impact on the financial position of the Group.

Note 13: 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.

The Group	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss: Held for trading £m	Mandatorily held at fair value through profit or loss: Other £m	Designated at fair value through profit or loss £m	Held at amortised cost £m	Total £m
At 31 December 2023						
Financial assets						
Cash and balances at central banks	–	–	–	–	3,009	3,009
Financial assets at fair value through profit or loss	–	–	266	–	–	266
Derivative financial instruments	30	2,820	–	–	–	2,850
Loans and advances to banks	–	–	–	–	206	206
Loans and advances to customers	–	–	–	–	292,470	292,470
Debt securities	–	–	–	–	1,696	1,696
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	16,773	16,773
Financial assets at amortised cost	–	–	–	–	311,145	311,145
Other	–	–	–	–	51	51
Total financial assets	**30**	**2,820**	**266**	**–**	**314,205**	**317,321**
Financial liabilities						
Deposits from banks	–	–	–	–	179	179
Customer deposits	–	–	–	–	161,946	161,946
Repurchase agreements	–	–	–	–	30,397	30,397
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	95,098	95,098
Financial liabilities at fair value through profit or loss	–	–	–	23	–	23
Derivative financial instruments	644	3,784	–	–	–	4,428
Notes in circulation	–	–	–	–	1,392	1,392
Debt securities in issue at amortised cost	–	–	–	–	8,610	8,610
Other	–	–	–	–	554	554
Subordinated liabilities	–	–	–	–	1,532	1,532
Total financial liabilities	**644**	**3,784**	**–**	**23**	**299,708**	**304,159**
At 31 December 2022						
Financial assets						
Cash and balances at central banks	–	–	–	–	3,004	3,004
Financial assets at fair value through profit or loss	–	–	291	–	–	291
Derivative financial instruments	36	3,441	–	–	–	3,477
Loans and advances to banks	–	–	–	–	198	198
Loans and advances to customers	–	–	–	–	292,416	292,416
Debt securities	–	–	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	–	–	–	–	16,048	16,048
Financial assets at amortised cost	–	–	–	–	308,662	308,662
Other	–	–	–	–	47	47
Total financial assets	36	3,441	291	–	311,713	315,481
Financial liabilities						
Deposits from banks	–	–	–	–	195	195
Customer deposits	–	–	–	–	166,363	166,363
Repurchase agreements	–	–	–	–	30,210	30,210
Due to fellow Lloyds Banking Group undertakings	–	–	–	–	91,287	91,287
Financial liabilities at fair value through profit or loss	–	–	–	26	–	26
Derivative financial instruments	1	4,569	–	–	–	4,570
Notes in circulation	–	–	–	–	1,280	1,280
Debt securities in issue at amortised cost	–	–	–	–	6,123	6,123
Other	–	–	–	–	668	668
Subordinated liabilities	–	–	–	–	1,598	1,598
Total financial liabilities	1	4,569	–	26	297,724	302,320

Note 13: Measurement basis of financial assets and liabilities continued

The Bank	Derivatives designated as hedging instruments £m	Mandatorily held at fair value through profit or loss: Held for trading £m	Mandatorily held at fair value through profit or loss: Other £m	Held at amortised cost £m	Total £m
At 31 December 2023					
Financial assets					
Cash and balances at central banks	–	–	–	3,009	3,009
Financial assets at fair value through profit or loss	–	–	111	–	111
Derivative financial instruments	30	2,820	–	–	2,850
Loans and advances to banks	–	–	–	180	180
Loans and advances to customers	–	–	–	286,187	286,187
Debt securities	–	–	–	1,696	1,696
Due from fellow Lloyds Banking Group undertakings	–	–	–	20,921	20,921
Financial assets at amortised cost	–	–	–	308,984	308,984
Other	–	–	–	51	51
Total financial assets	30	2,820	111	312,044	315,005
Financial liabilities					
Deposits from banks	–	–	–	179	179
Customer deposits	–	–	–	161,946	161,946
Repurchase agreements	–	–	–	30,397	30,397
Due to fellow Lloyds Banking Group undertakings	–	–	–	94,394	94,394
Derivative financial instruments	644	3,653	–	–	4,297
Notes in circulation	–	–	–	1,392	1,392
Debt securities in issue at amortised cost	–	–	–	7,992	7,992
Other	–	–	–	554	554
Subordinated liabilities	–	–	–	1,532	1,532
Total financial liabilities	644	3,653	–	298,386	302,683
At 31 December 2022					
Financial assets					
Cash and balances at central banks	–	–	–	3,004	3,004
Financial assets at fair value through profit or loss	–	–	113	–	113
Derivative financial instruments	36	3,440	–	–	3,476
Loans and advances to banks	–	–	–	171	171
Loans and advances to customers	–	–	–	283,621	283,621
Debt securities	–	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	–	–	–	22,999	22,999
Financial assets at amortised cost	–	–	–	306,791	306,791
Other	–	–	–	47	47
Total financial assets	36	3,440	113	309,842	313,431
Financial liabilities					
Deposits from banks	–	–	–	195	195
Customer deposits	–	–	–	166,363	166,363
Repurchase agreements	–	–	–	30,210	30,210
Due to fellow Lloyds Banking Group undertakings	–	–	–	91,563	91,563
Derivative financial instruments	1	4,420	–	–	4,421
Notes in circulation	–	–	–	1,280	1,280
Debt securities in issue at amortised cost	–	–	–	5,376	5,376
Other	–	–	–	668	668
Subordinated liabilities	–	–	–	1,598	1,598
Total financial liabilities	1	4,420	–	297,253	301,674

Note 14: Fair values of financial assets and liabilities

At 31 December 2023, the carrying value of the Group's financial instrument assets held at fair value was £3,116 million (2022: £3,768 million), and its financial instrument liabilities held at fair value was £4,451 million (2022: £4,596 million). The carrying value of the Bank's financial instrument assets held at fair value was £2,961 million (2022: £3,589 million), and financial instrument liabilities was £4,297 million (2022: £4,421 million).

(1) Fair value measurement

Fair value is the price that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is a measure as at a specific date and may be significantly different from the amount which will actually be paid or received on maturity or settlement date.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments to those held by the Group. Where quoted market prices are not available, or are unreliable because of poor liquidity, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs. Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group. The Group measures valuation adjustments for its derivative exposures on the same basis as the derivatives are managed.

The carrying amount of the following financial instruments is a reasonable approximation of fair value: cash and balances at central banks, items in the course of collection from banks, items in course of transmission to banks and notes in circulation.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that are not financial instruments or for other assets and liabilities which are not carried at fair value in the Group's consolidated balance sheet. These items include intangible assets, property, plant and equipment, and shareholders' equity. These items are material and accordingly the Group believes that any fair value information presented would not represent the underlying value of the Group.

Valuation control framework

The key elements of the control framework for the valuation of financial instruments include model validation, product implementation review and independent price verification. These functions are carried out by appropriately skilled risk and finance teams, independent of the business area responsible for the products.

Model validation covers both qualitative and quantitative elements relating to new models. In respect of new products, a product implementation review is conducted pre and post-trading. Pre-trade testing ensures that the new model is integrated into the Group's systems and that the profit and loss and risk reporting are consistent throughout the trade lifecycle. Post-trade testing examines the explanatory power of the implemented model, actively monitoring model parameters and comparing in-house pricing to external sources. Independent price verification procedures cover financial instruments carried at fair value. The frequency of the review is matched to the availability of independent data, monthly being the minimum. Valuation differences in breach of established thresholds are escalated to senior management. The results from independent pricing and valuation reserves are reviewed monthly by senior management.

Formal committees, consisting of senior risk, finance and business management, meet at least quarterly to discuss and approve valuations in more judgemental areas, in particular for structured credit, derivatives and the credit valuation adjustment (CVA), funding valuation adjustment (FVA) and other valuation adjustments.

Valuation of financial assets and liabilities

Assets and liabilities carried at fair value or for which fair values are disclosed have been classified into three levels according to the quality and reliability of information used to determine the fair values.

Level 1

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise government securities.

Level 2

Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data. Examples of such financial instruments include most over-the-counter derivatives, financial institution issued securities, certificates of deposit and certain asset-backed securities.

Level 3

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Certain of the Group's loans and advances recognised at fair value and derivatives are also classified as level 3.

Transfers out of the level 3 portfolio arise when inputs that could have a significant impact on the instrument's valuation become market observable after previously having been non-market observable. In the case of asset-backed securities this can arise if more than one consistent independent source of data becomes available. Conversely, transfers into the portfolio arise when consistent sources of data cease to be available.

Note 14: Fair values of financial assets and liabilities continued

(2) Financial assets and liabilities carried at fair value

(A) Financial assets (excluding derivatives)

Valuation hierarchy

At 31 December 2023, the financial assets (excluding derivatives) carried at fair value totalled £266 million for the Group and £111 million for the Bank (2022 (£291 million for the Group and £113 million for the Bank). The table below analyses these financial assets by balance sheet classification, asset type and valuation methodology (level 1, 2 or 3, as described above). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

	2023				2022			
The Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Loans and advances to customers classified as financial assets at fair value through profit or loss	**–**	**–**	**266**	**266**	–	–	291	291

	2023				2022			
The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Loans and advances to customers classified as financial assets at fair value through profit or loss	**–**	**–**	**111**	**111**	–	–	113	113

Movements in level 3 portfolio

The table below analyses movements in level 3 financial assets (excluding derivatives) at fair value, recurring basis.

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
At 1 January	**291**	362	**113**	152
(Losses) gains recognised in the income statement within other income	**(1)**	(20)	**2**	(16)
Purchases/increases to customer loans	**–**	3	**–**	3
Sales/repayments of customer loans	**(24)**	(54)	**(4)**	(26)
At 31 December	**266**	291	**111**	113
Gains (losses) recognised in the income statement, within other income, relating to the change in fair value of those assets held at 31 December	**–**	(19)	**3**	(16)

Valuation methodology for financial assets (excluding derivatives)

Loans and advances to customers

The fair value of these assets is determined using discounted cash flow techniques. The discount rates are derived from market observable interest rates, a risk margin that reflects loan credit ratings and an incremental illiquidity premium based on historical spreads at origination on similar loans.

(B) Financial liabilities (excluding derivatives)

Valuation hierarchy

At 31 December 2023, the Group's financial liabilities (excluding derivatives) carried at fair value, comprised its financial liabilities at fair value through profit or loss and totalled £23 million (2022: £26 million). The table below analyses these financial liabilities by balance sheet classification and valuation methodology (level 1, 2 or 3, as described on **page 48**). The fair value measurement approach is recurring in nature. There were no significant transfers between level 1 and 2 during the year.

	2023				2022			
The Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Debt securities in issue designated at fair value through profit or loss	**–**	**–**	**23**	**23**	–	–	26	26

Movements in level 3 portfolio

The table below analyses movements in the level 3 financial liabilities (excluding derivatives) at fair value portfolio.

The Group	**2023 £m**	2022 £m
At 1 January	**26**	33
Gains recognised in the income statement within other income	**(1)**	(3)
Redemptions	**(2)**	(4)
At 31 December	**23**	26
Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 31 December	**(1)**	(3)

Note 14: Fair values of financial assets and liabilities continued

(C) Derivatives

Valuation hierarchy

All of the Group's derivative assets and liabilities are carried at fair value. At 31 December 2023, such assets totalled £2,850 million for the Group and the Bank (2022: £3,477 million for the Group and £3,476 million for the Bank) and liabilities totalled £4,428 million for the Group and £4,297 million for the Bank (2022: £4,570 million for the Group and £4,421 million for the Bank). The table below analyses these derivative balances by valuation methodology (level 1, 2 or 3, as described on **page 48**). The fair value measurement approach is *recurring in nature. There were no significant transfers between level 1 and level 2 during the year.*

	2023				2022			
The Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	–	**2,850**	–	**2,850**	–	3,477	–	3,477
Derivative liabilities	–	**(4,296)**	**(132)**	**(4,428)**	–	(4,420)	(150)	(4,570)

	2023				2022			
The Bank	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Derivative assets	–	**2,850**	–	**2,850**	–	3,476	–	3,476
Derivative liabilities	–	**(4,297)**	–	**(4,297)**	–	(4,421)	–	(4,421)

Movements in level 3 portfolio

The table below analyses movements in level 3 derivative assets and liabilities carried at fair value.

	2023		2022	
The Group	**Derivative assets £m**	**Derivative liabilities £m**	Derivative assets £m	Derivative liabilities £m
At 1 January	–	**(150)**	–	(176)
Losses recognised in the income statement within other income	–	**3**	–	1
Redemptions	–	**15**	–	25
At 31 December	–	**(132)**	–	(150)
Losses recognised in the income statement, within other income, relating to the change in fair value of those assets or liabilities held at 31 December	–	**2**	–	1

Valuation methodology for derivatives

The Group's derivatives are valued using techniques including discounted cash flow and options pricing models, as appropriate. The types of derivatives classified as level 2 and the valuation techniques used include:

- *Interest rate swaps which are valued using discounted cash flow models; the most significant inputs into those models are interest* rate yield curves which are developed from publicly quoted rates
- Foreign exchange derivatives that do not contain options which are priced using rates available from publicly quoted sources
- Credit derivatives are valued using standard models with observable inputs, including publicly available yield and credit default swap (CDS) curves
- Less complex interest rate and foreign exchange option products which are valued using volatility surfaces developed from publicly available interest rate cap, interest rate swaption and other option volatilities; option volatility skew information is derived from a market standard consensus pricing service.

Complex interest rate products where inputs to the valuation are significant and unobservable are classified as level 3.

Certain inputs used to calculate CVA, FVA, and own credit adjustments, are not significant in determining the classification of the derivative and debt instruments. Consequently, these inputs do not form part of the level 3 sensitivities presented.

Note 14: Fair values of financial assets and liabilities continued

Derivative valuation adjustments

Derivative financial instruments which are carried in the balance sheet at fair value are adjusted where appropriate to reflect credit risk, market liquidity and other risks.

(i) Uncollateralised derivative valuation adjustments

The following table summarises the movement on this valuation adjustment account during 2022 and 2023:

	2023 £m	2022 £m
At 1 January	**36**	88
Income statement credit	**(7)**	(52)
At 31 December	**29**	36

Represented by:

	2023 £m	2022 £m
Credit Valuation Adjustment	**25**	34
Debit Valuation Adjustment	**(2)**	(3)
Funding Valuation Adjustment	**6**	5
	29	36

Credit and Debit Valuation Adjustments (CVA and DVA) are applied to the Group's over-the-counter derivative exposures with counterparties that are not subject to strong interbank collateral arrangements. These exposures largely relate to the provision of risk management solutions for corporate customers.

A CVA is taken where the Group has a positive future uncollateralised exposure (asset). A DVA is taken where the Group has a negative future uncollateralised exposure (liability). These adjustments reflect interest rates and expectations of counterparty creditworthiness and the Group's own credit spread respectively.

The CVA is sensitive to:
- The current size of the mark-to-market position on the uncollateralised asset
- Expectations of future market volatility of the underlying asset
- Expectations of counterparty creditworthiness

Market Credit Default Swap (CDS) spreads are used to develop the probability of default for quoted counterparties. For unquoted counterparties, internal credit ratings and market sector CDS curves and recovery rates are used. The loss given default (LGD) is based on market recovery rates and internal credit assessments.

The combination of a one-notch deterioration in the credit rating of derivative counterparties and a 10 per cent increase in LGD increases the CVA by £7 million. Current market value is used to estimate the projected exposure for products not supported by the model, which are principally complex interest rate options that are traded in very low volumes. For these, the CVA is calculated on an add-on basis (although no such adjustment was required at 31 December 2023).

The DVA is sensitive to:
- The current size of the mark-to-market position on the uncollateralised liability
- Expectations of future market volatility of the underlying liability
- The Group's own CDS spread

A 1 per cent rise in the CDS spread would lead to an increase in the DVA of £3 million.

The risk exposures that are used for the CVA and DVA calculations are strongly influenced by interest rates. Due to the nature of the Group's business the CVA/DVA exposures tend to be on average the same way around such that the valuation adjustments fall when interest rates rise. A one per cent rise in interest rates would lead to a £12 million fall in the overall valuation adjustment to £11 million. The CVA model used by the Group does not assume any correlation between the level of interest rates and default rates.

The Group has also recognised a Funding Valuation Adjustment to adjust for the net cost of funding uncollateralised derivative positions. This adjustment is calculated on the expected future exposure discounted at a suitable cost of funds. A 10 basis points increase in the cost of funds will increase the funding valuation adjustment by £1 million.

(ii) Market liquidity

The Group includes mid to bid-offer valuation adjustments against the expected cost of closing out the net market risk in the Group's trading positions within a time frame that is consistent with historical trading activity and spreads that the trading desks have accessed historically during the ordinary course of business in normal market conditions.

At 31 December 2023, the Group's derivative trading business held mid to bid-offer valuation adjustments of £1 million (2022: £1 million).

Note 14: Fair values of financial assets and liabilities continued

(D) Sensitivity of level 3 valuations

Critical accounting judgements and key sources of estimation uncertainty

Key sources of estimation uncertainty:	Interest rate spreads, credit spreads, and interest rate volatility

The Group's valuation control framework and a description of level 1, 2 and 3 financial assets and liabilities is set out in section (1) above. The valuation techniques for level 3 financial instruments involve management judgement and estimates, the extent of which depends on the complexity of the instrument and the availability of market observable information. In addition, in line with market practice, the Group applies credit, debit and funding valuation adjustments in determining the fair value of its uncollateralised derivative positions. A description of these adjustments is set out in section (C)(i) above.

			2023			2022		
				Effect of reasonably possible alternative assumptions[1]			Effect of reasonably possible alternative assumptions[1]	
	Valuation techniques	Significant unobservable inputs[2]	Carrying value £m	Favourable changes £m	Unfavourable changes £m	Carrying value £m	Favourable changes £m	Unfavourable changes £m
Financial assets at fair value through profit or loss								
Loans and advances to customers	Discounted cash flows	Interest rate spreads (bps) (+/- 50bps)[3]	**266**	**21**	**(19)**	291	25	(23)
Level 3 financial assets carried at fair value			**266**			291		
Financial liabilities at fair value through profit or loss								
Securitisation notes	Discounted cash flows	Interest rate spreads (+/- 50bps)[3]	**23**	**1**	**(1)**	26	1	(1)
Derivative financial liabilities								
Shared appreciation right	Market values – property valuation	HPI (+/- 1%)[4]	**132**	**13**	**(12)**	150	16	(16)
Level 3 financial liabilities carried at fair value			**155**			176		

1 Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.
2 Ranges are shown where appropriate and represent the highest and lowest inputs used in the level 3 valuations.
3 2022: +/- 50bps.
4 2022: +/- 1%.

Unobservable inputs

Significant unobservable inputs affecting the valuation of debt securities and derivatives are as follows:

- Volatility parameters represent key attributes of option behaviour; higher volatilities typically denote a wider range of possible outcomes

Reasonably possible alternative assumptions

Valuation techniques applied to many of the Group's level 3 instruments often involve the use of two or more inputs whose relationship is interdependent. The calculation of the effect of reasonably possible alternative assumptions included in the table above reflects such relationships.

Note 14: Fair values of financial assets and liabilities continued

(3) Financial assets and liabilities carried at amortised cost

(A) Financial assets

Valuation hierarchy

The table below analyses the fair values of those financial assets of the Group and the Bank which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on **page 48**). Financial assets carried at amortised cost are mainly classified as level 3 due to significant unobservable inputs used in the valuation models. Where inputs are observable, debt securities are classified as level 1 or 2.

The Group	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2023					
Loans and advances to banks	**206**	**206**	**–**	**–**	**206**
Loans and advances to customers	**292,470**	**284,115**	**–**	**–**	**284,115**
Debt securities	**1,696**	**1,794**	**–**	**–**	**1,794**
Due from fellow Lloyds Banking Group undertakings	**16,773**	**16,773**	**–**	**–**	**16,773**
Financial assets at amortised cost	**311,145**	**302,888**	**–**	**–**	**302,888**
At 31 December 2022					
Loans and advances to banks	198	198	–	–	198
Loans and advances to customers	292,416	285,540	–	–	285,540
Debt securities	–	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	16,048	16,048	–	–	16,048
Financial assets at amortised cost	308,662	301,786	–	–	301,786

The Bank	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2023					
Loans and advances to banks	**180**	**180**	**–**	**–**	**180**
Loans and advances to customers	**286,187**	**277,832**	**–**	**–**	**277,832**
Debt securities	**1,696**	**1,794**	**–**	**–**	**1,794**
Due from fellow Lloyds Banking Group undertakings	**20,921**	**20,921**	**–**	**–**	**20,921**
Financial assets at amortised cost	**308,984**	**300,727**	**–**	**–**	**300,727**
At 31 December 2022					
Loans and advances to banks	171	171	–	–	171
Loans and advances to customers	283,621	276,680	–	–	276,680
Debt securities	–	–	–	–	–
Due from fellow Lloyds Banking Group undertakings	22,999	22,999	–	–	22,999
Financial assets at amortised cost	306,791	299,850	–	–	299,850

Valuation methodology

Loans and advances to banks

The carrying value of short-dated loans and advances to banks is assumed to be their fair value. The fair value of other loans and advances to banks is estimated by discounting the anticipated cash flows at a market discount rate adjusted for the credit spread of the obligor or, where not observable, the credit spread of borrowers of similar credit quality.

Loans and advances to customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates.

To determine the fair value of loans and advances to customers, loans are segregated into portfolios of similar characteristics. A number of techniques are used to estimate the fair value of fixed rate lending; these take account of expected credit losses based on historic trends, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is usually estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to market rates for similar loans of maturity equal to the remaining fixed interest rate period. The fair value of commercial loans is estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk.

Debt securities

The fair values of debt securities 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.

Note 14: Fair values of financial assets and liabilities continued

(B) Financial liabilities

Valuation hierarchy

The table below analyses the fair values of those financial liabilities of the Group and the Bank which are carried at amortised cost by valuation methodology (level 1, 2 or 3, as described on **page 48**).

The Group	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2023					
Deposits from banks	**179**	**179**	**–**	**179**	**–**
Customer deposits	**161,946**	**162,115**	**–**	**162,115**	**–**
Repurchase agreements	**30,397**	**30,397**	**–**	**30,397**	**–**
Due to fellow Lloyds Banking Group undertakings	**95,098**	**95,098**	**–**	**95,098**	**–**
Debt securities in issue at amortised cost	**8,610**	**8,633**	**–**	**8,633**	**–**
Subordinated liabilities	**1,532**	**1,556**	**–**	**1,556**	**–**
At 31 December 2022					
Deposits from banks	195	195	–	195	–
Customer deposits	166,363	166,264	–	166,264	–
Repurchase agreements	30,210	30,210	–	30,210	–
Due to fellow Lloyds Banking Group undertakings	91,287	91,287	–	91,287	–
Debt securities in issue at amortised cost	6,123	6,122	–	6,122	–
Subordinated liabilities	1,598	1,631	–	1,631	–

The Bank	Carrying value £m	Fair value £m	Valuation hierarchy Level 1 £m	Level 2 £m	Level 3 £m
At 31 December 2023					
Deposits from banks	**179**	**179**	**–**	**179**	**–**
Customer deposits	**161,946**	**162,115**	**–**	**162,115**	**–**
Repurchase agreements	**30,397**	**30,397**	**–**	**30,397**	**–**
Due to fellow Lloyds Banking Group undertakings	**94,394**	**94,394**	**–**	**94,394**	**–**
Debt securities in issue at amortised cost	**7,992**	**8,016**	**–**	**8,016**	**–**
Subordinated liabilities	**1,532**	**1,556**	**–**	**1,556**	**–**
At 31 December 2022					
Deposits from banks	195	195	–	195	–
Customer deposits	166,363	166,264	–	166,264	–
Repurchase agreements	30,210	30,210	–	30,210	–
Due to fellow Lloyds Banking Group undertakings	91,563	91,563	–	91,563	–
Debt securities in issue at amortised cost	5,376	5,375	–	5,375	–
Subordinated liabilities	1,598	1,631	–	1,631	–

Valuation methodology

Deposits from banks and customer deposits

The fair value of bank and customer deposits repayable on demand is assumed to be equal to their carrying value.

The fair value for all other deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Repurchase agreements

The carrying amount is deemed a reasonable approximation of fair value given the short-term nature of these instruments.

Debt securities in issue at amortised cost

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities in issue is calculated based on quoted market prices where available. Where quoted market prices are not available, fair value is estimated using discounted cash flow techniques at a rate which reflects market rates of interest and the Lloyds Banking Group's own credit spread.

Subordinated liabilities

The fair value of subordinated liabilities is determined by reference to quoted market prices where available or by reference to quoted market prices of similar instruments. Subordinated liabilities are classified as level 2, since the inputs used to determine their fair value are largely observable.

(4) Reclassifications of financial assets

There have been no reclassifications of financial assets in 2022 or 2023.

Note 15: Derivative financial instruments

The fair values and notional amounts of derivative instruments are set out in the following table:

The Group	2023 Contract/ notional amount £m	2023 Fair value Assets £m	2023 Fair value Liabilities £m	2022 Contract/ notional amount £m	2022 Fair value Assets £m	2022 Fair value Liabilities £m
Trading and other						
Exchange rate contracts	**9,106**	**98**	**237**	9,914	240	489
Interest rate contracts	**51,198**	**2,706**	**3,419**	59,688	3,153	3,939
Credit derivatives	**1,305**	**7**	**5**	1,292	38	–
Equity and other contracts	**65**	**9**	**123**	38	10	141
Total derivative assets/liabilities – trading and other	**61,674**	**2,820**	**3,784**	70,932	3,441	4,569
Hedging						
Derivatives designated as fair value hedges	**55,231**	**30**	**644**	745	36	1
Total derivative assets/liabilities – hedging	**55,231**	**30**	**644**	745	36	1
Total recognised derivative assets/liabilities	**116,905**	**2,850**	**4,428**	71,677	3,477	4,570

The notional amount of the contract does not represent the Group's 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; a large proportion of the Group's derivatives are held through exchanges such as London Clearing House and are collateralised through those exchanges. Further details are provided in note 36 Credit risk.

The Group holds derivatives as part of the following strategies:

- Customer driven, where derivatives are held as part of the provision of risk management products to Group customers
- To manage and hedge the Group's interest rate and foreign exchange risk arising from normal banking business. The hedge accounting strategy adopted by the Group is to utilise a combination of fair value and cash flow hedge approaches as described in note 36

The principal derivatives used by the Group are as follows:

- Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date
- Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date
- Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place
- Equity derivatives are also used by the Group as part of its equity-based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities, in the form of published indices on or before a specified future date

Note 15: Derivative financial instruments continued

Details of the Group's hedging instruments are set out below:

The Group At 31 December 2023	Maturity Up to 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	–	–	**8,595**	**46,400**	**236**	**55,231**
Average fixed interest rate	–	–	**5.09%**	**4.60%**	**6.00%**	
At 31 December 2022						
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	–	–	–	495	250	745
Average fixed interest rate	–	–	–	4.68%	6.00%	

The carrying amounts of the Group's hedging instruments are as follows:

The Group At 31 December 2023	Contract/ notional amount £m	Carrying amount of the hedging instrument Assets £m	Liabilities £m	*Changes in fair value used for calculating hedge ineffectiveness* £m
Fair value hedges				
Interest rate				
Interest rate swaps	**55,231**	**30**	**644**	**(677)**
At 31 December 2022				
Fair value hedges				
Interest rate				
Interest rate swaps	745	36	1	(116)

All amounts are held within derivative financial instruments.

Note 15: Derivative financial instruments continued

The Group's hedged items are as follows:

The Group At 31 December 2023	Carrying amount of the hedged item Assets £m	 Liabilities £m	Accumulated amount of fair value adjustment on the hedged item Assets £m	 Liabilities £m	Change in fair value of hedged item for ineffectiveness assessment £m	Cash flow hedging reserve Continuing hedges £m	 Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	**–**	**617**	**–**	**36**	**4**		
Fixed rate bonds[2]	**–**	**–**	**–**	**–**	**–**		
Fixed rate mortgages[3]	**55,145**	**–**	**645**	**–**	**645**		
Cash flow hedges							
Interest rate							
Customer loans[3]					**–**	**–**	**(129)**
Customer deposits[4]					**–**	**–**	**23**
At 31 December 2022							
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	–	550	–	4	141		
Fixed rate bonds[2]	–	–	–	–	(24)		
Fixed rate mortgages[3]	–	–	–	–	–		
Cash flow hedges							
Interest rate							
Customer loans[3]					–	–	(113)
Customer deposits[4]					–	–	23

1 Included within debt securities in issue at amortised cost.
2 Included within financial assets at fair value through other comprehensive income.
3 Included within loans and advances to customers.
4 Included within customer deposits.

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging gains and losses is a liability of £31 million (2022: liability of £37 million).

Gains and losses arising from hedge accounting are summarised as follows:

The Group At 31 December 2023	Gain (loss) recognised in other comprehensive income £m	Hedge ineffectiveness recognised in the income statement[1] £m	Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m	 Income statement line item that includes reclassified amount
Fair value hedges				
Interest rate				
Fixed rate issuance		**–**		
Fixed rate mortgages		**(28)**		
Cash flow hedges				
Interest rate				
Customer loans	**(5)**	**–**	**(10)**	**Interest income**
Customer deposits	**(2)**	**–**	**2**	**Interest expense**
At 31 December 2022				
Fair value hedges				
Interest rate				
Fixed rate issuance		1		
Fixed rate mortgages		–		
Cash flow hedges				
Interest rate				
Customer loans	14	–	(14)	Interest income
Customer deposits	(3)	–	3	Interest expense

1 Hedge ineffectiveness is included in the income statement within net trading income.

Note 15: Derivative financial instruments continued

There were no amounts reclassified from the cash flow hedging reserve in 2022 or 2023 for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

At 31 December 2023 £2,750 million of total recognised derivative assets of the Group and £4,326 million of total recognised derivative liabilities of the Group (2022: £3,258 million of assets and £4,484 million of liabilities) had a contractual residual maturity of greater than one year.

	2023			2022		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
The Bank	£m	Assets £m	Liabilities £m	£m	Assets £m	Liabilities £m
Trading and other						
Exchange rate contracts	**9,106**	**98**	**237**	9,914	240	489
Interest rate contracts	**51,198**	**2,707**	**3,411**	59,688	3,152	3,931
Credit derivatives	**1,304**	**6**	**5**	1,292	38	–
Equity and other contracts	**41**	**9**	**–**	10	10	–
Total derivative assets/liabilities – trading and other	**61,649**	**2,820**	**3,653**	70,904	3,440	4,420
Hedging						
Derivatives designated as fair value hedges:	**55,231**	**30**	**644**	745	36	1
Total derivative assets/liabilities – hedging	**55,231**	**30**	**644**	745	36	1
Total recognised derivative assets/liabilities	**116,880**	**2,850**	**4,297**	71,649	3,476	4,421

Details of the Bank's hedging instruments are set out below:

	Maturity					
The Bank At 31 December 2023	Up to 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	**–**	**–**	**8,595**	**46,400**	**236**	**55,231**
Average fixed interest rate	**–**	**–**	**5.09%**	**4.60%**	**6.00%**	
At 31 December 2022						
Fair value hedges						
Interest rate						
Interest rate swap						
Notional	–	–	–	495	250	745
Average fixed interest rate	–	–	–	4.68%	6.00%	

The carrying amounts of the Bank's hedging instruments are as follows:

	Carrying amount of the hedging instrument			
The Bank At 31 December 2023	Contract/ notional amount £m	Assets £m	Liabilities £m	Changes in fair value used for calculating hedge ineffectiveness £m
Fair value hedges				
Interest rate				
Interest rate swaps	**55,231**	**30**	**644**	**(677)**
At 31 December 2022				
Fair value hedges				
Interest rate				
Interest rate swaps	745	36	1	(116)

All amounts are held within derivative financial instruments.

Note 15: Derivative financial instruments continued

The Bank's hedged items are as follows:

The Bank At 31 December 2023	Carrying amount of the hedged item Assets £m	 Liabilities £m	Accumulated amount of fair value adjustment on the hedged item Assets £m	 Liabilities £m	Change in fair value of hedged item for ineffectiveness assessment £m	Cash flow hedging reserve Continuing hedges £m	 Discontinued hedges £m
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	**–**	**617**	**–**	**36**	**4**		
Fixed rate bonds[2]	**–**	**–**	**–**	**–**	**–**		
Fixed rate mortgages[3]	**55,145**	**–**	**645**	**–**	**645**		
Cash flow hedges							
Interest rate							
Customer loans[3]					**–**	**–**	**(129)**
Customer deposits[4]					**–**	**–**	**23**
At 31 December 2022							
Fair value hedges							
Interest rate							
Fixed rate issuance[1]	–	550	–	4	141		
Fixed rate bonds[2]	–	–	–	–	(24)		
Fixed rate mortgages[3]	–	–	–	–	–		
Cash flow hedges							
Interest rate							
Customer loans[3]					–	–	(113)
Customer deposits[4]					–	–	23

1 Included within debt securities in issue at amortised cost.
2 Included within financial assets at fair value through other comprehensive income.
3 Included within loans and advances to customers.
4 Included within customer deposits.

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging gains and losses is a liability of £31 million (2022: liability of £37 million).

Gains and losses arising from hedge accounting are summarised as follows:

The Bank At 31 December 2023	Gain (loss) recognised in other comprehensive income £m	Hedge ineffectiveness recognised in the income statement[1] £m	Amounts reclassified from reserves to income statement as: Hedged item affected income statement £m	 Income statement line item that includes reclassified amount
Fair value hedges				
Interest rate				
Fixed rate issuance		**–**		
Fixed rate mortgages		**(28)**		
Cash flow hedges				
Interest rate				
Customer loans	**(5)**	**–**	**(10)**	**Interest income**
Customer deposits	**(2)**	**–**	**2**	**Interest expense**
At 31 December 2022				
Fair value hedges				
Interest rate				
Fixed rate issuance		1		
Fixed rate mortgages		–		
Cash flow hedges				
Interest rate				
Customer loans	14	–	(14)	Interest income
Customer deposits	(3)	–	3	Interest expense

1 Hedge ineffectiveness is included in the income statement within net trading income.

Note 15: Derivative financial instruments continued

There were no amounts reclassified from the cash flow hedging reserve in 2022 or 2023 for which hedge accounting had previously been used but for which the hedged future cash flows are no longer expected to occur.

At 31 December 2023 £2,749 million of total recognised derivative assets of the Bank and £4,195 million of total recognised derivative liabilities of the Bank (2022: £3,258 million of assets and £4,334 million of liabilities) had a contractual residual maturity of greater than one year.

Note 16: Loans and advances to customers

	Gross carrying amount				Allowance for expected credit losses			
The Group	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
At 1 January 2023	**243,873**	**44,226**	**7,514**	**295,613**	**284**	**1,132**	**1,781**	**3,197**
Exchange and other adjustments	**640**	**–**	**–**	**640**	**(1)**	**–**	**114**	**113**
Transfers to Stage 1	**12,921**	**(12,909)**	**(12)**	**–**	**217**	**(213)**	**(4)**	**–**
Transfers to Stage 2	**(12,594)**	**13,209**	**(615)**	**–**	**(23)**	**79**	**(56)**	**–**
Transfers to Stage 3	**(702)**	**(2,252)**	**2,954**	**–**	**(7)**	**(160)**	**167**	**–**
Impact of transfers between stages	**(375)**	**(1,952)**	**2,327**	**–**	**(138)**	**211**	**241**	**314**
					49	**(83)**	**348**	**314**
Other changes in credit quality					**44**	**(113)**	**353**	**284**
Additions and repayments	**4,993**	**(1,320)**	**(1,943)**	**1,730**	**8**	**(44)**	**(886)**	**(922)**
Charge (credit) to the income statement					**101**	**(240)**	**(185)**	**(324)**
Disposals and derecognition[1]	**(1,313)**	**(888)**	**(447)**	**(2,648)**	**(1)**	**(35)**	**(85)**	**(121)**
Advances written off			**(684)**	**(684)**			**(684)**	**(684)**
Recoveries of advances written off in previous years			**88**	**88**			**88**	**88**
At 31 December 2023	**247,818**	**40,066**	**6,855**	**294,739**	**383**	**857**	**1,029**	**2,269**
Allowance for impairment losses	**(383)**	**(857)**	**(1,029)**	**(2,269)**				
Net carrying amount	**247,435**	**39,209**	**5,826**	**292,470**				
Drawn ECL coverage[2] (%)	**0.2**	**2.1**	**15.0**	**0.8**				

1 Relates to the securitisations of legacy retail mortgages.
2 Allowance for expected credit losses on loans and advances to customers as a percentage of gross loans and advances to customers.

	Gross carrying amount				Allowance for expected credit losses			
The Group	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2022	250,007	26,420	5,561	281,988	392	810	1,377	2,579
Exchange and other adjustments	8	–	–	8	–	–	55	55
Acquisition of business[1]	5,345	875	125	6,345	61	110	57	228
Transfers to Stage 1	5,473	(5,422)	(51)	–	75	(71)	(4)	–
Transfers to Stage 2	(24,077)	24,327	(250)	–	(31)	64	(33)	–
Transfers to Stage 3	(498)	(2,722)	3,220	–	(5)	(163)	168	–
Impact of transfers between stages	(19,102)	16,183	2,919	–	(57)	401	161	505
					(18)	231	292	505
Other changes in credit quality					(187)	(14)	329	128
Additions and repayments	7,615	748	(835)	7,528	36	(5)	(73)	(42)
(Credit) charge to the income statement					(169)	212	548	591
Advances written off			(350)	(350)			(350)	(350)
Recoveries of advances written off in previous years			94	94			94	94
At 31 December 2022	243,873	44,226	7,514	295,613	284	1,132	1,781	3,197
Allowance for impairment losses	(284)	(1,132)	(1,781)	(3,197)				
Net carrying amount	243,589	43,094	5,733	292,416				
Drawn ECL coverage[2] (%)	0.1	2.6	23.7	1.1				

1 On 30 November 2022 the Group acquired MBNA Limited, formerly a subsidiary of Lloyds Bank plc, a fellow Lloyds Banking Group undertaking.
2 Allowance for expected credit losses on loans and advances to customers as a percentage of gross loans and advances to customers.

Note 16: Loans and advances to customers continued

The Bank	**Gross carrying amount** Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	**Allowance for expected credit losses** Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2023	**237,443**	**42,046**	**6,946**	**286,435**	**216**	**935**	**1,663**	**2,814**
Exchange and other adjustments	**640**	**–**	**–**	**640**	**–**	**–**	**90**	**90**
Transfers to Stage 1	**12,413**	**(12,402)**	**(11)**	**–**	**164**	**(161)**	**(3)**	**–**
Transfers to Stage 2	**(12,292)**	**12,893**	**(601)**	**–**	**(18)**	**67**	**(49)**	**–**
Transfers to Stage 3	**(609)**	**(2,137)**	**2,746**	**–**	**(4)**	**(131)**	**135**	**–**
Impact of transfers between stages	**(488)**	**(1,646)**	**2,134**	**–**	**(111)**	**161**	**203**	**253**
					31	**(64)**	**286**	**253**
Other changes in credit quality					**36**	**(117)**	**235**	**154**
Additions and repayments	**4,910**	**(1,453)**	**(1,941)**	**1,516**	**15**	**(43)**	**(879)**	**(907)**
Charge (credit) to the income statement					**82**	**(224)**	**(358)**	**(500)**
Advances written off			**(477)**	**(477)**			**(477)**	**(477)**
Recoveries of advances written off in previous years			**49**	**49**			**49**	**49**
At 31 December 2023	**242,505**	**38,947**	**6,711**	**288,163**	**298**	**711**	**967**	**1,976**
Allowance for impairment losses	**(298)**	**(711)**	**(967)**	**(1,976)**				
Net carrying amount	**242,207**	**38,236**	**5,744**	**286,187**				
Drawn ECL coverage[1] *(%)*	**0.1**	**1.8**	**14.4**	**0.7**				

1 Allowance for expected credit losses on loans and advances to customers as a percentage of gross loans and advances to customers.

The Bank	Gross carrying amount Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Allowance for expected credit losses Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2022	247,854	25,363	5,251	278,468	389	748	1,326	2,463
Exchange and other adjustments	8	4	1	13	–	1	52	53
Transfers to Stage 1	5,405	(5,355)	(50)	–	74	(71)	(3)	–
Transfers to Stage 2	(23,455)	23,696	(241)	–	(28)	60	(32)	–
Transfers to Stage 3	(473)	(2,506)	2,979	–	(5)	(146)	151	–
Impact of transfers between stages	(18,523)	15,835	2,688	–	(55)	360	153	458
					(14)	203	269	458
Other changes in credit quality					(193)	(15)	304	96
Additions and repayments	8,104	844	(763)	8,185	34	(2)	(57)	(25)
(Credit) charge to the income statement					(173)	186	516	529
Advances written off			(313)	(313)			(313)	(313)
Recoveries of advances written off in previous years			82	82			82	82
At 31 December 2022	237,443	42,046	6,946	286,435	216	935	1,663	2,814
Allowance for impairment losses	(216)	(935)	(1,663)	(2,814)				
Net carrying amount	237,227	41,111	5,283	283,621				
Drawn ECL coverage[1] *(%)*	0.1	2.2	23.9	1.0				

1 Allowance for expected credit losses on loans and advances to customers as a percentage of gross loans and advances to customers.

At 31 December 2023 £277,133 million (2022: £274,927 million) of loans and advances to customers of the Group and £270,869 million (2022: £266,502 million) of the Bank had a contractual residual maturity of greater than one year.

The movement tables are compiled by comparing the position at 31 December to that at the beginning of the year. Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at 31 December.

Additions and repayments comprise new loans originated and repayments of outstanding balances throughout the reporting period.

The Group's impairment charge comprises impact of transfers between stages, other changes in credit quality and additions and repayments.

Advances written off have first been transferred to Stage 3 and then acquired a full allowance through other changes in credit quality.

Recoveries of advances written off in previous years are shown at the full recovered value, with a corresponding entry in repayments and release of allowance through other changes in credit quality.

Note 17: Allowance for expected credit losses

The Group recognises an allowance for expected credit losses (ECLs) for loans and advances to customers, debt securities held at amortised cost and certain loan commitment and financial guarantee contracts. At 31 December 2023, the Group's expected credit loss allowance was £2,404 million (2022: £3,327 million), of which £2,276 million (2022: £3,212 million) was in respect of drawn balances. At 31 December 2023, the Bank's expected credit loss allowance was £2,110 million (2022: £2,963 million), of which £2,022 million (2022: £2,882 million) was in respect of drawn balances.

The Group's total impairment allowances were as follows:

	At 31 December 2023				At 31 December 2022			
	Stage 1 £m	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of:								
Loans and advances to customers	**383**	**857**	**1,029**	**2,269**	284	1,132	1,781	3,197
Debt securities	**–**	**–**	**1**	**1**	–	–	1	1
Due from fellow Lloyds Banking Group undertakings	**6**	**–**	**–**	**6**	14	–	–	14
Drawn balances	**389**	**857**	**1,030**	**2,276**	298	1,132	1,782	3,212
Provisions in relation to loan commitments and financial guarantees	**72**	**55**	**1**	**128**	53	61	1	115
Total	**461**	**912**	**1,031**	**2,404**	351	1,193	1,783	3,327

The Bank's total impairment allowances were as follows:

	At 31 December 2023				At 31 December 2022			
	Stage 1 £m	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
In respect of:								
Loans and advances to customers	**298**	**711**	**967**	**1,976**	216	935	1,663	2,814
Debt securities	**–**	**–**	**1**	**1**	–	–	1	1
Due from fellow Lloyds Banking Group undertakings	**11**	**–**	**34**	**45**	33	–	34	67
Drawn balances	**309**	**711**	**1,002**	**2,022**	249	935	1,698	2,882
Provisions in relation to loan commitments and financial guarantees	**40**	**47**	**1**	**88**	29	51	1	81
Total	**349**	**758**	**1,003**	**2,110**	278	986	1,699	2,963

The calculation of the Group's expected credit loss allowances and provisions against loan commitments and guarantees, which are set out above, under IFRS 9 requires the Group to make a number of judgements, assumptions and estimates. The most significant are set out below:

Critical accounting judgements and key sources of estimation uncertainty

Critical judgements:	Determining an appropriate definition of default against which a probability of default, exposure at default and loss given default parameter can be evaluated
	Establishing the criteria for a significant increase in credit risk (SICR)
	The individual assessment of material cases and the use of judgemental adjustments made to impairment modelling processes that adjust inputs, parameters and outputs to reflect risks not captured by models
Key source of estimation uncertainty:	Base case and multiple economic scenarios (MES) assumptions, including the rate of unemployment and the rate of change of house prices, required for creation of MES scenarios and forward-looking credit parameters

Definition of default

The probability of default (PD) of an exposure, both over a 12-month period and over its lifetime, is a key input to the measurement of the ECL allowance. Default has occurred when there is evidence that the customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due. The definition of default adopted by the Group is described in note 2(H) Impairment of financial assets. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due which the Group now uses for all its products following changes to the definition of default for UK mortgages on 1 January 2022. In addition, other indicators of mortgage default include end-of-term payments on past due interest-only accounts and loans considered in probation due to recent arrears or forbearance, aligning the definition of Stage 3 credit-impaired for IFRS 9 to the CRD IV prudential regulatory definition of default.

Significant increase in credit risk

An ECL allowance equivalent to 12 months' expected losses is established against assets in Stage 1; assets classified as Stage 2 carry an ECL allowance equivalent to lifetime expected losses. Assets are transferred from Stage 1 to Stage 2 when there has been a significant increase in credit risk (SICR) since initial recognition. Credit-impaired assets are transferred to Stage 3 with a lifetime expected losses allowance. The Group uses both quantitative and qualitative indicators to determine whether there has been a SICR for an asset. For Retail, the following tables set out the retail master scale (RMS) grade triggers which result in a SICR for financial assets and the PD boundaries for each RMS grade.

Note 17: Allowance for expected credit losses continued

SICR triggers for key retail portfolios

Origination grade	1	2	3	4	5	6	7
Mortgages SICR grade	5	5	6	7	8	9	10
Credit cards, loans and overdrafts SICR grade	4	5	6	7	8	9	10

RMS grade	1	2	3	4	5	6	7	8	9	10	11	12	13	14
PD boundary[1] (%)	0.10	0.40	0.80	1.20	2.50	4.50	7.50	10.00	14.00	20.00	30.00	45.00	99.99	100.00

1 Probability-weighted annualised lifetime probability of default.

For commercial exposures a doubling of PD with a minimum increase in PD of 1 per cent and a resulting change in the underlying grade is treated as a SICR.

The Group uses the internal credit risk classification and watchlist as qualitative indicators to identify a SICR. The Group does not use the low credit risk exemption in its staging assessments. The use of a payment holiday in and of itself has not been judged to indicate a significant increase in credit risk, nor forbearance, with the underlying long-term credit risk deemed to be driven by economic conditions and captured through the use of forward-looking models. These portfolio level models are capturing the anticipated volume of increased defaults and therefore an appropriate assessment of staging and expected credit loss.

All financial assets are assumed to have suffered a SICR if they are more than 30 days past due; credit cards, loans and overdrafts financial assets are also assumed to have suffered a SICR if they are in arrears on three or more separate occasions in a rolling 12-month period. Financial assets are classified as credit-impaired if they are 90 days past due.

A Stage 3 asset that is no longer credit-impaired is transferred back to Stage 2 as no general probation period is applied to assets in Stage 3. UK mortgages is an exception to this rule where a probation period is enforced for non-performing, forborne and defaulted exposures in accordance with prudential regulation. If an exposure that is classified as Stage 2 no longer meets the SICR criteria, which in some cases capture customer behaviour in previous periods, it is moved back to Stage 1.

The setting of precise trigger points combined with risk indicators requires judgement. The use of different trigger points may have a material impact upon the size of the ECL allowance. The Group monitors the effectiveness of SICR criteria on an ongoing basis.

Lifetime of an exposure

A range of approaches, segmented by product type, has been adopted by the Group to estimate a product's expected life. These include using the full contractual life and taking into account behavioural factors such as early repayments, extensions and refinancing. For non-revolving retail assets, the Group has assumed the expected life for each product to be the time taken for all significant losses to be observed. For revolving retail products, the Group has considered the losses beyond the contractual term over which the Group is exposed to credit risk. For commercial overdraft facilities, the average behavioural life has been used. Changes to the assumed expected lives of the Group's assets could impact the ECL allowance recognised by the Group. The assessment of SICR and corresponding lifetime loss, and the PD, of a financial asset designated as Stage 2, or Stage 3, is dependent on its expected life.

Individual assessments and application of judgement in adjustments to modelled ECL

The table below analyses total ECL allowance, separately identifying the amounts that have been modelled, those that have been individually assessed and those arising through the application of judgemental adjustments.

	Modelled ECL £m	Individually assessed £m	Judgements due to: Inflationary and interest rate risk £m	Judgements due to: Other £m	Total ECL £m
At 31 December 2023	**2,060**	**167**	**144**	**33**	**2,404**
At 31 December 2022	2,048	877	137	265	3,327

Individual assessed ECL

The Stage 3 ECL relating to commercial clients is largely assessed on an individual basis using bespoke assessment of loss for each specific client. These assessments are carried out by the Business Support Unit based on detailed reviews and expected recovery strategies. While these assessments are based on the Group's latest economic view, the use of Group-wide multiple economic scenarios and weightings is not considered appropriate for these cases due to their individual characteristics. In place of this, a range of case-specific outcomes are considered with any alternative better or worse outcomes that carry a 25 per cent likelihood taken into account in establishing a probability-weighted ECL.

Application of judgement in adjustments to modelled ECL

Impairment models fall within the Group's model risk framework with model monitoring, periodic validation and back testing performed on model components, such as probability of default. Limitations in the Group's impairment models or data inputs may be identified through the ongoing assessment and validation of the output of the models. In these circumstances, management applies appropriate judgemental adjustments to the ECL to ensure that the overall provision adequately reflects all material risks. These adjustments are determined by considering the particular attributes of exposures which have not been adequately captured by the impairment models and range from changes to model inputs and parameters, at account level, through to more qualitative post-model adjustments. Post-model adjustments are not typically assessed under each distinct economic scenario used to generate ECL, but on final modelled ECL. All adjustments are reviewed quarterly and are subject to internal review and challenge, including by the Lloyds Banking Group Audit Committee, to ensure that amounts are appropriately calculated and that there are specific release criteria identified.

Note 17: Allowance for expected credit losses continued

During 2022 the intensifying inflationary pressures, alongside rising interest rates within the Group's outlook created further risks not deemed to be fully captured by ECL models. These pressures played out in 2023 with households experiencing increased interest rates and living costs. These risks, whilst still present, are beginning to subside with inflation now reducing and interest rates now believed to have peaked. As a result, the judgements held in respect of inflationary and interest rate risks are at a slightly reduced level of £144 million (2022: £137 million). Other judgements continue to be applied for broader data and model limitations, both increasing and decreasing ECL. These include incremental risks associated with a material devaluation in commercial real estate prices present since 2022. Given ECL models only capture future price movements, and not the suppressed level, there is a risk that further losses are yet to emerge as well as greater risk on specific sector valuations. At 31 December 2023 judgemental adjustments resulted in net additional ECL allowances totalling £177 million (2022: £402 million).

Judgements due to inflationary and interest rate risk

Inflationary and interest rate pressures: £144 million (2022: £137 million)

There has been only modest evidence of credit deterioration in the UK mortgages portfolio through 2023 despite the high levels of inflation and the rising interest rate environment. Increases in new to arrears and defaults that have emerged are mainly driven by variable rate customers, who have experienced material increases in their monthly payment. Mortgage ECL models use UK Bank Rate as a driver of predicted defaults largely capturing the stretch on customers due to increased payments, and that has contributed materially to the elevated levels of ECL at 31 December 2023. The impact is also partly mitigated by stressed affordability assessments applied at loan origination which means most customers have demonstrated the ability to absorb payment shocks.

However, there remains a potential risk to affordability from continued inflationary pressures combined with higher interest rates, and that this may not be fully captured by the Group's ECL models. The risk remains for customers maturing from low fixed rate deals, the accumulated impact on variable rate product holders, lower levels of real household income and rental cover value. Therefore a judgemental uplift in ECL has been taken in these segments of the mortgages portfolio, either where inflation is expected to present a more material risk, or where segments within the model do not recognise UK Bank Rate as a material driver of predicted defaults.

Other judgements

These adjustments principally comprise:

Increase in time to repossession: £126 million (2022: £159 million)

Due to the Group suspending mortgage litigation activity between late-2014 and mid-2018 due to policy changes for the treatment of arrears, and as collections strategy normalises post COVID-19 pandemic, the Group's experience of possessions data on which our models rely is limited. This reflects an adjustment made to allow for an increase in the time assumed between default and repossession. A number of defaulted accounts, equivalent in scale to the estimated shortfall in possessions experienced, have had their provision coverage judgementally increased to the level of those accounts already in repossession. A further adjustment is made to accounts which have been in default for more than 24 months, with an arrears balance increase in the last six months. These accounts have their probability of possession judgmentally set to an increased level based on observed historical losses incurred on accounts that were of an equivalent status.

Asset recovery values: £nil (2022: £93 million)

The low level of repossession volumes throughout 2020 to 2022 restricted the calibration of Forced Sale Discount (FSD) model parameters which uses the achieved sales price experience over the last 12 months. Over this period management partly incorporated an increasing trend in FSD rates through judgementally extending the observation period. At December 2023 the level of sales volumes observed over the past 12 months has subsequently returned to an adequate level for model calibrations to again be performed removing the need for judgemental adjustment..

Adjustment for specific segments: £24 million (2022: £27 million)

The Group monitors risks across specific segments of its portfolios which may not be fully captured through wider collective models. The judgement for fire safety and cladding uncertainty has been maintained. Though experience remains limited the risk is considered sufficiently material to address through judgement, given that there is evidence of assessed cases having defective cladding, or other fire safety issues.

Lifetime extension on revolving products: £53 million (2022: £63 million)

An adjustment is required to extend the lifetime used for Stage 2 exposures on Retail revolving products from a three-year modelled lifetime, which reflected the outcome data available when the ECL models were developed. Incremental defaults beyond year three are calculated through the extrapolation of the default trajectory observed throughout the three years and beyond. The judgement has reduced slightly in the period following refinement to the discounting methodology applied.

Adjustment for Stage 2 oversensitivity: £(66) million (2022: £nil)

Management has observed an increasing degree of oversensitivity in the number of recently originated low risk accounts moving to Stage 2 through the PD trigger mechanism. This arises from a blend of factors currently present, with the combination of the Group's current MES assumptions and the uplift approach applied, disproportionately applying greater forward-looking uplifts to recent vintages. Given these accounts have shown no significant movement in observed credit scores and were originated under a similar or more adverse economic outlook, an adjustment has been made pending a model rebuild. Management has judgementally increased the threshold applied to these accounts by one further grade (to what is set out on **page 63**)

Adjustments to loss given defaults: £(64) million (2022: £(76) million)

A number of adjustments have been made to the loss given default assumptions used within unsecured and motor credit models. For unsecured portfolios, the adjustments reflect the impact of changes in collection debt sale strategy on the Group's LGD models, incorporating up to date customer performance and forward flow debt sale pricing. For motor, the adjustment captures a decline in used car prices.

Following a review on the loss given default approach for commercial exposures, management deems that ECL should be adjusted to mitigate limitations identified in the approach which are causing loss given defaults to be inflated. These include the benefit from amortisation of exposures relative to collateral values at default and a move to an exposure-weighted approach being adopted. These temporary adjustments will be addressed through future model development.

Note 17: Allowance for expected credit losses continued

Corporate insolvency rates: £(47) million (2022: £(1) million)

During 2023, the volume of UK corporate insolvencies continued to exhibit an increasing trend beyond December 2019 levels, revealing a marked misalignment between observed UK corporate insolvencies and the Group's credit performance. This dislocation gives rise to uncertainty over the drivers of observed trends and the appropriateness of the Group's Commercial Banking model response which uses observed UK corporate insolvencies data to anchor future loss estimates to. Given the Group's asset quality remains strong with low new defaults, a negative adjustment is applied by using the long-term average rate. The larger negative adjustment in the period reflects the widening gap between the increasing industry level and the long-term average rate used.

Generation of multiple economic scenarios

The estimate of expected credit losses is required to be based on an unbiased expectation of future economic scenarios. The approach used to generate the range of future economic scenarios depends on the methodology and judgements adopted. The Group's approach is to start from a defined base case scenario, used for planning purposes, and to generate alternative economic scenarios around this base case. The base case scenario is a conditional forecast underpinned by a number of conditioning assumptions that reflect the Group's best view of key future developments. If circumstances appear likely to materially deviate from the conditioning assumptions, then the base case scenario is updated.

The base case scenario is central to a range of future economic scenarios generated by simulation of an economic model, for which the same conditioning assumptions apply as in the base case scenario. These scenarios are ranked by using estimated relationships with industry-wide historical loss data. With the base case already pre-defined, three other scenarios are identified as averages of constituent scenarios located around the 15th, 75th and 95th percentiles of the distribution. The full distribution is therefore summarised by a practical number of scenarios to run through ECL models representing an upside, the base case, and a downside scenario weighted at 30 per cent each, together with a severe downside scenario weighted at 10 per cent. The scenario weights represent the distribution of economic scenarios and not subjective views on likelihood. The inclusion of a severe downside scenario with a smaller weighting ensures that the non-linearity of losses in the tail of the distribution is adequately captured. Macroeconomic projections may employ reversionary techniques to adjust the paths of economic drivers towards long-run equilibria after a reasonable forecast horizon. The Group does not use such techniques to force the MES scenarios to revert to the base case planning view. Utilising such techniques would be expected to be immaterial for expected credit losses since loss sensitivity is highest over the initial five years of the projections. Most assets are expected to have matured, or reached the end of their behavioural life before the five-year horizon.

A forum under the chairmanship of the Chief Economist meets at least quarterly to review and, if appropriate, recommend changes to the method by which economic scenarios are generated, for approval by the Chief Financial Officer and Chief Risk Officer. In June 2022, the Group judged it appropriate to include an adjusted severe downside scenario to incorporate a high CPI inflation and UK Bank Rate profiles and to adopt this adjusted severe downside scenario to calculate the Group's ECL This is because the historic macroeconomic and loan loss data upon which the scenario model is calibrated imply an association of downside economic outcomes with easier monetary policy, and therefore low interest rates. The adjustment is considered to better reflect the risks around the Group's base case view in an economic environment where the potential for supply shocks remains an elevated concern. The Group has continued to include a non-modelled severe downside scenario for Group ECL calculations for 31 December 2023 reporting.

Base case and MES economic assumptions

The Group's base case economic scenario has been updated to reflect ongoing geopolitical developments, and further evidence of easing of inflationary pressures allowing shifts to less restrictive monetary policies globally. The Group's updated base case scenario has three conditioning assumptions: first, the wars in Ukraine and the Middle East remain geographically contained and do not lead to a major escalation in energy prices; second, China's economic stabilisation policy is effective; and third, less restrictive monetary and fiscal policy throughout this year.

Based on these assumptions and incorporating the economic data published in the fourth quarter, the Group's base case scenario is for slow expansion in GDP and a rise in the unemployment rate alongside modest changes in residential and commercial property prices. Following a reduction in inflationary pressures, UK Bank Rate is expected to be lowered during 2024. Risks around this base case economic view lie in both directions and are largely captured by the generation of alternative economic scenarios.

The Group has accommodated the latest available information at the reporting date in defining its base case scenario and generating alternative economic scenarios. The scenarios include forecasts for key variables in the fourth quarter of 2023, for which actuals may have since emerged prior to publication.

Scenarios by year

The key UK economic assumptions made by the Group are shown in the following tables across a number of measures explained below.

Annual assumptions

Gross domestic product (GDP) and Consumer Price Index (CPI) inflation are presented as an annual change, house price growth and commercial real estate price growth are presented as the growth in the respective indices over each year. Unemployment rate and UK Bank Rate are averages over the year.

Five-year average

The five-year average reflects the average annual growth rate, or level, over the five-year period. It includes movements within the current reporting year, such that the position as at 31 December 2023 covers the five years 2023 to 2027. The inclusion of the reporting year within the five-year period reflects the need to predict variables which remain unpublished at the reporting date and recognises that credit models utilise both level and annual changes. The use of calendar years maintains a comparability between the annual assumptions presented.

Five-year start to peak and trough

The peak or trough for any metric may occur intra year and therefore not be identifiable from the annual assumptions, so they are also disclosed. For GDP, house price growth and commercial real estate price growth, the peak, or trough, reflects the highest, or lowest cumulative quarterly position reached relative to the start of the five-year period, which as at 31 December 2023 is 1 January 2023. Given these metrics may exhibit increases followed by greater falls, the start to trough movements quoted may be smaller than the equivalent 'peak to trough' movement (and vice versa for start to peak). Unemployment, UK Bank Rate and CPI inflation reflect the highest, or lowest, quarterly level reached in the five-year period.

Note 17: Allowance for expected credit losses continued

At 31 December 2023	2023 %	2024 %	2025 %	2026 %	2027 %	2023 to 2027 average %	Start to peak %	Start to trough %
Upside								
Gross domestic product	0.3	1.5	1.7	1.7	1.9	1.4	8.1	0.2
Unemployment rate	4.0	3.3	3.1	3.1	3.1	3.3	4.2	3.0
House price growth	1.9	0.8	6.9	7.2	6.8	4.7	25.7	(1.2)
Commercial real estate price growth	(3.9)	9.0	3.8	1.3	1.3	2.2	11.5	(3.9)
UK Bank Rate	4.94	5.72	5.61	5.38	5.18	5.37	5.79	4.25
CPI inflation	7.3	2.7	3.1	3.2	3.1	3.9	10.2	2.1
Base case								
Gross domestic product	0.3	0.5	1.2	1.7	1.9	1.1	6.4	0.2
Unemployment rate	4.2	4.9	5.2	5.2	5.0	4.9	5.2	3.9
House price growth	1.4	(2.2)	0.5	1.6	3.5	1.0	4.8	(1.2)
Commercial real estate price growth	(5.1)	(0.2)	0.1	0.0	0.8	(0.9)	(1.2)	(5.3)
UK Bank Rate	4.94	4.88	4.00	3.50	3.06	4.08	5.25	3.00
CPI inflation	7.3	2.7	2.9	2.5	2.2	3.5	10.2	2.1
Downside								
Gross domestic product	0.2	(1.0)	(0.1)	1.5	2.0	0.5	3.4	(1.2)
Unemployment rate	4.3	6.5	7.8	7.9	7.6	6.8	8.0	3.9
House price growth	1.3	(4.5)	(6.0)	(5.6)	(1.7)	(3.4)	2.0	(15.7)
Commercial real estate price growth	(6.0)	(8.7)	(4.0)	(2.1)	(1.2)	(4.4)	(1.2)	(20.4)
UK Bank Rate	4.94	3.95	1.96	1.13	0.55	2.51	5.25	0.43
CPI inflation	7.3	2.8	2.7	1.8	1.1	3.2	10.2	1.0
Severe downside								
Gross domestic product	0.1	(2.3)	(0.5)	1.3	1.8	0.1	1.0	(2.9)
Unemployment rate	4.5	8.7	10.4	10.5	10.1	8.8	10.5	3.9
House price growth	0.6	(7.6)	(13.3)	(12.7)	(7.5)	(8.2)	2.0	(35.0)
Commercial real estate price growth	(7.7)	(19.5)	(10.6)	(7.7)	(5.2)	(10.3)	(1.2)	(41.8)
UK Bank Rate – modelled	4.94	2.75	0.49	0.13	0.03	1.67	5.25	0.02
UK Bank Rate – adjusted[1]	4.94	6.56	4.56	3.63	3.13	4.56	6.75	3.00
CPI inflation – modelled	7.3	2.7	2.2	0.9	(0.2)	2.6	10.2	(0.3)
CPI inflation – adjusted[1]	7.6	7.5	3.5	1.3	1.0	4.2	10.2	0.9
Probability-weighted								
Gross domestic product	0.3	0.1	0.8	1.6	1.9	0.9	5.4	0.1
Unemployment rate	4.2	5.3	5.9	5.9	5.7	5.4	6.0	3.9
House price growth	1.4	(2.5)	(0.9)	(0.3)	1.8	(0.1)	2.0	(2.8)
Commercial real estate price growth	(5.3)	(1.9)	(1.1)	(1.0)	(0.2)	(1.9)	(1.2)	(9.9)
UK Bank Rate – modelled	4.94	4.64	3.52	3.02	2.64	3.75	5.25	2.59
UK Bank Rate – adjusted[1]	4.94	5.02	3.93	3.37	2.95	4.04	5.42	2.89
CPI inflation – modelled	7.3	2.7	2.8	2.3	1.9	3.4	10.2	1.9
CPI inflation – adjusted[1]	7.4	3.2	3.0	2.4	2.0	3.6	10.2	2.0

1 The adjustment to UK Bank Rate and CPI inflation in the severe downside is considered to better reflect the risks around the Group's base case view in an economic environment where supply shocks are the principal concern.

Base case scenario by quarter[1] At 31 December 2023	First quarter 2023 %	Second quarter 2023 %	Third quarter 2023 %	Fourth quarter 2023 %	First quarter 2024 %	Second quarter 2024 %	Third quarter 2024 %	Fourth quarter 2024 %
Gross domestic product	0.3	0.0	(0.1)	0.0	0.1	0.2	0.3	0.3
Unemployment rate	3.9	4.2	4.2	4.3	4.5	4.8	5.0	5.2
House price growth	1.6	(2.6)	(4.5)	1.4	(1.1)	(1.5)	0.5	(2.2)
Commercial real estate price growth	(18.8)	(21.2)	(18.2)	(5.1)	(4.1)	(3.8)	(2.2)	(0.2)
UK Bank Rate	4.25	5.00	5.25	5.25	5.25	5.00	4.75	4.50
CPI inflation	10.2	8.4	6.7	4.0	3.8	2.1	2.3	2.8

1 Gross domestic product is presented quarter-on-quarter. House price growth, commercial real estate growth and CPI inflation are presented year-on-year, i.e. from the equivalent quarter in the previous year. Unemployment rate and UK Bank Rate are presented as at the end of each quarter.

Note 17: Allowance for expected credit losses continued

At 31 December 2022	2022 %	2023 %	2024 %	2025 %	2026 %	2022 to 2026 average %	Start to peak %	Start to trough %
Upside								
Gross domestic product	4.1	0.1	1.1	1.7	2.1	1.8	6.5	0.4
Unemployment rate	3.5	2.8	3.0	3.3	3.4	3.2	3.8	2.8
House price growth	2.4	(2.8)	6.5	9.0	8.0	4.5	24.8	(1.1)
Commercial real estate price growth	(9.4)	8.5	3.5	2.6	2.3	1.3	7.2	(9.4)
UK Bank Rate	1.94	4.95	4.98	4.63	4.58	4.22	5.39	0.75
CPI inflation	9.0	8.3	4.2	3.3	3.0	5.5	10.7	2.9
Base case								
Gross domestic product	4.0	(1.2)	0.5	1.6	2.1	1.4	4.3	(1.1)
Unemployment rate	3.7	4.5	5.1	5.3	5.1	4.8	5.3	3.6
House price growth	2.0	(6.9)	(1.2)	2.9	4.4	0.2	6.4	(6.3)
Commercial real estate price growth	(11.8)	(3.3)	0.9	2.8	3.1	(1.8)	7.2	(14.8)
UK Bank Rate	1.94	4.00	3.38	3.00	3.00	3.06	4.00	0.75
CPI inflation	9.0	8.3	3.7	2.3	1.7	5.0	10.7	1.6
Downside								
Gross domestic product	3.9	(3.0)	(0.5)	1.4	2.1	0.8	1.2	(3.6)
Unemployment rate	3.8	6.3	7.5	7.6	7.2	6.5	7.7	3.6
House price growth	1.6	(11.1)	(9.8)	(5.6)	(1.5)	(5.4)	6.4	(24.3)
Commercial real estate price growth	(13.9)	(15.0)	(3.7)	0.4	1.4	(6.4)	7.2	(29.6)
UK Bank Rate	1.94	2.93	1.39	0.98	1.04	1.65	3.62	0.75
CPI inflation	9.0	8.2	3.3	1.3	0.3	4.4	10.7	0.2
Severe downside								
Gross domestic product	3.7	(5.2)	(1.0)	1.3	2.1	0.1	0.7	(6.4)
Unemployment rate	4.1	9.0	10.7	10.4	9.7	8.8	10.7	3.6
House price growth	1.1	(14.8)	(18.0)	(11.5)	(4.2)	(9.8)	6.4	(40.1)
Commercial real estate price growth	(17.3)	(28.8)	(9.9)	(1.3)	3.2	(11.6)	7.2	(47.8)
UK Bank Rate – modelled	1.94	1.41	0.20	0.13	0.14	0.76	3.50	0.12
UK Bank Rate – adjusted[1]	2.44	7.00	4.88	3.31	3.25	4.18	7.00	0.75
CPI inflation – modelled	9.0	8.2	2.6	(0.1)	(1.6)	3.6	10.7	(1.7)
CPI inflation – adjusted[1]	9.7	14.3	9.0	4.1	1.6	7.7	14.8	1.5
Probability-weighted								
Gross domestic product	4.0	(1.8)	0.2	1.5	2.1	1.2	3.4	(1.8)
Unemployment rate	3.7	5.0	5.8	5.9	5.7	5.2	5.9	3.6
House price growth	1.9	(7.7)	(3.2)	0.7	2.9	(1.2)	6.4	(9.5)
Commercial real estate price growth	(12.3)	(5.8)	(0.8)	1.6	2.3	(3.1)	7.2	(18.6)
UK Bank Rate – modelled	1.94	3.70	2.94	2.59	2.60	2.76	3.89	0.75
UK Bank Rate – adjusted[1]	1.99	4.26	3.41	2.91	2.91	3.10	4.31	0.75
CPI inflation – modelled	9.0	8.3	3.6	2.1	1.4	4.9	10.7	1.3
CPI inflation – adjusted[1]	9.1	8.9	4.3	2.5	1.7	5.3	11.0	1.6

1 The adjustment to UK Bank Rate and CPI inflation in the severe downside is considered to better reflect the risks around the Group's base case view in an economic environment where supply shocks are the principal concern.

Base case scenario by quarter[1] At 31 December 2022	First quarter 2022 %	Second quarter 2022 %	Third quarter 2022 %	Fourth quarter 2022 %	First quarter 2023 %	Second quarter 2023 %	Third quarter 2023 %	Fourth quarter 2023 %
Gross domestic product	0.6	0.1	(0.3)	(0.4)	(0.4)	(0.4)	(0.2)	(0.1)
Unemployment rate	3.7	3.8	3.6	3.7	4.0	4.4	4.7	4.9
House price growth	11.1	12.5	9.8	2.0	(3.0)	(8.4)	(9.8)	(6.9)
Commercial real estate price growth	18.0	18.0	8.4	(11.8)	(16.9)	(19.8)	(15.9)	(3.3)
UK Bank Rate	0.75	1.25	2.25	3.50	4.00	4.00	4.00	4.00
CPI inflation	6.2	9.2	10.0	10.7	10.0	8.9	8.0	6.1

1 Gross domestic product is presented quarter-on-quarter. House price growth, commercial real estate growth and CPI inflation are presented year-on-year, i.e. from the equivalent quarter in the previous year. Unemployment rate and UK Bank Rate are presented as at the end of each quarter.

Note 17: Allowance for expected credit losses continued

ECL sensitivity to economic assumptions

The table below shows the Group's ECL for the probability-weighted, upside, base case, downside and severe downside scenarios, with the severe downside scenario incorporating adjustments made to CPI inflation and UK Bank Rate paths. The stage allocation for an asset is based on the overall scenario probability-weighted probability of default and hence the staging of assets is constant across all the scenarios. In each economic scenario the ECL for individual assessments is held constant reflecting the basis on which they are evaluated. Judgemental adjustments applied through changes to model inputs or parameters, or more qualitative post model adjustments, are apportioned across the scenarios in proportion to modelled ECL where this better reflects the sensitivity of these adjustments to each scenario. The probability-weighted view shows the extent to which a higher ECL allowance has been recognised to take account of multiple economic scenarios relative to the base case; the uplift being £461 million compared to £441 million at 31 December 2022.

	At 31 December 2023					At 31 December 2022				
	Probability-weighted £m	Upside £m	Base case £m	Downside £m	Severe downside £m	Probability-weighted £m	Upside £m	Base case £m	Downside £m	Severe downside £m
ECL allowance	**2,404**	**1,520**	**1,943**	**2,548**	**6,004**	3,327	2,484	2,886	3,604	6,343

The table below shows the Group's ECL for the upside, base case, downside and severe downside scenarios, with staging of assets based on each specific scenario probability of default. In each economic scenario the ECL for individual assessments is held constant reflecting the basis on which they are evaluated. Judgemental adjustments applied through changes to model inputs or parameters, or more qualitative post-model adjustments, are apportioned across the scenarios in proportion to modelled ECL where this better reflects the sensitivity of these adjustments to each scenario. A probability-weighted scenario is not shown as this view does not reflect the basis on which ECL is calculated. Comparing the probability-weighted ECL in the table above to the base case ECL with base case scenario specific staging, as shown in the table below, results in an uplift of £525 million compared to £520 million at 31 December 2022.

	At 31 December 2023				At 31 December 2022			
	Upside £m	Base case £m	Downside £m	Severe downside £m	Upside £m	Base case £m	Downside £m	Severe downside £m
ECL allowance	**1,477**	**1,879**	**2,496**	**7,024**	2,394	2,807	3,535	10,419

The impact of isolated changes in the UK unemployment rate and House Price Index (HPI) has been assessed on a univariate basis. Although such changes would not be observed in isolation, as economic indicators tend to be correlated in a coherent scenario, this gives insight into the sensitivity of the Group's ECL to gradual changes in these two critical economic factors. The assessment has been made against the base case with staging held flat to the reported probability-weighted view and is assessed through the direct impact on modelled ECL and only includes judgemental adjustments applied through changes to model inputs.

The table below shows the impact on the Group's ECL resulting from a 1 percentage point increase or decrease in the UK unemployment rate. The increase or decrease is presented based on the adjustment phased evenly over the first 10 quarters of the base case scenario. A more immediate increase or decrease would drive a more material ECL impact as it would be fully reflected in both 12-month and lifetime probability of defaults.

	At 31 December 2023		At 31 December 2022	
	1pp increase in unemployment £m	1pp decrease in unemployment £m	1pp increase in unemployment £m	1pp decrease in unemployment £m
ECL impact	**65**	**(64)**	73	(70)

The table below shows the impact on the Group's ECL in respect of UK mortgages of an increase or decrease in loss given default for a 10 percentage point increase or decrease in the UK HPI. The increase or decrease is presented based on the adjustment phased evenly over the first 10 quarters of the base case scenario.

	At 31 December 2023		At 31 December 2022	
	10pp increase in HPI £m	10pp decrease in HPI £m	10pp increase in HPI £m	10pp decrease in HPI £m
ECL impact	**(182)**	**275**	(207)	341

Note 18: Finance lease receivables

The Group's finance lease receivables are classified as loans and advances to customers and accounted for at amortised cost. These balances are analysed as follows:

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Not later than 1 year	**155**	128	**131**	104
Later than 1 year and not later than 2 years	**160**	126	**135**	101
Later than 2 years and not later than 3 years	**150**	116	**125**	91
Later than 3 years and not later than 4 years	**83**	62	**57**	37
Later than 4 years and not later than 5 years	**73**	66	**47**	40
Later than 5 years	**95**	122	**–**	–
Gross investment	**716**	620	**495**	373
Unearned future finance income	**(117)**	(109)	**(53)**	(34)
Rentals received in advance	**–**	–	**–**	–
Net investment	**599**	511	**442**	339

The net investment represents amounts recoverable as follows:

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Not later than 1 year	**125**	98	**117**	89
Later than 1 year and not later than 2 years	**134**	102	**121**	90
Later than 2 years and not later than 3 years	**127**	99	**111**	85
Later than 3 years and not later than 4 years	**68**	50	**51**	35
Later than 4 years and not later than 5 years	**61**	57	**42**	40
Later than 5 years	**84**	105	**–**	–
Net investment	**599**	511	**442**	339

Equipment leased to customers under finance lease receivables relates to structured financing transactions to fund the purchase of motor vehicles, ships, sea freight transportation, and waste water treatment facilities. There was an allowance for uncollectable finance lease receivables included in the allowance for impairment losses for the Group of £9 million (2022: £7 million) and for the Bank of £5 million (2022: £3 million).

Note 19: Goodwill

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
At 1 January	**452**	325	**325**	325
Adjustment on transfer of subsidiary	**–**	127	**–**	–
At 31 December	**452**	452	**325**	325
Cost	**452**	452	**325**	325
Accumulated impairment losses	**–**	–	**–**	–
At 31 December	**452**	452	**325**	325

The goodwill held in the Group's balance sheet is tested at least annually for impairment. This compares the estimated recoverable amount, being the higher of a cash-generating unit's fair value less costs to sell and its value in use, with the carrying value. When this indicates that the carrying value is not recoverable it is written down through the income statement as goodwill impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; the entire balance of £452 million has been allocated to the Bank of Scotland cash generating unit.

The recoverable amount of goodwill carried at 31 December 2023 has been based on a value in use calculation using post-tax cash flow projections based on financial budgets and plans approved by management covering a four-year period and a discount rate (post tax) of 10.5 per cent, based on the Group's cost of equity. This is equivalent to a pre-tax rate of 14.0 per cent. The budgets and plans are based upon past experience and having regard to expected market conditions and competitor activity The cash flows beyond the plan period are extrapolated using a growth rate of 3.5 per cent which does not exceed the long-term average for the markets in which Bank of Scotland participates. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount to fall below the balance sheet carrying value.

Note 20: Investment in subsidiary undertakings of the Bank

	2023 £m	2022 £m
At 1 January	**1,313**	84
Additions	**–**	1,229
Disposals	**(15)**	–
Impairment	**(4)**	–
At 31 December	**1,294**	1,313

Details of the subsidiaries and related undertakings are given on **pages 97 to 98** and are incorporated by reference.

Certain subsidiary companies currently have insufficient distributable reserves to make dividend payments, however, there were no further significant restrictions on any of the Bank's subsidiaries in paying dividends or repaying loans and advances.

Note 21: Other assets

	The Group		The Bank	
	2023 £m	2022[1] £m	2023 £m	2022[1] £m
Property, plant and equipment:				
Investment properties	**–**	3	**–**	–
Premises	**389**	373	**387**	373
Equipment	**171**	156	**169**	154
Right-of-use assets (note 22)	**415**	488	**416**	488
	975	1,020	**972**	1,015
Purchased credit card relationships	**240**	310	**–**	–
Capitalised software enhancements	**266**	232	**258**	232
Settlement balances and items in the course of collection from banks	**52**	51	**52**	51
Prepayments	**164**	133	**145**	127
Other assets	**27**	228	**32**	215
Total other assets	**1,724**	1,974	**1,459**	1,640

1 See note 1 regarding changes to presentation.

Note 22: Lessee disclosures

The table below sets out the movement in the Group's right-of-use assets, which are primarily in respect of premises, and are recognised within other assets (note 21).

The Group and the Bank	2023 £m	2022 £m
At 1 January	**488**	573
Exchange and other adjustments	**(1)**	(1)
Additions	**22**	16
Disposals	**(20)**	(22)
Depreciation charge for the year	**(74)**	(78)
At 31 December	**415**	488

The Group's lease liabilities are recognised within other liabilities (note 24). The maturity analysis of the Group's lease liabilities on an undiscounted basis is set out in the liquidity risk section of note 36.

The total cash outflow for leases in the year ended 31 December 2023 was £96 million (2022: £96 million). The amount recognised within interest expense in respect of lease liabilities is disclosed in note 4.

Note 23: Debt securities in issue

	The Group					
	2023			2022		
	At fair value through profit or loss £m	At amortised cost £m	Total £m	At fair value through profit or loss £m	At amortised cost £m	Total £m
Senior unsecured notes issued	–	6,022	6,022	–	4,876	4,876
Covered bonds	–	505	505	–	500	500
Securitisation notes	23	2,083	2,106	26	747	773
Total debt securities in issue	**23**	**8,610**	**8,633**	**26**	**6,123**	**6,149**

	The Bank					
	2023			2022		
	At fair value through profit or loss £m	At amortised cost £m	Total £m	At fair value through profit or loss £m	At amortised cost £m	Total £m
Senior unsecured notes issued	–	6,022	6,022	–	4,876	4,876
Covered bonds	–	505	505	–	500	500
Commercial paper	–	1,465	1,465	–	–	–
Total debt securities in issue	**–**	**7,992**	**7,992**	**–**	**5,376**	**5,376**

Covered bonds and securitisation programmes

At 31 December 2023, the bonds held by external parties and those held internally, were secured on certain loans and advances to customers amounting to £824 million (2022: £831 million) which have been assigned to bankruptcy remote limited liability partnerships to provide security for issues of covered bonds by the Group. The Group retains all of the risks and rewards associated with these loans and the partnerships are consolidated fully with the loans retained on the Group's balance sheet and the related covered bonds in issue included within debt securities in issue at amortised cost.

The Group has a covered bond programme, for which a limited liability partnership has been established to ring-fence the asset pool and guarantee the covered bonds issued by the Group. At the reporting date the Group had over-collateralised this programme to meet the terms of the programme, to secure the rating of the covered bonds and to provide operational flexibility. From time to time, the obligations of the Group to provide collateral may increase due to the formal requirements of the programme. The Group may also voluntarily contribute collateral to support the ratings of the covered bonds.

At 31 December 2023, the Group's securitisation notes in issue held by external parties includes £23 million at fair value through profit or loss (2022: £26 million). Those notes held internally, are secured on loans and advances to customers amounting to £29,649 million (2022: £24,811 million), the majority of which have been sold by subsidiary companies to bankruptcy remote structured entities. As the structured entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained by the subsidiary, the structured entities are consolidated fully and all of these loans are retained on the Group's balance sheet, with the related notes in issue included within debt securities in issue at amortised cost.

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships.

Cash deposits of £1,277 million (2022: £1,501 million) which support the debt securities issued by the structured entities, the term advances related to covered bonds and other legal obligations, are held by the Group. Additionally, the Group has certain contractual arrangements to provide liquidity facilities to some of these structured entities. At 31 December 2023 these obligations had not been triggered; the maximum exposure under these facilities was £4 million (2022: £4 million).

The Group recognises the full liabilities associated with its securitisation and covered bond programmes within debt securities in issue, although the obligations of the Group in respect of its securitisation issuances are limited to the cash flows generated from the underlying assets. The Group could be required to provide additional support to a number of the securitisation programmes to support the credit ratings of the debt securities issued, in the form of increased cash reserves and the holding of subordinated notes. Further, certain programmes contain contractual obligations that require the Group to repurchase assets should they become credit-impaired or as otherwise required by the transaction documents. The Group has not provided financial or other support by voluntarily offering to repurchase assets from any of its public securitisation programmes during 2023 (2022: none).

At 31 December 2023 £7,987 million (2022: £5,752 million) of debt securities in issue at amortised cost of the Group and £5,925 million (2022: £5,229 million) of the Bank had a contractual residual maturity of greater than one year.

Note 24: Other liabilities

	The Group		The Bank	
	2023 £m	2022[1] £m	2023 £m	2022[1] £m
Settlement balances and items in the course of transmission to banks	78	168	78	168
Lease liabilities	481	550	481	550
Other creditors and accruals	947	852	731	627
Total other liabilities	**1,506**	**1,570**	**1,290**	**1,345**

1 See note 1 regarding changes to presentation.

The maturity analysis of the lease liabilities on an undiscounted basis is set out in the liquidity risk section of note 36.

Note 25: Provisions

Critical accounting judgements and key sources of estimation uncertainty

Critical judgement:	Determining whether a present obligation exists and whether it is more likely than not that an outflow of resources will be required to settle that obligation

Determining the amount of the provisions, which represent management's best estimate of the cost of settling these issues, requires the exercise of significant judgement and estimation. It will often be necessary to form a view on matters which are inherently uncertain, such as the scope of reviews required by regulators, and to estimate the number of future complaints, the extent to which they will be upheld, the average cost of redress and the impact of decisions reached by legal and other review processes that may be relevant to claims received. Consequently the continued appropriateness of the underlying assumptions is reviewed on a regular basis against actual experience and other relevant evidence and adjustments made to the provisions where appropriate.

	The Group				The Bank			
	Provisions for financial commitments and guarantees £m	Regulatory and legal provisions £m	Other £m	Total £m	Provisions for financial commitments and guarantees £m	Regulatory and legal provisions £m	Other £m	Total £m
At 1 January 2023	115	709	149	973	81	668	148	897
Exchange and other adjustments	–	7	(3)	4	–	–	(4)	(4)
Provisions applied	–	(379)	(61)	(440)	–	(354)	(61)	(415)
Charge for the year	13	89	81	183	7	89	81	177
At 31 December 2023	128	426	166	720	88	403	164	655

Provisions for financial commitments and guarantees

Provisions are recognised for expected credit losses on undrawn loan commitments and financial guarantees.

Regulatory and legal provisions

In the course of its business, the Group is engaged on a regular basis in discussions with UK and overseas regulators and other governmental authorities on a range of matters, including legal and regulatory reviews and, from time to time, enforcement investigations (including in relation to compliance with applicable laws and regulations, such as those relating to prudential regulation, consumer protection, investment advice, business conduct, systems and controls, environmental, competition/anti-trust, tax, anti-bribery, anti-money laundering and sanctions). Any matters discussed or identified during such discussions and inquiries may result in, among other things, further inquiry or investigation, other action being taken by governmental and/or regulatory authorities, increased costs being incurred by the Group, remediation of systems and controls, public or private censure, restriction of the Group's business activities and/or fines. The Group also receives complaints in connection with its past conduct and claims brought by or on behalf of current and former employees, customers (including their appointed representatives), investors and other third parties and is subject to legal proceedings and other legal actions from time to time. Any events or circumstances disclosed could have a material adverse effect on the Group's financial position, operations or cash flows. Provisions are held where the Group can reliably estimate a probable outflow of economic resources. The ultimate liability of the Group may be significantly more, or less, than the amount of any provision recognised. If the Group is unable to determine a reliable estimate, a contingent liability is disclosed. The recognition of a provision does not amount to an admission of liability or wrongdoing on the part of the Group. During the year ended 31 December 2023 the Group charged a further £89 million in respect of legal actions and other regulatory matters and the unutilised balance at 31 December 2023 was £426 million (31 December 2022: £709 million). The most significant items are outlined below.

HBOS Reading – review

The Group continues to apply the recommendations from Sir Ross Cranston's review, issued in December 2019, including a reassessment of direct and consequential losses by an independent panel (the Foskett Panel), an extension of debt relief and a wider definition of de facto directors. The Foskett Panel's full scope and methodology was published on 7 July 2020. The Foskett Panel's stated objective is to consider cases via a non-legalistic and fair process and to make its decisions in a generous, fair and common sense manner, assessing claims against an expanded definition of the fraud and on a lower evidential basis.

In June 2022, the Foskett Panel announced an alternative option, in the form of a fixed sum award which could be accepted as an alternative to participation in the full re-review process, to support earlier resolution of claims for those deemed by the Foskett Panel to be victims of the fraud. Around 90 per cent of the population have now had outcomes via this new process. The provision is unchanged in 2023. Notwithstanding the settled claims and the increase in outcomes which builds confidence in the full estimated cost, uncertainties remain and the final outcome could be different from the current provision once the re-review is concluded by the Foskett Panel. There is no confirmed timeline for the completion of the Foskett Panel re-review process nor the review by Dame Linda Dobbs. The Group is committed to implementing Sir Ross Cranston's recommendations in full.

Payment protection insurance (PPI)

The Group has incurred costs for PPI over a number of years totalling £6,356 million. The Group continues to challenge PPI litigation cases, with mainly legal fees and operational costs associated with litigation activity recognised within regulatory and legal provisions.

Note 26: Subordinated liabilities

The movement in subordinated liabilities during the year was as follows:

	The Group and the Bank			
	Preferred securities £m	Undated £m	Dated £m	Total £m
At 1 January 2022	22	119	1,503	1,644
Repurchases and redemptions during the year[1]**:**				
7.281% Perpetual Regulatory Tier One Securities (Series B) (£150 million)	(22)	–	–	(22)
12% Perpetual Subordinated Bonds (£100 million)	–	(22)	–	(22)
	(22)	(22)	–	(44)
Other movements (cash and non-cash)[2]	–	(1)	(1)	(2)
At 31 December 2022	–	96	1,502	1,598
Repurchases and redemptions during the year[1]**:**				
7.375% Subordinated Undated Instruments (£150 million)	**–**	**(58)**	**–**	**(58)**
8.75% Perpetual Subordinated Bonds (£100 million)	**–**	**(5)**	**–**	**(5)**
	–	**(63)**	**–**	**(63)**
Other movements (cash and non-cash)[2]	**–**	**(4)**	**1**	**(3)**
At 31 December 2023	**–**	**29**	**1,503**	**1,532**

1 The repurchases and redemptions in the year resulted in cash outflows for the Group and the Bank of £63 million (2022: £44 million).
2 Other movements include cash payments in respect of interest on subordinated liabilities in the year amounting to £105 million for the Group and the Bank (2022: £58 million for the Group and the Bank) offset by the interest expense in respect of subordinated liabilities of £102 million for the Group and the Bank (2022: £57 million for the Group and the Bank).

Certain of the above securities were issued or redeemed under exchange offers, which did not result in an extinguishment of the original financial liability for accounting purposes.

These securities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer, other than creditors whose claims rank equally with, or are junior to, the claims of the holders of the subordinated liabilities. The subordination of specific subordinated liabilities is determined in respect of the issuer and any guarantors of that liability. The claims of holders of preference shares and preferred securities are generally junior to those of the holders of undated subordinated liabilities, which in turn are junior to the claims of holders of the dated subordinated liabilities. Neither the Group nor the Bank has had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2023 (2022: none).

The Bank has in issue preference shares which are all classified as liabilities under accounting standards. The rights and obligations attaching to these shares are set out in the Bank's articles of association, a copy of which can be obtained from Companies House or from the Lloyds Banking Group website (**www.lloydsbankinggroup.com/who-we-are/group-overview/corporate-governance.html**), and in the form SH01 uploaded by Companies House on 22 January 2010.

Note 27: Share capital

(1) Authorised share capital

	The Group and the Bank			
	2023 Number of shares	2022 Number of shares	2023 £m	2022 £m
Sterling				
Ordinary shares of 25p each	**24,085,301,755**	24,085,301,755	**6,021**	6,021
8.117% non-cumulative perpetual preference shares class 'A' of £10 each	**250,000**	250,000	**3**	3
7.754% non-cumulative perpetual preference shares class 'B' of £10 each	**150,000**	150,000	**2**	2
			6,026	6,026

(2) Issued and fully paid share capital

	The Group and the Bank			
	2023 Number of shares[1]	2022 Number of shares	2023 £m	2022 £m
Issued and fully paid ordinary shares				
Ordinary shares of 25p each				
At 1 January and 31 December	**23,388,340,553**	23,388,340,553	**5,847**	5,847
Issued and fully paid preference shares				
Preference shares of 25p each				
At 1 January and 31 December	**400**	400	**–**	–
Total share capital at 31 December			**5,847**	5,847

1 Ordinary shares represent effectively 100% of total share capital in issue as the issued preference shares represent below 0.01%

Note 27: Share capital continued

(3) Share capital and control

There are no limitations on voting rights or restrictions on the transfer of shares in the Bank 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).

Ordinary shares

The holders of ordinary shares are entitled to receive the Bank's report and accounts, attend, speak and vote at general meetings and appoint proxies to exercise voting rights. Holders of ordinary shares may also receive a dividend (subject to the provisions of the Bank's articles of association) and on a winding up may share in the assets of the Bank.

Preference shares

The Bank has in issue preference shares which are all classified as liabilities under accounting standards and which are included in note 26.

Note 28: Other reserves

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Merger reserve and other reserves[1]	**1,600**	1,600	**1,600**	1,600
Capital redemption reserve[1]	**482**	482	**482**	482
Non-distributable capital contribution reserve	**1,054**	1,054	**1,229**	1,229
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**1**	1	**–**	–
Cash flow hedging reserve	**(76)**	(65)	**(76)**	(65)
Foreign currency translation reserve	**–**	(21)	**–**	(8)
At 31 December	**3,061**	3,051	**3,235**	3,238

1 There have been no movements in these reserves in 2023 or 2022.

Movements in other reserves were as follows:

	The Group		The Bank	
Non-distributable capital contribution reserve[1]	**2023 £m**	2022 £m	**2023 £m**	2022 £m
At 1 January	**1,054**	–	**1,229**	–
Capital contribution received	**–**	1,054	**–**	1,229
At 31 December	**1,054**	1,054	**1,229**	1,229

1 This reserve comprises non-distributable capital contributions received by the Group.

	The Group		The Bank	
Revaluation reserve in respect of debt securities held at fair value through other comprehensive income	**2023 £m**	2022 £m	**2023 £m**	2022 £m
At 1 January	**1**	15	**–**	14
Change in fair value	**–**	(36)	**–**	(36)
Deferred tax	**–**	11	**–**	11
	–	(25)	**–**	(25)
Income statement transfers in respect of disposals (note 7)	**–**	15	**–**	15
Deferred tax	**–**	(4)	**–**	(4)
	–	11	**–**	11
At 31 December	**1**	1	**–**	–

	The Group and the Bank	
Cash flow hedging reserve	**2023 £m**	2022 £m
At 1 January	**(65)**	(63)
Change in fair value of hedging derivatives	**(7)**	11
Deferred tax	**2**	(5)
	(5)	6
Net income statement transfers	**(8)**	(11)
Deferred tax	**2**	3
	(6)	(8)
At 31 December	**(76)**	(65)

Note 28: Other reserves continued

	The Group		The Bank	
Foreign currency translation reserve	**2023 £m**	2022 £m	**2023 £m**	2022 £m
At 1 January	**(21)**	(21)	**(8)**	(8)
Income statement transfers	**21**	–	**8**	–
At 31 December	**–**	(21)	**–**	(8)

Note 29: Retained profits

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
At 1 January	**4,940**	3,975	**4,619**	3,554
Profit attributable to ordinary shareholders[1]	**149**	944	**740**	1,025
Post-retirement defined benefit scheme remeasurements	**1**	(6)	**1**	(6)
Capital contributions received	**43**	46	**43**	46
Adjustment on transfer of subsidiary	**–**	(19)	**–**	–
At 31 December	**5,133**	4,940	**5,403**	4,619

1 No income statement has been shown for the Bank, as permitted by Section 408 of the Companies Act 2006.

Note 30: Other equity instruments

	The Group and the Bank	
	2023 £m	2022 £m
At 1 January	**2,200**	2,200
Issued during the year: £350 million Floating Rate Additional Tier 1 Perpetual Permanent Write Down Capital Securities	**350**	–
Profit for the year attributable to other equity holders	**186**	122
Distributions on other equity instruments	**(186)**	(122)
At 31 December	**2,550**	2,200

The Bank has in issue £2,550 million of Additional Tier 1 (AT1) securities to Lloyds Banking Group plc. The AT1 securities are fixed rate resetting or floating rate Perpetual Subordinated Permanent Write-Down Securities with no fixed maturity or redemption date.

The principal terms of the AT1 securities are described below:

- The securities rank behind the claims against the Bank of unsubordinated creditors on a winding-up
- The fixed rate reset securities bear a fixed rate of interest until the first call date. After the initial call date, in the event that they are not redeemed, the fixed rate reset AT1 securities will bear interest at rates fixed periodically in advance. The floating rate AT1 securities will be reset quarterly both prior to and following the first call date
- Interest on the securities will be due and payable only at the sole discretion of the Bank and the Bank may at any time elect to cancel any interest payment (or any part thereof) which would otherwise be payable on any interest payment date. There are also certain restrictions on the payment of interest as specified in the terms
- The securities are undated and are repayable, at the option of the Bank, in whole at the first call date, or at any interest payment date thereafter. In addition, the AT1 securities are repayable, at the option of the Bank, in whole for certain regulatory or tax reasons. Any repayments require the prior consent of the PRA
- The securities will be subject to a Permanent Write Down should the Common Equity Tier 1 ratio of the Bank fall below 7.0 per cent

Note 31: Related party transactions

Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity; the Group's key management personnel are the members of the Lloyds Banking Group plc Group Executive Committee together with its non-executive directors.

The table below details, on an aggregated basis, key management personnel compensation:

Compensation	2023 £m	2022 £m
Salaries and other short-term benefits	**6**	4
Share-based payments	**6**	6
Total compensation	**12**	10

The aggregate of the emoluments of the directors was £3.7 million (2022: £3.7 million).

Aggregate company contributions in respect of key management personnel to defined contribution pension schemes were £nil (2022: £nil).

The total for the highest paid director (Charlie Nunn) was £2,042,000 (2022: Charlie Nunn: £2,064,000); this did not include any gain on exercise of Lloyds Banking Group plc shares in any year.

Share plans settled in Lloyds Banking Group plc shares	2023 million	2022 million
At 1 January	**72**	74
Granted, including certain adjustments (includes entitlements of appointed key management personnel)	**27**	29
Exercised/lapsed (includes entitlements of former key management personnel)	**(44)**	(31)
At 31 December	**55**	72

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:

Loans	2023 £m	2022 £m
At 1 January	**2**	3
Advanced (includes loans to appointed key management personnel)	**–**	1
Repayments (includes loans to former key management personnel)	**(1)**	(2)
At 31 December	**1**	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 1.09 per cent and 32.40 per cent in 2023 (2022: 1.01 per cent and 30.15 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2022: £nil).

Deposits	2023 £m	2022 £m
At 1 January	**10**	11
Placed (includes deposits of appointed key management personnel)	**44**	37
Withdrawn (includes deposits of former key management personnel)	**(40)**	(38)
At 31 December	**14**	10

Deposits placed by key management personnel attracted interest rates of up to 6.25 per cent (2022: 5.0 per cent).

At 31 December 2023, the Group did not provide any guarantees in respect of key management personnel (2022: none).

At 31 December 2023, transactions, arrangements and agreements entered into by the Lloyds Banking Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £23.6 thousand with six directors and no connected persons (2022: £2.1 thousand with three directors and no connected persons).

Notes to the financial statements continued
for the year ended 31 December

Note 31: Related party transactions continued

Balances and transactions with fellow Lloyds Banking Group undertakings

Balances and transactions between members of the Bank of Scotland Group

In accordance with IFRS 10 *Consolidated Financial Statements*, transactions and balances between the Bank and its subsidiary undertakings, and between those subsidiary undertakings, have all been eliminated on consolidation and thus are not reported as related party transactions of the Group.

The Bank, as a result of its position as parent of a banking group, has a large number of transactions with various of its subsidiary undertakings; these are included on the balance sheet of the Bank as follows:

	2023 £m	2022 £m
Assets, included within:		
Derivative financial instruments	**6**	26
Financial assets at amortised cost: due from fellow Lloyds Banking Group undertakings	**4,267**	7,094
Liabilities, included within:		
Due to fellow Lloyds Banking Group undertakings	**5,172**	5,810
Debt securities in issue at amortised cost	**1,465**	–

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2023 the Bank earned interest income on the above asset balances of £1,082 million (2022: £557 million) and incurred interest expense on the above liability balances of £1,158 million (2022: £510 million).

Details of intercompany recharges recognised within other operating income are given in note 7.

Balances and transactions with Lloyds Banking Group plc and fellow subsidiaries of the Lloyds Banking Group

The Bank and its subsidiaries have balances due to and from the Bank's ultimate parent company, Lloyds Banking Group plc and fellow subsidiaries of the Lloyds Banking Group. These are included on the balance sheet as follows:

	The Group		The Bank	
	2023 £m	2022 £m	2023 £m	2022 £m
Assets, included within:				
Derivative financial instruments	**2,334**	2,901	**2,334**	2,901
Financial assets at amortised cost: due from fellow Lloyds Banking Group undertakings	**16,773**	16,048	**16,654**	15,905
Liabilities, included within:				
Due to fellow Lloyds Banking Group undertakings	**95,098**	91,287	**89,222**	85,753
Derivative financial instruments	**3,986**	4,090	**3,986**	4,090
Debt securities in issue at amortised cost	**5,371**	4,196	**5,371**	4,196
Subordinated liabilities	**1,503**	1,564	**1,503**	1,564

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2023 the Group and the Bank earned £660 million interest income on the above asset balances (2022: Group and Bank £325 million); the Group incurred £5,109 million and the Bank incurred £4,899 million interest expense on the above liability balances (2022: Group £2,727 million and Bank £2,709 million).

Other related party transactions

Pension funds

At 31 December 2023 customer deposits of £19 million (2022: £33 million) related to the HBOS Group's pension funds.

Joint ventures and associates

At 31 December 2023 there were loans and advances to customers of £25 million (2022: £17 million) outstanding and balances within customer deposits of £1 million (2022: £6 million) relating to joint ventures and associates.

Note 32: Contingent liabilities, commitments and guarantees

Contingent liabilities, commitments and guarantees

At 31 December 2023 contingent liabilities, such as performance bonds and letters of credit, arising from the banking business were £109 million for the Group and the Bank (2022: £97 million).

The contingent liabilities of the Group and the Bank arise in the normal course of its banking business and it is not practicable to quantify their future financial effect. Total commitments and guarantees were £60,718 million (2022: £65,188 million) for the Group and £39,487 million (2022: £42,996 million) for the Bank, of which in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £13,967 million (2022: £17,458 million) for the Group and £13,966 million (2022: £17,356 million) for the Bank were irrevocable.

Capital commitments

There was no capital expenditure contracted but not provided for at 31 December 2023 (2022: £nil).

Interchange fees

With respect to multi-lateral interchange fees (MIFs), the Lloyds Banking Group is not a party in the ongoing or threatened litigation which involves the card schemes Visa and Mastercard (as described below). However, the Group is a member/licensee of Visa and Mastercard and other card schemes. The litigation in question is as follows:

- Litigation brought by or on behalf of retailers against both Visa and Mastercard in the English Courts, in which retailers are seeking damages on grounds that Visa and Mastercard's MIFs breached competition law (this includes a judgment of the Supreme Court in June 2020 upholding the Court of Appeal's finding in 2018 that certain historic interchange arrangements of Mastercard and Visa infringed competition law)
- Litigation brought on behalf of UK consumers in the English Courts against Mastercard

Any impact on the Group of the litigation against Visa and Mastercard remains uncertain at this time, such that it is not practicable for the Group to provide an estimate of any potential financial effect. Insofar as Visa is required to pay damages to retailers for interchange fees set prior to June 2016, contractual arrangements to allocate liability have been agreed between various UK banks (including the Lloyds Banking Group) and Visa Inc, as part of Visa Inc's acquisition of Visa Europe in 2016. These arrangements cap the maximum amount of liability to which the Lloyds Banking Group may be subject and this cap is set at the cash consideration received by the Lloyds Banking Group for the sale of its stake in Visa Europe to Visa Inc in 2016. In 2016, the Lloyds Banking Group received Visa preference shares as part of the consideration for the sale of its shares in Visa Europe. A release assessment is carried out by Visa on certain anniversaries of the sale (in line with the Visa Europe sale documentation) and as a result, some Visa preference shares may be converted into Visa Inc Class A common stock from time to time. Any such release and any subsequent sale of Visa common stock does not impact the contingent liability.

LIBOR and other trading rates

Certain Lloyds Banking Group companies, together with other panel banks, have been named as defendants in ongoing private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar, Japanese Yen and Sterling London Interbank Offered Rate and the Australian BBSW reference rate.

Certain Lloyds Banking Group companies are also named as defendants in (i) UK-based claims, and (ii) two Dutch class actions, raising LIBOR manipulation allegations. A number of claims against the Lloyds Banking Group in the UK relating to the alleged mis-sale of interest rate hedging products also include allegations of LIBOR manipulation.

It is currently not possible to predict the scope and ultimate outcome on the Lloyds Banking Group of any private lawsuits or ongoing related challenges to the interpretation or validity of any of the Lloyds Banking Group's contractual arrangements, including their timing and scale. As such, it is not practicable to provide an estimate of any potential financial effect.

Tax authorities

The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013, HMRC informed the Group that its interpretation of the UK rules means that the group relief is not available. In 2020, HMRC concluded its enquiry into the matter and issued a closure notice. The Group's interpretation of the UK rules has not changed and hence it appealed to the First Tier Tax Tribunal, with a hearing having taken place in May 2023. If the final determination of the matter by the judicial process is that HMRC's position is correct, management believes that this would result in an increase in current tax liabilities of the Group of approximately £185 million (including interest). The Group, following conclusion of the hearing and having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due.

There are a number of other open matters on which the Group is in discussions with HMRC, none of which is expected to have a material impact on the financial position of the Group.

FCA investigation into the Lloyds Banking Group's anti-money laundering control framework

The FCA has opened an investigation into the Lloyds Banking Group's compliance with domestic UK money laundering regulations and the FCA's rules and Principles for Businesses, with a focus on aspects of its anti-money laundering control framework. The Lloyds Banking Group has been fully co-operating with the investigation. It is not currently possible to estimate the potential financial impact, if any, to the Lloyds Banking Group.

Other legal actions and regulatory matters

In addition, in the course of its business the Group is subject to other complaints and threatened or actual legal proceedings (including class or group action claims) brought by or on behalf of current or former employees, customers (including their appointed representatives), investors or other third parties, as well as legal and regulatory reviews, enquiries and examinations, requests for information, audits, challenges, investigations and enforcement actions, which could relate to a number of issues. This includes matters in relation to compliance with applicable laws and regulations, such as those relating to prudential regulation, consumer protection, investment advice, business conduct, systems and controls, environmental, competition/anti-trust, tax, anti-bribery, anti-money laundering and sanctions, some of which may be beyond the Group's control, both in the UK and overseas. Where material, such matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. The Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position, operations or cash flows. Where there is a contingent liability related to an existing provision the relevant disclosures are included within note 25.

Note 33: Structured entities

The Group's interests in structured entities are both consolidated and unconsolidated. Details of the Group's interests in consolidated structured entities are set out in note 23 for securitisations and covered bond vehicles. Details of the Group's interests in unconsolidated structured entities are included below.

Unconsolidated structured entities

The Group considers itself the sponsor of a structured entity where it is primarily involved in the design and establishment of the structured entity and further where the Group transfers assets to the structured entity, markets products associated with the structured entity in its own name and/or provides guarantees regarding the structured entity's performance.

The following table describes the types of structured entities that the Group does not consolidate but in which it holds an interest.

			Total assets of structured entities	
Type of entity	**Nature and purpose of structured entities**	**Interest held by the Group**	**2023 £bn**	2022 £bn
Securitisation vehicles	These vehicles issue asset-backed notes to investors and facilitate the management of the Group's balance sheet.	• Interest in notes issued by the vehicles • Fees for loan servicing	**2**	–

The following table sets out an analysis of the carrying amount of interest held by the Group in the unconsolidated structured entities. The maximum exposure to loss is the carrying amounts of the assets held.

Carrying amount	**2023 £m**	2022 £m
Notes held in securitisation vehicles	**1,696**	–

During the year the Group has not provided any non-contractual financial or other support to these entities and has no current intention of providing any non-contractual financial or other support in the future.

The carrying amount of assets transferred to securitisation vehicles at the time of transfer was £2,626 million and the Group recognised a gain of £31 million on transfer.

Continuing involvement in financial assets that have been derecognised

The Group has derecognised financial assets in their entirety following transactions with securitisation vehicles, as noted above. The continuing involvement largely arises from funding provided to the vehicles through the purchase of issued notes. These notes are recognised as debt securities held at amortised cost. The carrying amount of these interests and the maximum exposure to loss is included in the table above. At 31 December 2023 the fair value of the retained notes was £1,707 million. The income from the Group's interest in these structures for the year ended 31 December 2023 and cumulatively for the lifetime was £114 million.

Note 34: Transfers of financial assets

Transferred financial assets derecognised in their entirety with ongoing exposure

Through asset securitisations, the Group has transferred financial assets which were derecognised in their entirety, with some continuing involvement. Further details are available in note 33.

Transferred financial assets that continue to be recognised

Details of transferred financial assets that continue to be recognised in full are as follows.

The Group and the Bank enter into repurchase and securities lending transactions in the normal course of business that do not result in derecognition of the financial assets as substantially all of the risks and rewards, including credit, interest rate, prepayment and other price risks are retained by the Group. In all cases, the transferee has the right to sell or repledge the assets concerned. See note 36, Credit risk (E).

As set out in note 23, included within financial assets measured at amortised cost are loans transferred under the Group's securitisation *and covered bond programmes. As the Group retains all or a majority of the risks and rewards associated with these loans, including* credit, interest rate, prepayment and liquidity risk, they remain on the Group's balance sheet. Assets transferred into the Group's securitisation and covered bond programmes are not available to be used by the Group while the assets are within the programmes. However, the Group retains the right to remove loans from the covered bond programmes where they are in excess of the programme's requirements. In addition, where the Group has retained some of the notes issued by securitisation and covered bond programmes, the Group has the ability to sell or pledge these retained notes.

The table below sets out the carrying values of the transferred assets and the associated liabilities. For repurchase and securities lending transactions, the associated liabilities represent the Group's obligation to repurchase the transferred assets. For securitisation programmes, the associated liabilities represent the external notes in issue (note 23). The liabilities shown in the table below have recourse to the transferred assets.

The Group	2023 Assets £m	2023 Liabilities £m	2022 Assets £m	2022 Liabilities £m
Securitisation programmes				
Financial assets at amortised cost:				
Loans and advances to customers[1]	**29,649**	**2,106**	24,811	773

1 The carrying value of associated liabilities for the Group excludes securitisation notes held by the Group of £19,546 million (31 December 2022: £21,403 million).

The Bank	2023 Assets £m	2023 Liabilities £m	2022 Assets £m	2022 Liabilities £m
Securitisation programmes				
Financial assets at amortised cost:				
Loans and advances to customers[1]	**29,649**	**–**	24,811	–

1 The carrying value of transferred assets for the Bank includes amounts relating to assets transferred to structured entities which are fully consolidated into the Group. The liabilities associated with such assets are issued by the structured entities.

Note 35: Offsetting of financial assets and liabilities

The following information relates to financial assets and liabilities which have been offset in the balance sheet and those which have not been offset but for which the Group has enforceable master netting agreements or collateral arrangements in place with counterparties.

				Related amounts where set off in the balance sheet not permitted[1]		
	Gross amounts of assets and liabilities[2] £m	Amount offset in the balance sheet £m	Net amounts presented in the balance sheet £m	Cash collateral received/ pledged £m	Non-cash collateral received/ pledged £m	Potential net amounts if offset of related amounts permitted £m
At 31 December 2023						
Financial assets						
Financial assets at fair value through profit or loss	**266**	**–**	**266**	**–**	**–**	**266**
Derivative financial instruments	**2,850**	**–**	**2,850**	**(171)**	**(2,422)**	**257**
Loans and advances to banks	**206**	**–**	**206**	**(175)**	**–**	**31**
Loans and advances to customers	**292,470**	**–**	**292,470**	**(1,589)**	**(422)**	**290,459**
Debt securities	**1,696**	**–**	**1,696**	**–**	**–**	**1,696**
Financial liabilities						
Deposits from banks	**179**	**–**	**179**	**(169)**	**–**	**10**
Customer deposits	**161,946**	**–**	**161,946**	**(3)**	**(422)**	**161,521**
Repurchase agreements	**30,397**	**–**	**30,397**	**–**	**(30,397)**	**–**
Financial liabilities at fair value through profit or loss	**23**	**–**	**23**	**–**	**–**	**23**
Derivative financial instruments	**4,428**	**–**	**4,428**	**(1,763)**	**(2,487)**	**178**
At 31 December 2022						
Financial assets						
Financial assets at fair value through profit or loss	291	–	291	–	–	291
Derivative financial instruments	3,477	–	3,477	(217)	(3,042)	218
Loans and advances to banks	198	–	198	(171)	–	27
Loans and advances to customers	292,416	–	292,416	(18)	(594)	291,804
Debt securities	–	–	–	–	–	–
Financial liabilities						
Deposits from banks	195	–	195	(194)	–	1
Customer deposits	166,363	–	166,363	(23)	(594)	165,746
Repurchase agreements	30,210	–	30,210	–	(30,210)	–
Financial liabilities at fair value through profit or loss	26	–	26	–	–	26
Derivative financial instruments	4,570	–	4,570	(189)	(3,096)	1,285

1 The Group enters into derivatives and repurchase and reverse repurchase agreements with various counterparties which are governed by industry standard master netting agreements. The Group holds and provides cash and securities collateral in respect of derivative transactions covered by these agreements. The right to set off balances under these master netting agreements or to set off cash and securities collateral only arises in the event of non-payment or default and, as a result, these arrangements do not qualify for offsetting under IAS 32.
2 Net of impairment allowances.

The effects of over-collateralisation have not been taken into account in the above table.

Note 36: Financial risk management

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: market risk, which includes interest rate risk and foreign exchange risk; credit risk; liquidity risk and capital risk. The following disclosures provide quantitative and qualitative information about the Group's exposure to these risks.

Market risk

(A) Interest rate risk

Interest rate risk arises from the different repricing characteristics of the Group's assets and liabilities. Liabilities are generally 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 UK Bank Rate, set by the Bank of England. The rates on the remaining liabilities are contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However, a significant proportion of the Group's lending assets, for example many personal loans and mortgages, bear interest rates which are contractually fixed.

The Group's risk management policy is to optimise reward while managing its market risk exposures within the risk appetite defined by the Lloyds Banking Group Board. The largest residual risk exposure arises from balances that are deemed to be insensitive to changes in market rates (including current accounts, a portion of variable rate deposits and investable equity), and is managed through the Lloyds Banking Group's structural hedge. The Lloyds Banking Group's structural hedge consists of longer-term fixed rate assets or interest rate swaps and the amount and duration of the hedging activity is reviewed regularly by the Lloyds Banking Group Asset and Liability Committee.

The Lloyds Banking Group establishes hedge accounting relationships for interest rate risk components using cash flow hedges and fair value hedges. The Lloyds Banking Group is exposed to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The derivatives used to manage the Lloyds Banking Group structural hedge may be designated into cash flow hedges to manage income statement volatility. The economic items related to the Lloyds Banking Group structural hedge, for example current accounts, are not eligible hedged items under IAS 39 for inclusion into accounting hedge relationships. The Lloyds Banking 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 Lloyds Banking Group applies netting between similar risks before applying hedge accounting.

Hedge ineffectiveness arises during the management of interest rate risk due to residual unhedged risk. Sources of ineffectiveness, which the Group may decide to not fully mitigate, can include basis differences, timing differences and notional amount differences. The effectiveness of accounting hedge relationships is assessed between the hedging derivatives and the documented hedged item, which can differ to the underlying economically hedged item.

At 31 December 2023 the aggregate notional principal of interest rate swaps designated as fair value hedges was £55,231 million (2022: £745 million) for the Group and the Bank with a net fair value liability of £614 million (2022: asset of £35 million) for the Group and the Bank (note 15). The losses on the hedging instruments were £677 million (2022: losses of £116 million) for the Group and the Bank. The gains on the hedged items attributable to the hedged risk were £4 million (2022: gains of £117 million) for the Group and the Bank. The gains and losses relating to the fair value hedges are recorded in net trading income.

(B) Foreign exchange risk

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are managed centrally within allocated exposure limits. Trading book exposures in the authorised trading centres are allocated exposure limits. The limits are monitored daily by the local centres and reported to the market and liquidity risk function in London.

The Group manages foreign currency accounting exposure via cash flow hedge accounting, utilising currency swaps and forward foreign exchange trades.

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 has overseas operations in Europe. Structural foreign currency exposures in respect of operations with a Euro functional currency are £473 million (2022: £179 million) for the Group and £490 million (2022: £194 million) for the Bank.

Note 36: Financial risk management continued

Credit risk

The Group's credit risk exposure arises in respect of the instruments below and predominantly in the United Kingdom. Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, which include the use of various credit risk rating systems as inputs and assess credit risk at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the 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 uses a range of approaches to mitigate credit risk, including internal control policies, obtaining collateral, using master netting agreements and other credit risk transfers, such as asset sales and credit derivatives based transactions.

(A) Maximum credit exposure

The maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	2023			2022		
The Group	**Maximum exposure £m**	**Offset[1] £m**	**Net exposure £m**	Maximum exposure £m	Offset[1] £m	Net exposure £m
Financial assets at fair value through profit or loss	**266**	**–**	**266**	291	–	291
Derivative financial instruments	**2,850**	**(99)**	**2,751**	3,477	(154)	3,323
Financial assets at amortised cost, net[2]:						
Loans and advances to banks, net[2]	**206**	**–**	**206**	198	–	198
Loans and advances to customers, net[2]	**292,470**	**(422)**	**292,048**	292,416	(594)	291,822
Debt securities, net[2]	**1,696**	**–**	**1,696**	–	–	–
	294,372	**(422)**	**293,950**	292,614	(594)	292,020
Off-balance sheet items:						
Other items serving as direct credit substitutes	**–**	**–**	**–**	2	–	2
Performance bonds, including letters of credit, and other transaction-related contingencies	**109**	**–**	**109**	95	–	95
Irrevocable commitments and guarantees	**13,967**	**–**	**13,967**	17,458	–	17,458
	14,076	**–**	**14,076**	17,555	–	17,555
	311,564	**(521)**	**311,043**	313,937	(748)	313,189

1 Offset items comprise deposit amounts available for offset and amounts available for offset under master netting arrangements that do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.
2 Amounts shown net of related impairment allowances.

	2023			2022		
The Bank	**Maximum exposure £m**	**Offset[1] £m**	**Net exposure £m**	Maximum exposure £m	Offset[1] £m	Net exposure £m
Financial assets at fair value through profit or loss	**111**	**–**	**111**	113	–	113
Derivative financial instruments	**2,850**	**(99)**	**2,751**	3,476	(154)	3,322
Financial assets at amortised cost, net[2]						
Loans and advances to banks, net[2]	**180**	**–**	**180**	171	–	171
Loans and advances to customers, net[2]	**286,187**	**(422)**	**285,765**	283,621	(594)	283,027
Debt securities, net[2]	**1,696**	**–**	**1,696**	–	–	–
	288,063	**(422)**	**287,641**	283,792	(594)	283,198
Off-balance sheet items:						
Other items serving as direct credit substitutes	**–**	**–**	**–**	2	–	2
Performance bonds, including letters of credit, and other transaction-related contingencies	**109**	**–**	**109**	95	–	95
Irrevocable commitments and guarantees	**13,966**	**–**	**13,966**	17,356	–	17,356
	14,075	**–**	**14,075**	17,453	–	17,453
	305,099	**(521)**	**304,578**	304,834	(748)	304,086

1 Offset items comprise deposit amounts available for offset and amounts available for offset under master netting arrangements that do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.
2 Amounts shown net of related impairment allowances.

Note 36: Financial risk management continued

(B) Concentrations of exposure

The Group's management of concentration risk includes portfolio controls on certain industries, sectors and products to reflect risk appetite as well as individual, customer and bank limit risk tolerances. Credit policies and appetite statements are aligned to the Lloyds Banking Group's risk appetite and restrict exposure to higher risk countries and potentially vulnerable sectors and asset classes. Exposures are monitored to prevent both an excessive concentration of risk and single name concentrations. The Group's largest credit limits are regularly monitored by the Lloyds Banking Group Board Risk Committee and reported in accordance with regulatory requirements. As part of its credit risk policy, the Group considers sustainability risk (which incorporates environmental (including climate), social and governance) in the assessment of commercial facilities.

At 31 December 2023 the most significant concentrations of exposure were in mortgages.

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Agriculture, forestry and fishing	**567**	585	**567**	585
Construction	**718**	701	**718**	701
Energy and water supply	**32**	62	**32**	62
Financial, business and other services	**720**	874	**720**	874
Lease financing	**599**	511	**442**	339
Manufacturing	**147**	161	**147**	161
Personal:				
Mortgages	**271,242**	271,243	**271,181**	268,555
Other	**16,435**	15,764	**10,077**	9,421
Postal and telecommunications	**72**	81	**72**	81
Property companies	**3,068**	3,007	**3,068**	3,032
Transport, distribution and hotels	**1,139**	2,624	**1,139**	2,624
Total loans and advances to customers before allowance for impairment losses	**294,739**	295,613	**288,163**	286,435
Allowance for impairment losses (note 17)	**(2,269)**	(3,197)	**(1,976)**	(2,814)
Total loans and advances to customers	**292,470**	292,416	**286,187**	283,621

The Group's operations are predominantly UK based and as a result an analysis of credit risk exposures by geographical region is not provided.

(C) Credit quality of assets

Cash and balances at central banks

Significantly all of the Group's cash and balances at central banks of £3,009 million (2022: £3,004 million) are due from the Bank of England.

Loans and advances banks

All of the Group's loans and advances to banks are assessed as Stage 1.

Loans and advances to customers

The Group uses two credit ratings systems, according to the characteristics of exposures and the way that they are managed internally; these credit ratings are set out below. All probabilities of default (PDs) include forward-looking information and are based on 12-month values, with the exception of credit-impaired.

RMS		CMS	
Quality classification	**IFRS 9 PD range**	**Quality classification**	**IFRS 9 PD range**
RMS 1–3	0.00–0.80%	CMS 1–5	0.000–0.100%
RMS 4–6	0.81–4.50%	CMS 6–10	0.101–0.500%
RMS 7–9	4.51–14.00%	CMS 11–14	0.501–3.000%
RMS 10	14.01–20.00%	CMS 15–18	3.001–20.000%
RMS 11–13	20.01–99.99%	CMS 19	20.001–99.999%
RMS 14	100.00%	CMS 20–23	100.000%

Stage 3 assets of the Group include balances of £73 million (2022: £109 million) (with outstanding amounts due of £426 million (2022: £444 million)) which have been subject to a partial write-off and where the Group continues to enforce recovery action.

Stage 2 and Stage 3 assets of the Group with a carrying amount of £100 million (2022: £120 million) were modified during the year. No material gain or loss was recognised by the Group.

As at 31 December 2023 assets that had been previously modified while classified as Stage 2 or Stage 3 and were classified as Stage 1 amounted to £nil (2022: £3,668 million).

Note 36: Financial risk management continued

The Group Gross drawn exposures and expected credit loss allowance	Drawn exposures Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Allowance for expected credit losses Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2023								
RMS 1–3	**204,442**	**3,608**	**–**	**208,050**	**128**	**38**	**–**	**166**
RMS 4–6	**35,183**	**25,816**	**–**	**60,999**	**145**	**200**	**–**	**345**
RMS 7–9	**2,262**	**3,874**	**–**	**6,136**	**83**	**170**	**–**	**253**
RMS 10	**40**	**883**	**–**	**923**	**3**	**65**	**–**	**68**
RMS 11–13	**10**	**4,869**	**–**	**4,879**	**1**	**321**	**–**	**322**
RMS 14	**–**	**–**	**6,496**	**6,496**	**–**	**–**	**855**	**855**
	241,937	**39,050**	**6,496**	**287,483**	**360**	**794**	**855**	**2,009**
CMS 1–5	**1,141**	**–**	**–**	**1,141**	**–**	**–**	**–**	**–**
CMS 6–10	**1,461**	**5**	**–**	**1,466**	**1**	**–**	**–**	**1**
CMS 11–14	**2,808**	**286**	**–**	**3,094**	**12**	**7**	**–**	**19**
CMS 15–18	**468**	**581**	**–**	**1,049**	**10**	**37**	**–**	**47**
CMS 19	**3**	**144**	**–**	**147**	**–**	**19**	**–**	**19**
CMS 20–23	**–**	**–**	**359**	**359**	**–**	**–**	**174**	**174**
	5,881	**1,016**	**359**	**7,256**	**23**	**63**	**174**	**260**
Total loans and advances to customers	**247,818**	**40,066**	**6,855**	**294,739**	**383**	**857**	**1,029**	**2,269**

The Group Gross drawn exposures and expected credit loss allowance	Drawn exposures Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Allowance for expected credit losses Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2022								
RMS 1–3	222,564	22,179	–	244,743	88	176	–	264
RMS 4–6	13,913	12,503	–	26,416	99	219	–	318
RMS 7–9	1,819	3,998	–	5,817	70	248	–	318
RMS 10	24	1,064	–	1,088	2	89	–	91
RMS 11–13	9	3,314	–	3,323	2	349	–	351
RMS 14	–	–	5,976	5,976	–	–	900	900
	238,329	43,058	5,976	287,363	261	1,081	900	2,242
CMS 1–5	1,216	–	–	1,216	–	–	–	–
CMS 6–10	1,412	24	–	1,436	1	–	–	1
CMS 11–14	2,293	500	–	2,793	11	7	–	18
CMS 15–18	619	573	–	1,192	11	36	–	47
CMS 19	4	71	–	75	–	8	–	8
CMS 20–23	–	–	1,538	1,538	–	–	881	881
	5,544	1,168	1,538	8,250	23	51	881	955
Total loans and advances to customers	243,873	44,226	7,514	295,613	284	1,132	1,781	3,197

Note 36: Financial risk management continued

The Bank **Gross drawn exposures and expected credit loss allowance**	**Drawn exposures**				**Allowance for expected credit losses**			
	Stage 1 £m	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
At 31 December 2023								
RMS 1–3	**203,455**	**3,607**	**–**	**207,062**	**125**	**38**	**–**	**163**
RMS 4–6	**31,799**	**25,328**	**–**	**57,127**	**102**	**174**	**–**	**276**
RMS 7–9	**1,493**	**3,489**	**–**	**4,982**	**49**	**124**	**–**	**173**
RMS 10	**28**	**801**	**–**	**829**	**2**	**49**	**–**	**51**
RMS 11–13	**10**	**4,706**	**–**	**4,716**	**1**	**263**	**–**	**264**
RMS 14	**–**	**–**	**6,352**	**6,352**	**–**	**–**	**794**	**794**
	236,785	**37,931**	**6,352**	**281,068**	**279**	**648**	**794**	**1,721**
CMS 1–5	**1,141**	**–**	**–**	**1,141**	**–**	**–**	**–**	**–**
CMS 6–10	**1,461**	**5**	**–**	**1,466**	**–**	**–**	**–**	**–**
CMS 11–14	**2,714**	**286**	**–**	**3,000**	**12**	**7**	**–**	**19**
CMS 15–18	**404**	**581**	**–**	**985**	**7**	**37**	**–**	**44**
CMS 19	**–**	**144**	**–**	**144**	**–**	**19**	**–**	**19**
CMS 20–23	**–**	**–**	**359**	**359**	**–**	**–**	**173**	**173**
	5,720	**1,016**	**359**	**7,095**	**19**	**63**	**173**	**255**
Total loans and advances to customers	**242,505**	**38,947**	**6,711**	**288,163**	**298**	**711**	**967**	**1,976**

The Bank Gross drawn exposures and expected credit loss allowance	Drawn exposures				Allowance for expected credit losses			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2022								
RMS 1–3	220,717	22,031	–	242,748	85	175	–	260
RMS 4–6	10,135	11,562	–	21,697	62	178	–	240
RMS 7–9	1,187	3,382	–	4,569	46	183	–	229
RMS 10	24	947	–	971	2	71	–	73
RMS 11–13	9	2,956	–	2,965	2	277	–	279
RMS 14	–	–	5,382	5,382	–	–	751	751
	232,072	40,878	5,382	278,332	197	884	751	1,832
CMS 1–5	1,216	–	–	1,216	–	–	–	–
CMS 6–10	1,412	24	–	1,436	1	–	–	1
CMS 11–14	2,194	500	–	2,694	10	7	–	17
CMS 15–18	545	573	–	1,118	8	36	–	44
CMS 19	4	71	–	75	–	8	–	8
CMS 20–23	–	–	1,564	1,564	–	–	912	912
	5,371	1,168	1,564	8,103	19	51	912	982
Total loans and advances to customers	237,443	42,046	6,946	286,435	216	935	1,663	2,814

Note 36: Financial risk management continued

Debt securities held at amortised cost).

All of the Group's and the Bank's debt securities held at amortised cost are investment grade (credit ratings equal to or better than 'BBB').

Derivative assets

An analysis of derivative assets is given in note 15. The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities.

The Group	2023 Investment grade[1] £m	2023 Other[2] £m	2023 Total £m	2022 Investment grade[1] £m	2022 Other[2] £m	2022 Total £m
Trading and other	377	139	516	406	170	576
Hedging	–	–	–	–	–	–
	377	139	516	406	170	576
Due from fellow Lloyds Banking Group undertakings			2,334			2,901
Total derivative financial instruments			**2,850**			3,477

The Bank	2023 Investment grade[1] £m	2023 Other[2] £m	2023 Total £m	2022 Investment grade[1] £m	2022 Other[2] £m	2022 Total £m
Trading and other	377	133	510	379	170	549
Hedging	–	–	–	–	–	–
	377	133	510	379	170	549
Due from fellow Lloyds Banking Group undertakings			2,340			2,927
Total derivative financial instruments			**2,850**			3,476

1 Credit ratings equal to or better than 'BBB'.
2 Other comprises sub-investment grade (2023: £116 million for the Group and the Bank; 2022: £105 million for the Group and the Bank) and not rated (2023: £23 million for the Group and £17 million for the Bank; 2022: £65 million for the Group and the Bank).

Note 36: Financial risk management continued

Financial guarantees and irrevocable loan commitments

Financial guarantees represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less. Most commitments to extend credit are contingent upon customers maintaining specific credit standards.

The Group Gross undrawn exposures and expected credit loss allowance	Undrawn exposures				Allowance for expected credit losses			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2023								
RMS 1–3	**41,834**	**59**	**–**	**41,893**	**26**	**–**	**–**	**26**
RMS 4–6	**12,404**	**1,838**	**–**	**14,242**	**34**	**26**	**–**	**60**
RMS 7–9	**579**	**303**	**–**	**882**	**8**	**9**	**–**	**17**
RMS 10	**4**	**47**	**–**	**51**	**–**	**3**	**–**	**3**
RMS 11–13	**–**	**119**	**–**	**119**	**–**	**9**	**–**	**9**
RMS 14	**–**	**–**	**71**	**71**	**–**	**–**	**–**	**–**
	54,821	**2,366**	**71**	**57,258**	**68**	**47**	**–**	**115**
CMS 1–5	**2,316**	**–**	**–**	**2,316**	**–**	**–**	**–**	**–**
CMS 6–10	**272**	**–**	**–**	**272**	**–**	**–**	**–**	**–**
CMS 11–14	**493**	**189**	**–**	**682**	**3**	**3**	**–**	**6**
CMS 15–18	**79**	**101**	**–**	**180**	**1**	**3**	**–**	**4**
CMS 19	**–**	**9**	**–**	**9**	**–**	**2**	**–**	**2**
CMS 20–23	**–**	**–**	**1**	**1**	**–**	**–**	**1**	**1**
	3,160	**299**	**1**	**3,460**	**4**	**8**	**1**	**13**
Total	**57,981**	**2,665**	**72**	**60,718**	**72**	**55**	**1**	**128**

The Group Gross undrawn exposures and expected credit loss allowance	Undrawn exposures				Allowance for expected credit losses			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2022								
RMS 1–3	45,478	192	–	45,670	16	–	–	16
RMS 4–6	11,664	2,455	–	14,119	26	26	–	52
RMS 7–9	556	400	–	956	7	14	–	21
RMS 10	2	60	–	62	–	4	–	4
RMS 11–13	–	112	–	112	–	11	–	11
RMS 14	–	–	68	68	–	–	–	–
	57,700	3,219	68	60,987	49	55	–	104
CMS 1–5	655	–	–	655	–	–	–	–
CMS 6–10	2,716	1	–	2,717	1	–	–	1
CMS 11–14	673	61	–	734	2	2	–	4
CMS 15–18	31	61	–	92	1	4	–	5
CMS 19	–	1	–	1	–	–	–	–
CMS 20–23	–	–	2	2	–	–	1	1
	4,075	124	2	4,201	4	6	1	11
Total	61,775	3,343	70	65,188	53	61	1	115

Note 36: Financial risk management continued

The Bank Gross undrawn exposures and expected credit loss allowance	Undrawn exposures				Allowance for expected credit losses			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2023								
RMS 1–3	**29,134**	**58**	**–**	**29,192**	**18**	**–**	**–**	**18**
RMS 4–6	**4,966**	**1,253**	**–**	**6,219**	**15**	**20**	**–**	**35**
RMS 7–9	**259**	**186**	**–**	**445**	**4**	**8**	**–**	**12**
RMS 10	**2**	**32**	**–**	**34**	**–**	**3**	**–**	**3**
RMS 11–13	**–**	**80**	**–**	**80**	**–**	**7**	**–**	**7**
RMS 14	**–**	**–**	**56**	**56**	**–**	**–**	**–**	**–**
	34,361	**1,609**	**56**	**36,026**	**37**	**38**	**–**	**75**
CMS 1–5	**2,316**	**–**	**–**	**2,316**	**–**	**–**	**–**	**–**
CMS 6–10	**272**	**1**	**–**	**273**	**–**	**–**	**–**	**–**
CMS 11–14	**493**	**189**	**–**	**682**	**2**	**3**	**–**	**5**
CMS 15–18	**79**	**101**	**–**	**180**	**1**	**4**	**–**	**5**
CMS 19	**–**	**9**	**–**	**9**	**–**	**2**	**–**	**2**
CMS 20–23	**–**	**–**	**1**	**1**	**–**	**–**	**1**	**1**
	3,160	**300**	**1**	**3,461**	**3**	**9**	**1**	**13**
Total	**37,521**	**1,909**	**57**	**39,487**	**40**	**47**	**1**	**88**

The Bank Gross undrawn exposures and expected credit loss allowance	Undrawn exposures				Allowance for expected credit losses			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2022								
RMS 1–3	31,512	177	–	31,689	8	–	–	8
RMS 4–6	4,853	1,565	–	6,418	14	21	–	35
RMS 7–9	272	253	–	525	3	12	–	15
RMS 10	2	43	–	45	–	4	–	4
RMS 11–13	–	69	–	69	–	9	–	9
RMS 14	–	–	49	49	–	–	–	–
	36,639	2,107	49	38,795	25	46	–	71
CMS 1–5	655	–	–	655	–	–	–	–
CMS 6–10	2,716	1	–	2,717	1	–	–	1
CMS 11–14	673	61	–	734	2	1	–	3
CMS 15–18	31	61	–	92	1	4	–	5
CMS 19	–	1	–	1	–	–	–	–
CMS 20–23	–	–	2	2	–	–	1	1
	4,075	124	2	4,201	4	5	1	10
Total	40,714	2,231	51	42,996	29	51	1	81

Note 36: Financial risk management continued

(D) Collateral held as security for financial assets

The principal types of collateral accepted by the Group include: residential and commercial properties; charges over business assets such as premises, inventory and accounts receivable; financial instruments; cash; and guarantees from third parties. The terms and conditions associated with the use of the collateral are varied and are dependent on both the type of agreement and the counterparty. The Group holds collateral against loans and advances and irrevocable loan commitments; qualitative and, where appropriate, quantitative information is provided in respect of this collateral below. Collateral held as security for financial assets at fair value through profit or loss and for derivative assets is also shown below.

The Group holds collateral in respect of loans and advances to customers as set out below. The Group does not hold collateral against debt securities which are classified as financial assets held at amortised cost.

Loans and advances to customers

Retail lending

Mortgages

An analysis by loan-to-value ratio of the Group's and the Bank's residential mortgage lending is provided below. The value of collateral used in determining the loan-to-value ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices. The market takes into account many factors, including environmental considerations such as flood risk and energy efficient additions, in arriving at the value of a home.

In some circumstances, where the discounted value of the estimated net proceeds from the liquidation of collateral (i.e. net of costs, expected haircuts and anticipated changes in the value of the collateral to the point of sale) is greater than the estimated exposure at default, no credit losses are expected and no ECL allowance is recognised.

	The Group				The Bank			
Gross drawn exposures	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 31 December 2023								
Less than 70 per cent	**167,098**	**26,761**	**5,253**	**199,112**	**167,076**	**26,746**	**5,238**	**199,060**
70 per cent to 80 per cent	**34,505**	**4,305**	**431**	**39,241**	**34,505**	**4,304**	**430**	**39,239**
80 per cent to 90 per cent	**20,243**	**2,728**	**171**	**23,142**	**20,243**	**2,727**	**171**	**23,141**
90 per cent to 100 per cent	**5,840**	**2,337**	**94**	**8,271**	**5,840**	**2,336**	**93**	**8,269**
Greater than 100 per cent	**18**	**87**	**186**	**291**	**18**	**86**	**184**	**288**
Total	**227,704**	**36,218**	**6,135**	**270,057**	**227,682**	**36,199**	**6,116**	**269,997**
At 31 December 2022								
Less than 70 per cent	180,384	31,457	4,842	216,683	179,093	30,670	4,477	214,240
70 per cent to 80 per cent	30,162	5,024	340	35,526	30,136	4,989	306	35,431
80 per cent to 90 per cent	11,499	2,501	134	14,134	11,495	2,478	114	14,087
90 per cent to 100 per cent	3,215	643	82	3,940	3,215	618	68	3,901
Greater than 100 per cent	10	161	185	356	10	135	147	292
Total	225,270	39,786	5,583	270,639	223,949	38,890	5,112	267,951

Commercial lending

Stage 1 and Stage 2 secured lending

For Stage 1 and Stage 2 secured commercial lending, the Group reports assets gross of collateral and therefore discloses the maximum loss exposure.

Stage 1 and Stage 2 secured commercial lending is predominantly managed on a cash flow basis. On occasion, it may include an assessment of underlying collateral, although, for Stage 3 lending, this will not always involve assessing it on a fair value basis. No aggregated collateral information for the entire unimpaired secured commercial lending portfolio is provided to key management personnel.

Stage 3 secured lending

The value of collateral is re-evaluated and its legal soundness reassessed if there is observable evidence of distress of the borrower; this evaluation is used to determine potential loss allowances and management's strategy to try to either repair the business or recover the debt.

At 31 December 2023, Stage 3 secured commercial lending amounted to £38 million, net of an impairment allowance of £43 million (2022: £nil, net of an impairment allowance of £73 million). The fair value of the collateral held in respect of impaired secured commercial lending was £69 million (2022: £43 million). In determining the fair value of collateral, no specific amounts have been attributed to the costs of realisation. For the purposes of determining the total collateral held by the Group in respect of impaired secured commercial lending, the value of collateral for each loan has been limited to the principal amount of the outstanding advance in order to eliminate the effects of any over-collateralisation and to provide a clearer representation of the Group's exposure.

Stage 3 secured commercial lending and associated collateral relates to lending to property companies and to customers in the financial, business and other services and construction industries.

Note 36: Financial risk management continued

Financial assets at fair value through profit or loss

Securities held as collateral in the form of stock borrowed amounted to £2,986 million for the Group and the Bank (2022: £2,055 million for the Group and the Bank). Of this amount, £233 million for the Group and the Bank (2022: £74 million for the Group and the Bank) had been resold or repledged as collateral for the Group's own transactions.

These transactions were generally conducted under terms that are usual and customary for standard secured lending activities.

Derivative assets, after offsetting of amounts under master netting arrangements

The Group reduces exposure to credit risk by using master netting agreements and by obtaining collateral in the form of cash or highly liquid securities. In respect of the net derivative assets after offsetting of amounts under master netting arrangements of £2,751 million for the Group and the Bank (2022: £3,323 million for the Group and £3,322 million for the Bank), cash collateral of £171 million for the Group and the Bank (2022: £217 million for the Group and the Bank) was held.

Irrevocable loan commitments and other credit-related contingencies

At 31 December 2023, the Group held irrevocable loan commitments and other credit-related contingencies of £14,076 million and £14,075 million for the Bank (2022: £17,555 million for the Group and £17,453 million for the Bank). Collateral is held as security, in the event that lending is drawn down, on £12,181 million for the Group and £12,180 million for the Bank (2022: £15,307 million for the Group and £15,205 million for the Bank) of these balances.

Collateral repossessed

During the year, £206 million for the Group and £205 million for the Bank of collateral was repossessed (2022: £198 million for the Group and £177 million for the Bank), consisting primarily of residential property.

In respect of retail portfolios, the Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. In certain circumstances the Group takes physical possession of assets held as collateral against commercial lending. In such cases, the assets are carried on the Group's balance sheet and are classified according to the Group's accounting policies.

(E) Collateral pledged as security

The Group pledges assets primarily for repurchase agreements and securities lending transactions which are generally conducted under terms that are usual and customary for standard securitised borrowing contracts.

Repurchase transactions

There are balances arising from repurchase transactions of £30,397 million for the Group and the Bank (2022: £30,210 million for the Group and the Bank), which include amounts due under the Bank of England's Term Funding Scheme with additional incentives for SMEs (TFSME). The fair value of the collateral provided under these agreements at 31 December 2023 was £30,397 million, capped at the repurchase agreement carrying value (2022: £38,544 million for the Group and the Bank including over collaterisation).

Securitisations and covered bonds

In addition to the assets detailed above, the Group also holds assets that are encumbered through the Group's securitisation and covered bond programmes. Further details of these assets are provided in note 23.

Note 36: Financial risk management continued

Liquidity risk

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost. Liquidity risk is managed through a series of measures, tests and reports that are primarily based on contractual maturity. The Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the PRA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

The table below analyses financial instrument liabilities of the Group and the Bank 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.

The Group	Up to 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
At 31 December 2023						
Deposits from banks	**10**	**–**	**–**	**169**	**–**	**179**
Customer deposits	**139,978**	**3,123**	**12,520**	**7,325**	**9**	**162,955**
Repurchase agreements	**397**	**–**	**1,056**	**31,398**	**–**	**32,851**
Financial liabilities at fair value through profit or loss	**–**	**–**	**–**	**23**	**–**	**23**
Debt securities in issue at amortised cost	**58**	**75**	**1,005**	**6,556**	**2,304**	**9,998**
Lease liabilities	**1**	**20**	**60**	**230**	**217**	**528**
Subordinated liabilities	**–**	**26**	**88**	**1,558**	**14**	**1,686**
Total non-derivative financial liabilities	**140,444**	**3,244**	**14,729**	**47,259**	**2,544**	**208,220**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**16**	**34**	**98**	**624**	**1,660**	**2,432**
Gross settled derivatives – inflows	**(1)**	**(7)**	**(96)**	**(628)**	**(1,695)**	**(2,427)**
Gross settled derivatives – net flows	**15**	**27**	**2**	**(4)**	**(35)**	**5**
Net settled derivative liabilities	**269**	**–**	**–**	**34**	**–**	**303**
Total derivative financial liabilities	**284**	**27**	**2**	**30**	**(35)**	**308**
At 31 December 2022						
Deposits from banks	1	–	–	195	1	197
Customer deposits	156,411	2,027	5,074	3,396	3	166,911
Repurchase agreements	216	–	904	33,054	38	34,212
Financial liabilities at fair value through profit or loss	–	–	–	–	26	26
Debt securities in issue at amortised cost	183	40	2,176	4,089	1,405	7,893
Lease liabilities	1	22	64	259	259	605
Subordinated liabilities	–	125	8	1,526	93	1,752
Total non-derivative financial liabilities	156,812	2,214	8,226	42,519	1,825	211,596
Derivative financial liabilities:						
Gross settled derivatives – outflows	85	28	68	646	1,615	2,442
Gross settled derivatives – inflows	(50)	(7)	(68)	(652)	(1,597)	(2,374)
Gross settled derivatives – net flows	35	21	–	(6)	18	68
Net settled derivative liabilities	265	–	–	–	37	302
Total derivative financial liabilities	300	21	–	(6)	55	370

Note 36: Financial risk management continued

The Bank	Up to 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
At 31 December 2023						
Deposits from banks	**10**	**–**	**–**	**169**	**–**	**179**
Customer deposits	**139,978**	**3,123**	**12,520**	**7,325**	**9**	**162,955**
Repurchase agreements	**397**	**–**	**1,056**	**31,398**	**–**	**32,851**
Debt securities in issue at amortised cost	**30**	**68**	**904**	**4,175**	**2,304**	**7,481**
Lease liabilities	**1**	**20**	**60**	**230**	**217**	**528**
Subordinated liabilities	**–**	**26**	**88**	**1,558**	**14**	**1,686**
Total non-derivative financial liabilities	**140,416**	**3,237**	**14,628**	**44,855**	**2,544**	**205,680**
Derivative financial liabilities:						
Gross settled derivatives – outflows	**16**	**34**	**98**	**624**	**1,660**	**2,432**
Gross settled derivatives – inflows	**(1)**	**(7)**	**(96)**	**(628)**	**(1,695)**	**(2,427)**
Gross settled derivatives – net flows	**15**	**27**	**2**	**(4)**	**(35)**	**5**
Net settled derivative liabilities	**269**	**–**	**–**	**–**	**–**	**269**
Total derivative financial liabilities	**284**	**27**	**2**	**(4)**	**(35)**	**274**
At 31 December 2022						
Deposits from banks	1	–	–	195	1	197
Customer deposits	156,411	2,027	5,074	3,396	3	166,911
Repurchase agreements	216	–	904	33,054	38	34,212
Debt securities in issue at amortised cost	11	34	1,924	3,656	1,405	7,030
Lease liabilities	1	22	64	259	259	605
Subordinated liabilities	–	125	8	1,526	93	1,752
Total non-derivative financial liabilities	156,640	2,208	7,974	42,086	1,799	210,707
Derivative financial liabilities:						
Gross settled derivatives – outflows	85	28	68	646	1,615	2,442
Gross settled derivatives – inflows	(50)	(7)	(68)	(652)	(1,597)	(2,374)
Gross settled derivatives – net flows	35	21	–	(6)	18	68
Net settled derivative liabilities	265	–	–	–	–	265
Total derivative financial liabilities	300	21	–	(6)	18	333

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of £4 million (2022: £4 million) per annum for the Group and the Bank which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

The figures below are presented in timing categories representing the remaining offer periods of lending commitments or remaining coverage periods of financial guarantees, but the Group could be required to lend or pay amounts under those arrangements earlier than the periods presented below. Payment under the significant majority of the Group's lending commitments and financial guarantee contracts could be required to be made on demand.

The Group	Within 1 year £m	1 to 3 years £m	3 to 5 years £m	Over 5 years £m	Total £m
At 31 December 2023					
Total contingent liabilities	**23**	**10**	**1**	**75**	**109**
Total commitments and guarantees	**58,834**	**1,216**	**522**	**146**	**60,718**
Total contingents, commitments and guarantees	**58,857**	**1,226**	**523**	**221**	**60,827**
At 31 December 2022					
Total contingent liabilities	17	8	1	71	97
Total commitments and guarantees	61,052	1,122	683	2,331	65,188
Total contingents, commitments and guarantees	61,069	1,130	684	2,402	65,285

Note 36: Financial risk management continued

The Bank	Within 1 year £m	1 to 3 years £m	3 to 5 years £m	Over 5 years £m	Total £m
At 31 December 2023					
Total contingent liabilities	**23**	**10**	**1**	**75**	**109**
Lending commitments and guarantees	**37,603**	**1,216**	**522**	**146**	**39,487**
Other commitments	**–**	**–**	**–**	**–**	**–**
Total commitments and guarantees	**37,603**	**1,216**	**522**	**146**	**39,487**
Total contingents, commitments and guarantees	**37,626**	**1,226**	**523**	**221**	**39,596**
At 31 December 2022					
Total contingent liabilities	17	8	1	71	97
Lending commitments and guarantees	38,860	1,122	683	2,331	42,996
Other commitments	–	–	–	–	–
Total commitments and guarantees	38,860	1,122	683	2,331	42,996
Total contingents, commitments and guarantees	38,877	1,130	684	2,402	43,093

Capital risk

Capital is actively managed on an ongoing basis for both the Bank and its regulated subsidiaries, with associated capital policies and procedures subjected to regular review. Regulatory capital ratios are considered a key part of the budgeting and planning processes and forecast ratios are reviewed by the Lloyds Banking Group and Ring-Fenced Banks Asset and Liability Committees. Target capital levels take account of current and future regulatory requirements, capacity for growth and to cover economic and business uncertainties.

The Bank assesses both its regulatory capital requirements and the quantity and quality of capital resources it holds to meet those requirements in accordance with the relevant provisions of the Capital Requirements Directive (CRD V) and Capital Requirements Regulation (UK CRR). This is supplemented through additional regulation set out under the PRA Rulebook and through associated statements of policy, supervisory statements and other regulatory guidance.

The minimum amount of total capital, under Pillar 1 of the regulatory capital framework, is set at 8 per cent of total risk-weighted assets. At least 4.5 per cent of risk-weighted assets are required to be met with common equity tier 1 (CET1) capital and at least 6 per cent of risk-weighted assets are required to be met with tier 1 capital. Minimum Pillar 1 requirements are supplemented by additional minimum requirements under Pillar 2A of the regulatory capital framework, the aggregate of which is referred to as the Bank's Total Capital Requirement (TCR).

Additional minimum capital requirements under Pillar 2A are set by the PRA as a firm-specific Individual Capital Requirement (ICR) reflecting a point in time estimate, which may change over time, of the minimum amount of capital to cover risks that are not fully covered by Pillar 1, such as credit concentration and operational risk, and those risks not covered at all by Pillar 1, such as pension obligation risk and interest rate risk in the banking book (IRRBB). This is set as a variable amount for Pillar 2A (being a set percentage of risk-weighted assets), with fixed add-ons for certain risk types. The Bank's Pillar 2A capital requirement is currently the equivalent of around 2.6 per cent of risk-weighted assets, of which the minimum amount to be met by CET1 capital is the equivalent of around 1.5 per cent of risk-weighted assets.

A range of additional bank specific regulatory capital buffers apply under the capital rules, which are required to be met with CET1 capital. These include a capital conservation buffer (2.5 per cent of risk-weighted assets) and a time-varying countercyclical capital buffer (CCyB) which is currently around 2.0 per cent of risk-weighted assets following the increase in the UK CCyB rate (which is set by the Bank of England's Financial Policy Committee) to 2 per cent in July 2023.

The Bank applies the full extent of the IFRS 9 transitional arrangements for capital as set out under CRR Article 473a (revised). Specifically, the Bank has opted to apply both paragraphs 2 and 4 of CRR Article 473a (static and dynamic relief) and in addition to apply a 100 per cent risk weight to the consequential Standardised credit risk exposure add-back as permitted under paragraph 7a of the revisions. The transitional arrangements for static relief (including 'locked' dynamic relief recognised prior to 1 January 2020) ended on 1 January 2023 and therefore no static relief exists at 31 December 2023 (31 December 2022: £80 million). As at 31 December 2023, no dynamic relief (from 1 January 2020) under the transitional arrangements has been recognised through CET1 capital (31 December 2022: £74 million).

Regulatory capital development

The regulatory framework within which the Bank operates continues to be developed at a global level through the Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS) and within the UK by the PRA and through directions from the Financial Policy Committee (FPC). The Bank continues to monitor these developments very closely, analysing the potential capital impacts to ensure that, through organic capital generation and management actions, the Bank and its regulated subsidiaries continue to maintain a strong capital position that exceeds both minimum regulatory requirements and the Bank's risk appetite and is consistent with market expectations.

Whilst no relief under the IFRS 9 transitional arrangements was recognised through CET1 capital at 31 December 2023, the transitional factor applied to dynamic relief reduced by a further 25 per cent on 1 January 2024.

Note 36: Financial risk management continued

Capital resources

Regulatory capital is divided into tiers depending on the degree of permanency and loss absorbency exhibited.

- Common equity tier 1 (CET1) capital represents the strongest form of capital consisting of shareholders' equity (ordinary share capital and reserves) after a number of regulatory adjustments and deductions are applied. These include adjustments for IFRS 9 transitional arrangements, the accrual for foreseeable dividends (where applicable), the elimination of the cash flow hedging reserve and deductions for goodwill, other intangible assets, prudent valuation, defined benefit pension surplus, significant investments and deferred tax assets.
- Fully qualifying additional tier 1 (AT1) capital comprises non-cumulative perpetual securities containing specific provisions to write down the security should the CET1 ratio fall to a defined trigger limit. CET1 and AT1 together form Tier 1 Capital (T1).
- Tier 2 (T2) capital largely comprises certain other subordinated debt securities that do not qualify as AT1. They must have an original term of at least 5 years, cannot normally be redeemed within their first 5 years and are phased out as T2 regulatory capital in the final 5 years before maturity through the application of regulatory amortisation. Eligible provisions, reflecting the excess of IFRS 9 expected credit losses over corresponding regulatory expected losses, are added back to T2 capital, net of the application of IFRS 9 transitional adjustments. Tier 1 and Tier 2 together form Total Capital.

The Bank's capital resources are summarised as follows:

	2023 £m	2022 £m
Common equity tier 1 capital	**11,966**	11,284
Additional tier 1 capital	**2,550**	2,200
Tier 2 capital	**1,894**	1,846
Total capital	**16,410**	15,330

Note 37: Cash flow statements

(A) Change in operating assets

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Change in amounts due from fellow Lloyds Banking Group undertakings	**(725)**	1,003	**2,078**	895
Change in other financial assets held at amortised cost	**(875)**	(7,315)	**(3,343)**	(8,029)
Change in financial assets at fair value through profit or loss	**25**	71	**1**	38
Change in derivative financial instruments	**620**	805	**619**	806
Change in other operating assets	**172**	(183)	**164**	(198)
Change in operating assets	**(783)**	(5,619)	**(481)**	(6,488)

(B) Change in operating liabilities

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Change in deposits from banks	**(16)**	(402)	**(16)**	(402)
Change in customer deposits	**(4,417)**	(4,414)	**(4,417)**	(4,413)
Change in repurchase agreements	**187**	182	**187**	182
Change in amounts due to fellow Lloyds Banking Group undertakings	**3,811**	8,178	**2,831**	8,370
Change in financial liabilities at fair value through profit or loss	**(3)**	(7)	**–**	–
Change in derivative financial instruments	**(142)**	250	**(124)**	277
Change in debt securities in issue at amortised cost	**2,487**	(1,230)	**2,616**	(764)
Change in other operating liabilities[1]	**45**	(103)	**58**	(81)
Change in operating liabilities	**1,952**	2,454	**1,135**	3,169

1 Includes £68 million (2022: £77 million) for the Group and the Bank in respect of lease liabilities.

Note 37: Cash flow statements continued

(C) Non-cash and other items

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Interest expense on subordinated liabilities	**102**	57	**102**	57
Depreciation and amortisation	**274**	224	**204**	212
Revaluation of investment properties	**1**	–	**–**	–
Regulatory and legal provisions	**89**	91	**89**	91
Other provision movements	**20**	(38)	**20**	(36)
Allowance for loan losses	**(332)**	602	**(522)**	554
Write-off of allowance for loan losses, net of recoveries	**(596)**	(256)	**(428)**	(231)
Impairment charge (credit) relating to undrawn balances	**13**	30	**7**	26
Dividends received from subsidiary undertakings	**–**	–	**(719)**	(126)
Foreign exchange impact on balance sheet[1]	**138**	216	**97**	222
Other non-cash items	**51**	127	**55**	125
Total non-cash items	**(240)**	1,053	**(1,095)**	894
Payments in respect of regulatory and legal provisions	**(379)**	(392)	**(354)**	(415)
Other	**(1)**	(1)	**15**	(1)
Total other items	**(380)**	(393)	**(339)**	(416)
Non-cash and other items	**(620)**	660	**(1,434)**	478

1 When considering the movement on each line of the balance sheet, the impact of foreign exchange rate movements is removed in order to show the underlying cash impact.

(D) Analysis of cash and cash equivalents as shown in the balance sheet

	The Group		The Bank	
	2023 £m	2022 £m	**2023 £m**	2022 £m
Cash and balances at central banks	**3,009**	3,004	**3,009**	3,004
Less mandatory reserve deposits[1]	**(923)**	(977)	**(923)**	(977)
	2,086	2,027	**2,086**	2,027
Loans and advances to banks	**206**	198	**180**	171
Less amounts with a maturity of three months or more	**(166)**	(172)	**(165)**	(171)
	40	26	**15**	–
Total cash and cash equivalents	**2,126**	2,053	**2,101**	2,027

1 Mandatory reserve deposits are held with local central banks in accordance with statutory requirements. Where these deposits are not held in demand accounts and are not available to finance the Group's day-to-day operations they are excluded from cash and cash equivalents.

Note 38: Other information

Bank of Scotland plc is incorporated as a public limited company and registered in Scotland with the registered number SC327000. Bank of Scotland plc's registered office is The Mound, Edinburgh, EH1 1YZ, and its principal executive offices are located at 25 Gresham Street, London, EC2V 7HN.

Bank of Scotland plc and its subsidiaries form a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services.

Bank of Scotland plc's immediate parent undertaking is HBOS plc and its ultimate parent undertaking and controlling party is Lloyds Banking Group plc which is incorporated in Scotland. Copies of the consolidated Annual Report and Accounts of Lloyds Banking Group plc may be obtained from Lloyds Banking Group's head office at 25 Gresham Street, London EC2V 7HN or downloaded via **www.lloydsbankinggroup.com**.

Subsidiaries and related undertakings

In compliance with section 409 of the Companies Act 2006, the following comprises a list of all related undertakings of the Group, as at 31 December 2023. The list includes each undertaking's registered office and the percentage of the class(es) of shares held by the Group. All shares held are ordinary shares unless indicated otherwise in the notes.

Subsidiary undertakings

The Group directly or indirectly holds 100 per cent of the share class and a majority of voting rights (including where the undertaking does not have share capital as indicated) in the following undertakings. All material subsidiary undertakings are consolidated by Lloyds Banking Group.

Name of undertaking	Notes
Anglo Scottish Utilities Partnership 1	+ *
Automobile Association Personal Finance Ltd	4 i
Bank of Scotland (B G S) Nominees Ltd	5 *
Bank of Scotland Edinburgh Nominees Ltd	5 *
Bank of Scotland Equipment Finance Ltd	9 i ‡
Bank of Scotland Structured Asset Finance Ltd	1 i
Bank of Scotland Transport Finance 1 Ltd	9 i ‡
Bank of Wales Ltd	7 i
Barents Leasing Ltd	1 i
Birmingham Midshires Financial Services Ltd	4 i ‡
Birmingham Midshires Mortgage Services Ltd	9 i ‡
BOS (Ireland) Property Services 2 Ltd	8 i ‡
BOS (Shared Appreciation Mortgages (Scotland)) Ltd	4 i
BOS (Shared Appreciation Mortgages (Scotland) No. 2) Ltd	4 i
BOS (Shared Appreciation Mortgages (Scotland) No. 3) Ltd	4 i
BOS (Shared Appreciation Mortgages) No. 1 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 2 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 3 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 4 plc	4 # i
BOS (Shared Appreciation Mortgages) No. 5 plc	4 i
BOS (Shared Appreciation Mortgages) No. 6 plc	4 i
BOS Personal Lending Ltd	4 ii iii
BOSSAF Rail Ltd	1 i
British Linen Leasing (London) Ltd	5 i
British Linen Leasing Ltd	5 i
British Linen Shipping Ltd	5 i
Capital 1945 Ltd	9 i ‡
Capital Bank Leasing 3 Ltd	9 i ‡
Capital Bank Leasing 5 Ltd	7 i
Capital Bank Leasing 12 Ltd	5 i
Capital Bank Property Investments (3) Ltd	7 i
Capital Personal Finance Ltd	4 i
CF Asset Finance Ltd	9 i ‡
First Retail Finance (Chester) Ltd	4 i
Forthright Finance Ltd	7 i
Halifax Leasing (March No.2) Ltd	1 i
Halifax Leasing (September) Ltd	1 i
Halifax Loans Ltd	4 i
Halifax Vehicle Leasing (1998) Ltd	4 i
HBOS Covered Bonds LLP	4 *
HBOS Social Housing Covered Bonds LLP	7 *
Home Shopping Personal Finance Ltd	4 i
IBOS Finance Ltd	9 i ‡
Lex Vehicle Leasing (Holdings) Ltd	9 ii iii iv ‡
Lex Vehicle Leasing Ltd	9 i ‡
Lloyds Capital GP Ltd	10 i ‡
Lloyds Secretaries Ltd	1 i
Loans.co.uk Ltd	7 i
MBNA Ltd	7 i
Membership Services Finance Ltd	4 i
NFU Mutual Finance Ltd	7 ii v
NWS Trust Ltd	5 i
Pacific Leasing Ltd	1 i
Seabreeze Leasing Ltd	1 i
Seaspirit Leasing Ltd	1 i
Standard Property Investment (1987) Ltd	5 ii #
Sussex County Homes Ltd	4 i
The British Linen Company Ltd	5 i
The Mortgage Business plc	4 i
Thistle Leasing	+ *
Tower Hill Property Investments (7) Ltd	9 i # ‡
Tower Hill Property Investments (10) Ltd	7 i #
Tranquility Leasing Ltd	1 i
Waymark Asset Investments Ltd	1 ii iii

The Group has determined that it has the power to exercise control over the following entities without having the majority of the voting rights of the undertakings. Unless otherwise stated, the undertakings do not have share capital or the Group does not hold any shares.

Name of undertaking	Notes
Addison Social Housing Holdings Ltd	2
Connery Holdings Ltd	2
Deva Financing Holdings Ltd	3 §
Edgbaston RMBS Holdings Ltd	3 §
Elland RMBS 2018 plc	3
Elland RMBS Holdings Ltd	3
Molineux RMBS 2016-1 plc	3
Molineux RMBS Holdings Ltd	3
Penarth Asset Securitisation Holdings Ltd	3
Penarth Funding 1 Ltd	3
Penarth Funding 2 Ltd	3
Penarth Master Issuer plc	3
Penarth Receivables Trustee Ltd	3
Permanent Funding (No. 1) Ltd	3
Permanent Funding (No. 2) Ltd	3
Permanent Holdings Ltd	3
Permanent Master Issuer plc	3
Permanent Mortgages Trustee Ltd	3
Permanent PECOH Holdings Ltd	3
Permanent PECOH Ltd	3
Syon Securities 2019 DAC	6
Syon Securities 2020 DAC	6
Syon Securities 2020-2 DAC	6
Wilmington Cards 2021-1 plc	3
Wilmington Cards Holdings Ltd	3
Wilmington Receivables Trustee Ltd	3

Subsidiaries and related undertakings continued

Associated undertakings

The Group has a participating interest in the following undertakings.

Name of undertaking	% of share class held by immediate parent company (or by the Group where this varies)	Registered office address	Notes
Addison Social Housing Ltd	20%	1 Bartholomew Lane, London, EC2N 2AX	i
Connery Ltd	20%	44 Esplanade, St. Helier, Jersey, JE4 9WG	i &

Registered office addresses	
1	25 Gresham Street, London, EC2V 7HN
2	44 Esplanade, St. Helier, Jersey, JE4 9WG
3	1 Bartholomew Lane, London, EC2N 2AX
4	Trinity Road, Halifax, West Yorkshire, HX1 2RG
5	The Mound, Edinburgh, EH1 1YZ
6	5th Floor, The Exchange, George's Dock, IFSC, Dublin 1, Ireland
7	Cawley House, Chester Business Park, Chester, CH4 9FB
8	Suite 6, Rineanna House, Shannon Free Zone, Co. Clare, Ireland
9	1 More London Place, London, SE1 2AF
10	c/o BDO LLP, 5 Temple Square, Temple Street, Liverpool, L2 5RH

Notes	
*	The undertaking does not have share capital
+	The undertaking does not have a registered office
#	In relation to subsidiary undertakings, an undertaking external to the Group holds shares
&	The Group holds voting rights of between 20% and 49.9%
‡	The undertaking is in liquidation
§	The undertaking has applied for Strike Off
i	Ordinary shares
ii	A Ordinary shares
iii	B Ordinary shares
iv	Redeemable preference shares
v	C Ordinary shares