Lloyds Banking Group plc
Form 20-F
March 16, 2012

As filed with the Securities and Exchange Commission on 16 March 2012

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

FORM 20-F

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

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended 31 December 2011

OR

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

OR

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

Commission file number 001-15246

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

Scotland
(Jurisdiction of Incorporation or Organization)

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

Harry Baines, Group Secretary
Tel +44 (0) 207 356 1400, Fax +44 (0) 207 356 3506
25 Gresham Street
London EC2V 7HN
United Kingdom
(Name, telephone, e-mail and/or facsimile number and address of Company contact person)

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

Title of each class	Name of each exchange on which registered
Ordinary shares of nominal value 10 pence each, represented by American Depositary Shares	The New York Stock Exchange
7.75% Public Income Notes due 2050	The New York Stock Exchange
4.875% Senior Notes due 2016	The New York Stock Exchange
6.375% Senior Notes due 2021	The New York Stock Exchange
Floating Rate Notes due 2014	The New York Stock Exchange

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

None

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

None

The number of outstanding shares of each of Lloyds Banking Group plc s classes of capital or common stock as of 31 December 2011 was:

Ordinary shares, nominal value 10 pence each	68,726,627,112
Limited voting shares, nominal value 10 pence each	80,921,051
Preference shares, nominal value 25 pence each	412,215,065
Preference shares, nominal value 25 cents each	1,917,280
Preference shares, nominal value 25 euro cents each	173,350

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

Yes x No o

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

Yes o No x

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

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

Yes x No o

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

Yes o No o

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

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

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

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

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

Item 17 o Item 18 o

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

Yes o No x

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PRESENTATION OF INFORMATION

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

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

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

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

Lloyds Banking Group publishes its consolidated financial statements expressed in British pounds (pounds sterling , sterling or £), the lawful currency of the UK. In this annual report, references to pence and p are to one-hundredth of one pound sterling; references to US dollars , US$ or $ are to the lawful currency of the United States (the US); references to cent or c are to one-hundredth of one US dollar; references to euro or e are to the lawful currency of the member states of the European Union that have adopted a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty of European Union; references to euro cent are to one-hundredth of one euro; and references to Japanese yen , Japanese ¥ or ¥ are to the lawful currency of Japan. Solely for the convenience of the reader, this annual report contains translations of certain pounds sterling amounts into US dollars at specified rates. These translations should not be construed as representations by Lloyds Banking Group that the pounds sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or at any other rate. Unless otherwise stated, the translations of pounds sterling into US dollars have been made at the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) in effect on 31 December 2011, which was $1.5537 = £1.00. The Noon

Buying Rate on 31 December 2011 differs from certain of the actual rates used in the preparation of the consolidated financial statements, which are expressed in pounds sterling, and therefore US dollar amounts appearing in this annual report may differ significantly from actual US dollar amounts which were translated into pounds sterling in the preparation of the consolidated financial statements in accordance with IFRS.

BUSINESS OVERVIEW

Lloyds Banking Group is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers. At 31 December 2011, total Lloyds Banking Group assets were £970,546 million and Lloyds Banking Group had some 98,538 employees (on a full-time equivalent basis). Lloyds Banking Group plc s market capitalisation at that date was some £17,825 million. The Group reported a loss before tax for the 12 months to 31 December 2011 of £342 million, and the capital ratios as at that date were 15.6 per cent for total capital, 12.5 per cent for tier 1 capital and 10.8 per cent for core tier 1 capital.

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

	2011	2010	2009
	£m	£m	£m
Net interest income	**12,698**	12,546	9,026
Other income	**14,114**	31,498	36,745
Total income	**26,812**	44,044	45,771
Insurance claims	**(6,041)**	(19,088)	(22,493)
Total income, net of insurance claims	**20,771**	24,956	23,278
Operating expenses	**(13,050)**	(16,470)	(15,984)
Trading surplus	**7,721**	8,486	7,294
Impairment	**(8,094)**	(10,952)	(16,673)
Share of results of joint ventures and associates	**31**	(88)	(752)
Gain on acquisition			11,173
Loss on disposal of businesses		(365)	
(Loss) profit before tax	**(342)**	(2,919)	1,042

Lloyds Banking Group s main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision. Services are offered through a number of well recognised brands including Lloyds TSB, Halifax, Bank of Scotland and Scottish Widows, and a range of distribution channels including the largest banking branch network in the UK.

The Group has five primary operating divisions, which constitute the Group s reporting segments: Retail, Wholesale, Commercial, Wealth and International, and Insurance. Retail provides banking, mortgages and other financial services to personal customers in the UK. Wholesale provides banking and related services for major UK and multinational corporates and financial institutions, with a turnover in excess of £15 million. Commercial services the needs of small and medium-size enterprises and community organisations with a turnover of up to £15 million. Wealth and International provides private banking and asset management in the UK and overseas and operates the Group s international business. Insurance offers life assurance, pensions and investment products in the UK and Europe and provides general insurance to personal customers in the UK.

The acquisition of HBOS plc on 16 January 2009 had a significant effect on the comparability of the Group s financial position and results with prior periods. Profit before tax is analysed further on pages 18 to 29 on a statutory basis and, in order to provide a more comparable representation of business performance of the Group s segments, on pages 32 to 51 on a combined businesses basis. The key principles adopted in the preparation of the combined businesses basis of reporting are described on page 32. The Group Executive Committee, which is the chief operating decision maker for the Group, reviews the Group s internal reporting based around these segments (which reflect the Group s organisational and management structures) in order to assess performance and allocate resources; this reporting is on a combined businesses basis, which the Group Executive Committee feel best represents the underlying performance of the Group. These combined businesses segmental results for 2011, 2010 and 2009 are therefore presented in compliance with IFRS 8 but the aggregated total of the combined businesses segmental profits and losses before tax constitutes a non-GAAP measure and a reconciliation of this aggregated total to the Group s statutory profit before tax is therefore provided on page 33. The following table shows the results of Lloyds Banking Group s Retail, Wholesale, Commercial, Wealth and International, and Insurance segments and Group Operations and Central items in the last three fiscal years, and their aggregation.

	2011	2010	2009
	£m	£m	£m
Retail	**3,636**	3,986	955
Wholesale	**828**	2,514	(4,682)
Commercial	**499**	291	(200)
Wealth and International	**(3,936)**	(4,950)	(2,433)
Insurance	**1,422**	1,326	1,203
Group Operations and Central items:			

Group Operations	**(56)**	(52)	(143)
Central items	**292**	(903)	(1,000)
	236	(955)	(1,143)
Profit (loss) before tax Combined businesses basis	**2,685**	2,212	(6,300)

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

SELECTED CONSOLIDATED FINANCIAL DATA

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

	2011	2010	2009	2008[1]	2007[1]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**20,771**	24,956	23,278	9,868	10,696
Operating expenses	**(13,050)**	(16,470)	(15,984)	(6,100)	(5,568)
Trading surplus	**7,721**	8,486	7,294	3,768	5,128
Impairment losses	**(8,094)**	(10,952)	(16,673)	(3,012)	(1,796)
Gain on acquisition			11,173		
(Loss) profit before tax	**(342)**	(2,919)	1,042	760	3,999
(Loss) profit for the year	**(378)**	(2,594)	2,953	798	3,320
(Loss) profit for the year attributable to equity shareholders	**(451)**	(2,656)	2,827	772	3,288
Total dividend for the year[2]				648	2,026
Balance sheet data at 31 December (£m)					
Share capital	**6,881**	6,815	10,472	1,513	1,432
Shareholders equity	**45,920**	43,725	43,278	9,393	12,141
Customer deposits	**413,906**	393,633	406,741	170,938	156,555
Subordinated liabilities	**35,089**	36,232	34,727	17,256	11,958
Loans and advances to customers	**565,638**	592,597	626,969	240,344	209,814
Total assets	**970,546**	992,438	1,027,255	436,033	353,346
Share information					
Basic earnings per ordinary share[3]	**(0.7)p**	(4.0)p	7.5p	6.7p	28.9p
Diluted earnings per ordinary share[3]	**(0.7)p**	(4.0)p	7.5p	6.6p	28.7p
Net asset value per ordinary share	**67p**	64p	68p	155p	212p
Total dividend per ordinary share[2]				11.4p	35.9p
Equivalent cents per share[2,4]				20.3c	71.0c
Market price per ordinary share (year end)	**25.9p**	65.7p	50.7p	126.0p	472.0p
Number of shareholders (thousands)	**2,770**	2,798	2,834	824	814
Number of ordinary shares in issue (millions)[5]	**68,727**	68,074	63,775	5,973	5,648
Financial ratios (%)[6]					
Dividend payout ratio				83.9	61.6
Post-tax return on average shareholders equity	**(1.0)**	(5.8)	8.8	7.0	28.1
Post-tax return on average assets	**(0.04)**	(0.26)	0.28	0.21	0.94
Average shareholders equity to average assets	**4.5**	4.6	3.1	2.9	3.3
Cost:income ratio[7]	**62.8**	66.0	68.7	61.8	52.1
Capital ratios (%)[8,9]					
Total capital	**15.6**	14.5	12.4	11.1	11.0
Tier 1 capital	**12.5**	11.0	9.6	7.9	8.1
Core tier 1 capital	**10.8**	9.6	8.1	5.5	7.4

1 Restated in 2009 for IFRS 2 (Revised).

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

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

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

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

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

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

8 Capital ratios are in accordance with Basel II requirements other than the ratios for 2007 which reflect Basel I.

9 Capital ratios for 2008 and 2009 were restated in 2010 to reflect a prior year adjustment to available-for-sale revaluation reserves.

EXCHANGE RATES

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

	2012 February	2012 January	2011 December	2011 November	2011 October	2011 September
US dollars per pound sterling:						
High	**1.60**	**1.58**	**1.57**	**1.61**	**1.61**	**1.62**
Low	**1.57**	**1.53**	**1.54**	**1.55**	**1.54**	**1.54**

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

	2011	2010	2009	2008	2007
US dollars per pound sterling:					
Average	**1.61**	1.54	1.57	1.84	2.01

On 9 March 2012, the latest practicable date, the US dollar Noon Buying Rate was $1.5677 = £1.00. Lloyds Banking Group makes no representation that amounts in pounds sterling have been, could have been or could be converted into US dollars at that rate or at any of the above rates.

BUSINESS

HISTORY AND DEVELOPMENT OF LLOYDS BANKING GROUP

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

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

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

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

Pursuant to two placing and open offers which were completed by the Company in January and June 2009 and the Rights Issue completed in December 2009, the UK Government acquired 43.4 per cent of the Company s issued ordinary share capital. Following further issues of ordinary shares, the UK Government s holding has been reduced to approximately 40.1 per cent at 9 March 2012.

STRATEGY OF LLOYDS BANKING GROUP

The Group is a well diversified UK financial services group providing a wide range of banking and financial services to personal, commercial and corporate customers. The main focus of the Group remains the financial services markets in the UK and the Group has leading positions in many of the markets in which it participates, a comprehensive distribution capability, well recognised brands and a large customer base.

The Group s corporate strategy is built around becoming the best bank for individual, commercial and corporate customers across the UK and creating value by investing in areas that make a real difference to these customers. Customer leadership driven by superior customer insight, tailored products, better service and relationship focus is the overriding priority. There are a number of other key elements to the strategy announced in June 2011, including simplifying the business, improving its agility and efficiency, whilst focusing on core markets which offer strong returns and attractive growth, maintaining a prudent approach to risk and further strengthening the Group s balance sheet.

The four key elements of the action plan to deliver the strategy are:

RESHAPE THE BUSINESS PORTFOLIO TO FIT THE GROUP S ASSETS, CAPABILITIES AND RISK APPETITE

The Group will invest in core areas which offer strong returns and attractive growth: these are businesses which are capital and liquidity efficient, with sustainable competitive advantages, and which are central to its core customer strategy.

In reshaping its business the Group is focusing on the continued reduction of assets outside of its risk appetite, the continued application of a conservative approach to, and a prudent appetite for, risk and the streamlining of its international presence.

BUSINESS

SIMPLIFY THE GROUP TO IMPROVE AGILITY AND EFFICIENCY

The HBOS integration programme was substantially completed in 2011, delivering a single IT platform and a run-rate of £2 billion per annum in cost synergies and other operating efficiencies. The Group is now targeting a further £1.7 billion of cost savings in 2014 through a series of simplification initiatives.

Savings will be released through a fundamental review of operations and processes, the creation of a more efficient distribution platform and increased use of digital channels, optimising sourcing and creating a more agile organisation through delayering the management structure, centralising control functions and simplifying the legal structures.

INVEST TO BE THE BEST BANK FOR CUSTOMERS

The Group intends to increase the investment in its business with a focus on becoming the best bank for customers, becoming the best through the cycle partner for its business customers and maintaining Bancassurance as a core element of this proposition.

STRENGTHEN THE GROUP S BALANCE SHEET AND LIQUIDITY POSITION

The Group aims to continue to strengthen its balance sheet and liquidity position through:

- Targeting a core tier 1 capital ratio prudently in excess of 10 per cent
- Exceeding regulatory liquidity requirements
- Maintaining a stable funding base
- Improving the Group s loan to deposit ratio to 130 per cent or below by end 2014, although it now expects to attain this in 2012.

SUMMARY

The Group is looking to create a simpler, more agile, efficient and responsive organisation with a real focus on operating sustainably and responsibly. Whilst focusing on core markets, which offer strong returns and attractive growth, the Group will maintain a prudent approach to risk and further strengthen its balance sheet.

The Group believes that the successful execution of its strategy to be the best bank for customers will enable delivery of strong and sustainable returns for shareholders.

BUSINESS AND ACTIVITIES OF LLOYDS BANKING GROUP

The Group is organised into five segments: Retail; Wholesale; Commercial; Wealth and International; and Insurance; see note 4 to the consolidated financial statements.

Further information on the Group s segments is set out on pages 32 to 51.

MATERIAL CONTRACTS

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

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

BUSINESS

ENVIRONMENTAL MATTERS

ENVIRONMENTAL RESPONSIBILITY

In 2011, the Group introduced a set of market leading long-term environmental targets under its Environmental Action programme to significantly reduce its environmental footprint. The Group aims to reduce paper, water and business travel by 20 per cent; ensure that less than 20 per cent of waste is sent to landfill; and reduce energy use by 30 per cent by 2020. The Group publishes a standalone, data-driven Climate and Environment Report on an annual basis which details progress it has made against its targets, and this is available from the Lloyds Banking Group website. Last year, the Group achieved the Carbon Trust Standard for its entire UK operations, which recognises its robust approach to measuring, managing and reducing its carbon emissions. The Group also reduced its use of energy by 1 per cent, its use of water by 3 per cent and paper use by 7 per cent in 2011 compared with 2010. Its overall carbon footprint reduced by 1 per cent in 2011 compared with 2010.

Over the last year the Group has been the UK s most active provider of finance to renewable energy projects, having lent over £413 million across 13 renewable energy projects in the UK, Germany and the US. The Group s approach to environmental risk management is covered on pages 123 and 124.

The Group is also encouraging businesses that bank with it to take action to address climate change. The Group has trained over 650 staff on its Business & Environment programme, to enable them to guide and support its customers in recognising environmental risks and seizing the opportunities. The Group is the only major UK bank to provide this kind of support to its business customers.

The Group recognises that its influence extends well beyond the size of its organisation. Its asset management business, Scottish Widows Investment Partnership (SWIP), has over £136 billion invested around the world and is committed to using its influence to encourage best practice in corporate governance and management of sustainability risks. SWIP has also launched a new sustainability strategy across its entire £8 billion property portfolio, including a target to reduce its energy consumption by 10 per cent by 2012 compared with 2009.

CO_2 Emissions (tonnes)

	2011	2010
Total UK CO_2 emissions	**421,568**	425,996
Scope 1 emissions	**52,179**	60,302
Scope 2 emissions	**321,698**	324,007
Scope 3 emissions	**42,691**	41,687

The Group has improved the accuracy of energy data for the 2010 reporting years, replacing estimates with actual data. The Group has also changed its method for reporting car travel data in 2011 and have applied this method to historical data.

TRACKING PROGRESS

Independent consultants verify the Group s performance every year. The Group also measures its performance against its peers through external benchmarks. In 2011, the Group was re-selected for the Dow Jones Sustainability Index. The Group was also ranked top UK bank in the FTSE4Good Index and was re-selected for the Carbon Disclosure Leadership Index. The Group has a Platinum ranking in Business in the Community s Corporate Responsibility Index and was awarded Business in the Community s CommunityMark, the national standard that publicly recognises excellence in community investment.

PROPERTIES

As at 31 December 2011, Lloyds Banking Group occupied 3,144 properties in the UK. Of these, 898 were held as freeholds and 2,246 as long-term leaseholds. The majority of these properties are retail branches, widely distributed throughout England, Scotland, Wales and Northern Ireland. Other buildings include the Lloyds Banking Group s head office in the City of London with other customer service and support centres located to suit business needs but clustered largely in eight core geographic conurbations London, Edinburgh, Glasgow, Midlands (Birmingham), Northwest (Chester and Manchester), West Yorkshire (Halifax and Leeds), South (Brighton and Andover) and Southwest (Bristol and Cardiff).

In addition, there are 423 properties which are either sub-let or vacant. There are also a number of ATM units situated throughout the UK, the majority of which are held as leasehold. The Group also has business operations elsewhere in the world, primarily holding property on a leasehold basis, principally in North America, Europe and Asia.

LEGAL ACTIONS AND REGULATORY MATTERS

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

INTERCHANGE FEES

The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard set a uniform Multilateral Interchange Fee (MIF) in respect of cross-border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the MIF be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the General Court of the European Union (the General Court). Lloyds TSB Bank plc and Bank of Scotland plc (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard s position that the arrangements for the charging of the MIF are compatible with European Union competition laws. The UK Government has also intervened in the General Court appeal supporting the European Commission position. An oral hearing took place on 8 July 2011 and the judgement is expected on 24 May 2012. MasterCard has reached an understanding with the European Commission on a new methodology for calculating intra-European Economic Area MIF on an interim basis pending the outcome of the appeal.

Meanwhile, the European Commission is pursuing an investigation with a view to deciding whether arrangements adopted by visa for the levying of the MIF in respect of cross-border payment transactions also infringe European Union competition laws. In this regard visa reached an agreement with the European Commission to reduce the level of interchange for cross-border debit card transactions to the interim levels agreed by

BUSINESS

MasterCard. The UK s Office of Fair Trading has also commenced similar investigations relating to the MIF in respect of domestic transactions in relation to both the MasterCard and visa payment schemes. The ultimate impact of the investigations on the Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

PAYMENT PROTECTION INSURANCE

There has been extensive scrutiny of the Payment Protection Insurance (PPI) market in recent years.

In October 2010, the UK Competition Commission confirmed its decision to prohibit the active sale of PPI by a distributor to a customer within seven days of a sale of credit. This followed the completion of its formal investigation into the supply of PPI services (other than store card PPI) to non-business customers in the UK in January 2009 and a referral of the proposed prohibition to the Competition Appeal Tribunal. The Competition Commission consulted on the wording of a draft Order to implement its findings from October 2010, and published the final Order on 24 March 2011 which became effective on 6 April 2011. Following an earlier decision to stop selling single premium PPI products, the Group ceased to offer PPI products to its customers in July 2010.

On 29 September 2009 the FSA announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. Lloyds Banking Group agreed in principle that it would undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. That review now forms part of the ongoing PPI work referred to below.

On 1 July 2008, the Financial Ombudsman Service (FOS) referred concerns regarding the handling of PPI complaints to the Financial Services Authority (FSA) as an issue of wider implication. On 29 September 2009 and 9 March 2010, the FSA issued consultation papers on PPI complaints handling. The FSA published its Policy Statement on 10 August 2010, setting out evidential provisions and guidance on the fair assessment of a complaint and the calculation of redress, as well as a requirement for firms to reassess historically rejected complaints which had to be implemented by 1 December 2010.

On 8 October 2010, the British Bankers Association (BBA), the principal trade association for the UK banking and financial services sector, filed an application for permission to seek judicial review against the FSA and the FOS. The BBA sought an order quashing the FSA Policy Statement and an order quashing the decision of the FOS to determine PPI sales in accordance with the guidance published on its website in November 2008.

The Judicial Review hearing was held in late January 2011 and on 20 April 2011 judgment was handed down by the High Court dismissing the BBA s application. On 9 May 2011, the BBA confirmed that the banks and the BBA did not intend to appeal the judgment.

After publication of the judgment, the Group entered into discussions with the FSA with a view to seeking clarity around the detailed implementation of the Policy Statement. As a result, and given the initial analysis that the Group has conducted of compliance with applicable sales standards, which is continuing, the Group concluded that there are certain circumstances where customer contact and/or redress will be appropriate. Accordingly the Group made a provision in its financial statements for the year ended 31 December 2010 of £3,200 million in respect of the anticipated costs of such contact and/or redress, including administration expenses. During 2011, the Group made redress payments of £1,045 million to customers. However, there are still a number of uncertainties as to the eventual costs from any such contact and/or redress given the inherent difficulties of assessing the impact of the detailed implementation of the Policy Statement for all PPI complaints, uncertainties around the ultimate emergence period for complaints, the availability of supporting evidence and the activities of claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs.

INTERBANK OFFERED RATE SETTING INVESTIGATIONS

Several government agencies in the UK, US and overseas, including the US Commodity Futures Trading Commission, the US SEC, the US Department of Justice and the FSA, as well as the European Commission, are conducting investigations into submissions made by panel members to the bodies that set various interbank offered rates. The Group, and/or its subsidiaries, were (at the relevant time) and remain members of various panels that submit data to these bodies in a number of jurisdictions. The Group has received requests from some government agencies for information and is co-operating with their investigations. In addition the Group has been named in private purported class action suits in the US with regard to the setting of London interbank offered rates (LIBOR). It is currently not possible to predict the scope and ultimate outcome of the various regulatory investigations or private lawsuits, including the timing and scale of the potential impact of any investigations and lawsuits on the Group.

LITIGATION IN RELATION TO INSURANCE BRANCH BUSINESS IN GERMANY

Clerical Medical Investment Group Limited (CMIG) has received a number of claims in the German courts, relating to policies issued by CMIG but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. CMIG has won the majority of decisions to date, although a small number of regional district and appeal courts have found against CMIG on specific grounds. CMIG s strategy includes defending claims robustly and appealing against adverse judgments. The ultimate financial effect, which could be significant, will only be known once all relevant claims have been resolved. However, consistent with this strategy, and having regard to the costs involved in managing these claims, and the inherent risks of litigation, the Group has recognised a provision of £175 million. Management believes this represents the most appropriate estimate of the financial impact, based upon a series of assumptions, including the number of claims received, the proportion upheld, and resulting legal and administration costs.

SHAREHOLDER COMPLAINTS

The Group and two former members of the Group s Board of Directors have been named as defendants in a purported securities class action pending in the United States District Court for the Southern District of New York. The complaint, dated 23 November 2011, asserts claims under the Securities Exchange Act of 1934 in connection with alleged material omissions from statements made in 2008 in connection with the acquisition of HBOS. No quantum is specified.

In addition, a UK-based shareholder action group has threatened multi-claimant claims on a similar basis against the Group and two former directors in the UK. No claim has yet been issued.

The Group considers that the claims are without merit and will defend them vigorously. The claims have not been quantified and it is not possible to estimate the ultimate financial impact on the Group at this early stage.

EMPLOYEE DISPUTES

The Group is aware that a union representing a number of the Group s employees is seeking to challenge the cap on pensionable pay introduced by the Group in 2011 on the grounds that it is unlawful. This challenge is at a very early stage. The Group will resist the challenge should it be pursued.

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The Group also faces a number of other threats of legal action from employees in relation to terms of employment including pay and bonuses. The Group considers that the complaints are without merit and, should proceedings be issued, they will be vigorously defended.

It is not possible to estimate the ultimate financial impact on the Group at this stage.

FSA INVESTIGATION INTO BANK OF SCOTLAND

In 2009 the FSA commenced a supervisory review into HBOS. The supervisory review was superseded when the FSA commenced an enforcement investigation into Bank of Scotland plc in relation to its Corporate Division between 2006 and 2008. These proceedings have now concluded. The FSA published its Final Notice on 9 March 2012. No financial penalty has been imposed on the Group or Bank of Scotland plc.

REGULATORY MATTERS

In the course of its business, the Group is engaged in discussions with the FSA in relation to a range of conduct of business matters including complaints handling, packaged bank accounts, savings accounts, product terms and conditions, interest only mortgages, sales processes and remuneration schemes. The Group is keen to ensure that any regulatory concerns are understood and addressed. The ultimate impact on the Group of these discussions can only be known at the conclusion of such discussions.

OTHER LEGAL ACTIONS AND REGULATORY MATTERS

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

COMPETITIVE ENVIRONMENT

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

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

In the competitive open market in which the Group operates there is an increasing range of products and services available to customers and with the current public scrutiny of banks the expectations and demands of customers continue to increase.

See *Risk Factors Competition Related Risks The Independent Commission on Banking and the UK Treasury Select Committee have reviewed competition in the UK retail banking industry. The potential impact of the recommendations is inherently uncertain and could have a material adverse effect on the interests of the Group* and *Business and Economic Risks The Group s businesses are conducted in highly competitive environments and the Group s financial performance depends upon management s ability to respond effectively to competitive pressures*.

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RECENT DEVELOPMENTS

PAYMENT OF ACCUMULATED INTEREST ON UPPER TIER TWO HYBRID CAPITAL SECURITIES ISSUED BY LLOYDS BANKING GROUP COMPANIES

The Group made the following announcement on 19 January 2012

Since 31 January 2010, the Group has been prohibited under the terms of an agreement with the European Commission from paying discretionary coupons and dividends on hybrid capital securities issued by the Company and certain of its subsidiaries. This prohibition ends on 31 January 2012.

The Group now confirms that it intends to pay on the upper tier two securities set out below which have cumulative deferrable coupon terms the relevant amount of Arrears of Interest (as defined therein).

ISIN	ISSUER	SECURITY
XS0083932144	Bank of Scotland plc	7.375% Subordinated Undated Instruments
GB0000395102	Bank of Scotland plc	8.750% Perpetual Subordinated Bonds
GB0000395094	Bank of Scotland plc	12.00% Perpetual Subordinated Bonds
GB0005242879	Bank of Scotland plc	9.375% Perpetual Subordinated Bonds
GB0000765403	Bank of Scotland plc	Undated Floating Rate Primary Capital Notes
XS0046690961	Bank of Scotland plc	8.625% Perpetual Subordinated Notes
XS0059171230	Bank of Scotland plc	10.25% Subordinated Undated Instruments
GB0000394915	Bank of Scotland plc	13.625% Perpetual Subordinated Bonds
XS0063730203	Bank of Scotland plc	Subordinated Undated Instruments due 2016
XS0188201536	HBOS plc	4.875% Undated Subordinated Fixed to Floating Rate Instruments
XS0188201619	HBOS plc	Floating Rate Undated Subordinated Instruments
US4041A3AF96 / US4041A2AG96	HBOS plc	5.375% Undated Fixed to Floating Rate Subordinated Notes
XS0177955381	HBOS plc	5.125% Undated Subordinated Fixed to Floating Rate Notes
XS0205326290	HBOS plc	5.625% Cumulative Callable Fixed to Floating Rate Undated Subordinated Notes
XS0145407507	Lloyds Banking Group plc	6.00% Undated Subordinated Guaranteed Bonds
GB0005224307	Lloyds TSB Bank plc	Primary Capital Undated Floating Rate Notes (Series 1)
XS0099508698	Lloyds TSB Bank plc	4.648% Undated Subordinated Step-up Notes
XS0099507534	Lloyds TSB Bank plc	6.50% Undated Subordinated Step-up Notes
XS0099507963	Lloyds TSB Bank plc	6.50% Undated Subordinated Step-up Notes
XS0079927850	Lloyds TSB Bank plc	8% Undated Subordinated Step-up Notes
GB0005232391	Lloyds TSB Bank plc	Primary Capital Undated Floating Rate Notes (Series 3)
GB0005205751	Lloyds TSB Bank plc	Primary Capital Undated Floating Rate Notes (Series 2)
XS0169667119	Lloyds TSB Bank plc	5.125% Upper Tier 2 Callable Perpetual Subordinated Notes
XS0056390007	Lloyds TSB Bank plc	5.57% Undated Subordinated Step Up Coupon Notes 2015

Such amounts will be calculated in accordance with the terms of such securities and will be paid on 9 February 2012 subject to, and in accordance with, the terms of those securities.

LLOYDS BANKING GROUP ANNOUNCES CHANGES TO ITS GROUP BOARD AND THE MANAGEMENT TEAM

The Group made the following announcement on 1 February 2012

Lloyds Banking Group has today announced changes to its Group Board and the management team.

The changes to the Board and the senior management organisational structure mean that there will be five business lines reporting directly to the Group Chief Executive as follows:

Alison Brittain will undertake the newly created role of Group Director of Retail with responsibility for our multi channel and multi brand strategy including Lloyds TSB, the Bank of Scotland and Halifax, retail products and marketing, as well as telephony and digital banking.

Antonio Lorenzo, Group Director of Strategy and Wealth and International, will also undertake responsibility for Asset Finance which had formerly been a part of the Wholesale business.

Truett Tate, Group Executive Director for Wholesale has decided to retire from the Group during February and will not seek re-election at the Group s Annual General Meeting in May. As a result of Truett s departure Andrew Géczy, CEO of Wholesale Banking and Markets, will report on an interim basis to Group Chief Executive, António Horta-Osório.

The Group has begun a search internally and externally for a permanent Director of the Group s Wholesale Division.

John Maltby remains as Director of Commercial continuing with his responsibility for our SME businesses.

Toby Strauss role also remains unchanged as Director of the Group s Insurance division.

Further to the centralisation of all control functions as part of the Group Strategic Review in 2011 there will now be five control and support functions as follows:

- Risk led by our Chief Risk Officer Juan Colombas.

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Finance led by our Group Finance Director, George Culmer when he joins the Group.

Operations led by our Director of Group Operations, Mark Fisher.

Corporate Affairs led by our Group Corporate Affairs Director, Matt Young.

Group Corporate Functions Human Resources, Legal and Secretariat and Group Audit will now report to a newly-created position of Group Corporate Functions Director. The Group Corporate Functions Director will be a member of the Group Executive Committee and the Group is currently recruiting for the role.

LLOYDS BANKING GROUP: CHANGES TO BOARD

The Group made the following announcement on 1 February 2012

Lloyds Banking Group is pleased to announce the appointment of Sara Weller as a non-executive director. Ms Weller will join the Board with effect from 1 February 2012 and will serve as a member of the Remuneration and the Risk Committees.

Sir Julian Horn-Smith has informed the Group of his intention to retire from the Board at the Annual General Meeting in May 2012 and will therefore not stand for re-election as a Director.

Truett Tate, Executive Director for Wholesale, has decided to retire from the Group at the Annual General Meeting in May 2012 and will therefore not seek re-election.

LLOYDS BANKING GROUP PLC RESIGNATION OF DIRECTOR

The Group made the following announcement on 6 February 2012

Further to the Group s announcement on 1 February 2012, Truett Tate, Executive Director, Wholesale, has resigned from the Board of Lloyds Banking Group plc with immediate effect.

LLOYDS BANKING GROUP PLC MANAGEMENT CHANGE

The Group made the following announcement on 24 February 2012

Further to the Group s announcement on 19 September 2011, Tim Tookey, Group Finance Director, will stand down from the Board of Lloyds Banking Group at close of business today, 24 February 2012.

LLOYDS BANKING GROUP ANNOUNCES BOARD CHANGES

The Group made the following announcement on 27 February 2012

The Board of Lloyds Banking Group plc announces that Glen Moreno, its Deputy Chairman and Senior Independent Director, intends not to seek re-election at the Annual General Meeting on 17 May 2012 and will retire from the Board on that date.

The Board has decided to appoint Anthony Watson, Chairman of the Remuneration Committee, as its Senior Independent Director and David Roberts, Chairman of the Risk Committee, as Deputy Chairman both with effect from 17 May 2012.

LLOYDS BANKING GROUP PLC MANAGEMENT CHANGE

The Group made the following announcement on 1 March 2012

Lloyds Banking Group plc announces that George Culmer will be appointed as Group Finance Director of Lloyds Banking Group with effect from 16 May 2012.

George Culmer has been Chief Financial Officer of RSA Insurance Group plc since May 2004.

Biographical details of George Culmer

Between 2004 and 2012, George was a director and Chief Financial Officer of RSA Insurance Group plc. His previous roles included Head of Capital Management of Zurich Financial Services and Chief Financial Officer of its UK operations. Prior to that he held various senior management positions at Prudential. George began his career at Coopers & Lybrand in London and New Zealand and read History at Cambridge. Age 49.

Key compensation notes

Compensation arrangements include an annual salary of £720,000 and a discretionary annual bonus up to a maximum of 200 per cent of salary. It is intended to award a long term performance-based share incentive of up to 225 per cent of salary for 2012 which will only vest in full in three years if stretching performance targets are exceeded. Mr Culmer will receive an allowance to fund personal pension arrangements amounting to 25 per cent of his salary.

Mr Culmer has deferred awards and a cash bonus from RSA Insurance Group plc, which he forfeits as a result of leaving RSA Insurance Group plc. He will therefore be partially compensated in respect of these by receiving shares in Lloyds Banking Group worth £1.9 million which will vest in 2013 and 2014. The extent to which Mr Culmer will receive future awards depends on the performance of Lloyds Banking Group in the short, medium and longer term against stretching performance measures.

LLOYDS BANKING GROUP PLC (GROUP) NOTIFICATION OF TRANSACTIONS BY PERSONS DISCHARGING MANAGERIAL RESPONSIBILITIES IN ORDINARY SHARES OF THE GROUP OF 10P EACH (SHARES)

The Group made the following announcement on 9 March 2012

The following announcement sets out details of awards made today, 9 March 2012, under the Group s share plans to the Group Chief Executive and members of the Group Executive Committee.

Deferred bonus awards for 2011 performance

Conditional awards of shares were made today in respect of bonus awards for 2011 performance. Part of the 2011 bonus awards will be made in June 2012 based on the prevailing share price. These shares will be notified at that time. Awards vesting over the period September 2012 to

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September 2015 are based on a share price of 34.786 pence and are detailed below. Bonus awards are subject to performance adjustment in full or in part if the performance that generated the award is found not to be sustainable.

Name	Maximum number of shares awarded
A Brittain	2,414,764
J Colombás	1,782,326
M Fisher	2,069,798
A Lorenzo	1,782,326
J Maltby	728,741
D Nicholson	436,957
A Risley	577,818
T Strauss	451,330
M Young	929,971

Long term incentive plan 2012 awards

Conditional share awards were made today under the Group s Long Term Incentive Plan as detailed below. The shares under the awards will only vest in 2015 subject to the satisfaction of stretching performance conditions over a three year period. The awards are based on a share price of 34.786 pence.

Name	Maximum number of shares awarded
A Horta-Osório	9,644,684
A Brittain	4,527,683
J Colombás	4,146,064
M Fisher	4,876,961
A Lorenzo	4,243,086
J Maltby	2,910,653
D Nicholson	2,587,247
A Risley	2,587,247
T Strauss	3,395,762
M Young	2,587,247

Emoluments of the eight highest paid senior executives

The following table sets out the Emoluments of the eight highest paid senior executives in respect of the 2011 performance year. The disclosure is made on the same basis as the five highest paid senior executives for the 2010 performance year, as shown in the Annual Report and Accounts 2010.

	Employee							
	8	7	6	5	4	3	2	1
Fixed	£000	£000	£000	£000	£000	£000	£000	£000
Cash based	342	480	310	233	754	941	956	500
Total fixed	342	480	310	233	754	941	956	500
Variable[1]								
Upfront cash	2	2	2	2	2	2	2	2
Deferred cash	0	0	0	0	0	0	0	0
Upfront shares[2]	20	0	0	332	0	205	320	0
Deferred shares	478	498	793	1,048	898	773	773	1,998
Long term incentive plan[3]	270	144	199	473	509	433	443	150
Total variable pay	770	644	994	1,855	1,409	1,413	1,538	2,150
Pension cost[4]	85	120	44	58	189	160	164	125
Total remuneration	1,197	1,244	1,348	2,146	2,352	2,514	2,658	2,775

1 Variable pay in respect of performance year 2011.

2 Award to compensate for loss of variable remuneration from previous employer which vested in 2011.

3 LTIP values shown are on an expected value basis.

4 Pension cost based on an average pension cost of 25 per cent of salary.

LLOYDS BANKING GROUP PLC (GROUP) - NOTIFICATION OF TRANSACTIONS BY PERSONS DISCHARGING MANAGERIAL RESPONSIBILITIES IN ORDINARY SHARES OF THE GROUP OF 10P EACH (SHARES)

The Group made the following announcement on 15 March 2012

The Group announces that today, following the successful delivery of the integration programme, the 2009 LTIP Integration Awards vested for the individuals listed in the table below. They have received the number of Shares as set out by their name, after the appropriate number of Shares had been withheld to cover tax and national insurance contributions. The Shares were acquired for nil consideration.

Name	**Shares**
M Fisher	748,008
J Maltby	480,862
D Nicholson	400,717
A Risley	400,718

The Group further announces that today Mr Fisher exercised an option over 1,984,093 Shares under the Lloyds Banking Group plc Executive Share Plan 2003. The Shares were acquired for nil consideration.

Mr Fisher sold 2,482,101 Shares today at 35.6711 pence per Share, inclusive of the appropriate number of Shares to cover tax and national insurance contributions due on the exercise of his option. Following the above transactions, Mr Fisher’s shareholding in the Group increased by 250,000 Shares bringing his total shareholding to 519,738 Shares.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OVERVIEW AND TREND INFORMATION

The external macro economic and regulatory environment in which the Group operates remains uncertain but the Group has endeavoured to outline below some of the key regulatory, economic and social factors impacting its markets.

REGULATION

The quantum of regulatory change remains high and the regulatory environment remains challenging but the Group is starting to see greater clarity in a number of areas. There are however a number of different issues that are likely to have a fundamental impact on the business going forward including the recommendations arising from the Independent Commission on Banking, future capital and liquidity requirements, and the changes to the UK banking supervisory structure:

Stringent UK capital and liquidity standards

More focus on consumer protection and transparency

Recovery and resolution mechanisms and Retail ring-fencing

Independent Commission on Banking final recommendations

Independent Commission on Banking (ICB)

In 2010 the UK Government appointed an ICB to review possible structural measures to reform the banking system and promote stability and competition. The ICB published its final report on 12 September 2011 putting forward proposals that would require ring-fencing some of the retail and SME activities of banks from their investment banking activities and additional capital requirements beyond those required under Basel III.

On 19 December 2011 the Chancellor delivered the UK Government s first formal response to the ICB s Final Report of 12 September. The response endorsed many of the key recommendations contained in the ICB s Final Report, including the ring-fencing of commercial and retail operations, higher capital requirements and a 7-day current account switching service. Importantly for the Group, the Government also supported the principle of a flexible ring fence, which allows banks to choose where to place some (but not all) services.

While the Group welcomes the increased clarity provided by the Government s initial response, significant uncertainty remains over key elements of the reforms, including what activities could be allowed inside the ring-fenced bank , the extent of depositor preference of other creditors and measures that could see some categories of wholesale funding bailed-in in the instance of resolution.

The Government has announced that it will be producing a formal White Paper in the spring and the Group would anticipate that this paper will provide additional clarity, while still leaving some issues open to consultation. The Group continues to work to assess the impact that the reforms may have on its business and continues to play a constructive role in the debate with the Government and other stakeholders.

Capital Requirements Directive IV

Evolving capital and liquidity requirements continue to be a priority for the Group. Separate to the capital recommendations laid out by the ICB, the Basel Committee on Banking Supervision has put forward proposals for a reform package which changes regulatory capital and liquidity standards, the definition of capital , introduces new definitions for the calculation of counterparty credit risk and leverage ratios, additional capital buffers and development of a global liquidity standard. Implementation of these changes is expected to be phased in between 2013 and 2018 and the fourth round of changes to the European Capital Requirements Directive IV is currently in draft form and progressing through the European legal framework towards finalisation.

UK Banking Supervisory Structure

The recent ongoing difficulties in global financial markets have prompted a review and alteration to the banking supervisory structure in the UK. In April 2011, the FSA commenced an internal reorganisation as a first step in a process towards the formal transition of regulatory and supervisory powers from the FSA to the new Financial Conduct Authority (FCA) and Prudential

Regulatory Authority (PRA) in 2012. Until this time the responsibility for regulating and supervising the activities of the Lloyds Banking Group and its subsidiaries will remain with the FSA. However, the reorganisation could lead to changes in how the Group is regulated and supervised on a day-to-day basis. In addition, the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority as new EU Supervisory Authorities are likely to have greater influence on regulatory approaches across the EU.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

THE ECONOMY

The global economy was split in 2011 between relatively strong growth in emerging markets, and economies struggling to recover from recession in much of the Western world. Indeed, the extent of the UK economic recovery has now fallen behind even the weak recovery after the late 1970 s recession.

The stark difference is due to the high levels of indebtedness that many developed economies accumulated prior to 2008, which are holding back economic growth through deleveraging of initially the private sector, but now governments too. In the Eurozone, countries with particularly high government debt or deficit levels have lost market confidence as they struggled to achieve the necessary fiscal tightening to bring their public finances onto a sustainable trajectory without damaging economic growth prospects too severely. Ireland, Portugal and Greece have received further IMF and EU financial support in return for accepting even more stringent austerity programmes, and at the time of writing it looks likely that private creditors will suffer effective haircuts of significantly more than 50 per cent on their Greek debt. Italy and Spain have also tightened public budgets further, and given their much greater size this is dragging down Eurozone economic growth more significantly. In the US, public finance concerns are less immediate, but the unsustainable long term trajectory of debt on current policies has led to political stalemate, raising the risk of sudden fiscal tightening as previous loosening measures expire, and in turn hurting businesses and consumers confidence. Global growth was also hampered in 2011 by natural disasters, including the floods in Australia and Thailand and the earthquake and tsunami in Japan, the latter causing significant disruption to global manufacturing supply chains.

First estimates suggest the UK economy grew by 0.9 per cent in 2011, well below the long term average of 2.3 per cent. The economy is currently estimated to have shrunk slightly in the final quarter of the year as consumers and businesses confidence fell, the result of relatively high inflation reducing consumers spending power, a faster than expected reduction in public sector employment, and the worsening outlook for the Eurozone which caused companies to postpone investment spending and recruitment. Unemployment rose from 7.7 per cent in the first quarter of 2011 to 8.4 per cent by December. Company failures in England and Wales rose from a low point of 3,973 in the final quarter of 2010 to 4,260 by the fourth quarter of 2011, although the failure rate remained steady over that period at just 0.7 per cent of companies, close to its pre-recession trough. Property prices were broadly flat through the year, however house prices on average fell marginally by 2 per cent in the year to December 2011, and commercial property prices rose on average by just 1 per cent.

Based on data for the first three quarters of 2011, the Irish economy appears to have grown in 2011 for the first time since 2007, and the unemployment rate appears to be stabilising. Strict austerity measures in recent years targeted at improving international competitiveness are beginning to pay off falling domestic demand is now being more than offset by increasing net exports. Property markets remain very weak, however; house prices fell by over 16 per cent in 2011 and CRE prices by 11 per cent. Despite the large fall in prices already, an overhang of vacant property continues to weigh on market prices.

Future economic developments in the UK and Ireland are highly contingent on how successful political leaders are at stemming the Eurozone crisis, to what extent the private sector can offset shrinking of the public sector, and how the implementation of new regulation on banks impacts their ability to supply credit whilst meeting tighter capital and liquidity criteria. The recent weakening in the Eurozone economy and the balance of risks make double-dip recession there in 2012 the most likely scenario indeed this is now the consensus view (Chart 2).

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The current consensus view for 2012 UK GDP growth is not yet that weak, at 0.4 per cent. The low level of imbalances in the economy relative to the 2008 position suggest that weak growth should not deteriorate into significant recession provided the Eurozone moves quickly towards a solution to the sovereign debt crisis. Bank Rate is likely to stay at or close to current low levels for some time, and property prices are expected to be broadly stable. Unemployment is likely to rise further, however, as estimates of public sector job cuts have increased. The current consensus view for 2012 Irish GDP growth is broadly flat, and the unemployment rate there is expected to be stable. Property prices are expected to fall further, but by less than in 2011.

However, whilst a definitive solution to the Eurozone crisis remains lacking there continues to be a risk that ongoing uncertainty around the Eurozone economic outlook, the survival of the Euro currency and the availability of credit could cause a significant recession in the UK and Ireland. Such a scenario would likely result in higher UK corporate failures, a second leg of falling property prices, albeit by less than during the 2008-9 recession, and rising commercial tenant defaults. Irish property prices would also fall by more than currently expected. In turn, this would have a negative impact on the Group s income, funding costs and impairment charges.

THE IMPACT ON THE GROUP S MARKETS

The weak economic recovery has kept growth in the Group s markets subdued. With the economy expected to grow very slowly in 2012, the Group s central expectation is that growth in its markets will remain weak in 2012.

For the market as a whole, net new mortgage lending has amounted to just 0.7 per cent of outstanding balances during 2011, very similar to 2010. Consumers made net repayments of unsecured debt (excluding student loans) of around 2 per cent of outstanding balances for the third consecutive year in 2011. Household deposits rose by 2.6 per cent in 2011 similar to the rate of increase in the previous two years but well down from the 8-9 per cent growth per year pre-recession.

Similarly, companies have been focussed on paying down existing debt, for the third successive year in 2011. Non-financial companies made net repayments of 3.7 per cent of sterling lending from banks and building societies in 2011, after repayments of 3.5 per cent in 2010 and 2.2 per cent in 2009. Company deposits with UK banks rose by 1.1 per cent in 2011, slower than the 1.8 per cent rise in 2010 and the 4.5 per cent increase in 2009. Although companies have held back investment spending and prioritised cashflow, much of this has fed into lower borrowing rather than higher deposits.

In Ireland, continued falls in house prices, despite the already steep reductions prior to 2011, have kept impairments high and the Group expects property prices to remain subdued.

The Group expects that another weak year for the UK economy in 2012 will be accompanied by weak customer deposit growth and a continued period of declining demand for borrowing, particularly from companies. The continuation of low interest rates, and the substantial adjustments that many companies and households have already made to their indebtedness, is likely to minimise any deterioration in arrears. The Group s central expectation of broadly flat property prices in the UK in 2012 is consistent with the subdued market expected.

CUSTOMER DRIVERS, INCLUDING COMPETITION

- Want simplicity and transparency
- Demand a quality, multi-channel customer service experience
- Growing demand for advice to plan/save for retirement
- Increasingly demand better value for their money

In the competitive open market in which the Group operates there is an increasing range of products and services available to customers, and with the current public scrutiny of banks the expectations and demands of customers continue to increase.

Access to convenient branches remains important for many customers but demand for a quality multi-channel banking proposition is now more prevalent and the provision of effective telephone, digital and mobile channels is increasingly important. Service remains one of the key drivers of customer satisfaction and customers are less accepting of poor service given the competitive nature of the market.

In the current low interest environment many customers are demanding better value for money but security and reputation remain important factors. Customers want clear and transparent products delivered with good service and access to helpful, relevant, expert advice when they need it. Customers are demanding basic banking services to be delivered well but there is also an increasing demand for advice in more complex areas such as help in planning and saving for retirement. Product innovation is also important for some whereas longstanding relationships remain important for others.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

As highlighted above, there are some clear customer trends emerging but the Group recognises that every customer, whether they be retail or corporate, has their own personal needs and has to be treated individually. It is clear that different customer segments have different demands and the opportunity exists to differentiate service for varied segments but fundamentally the customer has a choice and will select the provider that can most effectively service their personal needs.

The financial services market remains competitive. The Group is seeing a number of new entrants including virgin Money and Metro Bank looking to make inroads into the market and the disposal of the verde branches along with the improved switching process will further enhance competition.

The Group s strategy, as outlined on pages 4 and 5, reflects the market conditions and the changing needs of customers. Above all it recognises that the Group operates in a competitive market where additional challengers continue to emerge and the only way of ensuring success is by focusing on the changing needs of every customer.

CRITICAL ACCOUNTING POLICIES

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

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

FUTURE ACCOUNTING DEVELOPMENTS

Future developments in relation to the Group s IFRS reporting are discussed in note 58 to the consolidated financial statements.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RESULTS OF OPERATIONS 2011, 2010 AND 2009

SUMMARY

	2011	2010	2009
	£m	£m	£m
Net interest income	**12,698**	12,546	9,026
Other income	**14,114**	31,498	36,745
Total income	**26,812**	44,044	45,771
Insurance claims	**(6,041)**	(19,088)	(22,493)
Total income, net of insurance claims	**20,771**	24,956	23,278
Operating expenses	**(13,050)**	(16,470)	(15,984)
Trading surplus	**7,721**	8,486	7,294
Impairment	**(8,094)**	(10,952)	(16,673)
Share of results of joint ventures and associates	**31**	(88)	(752)
Gain on acquisition			11,173
Loss on disposal of businesses		(365)	
(Loss) profit before tax	**(342)**	(2,919)	1,042
Taxation	**(36)**	325	1,911
(Loss) profit for the year	**(378)**	(2,594)	2,953
Profit attributable to non-controlling interests	**73**	62	126
(Loss) profit attributable to equity shareholders	**(451)**	(2,656)	2,827
(Loss) profit for the year	**(378)**	(2,594)	2,953

2011 COMPARED WITH 2010

For the year ended 31 December 2011, the Group recorded a loss before tax of £342 million compared with a loss before tax in 2010 of £2,919 million, which had been driven by the £3,200 million payment protection insurance provision (see page 27) although this had been partly offset by a pension curtailment gain in the same year of £910 million.

Total income decreased by £17,232 million to £26,812 million in 2011 compared with £44,044 million in 2010, comprising a £17,384 million reduction in other income only marginally offset by an increase of £152 million in net interest income.

Net interest income was £12,698 million in 2011; an increase of £152 million, or 1 per cent compared to £12,546 million in 2010. There was a credit of £696 million in 2011 arising from liability management gains (see page 21) and a benefit of £1,117 million from a reduction in the amounts payable to unitholders in those Open-Ended Investment Companies included in the consolidated results of the Group. However, net interest income in the Group s banking businesses fell as a result of both a reduction in average interest earning banking assets in the year and a reduction in the net interest margin. The decline in the net interest margin reflected higher wholesale funding costs, higher deposit rates and the effect of refinancing a significant amount of government and central bank facilities, partially offset by an improvement in customer margins and funding mix.

Other income was £17,384 million, or 55 per cent, lower at £14,114 million in 2011 compared to £31,498 million in 2010. Fee and commission income was £57 million, or 1 per cent, lower at £4,935 million compared to £4,992 million in 2010. Fee and commission expense decreased by £291 million or 17 per cent to £1,391 million compared with £1,682 million in 2010. Net trading income decreased by £16,092 million to a deficit of £368 million in 2011 compared to a surplus of £15,724 million in 2010; this decrease included a reduction of £14,267 million in gains on policyholder investments held within the insurance business, offset by a similar decrease in the related claims expense, see below. Insurance premium income was largely unchanged at £8,170 million in 2011 compared with £8,148 million in 2010; an increase of £22 million. During 2011 the Group exchanged certain existing subordinated debt securities for new securities; these exchanges resulted in a gain on extinguishment of the existing securities of £599 million, being the difference between the carrying amount of the securities extinguished and the fair value of the new securities issued together with related fees and costs; this gain was £176 million, or 42 per cent higher than the liability management gains recognised in 2010. Excluding the liability management gains, other operating income was £1,724 million, or 44 per cent, lower at £2,169 million in 2011 compared to £3,893 million in 2010; this largely reflected an adverse variance of £1,411 million in the income arising from the movement in value of in-force insurance business.

Insurance claims expense was £13,047 million or 68 per cent, lower at £6,041 million in 2011 compared to £19,088 million in 2010. The insurance claims expense in respect of life and pensions business was £12,851 million, or 69 per cent lower at £5,698 million in 2011 compared to £18,549 million in 2010; this decrease in claims was matched by a similar reduction in net trading income, reflecting the performance of policyholder investments. Insurance claims in respect of general insurance business were £196 million, or 36 per cent, lower at £343 million compared to £539 million in 2010.

Operating expenses decreased by £3,420 million, or 21 per cent to £13,050 million in 2011 compared with £16,470 million in 2010; the main reasons for the reduction being the £3,200 million payment protection insurance provision and the £500 million customer goodwill payments provision, raised in 2010, partly offset by a pension curtailment gain of £910 million in the same year. Staff costs were £544 million, or 10 per cent higher at £6,166 million in 2011 compared with £5,622 million in 2010. However, excluding the pension curtailment gain in 2010, staff costs were £366 million, or 6 per cent lower at £6,166 million compared with £6,532 million in 2010. Premises and equipment costs were £126 million, or 11 per cent, lower at £1,051 million compared with £1,177 million in 2010. Other expenses, excluding the payment protection insurance provision from 2010, were £244 million, or 6 per cent lower, at £3,593 million in 2011 compared with £3,837 million in 2010. The decrease reflected the £500 million customer goodwill payments provision made in 2010, partly offset by the UK bank levy of £189 million and provision in relation to German insurance business litigation in 2011. Depreciation and amortisation costs were £257 million, or 11 per cent lower at £2,175 million in 2011 compared to £2,432 million in 2010. In 2011 there was a charge of £65 million in relation to the impairment of tangible fixed assets which was £137 million, or 68 per cent lower than the charge of £202 million in 2010.

Impairment losses decreased by £2,858 million, or 26 per cent, to £8,094 million in 2011 compared with £10,952 million in 2010. Impairment losses in respect of loans and advances to customers were £2,707 million, or 25 per cent, lower at £8,020 million compared with £10,727 million in 2010. The lower charges were principally due to the continued application of the Group s prudent risk appetite and strong risk management controls resulting in improved portfolio and new business quality, continued low interest rates, and broadly stable UK property prices, partly offset by weakening UK economic growth and rising unemployment. In Retail there was a higher secured impairment charge, with the increase on 2010 largely reflecting a less certain outlook for house prices, together with a decrease in the unsecured impairment charge, reflecting continued improving new business quality and portfolio trends as a result of the Group s risk appetite, with a focus on lending to existing customers. In Wholesale there was a decrease in the impairment charge, primarily driven by lower impairment from the corporate real estate and real estate related asset portfolios partly offset by higher impairment on leveraged acquisition finance exposures. The continued low interest rate environment helped to maintain defaults at a reduced level. In Commercial, the impairment charge decreased, reflecting the benefits of the low interest rate environment, which has helped maintain defaults at a lower level. In Wealth and International, impairment charges were also lower. The reduction predominantly reflects lower impairment charges in the Irish portfolio where the rate of impaired loan migration has slowed.

There was no impairment charge in respect of loans and advances to banks in 2011, whereas in 2010 there had been a credit of £13 million following releases in respect of a small number of specific exposures. The impairment charge in respect of debt securities classified as loans and receivables was £8 million, or 14 per cent, lower at £49 million in 2011 compared to £57 million in 2010 and the impairment charge in respect of available-for-sale financial assets was £26 million, or 25 per cent, lower at £80 million in 2011 compared to £106 million in 2010. There was a release of £55 million in respect of other credit provisions in 2011, as a number of commitments have now been drawn down; in 2010 a charge of £75 million resulted from a small number of specific new cases.

The Group s share of results of joint ventures and associates was a gain of £31 million in 2011 compared with a net loss of £88 million in 2010.

In 2011, the Group recorded a tax charge of £36 million compared to a tax credit of £325 million in 2010. The tax charge of £36 million in 2011 arose on a loss before tax of £342 million, reflecting the effect on deferred tax of the reduction in the UK corporation tax rate to 26 per cent with effect from 1 April 2011 and to 25 per cent with effect from 1 April 2012, offset by the net impact of certain tax losses where no deferred tax has been recognised and the recognition of other tax losses that had not previously been recognised.

The Group continues to focus on improving its risk profile and further strengthening its balance sheet, through improving the capital and funding position and making progress on reducing holdings of assets outside of its risk appetite, resulting in a reduction in such assets of £53 billion to £141 billion, against a commitment to decrease these assets to less than £90 billion by the end of 2014. There was a further strengthening of the funding position, with £35 billion of term wholesale funding raised, around £10 billion more than initially targeted. The Group s new pricing management of savings products and its multi-brand strategy have resulted in customer deposit growth (excluding balances arising from repurchase agreements) of 6 per cent, above market growth. The Group had a particularly strong performance from the Halifax challenger brand as a result of innovative products launched in the year. Deposit growth, progress in funding and the asset reductions facilitated further pay-down of government and central bank facilities from £97 billion at the 2010 year end to £24 billion at the end of 2011 (with nothing outstanding under the UK Special Liquidity Scheme).

The Group s credit market exposures primarily relate to asset-backed security exposures held in the Wholesale division; on the balance sheet these exposures are classified as loans and receivables, available-for-sale financial assets or trading and other financial assets at fair value through profit or loss depending on the nature of the investment. A detailed analysis of these asset-backed security exposures is provided in note 56 to the consolidated financial statements. The Wholesale division s total exposure to asset-backed securities has decreased by £19,443 million from £34,724 million at 31 December 2010 to £15,281 million at 31 December 2011 as these investment holdings continue to reduce.

As at 31 December 2011, the Group s capital ratios had increased with a total capital ratio on a Basel II basis of 15.6 per cent (compared to 14.5 per cent at 31 December 2010); a tier 1 capital ratio of 12.5 per cent (compared to 11.0 per cent at 31 December 2010) and a core tier 1 ratio of 10.8 per cent (compared to 9.6 per cent at 31 December 2010). During 2011 risk-weighted assets had decreased by £54,031 million to £352,341 million at 31 December 2011 compared with £406,372 million at 31 December 2010; this decrease reflected risk-weighted asset reductions across all divisions driven by balance sheet reductions, lower lending balances and stronger management of risk, including a £6,017 million reduction in the Retail division and a £32,398 million reduction in the Wholesale division.

2010 COMPARED WITH 2009

The Group recorded a loss before tax of £2,919 million in 2010 compared to a profit of £1,042 million in 2009 as a result of the £3,200 million payment protection insurance provision (see page 27). The results in 2010 also included a pension curtailment gain of £910 million, largely offset by a customer goodwill payments provision of £500 million (see page 27) and a loss on disposal of businesses of £365 million. The profit in 2009 had included a negative goodwill credit of £11,173 million in relation to the acquisition of HBOS plc by the Group and a fee of £2,500 million paid to the UK Government as part of the agreement for the Group not to enter into the Government Asset Protection Scheme. There were significant post-acquisition impairment losses in respect of the HBOS portfolios in both 2009 and 2010.

Total income decreased by £1,727 million, or 4 per cent, to £44,044 million in 2010 compared to £45,771 million in 2009; with a £3,520 million, or 39 per cent, increase in the Group s net interest income only partly offsetting a £5,247million, or 14 per cent, decrease in other income.

Net interest income was £3,520 million, or 39 per cent, higher at £12,546 million in 2010 compared to £9,026 million in 2009. Net interest income was increased as the benefit of higher asset pricing more than offset the impact of lower deposit margins. The Group s net interest margin increased by 61 basis points to 1.69 per cent in 2010 compared to 1.08 per cent in 2009 with increases in Retail, where margins improved as a result of improved asset pricing and decreases in the LIBOR to base rate spread, in Wholesale, again as a result of higher asset pricing to reflect customer risk, and in Commercial. There was, however, a reduced margin in Wealth and International as a result of lower base rates, a very competitive deposit environment and the impact of impaired lending balances.

Other income was £5,247 million, or 14 per cent, lower at £31,498 million in 2010 compared to £36,745 million in 2009. Fee and commission income was £264 million, or 6 per cent, higher at £4,992 million in 2010 compared to £4,728 million in 2009. Fee and commission expense was £165 million, or 11 per cent, higher at £1,682 million in 2010 compared to £1,517 million in 2009. Net trading income was £3,374 million lower at £15,724 million in 2010 compared to £19,098 million in 2009; this included a reduction of £2,551 million in gains on policyholder investments held in the Group s insurance businesses (although this was largely offset by a decrease in the related claims expense, see below) as a result of relative market conditions over 2010, compared to 2009; in addition, a loss of £620 million, which was £193 million, or 45 per cent, higher than the loss of £427 million in 2009, arose from the change in fair value of the embedded equity conversion feature contained in the Enhanced Capital Notes issued by the Group in 2009. During 2010 the Group exchanged certain existing subordinated debt securities for new securities, these exchanges resulted in a gain on extinguishment of the existing liabilities of £423 million, being the difference between the carrying amount of the securities extinguished and the fair value of the new securities together with related fees and costs; this was £1,075 million, or 72 per cent, lower than the gains of £1,498 million realised on similar transactions in 2009.

Insurance claims were £3,405 million lower at an expense of £19,088 million in 2010 compared to £22,493 million in 2009. The insurance claims expense in respect of life and pensions business was £3,310 million, or 15 per cent, lower at £18,549 million in 2010 compared to £21,859 million in

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2009 as a result of the relative returns on policyholder investments in the long-term insurance business; this movement in claims was broadly matched by a decrease in net trading income reflecting the gains on those policyholder investments. Insurance claims in respect of general insurance business were £95 million, or 15 per cent, lower at £539 million in 2010 compared to £634 million in 2009, this was due primarily to lower payment protection insurance claims related to unemployment.

Operating expenses increased by £486 million, or 3 per cent, to £16,470 million in 2010 compared to £15,984 million in 2009, this increase principally reflected the £3,200 million payment protection insurance provision in 2010, more than offsetting the impact of the non-repetition of the £2,500 million fee paid to the UK Government in 2009 as part of the agreement for the Group not to enter into the Government Asset Protection Scheme. A pension curtailment gain of £910 million in 2010 was offset by a £557 million increase in integration costs and a £500 million customer goodwill payments provision. Staff costs were £1,053 million, or 16 per cent, lower at £5,622 million in 2010 compared to £6,675 million in 2009. Excluding the pension curtailment gain of £910 million in 2010, staff costs were £143 million, or 2 per cent, lower at £6,532 million in 2010 compared to £6,675 million in 2009, as decreased salary costs, reflecting head count reductions, and lower levels of staff restructuring costs were partly offset by increases in other staff costs (reflecting greater use of agency staff in relation to the integration programme). Premises and equipment costs were £21 million, or 2 per cent, higher at £1,177 million in 2010 compared to £1,156 million in 2009. Other expenses, including the payment protection insurance provision, were £4,184 million higher at £7,037 million in 2010 compared to £2,853 million in 2009. This increase reflected the £3,200 million payment protection insurance provision and the £500 million customer goodwill payments provision, both in 2010, and increased communication costs and professional fees in relation to the ongoing integration of the Lloyds TSB and HBOS businesses. Depreciation and amortisation costs were £128 million lower at £2,432 million in 2010 compared to £2,560 million in 2009. In 2010 there was a charge of £202 million in respect of the impairment of tangible fixed assets; and in 2009 there was a charge of £240 million in respect of the impairment of goodwill attributable to the Group s asset finance business.

Impairment losses decreased by £5,721 million, or 34 per cent, to £10,952 million in 2010 compared to £16,673 million in 2009. Impairment losses in respect of loans and advances to customers were £5,056 million, or 32 per cent, lower at £10,727 million in 2010 compared to £15,783 million in 2009. This reflected improved credit experience in the Retail, Wholesale and Commercial divisions as a result of the improving economic environment in the UK and the US; partly offset by increased charges in the International business, especially in Ireland and Australia. The Group s through the cycle credit policies and procedures, which focus on the development of enduring client relationships, had resulted in higher quality new business being originated across the UK and very little new origination took place outside the UK. The Group s level of impairment is being managed in the current challenging economic environment by the Wholesale business support units, also covering Commercial and Retail collection and recovery units. The business support model has been expanded from Wholesale across Wealth and International division, with a central team established to manage the Group s business support activity globally. The Group had also strengthened resources within Retail collections and recoveries to enable more timely engagement with customers experiencing difficulties to drive more effective customer outcomes.

The Group s share of results of joint ventures and associates was a net loss of £88 million in 2010 compared to a net loss of £752 million in 2009; partly due to reduced losses in the joint venture vehicles and partly reflecting the fact that many of the investments are now substantially written-off.

On 16 January 2009, the Group had acquired 100 per cent of the ordinary share capital of HBOS plc. As the fair value of the identifiable net assets acquired was greater than the total consideration paid, negative goodwill of £11,173 million arose on the acquisition. The negative goodwill was recognised as a Gain on acquisition in the income statement for the year ended 31 December 2009. There was no such credit in 2010.

In 2010, the Group incurred a loss on disposal of businesses of £365 million (2009: nil). During 2009, the Group had acquired an oil drilling rig construction business through a previous lending relationship and, in the second half of 2010, the Group reached agreement to dispose of its interests in the two wholly-owned subsidiary companies through which this business operates.

In 2010, the Group recorded a tax credit of £325 million compared to a tax credit of £1,911 million in 2009. The tax credit of £325 million in 2010 arose on a loss before tax of £2,919 million, an effective tax rate of 11 per cent compared to the standard UK corporation tax rate of 28 per cent. This lower rate reflected losses where no deferred tax was recognised together with the impact of the tax charge attributable to UK life insurance policyholders and the Group s interests in Open Ended Investment Companies (OEICs), which is required to be included within the income tax charge, and a charge resulting from the change in the UK corporation tax rate being largely offset by overseas tax rate differences and other adjustments.

Total assets were £34,817 million lower at £992,438 million at 31 December 2010 compared to £1,027,255 million at 31 December 2009; loans and advances to customers were £34,372 million, or 5 per cent, lower at £592,597 million at 31 December 2010 compared to £626,969 million at 31 December 2009; and customer deposits were £13,108 million, or 3 per cent, lower at £393,633 million at 31 December 2010 compared to £406,741 million at 31 December 2009; total assets had reduced as the Group continued its strategy to reduce assets associated with non-relationship lending and investments, including business which is outside the Group s current risk appetite. The reduction in total assets was substantially driven by reductions in portfolios of lending which are outside of the Group s risk appetite across the three banking divisions, continued customer deleveraging and de-risking and subdued demand in lending markets.

The Wholesale division s total exposure to asset-backed securities decreased by £8,139 million from £42,863 million at 31 December 2009 to £34,724 million at 31 December 2010 as these investments continued to run-off.

Mortgage-backed security exposures were £2,562 million lower at £15,656 million at 31 December 2010 compared to £18,218 million at 31 December 2009. Exposures to Alt-A US residential mortgage-backed securities were £267 million lower at £3,700 million at 31 December 2010 compared to £3,967 million at 31 December 2009; there is no exposure to sub-prime US residential mortgage-backed securities.

Exposures where reliance is placed on monoline insurers were limited to a total of £254 million at 31 December 2010 (31 December 2009: £444 million); all of the exposure at 31 December 2010 was rated AA.

At the end of December 2010, the Group s capital ratios had increased with a total capital ratio on a Basel II basis of 14.5 per cent (compared to 12.4 per cent at 31 December 2009), a tier 1 ratio of 11.0 per cent (compared to 9.6 per cent at 31 December 2009) and a core tier 1 ratio of 9.6 per cent (compared to 8.1 per cent at 31 December 2009). During 2010, risk-weighted assets had decreased by £86,935 million to £406,372 million at 31 December 2010 compared to £493,307 million at 31 December 2009; this decrease reflected balance sheet reductions across all banking divisions, a revised assessment of the Retail division s secured lending risk-weighted assets following improvements in the economic outlook and changes introduced as a result of continuing the process of integrating the Lloyds TSB and HBOS regulatory capital approaches which had impacted particularly on the Wholesale division.

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NET INTEREST INCOME

	2011	2010[1]	2009[1]
Net interest income £m	**12,698**	12,546	9,026
Average interest-earning assets £m	**736,032**	741,883	833,503
Average rates:			
Gross yield on interest-earning assets[2] %	**3.58**	3.95	3.39
Interest spread[3] %	**1.62**	1.64	1.05
Net interest margin[4] %	**1.73**	1.69	1.08

1 During 2011 the Group has revised its treatment of offset accounts; average balances for 2010 and 2009 have been restated accordingly.

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

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

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

2011 COMPARED WITH 2010

Net interest income was £12,698 million in 2011; an increase of £152 million, or 1 per cent compared to £12,546 million in 2010. There was a credit of £696 million in 2011 arising from liability management gains (see below) and a benefit of £1,117 million from a reduction in the amounts payable to unitholders in those Open-Ended Investment Companies included in the consolidated results of the Group. However, there were decreases within the Retail division, as a result of higher wholesale funding costs which were not matched by average customer rates, and previous de-risking of the lending portfolio resulting in reduced secured lending balances; and in the Wholesale division reflecting lower interest-earning asset balances and higher funding costs partly offset by improved margins on deposit products.

Average interest-earning assets were £5,851 million, or 1 per cent, lower at £736,032 million in 2011 compared to £741,883 million in 2010. This reduction reflected the run-off of assets which were outside of the Group s risk appetite from the Group s balance sheet and subdued lending demand.

Average interest-earning assets in Retail were £10,963 million, or 3 per cent, lower at £362,145 million in 2011 compared to £373,108 million in 2010. Average personal mortgage balances were £7,235 million, or 2 per cent, lower at £335,496 million in 2011 compared with £342,731 million in 2010; Retail s new mortgage lending continued to be focused on home purchase with 70 per cent of lending being for house purchase rather than re-mortgaging. Average other personal lending balances were £3,728 million, or 12 per cent, lower at £26,649 million in 2011 compared with £30,377 million in 2010 as a result of customers continuing to reduce their personal indebtedness, particularly in unsecured lending.

Average interest-earning assets across the rest of the Group were £5,112 million, or 1 per cent, higher at £373,887 million in 2011 compared to £368,775 million in 2010. Relationship lending and similar average interest-earning assets in Wholesale were £24,787 million, or 16 per cent, lower at £130,209 million in 2011 compared to £154,996 million in 2010, as demand for new corporate lending and refinancing of existing facilities was more than offset by maturities, reflecting a continued trend of subdued corporate demand for lending and customer deleveraging. Balances in Wealth and International were £4,959 million, or 7 per cent, lower at £63,279 million in 2011 compared to £68,238 million in 2010. Average interest-earning assets in Commercial were £241 million, or 1 per cent, higher at £29,753 million in 2011 compared to £29,512 million in 2010. The remainder of the Group s average interest-earning assets, which include certain non-relationship and treasury-related balances in the Wholesale division and the bank deposits held in the insurance business, were £34,617 million, or 30 per cent, higher at £150,646 million in 2011 compared to £116,029 million in 2010.

The Group s net interest margin increased by 4 basis points to 1.73 per cent in 2011 compared to 1.69 per cent in 2010. However, net interest income in 2011 included £696 million in relation to the revision in the carrying values of certain debt securities. During December 2011, the Group completed the exchange of certain subordinated debt securities issued by Lloyds TSB Bank plc and HBOS plc for new subordinated debt securities issued by Lloyds TSB Bank plc by undertaking an exchange offer on certain securities which were eligible for call before 31 December 2012. As part of the exchange, the Group announced that all decisions to exercise calls on those original securities that remained outstanding following the exchange offer would be made with reference to the prevailing regulatory, economic and market conditions at the time. These securities will not, therefore, be called at their first available call date which will lead to coupons continuing to be paid until possibly the final redemption date of the securities. Consequently, the Group is required to adjust the carrying amount of these securities to reflect the revised estimated cash flows over their revised life and to recognise this change in carrying value in interest expense. Included within net interest income is a credit of £570 million in respect of the securities that remained outstanding following the exchange offer. In December 2011, the Group decided to defer payment of non-mandatory coupons on certain securities and, instead, settle them using an Alternative Coupon Satisfaction Mechanism (ACSM) on their contractual terms. This change in expected cashflows resulted in a gain of £126 million in net interest income from the recalculation of the carrying value of these securities. Excluding these amounts net interest income was £544 million, or 4 per cent, lower at £12,002 million in 2011 compared to £12,546 million in 2010 and the net interest margin was 6 basis points lower at 1.63 per cent in 2011 compared to 1.69 per cent in 2010. An increase in margin in Commercial was more than offset by reduced margins in Retail, Wholesale and Wealth and International. Margins in Commercial improved as a result of an increase in deposit balances, a consequently larger funding surplus and a more favourable deposit mix. In Retail margins decreased due to muted demand for credit and previous de-risking of the lending portfolios with a resulting reduction in unsecured balances. In Wholesale margins decreased slightly with the impact of higher funding costs almost fully offset by re-pricing activity and increased deposit margins and values. Margins in Wealth and International decreased reflecting the increased strains of lost earnings on higher impaired asset balances and higher funding costs although this was largely offset by stronger deposit margins in the Wealth businesses and higher deposit balances and margins in the Group s International on-line deposit business.

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2010 COMPARED WITH 2009

Net interest income was £3,520 million, or 39 per cent, higher at £12,546 million in 2010 compared to £9,026 million in 2009. Interest and similar income was £1,102 million, or 4 per cent, higher at £29,340 million in 2010 compared to £28,238 million in 2009; and interest and similar expense was £2,418 million, or 13 per cent, lower at £16,794 million in 2010 compared to £19,212 million in 2009. In the Retail division, this reflected higher asset pricing (partly due to mortgage customers moving onto and staying on standard variable rates and lending being priced to more appropriately reflect risk and rising funding costs), in part offset by the impact on interest expense of lower LIBOR to base rate spreads although there had been a reduction in the more expensive deposit balances. In the Wholesale division, lending was also being re-priced to reflect customer risk profiles resulting in higher customer margins on new business and from re-pricing on renewals. Across the Group, there had been some increase in funding costs as a result of the Group s improved funding profile but there had been a benefit from a £723 million reduction in the amounts payable to unit holders in those Open-Ended Investment Companies included in the consolidated results of the Group (although, since these are policyholder items, there was no impact on profit attributable to shareholders).

Average interest-earning assets were £91,620 million, or 11 per cent, lower at £741,883 million in 2010 compared to £833,503 million in 2009. This reduction reflected the successful removal of assets which were outside of the Group s risk appetite from the Group s balance sheet.

Average interest-earning assets in Retail were £11,175 million, or 3 per cent, lower at £373,108 million in 2010 compared to £384,283 million in 2009. Average personal mortgage balances were £7,141 million, or 2 per cent, lower at £342,731 million in 2010 compared to £349,872 million in 2009, in part reflecting a slight reduction in demand in the UK mortgage market in 2010; Retail had continued to focus on supporting the housing market with 70 per cent of new lending being for house purchases rather than re-mortgages. Average other personal lending balances were £4,034 million, or 12 per cent, lower at £30,377 million in 2010 compared to £34,411 million in 2009 as a result of reduced customer demand for credit and customers continuing to reduce their personal indebtedness, with reductions in both unsecured loan and credit card balances.

Average interest-earning assets across the rest of the Group were £80,445 million, or 18 per cent, lower at £368,775 million in 2010 compared to £449,220 million in 2009. Relationship lending and similar average interest-earning assets in Wholesale were £19,621 million, or 11 per cent, lower at £154,996 million in 2010 compared to £174,617 million in 2009 as demand for new corporate lending and refinancing of existing facilities was more than offset by the level of maturities, reflecting a continuing trend of subdued corporate lending and customer deleveraging. Such balances in Wealth and International were £645 million, or 1 per cent, lower at £68,238 million in 2010 compared to £68,883 million in 2009. Average interest-earning assets in Commercial were £920 million, or 3 per cent, lower at £29,512 million in 2010 compared to £30,432 million in 2009. The remainder of the Group s average interest-earning assets, which include certain non-relationship and treasury-related balances in the Wholesale division and the bank deposits held in the insurance businesses, were £59,259 million, or 34 per cent, lower at £116,029 million in 2010 compared to £175,288 million in 2009; this reflected planned balance sheet reductions.

The Group s net interest margin increased by 61 basis points to 1.69 per cent in 2010 compared to 1.08 per cent in 2009 with increases in Retail, Wholesale and Commercial only partly offset by reduced margins in the Wealth and International business. Margins in Retail improved as a result of improved asset pricing and decreases in the LIBOR to base rate spread. In Wholesale margins were also improved, again as result of higher asset pricing to reflect customer risk. Declining margins in Wealth and International reflected reduced base rates, a very competitive deposit environment and the impact of impaired lending balances.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OTHER INCOME

	2011 £m	2010 £m	2009 £m
Fee and commission income:			
Current account fees	**1,053**	1,086	1,088
Credit and debit card fees	**877**	812	765
Other[1]	**3,005**	3,094	2,875
	4,935	4,992	4,728
Fee and commission expense	**(1,391)**	(1,682)	(1,517)
Net fee and commission income	**3,544**	3,310	3,211
Net trading income	**(368)**	15,724	19,098
Insurance premium income	**8,170**	8,148	8,946
Liability management gains	**599**	423	1,498
Other	**2,169**	3,893	3,992
Other operating income	**2,768**	4,316	5,490
Total other income	**14,114**	31,498	36,745

1 In previous years the Group has included annual management charges on non-participating investment contracts within insurance claims. In light of developing practice, these amounts (2011: £606 million; 2010: £577 million; 2009: £474 million) are now included within net fee and commission income.

2011 COMPARED WITH 2010

Other income was £17,384 million, or 55 per cent, lower at £14,114 million in 2011 compared to £31,498 million in 2010, as a result of the factors discussed below.

Fee and commission income was little changed at £4,935 million in 2011 compared with £4,992 million at 2010; a reduction of £57 million or 1 per cent. Current account fees were £33 million, or 3 per cent, lower at £1,053 million in 2011 compared to £1,086 million in 2010, following a restructuring of the customer tariff. An increase of £65 million, or 8 per cent, in credit and debit card fees from £812 million in 2010 to £877 million in 2011 resulted from increased customer activity, particularly over the internet. Other fees and commissions were £89 million, or 3 per cent, lower at £3,005 million in 2011 compared with £3,094 million in 2010.

Fee and commission expense was £291 million, or 17 per cent, lower at £1,391 million in 2011 compared to £1,682 million in 2010.

Net trading income was £16,092 million lower at a deficit of £368 million in 2011 compared with a surplus of £15,724 million in 2010. Net trading income within the insurance businesses was a deficit of £518 million in 2011 compared to a surplus of £13,749 million in 2010, which reflected the market performance in 2011, however this decrease along with the increase in long-term insurance premium income were largely offset by the overall decrease in insurance claims expense. A loss of £5 million in 2011, compared with a loss in 2010 of £620 million, arose from the change in fair value of the embedded equity conversion feature contained in the Enhanced Capital Notes issued by the Group. Net trading income within the Group s banking activities was £2,440 million, or 94 per cent lower at £155 million in 2011 compared with £2,595 million in 2010. This decrease in the banking business reflected poor trading conditions and, in particular a total charge of £718 million for derivative valuation adjustments, compared to £42 million in 2010.

Insurance premium income was largely unchanged at £8,170 million in 2011 compared with £8,148 million in 2010; an increase of £22 million. Earned premiums in respect of the Group s long-term life and pensions business were £181 million, or 3 per cent, higher at £6,954 million in 2011 compared to £6,773 million in 2010. General insurance earned premiums were £159 million, or 12 per cent, lower at £1,216 million in 2011 compared with £1,375 million in 2010.

During December 2011 the Group completed the exchange of certain existing subordinated debt securities issued by Lloyds TSB Bank plc and HBOS plc for new subordinated debt securities issued by Lloyds TSB Bank plc by undertaking an exchange offer on certain securities which were eligible for call before 31 December 2012. This exchange resulted in a gain on extinguishment of the existing securities of £599 million, compared with £423 million in 2010, being the difference between the carrying value of the securities extinguished and the fair value of the new securities issued together with related fees and costs.

Other operating income, excluding the liability management gains, was £1,724 million, or 44 per cent, lower at £2,169 million in 2011 compared with £3,893 million in 2010; this was mainly driven by a significant decline in the movement in value of in-force business from a profit of £789 million in 2010 to a loss of £622 million in 2011, particularly reflecting non-economic assumption changes and economic variance (see note 30 to the financial statements), along with lower levels of operating lease rentals receivable and lower gains on disposal of available-for-sale financial assets.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

2010 COMPARED WITH 2009

Other income was £5,247 million lower at £31,498 million in 2010 compared to £36,745 million in 2009, as a result of the factors discussed below.

Fee and commission income was £264 million, or 6 per cent, higher at £4,992 million in 2010 compared to £4,728 million in 2009. Current account fees were little changed at £1,086 million in 2010 compared to £1,088 million in 2009 but credit and debit card fees were £47 million, or 6 per cent, higher at £812 million in 2010 compared to £765 million in 2009. Other fee and commission income was £219 million, or 8 per cent, higher at £3,094 million in 2010 compared to £2,875 million in 2009.

Fee and commission expense was £165 million, or 11 per cent, higher at £1,682 million in 2010 compared to £1,517 million in 2009. There had been increases in fees payable related to added-value account packages and higher levels of card fees payable, as well as increased levels of fees payable in respect of the Group s fund management activities.

Net trading income was £3,374 million lower at £15,724 million in 2010 compared to £19,098 million in 2009. Net trading income within the insurance businesses was £2,551 million, or 16 per cent, lower at £13,749 million in 2010 compared to £16,300 million in 2009 which reflected a more subdued market performance in 2010 (equity market values increased by 9 per cent in 2010 compared to 22 per cent in 2009) although this decrease and the reduction in long-term insurance premium income were largely offset by the decrease in the insurance claims expense. A loss of £620 million, which was £193 million, or 45 per cent, higher than the loss of £427 million in 2009, arose from the change in fair value of the embedded equity conversion feature contained in the Enhanced Capital Notes issued by the Group in 2009. Net trading income within the Group s banking activities was £630 million, or 20 per cent, lower at £2,595 million in 2010 compared to £3,225 million in 2009 as the Group continued to reduce activities outside of its risk appetite.

Insurance premium income was £798 million, or 9 per cent, lower at £8,148 million in 2010 compared to £8,946 million in 2009. Earned premiums in respect of the Group s long-term life and pensions business were £687 million, or 9 per cent lower, at £6,773 million in 2010 compared to £7,460 million in 2009, this reflected reduced new business sales, mainly as a result of the withdrawal, during 2009, of certain HBOS legacy products with lower returns. General insurance earned premiums were £111 million lower at £1,375 million in 2010 compared to £1,486 million in 2009; this primarily reflected the Group s withdrawal from the payment protection insurance market in July 2010.

During 2009 and 2010, as part of the Group s management of capital, the Group exchanged certain existing subordinated debt securities for new subordinated debt securities and ordinary shares. These exchanges resulted in a gain on extinguishment of the existing liabilities of £423 million (2009: £1,498 million), being the difference between the carrying value of the securities extinguished and the fair value of the new securities issued together with related fees and costs. On 18 February 2010, as part of the Group s recapitalisation and exit from its proposed participation in the Government Asset Protection Scheme, Lloyds Banking Group plc issued 3,141 million ordinary shares in exchange for certain existing preference shares and preferred securities. This exchange resulted in a gain of £85 million. During March 2010 the Group entered into a bilateral exchange, under which certain Enhanced Capital Notes denominated in Japanese Yen were exchanged for an issue of new Enhanced Capital Notes denominated in US Dollars; the securities subject to the exchange were cancelled and a profit of £20 million arose. In addition, during May and June 2010 the Group completed the exchange of a number of outstanding capital securities issued by Lloyds Banking Group plc and certain of its subsidiaries for ordinary shares in Lloyds Banking Group plc. The securities subject to exchange were cancelled, generating a total profit of £318 million for the Group.

Other operating income, excluding the gains on capital transactions, was £99 million lower at £3,893 million in 2010 compared to £3,992 million in 2009; increased gains on disposal of available-for-sale financial assets were more than offset by lower levels of operating lease rentals receivable and a reduction in the income arising from the movement in value of in-force business.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OPERATING EXPENSES

	2011 £m	2010[1] £m	2009 £m
Administrative expenses:			
Staff:			
Salaries	**3,784**	3,787	3,902
Performance-based compensation	**361**	533	491
Social security costs	**432**	396	383
Pensions and other post-retirement benefit schemes:			
Curtailment gain		(910)	
Other	**401**	628	744
	401	(282)	744
Restructuring costs	**124**	119	412
Other staff costs	**1,064**	1,069	743
	6,166	5,622	6,675
Premises and equipment:			
Rent and rates	**547**	602	569
Hire of equipment	**22**	18	20
Repairs and maintenance	**188**	199	226
Other	**294**	358	341
	1,051	1,177	1,156
Other expenses:			
Communications and data processing	**954**	1,126	668
Advertising and promotion	**398**	362	335
Professional fees	**576**	742	540
Customer goodwill payments provision		500	
Financial services compensation scheme levies	**179**	46	73
UK bank levy	**189**		
Provision in relation to German insurance business litigation	**175**		
Other	**1,122**	1,061	1,237
	3,593	3,837	2,853
Depreciation and amortisation:			
Depreciation of tangible fixed assets	**1,434**	1,635	1,716
Amortisation of acquired value of in-force non-participating investment contracts	**78**	76	75
Amortisation of other intangible assets	**663**	721	769
	2,175	2,432	2,560
Impairment of tangible fixed assets[2]	**65**	202	
Goodwill impairment			240
Total operating expenses, excluding payment protection insurance provision and Government Asset Protection Scheme fee	**13,050**	13,270	13,484
Payment protection insurance provision		3,200	
Government Asset Protection Scheme fee			2,500
Total operating expenses	**13,050**	16,470	15,984
Cost:income ratio (%)[3]	**62.8**	66.0	68.7

1 During 2011, the Group has reviewed the analysis of certain cost items and as a result has reclassified some items of expenditure; comparatives for 2010 have been restated accordingly.

2 £65 million (2010: £52 million; 2009: nil) of the impairment of tangible fixed assets relates to integration activities.

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

2011 COMPARED WITH 2010

Operating expenses decreased by £3,420 million, or 21 per cent, to £13,050 million in 2011 compared with £16,470 million in 2010. This decrease principally reflected the £3,200 million payment protection insurance provision made in 2010.

Staff costs were £544 million, or 10 per cent, higher in 2011 at £6,166 million compared to £5,622 million in 2010. However, excluding the net pension curtailment gain of £910 million in 2010, staff costs were actually lower by £366 million, a decrease of 6 per cent from £6,532 million in 2010. Salaries were largely unchanged at £3,784 million in 2011 compared with £3,787 million in 2010 as the impact of annual pay rises, and some enhancement of benefits following the harmonisation of terms and conditions across the Group, was offset by staff reductions. Pensions costs, excluding the curtailment gain in 2010, were £227 million, or 36 per cent, lower at £401 million in 2011 compared to £628 million in 2010, principally as a result of increased asset levels in the defined benefit schemes at the end of 2010 leading to a higher expected return. Staff bonuses were £172 million, or 32 per cent, lower at £361 million in 2011 compared with £533 million in 2010. variable pay is reflective of the performance of the business and total discretionary bonus awards are approximately 30 per cent lower than last year with bonuses above £2,000 subject to deferral and adjustment. Social security costs were £36 million, or 9 per cent, higher at £432 million in 2011 compared with £396 million in 2010 in part due to an increase in the percentage payable. Staff restructuring costs at £124 million in 2011 compared with £119 million in 2010, and other staff costs, at £1,064 million in 2011 compared with £1,069 million remained largely unchanged.

Premises and equipment costs were £126 million, or 11 per cent, lower at £1,051 million in 2011 compared to £1,177 million in 2010. Rent and rates was £55 million, or 9 per cent, lower at £547 million in 2011 compared to £602 million in 2010, mainly as a result of the closure of operations in Ireland; and other premises and equipment costs decreased by £64 million or 18 per cent, in part due to profits on disposal of operating lease assets and other equipment.

Other expenses (excluding the payment protection insurance provision charge of £3,200 million from 2010) were £244 million, or 6 per cent, lower at £3,593 million in 2011 compared with £3,837 million in 2010. Other expenses in 2010 included a charge of £500 million in respect of the customer goodwill payments provision, which was not repeated in 2011; and in 2011 there was a charge of £175 million in respect of German insurance business litigation, £189 million for the UK bank levy and a total of £179 million for Financial Services Compensation Scheme levies compared to only £46 million in 2010. Excluding these items, other expenses in 2011 were £241 million, or 7 per cent, lower at £3,050 million compared to £3,291 million in 2010. Communications and data processing costs were £172 million, or 15 per cent, lower at £954 million in 2011 compared with £1,126 million in 2010 as a result of increased amounts of software expenditure being suitable for capitalisation as the integration programme has progressed. Professional fees were £166 million, or 22 per cent, lower at £576 million in 2011 compared with £742 million in 2010 following reduced expenditure within the integration programme and on a number of specific projects.

Depreciation and amortisation costs were £257 million, or 11 per cent, lower at £2,175 million in 2011 compared with £2,432 million in 2010. This reflects reductions in the operating lease asset portfolio, certain tranches of equipment now being fully depreciated and some reduction in the charge for the amortisation of acquisition intangibles.

A charge of £65 million arose in respect of impairment of tangible fixed assets, all of which related to integration activities; in 2010, £52 million of the total charge of £202 million related to integration activities with the remainder related to impairment of assets held by an oil drilling rig business.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

2010 COMPARED WITH 2009

Operating expenses increased by £486 million, or 3 per cent, to £16,470 million in 2010 compared to £15,984 million in 2009. This increase principally reflected the £3,200 million payment protection insurance provision in 2010, which more than offset the non-repetition of the £2,500 million fee paid in 2009 to the UK Government as part of the agreement for the Group not to enter into the Government Asset Protection Scheme.

Staff costs were £1,053 million, or 16 per cent, lower at £5,622 million in 2010 compared to £6,675 million in 2009. Staff costs in 2010 were reduced by a curtailment gain related to the Group s pension schemes. Following changes by the Group to the terms of its UK defined benefit pension schemes, all future increases to pensionable salary will be capped each year at the lower of: Retail Prices Index inflation; each employee s actual percentage increase in pay; and 2 per cent of pensionable pay. In addition to this, during 2010 there was also a change in commutation factors in certain defined benefit schemes. The combined effect of these changes was a reduction in the Group s defined benefit obligation of £1,081 million and a reduction in the Group s unrecognised actuarial losses of £171 million, resulting in a net curtailment gain of £910 million recognised in the income statement in 2010. Excluding the pension curtailment gain of £910 million in 2010, staff costs were £143 million, or 2 per cent, lower at £6,532 million in 2010 compared to £6,675 million in 2009. Salaries were £115 million, or 3 per cent, lower at £3,787 million in 2010 compared to £3,902 million in 2009 as the impact of annual pay rises had been more than offset by staff reductions; performance-based compensation was £42 million, or 9 per cent, higher at £533 million in 2010 compared to £491 million in 2009; pension costs, excluding the curtailment gain, were £116 million, or 16 per cent, lower at £628 million in 2010 compared to £744 million in 2009, principally as a result of increased asset levels in the defined benefit schemes at the end of 2009 which led to a higher expected return; staff restructuring costs were £293 million, or 71 per cent, lower at £119 million in 2010 compared to £412 million in 2009 principally as the significant staff rationalisations as part of the Group integration programme in 2009 were not repeated in 2010; and other staff costs were £324 million, or 44 per cent, higher at £1,069 million in 2010 compared to £743 million in 2009, which largely reflected increased use of agency staff in relation to the integration programme.

Premises and equipment costs were £21 million, or 2 per cent, higher at £1,177 million in 2010 compared to £1,156 million in 2009. Rent and rates were £33 million, or 6 per cent, higher at £602 million in 2010 compared to £569 million in 2009, as a result of rent reviews and integration-related expenditure; and other premises and equipment costs were £17 million, or 5 per cent, higher at £358 million in 2010 compared to £341 million in 2009.

Other expenses were £984 million higher at £3,837 million in 2010 compared to £2,853 million in 2009. These costs in 2010 included a £500 million customer goodwill payments provision. Lloyds Banking Group had been in discussions with the FSA regarding the application of an interest variation clause in certain Bank of Scotland plc variable rate mortgage contracts where the wording in the offer documents received by certain customers had the potential to cause confusion. The relevant mortgages were written between 2004 and 2007 by Bank of Scotland plc under the Halifax brand. In February 2011, the Group reached agreement with the FSA in relation to initiating a customer review and contact programme and making goodwill payments to affected customers. In order to make these goodwill payments, Bank of Scotland plc had applied for a voluntary variation of Permission to carry out the customer review and contact programme to bring it within section 404F(7) of the Financial Services and Markets Act 2000 (FSMA).

Excluding the customer goodwill payments provision, other expenses in 2010 were £484 million, or 17 per cent, higher at £3,337 million compared to £2,853 million in 2009. Communications and data processing costs were £458 million, or 69 per cent, higher at £1,126 million in 2010 compared to £668 million in 2009 and professional fees were £202 million, or 37 per cent, higher at £742 million in 2010 compared to £540 million in 2009; in both cases reflecting increased levels of integration-related expenditure.

Depreciation and amortisation costs were £128 million, or 5 per cent, lower at £2,432 million in 2010 compared to £2,560 million in 2009.

A charge of £202 million (2009: nil) arose in respect of the impairment of tangible fixed assets. During 2009, the Group had acquired an oil drilling rig construction business through a previous lending relationship and consolidated the results and net assets of the business from the date that it exercised control; during 2010, as a result of a deteriorating market, the Group impaired the oil drilling rigs under construction held by the business by £150 million to reflect their reduced value in use. A further £52 million impairment charge related to the write-off of certain tangible fixed assets as a result of integration activities.

In 2009, a charge of £240 million had arisen in respect of the impairment of goodwill; there was no impairment charge in respect of goodwill in 2010.

Total operating expenses in 2010 included a £3,200 million payment protection insurance provision. On 8 October 2010, the British Bankers Association (BBA), the principal trade association for the UK banking and financial services sector, filed an application for permission to seek judicial review against the FSA and the FOS. The BBA sought an order quashing the FSA Policy Statement and an order quashing the decision of the FOS to determine PPI sales in accordance with the guidance published on its website in November 2008. The Judicial Review was heard in January 2011 and on 20 April 2011 judgment was handed down by the High Court dismissing the BBA s application. Subsequent to the publication of the judgment, the Group had been in discussions with the FSA with a view to seeking clarity around the detailed implementation of the Policy Statement. As a result, and given the initial analysis that the Group had conducted of compliance with applicable sales standards which was continuing, the Group had concluded that there were certain circumstances where customer contact and/or redress would be appropriate. Accordingly the Group made a provision in its income statement for the year ended 31 December 2010 of £3,200 million in respect of the anticipated costs of such contact and/or redress, including administration expenses.

IMPAIRMENT

	2011 £m	2010 £m	2009 £m
Impairment losses on loans and receivables:			
Loans and advances to banks		(13)	(3)
Loans and advances to customers	**8,020**	10,727	15,783
Debt securities classified as loans and receivables	**49**	57	248
Total impairment losses on loans and receivables	**8,069**	10,771	16,028
Impairment of available-for-sale financial assets	**80**	106	602
Other credit risk provisions	**(55)**	75	43
Total impairment charged to the income statement	**8,094**	10,952	16,673

2011 COMPARED WITH 2010

Impairment losses decreased by £2,858 million, or 26 per cent, to £8,094 million in 2011 compared to £10,952 million in 2010.

The decrease in the Group s charge was seen across all divisions. These lower charges were principally supported by the continued application of the Group s prudent risk appetite and strong risk management controls resulting in improved portfolio and new business quality, continued low interest rates, and broadly stable UK property prices, partly offset by weakening UK economic growth and rising unemployment.

The impairment charge in respect of loans and advances to customers was £2,707 million, or 25 per cent, lower at £8,020 million compared to £10,727 million in 2010.

In Retail there was a higher secured impairment charge, with the increase on 2010 largely reflecting a less certain outlook for house prices, and provisioning against existing credit risks which have longer emergence periods due to current low interest rates. These factors were partially offset by an improvement in the quality of the secured portfolio. Secured asset quality remained good and the number of customers entering arrears reduced through 2011 compared to 2010. The stock of properties in repossession remained stable and the sales prices of repossessed properties continued to be at expected values. The proportion of the mortgage portfolio with an indexed loan-to-value of greater than 100 per cent decreased to 12 per cent at 31 December 2011, benefitting from the regional mix of lending. The value of the portfolio with an indexed loan-to-value of greater than 100 per cent and more than three months in arrears was stable at just over £3 billion. There was a decrease in the unsecured impairment charge, reflecting continued improving new business quality and portfolio trends as a result of its conservative risk appetite, with a focus on lending to existing customers.

In Wholesale there was a decrease in the impairment charge, primarily driven by lower impairment from the corporate real estate and real estate related asset portfolios partly offset by higher impairment on leveraged acquisition finance exposures. The continued low interest rate environment helped to maintain defaults at a reduced level. In addition, newly impaired assets, being generally of better quality, require a lower level of provisions once impaired than previously impaired assets.

In Commercial, the impairment charge decreased, reflecting the benefits of the low interest rate environment, which helped maintain defaults at a lower level, and the continued application of the Group s prudent credit risk appetite.

In Wealth and International, impairment charges were also lower. The reduction predominantly reflects lower impairment charges in the Irish portfolio where the rate of impaired loan migration slowed. The impairment charge as a percentage of average loans and advances to customers improved. Impaired loans increased by £0.4 billion with an increase of £1.9 billion in Ireland partly offset by a reduction in the Australasian book as a result of write-offs and disposals, resulting in 42.8 per cent of the International portfolios (66.0 per cent of the Irish portfolio) being classified as impaired compared with 35.1 per cent in 2010.

There was no impairment charge in respect of loans and advances to banks in 2011, whereas in 2010 there had been a credit of £13 million following releases in respect of a small number of specific exposures. The impairment charge in respect of debt securities classified as loans and receivables was £8 million, or 14 per cent, lower at £49 million in 2011 compared to £57 million in 2010 and the impairment charge in respect of available-for-sale financial assets was £26 million, or 25 per cent, lower at £80 million in 2011 compared to £106 million in 2010.

There was a release of £55 million in respect of other credit provisions in 2011, as a number of commitments have now been drawn down; in 2010 a charge of £75 million resulted from a small number of specific new cases.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

2010 COMPARED WITH 2009

Impairment losses decreased by £5,721 million, or 34 per cent, to £10,952 million in 2010 compared to £16,673 million in 2009.

The reduction in the Group s impairment charge in 2010 reflected stabilisation of the wholesale portfolios and improved retail affordability and performance. Improvements in Wholesale, Commercial and Retail more than offset increased impairment charges in Ireland and Australia, the latter caused by difficult market conditions. The Group s through the cycle credit policies and procedures, which focus on the development of enduring client relationships, had resulted in higher quality new business being originated across the UK and very little new origination took place outside the UK. The Group s level of impairment was managed in the challenging economic environment by the Wholesale business support units, also covering Commerial, and Retail collection and recovery units. The business support model was expanded from Wholesale across Wealth and International division, with a central team established to manage the Group s business support activity globally. The Group had also strengthened resources within Retail collections and recoveries to enable more timely engagement with customers experiencing difficulties to drive more effective customer outcomes. The Group had actively reduced limits to Portugal, Ireland, Italy, Greece and Spain over 2009 and 2010, with the associated country risk profile modest in the context of the Group s asset base.

The impairment charge in respect of loans and advances to customers was £5,056 million, or 32 per cent, lower at £10,727 million in 2010 compared to £15,783 million in 2009. This improvement reflected reduced impairment charges in Retail, as a result of the improved quality of new business and a slow recovery in the UK economy, Wholesale, where stabilising economic conditions have led to lower impairment charges, particularly in the corporate real estate and real estate-related UK and US portfolios, and Commercial; only partly offset by increased impairment charges in Wealth and International as a result of difficult market conditions in a number of locations abroad, particularly Ireland and Australia, and especially in relation to the commercial real estate portfolios in those locations. The level of losses continued to be dominated by the economic environment in Ireland, and to a lesser extent had also been influenced by the performance of specific areas of the Australian economy.

In Retail, there was a lower secured impairment charge reflecting reduced impaired loan levels and improved arrears in the first half of 2010, although in the second half, and particularly in the last quarter, the Group had seen some signs of strain, with fewer customers returning their accounts to order than was the case six months previously. Although house prices fell slightly over 2010, the proportion of the mortgage portfolio with an indexed loan-to-value of greater than 100 per cent was broadly stable at 13 per cent. The value of the portfolio with an indexed loan-to-value greater than 100 per cent and more than three months in arrears increased by £0.2 billion and at 31 December 2010 was £3.2 billion, representing 0.9 per cent of the portfolio. The number of mortgage customers new to arrears had also remained relatively stable over 2010, and was well below the peak experienced in the second half of 2008. There was a decrease in the unsecured impairment charge, reflecting continued improving portfolio trends resulting from application of the Group s risk appetite, management actions taken over 2009 and 2010, and stable unemployment. Unsecured impaired loans decreased as a result of fewer cases going into arrears, improved quality of new business and increased write off of impaired loans.

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

The Commercial impairment charge was lower, again reflecting some stabilisation in the UK economy and the benefit to customers of the low interest rate environment.

The impairment charge in respect of loans and advances to banks improved by £10 million to a credit of £13 million compared to a credit of £3 million in 2009; this reflected releases in respect of a small number of specific exposures. The impairment charge in respect of debt securities classified as loans and receivables decreased by £191 million, or 77 per cent, to £57 million in 2010 compared to £248 million in 2009. Impairment losses in respect of available-for-sale financial assets were £496 million lower at £106 million in 2010 compared to £602 million in 2009. The charge in respect of other credit risk provisions was £32 million, or 74 per cent, higher at £75 million in 2010 compared to £43 million in 2009, as a result of a small number of specific new cases that arose in 2010.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

TAXATION

	2011 £m	2010 £m	2009 £m
UK corporation tax:			
Current tax on profits for the year	**(93)**	(146)	(227)
Adjustments in respect of prior years	**(146)**	310	(310)
	(239)	164	(537)
Double taxation relief		1	10
	(239)	165	(527)
Foreign tax:			
Current tax on profits for the year	**(90)**	(82)	(221)
Adjustments in respect of prior years	**36**	49	40
	(54)	(33)	(181)
Current tax credit (charge)	**(293)**	132	(708)
Deferred tax	**257**	193	2,619
Taxation (charge) credit	**(36)**	325	1,911

2011 COMPARED WITH 2010

The rate of tax is influenced by the geographic and business mix of profits. In 2011, a tax charge of £36 million arose on the loss before tax of £342 million and in 2010 a tax credit of £325 million arose on the loss before tax of £2,919 million. The statutory corporation tax rates were 26.5 per cent for 2011 and 28.0 per cent for 2010. The Group s tax charge or credit is distorted, in particular, by the requirement to include, within income tax in the income statement, the tax attributable to UK life insurance policyholder earnings and the Group s interests in Open Ended Investment Companies. The tax attributable to UK life insurance policyholder earnings and the Group s interest in Open Ended Investment Companies was a credit of £72 million in 2011 and a charge of £315 million in 2010. The changes in UK corporation tax rates lead to an additional charge of £420 million in 2011 (2010: £169 million) and in both years there was an additional charge arising in respect of tax losses where no deferred tax has been recognised (2011: £261 million; 2010: £487 million) but in 2011 this was more than offset by a credit of £332 million from the recognition of tax losses not previously recognised. The Group does not expect the tax rate, excluding the impact of policyholders tax and Open Ended Investment Companies, to vary significantly from the average UK corporation tax rate.

2010 COMPARED WITH 2009

In 2010, a tax credit of £325 million arose on a loss before tax of £2,919 million and in 2009 a tax credit of £1,911 million arose on a profit before tax of £1,042 million. The statutory corporation tax rate was 28 per cent in both years. The tax attributable to UK life insurance policyholder earnings and the Group s interest in Open Ended Investment Companies was a charge of £315 million for 2010 compared to a charge of £410 million in 2009. The tax position in 2009 was also particularly distorted by the gain on acquisition of £11,173 million, which did not attract a tax charge. In both 2010 and 2009, there was also an impact from tax losses, mostly in overseas jurisdictions, where deferred tax assets were not recognised, leading to an additional charge of £487 million in 2010 (2009: £332 million). The remainder of the variation in effective tax rates reflected normal fluctuations in disallowed and non-taxable items.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

INTEGRATION COSTS AND BENEFITS

The Group successfully achieved the Integration programme target of delivering run-rate cost synergies and other operating efficiencies of £2 billion per annum from the programme by the end of 2011.

The sustainable run-rate synergies achieved as at 31 December 2011 totalled £2,054 million, excluding a number of one-off savings. The table below analyses the run-rate synergies as at 31 December 2011 by division.

	2011		
	Synergy run-rate as at 31 December 2011 £m	**Allocation of Group Operations run-rate to divisions £m**	**Run-rate by market facing division £m**
Retail	**346**	**454**	**800**
Wholesale and Commercial	**324**	**270**	**594**
Wealth and International	**273**	**31**	**304**
Insurance	**204**	**59**	**263**
Group Operations	**857**	**(857)**	
Central items	**50**	**43**	**93**
Total	**2,054**		**2,054**

Cost synergies have been delivered through the integration of HBOS operations, processes and IT systems. These synergies have arisen through procurement; property with 83 head office sites vacated; IT cost savings and job reductions.

Integration costs of £1,097 million were incurred in the year and have been excluded from the combined businesses results. This brings the total integration costs since the HBOS acquisition to £3,846 million.

Migrating the business systems to a single platform

2011 saw the single biggest event of the Integration programme with the successful migration of the core business systems to a single IT platform. The Group has moved 30 million customer accounts and transferred 35 billion pieces of data between systems successfully. This has been one of the largest ever financial services IT integrations and at its peak it involved many thousands of colleagues across the organisation.

There were three major components to the system migrations:

- The Lloyds TSB Branch Counter System (ICS) was introduced to all Halifax and Bank of Scotland branches and 3,800 HBOS Automated Teller Machines (ATMs) and 667 Intelligent Deposit Machines (IDMs) were moved across to the Lloyds Banking Group IT network.
- The market leading Mortgage Sales Platform, already in use in Halifax and Bank of Scotland branches, was successfully rolled out to 800 Lloyds TSB mortgage advisors in England and Wales.
- In September 2011 30 million HBOS current accounts and savings accounts and Commercial and UK Private Banking accounts, were migrated onto the Lloyds Banking Group IT system. This customer data migration was successfully achieved after five proving cycles, 11 dress rehearsals including two full trial account migrations, over 250,000 business tests and 27,000 colleagues trained totalling 1.5 million hours.

The vast majority of integration activity is now complete, with a handful of peripheral migrations to be completed in 2012.

SIMPLIFICATION COSTS AND BENEFITS

The successful delivery of the Integration programme has provided a platform and single set of processes that now enables the Group to commence its next transformational journey. A core element of this transformational agenda is the Simplification programme. The programme is structured around four key initiatives:

- Operations & Processes getting processes right end-to-end, with the right IT in the right places.
- Sourcing better understanding needs across the Group and getting the right deals from suppliers.
- Organisation focusing on how the Group is structured and the way it works.
- Channels and Products simplifying products whilst continuing to improve and innovate channels.

The programme is well underway having achieved £178 million of Simplification and other cost savings in 2011, equivalent to an annual run-rate saving of £242 million. The programme is now targeting £1.7 billion of savings by 2014, an increase of £0.2 billion over previous guidance.

Simplification costs of £185 million were incurred in the year and have been excluded from the combined businesses results.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LINE OF BUSINESS INFORMATION

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

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

The segmental results and comparatives are presented on the basis reviewed by the chief operating decision maker and as a consequence include the pre-acquisition results of HBOS for the period from 1 January 2009 to 16 January 2009; during 2011 the chief operating decision maker has commenced reviewing the results of the Group s Commercial business separately to the Wholesale segment. As a consequence, the Group s activities are now organised into five financial reporting segments: Retail, Wholesale, Commercial, Wealth and International and Insurance.

During the third quarter of 2011, the Group implemented a new approach to its allocation methodologies for funding costs and capital that ensures that the cost of funding is more fully reflected in each segment s results. The new methodology is designed to ensure that funding costs are allocated to the segments and that the allocation is more directly related to the size and behavioural duration of asset portfolios, with a similar approach applied to recognise the value to the business from the Group s growing deposit base. Comparative figures have been restated accordingly.

Comparisons of results on a historical consolidated statutory basis are dominated by the impact of the acquisition of HBOS as the 2009 statutory results include the results of HBOS from 16 January 2009, together with the effects of the unwind of fair value adjustments made to the HBOS balance sheet on acquisition. In order to provide more meaningful and relevant comparatives, the results of the Group and divisions are presented on a combined businesses basis. The key principles adopted in the preparation of the combined businesses basis of reporting are described below.

- In order to reflect the impact of the acquisition of HBOS, the following adjustments have been made:
  - the 2009 results assume HBOS had been owned throughout that year;
  - the gain on acquisition of HBOS (in 2009) and amortisation of purchased intangible assets have been excluded; and
  - the unwind of acquisition-related fair value adjustments is shown as one line in the combined businesses income statements.
- In order to better present business performance the effects of liability management, volatile items and asset sales are shown on a separate line in the combined businesses income statement and the following items, not related to acquisition accounting, have also been excluded:
  - integration, simplification and EC mandated retail business disposal costs;
  - volatility arising in insurance businesses;
  - insurance gross-up;
  - goodwill impairment;
  - the provision in relation to German insurance business litigation;
  - the payment protection insurance provision;
  - the customer goodwill payments provision;

the curtailment gain in 2010 in respect of the Group s defined benefit pension schemes;

the loss on disposal of businesses in 2010; and

the Government Asset Protection Scheme (GAPS) fee paid in December 2009.

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

The results of the businesses are set out below:

	2011	2010[1]	2009[1]
	£m	£m	£m
Retail	**3,636**	3,986	955
Wholesale	**828**	2,514	(4,682)
Commercial	**499**	291	(200)
Wealth and International	**(3,936)**	(4,950)	(2,433)
Insurance	**1,422**	1,326	1,203
Group Operations and Central items:			
Group Operations	**(56)**	(52)	(143)
Central items	**292**	(903)	(1,000)
	236	(955)	(1,143)
Profit (loss) before tax combined businesses	**2,685**	2,212	(6,300)

1 As discussed above, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

	Note	**2011 £m**	2010 £m	2009 £m
Profit (loss) before tax combined businesses		**2,685**	2,212	(6,300)
Integration, simplification and EC mandated retail business disposal costs	1	**(1,452)**	(1,653)	(1,096)
Volatility arising in insurance businesses	2	**(838)**	306	478
Amortisation of purchased intangibles and goodwill impairment	4	**(562)**	(629)	(993)
Provision in relation to German insurance business litigation	5	**(175)**		
Payment protection insurance provision	6		(3,200)	
Customer goodwill payments provision	7		(500)	
Curtailment gain in respect of defined benefit pension schemes	8		910	
Loss on disposal of businesses	9		(365)	
Pre-acquisition results of HBOS plc	11			280
Negative goodwill credit	12			11,173
Government Asset Protection Scheme fee	13			(2,500)
(Loss) profit before tax statutory		**(342)**	(2,919)	1,042

1. Integration, simplification and EC mandated retail business disposal costs

Integration and simplification costs of £1,097 million and £185 million respectively were incurred in 2011 compared with integration costs of £1,653 million in 2010 and £1,096 million in 2009; these relate primarily to migrating business systems to a single IT platform, including the single biggest event of the Integration programme. The major components were migrating 30 million HBOS accounts onto the Lloyds Banking Group IT system, introduction of the Lloyds TSB Branch counter system to Halifax and Bank of Scotland branches and roll out of the HBOS mortgage sales platform to Lloyds TSB mortgage advisors. The vast majority of the integration activity is now complete, with a handful of peripheral migrations to be completed in 2012.

As part of the European Commission s decision approving state aid to the Group, the Group is required to dispose of a retail banking business with at least 600 branches, a 4.6 per cent share of the personal current accounts market in the UK and up to 19.2 per cent of Lloyds Banking Group s mortgage assets. This business is to be disposed of before the end of November 2013 and consists of the TSB brand, the branches, savings accounts and branch-based mortgages of Cheltenham & Gloucester, the branches and branch-based customers of Lloyds TSB Scotland and a related banking licence, additional Lloyds TSB branches in England and Wales, with branch-based customers and Intelligent Finance. Costs incurred in relation to this disposal in the year ended 31 December 2011 totalled £170 million (2010: £nil; 2009: £nil).

2. Volatility arising in insurance businesses

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

In 2011, the Group s statutory result before tax included negative insurance and policyholder interests volatility totalling £838 million compared to positive volatility of £306 million in 2010 and £478 million in 2009.

Volatility comprises the following:

	2011 £m	2010 £m	2009 £m
Insurance volatility	**(557)**	100	237
Policyholder interests volatility	**(283)**	216	298
Insurance hedging arrangements	**2**	(10)	(57)
Total	**(838)**	306	478

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

The most significant limitations associated with excluding volatility from the combined businesses results are:

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

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

Management compensates for the limitations above by:

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

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Insurance volatility

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

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

United Kingdom (Sterling)	**2012**	**2011**	2010	2009
	%	**%**	%	%
Gilt yields (gross)	**2.48**	**3.99**	4.45	3.74
Equity returns (gross)	**5.48**	**6.99**	7.45	6.74
Dividend yield	**3.00**	**3.00**	3.00	3.00
Property return (gross)	**5.48**	**6.99**	7.45	6.74
Corporate bonds in unit-linked and with-profit funds (gross)	**3.08**	**4.59**	5.05	4.34
Fixed interest investments backing annuity liabilities (gross)	**3.89**	**4.78**	5.30	5.72

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

The liabilities in respect of the Group s UK annuity business are matched by a portfolio of fixed interest securities, including a large proportion of corporate bonds. In accordance with the approach adopted in previous years, the value of in-force business for the UK annuity business has been calculated after taking into account an estimate of the market premium for illiquidity in respect of corporate bond holdings. The illiquidity premium is estimated to be 119 basis points as at 31 December 2011 (31 December 2010: 75 basis points; 31 December 2009: 75 basis points). The insurance businesses experienced negative volatility of £557 million during 2011, compared to positive volatility of £100 million in 2010 and £237 million in 2009. The negative insurance volatility during the year ended 31 December 2011 primarily reflected the underperformance of equity markets in the second half of 2011 and lower cash returns compared to long-term expectations. The positive volatility of £100 million in 2010 was primarily driven by strong performance of equity and property investments relative to the expected return. During 2010, equity market values had increased by 9 per cent and property returns had reached 19 per cent. Partly offsetting this were lower than expected returns on cash and fixed interest assets. This benefit in 2010 was lower than the £237 million positive volatility reported in 2009, as 2009 included significant benefits from reductions in corporate bond spreads, which did not occur in 2010, and greater out-performance of equity markets (during 2009, equities recovered by 22 per cent); these increases in 2009 being only partly offset by a reduction in gilts, reflecting an increase in yields and a reduction in property values of 6.6 per cent.

Policyholder interests volatility

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

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

During the year ended 31 December 2011, the statutory profit before tax included a charge to other income of £283 million which related to the policyholder interests volatility (2010: credits of £216 million in other income; 2009: charge of £298 million in other income). The charge in 2011 included the impact of deferred tax asset impairments due to less optimistic economic forecasts and changes in expected policyholder tax provisions. Policyholder tax liabilities increased during 2011 and led to a tax charge during the period. Strong market conditions in the latter part of 2010 had resulted in increased policyholder tax liabilities and led to a policyholder tax charge of £315 million (2009: charge of £410 million) for the year in the Group s tax charge. The market recovery in 2009 had increased policyholder tax liabilities and led to a policyholder tax charge during that year in the Group s tax charge; although this was partly offset by a credit relating to differences in the expected levels of policyholder tax provisions and charges.

Group hedging arrangements

The statutory results for the year ended 31 December 2011 also include a credit in relation to the Group s insurance hedging arrangements of £2 million (2010: charge of £10 million; 2009: charge of £57 million). To protect against further deterioration in equity market conditions, and the consequent negative impact on the value of in-force business on the Group balance sheet, the Group has been purchasing put option contracts since 2009.

The contracts purchased in 2009 led to a charge of £57 million in the year ended 31 December 2009 and expired in January 2010, resulting in a charge of £7 million in the year ended 31 December 2010. New protection against significant market falls, using option contracts, was acquired by the Group in January 2010, financed by selling some upside potential from equity market movements. There was no initial cost associated with these hedging arrangements. On a mark-to-market basis a loss of £3 million was recognised on these contracts in the year ended 31 December 2010. These contracts expired in January 2011, at which point a further charge of £3 million was recognised in the year ended 31 December 2011; again these contracts were replaced and a mark-to-market gain of £5 million has been recognised for the remainder of 2011.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

3. Insurance gross-up

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

4. Amortisation of purchased intangibles and goodwill impairment

A total of £4,650 million of customer-related intangibles, brands, core deposit intangibles and purchased credit card relationships were recognised on the acquisition of HBOS in 2009 and these are being amortised over their estimated useful lives, where this has been determined to be finite. This has resulted in a charge of £562 million in the year ended 31 December 2011 (2010: £629 million; 2009: £753 million).

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

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

5. Provision in relation to German insurance business litigation

Clerical Medical Investment Group Limited (CMIG) has received a number of claims in the German courts, relating to policies issued by CMIG but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. CMIG has won the majority of decisions to date, although a small number of regional district and appeal courts have found against CMIG on specific grounds. CMIG s strategy includes defending claims robustly and appealing against adverse judgments. The ultimate financial effect, which could be significant, will only be known once all relevant claims have been resolved. However, consistent with this strategy, and having regard to the costs involved in managing these claims, and the inherent risks of litigation, the Group has recognised a provision of £175 million. Management believes this represents the most appropriate estimate of the financial impact, based upon a series of assumptions, including the number of claims received, the proportion upheld, and resulting legal and administration costs.

6. Payment protection insurance provision

There has been intensive scrutiny of the payment protection insurance (PPI) market in recent years. On 8 October 2010, the British Bankers Association (BBA), the principal trade association for the UK banking and financial services sector, filed an application for permission to seek judicial review against the FSA and the FOS. The BBA sought an order quashing the FSA Policy Statement and an order quashing the decision of the FOS to determine PPI sales in accordance with the guidance published on its website in November 2008. The Judicial Review hearing was held in January 2011 and on 20 April 2011 judgment was handed down by the High Court dismissing the BBA s application. After publication of the judgment, the Group entered into discussions with the FSA with a view to seeking clarity around the detailed implementation of the Policy Statement. As a result, and given the initial analysis that the Group conducted of compliance with applicable sales standards, which is continuing, the Group concluded that there are certain circumstances where customer contact and/or redress will be appropriate. Accordingly the Group made a provision in its financial statements for the year ended 31 December 2010 of £3,200 million in respect of the anticipated costs of such contact and/or redress, including administration expenses.

7. Customer goodwill payments provision

Following discussions with the FSA regarding the application of an interest rate variation clause in certain Bank of Scotland plc variable rate mortgage contracts, Bank of Scotland plc applied for a Voluntary Variation of Permission (VVOP) in February 2011 and agreed to initiate a customer review and contact programme and to make goodwill payments to affected customers. The Group made a provision of £500 million in respect of this matter during the year ended 31 December 2010. Since that time further information has become available which has resulted in Bank of Scotland plc applying for, and being granted, an amended VVOP by the FSA in November 2011. No additional provision was required during the year ended 31 December 2011.

8. Curtailment gain in respect of defined benefit pension schemes

Following changes by the Group to the terms of its UK defined benefit pension schemes, all future increases to pensionable salary will be capped each year at the lower of: Retail Prices Index inflation; each employee s actual percentage increase in pay; and 2 per cent of pensionable pay. In addition to this, during the second half of 2010 there was a change in commutation factors in certain defined benefit schemes. The combined effect of these changes was a reduction in the Group s defined benefit obligation of £1,081 million and a reduction in the Group s unrecognised actuarial losses of £171 million, resulting in a net curtailment gain of £910 million recognised in the income statement in the year ended 31 December 2010 and an equivalent reduction in the balance sheet liability.

9. Loss on disposal of businesses

During 2009, the Group acquired an oil drilling rig construction business through a previous lending relationship and consolidated the results and net assets of the business from the date it exercised control. In the first half of 2010, as a result of a deteriorating market, the Group impaired the oil drilling rigs under construction held by the business by £150 million to reflect their reduced value in use. This impairment was recognised in the Wholesale segment. In the second half of 2010, the Group reached agreement to dispose of its interests in the two wholly-owned subsidiary companies through which this business operates; the sale was completed in January 2011. The Group extended vendor financing, on normal commercial terms and negotiated on an arms length basis, to facilitate the acquisition of the rig holding companies. The loan is not contingent on the performance of the oil rigs under construction. Accordingly, as at 31 December 2010, the subsidiaries were derecognised.

10. Unwind of acquisition-related fair value adjustments

The statutory (IFRS) and the combined businesses income statements include the impact of the acquisition-related adjustments arising from the acquisition of HBOS in 2009. On a statutory (IFRS) basis the acquisition-related adjustments affect a number of line items whereas the Group s combined businesses basis presents the aggregate of the impact of these adjustments on the Group s income statement.

The principal financial effects of the fair value unwind are to reflect the effective interest rates applicable at the date of acquisition, on assets and liabilities that were acquired at values that differed from their original book value, and to recognise the reversal of credit and liquidity risk adjustments as underlying instruments mature, are disposed of or become impaired. Generally, this leads to: higher interest expense as the value of HBOS s own debt accretes to par; higher other income arising on sale of debt securities from the pre-acquisition HBOS available-for-sale portfolio, as the gain or loss on sale is not reduced by re-cycling the pre-acquisition negative fair value movements reflected in reserves; and a lower impairment charge reflecting the impact of acquisition balance sheet valuation adjustments.

Further information on the drivers of the fair value unwind is included in the commentary on the segment performance in the Operating and Financial Review.

11. Pre-acquisition results of HBOS plc

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

12. Negative goodwill credit

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

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

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

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

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

13. Government Asset Protection Scheme fee

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

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RETAIL

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

Retail is focused on effectively meeting the needs of its customers. The division provides current accounts including packaged accounts and basic and social banking accounts. It is also the largest provider of personal loans in the UK, as well as being the UK s leading credit card issuer. Retail provides one in five new residential mortgages making it one of the leading UK mortgage lenders and provided over 52,000 mortgages to help first time buyers in 2011. Retail is the largest private sector savings provider in the UK. It is also a major general insurance and Bancassurance distributor, offering a wide range of long-term savings, investment and general insurance products.

	2011	2010[1]	2009[1]
	£m	£m	£m
Net interest income	**7,497**	8,648	7,543
Other income	**1,649**	1,607	1,804
Effects of liability management, volatile items and asset sales	**48**		
Total income	**9,194**	10,255	9,347
Operating expenses	**(4,438)**	(4,644)	(4,566)
Trading surplus	**4,756**	5,611	4,781
Impairment	**(1,970)**	(2,747)	(4,227)
Share of results of joint ventures and associates	**11**	17	(6)
Profit before tax and fair value unwind	**2,797**	2,881	548
Fair value unwind	**839**	1,105	407
Profit before tax	**3,636**	3,986	955

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

2011 COMPARED WITH 2010

Profit before tax for Retail in 2011 of £3,636 million was £350 million, or 9 per cent, lower than 2010.

Profit before tax and fair value unwind decreased to £2,797 million, a reduction of 3 per cent compared to 2010, driven by higher funding costs and the muted demand for credit.

Total income decreased by £1,061 million, or 10 per cent, to £9,194 million. This was driven by a reduction in net interest income of £1,151 million, while other income increased by £42 million.

Net interest income reduced by 13 per cent compared to 2010. One of the main drivers was the increase in wholesale funding costs which were not matched by average customer rates. Net interest margin in 2011 decreased by 22 basis points to 2.09 per cent. Income growth was also constrained by muted demand for credit. Previous de-risking of the lending portfolio, with a resulting reduction in unsecured balances, also contributed to the reduction in income albeit with a proportionately greater reduction in impairment. Net interest margin, minus impairment rate, remained stable reflecting progress in de-risking the balance sheet. Finally, increased competition for deposits and strong balance growth resulted in an increase in the average rate paid on customer deposits.

Other income increased by 3 per cent in 2011 to £1,649 million from £1,607 million largely as a result of higher bancassurance income, driven by an increase in the value of protection products sold through the branch network. Total income also includes the gain on the disposal of VISA Inc shares.

Operating expenses and other costs fell by 4 per cent compared to 2010 and the cost:income ratio was 48.3 per cent (2010: 45.3 per cent). Operating expenses benefited from integration activities, the start of the simplification programme, and other day-to-day cost management activities to offset inflation. The Group continues to invest in the Retail business to improve products and services for its customers including digital platforms and branches. During 2011 Retail completed a major milestone in the

Integration programme, the consolidation of its main Retail product systems. This now creates a solid platform to deliver the simplification programme.

Credit performance across the business continued to be supported by a conservative approach to risk, a continued focus on existing customers and low interest rates. The impairment charge on loans and advances decreased by £777 million, or 28 per cent, to £1,970 million driven by reductions in the unsecured charge. The unsecured impairment charge reduced to £1,507 million from £2,455 million in 2010, reflecting the impact of the continued conservative approach to risk (resulting in improved new business quality), effective portfolio management and a reduction in unsecured balances. The secured impairment charge increased to £463 million from £292 million in 2010 largely reflecting a less certain outlook on house prices and appropriate provisioning against existing credit risks which have longer emergence periods due to current low interest rates. These factors were partially offset by underlying improvement in the quality of the secured portfolio.

The fair value unwind net credit was £839 million compared with £1,105 million in 2010. This reduction was driven largely by the maturing balances of the pre-acquisition portfolio.

Total customer balances remained stable at £599,900 million as Retail continued to maintain its relationships with customers. The mix of these balances continued to move towards customer deposits as customers continued to reduce their personal indebtedness and Retail continued to make strong progress in attracting savings balances. This change in customer balance composition has additionally supported the Group s funding although it has also contributed to a reduction in income and profit.

Loans and advances to customers decreased by £10,919 million, or 3 per cent, to £352,812 million, compared to 31 December 2010. This was driven by reduced customer demand for new credit, existing customers continuing to reduce their personal indebtedness, run off of lending outside of the Group s risk appetite and Retail maintaining a conservative approach to risk. The reduction in lending to customers was in part due to the repayment of unsecured debt where balances reduced by £2,719 million, or 10 per cent. Secured balances reduced by £8,200 million, or 2 per cent. The proportion of mortgages on standard variable rate, or equivalent products, now stands at 56 per cent and is expected to remain broadly stable in 2012.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Retail s gross mortgage lending was £27,977 million in 2011 which was equivalent to a market share of 20 per cent. Retail s new mortgage lending continued to be focused on home purchase with 70 per cent of lending being for house purchase rather than re-mortgaging.

Total customer deposits increased by £11,497 million, or 5 per cent, to £247,088 million in 2011. This increase was largely driven by strong growth in tax free cash ISA balances. Retail continues to perform well in the savings market despite the high levels of competition, with a strong stable of savings brands providing customers with an award winning range of products to meet their savings needs.

2010 COMPARED WITH 2009

Profit before tax from Retail was £3,031 million higher at £3,986 million compared to £955 million in 2009; profit in 2010 included £1,105 million in respect of the unwinding of the fair value adjustments arising on the acquisition of HBOS plc by the Group compared with £407 million in 2009.

Profit before tax and fair value unwind increased by £2,333 million to £2,881 million in 2010 compared to £548 million in 2009. This increase in profit was driven by higher income and a significant reduction in impairment losses, in the context of a stabilising economy, partly offset by an increase in operating expenses.

Total income increased by £908 million, or 10 per cent, to £10,255 million compared with £9,347 million in 2009 reflecting an increase in net interest income of £1,105 million, partially offset by a reduction in other income of £197 million.

Net interest income increased by 15 per cent. The net interest margin was 2.31 per cent compared with 1.95 per cent in 2009. Asset margins expanded in 2010 as a result of decreases in the LIBOR to base rate spread and stable customer interest rates. The asset margin also widened partly as a result of mortgage customers continuing to move onto, and staying on, standard variable rates and assets being priced to more appropriately reflect risk, offset by rising funding costs. The liability margin, on the other hand, has reduced as the effect of lower LIBOR to base rate spreads was partially offset by the reduction of expensive deposit balances.

Lending to customers in Retail, net of impairment provisions and fair value adjustments, was £7,327 million, or 2 per cent, lower at £363,731 million at the end of 2010 compared with £371,058 million at 31 December 2009. This reflected reduced customer demand for credit and customers continuing to reduce their personal indebtedness.

Retail s gross new mortgage lending was £30,113 million in 2010 representing a market share of 22.1 per cent. New mortgage lending continued to be focused on supporting the housing market, with 70 per cent of the lending being for house purchase rather than re-mortgaging. Retail remained the largest lender to first time buyers in the market helping over 50,000 customers to buy their first home. It also continued to be an industry leader in its support for shared equity and shared ownership schemes. Average loan-to-value on new mortgage lending in 2010 was 60.9 per cent compared with 59.3 per cent in 2009, whilst average indexed loan-to-value on the mortgage portfolio was 55.6 per cent at 31 December 2010 compared with 54.8 per cent at 31 December 2009 and reflected the net fall in house prices in 2010.

Total customer deposits were £11,442 million, or 5 per cent, higher at £235,591 million at 31 December 2010 compared with £224,149 million at the end of 2009. The growth was predominantly from instant access and tax free cash ISA accounts, rather than more expensive term deposits. Retail continued to perform well in the savings market, with a strong stable of savings brands which can be tailored to customer demands.

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

Operating expenses increased by £78 million, or 2 per cent, to £4,644 million compared with £4,566 million in 2009. This was against a background of an increase in total income of 10 per cent and reflected ongoing cost control and synergies from the integration. The cost:income ratio for the year ended 31 December 2010 was 45.3 per cent compared to 48.8 per cent in 2009.

Impairment losses decreased by £1,480 million, or 35 per cent, to £2,747 million in 2010 compared with £4,227 million in 2009. Impairment losses as a percentage of average loans and advances to customers were 0.74 per cent in 2010 compared with 1.11 per cent in 2009. This reduction was driven primarily by the improved quality of new business and effective portfolio management, combined with the continued slow recovery of the economy. Across Retail in 2010, there were fewer cases going into arrears.

Unsecured impairment losses reduced by £983 million to £2,455 million compared with £3,438 million in 2009. This reflected a continuation of the improving portfolio trends resulting from the Group s prudent risk appetite, with a focus on lending towards existing customers, combined with stable unemployment. Secured impairment losses of £292 million, compared with £789 million in 2009, reflected a reduction in impaired loans and improved arrears in 2010, together with the stabilising economy, more stable house prices, low interest rates and prudent lending criteria.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Impaired loans in the unsecured portfolio decreased by £838 million to £2,981 million which represented 10.7 per cent of closing loans and advances to customers at 31 December 2010, compared with 11.9 per cent at 31 December 2009. The movement in impaired loans is consistent with the trends seen in both the flow of accounts to arrears and arrears balances, both of which have fallen across all unsecured products during 2010. This is a result of tightening credit policy across the credit lifecycle, including stronger controls on customer affordability, set against a stable economic environment. Retail s exposure to revolving credit products has been actively managed to ensure that it is appropriate to customers changing financial circumstances. The portfolios results are supported by pre-recessionary levels of early arrears for accounts acquired in the last two years, highlighting an underlying improvement in the risk profile of the business. Impairment provisions decreased by £606 million, compared with 31 December 2009, to £1,507 million. Impairment provisions, as a percentage of impaired loans, decreased to 50.6 per cent at 31 December 2010 from 55.3 per cent at 31 December 2009, largely driven by more stringent criteria for new and existing unsecured collections repayment plans resulting in highly provided assets being written off.

Impaired loans in the secured portfolio decreased by £427 million to £6,769 million at 31 December 2010 and, as a percentage of closing loans and advances to customers, reduced to 2.0 per cent from 2.1 per cent at 31 December 2009. The reduction in impaired loans reflects the continued ability of customers to afford their mortgage payments in a low interest rate environment. The number of customers going into arrears remained stable throughout 2010. In the second half of 2010 fewer accounts in arrears returned to order, resulting in higher early arrears balances for 31 December 2010 compared to 30 June 2010. As reported at the 2009 year end, Specialist lending remained closed to new business and this book is in run-off.

The fair value unwind was a net credit of £1,105 million compared with a net credit of £407 million in 2009. The net fair value unwind was larger in 2010 than in 2009 and reflected a smaller charge related to the fixed rate mortgage portfolios as mortgages reached the end of their fixed term and borrowers moved to standard variable products. This was partially offset by a reduction in the credit attributed to the fixed rate savings portfolio as fixed rate term deposits, existing prior to acquisition, matured.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

WHOLESALE

The division comprises Wholesale Banking and Markets (WBM), Wholesale Business Support Unit and the Group s Asset Finance business. The Wholesale Banking and Markets business serves corporates with turnover above £15 million, and financial institutions with a range of relationship focused propositions, segmented according to customer need.

Wholesale Banking and Markets businesses are grouped into three areas, coverage and product, with a support function providing centralised coordination of critical business processes and activities.

Coverage comprises of Corporate Banking, Mid Markets and Sales. Corporate Banking is responsible for the overall management of relationships with major corporate and institutional customers principally in the UK. Similarly Mid Markets manages the relationships with mid market corporates, which operate on a pan-UK basis. Sales provides customers with tailor-made risk management solutions through liability, foreign exchange, commodity and interest rate management products.

Product comprises of Capital Markets, Portfolio Management, Trading, Structured Corporate Finance, Transaction Banking, Structured Transactions Group and Lloyds Development Capital. These product units work alongside the coverage teams to provide specialised lending, access to capital markets and multi product financing solutions to WBM s customers. In addition, these product units provide access to financial markets in order to meet the Group s balance sheet management requirements, and provide trading infrastructure to support execution of customer driven risk management transactions.

Wholesale Business Support Unit supports corporate customers that encounter difficulties during economic downturns. Wholesale operates three teams to support customers in such difficulties Corporate, Specialist Finance and Corporate Real Estate.

Asset Finance consists of a number of leasing and speciality lending businesses including Contract Hire (Lex Autolease) and Consumer Finance (Black Horse Motor and Personal Finance).

	2011	2010[1]	2009[1]
	£m	£m	£m
Net interest income	**2,139**	2,847	3,447
Other income	**3,335**	3,974	3,787
Effects of liability management, volatile items and asset sales	**(1,415)**	(295)	(77)
Total income	**4,059**	6,526	7,157
Costs:			
Operating expenses	**(2,518)**	(2,752)	(3,018)
Impairment of tangible fixed assets		(150)	
	(2,518)	(2,902)	(3,018)
Trading surplus	**1,541**	3,624	4,139
Impairment	**(2,901)**	(4,064)	(14,861)
Share of results of joint ventures and associates	**14**	(95)	(720)
Loss before tax and fair value unwind	**(1,346)**	(535)	(11,442)
Fair value unwind	**2,174**	3,049	6,760
Profit (loss) before tax	**828**	2,514	(4,682)

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

2011 COMPARED WITH 2010

Wholesale s profit before tax decreased by £1,686 million, or 67 per cent, to £828 million in 2011, compared to £2,514 million in 2010. The decrease comprised of £2,467 million lower income, an £875 million fall in fair value unwind, partially offset by £384 million lower costs, a £1,163 million decrease in the impairment charge, and the elimination of losses in joint venture businesses. The profit performance was impacted by the effects of net derivative valuation adjustments and asset disposals net of associated fair value unwind.

Wholesale s income performance was impacted by lower asset balances, losses on asset disposals in the year to strengthen the balance sheet and net derivative valuation adjustments. Net derivative valuation adjustments of £718 million were driven primarily by a fall in long-term sterling interest rates and higher market credit spreads. Losses on disposal of £697 million were realised from the disposal of assets and were offset by a related fair value unwind. Excluding these items, income reduced by £1,347 million or 20 per cent, primarily as a consequence of economic and market conditions, which resulted in customer deleveraging, higher funding costs, and lower trading revenues.

	2011	2010	Change
	£m	£m	%
Total income	**4,059**	6,526	(38)
Adjustments to exclude:			
Net derivative valuation adjustments	**718**	42	
Gains and losses on asset sales	**697**	253	
Total income excluding net derivative valuation adjustments and gains and losses on asset sales	**5,474**	6,821	(20)

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Net interest income decreased by £708 million, or 25 per cent, to £2,139 million in 2011 compared to £2,847 million in 2010. The decrease reflects a continued decrease of interest-earning asset balances in line with the Group s targeted balance sheet reduction of loans and advances to customers and banks, debt securities and available-for-sale positions. Net interest income was also adversely affected by higher funding costs. This was partially offset by an increase in the liability margin resulting from the increased market value of deposits.

The net banking margin, which excludes trading activity, decreased by three basis points to 1.56 per cent in 2011 compared to 1.59 per cent in 2010. This principally reflects increased wholesale funding costs, partly offset by customer re-pricing and increased deposit margins and volumes. Asset margins decreased as the benefit of higher customer rates was more than offset by funding costs, whilst liability margins improved.

Other income decreased by £639 million, or 16 per cent, to £3,335 million in 2011 compared to £3,974 million in 2010, mainly reflecting lower income in Asset Finance and reduced trading revenues. The effect of losses on asset disposals from the continued focus on balance sheet reductions and net derivative valuations adjustments due to the increased market implied credit risk associated with customer derivative balances resulted in losses of £1,415 million in 2011 compared to £295 million in 2010.

Operating expenses decreased by £234 million, or 9 per cent, to £2,518 million in 2011 compared to £2,752 million in 2010. The decrease reflected further savings from the Integration programme, lower operating lease depreciation, lower bonus accruals and other ongoing cost management actions to mitigate the impact of inflationary increases. This was partially offset by continued investment in customer facing resources and systems.

The impairment charge decreased by £1,163 million, or 29 per cent, to £2,901 million compared to £4,064 million in 2010, reflecting a sustained decrease since the peak in 2009. As a percentage of average loans and advances to customers, the impairment charge improved to 1.95 per cent in 2011 compared to 2.23 per cent in 2010. This reflected risk management initiatives and lower defaults from continued low interest rates despite a subdued economic environment.

The share of results from joint ventures and associates comprised a profit of £14 million, an improvement of £109 million compared to 2010, due to the non-recurrence of losses and impairments taken in 2010.

Fair value unwind decreased £875 million to £2,174 million in 2011 compared to £3,049 million in 2010 due to lower impairments in the loan book, reduced release on the treasury asset book and a risk based approach to release on certain treasury assets given market conditions, partially offset by favourable exchange rate movements.

2010 COMPARED WITH 2009

Profit before tax from Wholesale improved by £7,196 million to a profit of £2,514 million compared to a loss of £4,682 million in 2009. The improvement of £7,196 million includes a credit of £3,049 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc, which was reduced by £3,711 million compared to £6,760 million in 2009.

Loss before tax and fair value unwind of £535 million improved by £10,907 million from a loss of £11,442 million in 2009. The improvement was driven by a decrease in the impairment charge, a decrease in the negative share of results of joint ventures and associates and a decrease in costs, only partially offset by lower income.

Total income decreased by £631 million, or 9 per cent, to £6,526 million in 2010 due to lower net interest income and the effects of asset sales and net derivative valuation adjustments.

Net interest income was £600 million, or 17 per cent, lower at £2,847 million in 2010 compared to £3,447 million in 2009. The decline in net interest income primarily reflects lower interest-earning asset balances in line with the Group s targeted balance sheet reduction, mainly in loans and advances to customers, debt securities and available-for-sale positions. Net interest income was affected by higher funding costs and lower lending volumes, partly offset by higher customer margins on new business and from re-pricing on renewals.

Banking net interest income, which excludes trading activity, increased by £155 million, to £2,469 million in 2010 compared to £2,314 million in 2009, with the banking net interest margin increasing by 26 basis points to 1.59 per cent in 2010 compared to 1.33 per cent in 2009.

Other income was £187 million, or 5 per cent, higher at £3,974 million in 2010 compared to £3,787 million in 2009. Other income in 2010 benefited from investment gains in Wholesale Equity as a result of stabilisation in market conditions and improved fund investment performance, strong fee income across structuring and capital markets and more favourable performance in Treasury and Trading; although these benefits were partially offset by a decrease in mark-to-market gains in Wholesale Markets, due to lower levels of market movement compared to 2009, and lower operating lease income. The effects of liability management, volatile items and asset sales was a deficit of £295 million in 2010 compared to a deficit of £77 million in 2009. This deterioration primarily reflected the fact that 2010 experienced losses on sale of assets in targeted balance sheet reductions and adverse derivative valuation adjustments.

Operating expenses decreased by £266 million, or 9 per cent, to £2,752 million in 2010 compared to £3,018 million in 2009. The decrease reflected reduced levels of operating lease depreciation and cost savings attributable to the Integration programme. This was partially offset by additional costs in the Business Support Unit and continued investment in customer facing resources and systems.

The impairment charge decreased by £10,797 million to £4,064 million in 2010 compared to £14,861 million in 2009. The impairment charge on loans and advances as a percentage of average loans and advances to customers improved to 2.23 per cent in 2010 compared to 6.38 per cent in 2009. The decrease reflected reductions, notably in the heritage HBOS corporate real estate and real estate-related portfolios and heritage HBOS Corporate (UK and US) portfolios, and write backs from asset disposals, due to the stabilising economic environment, low interest rates which helped to maintain defaults at reduced levels, the stabilisation of UK real estate prices and provisioning against base case assumptions undertaken on the acquired heritage HBOS portfolios in the first half of 2009.

The share of losses from joint ventures and associates comprised a small loss for the year ended 31 December 2010 of £95 million, a decrease of £625 million. This represented a net reduction in both the value and size of the portfolio compared to the prior year. The majority of the portfolio was valued at nil with a remaining portfolio carrying value of approximately £128 million at 31 December 2010.

Wholesale s fair value unwind credit of £3,049 million decreased by £3,711 million in 2010 from £6,760 million in 2009 due to lower impairments in 2010 relating to the HBOS assets that were fair valued on acquisition, partially offset by charges relating to the expected losses on acquired debt securities and by fair value releases on sales.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

COMMERCIAL

The Commercial business serves in excess of a million small and medium sized enterprises (SMEs) and community organisations with turnover up to £15 million. Customers range from start-up enterprises to established corporations, with a range of propositions aligned to customer needs. The business comprises Commercial Banking and Commercial Finance, the invoice discounting and factoring business which also offers hire purchase, leasing and supplier finance products.

Commercial supports the trading, investment and protection needs of business customers, principally in the UK. Its vision is to be the relationship bank of choice across the UK for SME customers; committed to supporting the economy and communities through encouraging enterprise, providing access to finance and fair and transparent pricing. As part of this the business is working to meet Lending Commitments, agreed with the UK Government, with a focus on a through the cycle credit policy and a proactive programme of support. Lloyds Banking Group is investing both in Commercial and in other parts of the Group to enhance products and services to SMEs and support the lives and prospects of customers through their business life cycle.

	2011	2010[1]	2009[1]
	£m	£m	£m
Net interest	**1,251**	1,127	1,084
Other income	**446**	457	489
Total income	**1,697**	1,584	1,573
Operating expenses	**(948)**	(992)	(1,088)
Trading surplus	**749**	592	485
Impairment	**(303)**	(382)	(822)
Profit (loss) before tax and fair value unwind	**446**	210	(337)
Fair value unwind	**53**	81	137
Profit (loss) before tax	**499**	291	(200)

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

2011 COMPARED WITH 2010

Profit before tax increased by £208 million, or 71 per cent, to £499 million in 2011 compared to £291 million in 2010; this was due to higher income, combined with a reduction in impairments and costs.

Total income increased by £113 million, or 7 per cent, to £1,697 milion in 2011 compared to £1,584 million in 2010. Net interest income grew by £124 million, or 11 per cent, to £1,251 million in 2011 compared to £1,127 million in 2010 due largely to the increase in deposit balances, and a higher net interest margin. This deposit balance growth, the beneficial effect of the consequently larger funding surplus, and a more favourable deposit mix were the key drivers behind the 47 basis point increase in banking net interest margin. Other operating income decreased by 2 per cent, reflecting subdued levels of business activity in the early part of the year and reduced levels of money transmission income reflecting the greater use of electronic banking facilities by customers.

Operating expenses reduced by £44 million, or 4 per cent, to £948 million in 2011 compared to £992 million in 2010, primarily as a result of integration cost savings including lower back office staffing requirements.

The impairment charge reduced by £79 million, or 21 per cent, to £303 million in 2011 compared to £382 million in 2010 due to an overall improvement in the credit quality of the portfolio reflected in a reduction in observed default and delinquency rates. This is supported by the success of the specialist relationship support, which helps customers facing difficult business conditions.

Lending to customers in Commercial, net of impairment provisions and fair value adjustments arising from the acquisition of HBOS plc by the Group, was £196 million higher at £28,750 million at 31 December 2011 compared to £28,554 million at the end of 2010. This reflects the continuing support given to small and medium sized businesses, fully offsetting the reduction in assets outside the Group s risk appetite.

Customer deposits have risen by £796 million, or 3 per cent, from £31,311 million at 31 December 2010 to £32,107 million at 31 December 2011. This increase reflects ongoing success in SME recruitment, combined with targeted support in key customer segments such as the education and legal sectors.

Risk-weighted assets decreased by £1,118 million, or 4 per cent, from £26,552 million at 31 December 2010 to £25,434 million at 31 December 2011, reflecting the improved mix and risk profile of the portfolio.

2010 COMPARED WITH 2009

Profit before tax from Commercial increased by £491 million to a profit of £291 million in 2010 compared to a loss of £200 million in 2009. Profit before tax and fair value unwind increased by £547 million to a profit of £210 million in 2010 compared to a loss of £337 million in 2009, largely as a result of lower impairment charges.

Total income increased by £11 million, or 1 per cent, to £1,584 million in 2010 compared to £1,573 million in 2009.

Lending to customers in Commercial, net of impairment provisions and fair value adjustments arising from the acquisition of HBOS plc by the Group, was £73 million lower at £28,554 million at 31 December 2010 compared to £28,627 million at the end of 2009. Customer deposits were £881 million, or 3 per cent, higher at £31,311 million at 31 December 2010 compared to £30,430 million at the end of 2009.

Net interest income was £43 million, or 4 per cent, higher at £1,127 million in 2010 compared to £1,084 million in 2009. The net interest margin, adjusted to exclude products where either the funding costs or the related revenues are recognised in other income, improved by 29 basis points to 3.74 per cent in 2010 compared to 3.45 per cent in 2009.

Other income was £32 million lower at £457 million in 2010 compared to £489 million in 2009, mainly due to a decline in money transmission fees and commission income.

Operating expenses decreased by £96 million, or 9 per cent, to £992 million in 2010 compared to £1,088 million in 2009 as a result of embedded cost savings programmes across Commercial delivering positive results, leading to an improvement in the cost: income ratio to 62.6 per cent in 2010 from 69.2 per cent in 2009.

Impairment losses decreased by £440 million to £382 million in 2010 compared to £822 million in 2009. Impairment losses on loans and advances as a percentage of average loans and advances to customers were 1.24 per cent in 2010 compared to 2.72 per cent in 2009. There was an overall improvement in the credit quality of the portfolio and a reduction in observed default rates.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

WEALTH AND INTERNATIONAL

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

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

	2011	2010[1]	2009[1]
	£m	£m	£m
Net interest income	**828**	1,050	1,140
Other income	**1,197**	1,123	1,128
Effects of liability management, volatile items and asset sales		37	
Total income	**2,025**	2,210	2,268
Operating expenses	**(1,548)**	(1,536)	(1,544)
Trading surplus	**477**	674	724
Impairment	**(4,610)**	(5,988)	(4,078)
Share of results of joint ventures and associates	**3**	(8)	(21)
Loss before tax and fair value unwind	**(4,130)**	(5,322)	(3,375)
Fair value unwind	**194**	372	942
Loss before tax	**(3,936)**	(4,950)	(2,433)
Wealth	**189**	220	198
International	**(4,319)**	(5,542)	(3,573)
Loss before tax and fair value unwind	**(4,130)**	(5,322)	(3,375)

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

2011 COMPARED WITH 2010

Loss before tax and fair value unwind reduced by £1,192 million, or 22 per cent, to £4,130 million in 2011 compared to £5,322 million in 2010 as a lower impairment charge, predominantly in Ireland, more than offset lower income and higher costs.

Total income decreased by £185 million, or 8 per cent, to £2,025 million in 2011 compared to £2,210 in 2010.

Net interest income decreased by £222 million, or 21 per cent, to £828 million in 2011 compared to £1,050 million in 2010. There was a reduction of 25 per cent in constant currency terms. Higher funding costs and the increased strain of impaired assets, reflected in a reduction in net lending margins together with lower lending volumes impacting net interest income were partially offset by the impact of the stronger Australian dollar in International. Deposit margins increased, reflecting changing product mix predominantly as a result of continued deposit inflows in the on-line deposit business at higher margins together with improving margins across the Wealth businesses.

Other income increased by £74 million, or 7 per cent, to £1,197 million in 2011 compared to £1,123 million in 2010 mainly due to foreign exchange benefits in International. Excluding the impact of foreign exchange, other income decreased by 1 per cent.

Operating expenses and other costs increased by £12 million, or 1 per cent to £1,548 million in 2011 compared to £1,536 million in 2010, due to increased investment in the International deposit business, the impact of the stronger Australian dollar and Swiss franc and additional regulatory costs in Wealth. On a constant currency basis, operating expenses reduced by 1 per cent, reflecting cost saving initiatives.

The impairment charge reduced by £1,378 million or 23 per cent, to £4,610 million in 2011 compared to £5,988 million in 2010. Following increased charges in the last quarter of 2010, driven by the significant deterioration in the economic environment in Ireland, the rate of impaired loan migration has slowed in 2011.

The impairment charge within Wealth increased by £54 million to £100 million in 2011 compared to £46 million in 2010 primarily due to increased charges in the Group s Spanish mortgage book reflecting deterioration in the local property markets and economic outlook in Spain.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The impairment charge in International decreased by £1,432 million, or 24 per cent, to £4,510 million in 2011 compared to £5,942 million in 2010.

This impairment charge is analysed by key geography in the following table.

	Impairment charges	
	2011	2010
	£m	£m
Ireland	**3,187**	4,264
Australia	**1,034**	1,362
Wholesale Europe	**204**	210
Latin America/Middle East	**64**	97
Netherlands	**21**	9
	4,510	5,942

The impairment charge reduced by £1,432 million, or 24 per cent, to £4,510 million due to reduced impairment charges in Ireland and Australia.

2010 COMPARED WITH 2009

The results of Wealth and International deteriorated by £2,517 million, or 103 per cent, to a loss before tax of £4,950 million in 2010 compared to a loss of £2,433 million in 2009.

Loss before tax and fair value unwind deteriorated by £1,947 million, or 58 per cent, to £5,322 million compared to a loss of £3,375 million in 2009, due, in particular, to a higher impairment charge, predominantly in Ireland. An improvement in profits in the Wealth business was more than offset by the increased losses in the International business.

Net interest income decreased by £90 million, or 8 per cent, to £1,050 million in 2010 compared to £1,140 million in 2009, as a 12 basis points decline in the banking net interest margin more than offset the favourable impact of foreign currency movements, particularly the Australian dollar, and the income on the £7 billion European loan portfolio transferred in from the Wholesale division in the second half of 2009.

Other income was £32 million, or 3 per cent, higher at £1,160 million in 2010 compared to £1,128 million in 2009. This increase reflected favourable foreign exchange movements and restrained growth in the Wealth business, with lower asset management fee income following the sale of the external fund management business of Insight Investment in November 2009.

Operating expenses decreased by £8 million, or 1 per cent, to £1,536 million in 2010 compared to £1,544 million in 2009, with cost savings achieved from integration, particularly in the asset management businesses in Wealth, partly offset by investment in International s German deposit taking operation, increased risk management resources to manage impaired asset portfolios in Ireland and Australia, costs associated with the closure of the Irish business, and the effect of stronger foreign currency rates.

The impairment charge was £1,910 million, or 47 per cent, higher at £5,988 million in 2010, compared to £4,078 million in 2009, reflecting the material deterioration in the economic environment in Ireland in the last quarter of 2010, that resulted in EU-IMF financial support in late November 2010, and the tightening of liquidity in the second half of 2010 in regional Australian property markets to which the Group is exposed.

The impairment charge is summarised by key geography in the following table.

	2010	2009
	£m	£m
Ireland	**4,264**	2,949
Australia	**1,362**	849
Wholesale Europe	**210**	129
Latin America/Middle East	**97**	69
Netherlands	**9**	11
International	**5,942**	4,007

Wealth	**46**	71
Wealth and International	**5,988**	4,078

Loans and advances to customers decreased by £8,191 million, or 13 per cent, to £55,357 million at 31 December 2010 compared to £63,548 million at the end of 2009, reflecting net repayments of some £4.1 billion, and additional impairment provisions in the International businesses, partly offset by foreign exchange movements of some £1.1 billion.

Customer deposits increased by £3,747 million, or 13 per cent, to £32,784 million at 31 December 2010 compared to £29,037 million at the end of 2009, due to strong inflows in UK Private Banking and Bank of Scotland Germany, partly offset by outflows in Ireland following the closure of the Irish retail branch network.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

INSURANCE

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

Life, Pensions and Investments UK

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

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

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

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

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

Life, Pensions and Investments Europe

The European Life, Pensions and Investments business distributes products primarily in the German market under the Heidelberger Leben and Clerical Medical brands.

General Insurance

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

	2011 **£m**	2010[1] £m	2009[1] £m
Net interest income	**(67)**	(39)	(59)
Other income	**2,687**	2,799	2,944
Effects of liability management, volatile items and asset sales		15	
Total income	**2,620**	2,775	2,885
Insurance claims	**(343)**	(542)	(637)
Total income, net of insurance claims	**2,277**	2,233	2,248
Operating expenses	**(812)**	(854)	(974)
Share of results of joint ventures and associates		(10)	(22)
Profit before tax and fair value unwind	**1,465**	1,369	1,252
Fair value unwind	**(43)**	(43)	(49)
Profit before tax	**1,422**	1,326	1,203
Profit before tax and fair value unwind by business unit			
Life, Pensions and Investments:			
UK business	**886**	830	792
European business	**82**	127	95

Total Life, Pensions and Investments	**968**	957	887
General Insurance	**497**	412	365
Profit before tax and fair value unwind	**1,465**	1,369	1,252

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

2011 COMPARED WITH 2010

Profit before tax from Insurance was £96 million, or 7 per cent higher, at £1,422 million compared to £1,326 million in 2010. In 2010 income was reduced by a non-recurring charge of £70 million in respect of the Group s decision to cease writing new PPI business. Excluding this charge profit before tax and fair value unwind increased by £26 million, or 2 per cent in 2011.

Total income, net of insurance claims, increased by £44 million, or 2 per cent, to £2,277 million from £2,233 million in 2010. This is attributable to strong sales of corporate pensions through the intermediary channel and the continued change in new business mix within Life, Pensions and Investments UK (LP&I UK) towards a more profitable protection business reflecting a focus on meeting customer needs in an area where there is a general level of under provision in the UK. Improved claims experience within General Insurance which has been offset by lower PPI related income is also a significant contributor to this.

Insurance claims of £343 million were £199 million, or 37 per cent lower, than £542 million in 2010, mainly due to improved claims experience as a result of the run off of the PPI business and lower unemployment claims and lower property claims following the severe weather events that impacted January and December 2010.

Operating expenses and other costs decreased by £42 million, or 5 per cent, from £854 million to £812 million due mainly to a continued focus on cost management and delivery of integration cost savings, partly offset by an additional charge in relation to an industry wide Financial Services Compensation Scheme (FSCS) levy in 2011.

2010 COMPARED WITH 2009

Profit before tax from Insurance was £123 million higher, or 10 per cent, at £1,326 million compared to £1,203 million in 2009. Profit before tax and fair value unwind was £117 million higher, or 9 per cent, at £1,369 million compared to £1,252 million in 2009.

Net interest income was £20 million, or 34 per cent, better at a deficit of £39 million in 2010 compared to a deficit of £59 million in 2009.

Other income decreased by £130 million, or 4 per cent, to £2,814 million in 2010 compared to £2,944 million in 2009 largely resulting from the decrease in PPI income as a result of the Group s decision to cease writing payment protection business, partially off-set by improved new business income and the higher than expected return from improved investment markets.

Total income, net of insurance claims, decreased by £15 million, or 1 per cent, to £2,233 million in 2010 compared to £2,248 million in 2009, primarily reflecting lower PPI income and claims arising from the freeze events in 2010, which are offset by reduced payment protection insurance claims and improved investment markets.

Insurance claims were £95 million, or 15 per cent, lower at £542 million in 2010 compared to £637 million in 2009 reflecting improved unemployment claims experience. The home book has been particularly affected by the freeze events experienced in January and December 2010. This was partly offset by the benefits of ongoing claims processing improvements and integration.

Operating expenses decreased by £120 million, or 12 per cent, to £854 million in 2010 compared to £974 million in 2009 due to a continued focus on cost management and delivery of integration synergies.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

LIFE, PENSIONS AND INVESTMENTS
UK BUSINESS

	2011 £m	2010[1] £m	2009[1] £m
Net interest income	**(62)**	(48)	(86)
Other income	**1,458**	1,408	1,474
Total income	**1,396**	1,360	1,388
Operating expenses	**(510)**	(530)	(596)
Profit before tax and fair value unwind	**886**	830	792
Profit before tax and fair value unwind analysis			
New business profit insurance business[2]	**382**	332	328
investment business[2]	**(51)**	(65)	(196)
Total new business profit	**331**	267	132
Existing business profit[3]	**539**	611	606
Experience and assumption changes	**16**	(48)	54
Profit before tax and fair value unwind	**886**	830	792

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

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

3 The disclosure of existing business profit has been changed to better reflect the performance of the business. Existing business profit includes the expected return on shareholder s net assets and experience and assumption changes are disclosed separately.

2011 COMPARED WITH 2010

Total new business profit increased by £64 million, or 24 per cent, to £331 million. The increase is primarily attributable to strong sales of corporate pensions through the intermediary channel, the continued growth of protection business in the bancassurance channel as the Group helps more customers and address the sizeable protection gap that exists in the UK and reduction in lower margin business following the launch of the integrated bancassurance proposition in June 2010.

Existing business profit has decreased by £72 million, or 12 per cent, to £539 million. The decrease predominantly reflects higher interest payments following capital restructuring initiatives, a reduction in the assumed rate of return, and lower levels of shareholder net assets following capital repatriation initiatives in 2010.

The net impact of experience variances and assumption changes has increased to a credit of £16 million in 2011 from a charge of £48 million in 2010. The benefit mainly reflects the absence of the £70 million charge taken in 2010 from the Group s decision to cease writing new PPI business.

2010 COMPARED WITH 2009

Profit before tax and fair value unwind increased by £38 million, or 5 per cent, to £830 million in 2010 compared to £792 million in 2009. New business profit increased by £135 million, or 102 per cent, to £267 million. The increase primarily reflects a reduction in initial commission on OEICs sold through the branch network and cost reductions through integration across the sales channels in addition to progress made on product participation choices.

Existing business profit increased by £5 million, or 1 per cent, to £611 million in 2010 compared to £606 million in 2009. This predominantly reflected higher asset values and a higher assumed rate of return following improved market conditions in the second half of 2009.

Profits arising from experience and assumption changes decreased by £102 million to a loss of £48 million mainly reflecting the non-recurrence of benefits recognised in 2009, including a liability management gain of £30 million. During 2010 a review was undertaken into the charging between the funds of Clerical Medical prior to the acquisition of HBOS, giving rise to a charge of £132 million. In addition, assumptions regarding future maintenance expenses within the Clerical Medical business were aligned to reflect the heritage Lloyds TSB approach, giving rise to a charge of £119 million.

These charges relate to pre-acquisition matters and were largely offset by the release of fair value provisions.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

EUROPEAN BUSINESS

2011 COMPARED WITH 2010

Profit before tax and fair value unwind decreased by £45 million, or 35 per cent, to £82 million in 2011 compared to £127 million in 2010. The reduction is driven largely by a non-recurring charge following clarification by the German regulator (BaFin) surrounding the deduction of tax and policy-holder distributions and experience and assumption charges.

2010 COMPARED WITH 2009

Profit before tax and fair value unwind increased by £32 million, or 34 per cent, to £127 million in 2010 compared to £95 million in 2009 driven largely by experience and assumption changes. New business sales reflected difficult economic and market conditions in Germany, the division s main European market.

NEW BUSINESS

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

		2011			2010			2009	
	UK £m	**Europe £m**	**Total £m**	UK £m	Europe £m	Total £m	UK £m	Europe £m	Total £m
Protection	**708**	**53**	**761**	574	56	630	519	49	568
Payment protection	**21**		**21**	70		70	153		153
Savings and investments	**1,133**	**246**	**1,379**	1,617	315	1,932	2,689	312	3,001
Individual pensions	**1,480**	**144**	**1,624**	1,606	141	1,747	2,275	185	2,460
Corporate and other pensions	**4,423**		**4,423**	2,750		2,750	2,600		2,600
Retirement income	**747**		**747**	889		889	887		887
Managed fund business	**116**		**116**	177		177	146		146
Life and pensions	**8,628**	**443**	**9,071**	7,683	512	8,195	9,269	546	9,815
OEICs	**1,591**		**1,591**	2,633		2,633	3,704		3,704
Total	**10,219**	**443**	**10,662**	10,316	512	10,828	12,973	546	13,519
Analysis by channel									
Intermediary	**6,415**	**443**	**6,858**	5,365	512	5,877	5,639	546	6,185
Bancassurance	**3,216**		**3,216**	4,432		4,432	6,997		6,997
Direct	**588**		**588**	519		519	337		337
Total	**10,219**	**443**	**10,662**	10,316	512	10,828	12,973	546	13,519

2011 COMPARED WITH 2010

Total sales (PVNBP) have reduced by £166 million, or 2 per cent to £10,662 million in 2011 compared to £10,828 million in 2010. New business margins have improved to 4.0 per cent in 2011 from 3.5 per cent in 2010. This partly reflects the launch of the integrated bancassurance proposition in June 2010 which has resulted in a change in mix away from higher single premium savings products towards lower premium, higher margin, protection business.

Despite the reduction in sales total new business profit within LP&I UK increased by £64 million, or 24 per cent, to £331 million.

Sales (PVNBP), excluding OEICs have increased by 11 per cent, and although OEIC sales have decreased by 40 per cent the new business margin on these sales has increased, reflecting the focus on value over volume.

Within the intermediary channel the increase in sales of £981 million, or 17 per cent, mainly reflects strong sales of corporate pensions in LP&I UK. The increase in sales has been achieved whilst maintaining the new business margin on corporate pension business.

In the bancassurance channel the reduction in sales reflects a change in mix away from savings products which generate a higher PVNBP towards protection business, which although more profitable, generates lower PVNBP. Sales of savings products have been particularly affected by recent stock market turbulence and lower consumer confidence, particularly in the second half of the year. Despite the reduction in PVNBP there was an increase in new business profit largely as a result of the increase in protection sales reflecting success in helping customers address their protection needs.

2010 COMPARED WITH 2009

The present value of new business premiums reduced by £2,691 million, or 20 per cent, to £10,828 million in 2010 compared to £13,519 million in 2009. This largely reflected the withdrawal in 2009 of certain HBOS legacy products with lower returns.

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

GENERAL INSURANCE

	2011	2010[1]	2009[1]
	£m	£m	£m
Home insurance	**857**	862	874
Payment protection insurance	**125**	253	349
Other	**53**	70	69
Net operating income	**1,035**	1,185	1,292
Claims paid on insurance contracts (net of reinsurance)	**(343)**	(542)	(637)
Operating income, net of claims	**692**	643	655
Operating expenses	**(195)**	(221)	(268)
Share of results of joint ventures and associates		(10)	(22)
Profit before tax and fair value unwind	**497**	412	365

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

2011 COMPARED WITH 2010

Profit before tax and fair value unwind from General Insurance increased by £85 million, or 21 per cent to £497 million compared to £412 million in 2010. The increase was primarily due to improved PPI claims experience from the run off of this business line, the absence of severe weather related claims as experienced in 2010 and lower expenses.

Total income for home insurance was broadly unchanged from 2010 at £857 million and reflects the maturity and competitiveness of the market.

Claims of £343 million were £199 million, or 37 per cent lower, than £542 million in 2010, mainly due to improved claims experience as a result of the run off of the PPI business and lower unemployment claims and lower property claims following the severe weather events that impacted January and December 2010.

Operating expenses decreased by £26 million, or 12 per cent, to £195 million in 2011 compared to £221 million in 2010 primarily as a result of further delivery of integration savings and a continued focus on cost management.

2010 COMPARED WITH 2009

Profit before tax and fair value unwind from General Insurance increased by £47 million, or 13 per cent, to £412 million in 2010 compared to £365 million in 2009, due primarily to improved unemployment claims experience plus integration synergies, after taking account of lower income resulting from ceasing to write new PPI business and freeze related claims.

Underwriting income for home insurance showed modest growth of £25 million, or 3 per cent, to £922 million in 2010 compared to £897 million in 2009. Home commission payable was adversely affected by the alignment of commission arrangements between the legacy businesses during the year.

PPI underwriting income decreased by £187 million, or 26 per cent, to £544 million in 2010 compared to £731 million in 2009 reflecting the continued impact on new business volumes from the market wide move to monthly premiums in 2009 and the Group s withdrawal from the payment protection market on 23 July 2010. Changes in commission payable reflected lower volumes of PPI written during the year.

Claims were £95 million, or 15 per cent, lower at £542 million in 2010 compared to £637 million in 2009 reflecting lower unemployment claims experience. The home book has been particularly affected by the freeze events experienced in January and December 2010. This has been partly offset by the benefits of ongoing claims processing improvements and integration.

Operating expenses decreased by £47 million, or 18 per cent, to £221 million in 2010 compared to £268 million in 2009 primarily as a result of the alignment of commission arrangements on home insurance, the delivery of integration savings and a continued focus on cost management.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

GROUP OPERATIONS

	2011 £m	2010[1,2] £m	2009[1,2] £m
Total income	**42**	(12)	(43)
Direct costs:			
Information technology	**(1,031)**	(1,204)	(1,249)
Operations	**(596)**	(656)	(704)
Property	**(909)**	(966)	(981)
Sourcing	**(56)**	(58)	(60)
Support functions	**(73)**	(89)	(109)
	(2,665)	(2,973)	(3,103)
Result before recharges to divisions	**(2,623)**	(2,985)	(3,146)
Total net recharges to divisions	**2,567**	2,930	2,978
Share of results of joint ventures and associates		3	3
Loss before tax and fair value unwind	**(56)**	(52)	(165)
Fair value unwind			22
Loss before tax	**(56)**	(52)	(143)

1 As discussed on page 32, divisional results for 2010 and 2009 have been restated to reflect new funding cost and capital allocation methodologies.

2 Comparative figures have also been amended to reflect the centralisation of operations across the Group as part of the integration programme. To ensure a fair comparison of 2011 performance, 2010 and 2009 direct costs have been changed with an equivalent offsetting adjustment in recharges to divisions.

2011 COMPARED WITH 2010

Loss before tax from Group Operations increased by £4 million to £56 million in 2011 compared to £52 million in 2010.

Total income, excluding recharges to divisions, improved by £54 million, to £42 million in 2011 compared to a deficit of £12 million in 2010.

Direct costs were £308 million, or 10 per cent, lower at £2,665 million in 2011 compared to £2,973 million in 2010; this reflected the continued focus on cost management and the delivery of integration synergy savings and Simplification benefits.

Information Technology costs decreased by 14 per cent primarily with integration savings offsetting inflationary savings; Operations costs decreased by 9 per cent through the continuing rationalisation of the major Operations functions; Group Property costs decreased by 6 per cent due to the continuing consolidation of the heritage property portfolios helping to deliver further integration benefits; Group Sourcing costs decreased by 3 per cent and Sourcing has also played a major part in helping to deliver Group wide sourcing synergies.

Support functions costs were £16 million, or 18 per cent, lower at £73 million in 2011 compared to £89 million in 2010.

Recharges to divisions were £363 million lower at £2,567 million in 2011 compared to £2,930 million in 2010.

2010 COMPARED WITH 2009

Loss before tax from Group Operations improved by £91 million to £52 million in 2010 compared to £143 million in 2009. The loss in 2009 included a credit of £22 million in relation to the unwinding of fair value adjustments arising from the acquisition of HBOS plc by the Group. Loss before tax and fair value unwind improved by £113 million to £52 million in 2010 compared to £165 million in 2009.

Total income, excluding recharges to divisions, improved by £31 million, to a deficit of £12 million in 2010 compared to a deficit of £43 million in 2009.

Direct costs were £130 million, or 4 per cent, lower at £2,973 million in 2010 compared to £3,103 million in 2009; this reflected the continued focus on cost management and the delivery of integration savings.

Information Technology costs decreased by 4 per cent primarily due to the further impact of integration benefits; Operations costs decreased by 7 per cent due to the continuing rationalisation of the major Operations functions and lower charges in respect of joint ventures; Group Property costs decreased by 2 per cent due to the continuing consolidation of the heritage property portfolios helping to deliver further integration benefits. Support functions costs were £20 million, or 18 per cent, lower at £89 million in 2010 compared to £109 million in 2009.

Recharges to divisions were £48 million lower at £2,930 million in 2010 compared to £2,978 million in 2009.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

CENTRAL ITEMS

	2011 **£m**	2010[1] £m	2009[1] £m
Net interest income (expense)	**585**	571	(26)
Other income	**(49)**	(73)	(79)
Effects of liability management, volatile items and asset sales	**1,293**	150	1,519
Total income	**1,829**		