Lloyds Banking Group plc
Form 20-F
March 10, 2017

As filed with the Securities and Exchange Commission on 10 March 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

¨ 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 2016

OR

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

OR

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

Commission file number 001-15246

LLOYDS BANKING GROUP plc

(previously Lloyds TSB Group plc)

(Exact name of Registrant as Specified in Its Charter)

Scotland

(Jurisdiction of Incorporation or Organization)

25 Gresham Street
London EC2V 7HN

United Kingdom

(Address of Principal Executive Offices)

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

United Kingdom

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

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

Title of each class	Name of each exchange on which registered
Ordinary shares of nominal value 10 pence each, represented by American Depositary Shares	The New York Stock Exchange
$824,033,000 5.3% Subordinated Securities due 2045	The New York Stock Exchange
$1,250,000,000 3.75% Senior Notes due 2027	The New York Stock Exchange
$1,500,000,000 4.65% Subordinated Securities due 2026	The New York Stock Exchange
$1,327,685,000 4.582% Subordinated Securities due 2025	The New York Stock Exchange
$1,250,000,000 3.5% Senior Notes due 2025	The New York Stock Exchange
$1,000,000,000 4.5% Subordinated Securities due 2024	The New York Stock Exchange
$1,500,000,000 3.0% Senior Notes due 2022	The New York Stock Exchange
$1,000,000,000 3.1% Senior Notes due 2021	The New York Stock Exchange
$2,500,000,000 6.375% Senior Notes due 2021	The New York Stock Exchange
$1,000,000,000 2.7% Senior Notes due 2020	The New York Stock Exchange
$1,000,000,000 2.4% Senior Notes due 2020	The New York Stock Exchange
$1,000,000,000 2.35% Senior Notes due 2019	The New York Stock Exchange
$750,000,000 2.05% Senior Notes due 2019	The New York Stock Exchange
$450,000,000 Floating Rate Notes due 2019	The New York Stock Exchange
$1,000,000,000 2.3% Senior Notes due 2018	The New York Stock Exchange
$700,000,000 2% Senior Notes due 2018	The New York Stock Exchange
$300,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,250,000,000 1.75% Senior Notes due 2018	The New York Stock Exchange
$400,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,000,000,000 1.75% Senior Notes due 2018	The New York Stock Exchange
$500,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,500,000,000 4.20% Senior Notes due 2017	The New York Stock Exchange

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

None

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

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

The number of outstanding shares of each of Lloyds Banking Group plc's classes of capital or common stock as of 31 December 2016 was:

Ordinary shares, nominal value 10 pence each	71,373,735,357
Limited voting shares, nominal value 10 pence each	80,921,051
Preference shares, nominal value 25 pence each	412,204,151
Preference shares, nominal value 25 cents each	809,160
Preference shares, nominal value 25 euro cents each	Nil

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

Yes x No ¨

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 ¨ No x

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

Yes x No ¨

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 ¨ No ¨

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 ¨ Non-Accelerated filer ¨

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

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

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 ¨ Item 18 ¨

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

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

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

Lloyds Banking Group publishes its consolidated financial statements expressed in British pounds (‘pounds sterling’, ‘sterling’ or ‘£’), the lawful currency of the UK. In this annual report, references to ‘pence’ and ‘p’ are to one-hundredth of one pound sterling; references to ‘US dollars’, ‘US$’ or ‘$’ are to the lawful currency of the United States (the US); references to ‘cent’ or ‘c’ are to one-hundredth of one US dollar; references to ‘euro’ or ‘€’ are to the lawful currency of the member states of the European Union (EU) that have adopted a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty of European Union; references to ‘euro cent’ are to one-hundredth of one euro; and references to ‘Japanese yen’, ‘Japanese ¥’ or ‘¥’ are to the lawful currency of Japan. Solely for the convenience of the reader, this annual report contains translations of certain pounds sterling amounts into US dollars at specified rates. These translations should not be construed as representations by Lloyds Banking Group that the pounds sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or at any other rate. Unless otherwise stated, the translations of pounds sterling into US dollars have been made at the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) in effect on 31 December 2016, which was $1.2337 = £1.00. The Noon Buying Rate on 31 December 2016 differs from certain of the actual rates used in the preparation of the consolidated financial statements, which are expressed in pounds sterling, and therefore US dollar amounts appearing in this annual report may differ significantly from actual US dollar amounts which were translated into pounds sterling in the preparation of the consolidated financial statements in accordance with IFRS.

BUSINESS OVERVIEW

Lloyds Banking Group is a leading provider of financial services to individual and business customers in the UK. At 31 December 2016, total Lloyds Banking Group assets were £817,793 million and Lloyds Banking Group had 70,433 employees (on a full-time equivalent basis). Lloyds Banking Group plc's market capitalisation at that date was £44,616 million. The Group reported a profit before tax for the 12 months to 31 December 2016 of £3,888 million, and its capital ratios at that date were 21.2 per cent for total capital, 16.8 per cent for tier 1 capital and 13.4 per cent for common equity tier 1 capital.

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

	2016	2015	2014
	£m	£m	£m
Net interest income	**9,274**	11,318	10,660
Other income	**30,337**	11,832	19,232
Total income	**39,611**	23,150	29,892
Insurance claims	**(22,344)**	(5,729)	(13,493)
Total income, net of insurance claims	**17,267**	17,421	16,399
Operating expenses	**(12,627)**	(15,387)	(13,885)
Trading surplus	**4,640**	2,034	2,514
Impairment	**(752)**	(390)	(752)
Profit before tax	**3,888**	1,644	1,762

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

At 31 December 2016, the Group's four primary operating divisions, which are also reporting segments, were: Retail; Commercial Banking; Consumer Finance and Insurance. Retail provides banking, mortgages and other financial services to personal and small business customers in the UK. Commercial Banking provides banking and related services to business clients, from SMEs to large corporates. Consumer Finance provides a range of products including personal loans, motor finance, credit cards, and European mortgages and deposit taking. Insurance provides long-term savings, protection and investment products as well as general insurance products in the UK.

Profit before tax is analysed on pages 13 to 16 on a statutory basis and, in order to provide a more comparable representation of business performance of the Group's segments, on pages 24 to 34 on an underlying basis. The key principles adopted in the preparation of this basis of reporting are described on page 24. The Group Executive Committee, which is the chief operating decision maker for the Group, reviews the Group's internal reporting based around these segments (which reflect the Group's organisational and management structures) in order to assess performance and allocate resources; this reporting is on an underlying basis. IFRS 8, *Operating Segments* requires that the Group presents its segmental profit before tax on the basis reviewed by the chief operating decision maker that is most consistent with the measurement principles used in measuring the Group's statutory profit before tax. Accordingly, the Group presents its segmental underlying basis profit before tax in note 4 to the financial statements in compliance with IFRS 8. The table below shows the results of Lloyds Banking Group's segments in the last three fiscal years, and their aggregation. Further information on non-GAAP measures and the reconciliations required by the Securities and Exchange Commission's Regulation G are set out on pages F-19 to F-22.

	2016	2015 [1]	2014 [1]
	£m	£m	£m
Retail	**3,003**	3,091	2,739
Commercial Banking	**2,468**	2,478	2,256
Consumer Finance	**1,283**	1,381	1,449
Insurance	**837**	962	922
Other	**276**	200	390
Profit before tax – underlying basis	**7,867**	8,112	7,756

1 Segmental analysis restated, as explained on page 24.

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.

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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.

	2016	2015	2014	2013	2012[1]
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	**17,267**	17,421	16,399	18,478	20,517
Operating expenses	**(12,627)**	(15,387)	(13,885)	(15,322)	(15,974)
Trading surplus	**4,640**	2,034	2,514	3,156	4,543
Impairment losses	**(752)**	(390)	(752)	(2,741)	(5,149)
Profit (loss) before tax	**3,888**	1,644	1,762	415	(606)
Profit (loss) for the year	**2,164**	956	1,499	(802)	(1,387)
Profit (loss) for the year attributable to ordinary shareholders	**1,651**	466	1,125	(838)	(1,471)
Dividends for the year[2,3]	**2,175**	1,962	535	–	–
Balance sheet data at 31 December (£m)					
Share capital	**7,146**	7,146	7,146	7,145	7,042
Shareholders' equity	**42,670**	41,234	43,335	38,989	41,896
Other equity instruments	**5,355**	5,355	5,355	–	–
Customer deposits	**415,460**	418,326	447,067	439,467	426,216
Subordinated liabilities	**19,831**	23,312	26,042	32,312	34,092
Loans and advances to customers	**457,958**	455,175	482,704	492,952	516,764
Total assets[1]	**817,793**	806,688	854,896	842,380	933,064
Share information					
Basic earnings (loss) per ordinary share	**2.4p**	0.8p	1.7p	(1.2)p	(2.1)p
Diluted earnings (loss) per ordinary share	**2.4p**	0.8p	1.6p	(1.2)p	(2.1)p
Net asset value per ordinary share	**59.8p**	57.9p	60.7p	54.6p	59.5p
Dividends per ordinary share[2,4]	**3.05p**	2.75p	0.75p	–	–
Equivalent cents per share[2,4,5]	**3.84c**	4.03c	1.16c	–	–
Market price per ordinary share (year end)	**62.5p**	73.1p	75.8p	78.9p	47.9p
Number of shareholders (thousands)	**2,510**	2,563	2,626	2,681	2,733
Number of ordinary shares in issue (millions)[6]	**71,374**	71,374	71,374	71,368	70,343
Financial ratios (%)[7]					
Dividend payout ratio[8]	**124.9**	359.3	45.1	–	–
Post-tax return on average shareholders' equity	**4.1**	1.3	2.9	(2.0)	(3.3)
Post-tax return on average assets	**0.26**	0.11	0.17	(0.09)	(0.14)
Average shareholders' equity to average assets	**5.2**	5.1	4.7	4.7	4.6
Cost:income ratio[9]	**73.1**	88.3	84.7	82.9	77.9
Capital ratios (%)[10,11,12]					
Total capital	**21.2**	21.5	22.0	20.8	17.3
Tier 1 capital	**16.8**	16.4	16.5	14.5	13.8
Common equity tier 1 capital/Core tier 1 capital	**13.4**	12.8	12.8	14.0	12.0

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

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

3 Dividends for the year in 2016 include a recommended special dividend totalling £356 million; dividends for the year in 2015 included a special dividend totalling £357 million.

4 Dividends per ordinary share in 2016 include a recommended special dividend of 0.5 pence; dividends per ordinary share in 2015 included a special dividend of 0.5 pence.

5 Translated into US dollars at the Noon Buying Rate on the date each payment was made, with the exception of the final and special dividends in respect of 2016, which have been translated at the Noon Buying Rate on 24 February 2017.

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

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

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

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

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

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

12 Capital ratios for 2014, 2015 and 2016 are in accordance with the CRD IV rules implemented by the PRA on 1 January 2014.

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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:

	2017 January	**2016 December**	**2016 November**	**2016 October**	**2016 September**	**2016 August**
US dollars per pound sterling:						
High	**1.26**	**1.27**	**1.25**	**1.28**	**1.34**	1.33
Low	**1.21**	**1.22**	**1.22**	**1.22**	**1.30**	1.29

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:

	2016	2015	2014	2013	2012
US dollars per pound sterling:					
Average	1.34	1.53	1.65	1.57	1.59

On 24 February 2017, the latest practicable date, the US dollar Noon Buying Rate was $1.2499 = £1.00. Lloyds Banking Group makes no representation that amounts in pounds sterling have been, could have been or could be converted into US dollars at that rate or at any of the above rates.

BUSINESS

HISTORY AND DEVELOPMENT OF LLOYDS BANKING GROUP

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

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

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

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

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

Pursuant to two placing and open offers which were completed by the Company in January and June 2009 and the Rights Issue completed in December 2009, the UK Government acquired 43.4 per cent of the Company’s issued ordinary share capital; through sales of shares in September 2013 and March 2014 and the impact of a trading plan with Morgan Stanley & Co. International plc (Morgan Stanley), this had reduced to 9.9 per cent by 31 December 2015.

UKFI announced on 7 October 2016 that it intended to continue to sell Her Majesty’s Treasury’s (HMT) shareholding in Lloyds Banking Group plc over the next 12 months through a pre-arranged trading plan managed by Morgan Stanley. Under the trading plan, Morgan Stanley has full discretion to effect a measured and orderly sell down of shares in Lloyds Banking Group plc on behalf of HMT. The trading plan commenced on 7 October and will terminate no later than 6 October 2017. HMT has instructed Morgan Stanley that (a) up to, but no more than, 15 per cent of the aggregate total trading volume in Lloyds Banking Group plc may be sold over the duration of the trading plan, and (b) shares may not be sold under the trading plan below a certain price per share that UKFI and HMT have determined represents fair value currently and continues to deliver value for money for the UK taxpayer. As at 22 February 2017, HMT owned approximately 2.8 billion ordinary shares in Lloyds Banking Group plc, which represents less than 4 per cent of the issued ordinary share capital.

Pursuant to its decision approving state aid to the Group, the European Commission required the Group to dispose of a retail banking business meeting minimum requirements for the number of branches, share of the UK personal current accounts market and proportion of the Group's mortgage assets. Following disposals in 2014, the Group retained an interest of approximately 50 per cent in TSB as at 31 December 2014. The Group sold its remaining interest in TSB to Banco de Sabadell (Sabadell) in 2015, with the acquisition becoming unconditional in all respects on 30 June 2015 following the receipt of all relevant regulatory clearances.

BUSINESS

STRATEGY OF LLOYDS BANKING GROUP

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

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

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

CREATING THE BEST CUSTOMER EXPERIENCE

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

BECOMING SIMPLER AND MORE EFFICIENT

The Group is focused on creating operational capability which is simpler and more efficient and will become more responsive to changing customer expectations while maintaining its cost leadership amongst UK high street banks. This includes a second phase of the Simplification programme to achieve run-rate savings of £1.4 billion per annum by the end of 2017. In order to achieve these savings, the Group will invest around £2.2 billion over three years on initiatives to simplify processes and increase automation.

DELIVERING SUSTAINABLE GROWTH

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

SUMMARY

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

BUSINESS AND ACTIVITIES OF LLOYDS BANKING GROUP

At 31 December 2016 the Group's activities were organised into four financial reporting segments: Retail; Commercial Banking; Consumer Finance and Insurance.

Further information on the Group's segments is set out on pages 28 to 34 and in note 4 to the financial statements.

MATERIAL CONTRACTS

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

BUSINESS

ENVIRONMENTAL MATTERS

MANAGING AND REDUCING OUR ENVIRONMENTAL IMPACTS

The Group's ability to help Britain prosper is inextricably linked to wider environmental issues. Man-made climate change and global trends, such as resource scarcity, extreme weather and rising energy and commodity prices, have an impact on the Group's its own operations and stakeholders. The Group is committed to managing its direct environmental impact and reducing its greenhouse gas emissions. The Group manages its impacts through its Environmental Action Plan, which focuses on reducing risk and creating value through improved efficiency.

Emissions

This year the Group's overall carbon emissions, measured in CO_2 equivalent tonnes (CO_2e), have decreased by 12.95 per cent year-on-year and by 38.83 per cent against the Group's 2009 baseline. This is mainly attributable to the reduction in consumption of gas and electricity (which make up the largest proportion of the Group's emissions) and the Group's energy optimisation programme.

CO_2e emissions

	Oct 2015 – Sept 2016	Oct 2014 – Sept 2015[1]	Oct 2013 – Sept 2014[1]
Total CO_2 e tonnes	**344,316**	395,554	437,721
Total scope 1	**52,438**	57,255	59,856
Total scope 2	**205,127**	239,721	261,623
Total scope 3	**86,752**	98,579	116,242

1 Restated 2013/2014 and 2014/2015 emissions data to improve the accuracy of reporting, using actual data to replace estimations.

Emissions in tonnes CO_2e in line with the GHG Protocol Corporate Standard (2004). The Group is in the process of transitioning to the revised Scope 2 guidance.

Criteria used to measure and report Scope 1, 2, 3 emissions is provided in the Lloyds Banking Group Reporting Criteria statement available online at www.lloydsbankinggroup.com/ResponsibleBusiness.

Scope 1 emissions include mobile and stationary combustion of fuel and operation of facilities.

Scope 2 emissions have been calculated using a location based methodology, as set out by the GHG Protocol.

Indicator is subject to limited ISAE3000 (revised) assurance by Deloitte LLP for the 2016 Annual Responsible Business Reporting. Deloitte's 2016 assurance statement and the 2016 Reporting Criteria are available online at www.lloydsbankinggroup.com/RBdownloads.

Supporting the low carbon economy

The Group continues to develop products and services to support customers' transition to a lower carbon, more resource efficient economy. Since 2014 the Group has launched two Environmental, Social and Governance (ESG) bonds totalling £500 million. Lloyds Bank became the first UK bank to develop an ESG deposit scheme in response to client demand to invest in products that create positive ESG impacts.

In March 2016 Lloyds Bank launched its innovative £1 billion Green Loan Initiative for commercial real estate lending. The initiative – the first of its kind in the UK – provides clients with loans at discounted margins to help incentivise energy efficiency and finance investment in green buildings. The Group completed the first tranche of deals in the second half of 2016, totalling £72 million, and has helped borrowers like HPH, a Bath-based property company with a diverse property portfolio, to fund energy efficiency projects. The Group has now set a target in its Helping Britain Prosper Plan to fund 10 million square feet of commercial real estate to become more energy efficient by 2020, the equivalent of seven London Shards.

In 2016 the Group's UK-based team was responsible for financing renewable projects with a combined capacity of more than 1.78GW. Globally, the Group's investments in renewable energy are in excess of 7.4GW in capacity and cover solar, offshore and onshore wind, waste to energy and biomass.

In 2016 Lloyds Bank played a key part in financing a major offshore wind farm off the Norfolk coast, with operations in Grimsby. Race Bank will provide enough energy to power 400,000 homes with a potential capacity of 573MW. It is anticipated the project, when in operation, will create more than 100 jobs associated with building and maintaining turbines for the Humber region.

PROPERTIES

At 31 December 2016, Lloyds Banking Group occupied 2,221 properties in the UK. Of these, 543 were held as freeholds and 1,678 as leasehold. The majority of these properties are retail branches, widely distributed throughout England, Scotland, Wales and Northern Ireland. Other buildings include the Lloyds Banking Group's head office in the City of London with other customer service and support centres located to suit business needs but clustered largely in eight core geographic conurbations – London, Edinburgh, Glasgow, Midlands (Birmingham), Northwest (Chester and Manchester), West Yorkshire (Halifax and Leeds), South (Brighton and Andover) and Southwest (Bristol and Cardiff).

In addition, there are 155 properties which are either sub-let or vacant. There are also a number of ATM units situated throughout the UK, the majority of which are held as leasehold. The Group also has business operations elsewhere in the world, primarily holding property on a leasehold basis.

LEGAL ACTIONS AND REGULATORY MATTERS

During the ordinary course of business the Group is subject to threatened or actual legal proceedings and regulatory reviews and investigations both in the UK and overseas. Set out below is a summary of the more significant matters.

PAYMENT PROTECTION INSURANCE

The Group increased the provision for PPI costs by a further £1,350 million in 2016, bringing the total amount provided to £17,375 million.

The charge to the provision in 2016 was largely driven by a higher total volume of complaints expected as a result of the Financial Conduct Authority's (FCA) industry deadline being extended to the end of August 2019 as well as changes to the rules and guidance that should apply when firms handle PPI complaints in light of the UK Supreme Court's decision in Plevin v Paragon Personal Finance Limited [2014] UKSC 61 (Plevin). Final rules and guidance were published by the FCA on 2 March 2017 (PS 17/3).

As at 31 December 2016, a provision of £2,608 million remained unutilised relating to complaints and associated administration costs. Total cash payments were £2,200 million during the year to 31 December 2016. Spend continues to reduce following the completion of the re-review of previously handled cases (remediation).

The provision is consistent with total expected reactive complaint volumes of 5.2 million (including complaints falling under the Plevin rules and guidance) in light of the FCA Policy Statement PS 17/3. Weekly complaint levels in the second half of 2016 have been approximately 8,300 versus approximately 8,600 in the first half, and are expected to vary significantly through to the industry deadline, now confirmed to be August 2019.

SENSITIVITIES

The Group estimates that it has sold approximately 16 million PPI policies since 2000. These include policies that were not mis-sold and those that have been successfully claimed upon. Since the commencement of the PPI redress programme in 2011 the Group estimates that it has contacted, settled or provided for approximately 50 per cent of the policies sold since 2000.

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

Key metrics and sensitivities are highlighted in the table below:

Sensitivities (exclude claims where no PPI policy was held)	Actuals to date	Anticipated future[3]	Sensitivity[3]
Customer initiated complaints since origination (m)[1]	3.9	1.3	0.1 = £190m
Average uphold rate per policy[2]	74%	89%	1% = £35m
Average redress per upheld policy[2]	£1,700	£1,250	£100 = £150m
Administrative expenses (£m)	3,190	490	1 case = £375

1 Sensitivity includes complaint handling costs.

2 Actuals to date are based on the last six months to 31 December 2016.

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Anticipated future and sensitivities are impacted by a proportion of complaints and re-complaints falling under the *Plevin* rules and guidance in light of the FCA Policy Statement PS 17/3.

PACKAGED BANK ACCOUNTS

In the year ended 31 December 2016 the Group has provided an additional £280 million in respect of complaints relating to alleged mis-selling of packaged bank accounts raising the total amount provided to £505 million. As at 31 December 2016, £215 million of the provision remained unutilised. The total amount provided represents the Group's best estimate of the likely future cost, however a number of risks and uncertainties remain in particular with respect to future volumes.

ARREARS HANDLING RELATED ACTIVITIES

Following a review of the Group's secured and unsecured arrears handling activities, the Group has put in place a number of actions to further improve its handling of customers in these areas. As a result, the Group has provided an additional £261 million in the year ended 31 December 2016 (bringing the total provision to £397 million), for the costs of identifying and rectifying certain arrears management fees and activities. As at 31 December 2016, the unutilised provision was £383 million (31 December 2015: £136 million).

CUSTOMER CLAIMS IN RELATION TO INSURANCE BRANCH BUSINESS IN GERMANY

The Group continues to receive claims in Germany from customers relating to policies issued by Clerical Medical Investment Group Limited (subsequently renamed Scottish Widows Limited). The German industry-wide issue regarding notification of contractual 'cooling off' periods has continued to lead to an increasing number of claims in 2016. Accordingly a provision increase of £94 million was recognised in the year ended 31 December 2016 giving a total provision of £639 million; the remaining unutilised provision as at 31 December 2016 is £168 million (31 December 2015: £124 million). The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will be known only once all relevant claims have been resolved.

PROVISIONS FOR OTHER LEGAL ACTIONS AND REGULATORY MATTERS

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Group also receives complaints and claims from customers in connection with its past conduct and, where significant, provisions are held against the costs expected to be incurred as a result of the conclusions reached. In the year ended 31 December 2016, the Group charged an additional £450 million in respect of matters across all divisions. At 31 December 2016, the Group held unutilised provisions totalling £573 million for these other legal actions and regulatory matters.

INTERCHANGE FEES

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

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

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

- Any ultimate impact on the Group of the above investigations and the litigation against Visa and MasterCard remains uncertain at this time.

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Visa Inc completed its acquisition of Visa Europe on 21 June 2016. The Group's share of the sale proceeds comprised cash consideration of approximately £330 million (of which approximately £300 million was received on completion of the sale and £30 million is deferred for three years) and preferred stock, which the Group measures at fair value. The preferred stock is convertible into Class A Common Stock of Visa Inc or its equivalent upon the occurrence of certain events. As part of this transaction, the Group and certain other UK banks also entered into a Loss Sharing Agreement (LSA) with Visa Inc, which clarifies the allocation of liabilities between the parties should the litigation referred to above result in Visa Inc being liable for damages payable by Visa Europe. The maximum amount of liability to which the Group may be subject under the LSA is capped at the cash consideration which was received by the Group at completion. Visa Inc may also have recourse to a general indemnity, currently in place under Visa Europe's Operating Regulations, for damages claims concerning inter or intra-regional MIF setting activities.

LIBOR AND OTHER TRADING RATES

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

Certain Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar, Japanese Yen and Sterling LIBOR and the Australian BBSW Reference Rate. The lawsuits, which contain broadly similar allegations, allege violations of the Sherman Antitrust Act, the Racketeer Influenced and Corrupt Organizations Act and the Commodity Exchange Act, as well as various state statutes and common law doctrines. Certain of the plaintiffs' claims, including those asserted under US anti-trust laws, were dismissed by the US Federal Court for Southern District of New York (the District Court). In November 2015 OTC and exchange-based plaintiffs' claims against the Group were dismissed for lack of personal jurisdiction. On 20 December 2016, the Federal Court for Southern District of New York dismissed all antitrust class action claims against LBG and its affiliates in the Multi District Litigation arising from the alleged manipulation of USD LIBOR. Further appeals in relation to the anti-trust claims remain possible.

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

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

UK SHAREHOLDER LITIGATION

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

FINANCIAL SERVICES COMPENSATION SCHEME

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

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. At 31 March 2016, the end of the latest FSCS scheme year for which it has published accounts, the principal balance outstanding on these loans was £15,655 million (31 March 2015: £15,797 million). Although it is anticipated that the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants of the FSCS. The amount of future levies payable by the Group depends on a number of factors including the amounts recovered by the FSCS from asset sales, the Group's participation in the deposit-taking market at 31 December, the level of protected deposits and the population of deposit-taking participants.

TAX AUTHORITIES

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

RESIDENTIAL MORTGAGE REPOSSESSIONS

In August 2014, the Northern Ireland High Court handed down judgment in favour of the borrowers in relation to three residential mortgage test cases concerning certain aspects of the Group’s practice with respect to the recalculation of contractual monthly instalments of customers in arrears. The FCA is actively engaged with the industry in relation to these considerations. The Group will respond as appropriate to this and any investigations, proceedings, or regulatory action that may in due course be instigated as a result of these issues. The FCA has issued a consultation on new guidance on the treatment of customers with mortgage payment shortfalls. The guidance covers remediation for mortgage customers who may have been affected by the way firms calculate these customers’ monthly mortgage instalments. The output from this consultation is expected in the first quarter of 2017.

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BUSINESS

UPDATE TO THE FINANCIAL CONDUCT AUTHORITY'S ANNOUNCEMENT IN NOVEMBER 2015 ON A DEADLINE FOR PPI COMPLAINTS AND PLEVIN V PARAGON PERSONAL FINANCE LIMITED

On 2 August 2016, the Financial Conduct Authority (FCA) published a further consultation paper (CP16/20: Rules and guidance on payment protection insurance complaints: feedback on CP15/39 and further consultation), following on from the original consultation published in November 2015. The consultation papers proposed the introduction of a two year industry deadline by which consumers would need to make their PPI complaints and rules and guidance that should apply when firms handle PPI complaints in light of the UK Supreme Court's decision in Plevin v Paragon Personal Finance Limited [2014] UKSC 61. On 2 March 2017 the FCA confirmed that the deadline would be 29 August 2019, and new rules for Plevin would come into force in August 2017.

MORTGAGE ARREARS HANDLING ACTIVITIES

On 26 May 2016, the Group was informed that an enforcement team at the FCA had commenced an investigation in connection with the Group's mortgage arrears handling activities. This investigation is ongoing and it is currently not possible to make a reliable assessment of the liability, if any, that may result from the investigation.

HBOS READING – CUSTOMER REVIEW

The Group is commencing a review into a number of customer cases from the former HBOS Impaired Assets Office based in Reading. This review follows the conclusion of a criminal trial in which a number of individuals, including two former HBOS employees, were convicted of conspiracy to corrupt, fraudulent trading and associated money laundering offences which occurred prior to the acquisition of HBOS by the Group in 2009. The review is at an early stage and it is currently not possible to determine the ultimate financial impact on the Group.

CONTINGENT LIABILITIES IN RESPECT OF OTHER LEGAL ACTIONS AND REGULATORY MATTERS

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

COMPETITIVE ENVIRONMENT

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

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

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

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

See Regulation – Competition Regulation.

RECENT DEVELOPMENTS

CONSOLIDATED FINANCIAL STATEMENTS SET OUT IN THE GROUP'S ANNUAL REPORT AND ACCOUNTS

The audited consolidated financial statements set forth in the Group's Annual Report and Accounts published on 22 February 2017 were approved on 21 February 2017. As discussed in notes 38 and 55 of the audited consolidated financial statements included in this Annual Report on Form 20-F (which were approved on 10 March 2017 and which therefore include the impact of adjusting post balance sheet events up to this date), on 2 March 2017 the FCA confirmed that the deadline by which consumers will need to make their PPI complaints will be 29 August 2019 and that the final rules and guidance that should apply when firms handle PPI complaints in light of Plevin will come into force in August 2017. The Group has reassessed its provisioning in light of this guidance, leading to an additional charge of £350 million, bringing the total charge for the year ended 31 December 2016 to £1,350 million.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OVERVIEW AND TREND INFORMATION

MARKET OVERVIEW

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

ECONOMIC ENVIRONMENT

RESILIENT UK ECONOMY POST REFERENDUM

During 2016 the UK economy performed broadly in line with market expectations at the start of the year despite the decision to leave the European Union and significant changes in the political landscape, both in the UK and abroad.

Although post referendum most forecasters were predicting a reduction in growth, in practice growth has been resilient and the UK economy is estimated to have grown by 2 per cent in 2016, just shy of 2.2 per cent in 2015. Business and consumer confidence did fall immediately post referendum, but most of this has now been recovered and consumers' retail spending growth actually accelerated in the months after the referendum.

Manufacturers are expecting exports to benefit from the weaker pound, but confidence in the service sector has weakened. Towards the end of 2016 inflation started to rise and is likely to become a bigger headwind to consumers' spending growth through the coming year.

UK house prices increased by around 7 per cent during the year, largely driven by strong growth in the first quarter. Prices have continued to increase, albeit at slower rates, during the rest of the year in almost all geographic areas, although the most expensive parts of London have seen some reductions over the last six months.

GROWTH IN THE GROUP'S MARKETS

Household and business deleveraging since 2009 has created capacity for an increased pace of borrowing and the markets in which the Group operates continued to grow in 2016. Specifically:

- Mortgage market growth increased to 3 per cent, from 2.7 per cent in 2015, the strongest since 2007, and although buy-to-let growth was impacted by the change in stamp duty policy in April, it still grew significantly faster than the market as a whole
- Unsecured consumer credit growth rose to 8 per cent led by motor finance. Although the strongest growth since before the financial crisis, the level of unsecured debt remains close to a 20 year low relative to households' income
- Business borrowing from banks increased by 2 per cent, the first growth since 2008, and SMEs by 2 per cent also
- Household deposit growth rose to 6 per cent, the strongest since 2008
- Business deposit growth weakened, to 6 per cent, but remains strong after three years of elevated growth and a very high level of liquidity

INTEREST RATES LOW FOR LONGER

Interest rates remain at historical lows with the base rate having been cut to 0.25 per cent in August, and are expected to remain low in the foreseeable future. Market rates currently imply an increase to the base rate to 0.5 per cent during 2018, and to 0.75 per cent a year later. This flattening of the yield curve along with continued competition has meant bank margins remain under pressure. Significant competition has meant lending rates across the market remain low, particularly in mortgages, although deposit rates have fallen further during the year, offsetting the impact of lower lending rates.

IMPAIRMENT EXPECTED TO REMAIN BENIGN

Improving indebtedness, along with the continued low interest rate environment, is continuing to keep impairment levels low and they remain below through-the-cycle levels.

The expected mild rise in unemployment is likely to lead to an increase in impairment from the very low level of 2016, but it should remain low over the longer term.

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

OUTLOOK FOR 2017

How the economy evolves in 2017 is highly dependent on the type of EU-exit deal that companies expect to be achieved in 2019, how deeply that impacts investment and employment plans, and how much squeezed consumer spending power is offset by improved competitiveness of exports following the fall in sterling. Each of these carries a high degree of uncertainty.

The UK economic environment will also continue to be impacted by global uncertainties including the slowdown in China, European elections and the global trade environment, particularly in light of the recent US presidential election.

The consensus expectation is that UK GDP growth will slow from 2 per cent in 2016 to 1.6 per cent in 2017, and unemployment will remain low, but will rise from 4.9 per cent at the end of 2016 to 5.2 per cent at the end of 2017. House prices are expected to continue to rise, by around 3 per cent, supported by the ongoing shortage of property for sale, low levels of housebuilding and exceptionally low interest rates, while commercial real estate prices are expected to fall by 4 per cent.

If the economy evolves in line with this consensus view, the Group would expect growth across its markets to remain broadly stable in aggregate, with a mild weakening in the growth of unsecured consumer credit and commercial real estate lending offset by a marginal rise in mortgages and other lending to businesses.

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 set out in note 3 to the financial statements.

FUTURE ACCOUNTING DEVELOPMENTS

Future developments in relation to the Group's IFRS reporting are discussed in note 56 to the financial statements.

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RESULTS OF OPERATIONS – 2016, 2015 AND 2014

SUMMARY

	2016 **£m**	2015 £m	2014 £m
Net interest income	**9,274**	11,318	10,660
Other income	**30,337**	11,832	19,232
Total income	**39,611**	23,150	29,892
Insurance claims	**(22,344)**	(5,729)	(13,493)
Total income, net of insurance claims	**17,267**	17,421	16,399
Operating expenses	**(12,627)**	(15,387)	(13,885)
Trading surplus	**4,640**	2,034	2,514
Impairment	**(752)**	(390)	(752)
Profit before tax	**3,888**	1,644	1,762
Taxation	**(1,724)**	(688)	(263)
Profit for the year	**2,164**	956	1,499
Profit attributable to ordinary shareholders	**1,651**	466	1,125
Profit attributable to other equity holders[1]	**412**	394	287
Profit attributable to equity holders	**2,063**	860	1,412
Profit attributable to non-controlling interests	**101**	96	87
Profit for the year	**2,164**	956	1,499

1 The profit after tax attributable to other equity holders of £412 million (2015: £394 million; 2014: £287 million) is partly offset in reserves by a tax credit attributable to ordinary shareholders of £91 million (2015: £80 million; 2014: £62 million).

2016 COMPARED WITH 2015

During the year ended 31 December 2016, the Group recorded a profit before tax of £3,888 million compared with a profit before tax in 2015 of £1,644 million. The result in 2016 included provisions in respect of redress to customers (together with the related administrative costs) associated with both past sales of Payment Protection Insurance and other matters of £2,435 million (of which £2,374 million is charged within operating expenses and £61 million against income) compared to a charge of £4,837 million in the year ended 31 December 2015. Excluding these charges from both years, profit before tax was £158 million, or 2 per cent, lower at £6,323 million in the year ended 31 December 2016 compared to £6,481 million in the previous year. The comparison of results for 2016 to 2015 is also impacted by the sale of TSB Banking Group plc (TSB), which ceased to be consolidated in March 2015, with the sale of the Group's remaining holding becoming unconditional on 30 June 2015. The Group recognised a net loss of £660 million in 2015, relating to both the disposal of its shareholding and commitments under agreements entered into with TSB. After taking this item into account there has been a reduction in profit before tax of £818 million.

Total income increased by £16,461 million, or 71 per cent, to £39,611 million in 2016 compared with £23,150 million in 2015, comprising an £18,505 million increase in other income partly offset by a decrease of £2,044 million in net interest income.

Net interest income was £9,274 million in 2016; a decrease of £2,044 million, or 18 per cent compared to £11,318 million in 2015. There was a negative impact of £1,813 million in 2016 from an increase in the amounts payable to unit holders in those Open-Ended Investment Companies (OEICs) included in the consolidated results of the Group, reflecting different levels of investment returns on the assets held by the OEICs; the change in population of consolidated OEICs in 2016 compared to 2015 did not have a significant impact. After adjusting for this, net interest income was £231 million, or 2 per cent lower, of which £592 million related to TSB which was sold in 2015. Average interest-earning assets fell as a result of decreases in average UK mortgage balances and in the portfolio of assets which are outside of the Group’s risk appetite, as well as a reduction of some £5 billion as result of the sale of TSB, more than offsetting growth in small business and unsecured personal lending. Net interest margin improved, excluding the impact of amounts payable to OEIC unitholders.

Other income was £18,505 million higher at £30,337 million in 2016 compared to £11,832 million in 2015. Fee and commission income was £207 million, or 6 per cent, lower at £3,045 million compared to £3,252 million in 2015. Fee and commission expense decreased by £86 million, or 6 per cent, to £1,356 million compared with £1,442 million in 2015. The decrease in net fee and commission income largely reflects lower levels of current account and credit and debit card fees as well as reduced income from commercial banking activities. Net trading income increased by £14,831 million to £18,545 million in 2016 compared to £3,714 million in 2015; this increase reflected an improvement of £14,797 million in gains on policyholder investments held within the insurance business as a result of market conditions over 2016 relative to those in 2015. Insurance premium income was £3,276 million, or 68 per cent, higher at £8,068 million in 2016 compared with £4,792 million in 2015; there was an increase of £3,289 million in life insurance premiums and a £13 million decrease in general insurance premiums. Premium income in 2015 had been reduced by a charge of £1,959 million relating to the recapture by a third party insurer of a portfolio of policies previously reassured with the Group; excluding this item life insurance premium income was £1,330 million, or 23 per cent, higher at £7,210 million in 2016 compared to £5,880 million in 2015, principally reflecting growth in bulk annuity business. Other operating income was £519 million higher at £2,035 million in 2016 compared to £1,516 million in 2015 as a gain of £484 million on sale of the Group’s investment in VISA Europe and an improvement in income from the value of in-force insurance business more than offset a loss on redemption of the Group’s Enhanced Capital Notes.

Insurance claims expense was £16,615 million higher at £22,344 million in 2016 compared to £5,729 million in 2015. The insurance claims expense in respect of life and pensions business was £16,619 million higher at £21,978 million in 2016 compared to £5,359 million in 2015; this increase was matched by a similar improvement in net trading income, reflecting the relative performance of policyholder investments. Insurance claims in respect of general insurance business were £4 million or 1 per cent, lower at £366 million in 2016 compared to £370 million in 2015.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Operating expenses decreased by £2,760 million, or 18 per cent to £12,627 million in 2016 compared with £15,387 million in 2015; the main reason for the decrease being the £2,463 million reduction in charges for redress payments to customers in respect of PPI and other conduct related matters from £4,837 million in 2015 to £2,374 million in 2016 and a charge of £665 million in 2015 in relation to the disposal of TSB. Excluding these items from both years, operating expenses were £368 million, or 4 per cent, higher at £10,253 million in 2016 compared to £9,885 million in 2015. Staff costs were £140 million, or 3 per cent, higher at £4,817 million in 2016 compared with £4,677 million in 2015; although annual pay rises have been more than offset by the impact of headcount reductions resulting from the sale of TSB and the Group's rationalisation programmes, there has been an increase in severance costs in relation to restructuring initiatives. Premises and equipment costs were £43 million or 6 per cent, lower at £672 million in 2016 compared with £715 million in 2015. Other expenses, excluding the charge relating to the TSB disposal, were £3 million higher at £2,384 million in 2016 compared with £2,381 million in 2015. Depreciation and amortisation costs were £268 million, or 13 per cent, higher at £2,380 million in 2016 compared to £2,112 million in 2015, in line with increased asset balances, particularly operating lease assets and capitalised software.

Impairment losses increased by £362 million, or 93 per cent, to £752 million in 2016 compared with £390 million in 2015. Impairment losses in respect of loans and advances to customers were £149 million, or 34 per cent, higher at £592 million in 2016 compared with £443 million in 2015; this reflects a lower level of releases and recoveries rather than a deterioration in quality of the underlying portfolio. There was a credit of £13 million in respect of undrawn commitments in 2016, compared to a credit of £55 million in 2015. In addition there was an impairment charge of £173 million in respect of certain equity investments in the Group's available-for-sale portfolio.

In 2016, the Group recorded a tax charge of £1,724 million compared to a tax charge of £688 million in 2015, an effective tax rate of 44 per cent, compared to the standard UK corporation tax rate of 20 per cent, principally as a result of the banking surcharge, restrictions on the deductibility of conduct provisions and the negative impact on the net deferred tax asset of both the change in corporation tax rate and the expected utilisation by the life business.

Total assets were £11,105 million, or 1 per cent, higher at £817,793 million at 31 December 2016 compared to £806,688 million at 31 December 2015. Cash and balances at central banks were £10,965 million, or 19 per cent, lower at £47,452 million compared to £58,417 million at 31 December 2015, reflecting fewer opportunities for the favourable placement of funds and trading and other assets at fair value through profit or loss were £10,638 million, or 8 per cent, higher at £151,174 million compared to £140,536 million at 31 December 2015, principally due to increases in the long-term insurance and investment funds. Loans and advances to customers were £2,783 million, or 1 per cent, higher at £457,958 million at 31 December 2016 compared to £455,175 million at 31 December 2015; the continued reduction in the portfolio of assets which are outside of the Group's risk appetite and lower UK mortgage balances, as the Group concentrates on protecting margin in the current market, were more than offset by an £8,304 million increase in reverse repurchase agreement balances together with growth in SME lending and the UK consumer finance business. Available-for-sale financial assets were £23,492 million, or 71 per cent, higher at £56,524 million compared to £33,032 million at 31 December 2015; during 2016, the Group reviewed its holding of government securities classified as held-to-maturity (£19,808 million at 31 December 2015) in light of the prevailing low interest rate environment and they have been reclassified as available-for-sale. Total liabilities were £9,620 million, or 1 per cent, higher at £769,328 million at 31 December 2016 compared to £759,708 million at 31 December 2015. Debt securities in issue were £5,742 million, or 7 per cent, lower at £76,314 million compared to £82,056 million at 31 December 2015, reflecting reduced funding requirements; however Insurance and investment contract liabilities were, together, £11,431 million, or 11 per cent, higher at £114,502 million, compared to £103,071 million at 31 December 2015, in line with the increase in investment assets. Subordinated liabilities were £3,481 million or 15 per cent, lower at £19,831 million compared to £23,312 million at 31 December 2015 as a result of redemptions during the year, including the Group's Enhanced Capital Notes. Total equity was £1,485 million, or 3 per cent, higher at £48,465 million at 31 December 2016 compared to £46,980 million at 31 December 2015; this reflected positive revaluation movements in the available-for-sale and cash flow hedging reserves.

The Group has strengthened its capital position, with a common equity tier 1 ratio of 13.4 per cent (31 December 2015: 12.8 per cent), largely driven by the increase in profits and a reduction in risk-weighted assets. The total capital ratio reduced to 21.2 per cent (31 December 2015: 21.5 per cent) primarily reflecting managed reductions in Tier 2 loan stock, largely through calls and redemptions, offset by the increase in common equity tier 1 capital and the reduction in risk-weighted assets.

Risk-weighted assets reduced by £7,399 million, or 3 per cent, to £215,446 million at 31 December 2016 compared to £222,845 million at 31 December 2015, largely relating to active portfolio management, disposals, an improvement in credit quality and capital efficient securitisation activity, partially offset by model updates related to UK mortgage portfolios and foreign exchange movements reflecting the depreciation in Sterling.

The Group's liquidity position remains good, with liquidity coverage ratio (LCR) eligible assets of £121 billion. LCR eligible assets represent over 8 times the Group's money-market funding with a maturity of less than one year and were in excess of total wholesale funding at 31 December 2016. The Group's LCR ratio continues to exceed regulatory requirements.

The Group has recommended a final ordinary dividend of 1.70 pence per share, together with a capital distribution in the form of a special dividend of 0.5 pence per share. This is in addition to the interim ordinary dividend of 0.85 pence per share that was paid in September 2016.

The total ordinary dividend per share for 2016 of 2.55 pence per share has increased by 13 per cent, from 2.25 pence in 2015 and is in line with the Group's progressive and sustainable ordinary dividend policy. The Group continues to expect ordinary dividends to increase over the medium term with a dividend payout ratio of at least 50 per cent of sustainable earnings.

2015 COMPARED WITH 2014

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

The comparison of results for 2015 to 2014 is also impacted by the sale of TSB Banking Group plc (TSB), which ceased to be consolidated in March 2015, with the sale of the Group's remaining holding becoming unconditional on 30 June 2015. The Group recognised a net loss of £660 million in 2015, relating to both the disposal of its shareholding and commitments under agreements entered into with TSB.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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

Insurance claims expense was £7,764 million, or 58 per cent, lower at £5,729 million in 2015 compared to £13,493 million in 2014. The insurance claims expense in respect of life and pensions business was £7,804 million, or 59 per cent, lower at £5,359 million in 2015 compared to £13,163 million in 2014; this decrease was matched by a similar decline in net trading income, reflecting the relative performance of policyholder investments. Insurance claims in respect of general insurance business were £40 million or 12 per cent, higher at £370 million in 2015 compared to £330 million in 2014.

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

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

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

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

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

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

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

NET INTEREST INCOME

	2016	2015	2014
Net interest income £m	**9,274**	11,318	10,660
Average interest-earning assets £m	**600,435**	614,917	634,910
Average rates:			
Gross yield on interest-earning assets %[1]	**2.77**	2.86	3.03
Interest spread %[2]	**1.33**	1.67	1.52
Net interest margin %[3]	**1.54**	1.84	1.68

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

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

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

2016 COMPARED WITH 2015

Net interest income was £9,274 million in 2016, a decrease of £2,044 million, or 18 per cent, compared to £11,318 million in 2015. Net interest income in 2016 includes a charge of £2,057 million in respect of amounts payable to unitholders in consolidated Open-Ended Investment Companies compared to a charge in 2015 of £244 million. The increase reflects more favourable market conditions; the change in population of consolidated OEICs in 2016 compared to 2015 did not have a significant impact. After adjusting for the amounts payable to unitholders, net interest income was £231 million, or 2 per cent, lower at £11,331 million in 2016 compared to £11,562 million in 2015.

Average interest-earning assets were £14,482 million, or 2 per cent, lower at £600,435 million in 2016 compared to £614,917 million in 2015. The reduction reflected the impact of the sale of TSB part-way through 2015, the continuing run-off of assets which are outside of the Group's risk appetite and a reduction in UK mortgage balances, reflecting the focus on protecting margins, partly offset by increased SME lending and unsecured personal lending.

The net interest margin was 30 basis points lower at 1.54 per cent in 2016 compared to 1.84 per cent in 2015, however adjusting net interest income for the amounts allocated to unitholders in Open-Ended Investment Companies, the net interest margin was 1 basis point higher at 1.89 per cent in 2016 compared to 1.88 per cent in 2015. Margins in Retail fell only slightly despite the challenges of the continuing low interest rate environment; margins in Consumer Finance fell, largely due to the focus on high quality, lower margin motor finance business, with the margin also impacted by lower Euribor and planned reductions in deposits. Margins on relationship lending and similar interest-earning assets in Commercial Banking grew, supported by high quality deposit growth, disciplined deposit pricing and reduced funding costs.

2015 COMPARED WITH 2014

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

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

Average interest-earning assets in Retail were £1,581 million, or 1 per cent, lower at £307,001 million in 2015 compared to £308,582 million in 2014 and average interest-earning assets in Commercial Banking were £3,860 million, or 4 per cent, lower at £90,019 million in 2015 compared to £93,879 million in 2014. Average interest-earning assets across the rest of the Group were £14,552 million, or 6 per cent, lower at £217,897 million in 2015 compared to £232,449 million in 2014. The main driver for this reduction being the decrease of £17,309 million resulting from the sale of TSB and in the portfolio of assets which are outside of the Group's risk appetite, partly offset by growth in Consumer Finance and in non-relationship balances.

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

OTHER INCOME

	2016	2015	2014
	£m	£m	£m
Fee and commission income:			
Current account fees	**752**	804	918
Credit and debit card fees	**875**	918	1,050
Other	**1,418**	1,530	1,691
	3,045	3,252	3,659
Fee and commission expense	**(1,356)**	(1,442)	(1,402)
Net fee and commission income	**1,689**	1,810	2,257
Net trading income	**18,545**	3,714	10,159
Insurance premium income	**8,068**	4,792	7,125
Gains on sale of available-for-sale financial assets	**575**	51	131
Liability management	**(598)**	(28)	(1,386)
Other	**2,058**	1,493	946
Other operating income	**2,035**	1,516	(309)
Total other income	**30,337**	11,832	19,232

2016 COMPARED WITH 2015

Other income was £18,505 million higher at £30,337 million in 2016 compared to £11,832 million in 2015.

Fee and commission income was £207 million, or 6 per cent, lower at £3,045 million in 2016 compared with £3,252 million in 2015. Current account fees were £52 million, or 6 per cent, lower at £752 million in 2016 compared to £804 million in 2015, due to the disposal of TSB part-way through 2015 and lower levels of added-value account fees as a result of changing customer preferences. A decrease of £43 million, or 5 per cent, in credit and debit card fees from £918 million in 2015 to £875 million in 2016 resulted from reduced interchange income due to a market-wide cap on fees. Other fees and commissions receivable were £112 million, or 7 per cent lower at £1,418 million in 2016 compared with £1,530 million in 2015 again reflecting the disposal of TSB and reduced income in the Insurance and Commercial divisions and as the portfolio of assets which are outside of the Group’s risk appetite continues to run down.

Fee and commission expense was £86 million, or 6 per cent, lower at £1,356 million in 2016 compared to £1,442 million in 2015 in part due to the disposal of TSB during 2015 but also reflecting reduced activity in the mortgage market and lower fees payable following the changes in interchange regulation.

Net trading income was £14,831 million higher at £18,545 million in 2016 compared with £3,714 million in 2015. Net trading income within the insurance businesses was £14,798 million higher at £17,571 million in 2016 compared to £2,774 million in 2015, which reflects higher levels of returns on policyholder investments as a result of more favourable market conditions over 2016. However this increase, along with the increase in long-term insurance premium income, was largely offset by the increase in insurance claims expense and the £1,813 million increase in the amounts payable to unit holders in those Open-Ended Investment Companies consolidated into the Group's results within net interest income. Net trading income within the Group's banking activities was £34 million, or 4 per cent, higher at £974 million in 2016 compared to £940 million in 2015.

Insurance premium income was £8,068 million in 2016 compared with £4,792 million in 2015; an increase of £3,276 million, or 68 per cent. Premium income in 2015 had been reduced by a charge of £1,959 million relating to the recapture by a third party insurer of a portfolio of policies previously reassured with the Group. Excluding this item earned premiums in respect of the Group's long-term life and pensions business were £1,330 million, or 23 per cent, higher at £7,210 million in 2016 compared to £5,880 million in 2015 reflecting significant new bulk annuities business, more than offsetting reductions in protection and corporate pensions business. General insurance earned premiums were little changed, £13 million, or 1 per cent, lower at £858 million in 2016 compared with £871 million in 2015 as a result of the continuing run-off of closed business.

Other operating income was £519 million higher at £2,035 million in 2016 compared to £1,516 million in 2015 despite a net loss of £721 million arising on the Group's tender offers and redemptions in respect of its Enhanced Capital Notes which completed in March 2016. Excluding this item, other operating income was £1,240 million, or 82 per cent, higher at £2,756 million in 2016 compared to £1,516 million in 2015; this reflected a £634 million improvement in the movement in value of in-force insurance business, reflecting business growth and positive economic variance, and a £524 million increase in gains on disposal of available-for-sale financial assets, from £51 million in 2015 to £575 million in 2016, of which £484 million related to the sale of the Group's investment in Visa Europe.

2015 COMPARED WITH 2014

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

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

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

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

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

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

OPERATING EXPENSES

	2016 £m	2015 £m	2014 £m
Administrative expenses:			
Staff:			
Salaries	**2,750**	2,808	3,178
Performance-based compensation	**475**	409	390
Social security costs	**363**	349	398
Pensions and other post-retirement benefit schemes:			
Past service credits and curtailment gains	**–**	–	(822)
Other	**555**	548	596
	555	548	(226)
Restructuring costs	**241**	104	264
Other staff costs	**433**	459	741
	4,817	4,677	4,745
Premises and equipment:			
Rent and rates	**365**	368	424
Repairs and maintenance	**187**	173	221
Other	**120**	174	246
	672	715	891
Other expenses:			
Communications and data processing	**848**	893	1,118
Advertising and promotion	**198**	253	336
Professional fees	**265**	262	481
UK bank levy	**200**	270	237
TSB disposal	**–**	665	–
Other	**873**	703	1,017
	2,384	3,046	3,189
Depreciation and amortisation:			
Depreciation of tangible fixed assets	**1,761**	1,534	1,391
Amortisation of acquired value of in-force non-participating investment contracts	**37**	41	43
Amortisation of other intangible assets	**582**	537	501
	2,380	2,112	1,935
Total operating expenses, excluding regulatory provisions	**10,253**	10,550	10,760
Regulatory provisions:			
Payment protection insurance provision	**1,350**	4,000	2,200
Other regulatory provisions[1]	**1,024**	837	925
	2,374	4,837	3,125
Total operating expenses	**12,627**	15,387	13,885
Cost:income ratio (%)[2]	**73.1**	88.3	84.7

1 In addition, £61 million (2015: £nil; 2014: £nil) of regulatory provisions have been charged against income.

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

2016 COMPARED WITH 2015

Operating expenses decreased by £2,760 million, or 18 per cent, to £12,627 million in 2016 compared with £15,387 million in 2015. This decrease principally reflects the fact that 2016 includes a regulatory provisions charge of £2,374 million, which was £2,463 million, or 51 per cent, lower than the charge of £4,837 million in 2015.

Staff costs were £140 million, or 3 per cent, higher in 2016 at £4,817 million compared to £4,677 million in 2015, reflecting, in particular, increased expenditure in relation to the Group's restructuring programmes. Salaries were £58 million, or 2 per cent, lower at £2,750 million in 2016 compared with £2,808 million in 2015, as the impact of headcount reductions, including the sale of TSB, has more than offset annual pay rises; pension costs were £7 million, or 1 per cent, higher at £555 million in 2016 compared to £548 million in 2015; social security costs were £14 million, or 4 per cent, higher at £363 million in 2016 compared with £349 million in 2015; and other staff costs were £26 million, or 6 per cent, lower at £433 million in 2016 compared with £459 million in 2015, in part due to lower levels of agency staff costs.

Premises and equipment costs were £43 million, or 6 per cent, lower at £672 million in 2016 compared to £715 million in 2015. Rent and rates was £3 million, or 1 per cent, lower at £365 million in 2016 compared to £368 million in 2015, in part due to charges in respect of onerous lease contracts as the Group rationalises its property portfolio; repairs and maintenance costs were £14 million, or 8 per cent, higher at £187 million in 2016 compared to £173 million in 2015 and other premises and equipment costs decreased by £54 million, or 31 per cent, from £174 million in 2015 to £120 million in 2016, partly reflecting gains on disposal of property, plant and equipment.

Other expenses, excluding the regulatory provisions charges, were £662 million, or 22 per cent, lower at £2,384 million in 2016 compared with £3,046 million in 2015. The Group had incurred a charge of £665 million in 2015 relating to the disposal of TSB, which was not repeated in 2016; excluding this charge, other expenses of £2,384 million in 2016 were £3 million higher than £2,381 million in 2015. Communications and data processing costs were £45 million, or 5 per cent, lower at £848 million in 2016 compared with £893 million in 2015 as a result of the sale of TSB and efficiency initiatives; professional fees were £3 million, or 1 per cent, higher at £265 million in 2016 compared to £262 million in 2015 as reduced costs following the sale of TSB have been offset by costs in relation to regulatory developments such as ring-fencing; and advertising and promotion costs were £55 million, or 22 per cent, lower at £198 million in 2016 compared with £253 million in 2015 as a result of the sale of TSB and reduced spend on certain marketing initiatives. The cost of the Bank levy was £70 million, or 26 per cent, lower at £200 million in 2016 compared to £270 million in 2015, as a result of reduced levels of chargeable liabilities. Other costs were £170 million, or 24 per cent, higher at £873 million in 2016 compared with £703 million in 2015.

Depreciation and amortisation costs were £268 million, or 13 per cent, higher at £2,380 million in 2016 compared with £2,112 million in 2015. Charges for the depreciation of tangible fixed assets were £227 million, or 15 per cent, higher at £1,761 million in 2016 compared to £1,534 million in 2015, in line with increased asset balances, in particular operating lease assets. The charge for the amortisation of other intangible assets was £45 million, or 8 per cent, higher at £582 million in 2016 compared to £537 million in 2015, reflecting increased capitalised software balances.

The Group incurred a regulatory provisions charge in operating expenses of £2,374 million in 2016 compared to £4,837 million in 2015 (in addition to £61 million, 2015: £nil, charged against income) of which £1,350 million (2015: £4,000 million) related to payment protection insurance. For further details see note 38 to the financial statements.

2015 COMPARED WITH 2014

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

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

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

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

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

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

The Group incurred a regulatory provisions charge in operating expenses of £4,837 million in 2015 compared to £3,125 million in 2014 of which £4,000 million (2014: £2,200 million) related to payment protection insurance.

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IMPAIRMENT

	2016 £m	2015 £m	2014 £m
Impairment losses on loans and receivables:			
Loans and advances to customers	592	443	735
Debt securities classified as loans and receivables	–	(2)	2
Total impairment losses on loans and receivables	592	441	737
Impairment of available-for-sale financial assets	173	4	5
Other credit risk provisions	(13)	(55)	10
Total impairment charged to the income statement	752	390	752

2016 COMPARED WITH 2015

Impairment losses increased by £362 million, or 93 per cent, to £752 million in 2016 compared to £390 million in 2015, largely due to lower levels of releases and write-backs and a charge in respect of available-for-sale financial assets.

The impairment charge in respect of loans and advances to customers was £149 million, or 34 per cent, higher at £592 million in 2016 compared to £443 million in 2015. In Retail, increased charges reflected a lower level of benefit from improvements in house prices in the secured book. The increased charges in Commercial Banking were driven by lower levels of releases and recoveries; and in Consumer Finance were as a result of overall growth and the non-recurrence of a favourable one-off release in 2015. The impairment charge relating to assets which are outside of the Group’s risk appetite reduced, reflecting the continued run down of the portfolio.

The impairment charge in respect of available-for-sale financial assets was £173 million in 2016, compared to £4 million in 2015, as a result of a charge in respect of certain equity investments; and there was a credit of £13 million (2015: credit of £55 million) in respect of other credit risk provisions, in both years reflecting improved credit quality in a number of corporate relationships

2015 COMPARED WITH 2014

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

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

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

TAXATION

	2016 £m	2015 £m	2014 £m
UK corporation tax:			
Current tax on profits for the year	**(1,010)**	(485)	(162)
Adjustments in respect of prior years	**156**	(90)	213
	(854)	(575)	51
Foreign tax:			
Current tax on profits for the year	**(20)**	(24)	(39)
Adjustments in respect of prior years	**2**	27	3
	(18)	3	(36)
Current tax (charge) credit	**(872)**	(572)	15
Deferred tax	**(852)**	(116)	(278)
Taxation charge	**(1,724)**	(688)	(263)

2016 COMPARED WITH 2015

In 2016, a tax charge of £1,724 million arose on the profit before tax of £3,888 million and in 2015 a tax charge of £688 million arose on the profit before tax of £1,644 million. The statutory corporation tax rates were 20 per cent for 2016 and 20.25 per cent for 2015.

The tax charge for 2016 represents an effective tax rate of 44 per cent; the high effective tax rate in 2016 was largely due to the banking surcharge, restrictions on the deductibility of conduct provisions and the negative impact on the net deferred tax asset of both the change in corporation tax rate and the expected utilisation by the life assurance business.

2015 COMPARED WITH 2014

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

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

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

LINE OF BUSINESS INFORMATION

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

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

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

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

The Group's activities are organised into four financial reporting segments: Retail; Commercial Banking; Consumer Finance and Insurance. The Group's unsecured personal lending portfolio, previously part of Retail, is now managed by Consumer Finance and elements of the Group's business in the Channel Islands and Isle of Man were transferred from Retail to Commercial Banking; comparatives have been restated accordingly.

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

– losses on redemption of the Enhanced Capital Notes and the volatility in the value of the embedded equity conversion feature;

– market volatility and other items, which includes the effects of certain asset sales, the impact of liability management actions, the volatility relating to the Group’s own debt and hedging arrangements as well as that arising in the insurance businesses, insurance gross up, the unwind of acquisition-related fair value adjustments arising from the HBOS acquisition, and the amortisation of purchased intangible assets;

– restructuring costs (which in 2015 and 2016 comprised severance related costs relating to the Simplification programme announced in October 2014 and in 2014 included severance, IT and business costs relating to the programme started in 2011) and the costs of implementing regulatory reform, ring fencing and rationalisation of the non-branch property portfolio;

– TSB build and dual running costs and the loss relating to the TSB sale in 2015;

– payment protection insurance and other conduct provisions; and

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

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

	2016	2015[1]	2014[1]
	£m	£m	£m
Retail	**3,003**	3,091	2,739
Commercial Banking	**2,468**	2,478	2,256
Consumer Finance	**1,283**	1,381	1,449
Insurance	**837**	962	922
Other	**276**	200	390
Underlying profit before tax	**7,867**	8,112	7,756

1 Segmental analysis restated, as explained above.

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Reconciliation of underlying profit to statutory profit before tax for the year

	Note	**2016 £m**	2015 £m	2014 £m
Underlying profit before tax		**7,867**	8,112	7,756
Asset sales	1	**217**	54	138
Enhanced Capital Notes	2	**(790)**	(101)	(961)
Liability management	3	**123**	(28)	(24)
Own debt volatility	4	**(11)**	127	(3)
Other volatile items	5	**201**	(129)	(112)
Volatility arising in insurance businesses	6	**(91)**	(105)	(228)
Restructuring and TSB build and dual running costs	8	**(622)**	(255)	(1,524)
Charge relating to TSB disposal	9	**–**	(660)	–
Payment protection insurance provision	10	**(1,350)**	(4,000)	(2,200)
Other conduct provisions	11	**(1,085)**	(837)	(925)
Past service pension credit	12	**–**	–	710
Amortisation of purchased intangibles	13	**(340)**	(342)	(336)
Fair value unwind and other items	14	**(231)**	(192)	(529)
Statutory profit before tax		**3,888**	1,644	1,762

1. Asset sales

Asset sales comprise the gains and losses on asset disposals (2016: gains of £217 million; 2015: gains of £54 million; 2014: gains of £138 million), including assets which were outside of the Group's risk appetite; the gain in the year ended 31 December 2016 includes the gain of £484 million on the sale of the Group's investment in Visa Europe.

2. Enhanced Capital Notes

The Group completed tender offers and redemptions in respect of its Enhanced Capital Notes (ECNs) in March 2016, resulting in a net loss to the Group of £721 million in the year ended 31 December 2016, principally comprising the write-off of the embedded equity conversion feature and premiums paid under the terms of the transaction. In addition there was a charge of £69 million reflecting the change in fair value of the embedded equity conversion feature in the period prior to the transaction.

In the year ended 31 December 2015, a charge of £101 million arose from the change in fair value of the embedded equity conversion feature.

In April 2014, the Group completed exchange offers with holders of certain series of its Enhanced Capital Notes (ECNs) to exchange the ECNs for new Additional Tier 1 (AT1) securities and completed a tender offer to eligible retail holders outside the United States to sell their Sterling-denominated ECNs for cash. A loss of £1,362 million was recognised in relation to these exchange and tender transactions in the year ended 31 December 2014; partly offset by a gain of £401 million arising from the change in fair value of the remaining embedded equity conversion feature.

3. Liability management

Gains of £123 million (2015: losses of £28 million; 2014: losses of £24 million) arose on other transactions undertaken as part of the Group's management of wholesale funding and capital. The liability management gains and losses were included in other income.

4. Own debt volatility

Own debt volatility includes a £31 million loss (2015: gain of £114 million; 2014: gain of £33 million) relating to the change in fair value of the small proportion of the Group's wholesale funding which was designated at fair value at inception.

5. Other volatile items

Other volatile items include the change in fair value of interest rate derivatives and foreign exchange hedges in the banking book not mitigated through hedge accounting. A gain of £259 million was included in 2016 (2015: charge of £99 million; 2014: charge of £138 million). Also included in 2016 was a negative net derivative valuation adjustment of £58 million (2015: charge of £30 million; 2014: credit of £26 million), reflecting movements in the market implied credit risk associated with customer derivative balances.

6. Volatility arising in insurance businesses

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

In 2016, the Group's statutory result before tax included negative insurance and policyholder interests volatility totalling £91 million compared to negative volatility of £105 million in 2015 and negative volatility of £228 million in 2014.

Volatility comprises the following:

	2016	2015	2014
	£m	£m	£m
Insurance volatility	**(152)**	(303)	(219)
Policyholder interests volatility	**241**	87	17
Insurance hedging arrangements	**(180)**	111	(26)
Total	**(91)**	(105)	(228)

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

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

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

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

Management compensates for the limitations above by:

(i)

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

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

Insurance volatility

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

The expected gross investment returns used to determine the underlying profit of the business are based on prevailing market rates and published research into historical investment return differentials for the range of assets held. The basis for calculating these expected returns reflects an average of the 15 year swap rate over the preceding 12 months updated throughout the year to reflect changing market conditions. The negative insurance volatility during 2016 of £152 million primarily reflects reductions in yields, widening credit spreads and low returns on cash investments partially offset by positive returns on equities.

Policyholder interests volatility

The application of accounting standards results in the introduction of other sources of significant volatility into the pre-tax profits of the life, pensions and investments business. In order to provide a clearer representation of the performance of the business, and consistent with the way in which it is managed, adjustments are made to remove this volatility from underlying profits. The effect of these adjustments is separately disclosed as policyholder interests volatility.

Accounting standards require that tax on policyholder investment returns relating to life products should be included in the Group's tax charge rather than being offset against the related income. The result is, therefore, to either increase or decrease profit before tax with a related change in the tax charge. Timing and measurement differences exist between provisions for tax and charges made to policyholders. Consistent with the expected approach taken in respect of insurance volatility, differences in the expected levels of the policyholder tax provision and policyholder charges are adjusted through policyholder interests volatility. In 2016, the statutory results before tax included a credit to other income which relates to policyholder interests volatility totalling £241 million reflecting movements in equity, bond and gilt returns relating to life products.

Insurance hedging arrangements

The Group purchased put option contracts in 2016 to protect against deterioration in equity market conditions and the consequent negative impact on the value of in-force business on the Group balance sheet. These were financed by selling some upside potential from equity market movements. A loss of £180 million was recognised in relation to these contracts in 2016 which was less than the gain from the underlying exposure.

7. Insurance gross-up

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

8. Restructuring costs and TSB build and dual-running costs

Restructuring costs were £622 million in 2016 and comprised costs relating to the Simplification programme, the announced rationalisation of the non-branch property portfolio and the work on implementing the ring-fencing requirements. Restructuring costs of £170 million in 2015 related to the next phase of Simplification announced in October 2014. The costs of £966 million in 2014 related to phase 1 of the Simplification programme which was completed in 2014.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

9. Charge relating to TSB disposal

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

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

10. Payment protection insurance (PPI) provision

A provision of £1,350 million to cover further operating costs and redress relating to PPI was recognised in the 2016 (2015: £4,000 million; 2014: £2,200 million). The charge of £1,350 million in 2016 was largely driven by a higher total volume of complaints expected as a result of the Financial Conduct Authority's (FCA) industry deadline being extended to the end of August 2019 as well as changes to the rules and guidance that should apply when firms handle PPI complaints in light of the UK Supreme Court's decision in Plevin v Paragon Personal Finance Limited [2014] UKSC 61 (Plevin). Final rules and guidance were published by the FCA on 2 March 2017 (PS 17/3).

11. Other conduct provisions

There was a charge of £1,085 million in 2016 to cover a range of other conduct issues (2015: £837 million; 2014: £925 million). The charge for the year included £280 million in respect of complaints relating to packaged bank accounts, £261 million in respect of arrears-related activities on secured and unsecured retail products and £94 million related to insurance products sold in Germany, together with a number of other conduct risk provisions totalling £450 million across all divisions.

12. Past service pension credit

On 11 March 2014 the Group announced a change to its defined benefit pension arrangements, revising the existing cap on the increases in pensionable pay used in calculating the pension benefit, from 2 per cent to nil with effect from

2 April 2014. The effect of this change was to reduce the Group's retirement benefit obligations recognised on the balance sheet by £843 million with a corresponding curtailment gain recognised in the income statement. This was partly offset by a charge of £133 million relating to the cost of other changes to the pay, benefits and reward offered to employees to give a net credit of £710 million recognised in 2014.

13. Amortisation of purchased intangibles

The Group incurred a charge for the amortisation of intangible assets, principally those recognised on the acquisition of HBOS in 2009, of £340 million (2015: £342 million; 2014: £336 million).

14. Fair value unwind and other items

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

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

DIVISIONAL RESULTS

RETAIL

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

	2016	2015[1]	2014[1]
	£m	£m	£m
Net interest income	**6,497**	6,664	6,270
Other income	**1,053**	1,115	1,202
Total income	**7,550**	7,779	7,472
Operating expenses	**(4,174)**	(4,339)	(4,239)
Impairment	**(373)**	(349)	(494)
Underlying profit	**3,003**	3,091	2,739

1 Restated, as explained on page 24.

2016 COMPARED WITH 2015

Underlying profit decreased by £88 million, or 3 per cent, to £3,003 million in 2016 compared to £3,091 million in 2015, reflecting the challenging interest rate environment and continued pressure on other operating income.

Net interest income decreased by £167 million, or 3 per cent, to £6,497 million in 2016 compared to £6,664 million in 2015, largely due to a reduction in mortgage balances as Retail focus on protecting margins. Banking margin fell by just 2 basis points despite the continuing low interest rate environment.

Other income decreased £62 million, or 6 per cent, to £1,053 million in 2016 compared to £1,115 million in 2015, driven by changing customer behaviour and improvements to the customer proposition.

Operating expenses decreased by £165 million, or 4 per cent, to £4,174 million in 2016 compared to £4,339 million in 2015 as efficiency savings more than covered an increase in investment. Staff numbers have reduced by 11 per cent in the year.

Impairment increased by £24 million, or 7 per cent, to £373 million in 2016 compared to £349 million in 2015. Underlying credit quality remains stable.

2015 COMPARED WITH 2014

Underlying profit increased by £352 million, or 13 per cent to £3,091 million in 2015 compared to £2,739 million in 2014, driven by improved margins and reduced impairments.

Net interest income increased £394 million, or 6 per cent, to £6,664 million in 2015 compared to £6,270 million in 2014. Margin performance was strong, increasing 12 basis points to 2.22 per cent in 2015 compared to 2.10 per cent in 2014, driven by improved deposit mix and margin, more than offsetting reduced lending rates.

Other income decreased £87 million, or 7 per cent, to £1,115 million in 2015 compared to £1,202 million in 2014, driven by current account transaction related income and regulatory changes, in particular, impacting the Wealth business.

Operating expenses increased £100 million, 2 per cent, to £4,339 million in 2015 compared to £4,239 million in 2014. The increase reflects continued business investment and simplification to improve customer experiences.

Impairment reduced by £145 million, or 29 per cent, to £349 million in 2015 compared to £494 million in 2014, driven by continued low risk underwriting discipline, strong portfolio management and a favourable credit environment.

COMMERCIAL BANKING

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

	2016	2015 [1]	2014 [1]
	£m	£m	£m
Net interest income	**2,735**	2,576	2,542
Other income	**1,987**	2,072	1,962
Total income	**4,722**	4,648	4,504
Operating lease depreciation	**(105)**	(30)	(24)
Net income	**4,617**	4,618	4,480
Operating expenses	**(2,133)**	(2,162)	(2,139)
Impairment	**(16)**	22	(85)
Underlying profit	**2,468**	2,478	2,256

1 Restated, as explained on page 24.

2016 COMPARED WITH 2015

Commercial Banking underlying profit decreased by £10 million, to £2,468 million in 2016 compared to £2,478 million in 2015 due to additional charges relating to certain leasing assets partially offset by total income growth.

Net interest income increased by £159 million, or 6 per cent, to £2,735 million in 2016 compared to £2,576 million in 2015 with an improvement in net interest margin supported by high quality deposit growth, disciplined deposit pricing and reduced funding costs.

Other income decreased by £85 million, or 4 per cent, to £1,987 million in 2016 compared to £2,072 million in 2015 driven by non-recurring income recognised in 2015, relating to refinancing support of Global Corporates clients.

Operating lease depreciation increased by £75 million to £105 million in 2016 compared to £30 million in 2015 due to additional charges relating to certain leasing assets.

Operating expenses decreased by £29 million to £2,133 million in 2016 compared to £2,162 million in 2015.

Impairments increased by £38 million, to £16 million charge in 2016 compared to £22 million release in 2015.

2015 COMPARED WITH 2014

Commercial Banking underlying profit increased by £222 million, or 10 per cent, to £2,478 million in 2015 compared to £2,256 million in 2014 due to lower impairments and increased total underlying income partially offset by higher operating costs.

Net interest income increased by £34 million, or 1 per cent, to £2,576 million in 2015 compared to £2,542 million in 2014 driven by reduced funding costs and higher net interest margin due to disciplined new lending and an increase in deposits.

Other income increased by £110 million, or 6 per cent, to £2,072 million in 2015 compared to £1,962 million in 2014 driven by refinancing support provided to Global Corporate clients and increases in Mid Markets.

Operating lease depreciation increased by £6 million to £30 million in 2015 compared to £24 million in 2014.
Operating expenses increased by £23 million, to £2,162 million in 2015 compared to £2,139 million in 2014.

Impairments improved by £107 million to a £22 million release in 2015 compared to an £85 million charge in 2014 reflecting lower gross charges and an increase in write-backs.

CONSUMER FINANCE

Consumer Finance comprises motor finance, credit cards, unsecured personal loans and its European business, which includes mortgages and deposit taking. Unsecured personal loans joined the division in 2016 in order to reposition this business for growth. This brings together all consumer lending products to enable better and more coordinated focus on these markets. Consumer Finance's aim is to deliver sustainable growth within risk appetite through building digital capability and continuing to create innovative propositions, underpinned by improvements to customer experience.

	2016	2015 [1]	2014 [1]
	£m	£m	£m
Net interest income	**1,941**	1,954	2,037
Other income	**1,338**	1,359	1,368
Total income	**3,279**	3,313	3,405
Operating lease depreciation	**(775)**	(720)	(667)
Net income	**2,504**	2,593	2,738
Operating expenses	**(939)**	(977)	(971)
Impairment	**(282)**	(235)	(318)
Underlying profit	**1,283**	1,381	1,449

1 Restated, as explained on page 24.

2016 COMPARED WITH 2015

Underlying profit was £1,283 million in 2016 compared to £1,381 million in 2015, a decrease of £98 million, or 7 per cent, driven by slightly lower income and increased impairment.

Total income decreased by £34 million to £3,279 million in 2016 compared to £3,313 million in 2015.

Net interest margin decreased by 73 basis points to 5.88 per cent, contributing to a reduction in net interest income to £1,941 million in 2016 compared to £1,954 million in 2015. Net interest margin was down due to the focus on high quality, lower margin motor finance business, with the margin also impacted by lower Euribor and planned reductions in deposits, in line with the Lloyds Banking Group's funding strategy.

Other income reduced by £21 million to £1,338 million in 2016 compared to £1,359 million in 2015, due to the market-wide reduction in credit card interchange fees, partly offset by continued fleet growth in Lex Autolease.

Operating expenses reduced by £38 million, or 4 per cent, to £939 million in 2016 compared to £977 million in 2015 with continued investment in the business more than offset by underlying efficiency savings.

The impairment charge increased by £47 million, or 20 per cent, to £282 million in 2016 compared to £235 million in 2015, primarily due to overall growth and the non-recurrence of a favourable one-off release in 2015.

2015 COMPARED WITH 2014

Underlying profit was £1,381 million in 2015 compared to £1,449 million in 2014 with growth in better quality but lower margin lending resulting in lower income but lower impairments, offset by increased cost of investment in growth initiatives.

Total income decreased by £92 million to £3,313 million in 2015 compared to £3,405 million in 2014.

Net interest margin decreased by 68 basis points to 6.61 per cent, contributing to a reduction in net interest income to £1,954 million in 2015 compared to £2,037 million in 2014. Net interest margin was down due to the acquisition of lower risk but lower margin new business, an increased proportion of Black Horse lending including the partnership with Jaguar Land Rover, lower unsecured personal lending balances and the impact of the planned reduction in deposits in line with the Group's balance sheet funding strategy.

Other income reduced by £9 million to £1,359 million in 2015 compared to £1,368 million in 2014, as higher income from growing the Lex Autolease fleet was offset by the impact of lower interchange income in Cards following the recent EU ruling.

Operating expenses increased by £6 million to £977 million in 2015 compared to £971 million in 2014 as operating cost savings were offset by continued investment in growth initiatives.

The impairment charge reduced by £83 million, or 26 per cent, to £235 million in 2015 compared to £318 million in 2014. This has been driven by continued underlying improvement in portfolio quality and supported by the sale of recoveries assets in the credit card and unsecured personal lending portfolios together with a one-off release in the motor business. The asset quality ratio improved by 28 basis points.

INSURANCE

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

Life, Pensions and Investments

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

General Insurance

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

	2016	2015	2014
	£m	£m	£m
Net interest expense	**(146)**	(163)	(131)
Other income	**1,755**	1,827	1,725
Total income, net of insurance claims	**1,609**	1,664	1,594
Operating expenses	**(772)**	(702)	(672)
Underlying profit	**837**	962	922

2016 COMPARED WITH 2015

Underlying profit from Insurance was £125 million, or 13 per cent lower at £837 million compared to £962 million in 2015. A 17 per cent increase in new business income was more than offset by adverse economics impacting existing business income together with increased investment costs.

Net interest expense decreased by £17 million, or 10 per cent, to £146 million from £163 million in 2015 due to lower interest rates.

Other income decreased by £72 million, or 4 per cent, to £1,755 million from £1,827 million in 2015. The decrease was driven by adverse economics impacting existing business income partly offset by growth in the planning and retirement and protection propositions and increased general insurance income.

2015 COMPARED WITH 2014

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

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

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

UNDERLYING PROFIT BY PRODUCT GROUP

	2016			2015			2014		
	New business income £m	**Existing business income £m**	**Total income £m**	New business income £m	Existing business income £m	Total income £m	New business income £m	Existing business income £m	Total income £m
Corporate pensions	**123**	**135**	**258**	140	175	315	143	164	307
Bulk annuities	**121**	**16**	**137**	125	–	125	–	–	–
Planning and retirement	**109**	**95**	**204**	40	94	134	63	123	186
Protection	**19**	**33**	**52**	12	37	49	46	31	77
Longstanding life, pensions and investments	**9**	**393**	**402**	9	467	476	16	483	499
	381	**672**	**1,053**	326	773	1,099	268	801	1,069
Life and pensions experience and other items			**223**			235			26
General Insurance			**354**			323			418
Net interest income and free asset return			**(21)**			7			81
Total costs			**(772)**			(702)			(672)
Underlying profit			**837**			962			922

2016 COMPARED WITH 2015

New business income has increased by £55 million to £381 million driven by growth in planning and retirement and protection propositions. This has more than offset lower income from corporate pensions.

Existing business income has decreased by £101 million, primarily driven by adverse economics.

There was a net benefit of £223 million as a result of experience and other items. This included one off benefits following an update to the methodology for calculating the illiquidity premium and the addition of a new death benefit to legacy pension contracts, to align terms with other pensions products. These were partly offset by the effect of recent reforms on activity within the pensions market.

General insurance income net of claims has increased by £31 million primarily driven by lower weather related claims.

Net interest income and free asset return has decreased by £28 million with benefits from lower interest rates on net interest income being more than offset by a lower expected rate of return on free assets.

Total costs were £70 million higher reflecting increased investment and £28 million annual levy associated with the Flood Re scheme.

2015 COMPARED WITH 2014

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

Existing business income decreased by £28 million reflecting the reduction in the expected rate of return used to calculate life and pensions income. The rate of return is largely set by reference to an average 15 year swap rate (2.57 per cent in 2015 and 3.48 per cent in 2014).

Life and pensions experience and other items increased by £209 million. 2015 assumption changes and experience variances include an adverse impact of £208 million in Pensions and Investments as a result of the strengthening of lapse assumptions on the pensions book to allow for the impact of the recent pension reforms. This was more than offset by the £240 million of benefit recognised within Planning and Retirement, primarily as a result of changes to assumptions on longevity. These longevity changes reflect both experience in the annuity portfolio and the adoption of a new industry model reflecting an updated view of future life expectancy. Benefits from the long term investment strategy increased by £15 million, reflecting the successful acquisition of a further £1.4 billion of higher yielding assets to match the long duration annuity liabilities.

General Insurance income net of claims has fallen by £95 million. This reflects the run-off of products closed to new customers, the impact of becoming a sole underwriter of the home insurance business (which has resulted in a short-term reduction from the loss of commission recognised upfront) and the impact of adverse weather conditions.

Net interest income and free asset return has decreased by £74 million due to holding increased debt whilst a tranche of subordinated debt was re-financed and a lower rate of return on free assets.

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

OTHER

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

Run-off

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

	2016	2015	2014
	£m	£m	£m
Net interest expense	**(110)**	(88)	(116)
Other income	**120**	145	451
Total income	**10**	57	335
Operating lease depreciation	**(15)**	(14)	(29)
Net income	**(5)**	43	306
Operating expenses	**(77)**	(150)	(279)
Impairment	**26**	(8)	(203)
Underlying loss	**(56)**	(115)	(176)

2016 COMPARED WITH 2015

The underlying loss of £56 million was an improvement of £59 million compared to the loss of £115 million in 2015.

Total income decreased by £47 million to £10 million in 2016 compared to £57 million in 2015, in particular reflecting reduced fee and other income as the portfolio continues to run off.

Operating expenses were £73 million, or 49 per cent, lower at £77 million compared to £150 million in 2015 reflecting the reducing costs of managing the portfolio as it runs down.

Impairment was a credit of £26 million compared to a charge of £8 million in 2015, in particular reflecting a credit in 2016 compared to a charge in 2015 in relation to Irish lending

2015 COMPARED WITH 2014

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

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

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

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

TSB

TSB served retail and small business customers; providing a full range of retail banking products. The Group sold its controlling interest in TSB in March 2015 and ceased to consolidate TSB's results at that point.

	2016	2015	2014
	£m	£m	£m
Net interest income	–	192	786
Other income	–	31	140
Total income	–	223	926
Operating expenses	–	(86)	(370)
Impairment	–	(19)	(98)
Underlying profit	–	118	458

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

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OTHER (continued)

2016 COMPARED WITH 2015

Because TSB was sold during 2015, no results have been consolidated in 2016, this compares to a profit of £118 million in 2015, for the period up to sale in March 2015.

2015 COMPARED WITH 2014

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

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

Central items

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

	2016	2015	2014
	£m	£m	£m
Total income	**330**	176	132
Operating expenses credit (expense)	**2**	19	(22)
Impairment release (charge)	**–**	2	(2)
Underlying profit	**332**	197	108

2016 COMPARED WITH 2015

The underlying profit of £332 million was £135 million, or 69 per cent, higher than £197 million in 2015.

Total income increased by £154 million to £330 million in 2016 compared to £176 million in 2015 largely as a result of sales of liquid assets including gilts, and the timing of dividends from the Group’s strategic investments.

Operating expenses were a credit of £2 million compared to a credit of £19 million in 2015.

2015 COMPARED WITH 2014

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

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

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

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

AVERAGE BALANCE SHEET AND NET INTEREST INCOME

	2016 Average balance £m	**Interest income £m**	**Yield %**	2015 Average balance £m	Interest income £m	Yield %	2014 Average balance £m	Interest income £m	Yield %
Assets									
Loans and receivables:									
Loans and advances to banks	**82,409**	**381**	**0.46**	94,543	397	0.42	78,762	406	0.52
Loans and advances to customers	**457,622**	**15,190**	**3.32**	464,012	16,256	3.50	504,246	17,806	3.53
Debt securities	**3,797**	**56**	**1.47**	2,139	40	1.87	1,633	42	2.57
Available-for-sale financial assets	**40,604**	**762**	**1.88**	40,967	725	1.77	50,269	957	1.90
Held-to-maturity investments	**16,003**	**231**	**1.44**	13,256	197	1.49	–	–	–
Total interest-earning assets of banking book	**600,435**	**16,620**	**2.77**	614,917	17,615	2.86	634,910	19,211	3.03
Total interest-earning trading securities and other financial assets at fair value through profit or loss	**81,961**	**1,594**	**1.94**	87,583	1,955	2.23	82,018	1,993	2.43
Total interest-earning assets	**682,396**	**18,214**	**2.67**	702,500	19,570	2.79	716,928	21,204	2.96
Allowance for impairment losses on loans and receivables	**(2,536)**			(4,729)			(10,051)		
Non-interest earning assets	**148,965**			145,224			158,584		
Total average assets and interest income	**828,825**	**18,214**	**2.20**	842,995	19,570	2.32	865,461	21,204	2.45

	2016 Average interest earning assets £m	**Net interest income £m**	**Net interest margin %**	2015 Average interest earning assets £m	Net interest income £m	Net interest margin %	2014 Average interest earning assets £m	Net interest income £m	Net interest margin %
Average interest-earning assets and net interest income:									
Banking business	**600,435**	**9,274**	**1.54**	614,917	11,318	1.84	634,910	10,660	1.68
Trading securities and other financial assets at fair value through profit or loss	**81,961**	**1,060**	**1.29**	87,583	1,205	1.38	82,018	1,464	1.78
	682,396	**10,334**	**1.51**	702,500	12,523	1.78	716,928	12,124	1.69

	2016 Average balance £m	**Interest expense £m**	**Cost %**	2015 Average balance £m	Interest expense £m	Cost %	2014 Average balance £m	Interest expense £m	Cost %
Liabilities and shareholders' funds									
Deposits by banks	**10,540**	**68**	**0.65**	10,442	43	0.41	11,604	86	0.74
Customer deposits	**366,178**	**2,520**	**0.69**	380,137	3,299	0.87	416,651	4,781	1.15
Liabilities to banks and customers under sale and repurchase agreements	**8,342**	**38**	**0.46**	5,960	34	0.57	2,104	55	2.61
Debt securities in issue[1]	**85,030**	**799**	**0.94**	85,462	586	0.69	88,289	552	0.63
Amounts payable to unitholders in consolidated open-ended investment vehicles	**18,961**	**2,057**	**10.85**	21,059	244	1.16	18,620	602	3.23
Subordinated liabilities	**22,330**	**1,864**	**8.35**	24,975	2,091	8.37	29,332	2,475	8.44
Total interest-bearing liabilities of banking book	**511,381**	**7,346**	**1.44**	528,035	6,297	1.19	566,600	8,551	1.51
Total interest-bearing liabilities of trading book	**50,700**	**534**							