SUPPLEMENTARY PROSPECTUS DATED 5 MARCH 2010

Lloyds Banking Group plc

as Issuer and Guarantor

(incorporated in Scotland with limited liability under the Companies Act 1985 with registered number 95000)

Lloyds TSB Bank plc

as Issuer

(incorporated in England with limited liability under the Companies Act 1862 and the Companies Act 1985 with registered number 2065)

U.S.$35,000,000,000
Senior and Subordinated Medium-Term Notes
Due Nine Months or More from Date of Issue

This Supplement (the "**Supplement**") to the Base Prospectus dated 11 November 2009 (the "**Base Prospectus**"), which comprises a base prospectus for the purposes of Article 5.4 of Directive 2003/71/EC, constitutes a supplementary prospectus for the purposes of Section 87G of the Financial Services and Markets Act 2000 (the "**FSMA**") and is prepared in connection with the U.S.$35,000,000,000 Medium-Term Note Programme (the "**Programme**") established by Lloyds Banking Group plc (the "**Company**" or the "**Guarantor**") and Lloyds TSB Bank plc (the "**Bank**") (each, an "**Issuer**" and together, the "**Issuers**").

This Supplement is supplemental to, and should be read in conjunction with, the Base Prospectus and the documents incorporated by reference therein. This Supplement should also be read and construed in conjunction with the supplement to the Base Prospectus dated 4 January 2010 (the "**January 2010 Supplement**") which was previously published and approved by the Financial Services Authority (the "**FSA**") and filed with it and forms part of the Base Prospectus.

Each of the Issuers and the Guarantor accepts responsibility for the information contained in this Supplement. To the best of the knowledge of each of the Issuers and the Guarantor (each having taken all reasonable care to ensure that such is the case) the information contained in this Supplement is in accordance with the facts and does not omit anything likely to affect the import of such information.

AMENDMENTS TO THE BASE PROSPECTUS

Incorporation of Information by Reference

The following documents, which have been previously published and approved by the FSA or filed with it, shall be deemed to be incorporated in, and form part of, the Base Prospectus:

(i) (a) the unaudited condensed consolidated financial statements for the financial year ended 31 December 2009, as set out on pages 97 to 136 of the Company's Results News Release for the year ended 31 December 2009 (the "**Company's 2009 Results**"); (b) the first complete paragraph on page 14 of the Company's 2009 Results (together with note 6 on page 112 of the Company's 2009 Results, the "**Impairment Update**"); and (c) the first sentence of the fourth complete paragraph on page 17 of the Company's 2009 Results;

(ii) the Bank's Results Announcement for the year ended 31 December 2009 (the "**Bank's 2009 Results**"); and

(iii) HBOS's Results Announcement for the year ended 31 December 2009 (the "**HBOS 2009 Results**");.

Any documents themselves incorporated by reference in the documents incorporated by reference in the Base Prospectus shall not form part of the Base Prospectus.

Risk Factors

The section entitled "Risks relating to the Issuers" in Appendix 1 to the January 2010 Supplement shall be deleted and replaced with the contents of Appendix 1 hereto.

Lloyds Banking Group

The section entitled "Lloyds Banking Group" in Appendix 2 to the January 2010 Supplement shall be deleted and replaced with the contents of Appendix 2 hereto.

Recent Developments

The section entitled "Recent Developments" in Appendix 3 to the January 2010 Supplement shall be deleted and replaced with the contents of Appendix 3 hereto.

General Information

Paragraph 1 of the section entitled "General Information" on page 194 of the Base Prospectus shall be deleted and replaced with the following:

"The Company was incorporated and registered in Scotland on 21 October 1985 with registered number 95000 as a public company limited by shares under the name TSB Group Public Limited Company. On 28 December 1995, it changed its name to Lloyds TSB Group plc. On 16 January 2009, the Company changed its name to its present name. The principal legislation under which the Company operates is the Companies Act and regulations made thereunder. The Company is domiciled in Scotland. Its head office is at 25 Gresham Street, London EC2V 7HN (Tel. +44 (0)20 7626 1500) and its registered office is at The Mound, Edinburgh EH1 1YZ."

Paragraph 5 of the section entitled "General Information" on page 194 of the Base Prospectus shall be deleted and replaced with the following:

"Save as disclosed in the section entitled "Lloyds Banking Group - Legal Actions" on page 43 of the supplement published on 5 March 2010, there are no governmental, legal or arbitration proceedings (including any such proceedings pending or threatened of which the Company is aware) during the 12 months preceding the date of this Prospectus, which may have or have had in the recent past, significant effects on the financial position or profitability of Lloyds Banking Group."

Paragraph 6 of the section entitled "General Information" on page 194 of the Base Prospectus shall be deleted and replaced with the following:

"Save as disclosed in the section entitled "Lloyds Banking Group - Legal Actions" on page 43 of the supplement published on 5 March 2010, there are no governmental, legal or arbitration proceedings (including any such proceedings pending or threatened of which the Bank is aware) during the 12 months preceding the date of this Prospectus, which may have or have had in the recent past, significant effects on the financial position or profitability of Lloyds TSB Bank Group."

Paragraph 7 of the section entitled "General Information" on page 194 of the Base Prospectus shall be deleted and replaced with the following:

"Save as disclosed in the sub-section entitled "Capital Restructuring" under the heading "Recent Developments" on page 47 of the supplement filed on 5 March 2010, there has been no significant change in the financial or trading position of Lloyds Banking Group since 30 June 2009, the date to which the Group's last published interim financial information was prepared, and save as disclosed in Risk Factor 1.3 of this document relating to the European Commission state aid review of the aid given by HM Treasury to the Group, there has been no material adverse change in the prospects of Lloyds Banking Group since 31 December 2008."

Paragraph 8 of the section entitled "General Information" on page -2- of the January 2010 Supplement shall be deleted and replaced with the following:

"Save as disclosed in the sub-section entitled "Group Reorganisation" under the heading "Recent Developments" on page 47 of the supplement published on 5 March 2010, there has been no significant change in the financial or trading position of Lloyds TSB Bank Group since 30 June 2009, the date to which Lloyds TSB Bank Group's last published interim financial information was prepared, and save as disclosed in Risk Factor 1.3 relating to European Commission state aid review of the aid given by HM Treasury to the Group, there has been no material adverse change in the prospects of Lloyds TSB Bank Group since 31 December 2008."

Paragraph 9 of the section entitled "General Information" on page 195 of the Base Prospectus shall be deleted and replaced with the following:

"For so long as the medium-term note programme described in this Base Prospectus remains in effect or any notes shall be outstanding, copies and, where appropriate, the following documents may be inspected during normal business hours at the specified office of the paying agent and the registered office of the Company, The Mound, Edinburgh EH1 1YZ, including:

(a) the constitutive documents of the Company and the Bank;

(b) this Base Prospectus in relation to the medium-term note programme, together with any amendments;

(c) the Program Agreement;

(d) the Senior Indenture;

(e) the Subordinated Indenture;

(f) the most recent publicly available reviewed or audited consolidated financial statements for the Company and the Bank beginning with such financial statements for the six months ended 30 June 2009 and the years ended 31 December 2008, 2007 and 2006;

(g) the report of PricewaterhouseCoopers LLP in respect of the audited consolidated financial statements of the Company and the Bank for the financial years ended 31 December 2008, 31 December 2007 and 31 December 2006; and

(h) any Final Terms relating to notes issued under the medium-term note programme described in this Base Prospectus that are listed, traded and/or quoted on a stock exchange.

The issue of notes under the programme by the Company and the giving of the Guarantees by the Company has been authorised by resolutions of the board of directors of the Company dated 25 January 2008 and 19 June 2009. The issue of notes under the programme by the Bank has been authorised by resolutions of the board of directors of the Bank dated 25 January 2008, 17 April 2009 and 19 June 2009."

The Issuers and Guarantor will provide, without charge, to each person to whom a copy of this Supplement has been delivered, upon the oral or written request of such person, a copy of any or all of the documents which are incorporated in whole or in part by reference herein or in the Base Prospectus. Written or oral requests for such documents should be directed to the Company at its registered office at The Mound, Edinburgh, EH1 1YZ or to the Bank at its registered office at 25 Gresham Street, London, EC2V 7HN.

To the extent that there is any inconsistency between (a) any statement in this Supplement or any statement incorporated by reference into the Base Prospectus by this Supplement and (b) any other statement in or incorporated by reference in the Base Prospectus, the statements in (a) above will prevail.

Save as disclosed in this Supplement, no other significant new factor, material mistake or inaccuracy relating to information included in the Base Prospectus has arisen or been noted, as the case may be, since the publication of the Base Prospectus.

An investor should be aware of its rights arising pursuant to Section 87Q(4) of the FSMA.

Appendix 1
RISK FACTORS

1 RISKS RELATING TO THE GROUP

1.1 The Group's businesses are subject to inherent risks arising from general and sector-specific economic conditions in the UK and other markets in which it operates. Adverse developments, such as the severe dislocation in the global financial markets, recession, and further deterioration of general economic conditions, particularly in the UK, have already adversely affected the Group's earnings and profits and could continue to cause its earnings and profitability to decline. In addition, any credit rating downgrades of sovereigns, particularly the United Kingdom, Spain and Republic of Ireland (or a perception that downgrades may occur) may severely destabilise the markets and could have a material adverse effect on the Group's operating results, financial condition and prospects.

The Group's businesses are subject to inherent risks arising from general and sector-specific economic conditions in the markets in which it operates, particularly the United Kingdom, in which the Group's earnings are predominantly generated. Over approximately the past two years, the global economy and the global financial system have been experiencing a period of significant turbulence and uncertainty. The very severe dislocation of the financial markets around the world, that began in August 2007 and has substantially worsened since September 2008, triggered widespread problems at many large global and UK commercial banks, investment banks, insurance companies and other financial and related institutions. This dislocation has severely impacted general levels of liquidity, the availability of credit and the terms on which credit is available. This crisis in the financial markets led the UK Government and other governments to inject liquidity into the financial system and to require (and participate in) recapitalisation of the banking sector to reduce the risk of failure of certain large institutions and provide confidence to the market.

Despite this intervention, the volatility and market disruption in the banking sector has continued albeit with some easing in the second half of 2009. This market dislocation has also been accompanied by recessionary conditions and trends in many economies throughout the world, including the United Kingdom. The global economy has been in a severe recession, possibly the worst since World War II, although indications are that the UK has now emerged from its 18 month recession. The widespread and severe deterioration in the UK and virtually all other economies throughout the world, including, but not limited to, business and consumer confidence, unemployment trends, the state of the housing market, the commercial real estate sector, equity markets, bond markets, foreign exchange markets, commodity markets, counterparty risk, inflation, the availability and cost of credit, lower transaction volumes in key markets, the liquidity of the global financial markets and market interest rates, has already and could continue to reduce the level of demand for, and supply of, the Group's products and services, lead to lower asset and other realisations and increased negative fair value adjustments and impairments of investments and other assets and materially and adversely impact its operating results, financial condition and prospects. While recent economic figures show a number of countries exiting recession, forecasts are that the recovery will be at a modest pace and is likely to be protracted. Any further significant deterioration in the UK and other economies in which the Group operates could have a material adverse impact on the future results of operations of the Group. Moreover, any return to economic growth may be modest and is likely to be insufficient to prevent unemployment rising further. The rate at which deterioration of the global and UK economies has occurred has proven very difficult to predict and this will apply to any further deterioration or any recovery.

Additionally, the profitability of the Group's businesses could be affected by increased insurance and other claims arising from market factors such as increased unemployment which may continue even following a return to economic growth in the markets in which the Group operates. Significantly higher unemployment in the UK and elsewhere, reduced corporate profitability, reduced personal non-salary income levels, increased corporate insolvency rates, increased personal insolvency rates, increased tenant defaults and/or increased interest rates may reduce borrowers' ability to repay loans and may cause prices of residential or commercial real estate or other asset prices to fall further, thereby reducing the collateral value on many of the Group's loans. This, in turn, would cause increased impairments in the event of default. Poor general economic conditions, lack of market liquidity and lack of transparency of asset structures have depressed asset valuations for the Group and could continue to do so if there is a further deterioration in general economic conditions.

The Group has significant exposures, particularly by way of loans, in a number of overseas jurisdictions, notably Ireland, Spain, Australia and the United States, and is therefore subject to a variety of risks relating to the performance of these economies as well.

In addition, the Group's businesses are subject to risks arising from the current UK macroeconomic environment, high and increasing levels of UK government debt and uncertainty around the outcome of the forthcoming UK general election (including the possibility of a minority or coalition administration which may be unable to take decisive fiscal and other measures to reduce government debt levels resulting in heightened market uncertainty). Further, any downgrade of the UK sovereign credit rating or the perception that such a downgrade may occur may severely destabilise the markets and have a material adverse effect on the Group's operating results, financial condition and prospects. This might also include impact on the Group's own credit ratings, borrowing costs and ability to fund itself.

A UK sovereign downgrade or the perception that such a downgrade may occur would be likely to have a material effect in depressing consumer confidence, restricting the availability, and increasing the cost, of funding for individuals and companies, further depressing economic activity, increasing unemployment, reducing asset prices and consequently increasing the risk of a "double-dip" recession.

These risks are exacerbated by concerns over the levels of the public debt of, and the weakness of the economies in, Italy, the Republic of Ireland, Greece, Portugal, and Spain in particular. Further instability in these countries or others within the Eurozone might lead to contagion, which may have a material adverse effect on the Group's operating results, financial condition and prospects.

The exact nature of the risks faced by the Group is difficult to predict and guard against in view of (i) the severity of the global financial crisis, (ii) difficulties in predicting whether the recovery will be sustained and at what rate, and (iii) the fact that many of the related risks to the business are totally, or in part, outside the control of the Group.

1.2 ***The Commissioners of Her Majesty's Treasury ("HM Treasury") is the largest shareholder of the Company. Through its shareholding in, and other relationships with, the Company, HM Treasury is in a position to exert significant influence over the Group and its business.***

HM Treasury currently holds approximately 41.3 per cent. of the ordinary share capital of the Company. The two exchange offers announced by the Group on 3 November 2009 (the "**Exchange Offers**") involve the potential conversion of the enhanced capital notes (the "**Enhanced Capital Notes**" or "**ECNs**"), which are being offered for exchange, into ordinary shares pursuant to their terms. It is not possible to calculate precisely the total dilutive effect any potential conversion of ECNs may have on HM Treasury's ownership interest in the Company but HM Treasury is expected to remain a significant shareholder in the Company.

In the longer term, it may become necessary for the Group to raise further capital or seek the support of the UK Government (as described in Risk Factor 1.5). Any such capital raising or support from the UK Government could result in an increase in HM Treasury's shareholding in the Company.

No formal "relationship agreement" has been concluded between the Group and the UK Government in respect of its shareholding in the Company and no specific measures are in place to limit the level of control which may be exercised by HM Treasury. However, the relationship falls within the scope of the revised framework document between HM Treasury and UK Financial Investments Limited published on 13 July 2009. Nevertheless, there is a risk that HM Treasury might seek to exert influence over the Group, and may disagree with the commercial decisions of the Group, including over such matters as the implementation of synergies, commercial and consumer lending policies and management of the Group's assets and/or business.

There is also a risk that, through its interests in the Company, the UK Government and HM Treasury may be able to influence the Group in other ways that would have a material adverse effect on the Group's business, including among other things, the election of directors, the appointment of senior management at the Company, staff remuneration policies, lending policies and commitments, management of the Group's business including, in particular, management of the Group's assets such as its existing retail and corporate loan portfolios, significant corporate transactions and the issue of new ordinary shares. Shareholders may disagree as to whether an action opposed or supported by HM Treasury is in the best interests of the Group generally. Furthermore, HM Treasury also has interests in other UK financial institutions, as well as an interest in the health of the UK banking industry and other industries generally, and those interests may not always be aligned with the commercial interests of the Group or its shareholders.

1.3 The Group is subject to European state aid obligations following the approval of its restructuring plan by the European Commission on 18 November 2009. The implementation of this restructuring plan may have consequences that are materially adverse to the interests of the Group. Moreover, should a third party successfully challenge the European Commission's decision to approve the Group's restructuring plan, or should the Group require additional state aid in the future, further restructuring measures could be required and these may be materially adverse to the interests of the Group.

As a result of the Group's placing and open offer in November 2008 and the Group's participation in HM Treasury's credit guarantee scheme (the "**Credit Guarantee Scheme**"), which was announced on 8 October 2008, the Group has been required to cooperate with HM Treasury to submit a restructuring plan to the European Commission setting out the Group's plans to restructure and return to a position of viability in which it no longer relies on state aid.

On 18 November 2009 the European Commission approved the Group's restructuring plan. The principal elements of the plan are set out in this document at "Recent Developments — Capital Restructuring" and address competition distortions from all elements of state aid that the Group has received, including HM Treasury's participation in the placing and compensatory open offer in June 2009 and the rights issue in November 2009 (the "**Rights Issue**"), as well as any commercial benefit received by the Group following its announcement in March 2009 of the intention it held at that time to participate in GAPS. The approval also covers the Group's ongoing participation in HM Treasury's Credit Guarantee Scheme at current levels up to June 2010. The Company has agreed with HM Treasury in the deed of withdrawal relating to the Company's withdrawal from GAPS (the "**GAPS Withdrawal Deed**") that it will comply with the terms of the European Commission's decision.

It is possible that a third party could challenge the decision of the College of Commissioners to approve the restructuring plan in the European Courts. The Group does not believe that any such challenge would be likely to succeed, but if it were to succeed the Commission would need to reconsider its decision, which could result in more extensive remedies being applied including the disposal of a significantly larger proportion of the Group's assets and/or a significantly more stringent divestment timetable or more onerous behavioural restrictions than those contemplated in the approved restructuring plan.

The Group will also be subject to a variety of risks as a result of implementing the restructuring plan. There is no assurance that the price that the Group receives for any assets sold pursuant to the restructuring plan will be at a level the Group considers adequate or which it could obtain in circumstances in which the Group was not required to sell such assets in order to implement a state aid restructuring plan or if such sale were not subject to the restrictions contained in the terms thereof. In particular, should the Group fail to complete the disposal of the retail banking business that the Group is required to divest within four years, a divestiture trustee would be appointed to conduct the sale, with a mandate to complete the disposal with no minimum price (including at a negative price). In implementing the plan, the Group will lose existing customers, deposits and other assets (both directly through the sale and potentially through damage to the rest of the Group's business arising from implementing the restructuring plan) and the potential for realising additional associated revenues and margins that it otherwise might have achieved in the absence of such disposals. Such implementation may also result in disruption to the retained business, impacting on customers and separation costs which could potentially be substantial.

The effect of implementing the approved restructuring plan may be the emergence of one or more new viable competitors in the UK banking market or a material strengthening of one or more of the Group's competitors in that market. There can be no assurance that the Group will be able to continue to compete as effectively (whether against existing or new or strengthened competitors) and maintain or improve its revenues and margins in the resulting competitive environment, which could adversely affect the Group's results of operations and financial condition and its business generally. If any or all of the risks described in this paragraph, or any other currently unforeseen risks, materialise, there could be a negative impact, which could be material, on the Group's business, operations and competitive position.

Should the Group require any further state aid that was not covered in the European Commission's approval decision of 18 November 2009, this may require the Group to commit to further restructuring measures. Any such measures could be materially adverse to the interests of the Group.

1.4 Future legislative and regulatory changes could force the group to comply with certain operational restrictions, take steps to raise further capital, or divest assets.

In July 2009, the UK Government issued a White Paper (the "**White Paper**") which builds on and responds to the previously published Turner Review (March 2009) and Bank of England Financial Stability Report (June 2009), both of which contained proposals for reform of the structure and regulation of the UK banking system.

Proposals in the White Paper include: enhanced regulatory powers for the FSA; introducing pre-funding for the UK's deposit guarantee scheme by 2012; requiring banks to develop and maintain detailed plans for winding down (or resolution); and more stringent capital and liquidity requirements for systemically significant firms. The Government's stated aim in linking capital requirements to the size and complexity of systemically significant firms, is that, "The capital requirements in place for systemically significant institutions would need to be sufficient to change incentives of banks to overindulge in risky activities throughout the economic cycle. This should encourage them to reduce or at least better understand the riskier activities they undertake (for example, proprietary trading) and reduce the moral hazard problem by removing the incentive for firms to become systemically significant".

A second Turner Review discussion paper (October 2009) developed issues highlighted for further discussion in the March review, specifically how to offset the moral hazard created by the existence of systemically important banks and the cumulative impact of changes to the capital and liquidity schemes. Key proposals include: using contingent capital which converts to equity when required; reducing the interconnectedness of large cross-border banks; restricting retail banks from engaging in proprietary trading activities; and emphasising the need to prioritise capital conservation and enhancement above employee bonus payments.

In November 2009 the draft Financial Services Bill was presented to Parliament. This bill consolidates some of the proposals presented in the White Paper, in addition to enhancing the FSA's disciplinary and enforcement powers. Specifically, the bill provides the FSA with the power to require authorised firms to prepare recovery and resolution plans and act in accordance with the FSA's remuneration rules. The proposals set out in the White Paper, Turner Reviews and draft legislation, if implemented, could have a significant impact on the operations, structure and costs of the Group.

There is a risk that the regulation or legislation that may be developed over time to implement these proposals (including the Financial Services Bill) could force the Group to divest core assets, withdraw from or not engage in some activities, and/or increase its capital. Such regulations or legislation, taken with the more regular and detailed reporting obligations which are expected to accompany regulatory reform, the development and maintenance of a wind down plan, and the move to pre-funding of the deposit protection scheme in the UK, would result in additional costs for the Group, and such costs could be material.

Such measures could have a material adverse effect on the Group's results of operations, financial condition and prospects.

On 5 October 2009, the FSA published its new liquidity rules which significantly broaden the scope of the existing liquidity regime and are designed to enhance regulated firms' liquidity risk management practices. Procedures to comply with the FSA's liquidity proposals are already incorporated within the Group's liquidity funding plans. These will result in more stringent requirements, which may lead to additional costs for the Group. See Risk Factor 1.14 for a fuller discussion of liquidity risks affecting the Group.

1.5 Regulatory capital requirements affect the Group's business.

The Group is subject to extensive regulation and regulatory supervision in relation to the levels of capital in its business. Currently, the Group meets and exceeds its regulatory capital requirements. The Group expects to continue to meet both its regulatory capital requirements and the additional capital requirements imposed by the FSA Stress Test. However, the FSA could apply increasingly stringent stress case scenarios in determining the required capital ratios for the Group and other banks, increase the minimum regulatory requirements imposed on the Group, introduce liquidity restrictions, introduce new ratios and/or change the manner in which it applies existing regulatory requirements to recapitalised banks including those within the Group. Specifically, in relation to the consultation papers issued by the Basel Committee on Banking Supervision ("Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring"), the Group is participating in the industry-wide consultation and calibration exercises taking place through 2010. In order to meet additional regulatory capital requirements, the Group may be forced to raise further capital.

Further, within the Group, the heritage Lloyds TSB Group and HBOS Group businesses may have approaches to the Basel II modelling of regulatory capital requirements which may differ according to the assumptions used. As the two model methodologies are aligned over time this may result in changes to the Group's combined reported level of regulatory capital.

The Group's ability to maintain its targeted and regulatory capital ratios in the longer term could be affected by a number of factors, including net synergies and implementation costs following the Acquisition, and its level of risk-weighted assets, post-tax profit and fair value adjustments. In addition to the fair value adjustments, the Group's core tier 1 capital ratio will be directly impacted by any shortfall in forecasted after-tax profit (which could result, most notably, from greater than anticipated asset impairments and/or adverse volatility relating to the insurance or lending businesses). Furthermore, under Basel II, capital requirements are inherently more sensitive to market movements than under previous regimes and capital requirements will increase if economic conditions or negative trends in the financial markets worsen.

If the regulatory capital requirements, liquidity restrictions or ratios applied to the Group are increased in the future, any failure of the Group to maintain such increased regulatory capital ratios could result in administrative actions or sanctions, which in turn may have a material adverse effect on the Group's operating results, financial condition and prospects. A shortage of available capital would also affect the Group's ability to pay dividends, continue organic growth or pursue acquisitions or other strategic opportunities. In particular, changes in regulatory capital requirements imposed by the Group's regulators could cause the Group to defer the re-introduction of ordinary dividends or change its dividend policy.

The Group's life assurance and general insurance businesses in the UK are subject to capital requirements prescribed by the FSA, and the Group's life and general insurance companies outside the UK are subject to local regulatory capital requirements. In July 2007, the European Commission published a draft proposal for primary legislation to define broad 'framework' principles for Solvency II, a fundamental review of the capital adequacy regime for the European insurance industry. Solvency II aims to establish a revised set of EU-wide capital requirements where the required regulatory capital will be dependent upon the risk profile of the entities, together with risk management standards, that will replace the current Solvency I requirements. Solvency II is still in development, but there is a risk that the final regime could increase the amount of regulatory capital the Group's life assurance and general insurance businesses are required to hold, thus decreasing the amount of capital available for other uses.

1.6 The Company has agreed to certain undertakings with HM Treasury in relation to the operation of its business in connection with the Company's placing and open offers in November 2008 and May 2009, in connection with the Group's participation in the Credit Guarantee Scheme and as part of its formerly proposed participation in GAPS. The implications of some of these undertakings remain unclear and they could have a material adverse effect on the Group's results of operations, financial condition and prospects. The Group also agreed to certain other commitments in the GAPS Withdrawal Deed.

In connection with HM Treasury's participation in the placing and open offers in November 2008 and May 2009, the Group's participation in the Credit Guarantee Scheme and its possible participation in GAPS, the Company provided certain undertakings aimed at ensuring that the acquisition by HM Treasury of the Company's shares and the participation of the Group in the UK Government funding scheme as part of its support for the banking industry is consistent with the European state aid clearance. The state aid rules aim to prevent companies from being given an artificial or unfair competitive advantage as a result of governmental assistance. It is the Group's understanding that the undertakings are also aimed at supporting certain objectives of HM Treasury in providing assistance to the UK banking industry. These undertakings include (i) supporting UK Government policy in relation to mortgage lending and lending to businesses through to the end of February 2011, (ii) regulating the remuneration of management and other employees and (iii) regulating the rate of growth of the Group's balance sheet. There is a risk that these undertakings or any further requirements introduced by HM Treasury could have a materially adverse effect on the operations of the Group.

On 6 March 2009, in connection with the Group's then proposed participation in GAPS, the Company entered into a commitment to increase lending by £14 billion in the 12 months commencing 1 March 2009 to support UK businesses (£11 billion) and homeowners (£3 billion). As part of withdrawing from GAPS, the Group has agreed in the GAPS Withdrawal Deed to reaffirm its overall lending commitments and to maintain in the 12 months commencing 1 March 2010 similar levels of lending as in the 12 months commencing 1 March 2009, subject to adjustment of the lending commitments by agreement with the UK Government to reflect circumstances at the start of the 12 month period commencing 1 March 2010. Negotiations are ongoing with the UK Government to agree the precise terms of the commitment in respect of the year commencing 1 March 2010, in line with these requirements. This additional lending in 2009 and 2010 is expected to be subject to the Group's prevailing commercial terms and conditions (including pricing and risk assessment) and, in relation to mortgage lending, the Group's standard credit and other acceptance criteria. This commitment could, however, limit the operational flexibility of the Group.

1.7 The Group could fail to attract or retain senior management or other key employees.

The Group's success depends on the ability and experience of its senior management and other key employees. The loss of the services of certain key employees, particularly to competitors, could have a material adverse effect on the Group's results of operations, financial condition and prospects. In addition, as the Group's businesses develop, both in the UK and in other jurisdictions, future success will depend on the ability to attract and retain highly-skilled and qualified personnel, which cannot be guaranteed, particularly in light of the increased regulatory intervention in financial institutions and management compensation arrangements coming under government prescription. For example, the Group's remuneration arrangements are subject to the FSA's Rule and supporting Code on remuneration (which only apply to certain financial institutions), effective from 1 January 2010 for the 2009 performance year. In addition, in the GAPS Withdrawal Deed, the Group has acknowledged to HM Treasury its commitment to the principle that, from 2010, it should be at the leading edge of implementing the G20 principles, the FSA code and any remuneration provisions accepted by the Government from the Walker Review, provided that this principle shall always allow the Group to operate on a level playing field with its competitors. Furthermore, the Group has agreed with HM Treasury the specific deferral and clawback terms which will apply to any bonuses in respect of the 2009 performance year and these may affect the Group's ability to offer competitive remuneration arrangements.

Therefore, depending on the nature of the remuneration arrangements developed, staff retention and recruitment may become more difficult. The failure to attract or retain a sufficient number of appropriate personnel could significantly impede the Group's financial plans, growth and other objectives and have an adverse effect on its business, financial position and results of operations.

In addition, failure to manage trade union relationships effectively may result in disruption to the business and its operations causing potential financial and reputational loss.

1.8 The Group's businesses are subject to substantial regulation, and regulatory and governmental oversight. Adverse regulatory developments or changes in government policy could have a significant material adverse effect on the Group's operating results, financial condition and prospects.

The Group conducts its businesses subject to ongoing regulation and associated regulatory risks, including the effects of changes in the laws, regulations, policies, voluntary codes of practice and interpretations in the UK and the other markets where it operates. This is particularly the case in the current market environment, which is witnessing increased levels of government and regulatory intervention in the banking sector, which the Group expects to continue for the foreseeable future. Future changes in regulation, fiscal or other policies are unpredictable and beyond the control of the Group and could materially adversely affect the Group's business.

Areas where changes could have an adverse impact include, but are not limited to:

(i) the monetary, interest rate and other policies of central banks and regulatory authorities;

(ii) general changes in government or regulatory policy, or changes in regulatory regimes that may significantly influence investor decisions in particular markets in which the Group operates, may change the structure of those markets and the products offered or may increase the costs of doing business in those markets;

(iii) changes to prudential regulatory rules relating to capital adequacy and liquidity frameworks;

(iv) external bodies applying or interpreting standards or laws differently to those applied by the Group historically;

(v) changes in competition and pricing environments;

(vi) further developments in requirements relating to financial reporting, corporate governance, conduct of business and employee compensation;

(vii) expropriation, nationalisation, confiscation of assets and changes in legislation relating to foreign ownership; and

(viii) other unfavourable political, military or diplomatic developments producing social instability or legal uncertainty which, in turn, may affect demand for the Group's products and services.

In particular, the July 2009 White Paper and the Financial Services Bill (presented to Parliament in November 2009) both contain a wide range of legislative proposals. Some proposals (how to offset moral hazard problems and the impact of changes to the capital and liquidity schemes) were discussed in the second Turner Review published in October 2009 and, more recently, in the Basel Committee on Banking Supervision consultation papers released in December 2009. Although many of the proposals in these papers are subject to further discussion and the achievement of a wider international consensus, see Risk Factor 1.4 for a further discussion of liquidity proposals which are expected to proceed in advance of any international consensus, there is a risk that if the Government chooses to proceed with certain of its proposals more quickly than anticipated, this could adversely affect the competitive position of UK banks, including the Group.

In addition, under the Banking Act, substantial powers over the Group's business, including the ability to take control of the Group's business, have been granted to HM Treasury, the Bank of England and the FSA. In the longer term, if the position of a relevant entity in the Group were to decline so dramatically that it was considered to be failing, or likely to fail, to meet threshold authorisation conditions in the FSMA, it could become subject to the exercise of powers by HM Treasury or the

Bank of England under the special resolution regime (the "**SRR**"). There can be no assurance that, if economic conditions deteriorate significantly in the future and/or if the financial position of the Group deteriorates significantly in the future, further UK Government or other intervention will not take place, including pursuant to the Banking Act. For a discussion of the Banking Act see "Lloyds Banking Group — Regulation — Other Relevant Legislation and Regulation — UK Government") herein.

In the United Kingdom and elsewhere, there is also increased political and regulatory scrutiny of the banking industry and, in particular, retail banking. Increased regulatory intervention may lead to requests from regulators to carry out wide ranging reviews of past sales and/or sales practices. In the United Kingdom, the Competition Commission, the FSA and the Office of Fair Trading ("**OFT**") have recently carried out, or are currently conducting, several inquiries. In recent years, regulators have increased their focus on consumer protection and there have been several issues in the UK financial services industry in which the FSA has intervened directly, including the sale of investment products, personal pensions and mortgage-related endowments. See "Lloyds Banking Group — Regulation" herein. Under the GAPS Withdrawal Deed, the Group has, among other things, agreed to implement any measures relating to personal current accounts agreed between the OFT and the UK banking industry.

In light of the ongoing market uncertainty, the Group expects to face increased regulation and political and regulatory scrutiny of the financial services industry. The UK Government, the FSA or other regulators in the United Kingdom or overseas may intervene further in relation to the areas of industry risk already identified, or in new areas, which could adversely affect the Group.

In addition, the Group faces increased political and regulatory scrutiny as a result of the Acquisition. Such scrutiny may focus on, or include review of, the historical or future operations of the HBOS Group as well as the characteristics of the enlarged Group and future operation of the markets concerned. Regulatory reviews and investigations may result in enforcement actions and public sanction, which could expose the Group to an increased risk of litigation in addition to financial penalties and/or the deployment of such regulatory tools as the relevant regulator deems appropriate in the circumstances. The outcome of any regulatory review, proceeding or complaint against the Group or the heritage HBOS Group is inherently uncertain and difficult to predict particularly at the early stages and could have a material adverse effect on the Group's operations and/or financial condition, especially to the extent the scope of any such proceedings expands beyond its original focus. See "Lloyds Banking Group — Regulation — Regulatory Approach of the FSA — FSA Supervisory Review into Historical HBOS Disclosures" and "Lloyds Banking Group-Regulation — Other Relevant Legislation and Regulation" herein.

Such increased scrutiny may result in part from the Group's increased size and systemic importance following the Acquisition. For example, in clearing the Acquisition without a reference to the UK Competition Commission, the Secretary of State noted that there were some competition concerns identified by the OFT in the markets for personal current accounts and mortgages in Great Britain and the market for SME banking in Scotland. The Secretary of State then asked the OFT to keep relevant markets under review in order to protect the interests of UK consumers and the British economy. Partly in response to this request, in April 2009 the OFT launched a consultation on its plans for keeping UK financial markets under review. At this time, the OFT has indicated its intention to focus its efforts in the financial services markets on the banking sector, including credit, leasing and debt recovery activities. Amongst other plans, it has announced its intention to launch a review of the unsecured consumer credit sector in 2009 which will address the offerings of suppliers, the role of intermediaries and the behaviour of and decisions made by consumers. The OFT has also reiterated that it will consider whether to refer any banking markets to the Competition Commission if it identifies any prevention, restriction or distortion of competition. On 29 July 2009, following consultation on its proposed plans, the OFT published a final plan for its activities in the financial services markets in 2009. The outcome of any reviews by the OFT or referrals to the Competition Commission could adversely affect the Group.

Compliance with any changes in regulation or with any regulatory intervention resulting from political or regulatory scrutiny may significantly increase the Group's costs, impede the efficiency of its internal business processes, limit its ability to pursue business opportunities, or diminish its reputation. Any of these consequences could have a material adverse effect on the Group's operating results, financial condition and prospects.

1.9 The Group's businesses are inherently subject to the risk of market fluctuations, which could materially adversely affect its operating results, financial condition and prospects.

The Group's businesses are inherently subject to risks in financial markets and in the wider economy, including changes in, and increased volatility of, interest rates, inflation rates, credit spreads, foreign exchange rates, commodity, equity, bond and property prices and the risk that its customers act in a manner which is inconsistent with business, pricing and hedging assumptions.

Market movements have had and will have an impact on the Group in a number of key areas. For example, adverse market movements have had and would have an adverse effect, which could be material, upon the financial condition of the pension schemes of the Group. Banking and trading activities that are undertaken by the Group are subject to interest rate risk, foreign exchange risk, inflation risk and credit spread risk. For example, changes in interest rate levels, yield curves and spreads affect the interest rate margin realised between lending and borrowing costs. Since August 2007, there has been a period of unprecedented high and volatile interbank lending margins over official rates (to the extent banks have been willing to lend at all), which has exacerbated these risks. The margins over official rates have recently reduced to historically more normal levels but volatility and increases in margins may return. Competitive pressures on fixed rates or product terms in existing loans and deposits sometimes restrict the Group in its ability to change interest rates applying to customers in response to changes in official and wholesale market rates.

The insurance businesses of the Group face market risk arising, for example, from equity, bond and property markets in a number of ways depending upon the product and associated contract; for example, the annual management charges received in respect of investment and insurance contracts fluctuate, as do the values of the contracts, in line with the markets. Some of these risks are borne directly by the customer and some are borne by the insurance businesses. Some insurance contracts involve guarantees and options that have increased in value in the current adverse investment markets and may continue to do so. There is a risk that the insurance businesses will bear some of the cost of such guarantees and options. The insurance businesses also have capital directly invested in the markets that are exposed to market risk. The performance of the investment markets will thus have a direct impact upon the embedded value of insurance and investment contracts and the Group's operating results, financial condition and prospects. Adverse market conditions affect investor confidence, which in turn can result in lower sales and/or reduced persistency.

Changes in foreign exchange rates affect the value of assets and liabilities denominated in foreign currencies and such changes and the degree of volatility with respect thereto may affect earnings reported by the Group. In the Group's international businesses, earnings and net assets are denominated in local currency, which will fluctuate with exchange rates in pounds sterling terms. It is difficult to predict with any accuracy changes in economic or market conditions, and such changes could have a material adverse effect on the Group's operating results, financial condition and prospects.

1.10 Market conditions have resulted, and are expected to result in the future, in material changes to the estimated fair values of financial assets of the Group. Negative fair value adjustments have had, and may continue to have in the future, a further material adverse effect on the Group's operating results, financial condition and prospects.

Financial markets have been subject to significant stress conditions resulting in steep falls in perceived or actual financial asset values, particularly due to the severe dislocation in the global financial markets.

The Group has material exposures to securities and other investments, including, but not limited to, asset-backed securities, structured investments and private equity investments, that are recorded at fair value and are therefore exposed to further negative fair value adjustments, particularly in view of market dislocation and the fragility of the economic recovery. Although the Board of Directors of the Company (the "**Board**") believes that overall impairments for the Group have peaked, asset valuations in future periods, reflecting prevailing market conditions, may result in further negative changes in the fair values of the Group's financial assets and these may also translate into increased impairments. In addition, the value ultimately realised by the Group for its securities and other investments may be lower than the current fair value. Any of these factors could require the Group to record further negative fair value adjustments, which may have a material adverse effect on its operating results, financial condition or prospects.

The Group has made asset redesignations as permitted by recent amendments to IAS 39 ("**Financial Instruments: Recognition and Measurement**"). The effect of such redesignations has been, and would be, that any effect on the income statement of movements in the fair value of such redesignated assets that have occurred since 1 July 2008, in the case of assets redesignated prior to 1 November 2008, or may occur in the future, may not be recognised until such time as the assets become impaired or are disposed of.

In addition, to the extent that fair values are determined using financial valuation models, the data used by such models may not be available or may become unavailable due to changes in market conditions, particularly for illiquid assets, and particularly in times of substantial instability. In such circumstances, the Group's valuation methodologies require it to make assumptions, judgements and estimates in order to establish fair value. These valuation models are complex and the assumptions used are difficult to make and are inherently uncertain, particularly in light of the uncertainty resulting from the current and ongoing crisis in the global financial markets, and any consequential impairments or write-downs could have a material adverse effect on the Group's operating results, financial condition and prospects.

1.11 The Group may fail to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or may incur unanticipated costs associated with, the Acquisition. As a consequence, the Group's results of operations, financial condition and prospects may suffer.

The continued integration of the HBOS Group into the Group is complex, expensive and presents a number of challenges for the management of both the heritage Lloyds TSB Group, the HBOS Group and their respective staff and potentially their respective customers. The Group believes that it will achieve its reported anticipated cost synergies as well as other operating efficiencies and business growth opportunities, revenue benefits and other benefits from the Acquisition. However, these expected business growth opportunities, revenue benefits, cost synergies and other operational efficiencies and other benefits may not develop, including because the assumptions upon which the Group determined the Acquisition consideration may prove to be incorrect. For example, the expected cost synergies were calculated by the Group on the basis of the existing and projected cost and operating structures of the Group and its estimate of the existing and projected cost and operating structures of the HBOS Group. Statements of estimated synergies and other effectiveness and calculations of the costs of achieving them relate to future actions and circumstances which, by their nature, involve risks, uncertainties, contingencies and other factors. As a result, the synergies and other efficiencies referred to may not be achieved, or those achieved may be materially different from those estimated.

The Group may also face a number of other risks with respect to the Acquisition including retaining key employees; redeploying resources in different areas of operations to improve efficiency; unifying financial reporting and internal control procedures, minimising the diversion of management attention from ongoing business concerns, overcoming integration challenges (particularly as the Company's management may be unfamiliar with some aspects of the HBOS Group's business and operations) and addressing possible differences between the Bank's business culture, risk management, compliance systems and processes, controls, procedures, systems, accounting practices and implementation of accounting standards in respect of the HBOS Group.

Under any of these circumstances, the business growth opportunities, revenue benefits, cost synergies and other benefits anticipated by the Group to result from the Acquisition may not be achieved as expected, or at all, or may be delayed. To the extent that the Group incurs higher integration costs or achieves lower revenue benefits or fewer cost savings than expected, its operating results, financial condition and prospects may suffer.

1.12 The Group's businesses are subject to inherent risks concerning borrower and counterparty credit quality which have affected and are expected to continue to affect the recoverability and value of assets on the Group's balance sheet.

As one of the UK's largest lenders with substantial business and operations overseas, the Group has exposures to many different products and counterparties, and the credit quality of its exposures can have a significant impact on its earnings. The Group makes both secured and unsecured loans to retail and corporate customers and the Group's businesses are subject to inherent risks regarding the credit quality of, the recovery of loans to and amounts due from, customers and market counterparties. Adverse changes in the credit quality of the Group's UK and/or international borrowers and counterparties, or in their behaviour, would be expected to reduce the value of the Group's assets, and materially increase the Group's write-downs and allowances for impairment losses.

The Group estimates and establishes reserves for credit risks and potential credit losses inherent in its credit exposure. This process, which is critical to its results and financial condition, requires difficult, subjective and complex judgements, including forecasts of how these economic conditions might impair the ability of its borrowers to repay their loans. As is the case with any such assessments, there is always a risk that the Group will fail to identify the proper factors or that it will fail to estimate accurately the impact of factors that it identifies.

As a result of the Acquisition, the composition of the Group's wholesale portfolio has materially changed, with much larger sectoral concentrations (for example in real estate, leveraged lending, asset-backed securities and floating rate notes issued by financial institutions) and higher levels of credit risk including substantially greater exposures, particularly in Ireland, Australia and the US.

At the time of the Acquisition, the average rating of the HBOS Group's corporate lending portfolio was significantly weaker than that of the heritage Lloyds TSB Group, and this continues to be the case.

HBOS had substantial lending to mid-sized and private companies, a greater exposure than the heritage Lloyds TSB Group to leveraged finance and subordinated loans, as well as significant exposure to the commercial real estate sector, including hotels and residential property developers, which has been particularly adversely affected by the recessionary environment. These concentrations in cyclically weak sectors, as well as exposure at various levels of the capital structure, mean that the heritage HBOS wholesale business is potentially exposed to high and volatile levels of impairments.

It should be noted that the heritage HBOS portfolio in Ireland is heavily exposed to the commercial and residential real estate sectors, which have been negatively impacted by the current economic recession, the portfolio in Australia has material exposure to real estate and leveraged lending, and in the United States there are notable exposures to sectors such as gaming and real estate which are cyclically weak and have been negatively impacted by the economic recession. As in the UK, the heritage HBOS portfolio overseas is also particularly exposed to a small number of long-term customer relationships and these single name concentrations place the Group at risk of loss should default occur.

UK house prices have declined significantly, albeit modest increases have been evident in recent months, reflecting a correction of severely inflated asset values, triggered by the economic downturn and lower availability of credit. Economic or other factors may lead to further contraction in the mortgage market and further decreases in housing prices. Many borrowers in the UK borrow on short-term fixed or discounted floating rates and when such rates expire the continued reduced supply and stricter terms of mortgages, together with the potential for higher mortgage rates, could lead to higher default and delinquency rates. The Group provides mortgages to buy-to-let investors where increasing unemployment, an excess supply of rental property or falls in rental demand could also impact the borrowers' income and ability to service the loans. If interest rates rise, or the current economic recovery falters, causing further decreases in house prices and/or increases in unemployment, the Group's retail portfolios could generate substantial impairment losses which could materially affect its operations, financial condition and prospects. Furthermore, the Group has direct exposure to self-certification and sub-prime mortgages in the UK and is therefore subject to the risks inherent in this type of mortgage lending in the event of decreases in house prices, increases in unemployment or a reduction in borrowers' incomes and the risk that the Group has incorrectly assessed the credit quality or willingness to pay of borrowers as a result of incomplete or inaccurate disclosure by those borrowers. At present, mortgage default and delinquency rates are cushioned by unprecedented low rates of interest which have improved customer affordability, and this has created the risk of increased defaults and delinquency rates as the economy recovers from the recession and interest rates start to rise.

Although the Board believes that overall impairments for the Group have peaked, there is a risk of further increases in the impairment charges for some businesses and there remain ongoing concerns with regard to the outlook for the Irish economy in particular. Moreover, there remains a risk that further material impairments in the Group's portfolios could come to light, particularly in the event of any further significant deterioration in the economic environment although the performance of some of the Group's exposures might deteriorate further even in the absence of further economic decline, particularly in Ireland. Any such unforeseen material further impairments could have a material and adverse effect on the Group's operations, financial condition and prospects.

1.13 Concentration of credit and market risk could increase the potential for significant losses.

The Group has exposure to concentration risk where its business activities focus particularly on a similar type of customer or product or geographic location including the UK market, which could be adversely affected by changes in economic conditions. Additionally, the heritage HBOS strategy of supporting UK entrepreneurs together with its joint venture model and its focus on commercial property lending has given rise to significant single name and risk capital exposure. Given the Group's high concentrations of property exposure, further decreases in residential or commercial property values and/or further tenant defaults are likely to lead to higher impairment losses, which could materially affect its operations, financial condition and prospects.

The Group's efforts to diversify or hedge its credit portfolio against concentration risks may not be successful and any concentration of credit risk could increase the potential for significant losses in its credit portfolio. In addition, the disruption in the liquidity or transparency of the financial markets may result in the Group's inability to sell or syndicate securities, loans or other instruments or positions held, thereby leading to increased concentrations of such positions. These concentrations could expose the Group to losses if the mark-to-market value of the securities, loans or other instruments or positions declines causing the Group to take write-downs. Moreover, the inability to reduce the Group's positions not only increases the market and credit risks associated with such positions, but also increases the level of risk-weighted assets on the Group's balance sheet, thereby increasing its capital requirements and funding costs, all of which could adversely affect the Group's operating results, financial condition and prospects. The Acquisition has in some cases increased the Group's exposure to concentration risk, since the combination of two portfolios inevitably gives rise to some greater concentrations than would otherwise have been permitted. Market conditions at present mean that it is difficult to achieve sales to ameliorate these concentrations.

1.14 The Group's businesses are subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits or the access to wholesale money markets continues to be limited or becomes more limited. The Group continues to be reliant on various government liquidity schemes and since certain of these schemes are not expected to be renewed or extended, the Group will face refinancing risk as transactions under these schemes mature.

The Group's businesses are subject to risks concerning liquidity, which are inherent in banking operations. If access to liquidity is constrained for a prolonged period of time, this could affect the Group's profitability. Whilst the Group expects to have sufficient access to liquidity to meet its funding requirements even in a stressed scenario, under extreme and unforeseen circumstances a prolonged and severe restriction on the Group's access to liquidity (including government and central bank funding and liquidity support) could affect the Group's ability to meet its financial obligations as they fall due or to fulfil its commitments to lend, and in such extreme circumstances the Group may not be in a position to continue to operate without additional funding support, which it may be unable to access, which could have a material impact on the Group's solvency. These risks can be exacerbated by many enterprise-specific factors, including an over-reliance on a particular source of funding (including, for example, securitisations, covered bonds, foreign markets and short-term and overnight money markets), changes in credit ratings, or market-wide phenomena such as market dislocation and major disasters. There is also a risk that corporate and institutional counterparties may look to reduce aggregate credit exposures to the Group or to all banks which could increase the Group's cost of funding and limit its access to liquidity. In addition, the funding structure employed by the Group may prove to be inefficient giving rise to a level of funding cost that is not sustainable in the long run. The funding needs of the Group will increase to the extent that customers, including conduit vehicles of the Group, draw down under existing credit arrangements with the Group and such increases in funding needs may be material. In order to continue to meet its funding obligations and to maintain or grow its businesses generally, the Group relies on customer savings and transmission balances, as well as ongoing access to the global wholesale funding markets, central bank liquidity facilities (for example, Bank of England, European Central Bank and Federal Reserve Bank of New York) and the UK

Government Credit Guarantee Scheme. The ability of the Group to access wholesale and retail funding sources on satisfactory economic terms is subject to a variety of factors, including a number of factors outside of its control, such as liquidity constraints, general market conditions, regulatory requirements the encouraged or mandated repatriation of deposits by foreign wholesale or central bank depositors and loss of confidence in the UK banking system any of which could affect the Group's profitability or, in the longer term under extreme circumstances, its ability to meet its financial obligations as they fall due.

Medium-term growth in the Group's lending activities will depend, in part, on the availability of retail funding on appropriate terms, for which there is increasing competition. See Risk Factor 1.23 for a discussion of the competitive nature of the banking industry and competitive pressures that could have a negative impact on the availability of customer deposits and retail funding. This reliance has increased in the recent past given the difficulties in accessing wholesale funding. Increases in the cost of such funding will impact on the Group's margins and affect profit, and a lack of availability of such retail deposit funding could impact on the Group's future growth.

The ongoing availability of retail deposit funding is dependent on a variety of factors outside the Group's control, such as general economic conditions and market volatility, the confidence of retail depositors in the economy in general and in the Group in particular, the financial services industry specifically and the availability and extent of deposit guarantees. These or other factors could lead to a reduction in the Group's ability to access retail deposit funding on appropriate terms in the future. Any loss in consumer confidence in the banking businesses of the Group could significantly increase the amount of retail deposit withdrawals in a short space of time and this may have an adverse effect on the Group's profitability. Should the Group experience an unusually high and unforeseen level of withdrawals, in such extreme circumstances the Group may not be in a position to continue to operate without additional funding support, which it may be unable to access, which could have a material impact on the Group's solvency.

Whilst the Group expects to have sufficient access to liquidity to meet its funding requirements even in a stressed scenario, under extreme and unforeseen circumstances a prolonged and severe restriction on the Group's access to liquidity (including government and central bank funding and liquidity support) could prevent the Group from meeting its regulatory minimum liquidity requirements.

In addition, if the current difficulties in the wholesale funding markets are not resolved or central bank provision of liquidity to the financial markets is abruptly curtailed, it is likely that wholesale funding will prove even more difficult to obtain. Such liquidity constraints could affect the Group's profitability. Whilst the Group expects to have sufficient access to liquidity to meet its funding requirements even in a stressed scenario, under extreme and unforeseen circumstances a prolonged and severe restriction on the Group's access to these traditional sources of liquidity could have a material adverse effect on the Group's business, financial position and results of operations, and in such extreme circumstances the Group may not be in a position to continue to operate without additional funding support, which it may be unable to access and which, in turn, could have a material impact on the Group's solvency.

Whilst various governments, including the UK Government, and central banks have taken substantial measures to ease the crisis in liquidity, (for example, the UK Credit Guarantee Scheme), there can be no assurance that these measures will succeed in materially improving the liquidity position of major UK banks, including the Group in the longer term. In addition, the availability and the terms on which any such measures will continue to be made available to the Group in the longer term are uncertain.

The Group does not have influence over the policy making behind such measures. Further, there can be no assurance that these conditions will not lead to an increase in the overall concentration risk and cost of funding of the Group. The Group has substantially relied on the Bank of England liquidity facilities as well as the UK Government funding scheme. The Group does not expect that there will be any extension or renewal of the Special Liquidity Scheme (which was closed for new transactions in January 2009) or the Credit Guarantee Scheme (which was closed for new issuance in February 2010). Accordingly, the Group will face a refinancing concentration during 2011 and 2012 associated with the maturity of the Special Liquidity Scheme transactions and Credit Guarantee Scheme issuance undertaken by the Group prior to the closure of those schemes. While the Group expects that the impact of this refinancing concentration can be mitigated by a combination of alternative funding over the course of the next two years and reductions in the Group's net wholesale funding requirement over the same period, there can be no assurance that these mitigation efforts will be successful. Under the GAPS Withdrawal Deed, the Group has agreed to develop with the FSA a medium term funding plan aimed at reducing dependence on short term funding, to be regularly reviewed by the FSA and the Bank of England. If the Group's funding plan is not successful in mitigating the impact of this refinancing concentration in 2011, the Group could at that time face serious liquidity constraints, which would have a material adverse impact on its solvency.

At the time of the Acquisition, the HBOS Group had a funding profile that involved the need to refinance a higher volume of maturing wholesale funding than that of the heritage Lloyds TSB Group. As this continues to be the case, the funding profile of the Group involves substantially higher refinancing risk than the funding profile of the heritage Lloyds TSB Group on a stand-alone basis. The Group will also continue to be dependent on its credit ratings in order to be able to attract wholesale investors into its debt issuance programmes; should the ratings fall, the cost of refinancing will increase and it may not be possible to refinance borrowings as they mature on favourable terms. Such increased refinancing risk, in isolation or in concert with the related liquidity risks noted above, could have a material adverse effect on the Group's profitability and, in the longer term under extreme and unforeseen circumstances, its ability to meet its financial obligations as they fall due.

1.15 The Group has been and could continue to be negatively affected by the soundness and/or the perceived soundness of other financial institutions, which could result in significant systemic liquidity problems, losses or defaults by other financial institutions and counterparties, and which could materially adversely affect the Group's results of operations, financial condition and prospects.

Against the backdrop of the lack of liquidity and the recent high cost of funds relative to official rates in the interbank lending market, which was unprecedented in recent history, the Group is subject to the risk of deterioration of the commercial soundness and/or perceived soundness of other financial services institutions within and outside the United Kingdom. Financial services institutions that deal with each other are interrelated as a result of trading, investment, clearing, counterparty and other relationships. This risk is sometimes referred to as 'systemic risk' and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with whom the Group interacts on a daily basis, all of which could have an adverse effect on the Group's ability to raise new funding.

The Group routinely executes a high volume of transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds and other institutional clients, resulting in a significant credit concentration. The Group is exposed to counterparty risk as a result of recent financial institution failures and nationalisations and will continue to be exposed to the risk of loss if counterparty financial institutions fail or are otherwise unable to meet their obligations. A default by, or even concerns about the financial resilience of, one or more financial services institutions could lead to further significant systemic liquidity problems, or losses or defaults by other financial institutions, which could have a material and adverse effect on the Group's results of operations, financial condition and prospects.

1.16 If the perceived creditworthiness of market counterparties does not improve or continues to deteriorate, the Group may be forced to record further credit valuation adjustments on securities insured or guaranteed by such parties, which could have a material adverse effect on the Group's results of operations, financial condition and prospects.

The Group has credit exposure to market counterparties through securities insured or guaranteed by such parties and credit protection bought from such parties with respect to certain over-the-counter derivative contracts, mainly credit default swaps ("**CDSs**") which are carried at fair value. The fair value of these underlying CDSs and other securities, and the Group's exposure to the risk of default by the underlying counterparties, depend on the valuation and the perceived credit risk of the instrument insured or guaranteed or against which protection has been bought. Market counterparties have been adversely affected by their exposure to residential mortgage-linked products, and their perceived creditworthiness has deteriorated significantly since 2007. They may continue to be substantially adversely impacted by such or other events. Their creditworthiness may further deteriorate as a consequence of the deterioration of the value of underlying assets. Although the Group seeks to limit and manage direct exposure to market counterparties, indirect exposure may exist through other financial arrangements and counterparties. If the financial condition of market counterparties or their perceived creditworthiness deteriorates further, the Group may record further credit valuation adjustments on the underlying instruments insured by such parties in addition to those already recorded. Any primary or indirect exposure to the financial condition or creditworthiness of these counterparties could have a material adverse impact on the results of operations, financial condition and prospects of the Group.

1.17 The Group's insurance businesses and employee pension schemes are subject to risks relating to insurance claim rates, pension scheme benefit payment levels and changes in insurance customer and employee pension scheme member behaviour.

The life and pensions insurance businesses of the Group and its employee pension schemes are exposed to short-term and longer-term variability arising from uncertain longevity and ill-health rates. Adverse developments in any of these factors will increase the size of the Group's insurance and employee pension scheme liabilities and may adversely affect the Group's financial condition and results of operations.

Customer behaviour in the life and pensions insurance business may result in increased propensity to cease contributing to or cancel insurance policies at a rate in excess of business assumptions. The consequent reduction in policy persistency and fee income has an adverse impact upon the profitability of the life and pensions business of the Group. The behaviour of employee pension scheme members affects the levels of benefits payable from the schemes. For example, the rate at which members cease employment affects the aggregate amount of benefits payable by the schemes. This rate may differ from applicable business assumptions. Adverse variances may increase the size of the Group's aggregate pension liabilities and may adversely affect the Group's financial condition and results of operations.

The general insurance businesses of the Group are exposed to the risk of uncertain insurance claim rates. For example, extreme weather conditions can result in high property damage claims, higher levels of theft can increase claims on property, contents and motor vehicle insurance and changes to unemployment levels can increase claims on loan protection insurance. These claims rates may differ from business assumptions and negative developments may adversely affect the Group's financial condition and results of operations.

UK banks recognise an insurance asset in their balance sheets representing the value of in-force business ("**VIF**") in respect of long-term life assurance contracts, being insurance contracts and investment contracts with discretionary participation features. This asset represents the present value of future profits expected to arise from the portfolio of in-force life assurance contracts. Adoption of this accounting treatment results in the earlier recognition of profit on new business, but subsequently a lower contribution from existing business, when compared to the recognition of profits on investment contracts under IAS 39 (Financial Instruments: Recognition and Measurement). Differences between actual and expected experience may have a significant impact on the value of the VIF asset, as changes in experience can result in significant changes to modelled future cash flows. The VIF asset is calculated based on best-estimate assumptions made by management, including mortality experience and persistency. If these assumptions prove incorrect, the VIF asset could be materially reduced, which in turn could have a material adverse effect on the Group's financial condition and results of operations.

Also, as further described in Risk Factor 1.9, the Group's insurance assets are subject to the risk of market fluctuations.

1.18 The Group's borrowing costs and access to the capital markets depend significantly on the Company's credit ratings and market perception of the Company's financial resilience and those of the Bank, HBOS and BOS and any deterioration could materially adversely affect the Group's results of operations, financial condition and prospects.

As at 5 March 2010, the long-term credit ratings for the Company were A1 from Moody's Investors Service Limited, A from Standard & Poor's Ratings Services, AA- (AA minus) from Fitch Ratings Ltd and A (high) from DBRS. As at 5 March 2010, the long-term credit ratings for the Bank were Aa3 from Moody's Investors Service Limited, A+ (A plus) from Standard & Poor's Ratings Services, AA- (AA minus) from Fitch Ratings Ltd and AA (low) from DBRS. As at 5 March 2010, the long-term credit ratings for HBOS were A1 from Moody's Investors Service Limited, A from Standard & Poor's Rating Services, AA- (AA minus) from Fitch Ratings Ltd and AA (low) from DBRS. As at 5 March 2010, the long-term credit ratings for BOS were Aa3 from Moody's Investors Service Limited, A+ (A plus) from Standard & Poor's Ratings Services, AA- (AA minus) from Fitch Ratings Ltd and AA (low) from DBRS.

As at 5 March 2010, the Company also had short-term ratings of A-1 from Standard & Poor's Ratings Services and F1+ from Fitch Ratings Ltd. The Bank had short-term ratings of P-1 from Moody's Investors Service Limited, A-1 from Standard & Poor's Ratings Services, F1+ from Fitch Ratings Ltd and R-1 (middle) from DBRS. HBOS had short-term ratings of P-1 from Moody's Investors Service Limited, A-1 from Standard & Poor's Ratings Services, F1+ from Fitch Ratings Ltd and R-1 (middle) from DBRS. BOS had short-term ratings of P-1 from Moody's Investors Service Limited, A-1 from Standard & Poor's Ratings Services, F1+ from Fitch Ratings Ltd and R-1 (middle) from DBRS.

Reduction in the credit ratings of the Group or deterioration in the capital market's perception of the Group's financial resilience, could significantly increase its borrowing costs, limit its access to the capital markets and trigger additional collateral requirements in derivative contracts and other secured funding arrangements. Therefore, any further reduction in credit ratings or deterioration of market perception could materially adversely affect the Group's access to liquidity and competitive position, increase its funding costs and, hence, have a material adverse effect on the Group's business, financial position and results of operations. These material adverse effects could also follow from a reduction in the credit ratings of the Bank, HBOS or BOS.

1.19 In the United Kingdom, firms within the Group are responsible for contributing to compensation schemes in respect of banks and other authorised financial services firms that are unable to meet their obligations to customers.

In the United Kingdom, the Financial Services Compensation Scheme ("**FSCS**") was established under the FSMA and is the UK's statutory fund of last resort for customers of authorised financial services firms. The FSCS can pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it. The FSCS is funded by levies on firms authorised by the FSA, including firms within the Group. The recent arrangements put in place to protect the depositors of Bradford & Bingley and other failed deposit-taking institutions involving the FSCS are expected to result in a significant increase in the levies made by the FSCS on the industry. The Group has made a provision of £122 million in its 2008 accounts in respect of its current obligation to contribute its share of the management expenses levy and the estimated interest cost on the FSCS borrowings. Going forward, further provisions in respect of these costs are likely to be necessary until the borrowings are repaid. The ultimate cost to the industry, which will also include the cost of any compensation payments made by the FSCS and, if necessary, the cost of meeting any shortfall after recoveries on the borrowings entered into by the FSCS, remains uncertain although it may be significant and the associated costs to the Group may have a material adverse effect on its results of operations and financial condition.

There is also uncertainty over how the FSCS arrangements will develop as a consequence of regulatory reform initiatives in the United Kingdom and internationally. The FSCS and the arrangements which support it are potentially subject to changes which could impose additional costs and expose the Group to risks. For example, the FSA has proposed that UK deposit-taking institutions develop systems by 31 December 2010 to produce a Single Customer View ("**SCV**"), providing an aggregated view of each customer's eligibility for compensation in the event of a failure. As this proposal proceeds, and depending on how the FSA requires firms to execute it, the SCV has the potential to divert management attention from competing priorities. In the event that the Group fails to deliver such a project to the regulator's standards or timetables, there is the risk of public sanction, financial penalty and/or the deployment by the FSA of such other regulatory tools as it deems appropriate to the circumstances. Other potential changes to the FSCS arrangements with the potential to require the Group to incur additional costs or expose the Group to risks may arise from ongoing discussions at the national and European Union levels around the future design of deposit protection schemes, including but not limited to potentially increasing the level of protection which is accorded to deposits and/or moving to pre-funding of compensation schemes. HM Treasury intends to carry out a consultation exercise before introducing any proposals relating to pre-funding of the FSCS.

1.20 The Group's financial statements are based in part on assumptions and estimates which, if wrong, could cause losses in the future.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, include impairment of financial assets, valuation of financial instruments, pensions, goodwill, insurance and taxation. If the judgements, estimates and assumptions used by the Group in preparing its consolidated financial statements are subsequently found to be incorrect, there could be a material impact on the Group's results of operations.

1.21 *The Group is exposed to various forms of legal and regulatory risk, including the risk of mis-selling financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice, any of which could have a material adverse effect on its results or its relations with its customers.*

The Group is exposed to many forms of legal and regulatory risk, which may arise in a number of ways. Primarily:

(i) certain aspects of the Group's business may be determined by the authorities, the Financial Ombudsman Service ("**FOS**") or the courts as not being conducted in accordance with applicable laws or regulations, or, in the case of FOS, with what is fair and reasonable in the Ombudsman's opinion. For more information on additional constraints that may be imposed as a result of the European state aid clearance process, see also Risk Factor 1.3;

(ii) the possibility of alleged mis-selling of financial products or the mishandling of complaints related to the sale of such products by or attributed to a member of the Group, resulting in disciplinary action or requirements to amend sales processes, withdraw products, or provide restitution to affected customers; all of which may require additional provisions;

(iii) contractual obligations may either not be enforceable as intended or may be enforced against the Group in an adverse way;

(iv) the Group holds accounts for a number of customers that might be or are subject to interest from various regulators and authorities including the Serious Fraud Office, those in the US and others. The Group is not aware of any current investigation into the Group as a result of any such enquiries but cannot exclude the possibility of the Group's conduct being reviewed as part of any such investigations;

(v) the intellectual property of the Group (such as trade names) may not be adequately protected; and

(vi) the Group may be liable for damages to third parties harmed by the conduct of its business.

In addition, the Group faces risk where legal or regulatory proceedings, complaints made by FOS or other complaints are brought against it in the UK High Court or elsewhere, or in jurisdictions outside the UK, including other European countries and the United States (which may include class action lawsuits). See Note 48 to the 2008 consolidated financial statements beginning on page 162 of the Company's 2008 Annual Report (such pages being incorporated by reference into this Prospectus). For example, a major focus of US governmental policy relating to financial institutions in recent years has been combating money laundering and terrorist financing and enforcing compliance with US economic sanctions.

Failure to manage these risks adequately could impact the Group adversely, both financially and reputationally, through an adverse impact on the Group's brands.

1.22 *Weaknesses or failures in the Group's internal processes and procedures and other operational risks could materially adversely affect the Group's results of operations, financial condition and prospects and could result in reputational damage.*

Operational risks, through inadequate or failed internal processes and/or systems (including financial reporting and risk monitoring processes) or from people-related or external events, including the risk of fraud and other criminal acts carried out against the Group, are present in the Group's businesses. The Group's businesses are dependent on their ability to process and report accurately and efficiently a high volume of complex transactions across numerous and diverse products and services, in different currencies and subject to a number of different legal and regulatory regimes. Any weakness in such internal controls and processes could have a negative impact on the Group's results or its ability to report adequately such results during the affected period. Furthermore, damage to the Group's reputation (including to customer confidence) arising from actual or perceived inadequacies, weaknesses or failures in Group systems or processes could have a significant adverse impact on the Group's businesses. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that either the Company or any relevant company within the Group will be unable to comply with its obligations as a company with securities admitted to the Official List or as a supervised firm regulated by the FSA (as the case may be).

1.23 The Group's businesses are conducted in highly competitive environments and the Group's financial performance depends upon management's ability to respond effectively to competitive pressures.

The markets for UK financial services, and the other markets within which the Group operates, are highly competitive, and management expects such competition to intensify in response to competitor behaviour, consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors. Moreover, UK Government and/or European intervention in the banking sector may impact the competitive position of the Group relative to its international competitors which may be subject to different forms of government intervention, thus potentially putting the Group at a competitive disadvantage to local banks in such jurisdictions. Any combination of these factors could result in a reduction in profit. The Group's financial performance and its ability to capture additional market share depends significantly upon the competitive environment and management's response to it.

The Group's financial performance may be materially and adversely affected by competition, including declining lending margins or competition for savings driving up funding costs which cannot be recovered from borrowers. Adverse persistency in the Group's insurance business is a risk to current and future earnings.

A key part of the Group's strategy involves building strong customer relationships in order to win a bigger share of its customers' financial services spend. If the Group is not successful in retaining and strengthening customer relationships it will not be able to deliver on this strategy, and may lose market share, incur losses on some or all of its activities or fail to attract new and retain existing deposits, which could have a material adverse effect on its business, financial condition and results of operations.

1.24 Terrorist acts, other acts of war, geopolitical, pandemic or other such events could have a material adverse impact on the Group's results of operations, financial condition and prospects.

Terrorist acts, other acts of war or hostility, geopolitical, pandemic or other such events and responses to those acts/events may create economic and political uncertainties, which could have a material adverse impact on UK and international economic conditions generally, and more specifically on the business and results of the Group in ways that cannot necessarily be predicted.

1.25 The Company is wholly dependent on dividends from its subsidiary to meet its obligations, including obligations with respect to debt securities.

Lloyds Banking Group plc is a non-operating holding company and as such its principal source of income is from its operating subsidiary Lloyds TSB Bank plc which holds the principal assets of the Group. As a separate legal entity, the Company relies on remittance of dividends and other funds in order to be able to pay obligations to debt holders as they fall due.

1.26 The Bank is partly dependent on dividends from its subsidiaries to meet its obligations, including its obligations with respect to debt securities.

Lloyds TSB Bank plc is a bank as well as a holding company and as such one of its sources of income is dividends from its operating subsidiaries in order to be able to pay obligations to debt holders as they fall due. Following the Group Reorganisation, a proportion of Lloyds TSB Bank plc's income will in future be derived from the businesses and assets of the HBOS Group. As a result, Lloyds TSB Bank plc relies in part on remittance of dividends and other funds through the HBOS Group in order to be able to pay obligations to debt holders as they fall due.

1.27 Changes in taxation rates or law, or failure to manage the risks associated with such changes, or misinterpretation of the law, could materially and adversely affect the Group's results of operations, financial condition and prospects.

Tax risk is the risk associated with changes in taxation rates or law, or misinterpretation of the law. This could result in increased charges, financial loss including penalties, and reputational damage. Changes in taxation rates or law, or failure to manage these risks adequately could impact the Group materially and adversely and could have a material negative impact on the Group's performance.

1.28 HM Treasury's acquisition of its shareholding in the Company, the Acquisition, any further increase in HM Treasury's shareholding in the Company or the aggregation of HM Treasury's interests with that of certain other shareholders could lead to the Group suffering adverse tax consequences.

Certain Group companies have material tax losses and reliefs which they anticipate carrying forward to reduce tax payable in the future. If HM Treasury's acquisition of its shareholding in the Company the Acquisition, any further increase in HM Treasury's shareholding in the Company, or the aggregation of HM Treasury's interests with that of other shareholders holding 5 per cent. or more, is coupled with the occurrence of certain specified events in relation to the Group companies with such losses or reliefs (including a major change in the nature or conduct of a trade carried on by such a Group company, or an increase in capital of such a Group company with an investment business), there would, in the case of legacy HBOS Group companies, and could, in the case of legacy Lloyds TSB Group companies, be restrictions on the ability to utilise these losses and reliefs. The Rights Issue, the Exchange Offers or the conversion of the Enhanced Capital Notes may result in certain shareholders holding 5 per cent. or more of the Company Restrictions on the ability to utilise losses and reliefs could affect the post-tax profitability and capital position of the Group.

The Company considers that it will be able to conduct its business, and the business of the Group, in a manner which avoids the occurrence of these specified events. However, the ability to do so cannot be predicted with any certainty at the date of this document.

Appendix 2
LLOYDS BANKING GROUP

The Bank was incorporated on 20 April 1865 (Registration number 2065). The Bank's registered office is at 25 Gresham Street, London EC2V 7HN, telephone number 020 7626 1500. The Bank, together with HBOS and BOS, is a wholly owned subsidiary of the Company.

Overview

The Group is a leading UK-based financial services group providing a wide range of banking and financial services in the UK and a limited number of locations overseas to personal and corporate customers. Its main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

History and development of Lloyds Banking Group

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

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

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

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

Pursuant to two placing and open offers which were completed by the Company in January and May 2009 and the Rights Issue completed in December 2009, the UK Government acquired 43.4 per cent. of the Company's issued ordinary share capital. Following the issue of ordinary shares in February 2010 as part of the Exchange Offers, the UK Government's holding was reduced to approximately 41.3 per cent. See "— Major Shareholders" and "— Related Party Transactions" herein for a description of the Group's relationship with the UK Government.

The Group now operates through a number of significant brands including Lloyds TSB, Halifax, Bank of Scotland, Scottish Widows, Clerical Medical and C&G.

Strategy

The Group's vision is to be recognised as the best financial services organisation in the UK by customers, colleagues (employees) and shareholders.

The strategy for the Group remains to grow the business through developing long-term relationships and building its customer franchise, and its focus remains within the UK. The Group's businesses are focused on extending the reach and depth of their customer relationships, whilst enhancing product capabilities to build competitive advantage. A prudent 'through the cycle' approach to risk continues to be applied within the Group and will remain important as the Group strives to improve its processing efficiency and use of capital.

The Group has a diversified UK financial services business and is a leading financial services provider in the UK. The board believes that the UK remains an attractive market and that the Group has good potential within its existing franchises to grow by meeting more of the Group's customers' needs as well as through adding new customers to the franchise, notwithstanding near term economic conditions (see Risk Factor 1.1 for a discussion of such economic conditions).

The integration with HBOS presents an opportunity to achieve cost leadership through combining both customer bases into the proven Lloyds TSB platform. The board believes that the Group has market leading distribution and sales capabilities, products and services as well as middle and back office processes that deliver a high quality customer experience. The Group aspires to have one of the lowest cost to income ratios for financial institutions in the UK, and the anticipated synergies, which are expected to be substantial, arising from the Acquisition will be key to further improving efficiency levels. The effective integration of the two businesses will be a significant challenge over the next few years, but the combination of the two businesses provides a real opportunity to create the UK's leading financial services organisation. See "Historical Financial Information Relating to Lloyds Banking Group - Operating and Financial Review Relating to Lloyds Banking Group for the Years Ending 31 December 2009 and 2008 - Overview, Trend Information and Outlook" for a discussion of the post-Acquisition synergies achieved in 2009.

The Group's directors believe that the heritage Lloyds TSB Group relationship-focused 'through the cycle' approach to risk management has demonstrated its effectiveness. This prudent approach to risk is being rolled out across the combined Group. The new Group has already exited a number of non-core areas in which HBOS previously participated and will continue to assess participation in business areas on a conservative basis.

The Group has four primary operating divisions: Retail, Insurance, Wholesale, and Wealth and International. The key product markets in which these divisions participate is presented in "Businesses and Activities".

Since August 2007, global financial markets have experienced a period of significant turmoil resulting in a negative impact on capital ratios and liquidity in the banking sector. Throughout this period, the Group has maintained a robust liquidity position based on its significant retail and corporate deposit base and funding from the wholesale markets. The Group has continued to reinforce its funding position by actively participating in the liquidity initiatives introduced by the Bank of England and HM Treasury.

The Group believes that the successful execution of this strategy focusing on core markets, customer and cost leadership, capital efficiency and a prudent risk appetite will enable the Group to achieve its vision to be recognised as the best financial services organisation in the UK.

Businesses and Activities

The Group's activities are organised into four divisions: Retail, Insurance, Wholesale and Wealth and International. The main activities of these divisions and key statistics as at 31 December 2009 are described below.

Retail

The Retail division provides current accounts, savings, personal loans, credit cards and mortgages in the UK. With its strong stable of brands including Lloyds TSB, Halifax, Bank of Scotland and Cheltenham & Gloucester, it serves over 30 million customers through one of the largest branch and fee free ATM network in the UK.

Retail has approximately 22 million current account customers and provides social banking to over 4 million people through basic banking or social banking accounts. It is also a leading provider of personal loans and credit cards in the UK. Retail provides one in four residential mortgages, making it a leading UK mortgage lender in addition to being a major provider of home finance for the first time buyer. Retail is the largest savings provider in the UK, with over 21 million savers. It is also a major bancassurance distributor, selling a wide range of long term savings and investment products.

Wholesale

The Wholesale division comprises Corporate Markets, Treasury and Trading and Asset Finance.

Corporate Markets comprises Corporate, Commercial, Corporate Real Estate, Specialist Finance and Wholesale Markets. Corporate, Commercial and Corporate Real Estate provide relationship-based banking, risk management and advisory services to corporate and commercial customers principally in the UK. Relationships with customers with an annual turnover greater than £15 million are managed within Corporate, and commercial property-based relationships (including hotel, property-based leisure and construction) are managed within the Corporate Real Estate business. Commercial provides financial services to business customers ranging from new start-ups to those with a turnover of up to £15 million and invoice discounting and factoring services to a broader range of customers. Specialist Finance includes the acquisition finance and private equity businesses; all new business is being written under the brand of Lloyds Acquisition Finance or Lloyds Development Capital. Wholesale Markets provides risk management solutions specialised lending, capital markets advisory and multi-product financing solutions to its customers, whilst managing the Group's own portfolio of structured credit investments and treasury assets.

Treasury and Trading's role is to provide access to financial markets in order to meet the Group's balance sheet management requirements, and it provides trading infrastructure to support execution of customer-driven risk management transactions whilst operating within a well controlled and conservative risk appetite.

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

Wealth and International

The Wealth business comprises private banking, wealth and asset management businesses in the UK and overseas. The key operations are UK and International Private Banking (which operate under the Lloyds TSB and Bank of Scotland brands), the Channel Islands and Isle of Man offshore businesses, the expatriates business and the Asset Management business, which following the completion of the sale of Insight Investment, is now consolidated within the Scottish Widows Investment Partnership. In addition, the Group holds a 60 per cent. stake in St. James's Place plc and a 55 per cent. stake in Invista Real Estate, the UK's largest independent listed wealth manager and real estate fund management group, respectively.

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

Insurance

The Insurance division comprises: Life, Pensions and Investments UK; Life, Pensions and Investments Europe; and General Insurance.

Life, Pensions and Investments UK

The UK Life, Pensions and Investments business is the leading bancassurance provider in the UK and has one of the largest intermediary sales forces in the industry. The business includes Scottish Widows, which, for a number of years, has been a subsidiary of the Bank and the provider of long term savings and investment products distributed through all channels of that group. Following the Acquisition, the Life, Pensions and Investments business also includes business written through the intermediary and bancassurance channels under the Clerical Medical and Halifax brands respectively.

Life, Pensions and Investments Europe

The European Life, Pensions and Investments business distributes products primarily in the German market under the Heidelberger Leben and Clerical Medical brands. The business unit was included within the International division of the former HBOS group.

General Insurance

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

Competitive Environment

The Group is a diversified UK based financial services group providing a wide range of banking and financial services, predominantly in the UK, to personal and corporate customers. Its main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision.

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

The Group's businesses are subject to inherent risks arising from general and sector-specific economic conditions in the markets in which it operates, particularly the United Kingdom in which the Bank's earnings are predominantly generated. Following the Acquisition, the Group now has greater exposure in a number of other jurisdictions; these include Ireland, Australia and the United States, and hence the Group is exposed to general and sector-specific economic conditions in these markets. Over approximately the past 30 months, the global economy and the global financial system have been experiencing a period of significant turbulence and uncertainty, particularly the very severe dislocation of the financial markets around the world that began in August 2007. This has substantially worsened since September 2008 and has contributed to related problems at many large global and UK commercial banks, investment banks, insurance companies and other financial and related institutions.

UK Government or EU intervention in the banking sector may impact the competitive position of banks within a country and among international competitors which may be subject to different forms of government intervention, thus potentially putting the Group at a competitive disadvantage to other banks.

Regulation

Overview of UK Regulation

The cornerstone of the regulatory regime in the UK is the FSMA which came into force on 1 December 2001 and replaced much of the previous legislation under which banks, insurance companies and investment businesses had been authorised and supervised. In accordance with the provisions of the FSMA on 30 November 2001, the FSA completed the process of assuming responsibility for the regulation and oversight of a wide range of financial services activities in the UK. More recently these responsibilities have been extended to include the regulation of mortgage lending, sales and administration (October 2004) and general insurance sales and administration (January 2005).

The FSA is responsible for the authorisation and supervision of institutions that provide regulated financial products and services as defined in the FSMA. As part of the authorisation process, the FSA reviews applicants to ensure that they satisfy the necessary criteria, including honesty, competence and financial soundness, to engage in regulated activity. The majority of the Group's regulated financial institutions became authorised by the FSA by virtue of having been authorised under previous legislation to carry on financial services business ("**grandfathering**").

Following the new regulations that were introduced for mortgage and general insurance business, additional entities were authorised by the FSA.

Regulatory Approach of the FSA

The FSA's regulatory approach aims to focus and reinforce the responsibility of senior management of a financial institution to ensure that it takes reasonable care to organise and control its affairs responsibly and effectively and that it develops and maintains adequate risk management systems.

The FSA Handbook of Rules and Guidance (the "**Handbook**") sets out 11 Principles for Businesses and the rules to which financial institutions are required to adhere.

A risk-based approach for the supervision of all financial institutions is adopted by the FSA and the starting point for the FSA's supervision is based on a systematic analysis of an institution's risk profile. Having determined the level of inherent risk, a minimum capital adequacy requirement is established, which the institution is required to meet at all times.

The FSA carries out its supervision of UK financial institutions through the collection of information from a series of prudential returns covering sterling and non-sterling operations, on-site reviews (through its ARROW reviews and through industry-wide thematic reviews), desk-based reviews, meetings with senior management and reports obtained from skilled persons. For major retail groups such as the Group, a dedicated relationship team coordinates much of this activity via its 'Close and Continuous' supervision regime.

Regular prudential reports required by the FSA include operating statements and returns covering (amongst other things) capital adequacy, liquidity, large single exposures and large exposures to related borrowers. Capital adequacy returns are submitted on a periodic basis for all the authorised institutions within the Group. Regular non-prudential reports required by the FSA include complaints data, daily transaction reporting returns and product sales data. Some returns are submitted on a consolidated basis for the Group, whilst others are provided on a legal entity basis, depending on the requirements set out within the relevant FSA rules. The FSA reporting rules were recently revised through the introduction of the Integrated Regulatory Reporting Programme, which came into effect in 2008. The Group was fully involved in the consultative process with the regulatory authorities and has implemented the required changes.

The Handbook sets out rules and guidance across a range of issues with which financial institutions are required to comply. These include, *inter alia*:

- Authorisation requirements - these are standards that need to be met in order to be authorised and continue to be met on an ongoing basis.

- Prudential rules - these relate to capital adequacy.

- Systems and controls requirements that are appropriate to the volume and complexity of activity undertaken.

- Conduct of Business rules that set out the requirements for aspects such as advising and selling, product disclosure, financial promotions (including compliance with the clear, fair and not misleading requirements), responsible lending and default.

- Reporting Requirements - these set out periodic reporting requirements and event driven notifications that must be submitted to the FSA.

- Training and Competence rules - these are standards that apply to firms providing advice to retail customers.

- Code of Market Conduct rules - this provides further rules and guidance on the market abuse offences set out in the FSMA.

A key theme running through most of the FSA's rules and regulations is the concept of Treating Customers Fairly ("**TCF**"), contained in Principle 6 of the FSA's Principles for Businesses. From 31 December 2008, the FSA now expects all firms to be able to demonstrate that full TCF compliance has been embedded within their business activities, operations and culture.

Although the FSA Conduct of Business standards apply to banks, the FSA historically allowed the Banking Code Standards Board to prescribe conduct rules governing the deposit-taking and account operating activities of banks and building societies (as is described further below). On 1 November 2009, responsibility for the regulation of deposit and payment products transferred to the FSA. In light of this change the Banking Code Standards Board has changed its name to the Lending Standards Board. The Lending Standards Board will monitor and enforce compliance with a new Lending Code that replaces those elements of the Banking Code and Business Banking Code relating to lending.

The FSA published the Turner Review ("A Regulatory Response to the Global Banking Crisis") on 18 March 2009. The Turner Review assesses the various factors which contributed to the severe financial problems suffered by banks at the end of 2008, and then considers a wide range of proposals to counter these factors and reform global financial regulation. These proposals include significantly increasing banks' minimum regulatory capital requirements, regulating banks' liquidity requirements, requiring banks to establish capital buffers, a maximum growth leverage ratio to prevent banks' excessive expansion, authorities' power to obtain information on significant unregulated financial institutions, central counterparty clearing of credit derivatives, and a major shift in the supervisory approach of the FSA, with an increased focus on high impact, complex and systemically important firms, business models and approved persons' technical skills. New arrangements for co-ordinated cross-border supervision of international and EU banking groups are also proposed. The FSA has also published a discussion paper intended to elicit market participants' comments on many of the proposals contained in the Turner Review. The impact of the proposals on banks and their business models is likely, in the view of the Group, to be very significant. The fundamental changes to capital and liquidity requirements could have a substantial impact on the shape of banks' business models. In the Group's view, banks can also expect a shift from the previous "light touch" principles-based regime to an intensive, and interventionist, rules-based regime. The cost of compliance with these proposals may well lead to reduced profitability, as well as to a lower return on equity.

The FSA published a Feedback Statement on the Turner Review and associated discussion paper on 30 September 2009. This continues the debate regarding how systemically important firms are dealt with, suggesting they should be required to produce recovery and resolution plans ("living wills") setting out how operations would be resolved in the event that the bank fails. Given the Group's systemic importance this is highly significant. If a bank's living will is deemed insufficient by the FSA and contains serious obstacles to resolution it could result in restructuring of the relevant bank's group.

A second Turner Review discussion paper (October 2009) developed issues highlighted for further discussion in the March review, specifically how to offset the moral hazard created by the existence of systemically important banks and the cumulative impact of changes to the capital and liquidity schemes. Key proposals include: using contingent capital which converts to equity when required; reducing the interconnectedness of large cross-border banks; restricting retail banks from engaging in proprietary trading activities; and emphasising the need to prioritise capital conservation and enhancement above employee bonus payments.

On 5 October 2009 the FSA published its new liquidity rules which significantly broaden the scope of the existing liquidity regime and are designed to enhance regulated firms' liquidity risk management practices and, in part, can be seen as a response to issues highlighted by the credit crisis. These new rules, which apply to a wider range of entities than the current liquidity regime, are based on the over-arching principle of regulated firms (their subsidiaries and branch offices) being self-sufficient and having adequate liquid resources to withstand particular liquidity stresses. The rules specify that this will be delivered through greatly enhanced systems and controls requirements and a regular and comprehensive liquidity risk assessment of the business which will be linked to the supervisory process and monitored through more granular and frequent reporting on the part of regulated firms. In particular, the rules have introduced enhanced quantitation requirements which will ultimately require regulated firms to hold a greater quantity of higher quality liquid assets as a buffer against liquidity stresses. It is noted that the specific rules vary depending on the type of regulated firm and some regulated firms may be able to benefit from particular relaxations.

The new systems and controls requirements will apply to most regulated firms from 1 December 2009 and the enhanced quantitative requirements will be introduced in stages over the course of 1 June to 1 November 2010, though are subject to further detailed nuances depending on the type of regulated firm affected.

Lloyds Banking Group believes that these new rules will apply to it and will likely require changes to its business model, in particular, the requirement to hold increased and higher quality liquid assets and the onerous reporting requirements (which may require Lloyds Banking Group to change or upgrade its systems) may result in reduced profitability for Lloyds Banking Group.

FSA Supervisory Review into Historical HBOS Disclosures

The FSA is conducting a supervisory review into the accuracy and completeness of financial disclosures made by HBOS in connection with its capital raisings in 2008, including information as to corporate impairments disclosed in the circulars and/or prospectuses issued by HBOS in connection with such capital raisings. The Group is cooperating fully with this review. See Risk Factor 1.8 for a discussion of the risks relating to regulatory oversight to which the Group is subject.

Financial Services Guarantee Schemes in the UK

Under the FSMA a compulsory single, industry-wide, investor's compensation scheme, the Financial Services Compensation Scheme (the "**FSCS**") has been set up. All authorised institutions are required to be members of the FSCS and are subject to a levy in proportion to their deposit base or volume of business undertaken. The FSCS applies to business undertaken by an FSA authorised institution or by the UK branch of a European Economic Area firm carrying on 'home state regulated activity'.

The FSMA allows for the establishment of different funds for different kinds of business and for different maximum amounts of claim. From 1 January 2010 (subject to the rules of the FSCS):

- eligible deposit claimants remain entitled to receive 100 per cent. compensation for financial loss up to £50,000;
- eligible investment business and mortgage advice and arranging claimants are entitled to receive 100 per cent. compensation for financial loss up to £50,000; and
- eligible insurance claimants are entitled to receive 90 per cent. of the claim (except compulsory insurance for which it is 100 per cent. of the claim).

On 16 March 2009, the Directive on Deposit Guarantee Schemes (1994/19/EC) was amended by Directive 2009/14/EC (the "**Amended Directive**"). The Amended Directive requires EU Member States, by 30 June 2009, to increase the minimum level of coverage they provide for deposits from €20,000 to €50,000 and to reduce the payout period in the event of bank failure from three months to 20 days. Furthermore, by 31 December 2010, Member States must set coverage for the aggregate deposits of each depositor at €100,000, unless a European Commission impact assessment, submitted to the European Parliament and the Council by 31 December 2009, concludes that such an increase and such harmonisation are inappropriate and are not financially viable for all Member States. See Risk Factor 1.19 for a discussion of the current and potential impact of the Group's obligations under the FSCS.

The FSA announced further changes to the FSCS on 24 July 2009, which in part seek to implement the fast payout rules set out under the Amended Directive referred to above through a SCV policy, as further detailed in Risk Factor 1.19. In addition, the other key changes announced by the FSA to the FSCS include the following:

- Changing the payout of compensation to avoid customers who hold loans and deposits with the same institution having any debt deducted from their compensation;
- Widening eligibility of the FSCS to include more individuals;
- Introducing a requirement that deposit takers must disclose the existence of the FSCS and the level of protection it offers to help familiarise consumers with the services it provides; and
- If an institution operates under a number of trading names, it must tell its customers which of the different trading names are covered by a particular authorisation.

Authorised firms within Lloyds Banking Group

As at 30 June 2009 there were approximately 50 UK authorised institutions across the Group. These are regulated by the FSA on both an individual and a consolidated basis.

There were six UK authorised banks: Lloyds TSB Bank plc, Lloyds TSB Scotland plc, Lloyds TSB Private Banking Limited, Scottish Widows Bank plc, AMC Bank Limited and Bank of Scotland plc.

The UK investment firms authorised within the Group were: Scottish Widows Investment Partnership Limited, Lloyds TSB Development Capital Limited, Lloyds TSB Venture Managers Limited, Lloyds TSB Independent Financial Advisers Limited, SWIP Fund Management Limited, Scottish Widows Unit Trust Managers Limited, Scottish Widows Fund Management Limited, Lloyds TSB Investments Limited, SWIP Multi-Manager Funds Limited, Bank of Scotland Independent Financial Advisers Ltd, Clerical Medical Financial Advisers Ltd, Clerical Medical Investment Fund Managers Ltd, Halifax Capital Trustees Ltd, Halifax Independent Financial Services Ltd, Halifax Investment Services Ltd, Halifax Share Dealing Ltd, HBOS Investment Fund Managers Ltd, IWEB (UK) Ltd, and Uberior Fund Manager plc.

The regulated entities conducting (i) insurance, (ii) life, or (iii) pensions business were: Black Horse Limited, Lloyds TSB Insurance Services Limited, Lloyds TSB General Insurance Limited, Scottish Widows Annuities Limited, Pensions Management (SWF) Limited, Scottish Widows Unit Funds Limited, Scottish Widows plc, Scottish Widows Administration Services Limited, Clerical Medical Managed Funds Ltd, Clerical Medical Investment Group Ltd, General Insurance Services Limited, Halifax Life Ltd, Lex Vehicle Leasing Ltd, St Andrew's Insurance plc and St Andrew's Life Assurance plc. The regulated entities specifically providing mortgage business were: Cheltenham & Gloucester plc and The Mortgage Business plc.

Basel II

Basel II has been implemented throughout the EU through the Capital Requirements Directive (which is discussed below under "European Union Impact on UK Financial Services Regulation"). This came into force for all European banks on 1 January 2007, following a consultative process which continued throughout 2006. Transitional provisions meant, however, that the Group was not required to be in compliance with all of the rules until 1 January 2008.

With effect from 1 January 2008, for credit risk, the heritage Lloyds TSB Group adopted the Foundation Internal Ratings Based approach for its non-retail exposures and the Advanced (Retail) Internal Ratings Based approach for its retail exposures. The heritage HBOS Group adopted the Advanced Internal Ratings Based approach for both its non-retail and retail exposures.

Both the heritage Lloyds TSB Group and the heritage HBOS Group adopted the Advanced Measurement Approach for Operational Risk from 1 January 2008.

The adoption of these approaches benefits the Group in terms of its internal capital allocation.

Other Relevant Legislation and Regulation

The Bank of England

The agreed framework for co-operation in the field of financial stability in the financial markets is set out in detail in the Memorandum of Understanding published jointly by HM Treasury, the FSA and the Bank of England at the end of October 1997 and updated in March 2006. The Bank of England has specific responsibilities in relation to financial stability, including: (i) ensuring the stability of the monetary system; (ii) oversight of the financial system infrastructure, in particular payments systems at home and abroad; and (iii) maintaining a broad overview of the financial system through its monetary stability role and the deputy governor's membership of the FSA's Board. HM Treasury, the FSA and the Bank of England work together to achieve stability in the financial markets.

UK Government

The UK Government is responsible for the overall structure of financial regulation and the legislation which governs it. It has no operational responsibility for the activities of the FSA or the Bank of England. However, there are a variety of circumstances where the FSA and the Bank of England will need to alert HM Treasury (the representative of the UK Government) about possible problems, for example, where there may be a need for a support operation or a problem arises which could cause wider economic disruption.

In light of the current crisis in financial markets, the Banking Act 2009 secured Royal Assent in February 2009 and certain provisions, including those relating to the SRR, bank insolvency and bank administration, came into force at that time. The Banking Act provides the FSA, Bank of England and HM Treasury with tools for dealing with failing institutions as part of the SRR. These powers enable the Authorities to deal with and stabilise UK-incorporated institutions with permission to accept deposits pursuant to Part IV of the FSMA (each a "relevant entity") that are failing or are likely to fail to satisfy the threshold conditions (within the meaning of section 41 of the FSMA).

The SRR consists of three stabilisation options: (i) transfer of all or part of the business of the relevant entity or the shares of the relevant entity to a private sector purchaser; (ii) transfer of all or part of the business of the relevant entity to a 'bridge bank' wholly-owned by the Bank of England; and (iii) temporary public ownership of the relevant entity. HM Treasury may also take a parent company of a relevant entity into temporary public ownership where certain conditions are met. The Banking Act also provides for two new insolvency and administration procedures for relevant entities.

The stabilisation powers may only be exercised if the FSA is satisfied that a relevant entity (a) is failing, or is likely to fail, to satisfy the threshold conditions set out in Schedule 6 to the FSMA required to retain its FSA authorisation to accept deposits; and (b) having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilising options) action will be taken that will enable the relevant entity to satisfy those threshold conditions. In such circumstances, and where certain further conditions are satisfied, (i) the Bank of England or HM Treasury could exercise the stabilisation powers in relation to a relevant entity; or (ii) as a last resort, HM Treasury may take a parent undertaking of a relevant entity into temporary public ownership pursuant to section 82 of the Banking Act ("temporary public ownership") irrespective of the financial condition of such parent undertaking.

If a parent undertaking is taken into temporary public ownership, HM Treasury may take various actions in relation to any securities issued by it without the consent of the holders thereof ("**Investors**"), including (among other things):

- transferring securities free from any restrictions on transfer and free from any trust, liability or encumbrance;
- delisting the securities;
- converting securities into another form or class; or
- prescribing that the transfer of shares takes place free from any trust.

Accordingly, the taking of any such actions could adversely affect the rights of Investors, the price or value of their investment, and the ability of such parent undertaking to satisfy its obligations under the issued securities or the related contracts.

If a parent undertaking is taken into temporary public ownership and a partial transfer of its, or a relevant entity in its group's, business to another entity is effected or if a relevant entity in the group is made subject to the SRR and a partial transfer of such relevant entity's business to another entity were effected:

- the transfer order or instrument may directly affect the parent undertaking and/or its group companies and commercial counterparties by creating, modifying or cancelling their contractual arrangements with a view to ensuring the provision of such services and facilities as are required to enable the bridge bank or private sector purchaser to operate the transferred business (or any part of it) effectively; and
- the quality of the assets and the quantum of the liabilities not transferred and remaining with the parent undertaking may result in a deterioration in its creditworthiness and increase the risk that it may eventually become subject to administration or insolvency proceedings pursuant to the Banking Act or the Insolvency Act 1986.

Where the stabilisation powers are exercised, HM Treasury must make statutory provision for a scheme or other arrangements for determining the compensation, if any, due to those affected by an exercise of the powers. However, there can be no assurance that Investors would thereby recover compensation promptly and equal to any loss actually incurred. See Risk Factor 1.8.

In July 2009, HM Treasury published a White Paper "Reforming financial markets" containing wide ranging proposals. The other main UK political parties have subsequently published their own alternative agendas for reform. It is not possible to predict which, if any, of these proposals will be implemented either before or subsequent to the next UK General Election. In November 2009 the draft Financial Services Bill was presented to Parliament. This bill consolidates some of the proposals presented in the White Paper, in addition to enhancing the FSA's disciplinary and enforcement powers. Specifically, the bill provides the FSA with the power to require authorised firms to prepare recovery and resolution plans (living wills) and proposes new mechanisms for consumer redress and class actions. The bill also proposes additional powers be given to the FSA in relation to remuneration following the introduction of the FSA's new Remuneration Code in August 2009. The code will take effect from 1 January 2010 and sets out how employers should mitigate risk when rewarding staff with pay and bonuses. The code is designed to make sure that boards focus more closely on ensuring that the total amount distributed by a firm is consistent with good risk management and sustainability, as well as ensure that individual compensation practices provide the right incentives.

*UK Financial Ombudsman Service ("**FOS**")*

The FOS was established on 1 December 2001 pursuant to the FSMA to provide customers with a free and independent service designed to resolve disputes where the customer is not satisfied with the response received from the regulated firm. The FOS resolves disputes that cover most financial products and services provided in (or from) the UK, from insurance and pension plans to bank accounts and investments, for eligible complainants, private individuals and small businesses, charities or trusts. The jurisdiction of FOS was extended in 2007 to include firms conducting activities under the Consumer Credit Act. Although the FOS takes account of relevant regulation and legislation, its guiding principle is to resolve cases on the basis of what is fair and reasonable; in this regard, the FOS is not bound by law or even its own precedent. The decisions made by the FOS are binding on firms.

Banking Conduct Regime

On 1 November 2009, the FSA assumed responsibility for the regulation of deposit and payment products under a new Banking Conduct regime. Such regulation includes banking conduct of business rules regarding retail deposit-taking business and FSA requirements relating to payment services pursuant to the Payment Services Regulations 2009.

Lending Code

The Lending Standards Board (formerly the Banking Code Standards Board) is responsible for monitoring and enforcing compliance with a new Lending Code introduced on 1 November 2009 which relates to lending to private customers and small businesses.

Unarranged overdraft charges

The Supreme Court published its judgment in respect of the fairness of unarranged overdraft charges on personal current accounts on 25 November 2009, finding in favour of the litigant banks. On 22 December 2009, the OFT announced that it will not continue its investigation into the fairness of these charges. The Group is working with the regulators to ensure that outstanding customer complaints are concluded as quickly as possible and anticipate that most cases in the county courts will be discontinued. The Group expects that some customers will argue that despite the test case ruling they are entitled to a refund of unarranged overdraft charges on the basis of other legal arguments or challenges. The Group would robustly defend any such complaints or claims and does not expect any such complaints or claims to have a material effect on the Group.

The OFT is however continuing to discuss its concerns in relation to the personal current account market with the banks, consumer groups and other organisations under the auspices of its Market Study into personal current accounts. In October 2009, the OFT published voluntary initiatives agreed with the industry and consumer groups to improve transparency of the costs and benefits of personal current accounts and improvements to the switching process. The OFT aims to report on progress in respect of further changes it believes are required to make the market work in the best interest of bank customers by the end of March 2010.

Interchange fees

The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard issuers charged a uniform fallback interchange fee in respect of cross border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the European General Court. The Bank and BOS (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of a uniform fallback interchange fee are compatible with European Commission competition laws. MasterCard has announced that it has reached an understanding with the European Commission on a new methodology for calculating intra European Economic Area multi-lateral interchange fees on an interim basis pending the outcome of the appeal. Meanwhile, the European Commission and the UK's OFT are pursuing investigations with a view to deciding whether arrangements adopted by other payment card schemes for the levying of uniform fallback interchange fees in respect of domestic and/or cross-border payment transactions also infringe European Commission and/or UK competition laws. As part of this initiative, the OFT will also intervene in the European General Court appeal supporting the European Commission position. The ultimate impact of the investigations on the Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

Continuing Obligations

The Company and each of the other members of the Group which have securities listed on the Official List or on other regulated markets intend to comply with their obligations as companies with securities admitted to the Official List in connection with further disclosures in relation to the impact of the reviews and inquiries being conducted by the UK Office of Fair Trading as disclosed above on the Group. Under the GAPS Withdrawal Deed, the Group has, among other things, agreed to implement any measures relating to personal current accounts agreed between the OFT and the UK banking industry. See "Recent Developments — Capital Restructuring— GAPS Withdrawal Deed" herein for a fuller description of such commitments.

UK Competition Commission

In January 2009, the Competition Commission completed its formal investigation into the supply of Payment Protection Insurance ("**PPI**") services (except store card PPI) to non-business customers in the UK. Various members of the Group underwrite PPI, while other members distribute PPI, by offering it for sale with a variety of the credit products which they supply.

On 5 June 2008, the Competition Commission issued its provisional findings, to the effect that there are market features which prevent, restrict or distort competition in the supply of PPI to non-business customers, with an adverse effect on competition and with the result being detrimental to consumers.

Following consultation, the Competition Commission published its final report on 29 January 2009 setting out its remedies. In summary, the Competition Commission has decided to adopt the following remedies: (i) a prohibition on the active sale of PPI by a distributor to a customer within seven days of the distributor's sale of credit to that customer. However, customers may pro-actively return to the distributor to initiate a purchase by telephone or online from 24 hours after the credit sale; (ii) a requirement on all PPI providers to provide certain information and messages in PPI marketing materials; (iii) a requirement to provide personal PPI quotes to customers; (iv) a requirement on all PPI providers to provide certain information on PPI policies to the FSA; (v) a recommendation to the FSA that it use the information provided under the requirement in (iii) to populate its PPI price comparison tables; (vi) a requirement on distributors to provide an annual statement for PPI customers containing information on their PPI policy and what it costs; and (vii) a prohibition on the levying by distributors of payments for PPI on a single premium basis. Instead, distributors are permitted to charge only regular premiums at a constant rate, paid monthly or annually. This remedy therefore precludes the selling of multi-year PPI policies for a single premium.

On 30 March 2009, Barclays Bank plc lodged an appeal in the Competition Appeal Tribunal against the Competition Commission's findings. In particular, it requested that the Competition Appeal Tribunal quash the decision of the Competition Commission insofar as it relates to the prohibition of distributors selling PPI at the credit point of sale and the Competition Commission's findings on market definition and the nature and extent of competition in the supply of PPI. The Group filed a notice of its intention to intervene in the appeal on 23 April 2009. On 28 April 2009, the Group was granted permission by the Competition Appeal Tribunal to intervene in the appeal. The hearing of the appeal took place from 7 September 2009 to 11 September 2009. The Competition Appeal Tribunal handed down its judgment on 16 October 2009. It found in favour of Barclays in respect of its challenge to the Competition Commission's prohibition of distributors selling PPI at the credit point of sale but it did not uphold Barclays' challenge to the Competition Commission's findings on market definition. The matter will now be referred back to the Competition Commission with direction to reconsider their remedies and make a new decision in accordance with the Competition Appeal Tribunal's ruling. This may or may not result in the Competition Commission ultimately reaching a different conclusion.

Depending on the outcome of the referral back to the Competition Commission, the Competition Commission's decision may have a significant adverse impact on the level of sales and thus the revenue generation and profitability of the payment protection insurance products which the Group offers its customers, but the ultimate impact would be determined by a number of factors including the extent to which the Group was able to mitigate the potentially adverse effects of such statutory changes through restructuring the payment protection products which it offers its customers and/or developing alternative products and revenue streams. To this end, the Group took a commercial decision to sell only regular monthly premium PPI to its personal loan customers in the UK from early 2009. The FSA subsequently wrote to certain other firms still selling single premium PPI with unsecured personal loans asking them to withdraw the product as soon as possible, and no later than 29 May 2009.

*UK Financial Ombudsman Service ("**FOS**")*

On 1 July 2008 the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. The Group and other industry members and trade associations have made submissions to the FSA regarding this referral. The matter was considered at the FSA Board meeting on 25 September 2008. The Group has been working with other industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints. On 29 September 2009, the FSA issued a consultation paper on PPI complaints handling to which the Group responded on 30 October 2009, endorsing the response submitted on behalf of the retail banking industry by the British Banking Association. The FSA has escalated its regulatory activity in relation to past PPI sales generally and has proposed new guidance on the fair assessment of a complaint and the calculation of redress and a new rule requiring firms to reassess historically rejected complaints.

The statement on 29 September 2009 also announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. The Group has subsequently agreed in principle that it will undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. The precise details of the review are still being discussed with the FSA. The ultimate impact on the Group of any review and/or assessment can only be known at the conclusion of these discussions and on publication of the FSA's final rules.

UK Information Commissioner's office

This office is responsible for overseeing implementation of the Data Protection Act 1998. This Act regulates, among other things, the retention and use of data relating to individual customers.

The Freedom of Information Act 2000 (the "**FOIA**") sets out a scheme under which any person can obtain information held by, or on behalf of, a "public authority" without needing to justify the request. A public authority will not be required to disclose information if certain exemptions set out in the FOIA apply.

Under section 2(1) of the FOIA, a public authority is not required to disclose information where an absolute exemption applies or if the public interest in maintaining the exemption outweighs the public interest in disclosing the information. If a requester is dissatisfied with his response from a public authority, he may refer the matter to the Information Commissioner who may order the disclosure of the information, for example if he considers that the public interest in disclosing the information outweighs the public interest in maintaining the exemption. The Group is not a public body but HM Treasury and certain other public authorities and associated companies are. Any confidential information required to be disclosed by the Group to a public authority could be subject to enforced disclosure to members of the public pursuant to the FOIA.

European Union Impact on UK Financial Services Regulation

Retail banking investigation

On 10 January 2007, the European Commission published the Final Report of its sector inquiry into European retail banking markets covering payment cards and (non-card) payment systems and current accounts and related services. The European Commission found that markets were fragmented along national lines, limiting consumer choice and leading to higher costs for current accounts, loans or payments.

High degrees of variation of prices, profit margins and selling patterns between EU Member States and high degrees of homogeneity within EU Member States were found to be indicative of persisting regulatory or behavioural barriers to competition.

The Final Report identified competition concerns in several areas of retail banking, including:

- the combination of sustained high profitability, high market concentration and evidence of entry barriers in some Member States raise concerns about banks' ability to influence the level of prices for consumers and small firms;
- large variations in merchant and interchange fees between banks across the EU may indicate competition barriers;
- the existence of high joining fees for payment cards, co-branding, surcharging and the practice of "blending" card fees where a retailer is charged the same merchant fee irrespective of the different costs of card types;
- some credit registers, holding confidential data that lenders use to set loan rates, may be used to exclude new entrants to retail banking markets;
- some aspects of co-operation among banks, including savings and co-operative banks, can reduce competition and deter market entry;

- product tying by banks is widespread in Member States and can reduce consumer choice and increase banks' power in the market place to influence prices; and

- obstacles to customer mobility in banking, notably the inconvenience of changing a current account, are high.

Some of these concerns have already been addressed, at least in part. For example, following the interim report being published, the European Commission met with Austrian banks who agreed to review arrangements for setting interchange fees and announced that a reduction can be expected. In Portugal, issuers and acquirers have met some of the concerns raised in the report by reducing domestic interchange fees and removing preferential bilateral domestic interchange fees. The establishment of a Single Euro Payments Area ("**SEPA**") is also seen as a method of remedying some of the competition concerns raised in the report. Since 1 January 2008, banks have been able to make the first SEPA products available and are aiming to make SEPA a reality for all customers by the end of 2010.

The Final Report also listed the following specific areas where enforcement action by the European Commission and the national competition authorities is appropriate:

- high interchange fees and merchant fees in some payment card networks;

- access barriers and discriminatory rules in relation to credit registers;

- tying of products by some banks; and

- bank co-operation (in respect to which the European Commission indicated that it intended to gather more information before acting).

Since the Final Report was published, the European Commission has adopted three decisions affecting payment card services. On 3 October 2007, the European Commission fined Visa International and Visa Europe €10.2 million for refusing to admit Morgan Stanley as a member from March 2000 to September 2006. In a decision dated 17 October 2008, the European Commission concluded that the Groupement des Cartes Bancaires infringed Article 101 of the Treaty on the functioning of the European Union by adopting price measures hindering the issuing of cards in France at competitive rates by certain member banks, thereby keeping the price of payment cards artificially high and thus favouring the major French banks. As referred to above, on 19 December 2007, the European Commission adopted a decision prohibiting MasterCard's multilateral interchange fees for cross-border card payments with MasterCard and Maestro consumer credit and debit cards between Member States of the European Economic Area (intra-EEA MIFs).

EU directives

Work continues on the Financial Services Action Plan which is intended to create a single market for financial services across the EU. The Group will continue to monitor the progress of these initiatives, provide specialist input on their drafting and assess the likely impact on its business.

EU directives, which are required to be implemented in EU Member States through national legislation, have a strong influence over the framework for supervision and regulation of financial services in the UK. The directives aim to harmonise financial services regulation and supervision throughout the EU by setting standards in key areas such as capital adequacy, access to financial markets, consumer protection and compensation schemes.

Financial institutions, such as those in the Group, are primarily regulated in their home state by a local regulator but the EU directives prescribe criteria for the authorisation of such institutions and the prudential conduct of business supervision applicable to them. Different directives require Member States to give 'mutual recognition' to each other's standards of regulation through the operation of a 'passport' concept.

This passport gives a financial institution which has been authorised in its 'home' state the freedom to establish branches in, and to provide cross-border services into, other Member States without the need for additional local authorisation.

Directives recently implemented

The Acquisitions Directive was implemented in the UK on 21 March 2009. The purpose of the Directive is to prevent EU Member States from blocking acquisitions of financial services firms for improper (e.g. protectionist) reasons and to facilitate the acquisition process.

Key measures include:

- introduction of assessment criteria, which are more tightly defined than the current assessment criteria and are limited to a prudential assessment; and
- provisions to increase the transparency of the process and ensure that potential acquirers that are declined permission are given the information they need to challenge the decision.

The Payment Services Directive was fully implemented in the UK on 1 November 2009 and enhances the movement towards a Single European Payments Area. Key measures include:

- the right to provide payment services to the public;
- transparency and information requirements; and
- rights and obligations of users and providers of payment services.

Directives currently being implemented

A number of other EU directives, including amendments to the Deposit Guarantee Schemes Directive (please see "Financial Services Guarantee Schemes in the UK" above) and the Consumer Credit Directive are currently being implemented in the UK.

Draft provisions for implementing the Consumer Credit Directive were published in 2009, with the deadline for implementation being June 2010. The Directive aims to establish the conditions for a genuine EU market, ensure a high level of consumer protection, and improve clarity by recasting the existing EU directive on consumer credit.

Directives under review

Amendments to a number of EU directives are being considered, including the Distance Marketing Directive, Capital Requirements Directive, E-Money Directive, Undertakings for Collective Investment in Transferable Securities ("**UCITS**") Directive and the Financial Groups Directive. Legislative amendments may be forthcoming.

The EU is also considering regulatory proposals for, inter alia;

- mortgage credit;
- a recast UCITS Directive; and
- capital adequacy requirements for insurance companies (Solvency II).

International regulation

The Group operates in many other countries around the world. The Group's overseas operations are subject to reporting and reserve requirements and controls imposed by the relevant central banks and regulatory authorities.

In view of the global financial crisis and the increased scrutiny financial regulators have come under, it is also expected that regulatory regimes in many jurisdictions will be significantly tightened, e.g. emergency restrictions on short-selling practices were implemented in a number of jurisdictions including the UK, Ireland, France, Germany, and the Netherlands, following the market volatility in September 2008. At a G20 meeting to tackle the financial crisis in November 2008, a set of common principles for the reform of financial markets was set out. These principles have the aim of strengthening transparency and accountability; enhancing sound regulation; promoting integrity in financial markets; re-enforcing international co-operation and reforming international institutions. As a result of this and other domestic pressures, it is expected that Group entities in all jurisdictions will be subject to increased scrutiny.

Legal Actions

The Group is periodically subject to threatened or filed legal actions in the ordinary course of business.

Starting in 2007, the Bank provided information in relation to its review of historic U.S. Dollar payments involving countries, persons or entities subject to U.S. economic sanctions administered by the Office of Foreign Assets Control ("OFAC") to a number of authorities reported to be conducting a review of sanctions compliance by non-U.S. financial institutions. On 9 January 2009, the settlement reached by the Bank with both the U.S. Department of Justice and the New York County District Attorney's Office in relation to their investigations was announced. The settlement documentation contains details of the results of the investigations including the identification of certain activities relating to Iran, Sudan and Libya which the Bank conducted during the relevant period. In 2008, the Bank made a provision of £180 million which fully covered the settlement amount paid to the Department of Justice and the New York County District Attorney's Office. On 22 December 2009, OFAC announced the settlement it had reached with the Bank in relation to its investigation and confirmed that the settlement sum due to OFAC had been fully satisfied by the Bank's payment to the Department of Justice and the New York County District Attorney's Office. No further enforcement actions are expected in relation to the matters set out in the settlement agreements. A purported shareholder filed a derivative civil action in the Supreme Court of New York, Nassau County, on 26 February 2009 against certain current and former directors, and nominally against the Bank and the Company, seeking various forms of relief following the settlement. The derivative action is at a very early stage.

The Group is involved in ongoing issues relating to unarranged overdraft charges, the payment of interchange fees and payment protection insurance. See "— Regulation — Other Relevant Legislation and Regulation — Unarranged overdraft charges", "— Regulation — Other Relevant Legislation and Regulation — Interchange fees" and "— Regulation — Other Relevant Legislation and Regulation — UK Competition Commission" herein.

Material Contracts

Contracts (not being contracts entered into in the ordinary course of business) that have been entered into by members of the Group: (a) within the two years immediately preceding the date of this document which are, or may be, material to the Group; or (b) at any time and contain obligations or entitlements which are, or may be, material to the Group as at the date of this document are set out on pages 7 to 9 of the Company's 2008 Annual Report on Form 20-F.

In addition, the Company and HM Treasury have:

- amended the Registration Rights Agreement (as defined in the Company's 2008 Annual Report on Form 20-F) with effect from 11 June 2009 to include as "Registrable Securities" (as defined in the Registration Rights Agreement) any new shares subscribed for by HM Treasury under the 2009 Placing and Open Offer Agreement (as defined in the Company's 2008 Annual Report on Form 20-F), any B Shares and other securities in the Company held by HM Treasury from time to time and securities issued by HM Treasury from time to time which are exchangeable for, convertible into, give rights over or are referable to such new shares or other securities;

- entered into a Resale Rights Agreement with effect from 11 June 2009 in order to enable certain securities of the Company held by HM Treasury and securities issued by HM Treasury which are exchangeable for, convertible into, give rights over or are referable to such securities to be sold in such jurisdictions and in such manner as HM Treasury determines;
- entered into a GAPS Withdrawal Deed which contains various commitments and undertakings by the Company including with regard to lending and remuneration, in addition to provisions requiring the Company to implement the expected state aid remedies (see "Recent Developments — Capital Restructuring— GAPS Withdrawal Deed");
- entered into an agreement (the "**HMT Undertaking to Subscribe**") in connection with the capital raising transactions announced on 3 November 2009 in which HM Treasury undertook to (i) vote in favour of all of the resolutions relating to the capital raising on which it was entitled to vote and (ii) take up its rights to subscribe for all of the shares to which it is entitled under the Rights Issue (see "Recent Developments — Capital Restructuring— HMT Undertaking to Subscribe"); and
- entered into a deed dated 2 November 2009 in which the Group agreed to pay for the UK Government's set-up costs relating to the proposed participation of the Group in GAPS (including all costs of the UK Government relating to the proposed participation of the Group in, and its withdrawal from, GAPS) and the UK Government's costs associated with the European Commission's approval of state aid to the Group.

In addition, the Group has entered into a rights issue underwriting agreement (the "**Rights Issue Underwriting Agreement**") and an underwriting agreement relating to additional issues of Enhanced Capital Notes in connection with the capital raising transactions announced on 3 November 2009.

Major Shareholders and Related Party Transactions

Details of interests

As at 26 February 2010, notification had been received that The Solicitor for the Affairs of Her Majesty's Treasury had a direct interest of approximately 41.3 per cent. in the Company's ordinary share capital.

Related Party Transactions

Other than as disclosed in (i) note 45 of the audited consolidated annual financial statements of the Company for the financial years ended 31 December 2006 and 2007; (ii) note 47 of the audited consolidated annual financial statements of the Company for the financial year ended 31 December 2008; (iii) notes 47 and 48 of the audited consolidated annual financial statements of HBOS for the financial years ended 31 December 2006 and 2007; and (iv) notes 51 and 52 of the audited consolidated annual financial statements of HBOS for the financial year ended 31 December 2008, the Group has not entered into any related party transactions other than with wholly owned subsidiaries during the period ended 31 December 2008.

In the period between 31 December 2008 and the date of this document, save as disclosed in note 28 of the Company's 2009 Results and save as set out in "- Material Contracts", the Group has not entered into any material related party transactions other than with wholly owned subsidiaries.

Directors

The directors of the Group and the Bank, the business address of each of whom is 25 Gresham Street, London EC2V 7HN, England, and their respective principal outside activities, where significant to the Group and/or the Bank, are as follows:

Name	**Principal outside activities**
Sir Winfried Bischoff Chairman	A non-executive director of the McGraw-Hill Companies, Inc. and Eli Lilly and Company. Chairman of the UK Career Academy Foundation. A member of the Akbank International Advisory Board.
Lord Leitch Deputy Chairman	Chairman of Scottish Widows. Chairman of the Government's Review of Skills and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster.
Executive directors	
J. Eric Daniels Group Chief Executive	A non-executive director of BT Group.
Archie G. Kane Group Executive Director, Insurance	Chairman of the Association of British Insurers and a member of the Chancellor's Financial Services Global Competitiveness Group, The Takeover Panel and the Chancellor's Insurance Industry Working Group.
G. Truett Tate Group Executive Director, Wholesale	A non-executive director of BritishAmerican Business Inc. A director of Business in the Community and Arora Holdings and a director and trustee of In Kind Direct.
Tim J.W. Tookey Group Finance Director	None.
Helen A. Weir CBE Group Executive Director, Retail	A member of the Said Business School Advisory Board.
Non-executive directors	
Wolfgang C.G. Berndt	A non-executive director of Cadbury, GfK AG and MIBA AG.
Sir Julian Horn-Smith	A non-executive director of De La Rue, Digicel Group and Emobile (Japan), a director of Sky Malta, a member of the Altimo International advisory board and a senior adviser to UBS and CVC Capital Partners in relation to the global telecommunications sector.
Glen Moreno **(from 1 March 2010)**	Chairman of Pearson and a non-executive director of Fidelity International.
David Roberts **(from 1 March 2010)**	A member of the strategy board for Henley Business School, non-executive chairman of The Mind Gym and a non-executive director of Campion Willcocks.

T. Timothy Ryan Jr	President and chief executive of the Securities Industry and Financial Markets Association. A director of the U.S.-Japan Foundation, Great-West Life Annuity Insurance Co. and Putnam Investments and a member of the Global Markets Advisory Committee for the National Intelligence Council.
Martin A. Scicluna	Chairman of Great Portland Estates. A member of the council of Leeds University and a governor of Berkhamsted School.
Anthony Watson CBE	A non-executive director of Hammerson, Vodafone and Witan Investment Trust and chairman of Marks and Spencer Pension Trust, Asian Infrastructure Fund and Lincoln’s Inn investment committee.

None of the directors of the Group or the Bank have any actual or potential conflict between their duties to the Group or the Bank and their private interests or other duties as listed above.

Appendix 3
RECENT DEVELOPMENTS

esure

On 11 February 2010, the Group announced the sale of its 70 per cent. stake in esure to a management buyout vehicle to be called esure Group Holdings Ltd for a cash consideration slightly in excess of book value in the Lloyds Banking Group accounts (31 December 2008: £185 million).

Group Reorganisation

On 1 January 2010, the Company transferred its holding in HBOS to the Bank (the "**Group Reorganisation**"). As a result of the Group Reorganisation, the Bank has become the immediate parent of HBOS. The Company will continue to own the Bank directly but, as a result of the Group Reorganisation, will own HBOS indirectly, as the Bank will be the immediate parent of HBOS. The capital ratios of Lloyds Banking Group will not change as a result of the Group Reorganisation. The Group Reorganisation has been approved by the FSA.

Preference Share Exchanges

On 11 December 2009 Lloyds Banking Group plc announced that it had agreed to repurchase U.S.$359,790,000 of its U.S.$750,000,000 6.413 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.$194,457,000 of its U.S.$750,000,000 5.92 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.$252,842,000 of its U.S.$750,000,000 6.657 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares and U.S.$451,542,000 of its U.S.$1,000,000,000 6.267 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, which are held by a limited number of investors in the United States, for new U.S.$1,258,631,000 8.00 per cent. Fixed to Floating Rate Undated Enhanced Capital Notes. The exchanges settled on 15 and 16 December 2009.

On 14 December 2009 Lloyds Banking Group plc announced that it had agree to repurchase U.S.$15,400,000 of its U.S.$750,000,000 6.413 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.$183,610,000 of its U.S.$750,000,000 5.92 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, U.S.$62,808,000 of its U.S.$750,000,000 6.657 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares and U.S.$14,840,000 of its U.S.$1,000,000,000 6.267 per cent. Non-Cumulative Fixed to Floating Rate Preference Shares, for new U.S.$276,658,000 8.50 per cent. Undated Enhanced Capital Notes. The exchanges settled on 17 December 2009.

Registered Office of the Company

On 25 November 2009, the registered office of the Company was changed to The Mound, Edinburgh, EH1 1YZ.

Capital Restructuring

On 3 November 2009 Lloyds Banking Group plc announced proposals intended to meet its current and long-term capital requirements including a Rights Issue and two separate Exchange Offers (together, the "**Proposals**"). The Proposals, which were fully underwritten, were approved by shareholders on 26 November 2009. The Rights Issue, which raised £13.5 billion (£13 billion net of the expenses of the Proposals) was completed on 14 December 2009 with 95.3 per cent. of shares placed with shareholders. The remaining 4.7 per cent. rump was placed with investors and settled on 17 December 2009. The Exchange Offers were substantially completed during December 2009 and generated approximately £7.5 billion in nominal value of contingent core tier 1 capital at that time. The remaining elements of the Exchange Offers were completed on 18 February 2010 when Lloyds Banking Group plc issued 3,140,686,402 ordinary shares at a price of £0.486985 per share. The issue of ordinary shares generated approximately £1.5 billion in core tier 1 capital.

HM Treasury voted in favour of the resolutions to implement the Proposals to the extent it was entitled to vote. HM Treasury also participated in full in respect of its rights in the Rights Issue. In addition, all of Lloyds Banking Group's Directors participated in respect of their rights in the Rights Issue. HM Treasury currently holds approximately 41.3 per cent. of the Company's ordinary share capital.

Alongside the Proposals, Lloyds Banking Group has paid to HM Treasury, with shareholder approval (excluding HM Treasury), a fee of £2.5 billion for the benefit to Lloyds Banking Group's trading operations arising as a result of HM Treasury proposing to make GAPS available to Lloyds Banking Group (the "**GAPS Payment**") and a commission, being a commission of up to £143.7 million in consideration, inter alia, of HM Treasury's pre-launch commitment to participate in full in respect of its entitlements under the Rights Issue (the "**HMT Commitment Commission**"). Payment of a fee in relation to the benefit to Lloyds Banking Group's trading operations as described above was also required by the European Commission as part of the state aid remedies. Lloyds Banking Group has also agreed to reaffirm the lending commitments that it gave to HM Treasury in March 2009 and to maintain in the 12 months commencing 1 March 2010 similar overall levels of lending as in the 12 months commencing 1 March 2009.

During the second half of 2009, HM Treasury and Lloyds Banking Group were involved in detailed negotiations with the European Commission in relation to the terms of a restructuring plan which was required in the context of a review resulting from the state aid received by Lloyds Banking Group. On 18 November 2009 the European Commission approved Lloyds Banking Group's restructuring plan. Lloyds Banking Group is confident that the implementation of the restructuring plan will not have a materially negative impact on Lloyds Banking Group. However, Lloyds Banking Group has been prevented from paying dividends on ordinary shares for so long as it is prohibited from making coupon payments on certain of its other securities (which is between 31 January 2010 and 31 January 2012) as a result of the restrictions required by the European Commission as part of the restructuring plan. Further details on the state aid position are set out below under the section entitled "State Aid".

The Proposals comprised:

(i) an equity raising of £13.5 billion (£13 billion net of the expenses of the Proposals) by way of a rights issue. The Rights Issue was fully underwritten. The issue price at which qualifying shareholders were invited to subscribe for new shares was set at 37 pence per new share at the general meeting held on 26 November 2009; and

(ii) two separate exchange offers. Under the Exchange Offers, eligible holders of existing securities were invited to offer to exchange such existing securities for either: (a) new lower tier 2 capital qualifying notes which are guaranteed by either Lloyds Banking Group plc and/or Lloyds TSB Bank plc ("**Enhanced Capital Notes**" or "**ECNs**") and which will convert into ordinary shares if Lloyds Banking Group's published consolidated core tier 1 capital ratio falls to less than 5 per cent.; or (b) in one of the Exchange Offers only, an exchange consideration amount which was settled in new ordinary shares. The Exchange Offers were substantially completed during December 2009 and generated approximately £7.5 billion in nominal value of contingent core tier 1 capital at that time. The remaining elements of the Exchange Offers were completed on 18 February 2010 when Lloyds Banking Group plc issued 3,140,686,402 ordinary shares at a price of £0.486985 per share. The issue of ordinary shares generated approximately £1.5 billion in core tier 1 capital.

Rationale and key benefits of the Proposals

The Board believes that the economic environment in the UK has begun to stabilise and that the UK economy is now expected to return to growth in 2010. This represents a significantly more positive environment for Lloyds Banking Group than the conditions prevailing when a stress test was carried out under Lloyds Banking Group's financial modelling which is based on the economic assumptions published by the FSA in March 2009 (the "**FSA Stress Test**") at the time at which Lloyds Banking Group announced its intended participation in GAPS. As previously announced, the Board continues to expect that Lloyds Banking Group's overall impairments in 2010 will be significantly lower than those incurred in 2009, with progressive reductions expected thereafter.

Claims under GAPS could only be made after the First Loss (as defined below) had been exceeded. However, based on the Board's view of the economic outlook for the UK, Lloyds Banking Group does not expect that its overall impairments will be high enough to have justified entering into GAPS. On this basis Lloyds Banking Group would not have expected to make any claim were it to have participated in GAPS, but would nevertheless still incur significant costs. Even if the UK economy were to deteriorate to the level assumed in the FSA Stress Test, which the Board considers to be unlikely, the Board believes that the net amounts that Lloyds Banking Group would have received under GAPS would have been less than the £15.6 billion participation fee which it would have been required to pay to participate in GAPS on the terms announced in March.

Accordingly, the Board is of the view that an alternative approach to meeting its current and long-term capital commitments, in the form of the Proposals, is in the best interests of Lloyds Banking Group. The Proposals have been structured in consultation with the FSA. The Board is therefore confident that the Proposals, together with other management actions which the Board considers to be readily actionable, will generate sufficient capital to ensure that Lloyds Banking Group no longer requires the asset protection which it would have obtained through participation in GAPS, even if the severe scenario envisaged by the FSA Stress Test were to occur. The Board believes that the Proposals represent a significant step in meeting its long-term objective: that Lloyds Banking Group operates as a wholly privately-owned, self-supporting commercial enterprise.

The Board was pleased that it was able to offer a market-based solution to meet its capital requirements. Such a solution was not available to Lloyds Banking Group at the time of the announcement of Lloyds Banking Group's intended participation in GAPS in March 2009.

Key benefits

Were it to have participated in GAPS, Lloyds Banking Group would have benefited from certain loss and regulatory capital relief. However, the Board believes that the Proposals offer substantial benefits to shareholders, both on their own merits and as a significantly more attractive option in comparison to GAPS, for the reasons described in more detail below. The Board believes that the Proposals, after taking into account the GAPS Payment, will enhance both earnings per share and returns on equity for the Company relative to GAPS, even if the UK economy deteriorates to the level implied by the FSA Stress Test, which the Board considers to be unlikely.

Substantial increase in non-amortising core tier 1 equity capital: The Rights Issue raised a total of £13.5 billion of immediately available and non-amortising core tier 1 capital, before expenses of the Proposals. The Group had a core tier 1 capital ratio of approximately 8.1 per cent. at 31 December 2009. The Group's core tier 1 ratio would have been 8.4 per cent. had the Exchange Offers settled in December 2009. The Board considers that this implied level of core tier 1 capital represents a strong capital foundation to support the future stability and success of the Group.

Moreover, the core tier 1 capital raised by the Rights Issue will be available to absorb potential losses across all of Lloyds Banking Group's assets, as opposed to GAPS which would have only protected against losses on those particular assets covered by the scheme. The core tier 1 capital which would be created on conversion of the ECNs (if and when they were to convert) would also be available to absorb potential losses across all Lloyds Banking Group's assets.

By contrast, based on the terms announced in March 2009, GAPS would have created an initial £15.6 billion of core tier 1 capital through the subscription by HM Treasury, using the GAPS participation fee, for B Shares. However, the core tier 1 capital benefit of £15.6 billion from the issue of the B Shares would have been largely offset over the subsequent seven-year period by the GAPS participation fee which would have been amortised through the Group's income statement. After taking tax into consideration, this would have reduced core tier 1 capital by £11.2 billion. Furthermore, although GAPS would offer an additional core tier 1 capital benefit by providing capital relief on the risk-weighted assets that would initially have been included in the scheme, this benefit would have reduced significantly as the assets within GAPS matured or otherwise ceased to be covered by GAPS in the short-to-medium term.

Improved capital efficiency and lower shareholder dilution: The ECNs issued pursuant to the Exchange Offers have been designed to provide capital to Lloyds Banking Group without being dilutive to shareholders at the time of their issue. The ECNs qualified at the time of their issue as lower tier 2 capital and automatically convert into ordinary shares if Lloyds Banking Group's published consolidated core tier 1 capital ratio falls to less than 5 per cent., thereby increasing Lloyds Banking Group's core tier 1 capital at such time. In the event of a conversion pursuant to this feature, up to £7.5 billion of core tier 1 capital would be generated. This provides protection against unexpected deterioration in the UK economy and the effect that such deterioration would have on Lloyds Banking Group's capital ratios. Conversion of the ECNs, and the resulting dilution of ordinary shareholders, would only occur if Lloyds Banking Group's results (in particular impairments) were significantly worse than the Board currently expects.

By contrast, under GAPS, the B Shares to be issued to HM Treasury, at a cost to HM Treasury of £15.6 billion, would have been available for conversion at HM Treasury's option into 13.6 billion ordinary shares, and would have converted automatically if the volume weighted average trading price of the ordinary shares equalled or exceeded 150 pence per ordinary share for 20 complete trading days in any 30 trading-day period. Upon such conversion, HM Treasury's ownership of the Company would have increased to approximately 62.3 per cent. from its current level of approximately 41.3 per cent. This substantial dilution to ordinary shareholders (other than HM Treasury) would, therefore, have occurred in the event that Lloyds Banking Group plc's share price increased to such levels or if HM Treasury exercised its option to convert to ordinary shares.

Cost effective: By implementing the Proposals, although Lloyds Banking Group was required to make the GAPS Payment, Lloyds Banking Group will not have to pay the £15.6 billion GAPS participation fee to HM Treasury. In addition, the Company will not issue any B Shares and, accordingly, will not have to pay HM Treasury the proposed annual dividend on the B Shares of at least £1.1 billion, subject to the Company having sufficient distributable reserves.

Improved EU state aid position relative to GAPS: Based on discussions with HM Treasury and the European Commission, the Board believes that the total amount of state aid received by Lloyds Banking Group is significantly lower than would have been expected to be the case had Lloyds Banking Group participated in GAPS. The Board believes that this has significantly reduced the severity of the final terms of the restructuring plan required by the European Commission to limit distortions of competition resulting from the state aid received by the Group. An update on Lloyds Banking Group's current state aid position is set out below, see "— State Aid".

No additional administrative and operational burden: Participation in GAPS would have required Lloyds Banking Group to create an additional administrative and reporting infrastructure that would have been costly, both from a financial perspective and in terms of management time. This would have inhibited Lloyds Banking Group's operational and commercial efficiency and flexibility and absorbed substantial Lloyds Banking Group resources.

GAPS Withdrawal Deed

Alongside the Proposals, Lloyds Banking Group plc has entered into the GAPS Withdrawal Deed. This agreement sets out the various commitments and terms agreed with HM Treasury including with respect to the implementation of the expected state aid remedies.

The GAPS Withdrawal Deed provides for Lloyds Banking Group to make the GAPS Payment. This is a fee which Lloyds Banking Group has paid to HM Treasury for the benefit to Lloyds Banking Group's trading operations arising as a result of HM Treasury proposing to make GAPS available to Lloyds Banking Group from the time of the announcement of its intention to participate in GAPS in March 2009 until the announcement of the Proposals. Payment of a fee was also required by the European Commission as part of the state aid remedies.

Had Lloyds Banking Group not reached agreement with HM Treasury on the amount of the GAPS Payment, the Group would not have been able to pursue and implement the Proposals since payment of an agreed fee was a prerequisite to finalising negotiations with the European Commission in respect of the remedies to address the state aid Lloyds Banking Group has received.

The terms announced in March in connection with Lloyds Banking Group's intended participation in GAPS did not address whether a fee should be paid by Lloyds Banking Group if it did not ultimately accede to GAPS. Therefore, there was no contractual measure by which Lloyds Banking Group could determine the level of such fee. Furthermore, whilst the European Commission required that a commercially appropriate fee be paid, they did not prescribe the amount. The GAPS Payment was negotiated between Lloyds Banking Group plc and HM Treasury and was approved by the European Commission.

In order to determine what level of fee it would be appropriate to pay, the Group sought to quantify the benefit to Lloyds Banking Group's trading operations arising as a result of HM Treasury making GAPS available to Lloyds Banking Group.

The benefit to Lloyds Banking Group was calculated based on an estimate of the cost of capital for Lloyds Banking Group equal to the amount of regulatory capital benefit which the Board considers would have been received by or generated for Lloyds Banking Group through GAPS for the period from the announcement of its intention to participate in GAPS until the announcement of the Proposals. Had GAPS not been available to Lloyds Banking Group it would have needed to raise further capital. The calculation is difficult and, in some material respects, relies upon subjective judgements of some complexity and uncertainty. However, the amount of such regulatory capital benefit is based on: (i) the reduction of risk-weighted assets which would have arisen by virtue of GAPS; and (ii) the issuance of the B Shares. In order to determine the cost of capital for Lloyds Banking Group, a range of outcomes can be derived from long-term historical data as well as relevant market transactions during the period. However, in this case, the Board took into account the fact that, in March 2009, the capital markets were under severe stress and the cost of capital for Lloyds Banking Group would have been correspondingly materially higher than might have been available were only long-term historical data being used.

There are several other reasonable and supportable bases on which one can seek to quantify the benefit to Lloyds Banking Group, and therefore the appropriate amount of the GAPS Payment. Before coming to an agreement with HM Treasury on the amount of the GAPS Payment based on the cost of capital for Lloyds Banking Group, Lloyds Banking Group carried out a number of analyses, in addition to the analysis referenced above, and determined a range of amounts which the Board believes reflect the amount of benefit received by Lloyds Banking Group. The amount of the GAPS Payment negotiated and agreed with HM

Treasury falls within the range of such appropriate amounts, albeit at the high end of that range. However, the Board believes that the GAPS Payment is a proportionate fee and reflects the amount of benefit received by Lloyds Banking Group's trading operations.

The Board, having assessed carefully the amount of the GAPS Payment and the substantial benefits of the Proposals, believes that the Proposals, after taking into account the GAPS Payment, will enhance earnings per share and returns on equity for the Company relative to GAPS and, therefore, represent superior economic value to shareholders.

Undertakings with respect to the state aid approval

Under the GAPS Withdrawal Deed Lloyds Banking Group also makes certain undertakings in relation to the state aid approval obtained from the European Commission. In particular, Lloyds Banking Group is required to do all acts and things necessary to ensure the UK Government's compliance with its obligations under the European Commission's decision approving state aid to Lloyds Banking Group. This undertaking includes an obligation: (i) to comply with the restructuring measures that Lloyds Banking Group agreed to undertake; (ii) to comply with the terms of the restructuring plan submitted to and accepted by the European Commission in connection with the approval of state aid to Lloyds Banking Group; and (iii) to provide certain information to HM Treasury and do such acts as are necessary to enable compliance with the state aid approval to be monitored. HM Treasury has undertaken that, now that the European Commission has approved the state aid to Lloyds Banking Group, it will not, without the consent of Lloyds Banking Group plc, agree modifications to Lloyds Banking Group's undertakings with respect to state aid which are significantly more onerous to Lloyds Banking Group plc than those granted in order to obtain the state aid approval.

Lloyds Banking Group has undertaken to repay any state aid required by any future decision of the European Commission (subject to the Group's right to challenge any such decision in the European courts).

Other undertakings

The GAPS Withdrawal Deed also includes undertakings by Lloyds Banking Group plc in respect of certain other matters. In particular, with respect to remuneration, Lloyds Banking Group plc has acknowledged its commitment to the principle that, from 2010, it should be at the leading edge of implementing the G20 principles, the FSA code on remuneration and any remuneration provisions accepted by the Government from the Walker Review, provided that this principle shall always allow Lloyds Banking Group to operate on a level playing field with its competitors. In addition, Lloyds Banking Group plc has agreed with HM Treasury the specific deferral and clawback terms which will apply to any bonuses in respect of the 2009 performance year.

Furthermore, under the GAPS Withdrawal Deed, Lloyds Banking Group has agreed to reaffirm the lending commitments which were originally given in the Lending Commitments Deed entered into by the Group on 6 March 2009 in connection with Lloyds Banking Group's then proposed participation in GAPS. Under those lending commitments, the Company agreed to increase lending by approximately £14 billion in the 12 months commencing 1 March 2009 to support UK businesses (£11 billion) and homeowners (£3 billion). Lloyds Banking Group has agreed to maintain similar levels of lending in the 12 months commencing 1 March 2010, subject to adjustment of the funding commitments by agreement with the UK Government to reflect circumstances at the start of the 12-month period commencing 1 March 2010.

This additional lending in 2009 and 2010 is expressed to be subject to Lloyds Banking Group's prevailing commercial terms and conditions (including pricing and risk assessment) and, in relation to mortgage lending, Lloyds Banking Group's standard credit and other acceptance criteria. This lending commitment is part of Lloyds Banking Group's ongoing support for UK businesses and homeowners.

Lloyds Banking Group has additionally pledged its support for various Government schemes designed to provide additional funding for small businesses, and has also published charters for its small business customers making a range of pledges to help firms through the downturn.

In addition, as part of its lending commitment to businesses, Lloyds Banking Group has agreed to contribute to the National Investment Corporation the lesser of £100 million and 10 per cent. of the total sums invested in the National Investment Corporation. It has also committed: (i) to ensure that its public financial statements comply with best industry practice; and (ii) to enter into discussions with HM Treasury with a view to ensuring that such public financial statements: (a) enable investors to assess the quality of the assets and liabilities of banking institutions, the financial position and performance of banking institutions and the nature and extent of risks arising from financial instruments to which banking institutions are exposed; and (b) are comparable as between similar banking institutions.

Further Lloyds Banking Group has agreed to develop with the FSA, and implement, a medium term funding plan aimed at reducing dependence on short term funding to be regularly reviewed by the FSA, UKLA and HM Treasury and has agreed to implement any measures relating to personal current accounts agreed between the OFT and the UK banking industry: (i) as detailed in the OFT's report "Personal current accounts in the UK – a follow up report, October 2009" and (ii) relating to fees and charges, and the terms and conditions of personal current accounts where any such measures are within the scope of current negotiations with respect thereto.

HMT Undertaking to Subscribe

Under the HMT Undertaking to Subscribe, subject to certain terms and conditions, HM Treasury irrevocably agreed to procure and did procure that the Solicitor for the Affairs of Her Majesty's Treasury (as nominee for HM Treasury) (i) voted in favour of all of the resolutions relating to the Proposals upon which it was eligible to vote and (ii) took up its rights to subscribe for all of the shares to which it was entitled under the Rights Issue. On that basis, the Company paid to HM Treasury the HMT Commitment Commission. If HM Treasury had not committed to participate in full in respect of its entitlements under the Rights Issue, then Lloyds Banking Group would have sought to ensure that HM Treasury's entitlement under the Rights Issue would have been covered by the underwriting commitments given by the Underwriters in which case an amount similar to that to be paid to HM Treasury would have been expected to have been paid instead to the Underwriters.

State Aid

Lloyds Banking Group has previously announced that, as a result of HM Treasury's investment in Lloyds Banking Group in the context of the placing and open offer in November 2008 and Lloyds Banking Group's participation in the Credit Guarantee Scheme, Lloyds Banking Group was required to work with HM Treasury to submit a restructuring plan to the European Commission in the context of a state aid review. The plan was required to contain measures to limit any competition distortions resulting from the state aid received by Lloyds Banking Group.

The College of Commissioners announced its formal approval of Lloyds Banking Group's restructuring plan on 18 November 2009. See Risk Factor 1.3 for further discussion of the risks relating to the state aid proceedings. The restructuring plan consists of the following principal elements:

(i) the disposal of a retail banking business with at least 600 branches, a 4.6 per cent., share of the personal current accounts market in the UK and approximately 19 per cent., of Lloyds Banking Group's mortgage assets. The business would consist of:

- the TSB brand;

- the branches, savings accounts and branch-based mortgages of Cheltenham & Gloucester;
- the branches and branch-based customers of Lloyds TSB Scotland and a related banking licence;
- additional Lloyds TSB branches in England and Wales, with branch-based customers; and
- Intelligent Finance,

and would need to be disposed of within four years;

(ii) an asset reduction programme to achieve a £181 billion reduction in a specified pool of assets by 31 December 2014; and

(iii) behavioural commitments, including commitments:

- not to make certain acquisitions for approximately three to four years; and
- not to make discretionary payments of coupons or to exercise voluntary call options on hybrid securities from 31 January 2010 until 31 January 2012, which will prevent Lloyds Banking Group from paying dividends on its ordinary shares for the same duration.

The assets and liabilities, and associated income and expenses, of the business to be divested (referred to in sub-paragraph (i) above) cannot be determined with any precision until nearer the date of sale. However, Lloyds Banking Group estimated that, as at 31 December 2008 and after aggregating the elements relating to the Lloyds TSB Bank Group (which at that date did not include the HBOS Group) and the HBOS Group, the business to be divested comprised approximately £70 billion of customer lending and £30 billion of customer deposits and, on this basis, approximately £18 billion of risk-weighted assets. For the year ended 31 December 2008, the Board estimated that the business to be divested generated income of approximately £1.4 billion and, after associated direct expenses of approximately £600 million and impairment charges of £300 million, contributed approximately £500 million of profit before tax to Lloyds Banking Group.

The Board is confident that this restructuring plan will not have a materially negative impact on Lloyds Banking Group.

Background to GAPS

Given the extremely uncertain outlook for the UK economy at the end of 2008 and into 2009, Lloyds Banking Group worked with the FSA to identify and analyse the potential impact of an extended and severe UK recession on Lloyds Banking Group's regulatory capital ratios. Due to the significant uncertainty at that time over the length and depth of the recession, Lloyds Banking Group was tested against the FSA Stress Test.

The conclusion from this exercise was that Lloyds Banking Group would need additional capital to enable it to absorb the future impairments anticipated in such a severe scenario.

As a result, on 7 March 2009, Lloyds Banking Group announced its intention to participate in GAPS in respect of certain assets with an aggregate par value of approximately £260 billion. This announcement was made, in part, on the basis of the term sheet published by HM Treasury on 26 February 2009, which set out the expected key terms, conditions and operational principles of GAPS.

As consideration for entering into GAPS, it was expected that Lloyds Banking Group would pay a participation fee to HM Treasury of £15.6 billion, to be amortised over an estimated seven-year period. The proceeds of this fee would have been applied by HM Treasury in subscribing for an issue of B Shares by the Company. In addition to the participation fee, Lloyds Banking Group would also have had to assume 100 per cent. of the losses relating to the first £35 billion of impairments (including historical impairments and write-downs) relating to the assets covered by GAPS (the "**First Loss**") and a further 10 per cent. of cumulative losses in the whole portfolio of assets thereafter, up until the date specified as the maturity date of each covered asset.

The £15.6 billion of B Shares would have carried an annual dividend to be paid to HM Treasury (subject to the availability of distributable reserves and any restriction on payment of dividends that might have been required by the European Commission) of the greater of 7 per cent. of the issue price of the B Shares and 125 per cent. of any dividend on ordinary shares for each period. It was expected that the dividend payable on the B Shares would have been at least £1.1 billion per annum, subject to the availability of distributable reserves.

The entry into GAPS was intended to provide two key benefits to Lloyds Banking Group. First, loss relief, particularly in a scenario of severe economic stress such as would be implied by the FSA Stress Test. Once the First Loss had been utilised Lloyds Banking Group would not have been exposed to the full amount of losses it might otherwise have incurred in respect of non-performing assets covered by the scheme. Second, the entry into GAPS was intended to provide regulatory capital relief (or an increase in Lloyds Banking Group's core tier 1 capital ratio), arising from a reduction in Lloyds Banking Group's risk-weighted assets as well as the generation of new core tier 1 capital through the issuance of the B Shares.

Background to the Proposals

Lloyds Banking Group accepts and agrees with the merits of severe stress testing of regulatory capital, and the Proposals, together with other management actions which the Board considers to be readily actionable, are specifically designed to provide the capital enhancement that the Board believes is necessary to meet the capital requirements of the FSA Stress Test. The Board believes that, since commencing the negotiation of the terms of GAPS, the UK economy has begun to stabilise and is now expected to return to growth in 2010.

Accordingly, the Board believes that the likelihood of the UK economy deteriorating to the levels implied by the FSA Stress Test, the assumptions behind which remain unchanged, is now materially lower than was the case in March 2009.

Since March 2009, Lloyds Banking Group's core business has proved to be resilient despite the difficult economic circumstances under which it has had to operate.

In addition, Lloyds Banking Group has completed detailed credit reviews of its asset portfolio in accordance with Lloyds Banking Group's risk management approach, including, most importantly, the legacy HBOS portfolio and file-level credit reviews of Lloyds Banking Group's wholesale portfolio. This analysis, in conjunction with management's view of the economic outlook for the UK, underpins the Board's belief that Lloyds Banking Group's overall impairments peaked in the first half of 2009.

It also gives the Board a high level of confidence both in the adequacy of the substantial impairments which it has already taken against these assets (including with respect to Lloyds Banking Group's commercial and residential property exposures) and in the scale and timing of expected future impairments. Further detail on Group impairments by division is set out below and in the Impairment Update, which is incorporated by reference herein.

Impairments

A significant proportion of Lloyds Banking Group's impairments to date have originated in Lloyds Banking Group's Wholesale division, primarily reflecting the significant and rapid decline in commercial property prices and reducing levels of corporate cash flow. Lloyds Banking Group's impairments were also impacted by the exposures in certain legacy HBOS portfolios, which were more sensitive to the downturn in the economic environment. Having analysed the portfolio of wholesale assets, the Board expects a significant overall reduction in the Wholesale impairment charge in 2010, with modest reductions thereafter.

In the Retail division, the Company experienced a change in the mix of impairments in 2009, as the relative weighting between secured and unsecured impairments returned to a more normal pattern. This change has been more positive than expected due to a variety of factors, including: (i) a stabilising outlook for house prices (which has had a positive impact, primarily on the secured portfolio); (ii) increasing levels of unemployment (which has had a negative impact, primarily on the unsecured portfolio); and (iii) lower than previously expected house repossessions as customers benefit from the low interest rate environment and therefore lower mortgage payments (which has had a positive impact, primarily on the secured portfolio). In light of these trends, and management's expectations with regard to the UK economic outlook, the Board believes that Retail impairments have peaked in 2009, with a modest reduction expected in 2010.

In the Wealth and International division, the impairment charge increased in 2009, reflecting significant provisions against Lloyds Banking Group's Irish and Australian commercial real estate portfolios. Lloyds Banking Group continues to have ongoing concerns with regard to the outlook for the Irish economy and expects the high level of impairments to continue throughout 2010.

In conclusion, given its view of the economic outlook for the UK, the Board believes that, at the Group level, the overall impairment charge has now peaked and that the overall impairment charge in 2010 will be significantly lower than the overall impairment charge in 2009, with a modest reduction thereafter.

GAPS

Since 7 March 2009, the Company worked closely with HM Treasury to finalise the terms and conditions and operational mechanics of Lloyds Banking Group's participation in GAPS. However, as these terms and conditions were being negotiated, it became clear that the benefits of GAPS to Lloyds Banking Group would have been materially less extensive and that the costs to Lloyds Banking Group of participating in the scheme, both financially and in terms of management time, would have been materially higher (and the impact on Lloyds Banking Group materially more onerous) than was anticipated by the Board at the time its intended participation in GAPS was announced. The following issues in particular are relevant:

Capital Relief: The capital relief arising as a result of the large reduction in risk-weighted assets would have been much lower than had been anticipated by the Board in March 2009. This is due to various factors, including the fact that: (i) in March 2009 significant benefit was expected to arise in respect of Lloyds Banking Group's Treasury assets (however, Lloyds Banking Group has (with FSA approval) successfully resecuritised those assets and thereby reduced the risk-weighting of the assets); and (ii) updated, more accurate forecasting has changed Lloyds Banking Group's expectations of its quantum of risk-weighted assets. Further, it has become clear to the Board that the operation of GAPS, as it would apply to Lloyds Banking Group, would serve to remove certain assets from coverage within a short period after commencement of the scheme, which would mean the risk-weighted asset relief afforded by GAPS would reduce more quickly than had been anticipated by the Board in March.

GAPS Rules: The development of the detailed scheme rules for GAPS since the GAPS term sheet was published in February 2009 has meant that, in many areas, the scheme rules are more disadvantageous for Lloyds Banking Group than the position which had been anticipated by the Board when it announced its initial intention to participate. In practice, the Board believes it is highly likely that the operation of GAPS would have been economically unsatisfactory for Lloyds Banking Group. For example, although it is expected that, under GAPS, losses relating to restructuring events would be covered, Lloyds Banking Group may not have benefited from full coverage for certain restructuring and refinancing activities.

Consideration of alternative solutions

These circumstances and improved economic conditions caused the Board to consider alternative solutions that might provide superior economic value to shareholders than entry into GAPS. These potential alternative solutions included:

- renegotiating the commercial terms of GAPS, the type and quantum of assets covered by the scheme and the scheme rules;
- not entering into GAPS at all and instead raising sufficient additional capital on the public capital markets; or
- a combination of either of the above options.

During 2009, the Board held negotiations with HM Treasury and discussions with other relevant authorities in relation to these potential alternatives. The Board gave careful consideration to possible alternative formulations of GAPS, including a possible combination of a smaller version of GAPS with elements of the Proposals. The Board concluded it would not be in the best interests of its shareholders to pursue these alternative formulations for the reasons set out below:

- State aid: The alternative formulations of GAPS would, in the view of the Board, constitute additional state aid, which would likely require more severe compensatory measures than is expected to be the case if the Proposals are implemented;
- Uncertainty of outcome and potential delay: There was no agreement between Lloyds Banking Group and HM Treasury either on the general outline of any specific alternative formulation of GAPS or on the precise commercial terms on which any alternative formulation would have been made available to Lloyds Banking Group. While the Board believes that had negotiations continued, they would have been conducted in good faith, it had no certainty as to the outcome of such negotiations or whether or when such negotiations would have been concluded to the parties' mutual satisfaction, whereas the Proposals can be implemented immediately;
- Shareholder dilution: The issue of any B Shares in connection with a renegotiated or reduced form of GAPS would still have resulted in dilution for ordinary shareholders (other than HM Treasury) and would have increased the percentage holding of HM Treasury in the Company, thereby potentially delaying and making more difficult any eventual orderly exit by HM Treasury from its shareholding;
- Non-market-based solution: The Board's aim is that Lloyds Banking Group returns to being a self-standing, wholly privately-financed institution as soon as practicable. The Board believes that the Proposals advance this objective more quickly and effectively than would have been the case had Lloyds Banking Group participated in GAPS. At the same time, the Proposals improve the quality of Lloyds Banking Group's capital structure in a way that is to the long-term benefit of Lloyds Banking Group; and
- Cost and complexity: The alternative formulations of GAPS would have involved additional administrative and reporting structures which would, in the Board's view, have inhibited Lloyds Banking Group's operational and commercial flexibility.

Group capital and liquidity policies

In September 2008, Lloyds Banking Group set out a target that its core tier 1 capital ratio be in the range of 6 to 7 per cent. Reflecting the increase in expected levels of core tier 1 capital across the industry since that time, the Board's target has now been increased to be more than 7 per cent.

As discussed above, the Rights Issue raised a total of £13.5 billion of core tier 1 capital before expenses of the Proposals and before the making of the GAPS Payment. Had the Rights Issue been completed as at 30 June 2009, this would have resulted in a pro forma core tier 1 capital ratio for Lloyds Banking Group of approximately 8.6 per cent. after expenses of the Proposals and the GAPS Payment.

Retail Holdings Offer

On 19 January 2010, Lloyds Banking Group plc announced that it had repurchased £13,836,376 in liquidation preferences of its £186,190,532 6.475 per cent. Non-Cumulative Preference Shares and £7,591 in liquidation preference of its £99,999,942 9.75 per cent. Non-Cumulative Preference Shares for cash. The repurchases were made pursuant to an invitation to certain individuals who had been ineligible to participate in the Exchange Offers.