Lloyds Banking Group plc
Form 20-F
March 09, 2018

As filed with the Securities and Exchange Commission on 9 March 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended 31 December 2017
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-15246

LLOYDS BANKING GROUP plc

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

Scotland
(Jurisdiction of Incorporation or Organization)

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

Malcolm Wood, Company Secretary
Tel +44 (0) 20 7356 1274, Fax +44 (0) 20 7356 1808
25 Gresham Street
London EC2V 7HN
United Kingdom
(Name, telephone, e-mail and/or facsimile number and address of Company contact person)

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

Title of each class	Name of each exchange on which registered
Ordinary shares of nominal value 10 pence each, represented by American Depositary Shares	The New York Stock Exchange
$1,500,000,000 4.344% Subordinated Securities due in 2048	The New York Stock Exchange
$824,033,000 5.3% Subordinated Securities due 2045	The New York Stock Exchange
$1,750,000,000 3.574% Senior Notes due in 2028 (callable in 2027)	The New York Stock Exchange
$1,250,000,000 3.75% Senior Notes due 2027	The New York Stock Exchange
$1,500,000,000 4.65% Subordinated Securities due 2026	The New York Stock Exchange
$1,327,685,000 4.582% Subordinated Securities due 2025	The New York Stock Exchange
$1,250,000,000 3.5% Senior Notes due 2025	The New York Stock Exchange
$1,000,000,000 4.5% Subordinated Securities due 2024	The New York Stock Exchange
$2,250,000,000 2.907% Senior Notes due 2023 (callable in 2022)	The New York Stock Exchange
$1,500,000,000 3.0% Senior Notes due 2022	The New York Stock Exchange
$1,000,000,000 3.1% Senior Notes due 2021	The New York Stock Exchange
$2,500,000,000 6.375% Senior Notes due 2021	The New York Stock Exchange
$1,000,000,000 2.7% Senior Notes due 2020	The New York Stock Exchange
$1,000,000,000 2.4% Senior Notes due 2020	The New York Stock Exchange
$1,000,000,000 2.35% Senior Notes due 2019	The New York Stock Exchange
$750,000,000 2.05% Senior Notes due 2019	The New York Stock Exchange
$450,000,000 Floating Rate Notes due 2019	The New York Stock Exchange
$1,000,000,000 2.3% Senior Notes due 2018	The New York Stock Exchange
$700,000,000 2% Senior Notes due 2018	The New York Stock Exchange
$300,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,250,000,000 1.75% Senior Notes due 2018	The New York Stock Exchange
$400,000,000 Floating Rate Notes due 2018	The New York Stock Exchange
$1,000,000,000 1.75% Senior Notes due 2018	The New York Stock Exchange
$500,000,000 Floating Rate Notes due 2018	The New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act:
None
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:
7.50% Fixed Rate Reset Additional Tier 1 Perpetual Subordinated Contingent Convertible Securities

The number of outstanding shares of each of Lloyds Banking Group plc's classes of capital or common stock as of 31 December 2017 was:

Ordinary shares, nominal value 10 pence each	71,972,949,589
Preference shares, nominal value 25 pence each	412,204,151
Preference shares, nominal value 25 cents each	809,160
Preference shares, nominal value 25 euro cents each	Nil

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes x No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
Yes o No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definitions of "large accelerated filer", "accelerated filer," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer x Accelerated filer o Non-Accelerated filer o Emerging Growth Company o

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards[†]provided pursuant to Section 13(a) of the Exchange Act.
Yes o No o

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

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

If 'Other' has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:
Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

† The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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PRESENTATION OF INFORMATION

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

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

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

Lloyds Banking Group publishes its consolidated financial statements expressed in British pounds (‘pounds sterling’, ‘sterling’ or ‘£’), the lawful currency of the UK. In this annual report, references to ‘pence’ and ‘p’ are to one-hundredth of one pound sterling; references to ‘US dollars’, ‘US$’ or ‘$’ are to the lawful currency of the United States (the US); references to ‘cent’ or ‘c’ are to one-hundredth of one US dollar; references to ‘euro’ or ‘€’ are to the lawful currency of the member states of the European Union (EU) that have adopted a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty of European Union; references to ‘euro cent’ are to one-hundredth of one euro; and references to ‘Japanese yen’, ‘Japanese ¥’ or ‘¥’ are to the lawful currency of Japan. Solely for the convenience of the reader, this annual report contains translations of certain pounds sterling amounts into US dollars at specified rates. These translations should not be construed as representations by Lloyds Banking Group that the pounds sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or at any other rate. Unless otherwise stated, the translations of pounds sterling into US dollars have been made at the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) in effect on 31 December 2017, which was $1.3529 = £1.00. The Noon Buying Rate on 31 December 2017 differs from certain of the actual rates used in the preparation of the consolidated financial statements, which are expressed in pounds sterling, and therefore US dollar amounts appearing in this annual report may differ significantly from actual US dollar amounts which were translated into pounds sterling in the preparation of the consolidated financial statements in accordance with IFRS.

BUSINESS OVERVIEW

Lloyds Banking Group is a leading provider of financial services to individual and business customers in the UK. At 31 December 2017, total Lloyds Banking Group assets were £812,109 million and Lloyds Banking Group had 67,905 employees (on a full-time equivalent basis). Lloyds Banking Group plc's market capitalisation at that date was £48,985 million. The Group reported a profit before tax for the 12 months to 31 December 2017 of £5,625 million, and its capital ratios at that date were 21.2 per cent for total capital, 17.2 per cent for tier 1 capital and 14.1 per cent for common equity tier 1 capital.

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

	2017	2016	2015
	£m	£m	£m
Net interest income	10,912	9,274	11,318
Other income	23,325	30,337	11,832
Total income	34,237	39,611	23,150
Insurance claims	(15,578)	(22,344)	(5,729)
Total income, net of insurance claims	18,659	17,267	17,421
Operating expenses	(12,346)	(12,627)	(15,387)
Trading surplus	6,313	4,640	2,034
Impairment	(688)	(752)	(390)
Profit before tax	5,625	3,888	1,644

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

At 31 December 2017, the Group's three primary operating divisions, which are also reporting segments, were: Retail; Commercial Banking; and Insurance and Wealth. Retail provides banking, mortgages, personal loans, motor finance, credit cards and other financial services to personal and small business customers. Commercial Banking provides banking and related services to business clients, from SMEs to large corporates. Insurance and Wealth provides long-term savings, protection and investment products as well as general insurance products.

Profit before tax is analysed on pages 13 to 22 on a statutory basis and, in order to provide a more comparable representation of business performance of the Group's segments, on pages 24 to 32 on an underlying basis. The key principles adopted in the preparation of this basis of reporting are described on page 24. The Group Executive Committee, which is the chief operating decision maker for the Group, reviews the Group's internal reporting based around these segments (which reflect the Group's organisational and management structures) in order to assess performance and allocate resources; this reporting is on an underlying basis. IFRS 8, *Operating Segments* requires that the Group presents its segmental profit before tax on the basis reviewed by the chief operating decision maker that is most consistent with the measurement principles used in measuring the Group's statutory profit before tax. Accordingly, the Group presents its segmental underlying basis profit before tax in note 4 to the financial statements in compliance with IFRS 8. The table below shows the results of Lloyds Banking Group's segments in the last three fiscal years, and their aggregation. Further information on non-GAAP measures and the reconciliations required by the Securities and Exchange Commission's Regulation G are set out on pages F-18 to F-21.

	2017	2016[1]	2015[1]
	£m	£m	£m
Retail	4,403	4,058	4,255
Commercial Banking	2,489	2,379	2,383
Insurance and Wealth	939	973	1,090
Other	662	457	384
Profit before tax – underlying basis	8,493	7,867	8,112

1 Segmental analysis restated, as explained on page 24.

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

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SELECTED CONSOLIDATED FINANCIAL DATA

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

	2017	2016	2015	2014	2013
Income statement data for the year ended 31 December (£m)					
Total income, net of insurance claims	18,659	17,267	17,421	16,399	18,478
Operating expenses	(12,346)	(12,627)	(15,387)	(13,885)	(15,322)
Trading surplus	6,313	4,640	2,034	2,514	3,156
Impairment losses	(688)	(752)	(390)	(752)	(2,741)
Profit before tax	5,625	3,888	1,644	1,762	415
Profit (loss) for the year	3,897	2,164	956	1,499	(802)
Profit (loss) for the year attributable to ordinary shareholders	3,392	1,651	466	1,125	(838)
Dividends for the year[1,2]	2,195	2,175	1,962	535	–
Balance sheet data at 31 December (£m)					
Share capital	7,197	7,146	7,146	7,146	7,145
Shareholders' equity	43,551	42,670	41,234	43,335	38,989
Other equity instruments	5,355	5,355	5,355	5,355	–
Customer deposits	418,124	415,460	418,326	447,067	439,467
Subordinated liabilities	17,922	19,831	23,312	26,042	32,312
Loans and advances to customers	472,498	457,958	455,175	482,704	492,952
Total assets	812,109	817,793	806,688	854,896	842,380
Share information					
Basic earnings (loss) per ordinary share	4.9p	2.4p	0.8p	1.7p	(1.2)p
Diluted earnings (loss) per ordinary share	4.8p	2.4p	0.8p	1.6p	(1.2)p
Net asset value per ordinary share	60.5p	59.8p	57.9p	60.7p	54.6p
Dividends per ordinary share[1,3]	3.05p	3.05p	2.75p	0.75p	–
Equivalent cents per share[1,3,4]	4.21c	3.95c	4.03c	1.16c	–
Market price per ordinary share (year end)	68.1p	62.5p	73.1p	75.8p	78.9p
Number of shareholders (thousands)	2,450	2,510	2,563	2,626	2,681
Number of ordinary shares in issue (millions)[5]	71,973	71,374	71,374	71,374	71,368
Financial ratios (%)[6]					
Dividend payout ratio[7]	62.8	124.9	359.3	45.1	–
Post-tax return on average shareholders' equity	8.0	4.1	1.3	2.9	(2.0)
Post-tax return on average assets	0.48	0.26	0.11	0.17	(0.09)
Average shareholders' equity to average assets	5.3	5.2	5.1	4.7	4.7
Cost:income ratio[8]	66.2	73.1	88.3	84.7	82.9
Capital ratios (%)[9,10]					
Total capital	21.2	21.2	21.5	22.0	20.8
Tier 1 capital	17.2	16.8	16.4	16.5	14.5
Common equity tier 1 capital/Core tier 1 capital	14.1	13.4	12.8	12.8	14.0

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

2 Dividends for the year in 2016 included a special dividend totalling £356 million; (2015: £357 million).

3 Dividends per ordinary share in 2016 included a recommended special dividend of 0.5 pence; (2015: 0.5 pence).

4 Translated into US dollars at the Noon Buying Rate on the date each payment was made, with the exception of the final dividend in respect of 2017, which has been translated at the Noon Buying Rate on 23 February 2018.

5 For 2016 and previous years, this figure excluded the limited voting ordinary shares owned by the Lloyds Bank Foundations. The limited voting ordinary shares were redesignated as ordinary shares on 1 July 2017.

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

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

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

9 Capital ratios for 2013 are in accordance with the modified Basel II framework as implemented by the PRA.

10 Capital ratios for 2014 and later years are in accordance with the CRD IV rules implemented by the PRA on 1 January 2014.

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EXCHANGE RATES

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

	2018 January	**2017 December**	**2017 November**	**2017 October**	**2017 September**	**2017 August**
US dollars per pound sterling:						
High	**1.43**	**1.35**	**1.35**	**1.33**	**1.36**	1.32
Low	**1.35**	**1.33**	**1.31**	**1.31**	**1.30**	1.28

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

	2017	2016	2015	2014	2013
US dollars per pound sterling:					
Average	**1.30**	1.34	1.53	1.65	1.57

On 23 February 2018, the latest practicable date, the US dollar Noon Buying Rate was $1.3979 = £1.00. Lloyds Banking Group makes no representation that amounts in pounds sterling have been, could have been or could be converted into US dollars at that rate or at any of the above rates.

BUSINESS

HISTORY AND DEVELOPMENT OF LLOYDS BANKING GROUP

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

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

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

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

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

Pursuant to two placing and open offers which were completed by the Company in January and June 2009 and the Rights Issue completed in December 2009, the UK Government acquired 43.4 per cent of the Company's issued ordinary share capital. Following sales of shares in September 2013 and March 2014 and the completion of trading plans with Morgan Stanley & Co. International plc (Morgan Stanley), the UK Government completed the sale of its shares in May 2017, returning the Group to full private ownership.

Pursuant to its decision approving state aid to the Group, the European Commission required the Group to dispose of a retail banking business meeting minimum requirements for the number of branches, share of the UK personal current accounts market and proportion of the Group's mortgage assets. Following disposals in 2014, the Group sold its remaining interest in TSB to Banco de Sabadell (Sabadell) in 2015, and all EC state aid requirements were met by 30 June 2017.

On 1 June 2017, following the receipt of competition and regulatory approval, the Group acquired 100 per cent of the ordinary share capital of MBNA Limited, which together with its subsidiaries operates a UK consumer credit card business, from FIA Jersey Holdings Limited, a wholly-owned subsidiary of Bank of America.

BUSINESS

STRATEGY OF LLOYDS BANKING GROUP

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

In 2017 the Group successfully completed the second phase of its strategic plan, which focussed on creating the best customer experience, becoming simpler and more efficient and delivering sustainable growth.

As the Group looks to the future, it sees the external environment evolving rapidly. Changing customer behaviours, the pace of technological evolution and changes in regulation all present opportunities. Given the Group's strong capabilities and the significant progress made in recent years the Group believes it is in a unique position to compete and win in this environment by developing additional competitive advantages. The Group will continue to transform itself to succeed in this digital world and the next phase of its strategy will ensure the Group has the capabilities to deliver future success.

STRATEGIC PRIORITIES

The Group has identified four strategic priorities focused on the financial needs and behaviours of the customer of the future: further enhancing the Group's leading customer experience; further digitising the Group; maximising Group capabilities; and transforming ways of working. The Group will invest more than £3 billion in these strategic initiatives through the plan period that will drive the Group's transformation into a digitised, simple, low risk, customer focused UK financial services provider.

Delivering a leading customer experience

The Group will drive stronger customer relationships through best in class propositions while continuing to provide the Group's customers with brilliant servicing and a seamless experience across all channels. This will include:

- remaining the number 1 digital bank in the UK with open banking functionality;
- unrivalled reach with UK’s largest branch network serving complex needs; and
- data-driven and personalised customer propositions.

Digitising the Group

The Group will deploy new technology to drive additional operational efficiencies that will make banking simple and easier for customers whilst reducing operating costs, pursuing the following initiatives:

- deeper end-to-end transformation targeting over 70 per cent of cost base;
- simplification and progressive modernisation of our data and IT infrastructure; and
- technology enabled productivity improvements across the business.

Maximising the Group’s capabilities

The Group will deepen customer relationships, grow in targeted segments and better address our customers’ banking and insurance needs as an integrated financial services provider. This will include:

- increasing Financial Planning and Retirement (FP&R) open book assets by more than £50 billion by 2020 with more than 1 million new pension customers;
- implementing an integrated FP&R proposition with single customer view; and
- start-up, SME and Mid Market net lending growth (more than £6 billion in the plan period).

Transforming ways of working

The Group is making its biggest ever investment in people, increasing colleague training and development by 50 per cent to 4.4 million hours per annum and embracing new technology to drive better customer outcomes. The hard work, commitment and expertise of the Group’s colleagues has enabled it to deliver to date and the Group will further invest in capabilities and agile working practices. The Group has already restructured the business and reorganised the leadership team to ensure effective implementation of the new strategy.

BUSINESS AND ACTIVITIES OF LLOYDS BANKING GROUP

As part of a Group restructuring during 2017 the Consumer Finance division has now become part of Retail; the Group's UK wealth business, previously part of Retail, has been transferred to the Insurance division, now renamed Insurance and Wealth; the Group's International wealth business, previously part of Retail, has been transferred to the Commercial Banking division; and the Group's venture capital business, previously part of Commercial Banking, has been transferred to Other.

Following this restructuring, the Group's activities are now organised into three financial reporting segments: Retail; Commercial Banking; and Insurance and Wealth.

Further information on the Group's segments is set out on pages 24 to 32 and in note 4 to the financial statements.

MATERIAL CONTRACTS

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

BUSINESS

ENVIRONMENTAL MATTERS

A sustainable and responsible approach is integral to how the Group operates.

The Group needs to use scarce natural resources more sustainably, manage its environmental impacts and support its customers by financing opportunities created by the transition to a low carbon economy.

MANAGING ENVIRONMENTAL IMPACTS

Delivering the science-based carbon reduction and climate resilience targets set out in the Paris Agreement will have significant structural implications for the economy and the businesses and communities the Group serves. That is why the Group is evolving its Group-wide sustainability strategy.

This year, overall carbon emissions were 292,848 tonnes of CO_2e, a decrease of 14 per cent year-on-year and of 48 per cent against the 2009 baseline. This is mainly attributable to the reduction in consumption of gas and electricity, which make up the largest proportion of the Group's emissions, as a result of its extensive energy management programme. In 2017, the Group also reduced the CO_2e related to its business travel by promoting 'No Travel Week', encouraging travel alternatives and the successful roll out of 'WebEx', Group-wide.

CO_2E EMISSIONS

	Oct 16 - Sept 17	Oct 15 - Sept 16[1,2]	Oct 14 - Sept 15[1,2]
Total CO_2 e	**292,848**	340,382	395,543
Total Scope 1	**52,160**	53,026	58,851
Total Scope 2	**166,617**	202,414	239,709
Total Scope 3	**74,071**	84,943	96,983

1 Restated 2014/2015 and 2015/2016 emissions data to improve the accuracy of reporting, using actual data to replace estimates.

2 Restated all historic years to reflect improved methodology in assigning road travel between reporting scopes.

Emissions in tonnes CO_2 e in line with the GHG Protocol Corporate Standard (2004). The Group is in the process of transitioning to the revised Scope 2 guidance. Criteria used to measure and report Scope 1, 2, 3 emissions is provided in the Lloyds Banking Group Reporting Criteria statement available online at www.lloydsbankinggroup.com/responsible-business.

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

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

Indicator is subject to Limited ISAE3000 (revised) assurance by Deloitte LLP for the 2017 Annual Responsible Business Reporting. Deloitte's 2017 assurance statement and the 2017 Reporting Criteria are available online at www.lloydsbankinggroup.com/rbdownloads

SUPPORTING THE LOW CARBON ECONOMY

The Group is helping more of its commercial clients to understand and manage their sustainability risks and the Group completes an environmental risk assessment at the start of every new client relationship. The Group is currently exploring ways to build sustainability considerations into its policies and risk management processes. The Group offers customers products and services that help them embrace sustainability. In 2016, the Group launched an innovative £1 billion Green Loan Initiative to incentivise commercial real estate to become more energy efficient and this year exceeded its target to help 2 million square feet of real estate.

At the end of 2017, the Group's UK team had financed renewable projects with a combined capacity of over 2.75GW (2016: 1.78GW) and internationally the Group's existing investments in renewables exceed 8.9GW (2016: 7.4GW). In 2017 Lloyds Bank played an important part in Macquarie's acquisition of the Green Investment Bank (now Green Investment Group), providing financing for a significant portfolio of operational offshore wind farms including Sheringham Shoal, Gwynt y Mor, Rhyl Flats and projects in construction, including Galloper and Rampion offshore wind farms. Together the projects have a total capacity of approximately 2.4GW, which is enough to power over 1.7 million homes and they will support a significant number of jobs across the UK through the supply chain and maintenance of the wind farms.

THE IMPACT OF CLIMATE RISK

The Group welcomes the recommendations of the Financial Stability Board Taskforce on Climate-related Financial Disclosures (TCFD) and has mapped its approach to them. The Group is developing a strategy and implementing processes to:

Assess the materiality of climate risk across its business
Identify and define a range of scenarios, including relevant physical and transition risk
Evaluate the business impacts
Identify potential responses to manage the risks and opportunities

The Group will address a number of these and will disclose further information on its work in this important area.

CLIMATE RELATED FINANCIAL DISCLOSURES

Strategy

In 2017, the Group reviewed how it integrates environmental sustainability into its strategy and risk management processes, taking advice from external advisors and working with all parts of the business to understand work already in plan and where it needs to do more. The Group is committed to supporting the transition to a low carbon economy through its financial products and services, including renewable energy services.

Governance of climate change

The Responsible Business Committee, a sub-committee of the Board, will take overall responsibility for the Group's climate-related impacts and risks from 2018. It is chaired by an Independent Director, Sara Weller, and meets regularly throughout the year. The Group has refocused its executive-level Responsible Business Management Committee to become its Sustainability Committee and will ensure that staff with operational responsibilities across the Group's key divisions are actively involved in the development and implementation of a comprehensive environmental sustainability strategy. Discussions involving these Committees and the Commercial Banking leadership team were held in 2017 to start to examine the strategic implications of environmental challenges, including climate change.

BUSINESS

Risk management

The Sustainability Committee will oversee the assessment of the Group's climate-related risks, escalating to the Responsible Business Committee and the Board Risk Committee as appropriate. The Group's divisions are each exposed to different levels of climate risk. For example, as a large home insurer, the Group is aware that global warming is projected to increase the risk of flooding and consequently weather-related insurance claims. It is important that the Group continues to work with its customers, industry peers and government to ensure this risk is minimised and mitigated to keep flood insurance affordable.

Metrics and targets

The Group is working to develop strategic commitments and targets in response to climate-related risks and opportunities, with different parts of the business feeding into this target setting process. This builds on its work to reduce the environmental impact of its own operations.

The target is to reduce the Group's overall CO_2e by 60 per cent by 2030 and 80 per cent by 2050, in line with the UK's emission reduction targets. This follows a science-based target setting methodology. As part of its Green Loan Initiative, the Group's target is to fund 5 million square feet of commercial real estate to become more energy efficient by 2020, the equivalent of five London Shards. The Group has set a new target to help provide power for 5 million homes through its investment in renewable energy by 2020.

The Group will also consider the supplementary industry specific recommendations for the financial sector.

PROPERTIES

At 31 December 2017, Lloyds Banking Group occupied 2,021 properties in the UK. Of these, 429 were held as freeholds and 1,592 as leasehold. The majority of these properties are retail branches, widely distributed throughout England, Scotland, Wales and Northern Ireland. Other buildings include the Lloyds Banking Group's head office in the City of London with other customer service and support centres located to suit business needs but clustered largely in eight core geographic conurbations – London, Edinburgh, Glasgow, Midlands (Birmingham), Northwest (Chester and Manchester), West Yorkshire (Halifax and Leeds), South (Brighton and Andover) and Southwest (Bristol and Cardiff).

In addition, there are 169 properties which are either sub-let or vacant. There are also a number of ATM units situated throughout the UK, the majority of which are held as leasehold. The Group also has business operations elsewhere in the world, primarily holding property on a leasehold basis.

LEGAL ACTIONS AND REGULATORY MATTERS

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

PAYMENT PROTECTION INSURANCE (EXCLUDING MBNA)

The Group increased the provision for PPI costs by a further £1,300 million in 2017, of which £600 million was in the fourth quarter, bringing the total amount provided to £18,675 million. The remaining provision is consistent with an average of 11,000 complaints per week (previously 9,000) through to the industry deadline of August 2019, in line with the average experience over the last nine months.

The higher volume of complaints received has been driven by increased claims management company (CMC) marketing activity and the Financial Conduct Authority (FCA) advertising campaign.

At 31 December 2017, a provision of £2,438 million remained unutilised relating to complaints and associated administration costs. Total cash payments were £1,470 million during the year to 31 December 2017.

SENSITIVITIES

The Group estimates that it has sold approximately 16 million PPI policies since 2000. These include policies that were not mis-sold and those that have been successfully claimed upon. Since the commencement of the PPI redress programme in 2011 the Group estimates that it has contacted, settled or provided for approximately 53 per cent of the policies sold since 2000.

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

For every additional 1,000 reactive complaints per week above 11,000 on average through to the industry deadline of August 2019, the Group would expect an additional charge of £200 million.

PAYMENT PROTECTION INSURANCE (MBNA)

With regard to MBNA, as announced in December 2016, the Group's exposure is capped at £240 million already provided for, through an indemnity received from Bank of America.

OTHER PROVISIONS FOR LEGAL ACTIONS AND REGULATORY MATTERS

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other UK and overseas regulators and other governmental authorities on a range of matters. The Group also receives complaints in connection with its past conduct and claims brought by or on behalf of current and former employees, customers, investors and other third parties and is subject to legal proceedings and other legal actions. Where significant, provisions are held against the costs expected to be incurred in relation to these matters and matters arising from related internal reviews. During the year ended 31 December 2017 the Group charged a further £865 million in respect of legal actions and other regulatory matters, the unutilised balance at 31 December 2017 was £1,292 million (31 December 2016: £1,339 million). The most significant items are as follows.

ARREARS HANDLING RELATED ACTIVITIES

The Group has provided an additional £245 million (bringing the total provided to date to £642 million), for the costs of identifying and rectifying certain arrears management fees and activities. Following a review of the Group’s arrears handling activities, the Group has put in place a number of actions to improve further its handling of customers in these areas and has made good progress in reimbursing mortgage arrears fees to the 590,000 impacted customers.

PACKAGED BANK ACCOUNTS

In 2017 the Group provided an additional £245 million in respect of complaints relating to alleged mis-selling of packaged bank accounts raising the total amount provided to £750 million. A number of risks and uncertainties remain in particular with respect to future volumes.

CUSTOMER CLAIMS IN RELATION TO INSURANCE BRANCH BUSINESS IN GERMANY

The Group continues to receive claims in Germany from customers relating to policies issued by Clerical Medical Investment Group Limited (subsequently renamed Scottish Widows Limited). The German industry-wide issue regarding notification of contractual ‘cooling off’ periods continued to lead to an increasing number of claims in 2016 and 2017. Up to 31 December 2016 the Group had provided a total of £639 million and no further amounts have been provided to 31 December 2017. The validity of the claims facing the Group depends upon the facts and circumstances in respect of each claim. As a result the ultimate financial effect, which could be significantly different from the current provision, will be known only once all relevant claims have been resolved.

HBOS READING – CUSTOMER REVIEW

The Group is undertaking a review into a number of customer cases from the former HBOS Impaired Assets Office based in Reading. This review follows the conclusion of a criminal trial in which a number of individuals, including two former HBOS employees, were convicted of conspiracy to corrupt, fraudulent trading and associated money laundering offences which occurred prior to the acquisition of HBOS by the Group in 2009. The Group has provided £100 million in the year to 31 December 2017 and is in the process of paying compensation to the victims of the fraud for economic losses as well as ex-gratia payments and awards for distress and inconvenience. The review is ongoing and at 12 February 2018, the Group had made offers to 57 customers, which represents more than 80 per cent of the customers in review.

INTERCHANGE FEES

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

- The European Commission continues to pursue competition investigations against MasterCard and Visa probing, amongst other things, MIFs paid in respect of cards issued outside the EEA.
- Litigation brought by retailers continues in the English Courts against both Visa and MasterCard.

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

Visa Inc completed its acquisition of Visa Europe on 21 June 2016. As part of this transaction, the Group and certain other UK banks also entered into a Loss Sharing Agreement (LSA) with Visa Inc, which clarifies the allocation of liabilities between the parties should the litigation referred to above result in Visa Inc being liable for damages payable by Visa Europe. The maximum amount of liability to which the Group may be subject under the LSA is capped at the cash consideration which was received by the Group at completion. Visa Inc may also have recourse to a general indemnity, previously in place under Visa Europe's Operating Regulations, for damages claims concerning inter or intra-regional MIF setting activities.

LIBOR AND OTHER TRADING RATES

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

Certain Group companies, together with other panel banks, have also been named as defendants in private lawsuits, including purported class action suits, in the US in connection with their roles as panel banks contributing to the setting of US Dollar, Japanese Yen and Sterling LIBOR and the Australian BBSW Reference Rate. Certain of the plaintiffs' claims, including those in connection with USD and JPY LIBOR, have been dismissed by the US Federal

Court for Southern District of New York, and decisions are awaited on the Group's motions to dismiss the Sterling LIBOR and BBSW claims. The decisions leading to the Group's dismissal from the USD LIBOR claims are subject to two appeals; the first took place on 25 September 2017 and a decision is expected in the first quarter of 2018, and the second is expected to take place in the first half of 2018. The decisions leading to the Group's dismissal from the JPY LIBOR claims are not presently subject to appeal.

Certain Group companies are also named as defendants in: (i) UK based claims; and (ii) in a Dutch class action, each raising LIBOR manipulation allegations. A number of the claims against the Group in relation to the alleged mis-sale of Interest Rate Hedging Products also include allegations of LIBOR manipulation.

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

UK SHAREHOLDER LITIGATION

In August 2014, the Group and a number of former directors were named as defendants in a claim by a number of claimants who held shares in Lloyds TSB Group plc (LTSB) prior to the acquisition of HBOS plc, alleging breaches of duties in relation to information provided to shareholders in connection with the acquisition and the recapitalisation of LTSB. The defendants refute all claims made. A trial commenced in the English High Court on 18 October 2017 and is scheduled to conclude in the first quarter of 2018 with judgment to follow. It is currently not possible to determine the ultimate impact on the Group (if any).

FINANCIAL SERVICES COMPENSATION SCHEME

Following the default of a number of deposit takers in 2008, the Financial Services Compensation Scheme (FSCS) borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. In June 2017, the FSCS announced that following the sale of certain Bradford & Bingley mortgage assets, the principal balance outstanding on the HM Treasury loan was £4,678 million (31 December 2016: £15,655 million). Although it is anticipated that the substantial majority of this loan will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted, any shortfall will be funded by deposit-taking participants, including the Group, of the FSCS. The amount of future levies payable by the Group depends on a number of factors, principally, the amounts recovered by the FSCS from asset sales.

TAX AUTHORITIES

The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013 HMRC informed the Group that their interpretation of the UK rules which allow the offset of such losses denies the claim. If HMRC's position is found to be correct management estimate that this would result in an increase in current tax liabilities of approximately £650 million (including interest) and a reduction in the Group's deferred tax asset of approximately £350 million. The Group does not agree with HMRC's position and, having taken appropriate advice, does not consider that this is a case where additional tax will ultimately fall due. There are a number of other open matters on which the Group is in discussion with HMRC (including the tax treatment of certain costs arising from the divestment of TSB Banking Group plc), none of which is expected to have a material impact on the financial position of the Group.

RESIDENTIAL MORTGAGE REPOSSESSIONS

In August 2014, the Northern Ireland High Court handed down judgment in favour of the borrowers in relation to three residential mortgage test cases concerning certain aspects of the Group's practice with respect to the recalculation of contractual monthly instalments of customers in arrears. The FCA is actively engaged with the industry in relation to these considerations and has published Guidance on the treatment of customers with mortgage payment shortfalls. The Guidance covers remediation for mortgage customers who may have been affected by the way firms calculate these customers' monthly mortgage instalments. The Group is now determining its detailed approach to implementation of the Guidance and will contact affected customers during 2018.

MORTGAGE ARREARS HANDLING ACTIVITIES

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

CONTINGENT LIABILITIES RELATING TO OTHER LEGAL ACTIONS AND REGULATORY MATTERS

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

BUSINESS

COMPETITIVE ENVIRONMENT

The Group provides financial services to individual and business customers, predominantly in the UK but also overseas. The main business activities of the Group are retail and commercial banking and long-term savings, protection and investment.

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

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

For more information see "*Risk Factors – Business and economic risks – The Group's businesses are conducted in competitive environments, with increased competition scrutiny, and the Group's financial performance depends upon management's ability to respond effectively to competitive pressures.*"

RECENT DEVELOPMENTS

On 8 March 2018 the Group announced that it was launching a share buyback programme to repurchase up to £1 billion of its outstanding ordinary shares, as previously announced on 21 February 2018.

The Group has entered into an agreement with UBS AG, London Branch ("UBS") to conduct the share buyback programme on its behalf and to make trading decisions under the programme independently of the Group. Under the terms of the programme, the maximum consideration is £1 billion. The programme commenced on 8 March 2018 and will end no later than 4 February 2019. The sole purpose of the programme is to reduce the outstanding ordinary share capital of the Group.

UBS will purchase the Group's ordinary shares as principal and sell them on to the Group in accordance with the terms of their engagement. The Group intends to cancel the shares that it purchases through the programme.

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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Given the Group's UK focus, its prospects are closely linked to the strength of the UK economy
Despite near-term uncertainties about the future relationship with the EU, the UK economy is expected to remain resilient in 2018, growing at a similar pace to 2017. Longer term growth potential is still expected to be faster than the Eurozone and similar to the US
Interest rates are expected to remain low, with gradual rises beneficial to the Group's savings customers and the Group

OVERVIEW

As a UK focused financial services provider, the Group's prospects are closely aligned to the strength of and outlook for the UK economy. In the period following the decision to leave the EU, the UK economy has remained resilient. Growth has slowed only a little below its trend rate, unemployment has continued to fall to a 40-year low, and property prices have continued to rise slowly. In the absence of any sudden shocks to business or consumer confidence, this recent resilience is expected to continue in 2018 and the next few years. In common with many other countries, the biggest uncertainty for longer term growth is the degree to which productivity growth improves from its weak rate of the past decade.

OPPORTUNITIES

The economy's resilience bodes well for the Group and its customers. While interest rates are expected to increase only gradually, the Bank of England's first increase in Bank Rate in over 10 years has benefited savers, many of whom will have dealt with low rates for a prolonged period, and will support banking margins. In recent years, low interest rates and the Group's low risk approach have been reflected in low and falling levels of impairments against the Group's lending balances.

Looking ahead, impairments are expected to remain at benign levels at an industry level, with contributing factors including the slow pace of expected interest rate increases, unemployment remaining close to its current 40-year low, and the benefit of both continuing to support property prices. Meanwhile, business confidence has to date held up well in the face of global and domestic uncertainties. Manufacturers and exporters have been aided by sterling's depreciation since late 2015, and businesses generally are benefiting from low debt service costs.

CHALLENGES

Households' spending power has been squeezed over the past year as the rise in inflation to 3 per cent by the end of 2017 has outpaced growth in pay that has remained subdued in a broadly 2-2.5 per cent range over the year, partly reflecting weak productivity growth. While inflation is expected to slow, it is likely to trend towards 2 per cent only gradually through the next three year chapter of the Group's strategy, and whilst the Group expects wage growth to improve and end the spending power squeeze, it is uncertain how quickly this will happen. Meanwhile, the economy is more reliant than normal on business investment and exports to drive growth.

Business investment is likely to have been impacted by the uncertainty around the UK's future trading relationship with the EU but as negotiations progress and that relationship becomes clearer, investment spending should be supported. Operational impacts of the UK's exit from the EU present risks for some of the Group's customers' businesses, although the UK's continued competitive advantages in innovation and high value services, and the flexible labour market should enable the economy to prosper longer term in growing world markets.

OUTLOOK

Barring unexpected sudden shocks to consumer or business confidence, the near-term outlook for both the UK economy and the Group remains relatively benign. A tight labour market and gradual productivity improvements should over time underpin quickening wage growth, whilst inflation is expected to start falling through 2018, the combination gradually ending the squeeze on households' spending power. With unemployment remaining close to its current 40-year lows, Bank Rate is expected to continue to rise, but only slowly. House prices are expected to rise marginally, with the affordability impact of slightly higher interest rates offset by improving disposable incomes.

The Group is not immune to the challenges facing the near-term and medium-term economic outlook, but its UK focus means that the current benign conditions and resilience of the UK economy will be supportive to the Group's performance through the delivery of the next chapter of its strategy. Direct operational impacts from EU exit are also limited.

CRITICAL ACCOUNTING POLICIES

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

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

FUTURE ACCOUNTING DEVELOPMENTS

Future developments in relation to the Group's IFRS reporting are discussed in note 54 to the financial statements.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

RESULTS OF OPERATIONS – 2017, 2016 AND 2015

SUMMARY

	2017 £m	2016 £m	2015 £m
Net interest income	10,912	9,274	11,318
Other income	23,325	30,337	11,832
Total income	34,237	39,611	23,150
Insurance claims	(15,578)	(22,344)	(5,729)
Total income, net of insurance claims	18,659	17,267	17,421
Operating expenses	(12,346)	(12,627)	(15,387)
Trading surplus	6,313	4,640	2,034
Impairment	(688)	(752)	(390)
Profit before tax	5,625	3,888	1,644
Tax expense	(1,728)	(1,724)	(688)
Profit for the year	3,897	2,164	956
Profit attributable to ordinary shareholders	3,392	1,651	466
Profit attributable to other equity holders[1]	415	412	394
Profit attributable to equity holders	3,807	2,063	860
Profit attributable to non-controlling interests	90	101	96
Profit for the year	3,897	2,164	956

1 The profit after tax attributable to other equity holders of £415 million (2016: £412 million; 2015: £394 million) is partly offset in reserves by a tax credit attributable to ordinary shareholders of £102 million (2016: £91 million; 2015: £80 million).

2017 COMPARED WITH 2016

During the year ended 31 December 2017, the Group recorded a profit before tax of £5,625 million compared with a profit before tax in 2016 of £3,888 million.

Total income decreased by £5,374 million, or 14 per cent, to £34,237 million in 2017 compared with £39,611 million in 2016, comprising a £7,012 million decrease in other income only partly offset by an increase of £1,638 million in net interest income.

Net interest income was £10,912 million in 2017; an increase of £1,638 million, or 18 per cent compared to £9,274 million in 2016. There was a positive impact of £622 million in 2017 from a decrease in the amounts payable to unit holders in those Open-Ended Investment Companies (OEICs) included in the consolidated results of the Group, reflecting different levels of investment returns on the assets held by the OEICs; the change in population of consolidated OEICs in 2017 compared to 2016 did not have a significant impact. After adjusting for this, net interest income was £1,016 million, or 9 per cent higher. Average interest-earning assets fell as a result of decreases in average UK mortgage balances, lending to global corporates and in the portfolio of assets which are outside of the Group's risk appetite, more than offsetting the impact of the acquisition of MBNA. Net interest margin improved, excluding the impact of amounts payable to OEIC unitholders, as a result of lower deposit and wholesale funding costs and a positive impact from the acquisition of MBNA, more than offsetting continued pressure on asset margins.

Other income was £7,012 million, or 23 per cent, lower at £23,325 million in 2017 compared to £30,337 million in 2016. Fee and commission income was £80 million or 3 per cent, lower at £2,965 million compared to £3,045 million in 2016 as increased levels of card fees, reflecting both the acquisition of MBNA and higher levels of card usage, were more than offset by lower current account fees, reflecting reduced volumes of added-value accounts and changes in pricing structure, and lower levels of other fees receivable. Fee and commission expense increased by £26 million, or 2 per cent, to £1,382 million compared with £1,356 million in 2016. Net trading income decreased by £6,728 million, or 36 per cent, to £11,817 million in 2017 compared to £18,545 million in 2016; this decrease reflected a reduction of £6,630 million in gains on policyholder investments held within the insurance business as a result of market conditions over 2017 relative to those in 2016. Insurance premium income was £138 million, or 2 per cent, lower at £7,930 million in 2017 compared with £8,068 million in 2016; there was a decrease of £23 million in life insurance premiums and a £115 million decrease in general insurance premiums. The decrease in life insurance premiums reflects the fact that good growth in corporate pensions business has been offset by a lower level of bulk annuity deals, compared to the activity in 2016. General insurance premiums decreased as a result of market conditions and the continued run-off of closed books. Other operating income was £40 million, or 2 per cent, lower at £1,995 million in 2017 compared to £2,035 million in 2016.

Insurance claims expense was £6,766 million, or 30 per cent, lower at £15,578 million in 2017 compared to £22,344 million in 2016. The insurance claims expense in respect of life and pensions business was £6,737 million lower at £15,241 million in 2017 compared to £21,978 million in 2016; this decrease was matched by a similar reduction in net trading income, reflecting the relative performance of policyholder investments. Insurance claims in respect of general insurance business were £29 million or 8 per cent, lower at £337 million in 2017 compared to £366 million in 2016 as a result of the continued run-down of closed books and relatively benign weather conditions in 2017 compared to 2016.

Operating expenses decreased by £281 million, or 2 per cent to £12,346 million in 2017 compared with £12,627 million in 2016; the main reason for this decrease being the £209 million reduction in charges for redress payments to customers in respect of PPI and other conduct related matters from £2,374 million in 2016 to £2,165 million in 2017. Excluding these charges from both years, operating expenses were £72 million, or 1 per cent, lower at £10,181 million in 2017 compared to £10,253 million in 2016 as operating expenses of £172 million arising in MBNA since acquisition have been more than offset by the impact of underlying cost reductions. Staff costs were £207 million, or 4 per cent, lower at £4,610 million in 2017 compared with £4,817 million in 2016; increases in pension charges being more than offset by headcount related reductions in salaries and lower levels of severance costs. Premises and equipment costs were £58 million or 9 per cent, higher at £730 million in 2017 compared with £672 million in 2016. Other expenses were £79 million, or 3 per cent, higher

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

at £2,463 million in 2017 compared with £2,384 million in 2016. Depreciation and amortisation costs were £10 million lower at £2,370 million in 2017 compared to £2,380 million in 2016, as increased charges in respect of property, plant and equipment were more than offset by reduced charges relating to intangible assets.

Impairment losses decreased by £64 million, or 9 per cent, to £688 million in 2017 compared with £752 million in 2016; this reflects the fact that in 2016 there was an impairment charge of £173 million in respect of certain equity investments in the Group's available-for-sale portfolio which was not repeated in 2017. Impairment losses in respect of loans and advances to customers were £105 million, or 18 per cent, higher at £697 million in 2017 compared with £592 million in 2016; this includes a charge of £118 million in the MBNA business since acquisition and there were lower levels of releases and write-backs than in 2016. There was a credit of £9 million in respect of undrawn commitments in 2017, compared to a credit of £13 million in 2016.

In 2017, the Group recorded a tax expense of £1,728 million compared to a tax expense of £1,724 million in 2016, an effective tax rate of 31 per cent, compared to the standard UK corporation tax rate of 19.25 per cent, principally as a result of the banking surcharge and restrictions on the deductibility of conduct provisions.

Total assets were £5,684 million, or 1 per cent, lower at £812,109 million at 31 December 2017 compared to £817,793 million at 31 December 2016. Trading and other financial assets at fair value through profit or loss were £11,704 million, or 8 per cent, higher at £162,878 million compared to £151,174 million at 31 December 2016 due to the inclusion of a number of investments in OEICs which were de-consolidated during the year. However, loans and advances to banks were £20,291 million, or 75 per cent, lower at £6,611 million compared to £26,902 million at 31 December 2016 following the de-consolidation of these OEICs. Derivative assets were £10,304 million, or 29 per cent, lower at £25,834 million at 31 December 2017 compared to £36,138 million at 31 December 2016, largely as a result of exchange rate movements. Loans and advances to customers were £14,540 million, or 3 per cent, higher at £472,498 million at 31 December 2017 compared to £457,958 million at 31 December 2016; the addition of £8,144 million of lending following the acquisition of MBNA and an £8,528 million increase in reverse repurchase agreement balances together with the impact of the reacquisition of a portfolio of mortgages from TSB and growth in consumer finance and SME lending have more than offset reductions in the larger corporate sector, as the Group focuses on optimising capital and returns, and in closed mortgage books. Available-for-sale financial assets were £14,426 million, or 26 per cent, lower at £42,098 million at 31 December 2017 compared to £56,524 million at 31 December 2016 reflecting reductions in the Group's holdings of UK government securities.

Total liabilities were £6,362 million, or 1 per cent, lower at £762,966 million at 31 December 2017 compared to £769,328 million at 31 December 2016. Deposits from banks were £13,420 million, or 82 per cent, higher at £29,804 million at 31 December 2017 compared to £16,384 million at 31 December 2016 as a result of an increase of £15,896 million in repurchase agreements. Customer deposits were £2,664 million, or 1 per cent, higher at £418,124 million compared to £415,460 million at 31 December 2016 as reductions in non-relationship deposit balances were more than offset by strong inflows from Commercial clients. Derivative liabilities were £8,800 million, or 25 per cent, lower at £26,124 million at 31 December 2017 compared to £34,924 million at 31 December 2016, largely as a result of exchange rate movements. Debt securities in issue were £3,864 million, or 5 per cent, lower at £72,450 million at 31 December 2017 compared to £76,314 million at 31 December 2016 following maturities of some tranches of securitisation notes and covered bonds. Other liabilities were £8,463 million, or 29 per cent, lower at £20,730 million at 31 December 2017 compared to £29,193 million at 31 December 2016 reflecting the deconsolidation of a number of OEICs. Subordinated liabilities were £1,909 million, or 10 per cent, lower at £17,922 million at 31 December 2017 compared to £19,831 million at 31 December 2016 reflecting redemptions in the year.

Total equity was £678 million, or 1 per cent, higher at £49,143 million at 31 December 2017 compared to £48,465 million at 31 December 2016 as retained profits for the year have more than offset the Group's dividend payments, distributions on its AT1 securities and other reserve movements.

The Group has strengthened its capital position, with a common equity tier 1 ratio of 14.1 per cent (31 December 2016: 13.4 per cent), largely driven by the increase in equity, offset in part by the increase in the deduction for goodwill and other intangible assets following the acquisition of MBNA, and a reduction in risk-weighted assets. The total capital ratio was unchanged at 21.2 per cent.

Risk-weighted assets reduced by £4,527 million, or 2 per cent, to £210,919 million at 31 December 2017 compared to £215,446 million at 31 December 2016, largely relating to updates made to both mortgage and unsecured retail Internal Ratings Based (IRB) models, continued active portfolio management, foreign exchange movements, disposals and capital efficient securitisation activity, partly offset by targeted growth in key customer segments and the acquisition of MBNA.

The Group's liquidity surplus exceeds the regulatory minimum and internal risk appetite with a Liquidity Coverage Ratio of 127 per cent based on EU Delegated Act at 31 December 2017. Wholesale funding reduced by 9 per cent to £101 billion compared with £111 billion at 31 December 2016. In addition, the Group made use of central bank funding schemes and by the end of 2017 the Group had fully utilised its £20 billion capacity from the Bank of England's Term Funding Scheme.

The Group has recommended a final ordinary dividend of 2.05 pence per share. This is in addition to the interim ordinary dividend of 1.0 pence per share that was paid in September 2017. The total ordinary dividend per share for 2017 of 3.05 pence per share has increased by 20 per cent, from 2.55 pence in 2016.

The Group continues to give due consideration at each year end to the return of any surplus capital and for 2017, intends to implement a share buyback of up to £1 billion. This represents the return of capital over and above the Board's view of the current level of capital required to grow the business, meet regulatory requirements and cover uncertainties. The share buyback programme will commence in March 2018 and is expected to be completed during the next twelve months.

2016 COMPARED WITH 2015

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

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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

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

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

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

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

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

£3,481 million or 15 per cent, lower at £19,831 million compared to £23,312 million at 31 December 2015 as a result of redemptions during the year, including the Group's Enhanced Capital Notes. Total equity was £1,485 million, or 3 per cent, higher at £48,465 million at 31 December 2016 compared to £46,980 million at 31 December 2015; this reflected positive revaluation movements in the available-for-sale and cash flow hedging reserves.

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OPERATING AND FINANCIAL REVIEW AND PROSPECTS

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

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

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

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

The total ordinary dividend per share for 2016 of 2.55 pence per share had increased by 13 per cent, from 2.25 pence in 2015.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

NET INTEREST INCOME

	2017	2016	2015
Net interest income £m	10,912	9,274	11,318
Average interest-earning assets £m	585,374	600,435	614,917
Average rates:			
Gross yield on interest-earning assets %[1]	2.73	2.77	2.86
Interest spread %[2]	1.67	1.33	1.67
Net interest margin %[3]	1.86	1.54	1.84

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

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

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

2017 COMPARED WITH 2016

Net interest income was £10,912 million in 2017, an increase of £1,638 million, or 18 per cent, compared to £9,274 million in 2016. Net interest income in 2017 includes a charge of £1,435 million in respect of amounts attributable to third party investors in respect of its consolidated Open-Ended Investment Companies (OEICs) compared to a charge in 2016 of £2,057 million as a result of positive market movements in the year, with gains ranging from (1.0) per cent to 37.2 per cent in UK and global equity markets as well as in fixed income indices. The change in population of consolidated OEICs in 2017 compared to 2016 did not have a significant impact on this figure, contributing a net decrease of £65 million attributable to third party investors. After adjusting for the amounts payable to unitholders, net interest income was £1,016 million, or 9 per cent, higher at £12,347 million in 2017 compared to £11,331 million in 2016.

Average interest-earning assets were £15,061 million, or 3 per cent, lower at £585,374 million in 2017 compared to £600,435 million in 2016. The decrease reflected the impact of reductions in closed mortgage books, lending to global corporates and in the portfolio of assets which are outside of the Group’s risk appetite, more than offsetting the impact of the acquisition of MBNA.

The net interest margin was 32 basis points higher at 1.86 per cent in 2017 compared to 1.54 per cent in 2016, and adjusting net interest income for the amounts allocated to unitholders in Open-Ended Investment Companies, the net interest margin was 22 basis points higher at 2.11 per cent in 2017 compared to 1.89 per cent in 2016. The improvement in net interest margin reflected lower deposit and wholesale funding costs and a positive impact from the acquisition of MBNA, more than offsetting continued pressure on asset margins. Margins in Retail improved as a result of deposit repricing in the first quarter of 2017 and the positive impact of the acquisition of MBNA. Margins on relationship lending and similar interest-earning assets in Commercial Banking also improved as a result of the lower funding costs.

2016 COMPARED WITH 2015

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

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

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

OTHER INCOME

	2017 £m	2016 £m	2015 £m
Fee and commission income:			
Current account fees	712	752	804
Credit and debit card fees	953	875	918
Other	1,300	1,418	1,530
	2,965	3,045	3,252
Fee and commission expense	(1,382)	(1,356)	(1,442)
Net fee and commission income	1,583	1,689	1,810
Net trading income	11,817	18,545	3,714
Insurance premium income	7,930	8,068	4,792
Gains on sale of available-for-sale financial assets	446	575	51
Liability management	(14)	(598)	(28)
Other	1,563	2,058	1,493
Other operating income	1,995	2,035	1,516
Total other income	23,325	30,337	11,832

2017 COMPARED WITH 2016

Other income was £7,012 million, or 23 per cent, lower at £23,325 million in 2017 compared to £30,337 million in 2016.

Fee and commission income was £80 million, or 3 per cent, lower at £2,965 million in 2017 compared with £3,045 million in 2016. Current account fees were £40 million, or 5 per cent, lower at £712 million in 2017 compared to £752 million in 2016, due to lower volumes of added-value accounts and changes in pricing structure. An increase of £78 million, or 9 per cent, in credit and debit card fees from £875 million in 2016 to £953 million in 2017 resulted from the acquisition of MBNA and higher levels of card usage. Other fees and commissions receivable were £118 million, or 8 per cent, lower at £1,300 million in 2017 compared with £1,418 million in 2016.

Fee and commission expense was £26 million, or 2 per cent, higher at £1,382 million in 2017 compared to £1,356 million in 2016 as increased fees payable in card services, in part reflecting the acquisition of MBNA, have more than offset reductions on other fees payable.

Net trading income was £6,728 million, or 36 per cent, lower at £11,817 million in 2017 compared with £18,545 million in 2016. Net trading income within the insurance businesses was £6,630 million, or 38 per cent, lower at £10,941 million in 2017 compared to £17,571 million in 2016, which reflects reduced market gains over 2017 compared to 2016 in both debt security and equity investments. Net trading income within the Group's banking activities was £98 million, or 10 per cent, lower at £876 million in 2017 compared to £974 million in 2016, reflecting the change in fair value of interest rate derivatives and foreign exchange contracts in the banking book not mitigated through hedge accounting.

Insurance premium income was £7,930 million in 2017 compared with £8,068 million in 2016; a decrease of £138 million, or 2 per cent. Earned premiums in respect of the Group's long-term life and pensions business were £23 million lower at £7,187 million in 2017 compared to £7,210 million in 2016 reflecting the fact that good growth in corporate pensions business has been offset by a lower level of bulk annuity deals, compared to the activity in 2016. General insurance earned premiums were £115 million, or 13 per cent, lower at £743 million in 2017 compared with £858 million in 2016 as a result of market conditions and the continued run-off of closed books.

Other operating income was £40 million, or 2 per cent, lower at £1,995 million in 2017 compared to £2,035 million in 2016. In 2016 there was a loss of £721 million arising on the Group's tender offers and redemptions in respect of its Enhanced Capital Notes which completed in March 2016; in 2017 there has been a reduction of £637 million in the movement in value of in-force business from a gain of £472 million in the year ended 31 December 2016 to a charge of £165 million in 2017. The reduction in the movement in value of in-force business reflected the negative impact of assumption changes and experience variances. Gains on sales of available-for-sale financial assets in 2017 included a gain of £146 million on the sale of the Group's investment in Vocalink and £274 million (2016: £112 million) from the sale of UK government securities; 2016 included a gain of £484 million on sale of the Group's investment in VISA Europe.

2016 COMPARED WITH 2015

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

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

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

Net trading income was £14,831 million higher at £18,545 million in 2016 compared with £3,714 million in 2015. Net trading income within the insurance businesses was £14,797 million higher at £17,571 million in 2016 compared to £2,774 million in 2015, which reflects higher levels of returns on policyholder investments as a result of more favourable market conditions over 2016. However this increase, along with the increase in long-term insurance premium income, was largely offset by the increase in insurance claims expense and the £1,813 million increase in the amounts payable to unit holders in those Open-Ended Investment Companies consolidated into the Group's results within net interest income. Net trading income within the Group's banking activities was £34 million, or 4 per cent, higher at £974 million in 2016 compared to £940 million in 2015.

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

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

OPERATING EXPENSES

	2017 £m	2016 £m	2015 £m
Administrative expenses:			
Staff:			
Salaries	2,679	2,750	2,808
Performance-based compensation	473	475	409
Social security costs	361	363	349
Pensions and other post-retirement benefit schemes	625	555	548
Restructuring costs	24	241	104
Other staff costs	448	433	459
	4,610	4,817	4,677
Premises and equipment:			
Rent and rates	365	365	368
Repairs and maintenance	231	187	173
Other	134	120	174
	730	672	715
Other expenses:			
Communications and data processing	882	848	893
Advertising and promotion	208	198	253
Professional fees	328	265	262
UK bank levy	231	200	270
TSB disposal	–	–	665
Other	814	873	703
	2,463	2,384	3,046
Depreciation and amortisation:			
Depreciation of tangible fixed assets	1,944	1,761	1,534
Amortisation of acquired value of in-force non-participating investment contracts	34	37	41
Amortisation of other intangible assets	392	582	537
	2,370	2,380	2,112
Goodwill impairment	8	–	–
Total operating expenses, excluding regulatory provisions	10,181	10,253	10,550
Regulatory provisions:			
Payment protection insurance provision	1,300	1,350	4,000
Other regulatory provisions[1]	865	1,024	837
	2,165	2,374	4,837
Total operating expenses	12,346	12,627	15,387
Cost:income ratio (%)[2]	66.2	73.1	88.3

1 In 2016, regulatory provisions of £61 million (2017: £nil; 2015: £nil) were charged against income.

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

2017 COMPARED WITH 2016

Operating expenses decreased by £281 million, or 2 per cent, to £12,346 million in 2017 compared with £12,627 million in 2016. This decrease principally reflects the fact that 2017 includes a regulatory provisions charge of £2,165 million, which was £209 million, or 9 per cent, lower than the charge of £2,374 million in 2016.

Staff costs were £207 million, or 4 per cent, lower in 2017 at £4,610 million compared to £4,817 million in 2016, reflecting, in particular, the impact of reduced headcount. On a full-time equivalent basis, the Group had 67,905 employees at the end of 2017, a reduction of 2,528 from 70,433 employees at 31 December 2016; and this represents an underlying reduction of 4,231 employees offset by an increase of 1,703 employees as a result of the acquisition of MBNA. Salaries were £71 million, or 3 per cent, lower at £2,679 million in 2017 compared with £2,750 million in 2016. Pension costs were £70 million, or 13 per cent, higher at £625 million in 2017 compared to £555 million in 2016; social security costs were £2 million, or 1 per cent, lower at £361 million in 2017 compared with £363 million in 2016; and other staff costs were £15 million, or 3 per cent, higher at £448 million in 2017 compared with £433 million in 2016.

Premises and equipment costs were £58 million, or 9 per cent, higher at £730 million in 2017 compared to £672 million in 2016. Rent and rates were unchanged at £365 million; repairs and maintenance costs were £44 million, or 24 per cent, higher at £231 million in 2017 compared to £187 million in 2016, as a result of charges relating to property rationalisation, and other premises and equipment costs increased by £14 million, or 12 per cent, from £120 million in 2016 to £134 million in 2017.

Other expenses, excluding the regulatory provisions charges, were 79 million, or 3 per cent, higher at £2,463 million in 2017