Bank of Scotland plc

2018 Half-Year Results

Member of the Lloyds Banking Group

FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements with respect to the business, strategy, plans and / or results of the Bank of Scotland Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Bank of Scotland Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will or may occur in the future. Factors that could cause actual business, strategy, plans and/or results (including but not limited to the payment of dividends) to differ materially from forward looking statements made by the Bank of Scotland Group or on its behalf include, but are not limited to: general economic and business conditions in the UK and internationally; market related trends and developments; fluctuations in interest rates, inflation, exchange rates, stock markets and currencies; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the Bank of Scotland Group's or Lloyds Banking Group plc's, or Lloyds Bank plc's or HBOS plc's credit ratings; the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability, instability as a result of the exit by the UK from the European Union (EU) and the potential for other countries to exit the EU or the Eurozone and the impact of any sovereign credit rating downgrade or other sovereign financial issues; technological changes and risks to the security of IT and operational infrastructure, systems, data and information resulting from increased threat of cyber and other attacks; natural, pandemic and other disasters, adverse weather and similar contingencies outside the Bank of Scotland Group's or Lloyds Banking Group plc's or Lloyds Bank plc's or HBOS plc's control; inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, geopolitical, pandemic or other such events; changes in laws, regulations, practices and accounting standards or taxation, including as a result of the exit by the UK from the EU, or a further possible referendum on Scottish independence; changes to regulatory capital or liquidity requirements and similar contingencies outside the Bank of Scotland Group's or Lloyds Banking Group plc's or Lloyds Bank plc's or HBOS plc's control; the policies, decisions and actions of governmental or regulatory authorities or courts in the UK, the EU, the US or elsewhere including the implementation and interpretation of key legislation and regulation together with any resulting impact on the future structure of the Group; the ability to attract and retain senior management and other employees and meet its diversity objectives; actions or omissions by the Bank of Scotland Group's directors, management or employees including industrial action; the extent of any future impairment charges or write-downs caused by, but not limited to, depressed asset valuations, market disruptions and illiquid markets; the value and effectiveness of any credit protection purchased by the Bank of Scotland Group; the inability to hedge certain risks economically; the adequacy of loss reserves; the actions of competitors, including non-bank financial services, lending companies and digital innovators and disruptive technologies; and exposure to regulatory or competition scrutiny, legal, regulatory or competition proceedings, investigations or complaints. Please refer to the latest Annual Report on Form 20-F filed by Lloyds Banking Group plc with the US Securities and Exchange Commission for a discussion of certain factors and risks together with examples of forward looking statements.

Except as required by any applicable law or regulation, the forward looking statements contained in this document are made as of today's date, and the Bank of Scotland Group expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward looking statements contained in this document to reflect any change in the Bank of Scotland Group's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. The information, statements and opinions contained in this document do not constitute a public offer under any applicable law or an offer to sell any securities or financial instruments or any advice or recommendation with respect to such securities or financial instruments.

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FINANCIAL REVIEW

Principal activities

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

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

Review of results

During the half-year to 30 June 2018, the Group recorded a profit before tax of £1,132 million compared with a profit before tax in the half-year to 30 June 2017 of £1,627 million.

Total income decreased by £659 million, to £2,941 million in the half-year to 30 June 2018 compared with £3,600 million in the half-year to 30 June 2017, comprising a £181 million decrease in net interest income and a decrease of £478 million in other income.

Net interest income was £2,846 million in the half-year to 30 June 2018, a decrease of £181 million compared to £3,027 million in the half-year to 30 June 2017 as a result of balance sheet reductions and continued asset pricing pressure.

Other income was £478 million lower at £95 million in the half-year to 30 June 2018 compared to £573 million in the half-year to 30 June 2017. Net fee and commission income was £86 million lower at £108 million in the half-year to 30 June 2018 compared to £194 million in the half-year to 30 June 2017, in part reflecting a lower level of current account fees as a result of changes to overdraft charging announced in July 2017, which took effect in November. Net trading income was £207 million lower and other operating income was £185 million lower at a deficit of £21 million in the half-year to 30 June 2018 compared to income of £164 million in the half-year to 30 June 2017, due to a loss on sale of the Group Irish residential mortgage portfolio of £105 million; 2017 included a profit of £63 million on the sale of the Group's shares in Vocalink.

Operating expenses decreased by £181 million to £1,716 million in the half-year to 30 June 2018 compared with £1,897 million in the half-year to 30 June 2017. There was a £237 million reduction in regulatory provisions partly offset by a £56 million increase in other operating expenses. The charge in respect of regulatory provisions was £245 million compared to £482 million in the half-year to 30 June 2017 and comprised a charge of £175 million in respect of payment protection insurance and £70 million in respect of other conduct issues. Other operating expenses were £56 million higher at £1,471 million in the half-year to 30 June 2018 compared to £1,415 million in the half-year to 30 June 2017 reflecting increases in staff, restructuring and other costs.

Credit quality across the portfolio remains strong. Impairment losses increased by £17 million to £93 million in the half-year to 30 June 2018 compared with £76 million in the half-year to 30 June 2017, reflecting the expected lower releases and write-backs. In the current benign economic environment, the implementation of IFRS 9 has not had a significant effect on the Group's impairment charge.

Balance sheet and capital

A reduction in balances with fellow Lloyds Banking Group undertakings contributed to a reduction in total assets and liabilities. Total assets were £26,044 million lower at £344,028 million at 30 June 2018 compared to £370,072 million at 31 December 2017, and total liabilities were £24,895 million lower at £331,657 million at 30 June 2018 compared to £356,552 million at 31 December 2017, both principally due to a reduction in balances with fellow Lloyds Banking Group undertakings.

Total equity has decreased by £1,149 million from £13,520 million at 31 December 2017 to £12,371 million at 30 June 2018, as dividends paid of £1,500 million have more than offset profits for the period.

The Group's common equity tier 1 capital ratio increased to 12.3 per cent (31 December 2017: 12.2 per cent) and the tier 1 capital ratio increased to 15.2 per cent (31 December 2017: 15.0 per cent), largely driven by the reduction in risk-weighted assets, offset in part by the reduction in common equity tier 1 capital, mainly as a result of the accrual for foreseeable dividends in respect of 2018 earnings. The total capital ratio reduced to 20.8 per cent (31 December 2017: 21.3 per cent) reflecting both the reduction in common equity tier 1 capital and an increase in regulatory adjustments applied to tier 2 instruments, partially offset by the reduction in risk-weighted assets.

Risk-weighted assets reduced by £3,907 million, or 6 per cent, to £62,657 million at 30 June 2018 compared to £66,564 million at 31 December 2017, largely relating to the sale of the Irish mortgage portfolio.

FINANCIAL REVIEW (continued)

Capital position at 30 June 2018

The Group's capital position as at 30 June 2018, applying CRD IV transitional rules and IFRS 9 transitional arrangements, is set out in the following section.

Capital ratios

Capital resources (transitional)	At 30 June 2018 £m	At 31 Dec 2017 £m
Common equity tier 1		
Shareholders' equity per balance sheet	**10,863**	12,012
Adjustment to retained earnings for foreseeable dividends	**(1,500)**	(1,500)
Cash flow hedging reserve	**50**	(23)
Other adjustments	**292**	(3)
	9,705	10,486
Less: deductions from common equity tier 1		
Goodwill and other intangible assets	**(433)**	(437)
Prudent valuation adjustment	**(42)**	(119)
Excess of expected losses over impairment provisions and value adjustments	**–**	(46)
Securitisation deductions	**–**	(180)
Deferred tax assets	**(1,506)**	(1,571)
Common equity tier 1 capital	**7,724**	8,133
Additional tier 1		
Additional tier 1 instruments	**1,784**	1,824
Total tier 1 capital	**9,508**	9,957
Tier 2		
Tier 2 instruments	**3,423**	3,981
Eligible provisions	**111**	247
Total tier 2 capital	**3,534**	4,228
Total capital resources	**13,042**	14,185
Risk-weighted assets	**62,657**	66,564
Common equity tier 1 capital ratio	**12.3%**	12.2%
Tier 1 capital ratio	**15.2%**	15.0%
Total capital ratio	**20.8%**	21.3%

FINANCIAL REVIEW (continued)

	At 30 June 2018 £m	At 31 Dec 2017 £m
Risk-weighted assets		
Foundation Internal Ratings Based (IRB) Approach	**5,624**	5,808
Retail IRB Approach	**35,465**	38,010
Other IRB Approach	**1,076**	1,066
IRB Approach	**42,165**	44,884
Standardised Approach	**6,694**	7,431
Credit risk	**48,859**	52,315
Counterparty credit risk	**745**	995
Credit valuation adjustment risk	**201**	167
Operational risk	**10,807**	10,807
Market risk	**1,353**	1,608
Underlying risk-weighted assets	**61,965**	65,892
Threshold risk-weighted assets	**692**	672
Total risk-weighted assets	**62,657**	66,564

PRINCIPAL RISKS AND UNCERTAINTIES

The significant risks faced by the Group which could impact the success of delivering against the Group's long-term strategic objectives and through which global macro-economic conditions, on-going political uncertainty, regulatory developments and market liquidity dynamics could manifest, are detailed below. Except where noted, there has been no significant change to the description of these risks or key mitigating actions disclosed in the Group's 2017 Annual Report and Accounts, with any quantitative disclosures updated herein.

Lloyds Banking Group continues to consider and assess the potential implications of the UK leaving the European Union and manage related developments to assess, and if possible mitigate any impact to its customers, colleagues and products − as well as legal, regulatory, tax, financial and capital implications.

Credit risk – The risk that parties with whom the Group has contracted fail to meet their financial obligations (both on and off balance sheet). Adverse changes in the economic, geopolitical and market environment could impact profitability due to an increase in impairment losses, write downs and/or decrease in asset valuations.

Regulatory and legal risk – The risks of changing legislation, regulation, policies, voluntary codes of practice and their interpretation in the markets in which the Group operates may have a significant impact on the Group's operations, business prospects, structure, costs, capital requirements and/or ability to enforce contractual obligations.

Conduct risk – Conduct risk can arise from a number of areas including selling products to customers which do not meet their needs; failing to deal with customers' complaints effectively; not meeting customers' expectations; failing to promote effective competition in the interest of customers; and exhibiting behaviours which could impact on the integrity of the market or undermine wider regulatory standards.

Operational risk – The Group faces significant operational risks which may disrupt services to customers, cause reputational damage, and result in financial loss. These include the availability, resilience and security of the Group's core IT systems, unlawful or inappropriate use of customer data, theft of sensitive data, fraud and financial crime threats, and the potential for failings in the Group's customer processes.

People risk – Key people risks include the risk that the Group fails to maintain organisational skills, capability, resilience and capacity levels in response to organisational, political and external market change and evolving business needs.

Capital risk – The risk that the Group has a sub-optimal quantity or quality of capital or that capital is inefficiently deployed across the Group.

Funding and liquidity risk – The risk that the Group has insufficient financial resources to meet its commitments as they fall due.

Governance risk – Against a background of increased regulatory focus on governance and risk management, the most significant challenges arise from meeting the requirements to ring-fence core UK financial services and activities from January 2019 and further requirements under the Senior Manager and Certification Regime (SMCR).

Market risk – The risk that the Group's capital or earnings profile is affected by adverse market rates, in particular interest rates and credit spreads.

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

CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

CONSOLIDATED INCOME STATEMENT

	Note	**Half-year to 30 June 2018 £ million**	Half-year to 30 June 2017 £ million
Interest and similar income		**4,305**	4,488
Interest and similar expense		**(1,459)**	(1,461)
Net interest income		**2,846**	3,027
Fee and commission income		**292**	379
Fee and commission expense		**(184)**	(185)
Net fee and commission income	2	**108**	194
Net trading income		**8**	215
Other operating income		**(21)**	164
Other income		**95**	573
Total income		**2,941**	3,600
Regulatory provisions	10	**(245)**	(482)
Other operating expenses		**(1,471)**	(1,415)
Total operating expenses	3	**(1,716)**	(1,897)
Trading surplus		**1,225**	1,703
Impairment	4	**(93)**	(76)
Profit before tax		**1,132**	1,627
Tax expense	5	**(364)**	(520)
Profit for the period		**768**	1,107
Profit attributable to ordinary shareholders		**718**	1,056
Profit attributable to other equity holders [1]		**50**	51
Profit attributable to equity holders		**768**	1,107
Profit attributable to non-controlling interests		**–**	–
Profit for the period		**768**	1,107

[1] The profit after tax attributable to other equity holders of £50 million (half-year to 30 June 2017: £51 million) is offset in reserves by a tax credit attributable to ordinary shareholders of £14 million (half-year to 30 June 2017: £14 million).

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Half-year to 30 June 2018 £ million	Half-year to 30 June 2017 £ million
Profit for the period	**768**	1,107
Other comprehensive income		
Items that will not subsequently be classified to profit or loss:		
Movement in revaluation reserve in respect of equity shares held at fair value through other comprehensive income:		
Change in fair value	**11**	–
Tax	**–**	–
	11	–
Items that may subsequently be classified to profit or loss:		
Movement in revaluation reserve in respect of financial assets held at fair value through other comprehensive income – debt securities:		
Change in fair value	**(8)**	
Income statement transfers in respect of disposals	**–**	
Impairment	**1**	
Tax	**1**	
	(6)	
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value		11
Income statement transfers in respect of disposals		(116)
Income statement transfers in respect of impairments		10
Tax		11
		(84)
Movement in cash flow hedging reserve:		
Effective portion of changes in fair value	**(89)**	(54)
Net income statement transfers	**(11)**	15
Tax	**27**	10
	(73)	(29)
Currency translation differences (tax: nil)	**(1)**	1
Other comprehensive income for the period, net of tax	**(69)**	(112)
Total comprehensive income for the period	**699**	995
Total comprehensive income attributable to ordinary shareholders	**649**	944
Total comprehensive income attributable to other equity shareholders	**50**	51
Total comprehensive income attributable to equity shareholders	**699**	995
Total comprehensive income attributable to non-controlling interests	**–**	–
Total comprehensive income for the period	**699**	995

CONSOLIDATED BALANCE SHEET

	Note	**At 30 June 2018 £ million**	At 31 Dec 2017 £ million
Assets			
Cash and balances at central banks		**2,426**	2,677
Items in course of collection from banks		**216**	260
Financial assets at fair value through profit or loss	6	**571**	50
Derivative financial instruments		**10,112**	11,634
Loans and advances to banks		**1,145**	518
Loans and advances to customers	7	**263,240**	268,657
Debt securities		**9**	137
Due from fellow Lloyds Banking Group undertakings		**57,137**	81,663
Financial assets at amortised cost		**321,531**	350,975
Financial assets at fair value through other comprehensive income		**966**	
Available-for-sale financial assets			813
Goodwill		**325**	325
Other intangible assets		**108**	112
Property, plant and equipment		**771**	823
Current tax recoverable		**73**	2
Deferred tax assets		**1,887**	1,829
Other assets		**5,042**	572
Total assets		**344,028**	370,072

CONSOLIDATED BALANCE SHEET (continued)

Equity and liabilities	Note	At 30 June 2018 £ million	At 31 Dec 2017 £ million
Liabilities			
Deposits from banks		**20,845**	21,183
Customer deposits		**167,969**	171,198
Due to fellow Lloyds Banking Group undertakings		**109,095**	130,502
Items in course of transmission to banks		**282**	269
Financial liabilities at fair value through profit or loss		**104**	50
Derivative financial instruments		**11,581**	11,026
Notes in circulation		**1,140**	1,313
Debt securities in issue	9	**11,541**	10,919
Other liabilities		**618**	521
Current tax liabilities		**2**	503
Deferred tax liabilities		**–**	–
Other provisions		**1,686**	2,019
Subordinated liabilities		**6,794**	7,049
Total liabilities		**331,657**	356,552
Equity			
Share capital		**5,847**	5,847
Share premium account		**–**	–
Other reserves		**1,919**	2,003
Retained profits		**3,097**	4,162
Shareholders' equity		**10,863**	12,012
Other equity instruments		**1,500**	1,500
Total equity excluding non-controlling interests		**12,363**	13,512
Non-controlling interests		**8**	8
Total equity		**12,371**	13,520
Total equity and liabilities		**344,028**	370,072

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders						
	Share capital £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 31 December 2017:	5,847	2,003	4,162	12,012	1,500	8	13,520
Adjustment for IFRS9 and IFRS15 (note 15)	-	(14)	(335)	(349)	-	-	(349)
Balance at 1 January 2018:	5,847	1,989	3,827	11,663	1,500	8	13,171
Comprehensive income							
Profit for the period	–	–	768	768	–	–	768
Other comprehensive income							
Post retirement defined benefit scheme remeasurements, net of tax	–	–	–	–	–	–	–
Movements in revaluation reserve in respect of financial assets held at fair value through other comprehensive income, net of tax:							
Debt securities	–	(6)	–	(6)	–	–	(6)
Equity shares	–	11	–	11	–	–	11
Movements in cash flow hedging reserve, net of tax	–	(73)	–	(73)	–	–	(73)
Currency translation differences (tax: nil)	–	(1)	–	(1)	–	–	(1)
Total other comprehensive income	–	(69)	–	(69)	–	–	(69)
Total comprehensive income	–	(69)	768	699	–	–	699
Transactions with owners							
Dividends	–	–	(1,500)	(1,500)	–	–	(1,500)
Distributions on other equity instruments, net of tax	–	–	(36)	(36)	–	–	(36)
Capital contribution received	–	–	37	37	–	–	37
Total transactions with owners	–	–	(1,499)	(1,499)	–	–	(1,499)
Realised gains and losses on equity shares held at fair value through other comprehensive income	–	(1)	1	–	–	–	–
Balance at 30 June 2018	5,847	1,919	3,097	10,863	1,500	8	12,371

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

	Attributable to equity shareholders						
	Share capital £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2017	5,847	2,165	4,243	12,255	1,500	8	13,763
Comprehensive income							
Profit for the period	–	–	1,107	1,107	–	–	1,107
Other comprehensive income							
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(84)	–	(84)	–	–	(84)
Movements in cash flow hedging reserve, net of tax	–	(29)	–	(29)	–	–	(29)
Currency translation differences (tax: nil)	–	1	–	1	–	–	1
Total other comprehensive income	–	(112)	–	(112)	–	–	(112)
Total comprehensive income	–	(112)	1,107	995	–	–	995
Transactions with owners							
Dividends paid	–	–	(1,200)	(1,200)	–	–	(1,200)
Distributions on other equity instruments, net of tax	–	–	(37)	(37)	–	–	(37)
Capital contribution received	–	–	53	53	–	–	53
Total transactions with owners	–	–	(1,184)	(1,184)	–	–	(1,184)
Balance at 30 June 2017	5,847	2,053	4,166	12,066	1,500	8	13,574

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (continued)

	Attributable to equity shareholders						
	Share capital £ million	Other reserves £ million	Retained profits £ million	Total £ million	Other equity instruments £ million	Non-controlling interests £ million	Total £ million
Balance at 1 July 2017	5,847	2,053	4,166	12,066	1,500	8	13,574
Comprehensive income							
Profit for the period	–	–	881	881	–	–	881
Other comprehensive income							
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(8)	–	(8)	–	–	(8)
Movements in cash flow hedging reserve, net of tax	–	(37)	–	(37)	–	–	(37)
Currency translation differences (tax: nil)	–	(5)	–	(5)	–	–	(5)
Total other comprehensive income	–	(50)	–	(50)	–	–	(50)
Total comprehensive income	–	(50)	881	831	–	–	831
Transactions with owners							
Dividends paid	–	–	(900)	(900)	–	–	(900)
Distributions on other equity instruments, net of tax	–	–	(37)	(37)	–	–	(37)
Capital contribution received	–	–	52	52	–	–	52
Total transactions with owners	–	–	(885)	(885)	–	–	(885)
Balance at 31 December 2017	5,847	2,003	4,162	12,012	1,500	8	13,520

CONSOLIDATED CASH FLOW STATEMENT

	Half-year to 30 June 2018 £ million	Half-year to 30 June 2017 £ million
Profit before tax	**1,132**	1,627
Adjustments for:		
Change in operating assets	**24,929**	(36,024)
Change in operating liabilities	**(23,816)**	34,968
Non-cash and other items	**(589)**	103
Tax (paid) received	**(820)**	34
Net cash provided by operating activities	**836**	708
Cash flows from investing activities		
Purchase of financial assets	**(281)**	(194)
Proceeds from sale and maturity of financial assets	**297**	1,542
Purchase of fixed assets	**(90)**	(65)
Proceeds from sale of fixed assets	**50**	89
Disposal of businesses, net of cash disposed	**–**	26
Net cash (used in) provided by investing activities	**(24)**	1,398
Cash flows from financing activities		
Dividends paid to equity shareholders	**(1,500)**	(1,200)
Distributions on other equity instruments	**(50)**	(51)
Interest paid on subordinated liabilities	**(134)**	(128)
Repayment of subordinated liabilities	**(150)**	–
Net cash used in financing activities	**(1,834)**	(1,379)
Effects of exchange rate changes on cash and cash equivalents	**–**	1
Change in cash and cash equivalents	**(1,022)**	728
Cash and cash equivalents at beginning of period	**2,375**	3,052
Cash and cash equivalents at end of period	**1,353**	3,780

Cash and cash equivalents comprise cash and balances at central banks (excluding mandatory deposits) and amounts due from banks with a maturity of less than three months.

NOTES

1. Accounting policies, presentation and estimates

These condensed consolidated half-year financial statements as at and for the period to 30 June 2018 have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority (FCA) and with International Accounting Standard 34 (IAS 34), *Interim Financial Reporting* as adopted by the European Union and comprise the results of Bank of Scotland plc (the Bank) together with its subsidiaries (the Group). They do not include all of the information required for full annual financial statements and should be read in conjunction with the Group's consolidated financial statements as at and for the year ended 31 December 2017 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Copies of the 2017 Annual Report and Accounts are available on the Lloyds Banking Group's website and are available upon request from Investor Relations, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.

The directors consider that it is appropriate to continue to adopt the going concern basis in preparing the condensed consolidated half-year financial statements. In reaching this assessment, the directors have considered projections for the Group's capital and funding position.

Except as noted below, the accounting policies are consistent with those applied by the Group in its 2017 Annual Report and Accounts.

Changes in accounting policy

The Group has adopted IFRS 9 and IFRS 15 with effect from 1 January 2018.

(i) IFRS 9 *Financial Instruments*

IFRS 9 replaces IAS 39 and addresses classification, measurement and derecognition of financial assets and liabilities, the impairment of financial assets measured at amortised cost or fair value through other comprehensive income and general hedge accounting.

Impairment: IFRS 9 replaces the IAS 39 'incurred loss' impairment approach with an 'expected credit loss' approach. The revised approach applies to financial assets including finance lease receivables, recorded at amortised cost or fair value through other comprehensive income; loan commitments and financial guarantees that are not measured at fair value through profit or loss are also in scope. The expected credit loss approach requires an allowance to be established upon initial recognition of an asset reflecting the level of losses anticipated after having regard to, amongst other things, expected future economic conditions. Subsequently the amount of the allowance is affected by changes in the expectations of loss driven by changes in associated credit risk.

Classification and measurement: IFRS 9 requires financial assets to be classified into one of the following measurement categories: fair value through profit or loss, fair value through other comprehensive income and amortised cost. Classification is made on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instruments. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to the entity's own credit risk is recorded in other comprehensive income. The Group early adopted this requirement with effect from 1 January 2017.

1. Accounting policies, presentation and estimates (continued)

General hedge accounting: The new hedge accounting model aims to provide a better link between risk management strategy, the rationale for hedging and the impact of hedging on the financial statements. The standard does not explicitly address macro hedge accounting solutions, which are being considered in a separate IASB project – Accounting for Dynamic Risk Management. Until this project is finalised, the IASB has provided an accounting policy choice to retain IAS 39 hedge accounting in its entirety or choose to apply the IFRS 9 hedge accounting requirements. The Group has elected to continue applying hedge accounting as set out in IAS 39.

(ii) IFRS 15 *Revenue from Contracts with Customers*
IFRS 15 has replaced IAS 18 *Revenue* and IAS 11 *Construction Contracts*. The core principle of IFRS 15 is that revenue reflects the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled. The recognition of such revenue is in accordance with five steps to: identify the contract; identify the performance obligations; determine the transaction price; allocate the transaction price to the performance obligations; and recognise revenue when the performance obligations are satisfied.

Details of the impact of adoption of IFRS 9 and IFRS 15 are provided in note 15.

The following policies will substantially replace the relevant sections of the existing policies (D), (E) and (H) in the 2018 Annual Report and Accounts as they relate to revenue recognition, classification and measurement and impairment. Policies that are substantially unchanged such as accounting for borrowings, sales and repurchase agreements, recognition and derecognition and hedge accounting are not repeated.

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

Fees and commissions receivable which are not an integral part of the effective interest rate are recognised as income as the services are provided. Current account and card fees are accrued evenly over the course of the year. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan once drawn. Where it is unlikely that loan commitments will be drawn, loan commitment fees are recognised over the life of the facility. Incremental costs incurred to generate fee and commission income are charged to fees and commissions expense as they are incurred.

Dividend income is recognised when the right to receive payment is established.

1. Accounting policies, presentation and estimates (continued)

(E) Financial assets and liabilities

On initial recognition, financial assets are classified as measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss, depending on the Group's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest. The Group assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how the performance of the portfolio is managed and reported, and the frequency of asset sales. Financial assets with embedded derivatives are considered in their entirety when considering their cash flow characteristics. The Group reclassifies financial assets when and only when its business model for managing those assets changes.

Equity investments are measured at fair value through profit or loss unless the Group elects at initial recognition to account for the instruments at fair value through other comprehensive income. For these investments, dividends are recognised in profit or loss but fair value gains and losses are not subsequently reclassified to profit or loss following derecognition of the investment.

(1) Financial assets measured at amortised cost

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

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

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

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

1. Accounting policies, presentation and estimates (continued)

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

Financial assets are classified at fair value through profit or loss where they do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income or where they are designated at fair value through profit or loss to reduce an accounting mismatch. Derivatives are carried at fair value.

The assets backing the insurance and investment contracts issued by the Group do not meet the criteria to be measured at amortised cost or fair value through other comprehensive income as they are managed on a fair value basis and accordingly are measured at fair value through profit or loss. Similarly, trading securities, which are debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains, do not meet these criteria and are also measured at fair value through profit or loss. Financial assets measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur.

Financial liabilities are measured at fair value through profit or loss where they are trading liabilities or where they are designated at fair value through profit or loss in order to reduce an accounting mismatch; where the liabilities are part of a group of liabilities (or assets and liabilities) which is managed, and its performance evaluated, on a fair value basis; or where the liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for. Financial liabilities measured at fair value through profit or loss are recognised in the balance sheet at their fair value. Fair value gains and losses are recognised in the income statement within net trading income in the period in which they occur, except that gains and losses attributable to changes in own credit risk are recognised in other comprehensive income.

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

1. Accounting policies, presentation and estimates (continued)

(H) Impairment of financial assets

The impairment charge in the income statement includes the change in expected credit losses and certain fraud costs. Expected credit losses are recognised for loans and advances to customers and banks, other financial assets held at amortised cost, financial assets measured at fair value through other comprehensive income, and certain loan commitments and financial guarantee contracts.

Expected credit losses are calculated by using an appropriate probability of default, adjusted to take into account a range of possible future economic scenarios, and applying this to the estimated exposure of the Group at the point of default after taking into account the value of any collateral held or other mitigants of loss and including the impact of discounting using the effective interest rate.

At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is made for expected credit losses resulting from default events that are possible within the next 12 months (12-month expected credit losses). In the event of a significant increase in credit risk, allowance (or provision) is made for expected credit losses resulting from all possible default events over the expected life of the financial instrument (lifetime expected credit losses). Financial assets where 12-month expected credit losses are recognised are considered to be Stage 1; financial assets which are considered to have experienced a significant increase in credit risk are in Stage 2; and financial assets which have defaulted or are otherwise considered to be credit impaired are allocated to Stage 3.

An assessment of whether credit risk has increased significantly since initial recognition considers the change in the risk of default occurring over the remaining expected life of the financial instrument. The assessment is unbiased, probability-weighted and uses forward-looking information consistent with that used in the measurement of expected credit losses. In determining whether there has been a significant increase in credit risk, the Group uses a quantitative test based on relative and absolute PD movements linked to internal credit ratings together with qualitative indicators such as watchlists and other indicators of historic delinquency. However, unless identified at an earlier stage, the credit risk of financial assets is deemed to have increased significantly when more than 30 days past due. Where the credit risk subsequently improves such that it no longer represents a significant increase in credit risk since origination, the asset is transferred back to Stage 1.

Assets are transferred to Stage 3 when they have defaulted or are otherwise considered to be credit impaired. IFRS 9 contains a rebuttable presumption that default occurs no later than when a payment is 90 days past due. The Group uses this 90 day backstop for all its products except for UK mortgages. For UK mortgages, the Group has assumed a backstop of 180 days past due as mortgage exposures more than 90 days past due, but less than 180 days, typically show high cure rates and this aligns to the Group's risk management practices.

In certain circumstances, the Group will renegotiate the original terms of a customer's loan, either as part of an ongoing customer relationship or in response to adverse changes in the circumstances of the borrower. In the latter circumstances, the loan will remain classified as either Stage 2 or Stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows. Renegotiation may also lead to the loan and associated allowance being derecognised and a new loan being recognised initially at fair value.

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

1. Accounting policies, presentation and estimates (continued)

Future accounting developments

Details of those IFRS pronouncements which will be relevant to the Group but which will not be effective at 31 December 2018 and which have not been applied in preparing these condensed consolidated half-year financial statements are set out in note 16.

Critical accounting estimates and judgements

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that impact the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may include amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Other than in relation to the implementation of IFRS 9, there have been no significant changes in the basis upon which estimates have been determined, compared to that applied at 31 December 2017.

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

Definition of default

The probability of default (PD) of an exposure, both over a 12 month period and over its lifetime, is a key input to the measurement of the ECL allowance. Default has occurred when there is evidence that the customer is experiencing significant financial difficulty which is likely to affect the ability to repay amounts due.

The definition of default adopted by the Group is described in (H) Impairment of financial assets above. This definition is aligned to the regulatory definition of default used by the Group for capital and regulatory reporting except that the Group has made the decision to treat forborne non-performing past term interest only mortgages as credit impaired.

As noted in (H) Impairment of financial assets, the Group has rebutted the presumption in IFRS 9 that default occurs no later than when a payment is 90 days past due. The impact on the Group's ECL allowance of assuming a backstop of 180 days past due for UK mortgages is not material.

Lifetime of an exposure

To derive the PDs necessary to calculate the ECL allowance it is necessary to estimate the expected life of each financial instrument. A range of approaches has been adopted across different product groupings including the full contractual life and taking into account behavioural factors such as early repayments and refinancing. For Retail assets, the Group has defined the lifetime for each product by analysing the time taken for all losses to be observed and for a material proportion of the assets to fully resolve through either closure or write-off. For revolving products, the Group has considered the losses beyond the contractual term over which the Group is exposed to credit risk. For Commercial overdraft facilities, the average behavioural life has been used. Changes to the assumed expected lives of the Commercial assets could have a material effect on the ECL allowance recognised by the Group.

1. Accounting policies, presentation and estimates (continued)

Significant increase in credit risk (SICR)
Performing assets are classified as either Stage 1 or Stage 2. An ECL allowance equivalent to 12 months expected losses is established against assets in Stage 1; assets classified as Stage 2 carry an ECL allowance equivalent to lifetime expected losses. Assets are transferred from Stage 1 to Stage 2 when there has been an SICR since initial recognition. As described in (H) Impairment of financial assets above, the Group uses a quantitative test together with qualitative indicators and a backstop of 30 days past due for determining whether there has been a SICR. The setting of precise trigger points combined with risk indicators requires judgement. The use of different trigger points may have a material impact upon the size of the ECL allowance.

For Retail, a deterioration of four grades for credit cards, personal loans or overdrafts, or three grades for personal mortgages, or two grades for asset finance accounts, would trigger a transfer to Stage 2. For Commercial a doubling of PD with a minimum increase in PD of 1 per cent and a resulting change in the underlying grade would trigger a transfer.

Forward looking information
The measurement of expected credit losses is required to reflect an unbiased probability-weighted range of possible future outcomes.

In order to do this the Group uses a model to project a number of key variables to generate in excess of 2,000 possible future economic scenarios. These are ranked according to severity of loss and four scenarios are selected to represent the full loss distribution; a central scenario which reflects the assumptions used for medium-term planning purposes, an upside and a downside scenario and a severe downside scenario. Each scenario receives a 30 per cent weighting except for the severe downside scenario which is weighted at 10 per cent. These scenarios are used to produce a weighted average PD for each product grouping which is used to determine stage allocation and calculate the related ECL allowance.

The choice of alternative scenarios and probability weighting is a combination of quantitative analysis and judgemental assessments, designed to ensure that the full range of possible outcomes and material non-linearity are captured. The key UK economic assumptions made by the Lloyds Banking Group as at 30 June 2018 are shown below:

	Base Case %	Upside %	Downside %	Severe Downside %
Interest rate	**1.43**	**2.29**	**0.90**	**0.65**
Unemployment rate	**4.8**	**4.0**	**5.7**	**7.1**
House price growth	**2.7**	**6.5**	**(2.9)**	**(5.6)**
CRE price growth	**0.5**	**9.0**	**(5.3)**	**(8.1)**

2. Net fee and commission income

	Half-year to 30 June 2018 £m	Half-year to 30 June 2017 £m
Fee and commission income:		
Current accounts	**96**	114
Credit and debit card fees	**114**	117
Other	**82**	148
Total fee and commission income	**292**	379
Fee and commission expense	**(184)**	(185)
Net fee and commission income	**108**	194

3. Operating expenses

	Half-year to 30 June 2018 £m	Half-year to 30 June 2017 £m
Administrative expenses		
Staff costs	**702**	713
Premises and equipment	**141**	129
Other expenses	**548**	487
	1,391	1,329
Depreciation and amortisation	**80**	86
Total operating expenses, excluding regulatory provisions	**1,471**	1,415
Regulatory provisions:		
Payment protection insurance provision (note 10)	**175**	216
Other regulatory provisions (note 10)	**70**	266
	245	482
Total operating expenses	**1,716**	1,897

4. Impairment

	Half-year to 30 June 2018 £m	Half-year to 30 June 2017 £m
Loans and advances to customers	**108**	76
Debt securities	**–**	(4)
Financial assets at amortised cost	**108**	72
Undrawn balances	**(16)**	(2)
Financial assets at fair value through other comprehensive income (2017: available-for-sale financial assets)	**1**	6
Total impairment charged to the income statement	**93**	76

5. Taxation

In accordance with IAS 34, the Group's income tax expense for the half-year to 30 June 2018 is based on the best estimate of the weighted-average annual income tax rate expected for the full financial year. The tax effects of one-off items are not included in the weighted-average annual income tax rate, but are recognised in the relevant period.

An explanation of the relationship between tax expense and accounting profit is set out below:

	Half-year to 30 June 2018 £m	Half-year to 30 June 2017 £m
Profit before tax	**1,132**	1,627
UK corporation tax thereon at 19 per cent (2017: 19.25 per cent)	**(215)**	(313)
Impact of surcharge on banking profits	**(99)**	(147)
Non-deductible costs: conduct charges	**(33)**	(79)
Other non-deductible costs	**(7)**	(9)
Non-taxable income	**7**	2
Tax-exempt gains on disposals	**1**	18
Recognition of losses that arose in prior years	**(14)**	–
Remeasurement of deferred tax due to rate changes	**–**	(7)
Differences in overseas tax rates	**–**	(5)
Adjustments in respect of prior years	**(4)**	19
Tax effect of share of results of joint ventures	**–**	1
Tax expense	**(364)**	(520)

6. Financial assets at fair value through profit or loss

	At 30 June 2018 £m	At 31 Dec 2017 £m
Trading assets	**–**	–
Other financial assets at fair value through profit or loss:		
Loans and advances to customers	**495**	–
Equity shares	**76**	50
	571	50
Financial assets at fair value through profit or loss	**571**	50

7. Loans and advances to customers

	At 30 June 2018 £m	At 31 Dec 2017 £m
Agriculture, forestry and fishing	**666**	643
Energy and water supply	**113**	156
Manufacturing	**256**	266
Construction	**1,252**	1,248
Transport, distribution and hotels	**2,937**	2,868
Information and communication	**175**	272
Property companies	**4,395**	4,894
Financial, business and other services	**1,878**	2,415
Personal:		
Mortgages	**242,941**	247,117
Other	**10,447**	10,573
Leasing	**189**	198
Hire purchase	**149**	132
Gross loans and advances to customers	**265,398**	270,782
Allowance for impairment losses on loans and advances to customers (note 8)	**(2,158)**	(2,125)
Total loans and advances to customers	**263,240**	268,657

Loans and advances to customers include advances securitised under the Group's securitisation and covered bond programmes (see note 9).

8. Allowance for impairment losses

In respect of drawn balances	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Balance at 31 December 2017:				**2,136**
Adjustment for IFRS 9 (note 15)				**364**
Balance at 1 January 2018:	**164**	**1,076**	**1,260**	**2,500**
Exchange and other adjustments	**8**	**(2)**	**(60)**	**(54)**
Advances written off	**–**	**–**	**(387)**	**(387)**
Recoveries of advances written off in previous years	**–**	**–**	**8**	**8**
Charge to the income statement	**2**	**(155)**	**261**	**108**
	174	**919**	**1,082**	**2,175**
In respect of undrawn balances				
Balance at 31 December 2017:				**3**
Adjustment for IFRS 9 (note 15)				**84**
Balance at 1 January 2018:	**37**	**50**	**–**	**87**
Exchange and other adjustments	**–**	**(3)**	**4**	**1**
Charge to the income statement	**(9)**	**(20)**	**13**	**(16)**
	28	**27**	**17**	**72**
At 30 June 2018	**202**	**946**	**1,099**	**2,247**
In respect of:				
Loans and advances to customers (note 7)	**166**	**919**	**1,073**	**2,158**
Amounts due from fellow Lloyds Banking Group undertakings	**8**	**–**	**–**	**8**
Debt securities	**–**	**–**	**9**	**9**
Drawn balances	**174**	**919**	**1,082**	**2,175**
Provisions in relation to loan commitments and financial guarantees	**28**	**27**	**17**	**72**
Total allowance for impairment losses	**202**	**946**	**1,099**	**2,247**

9. Debt securities in issue

	30 June 2018			31 December 2017		
	At fair value through profit or loss £m	**At amortised cost £m**	**Total £m**	At fair value through profit or loss £m	At amortised cost £m	Total £m
Medium-term notes issued	–	**1,141**	**1,141**	–	1,182	1,182
Covered bonds	–	**6,033**	**6,033**	–	6,740	6,740
Securitisation notes	**54**	**4,367**	**4,421**	–	2,997	2,997
Total debt securities in issue	**54**	**11,541**	**11,595**	–	10,919	10,919

The notes issued by the Group's securitisation and covered bond programmes are held by external parties and by subsidiaries of the Group.

Securitisation programmes

At 30 June 2018, external parties held £4,421 million (31 December 2017: £2,997 million) and the Group's subsidiaries held £15,304 million (31 December 2017: £14,954 million) of total securitisation notes in issue of £19,725 million (31 December 2017: £17,951 million). The notes are secured on loans and advances to customers and debt securities classified as loans and receivables amounting to £23,328 million (31 December 2017: £25,226 million), the majority of which have been sold by subsidiary companies to bankruptcy remote structured entities. The structured entities are consolidated fully and all of these loans are retained on the Group's balance sheet.

Covered bond programmes

At 30 June 2018, external parties held £6,033 million (31 December 2017: £6,740 million) and the Group's subsidiaries held £700 million (31 December 2017: £700 million) of total covered bonds in issue of £6,733 million (31 December 2017: £7,440 million). The bonds are secured on certain loans and advances to customers amounting to £8,506 million (31 December 2017: £9,153 million) that have yet to be assigned to bankruptcy remote limited liability partnerships. These loans are retained on the Group's balance sheet.

Cash deposits of £1,732 million (31 December 2017: £1,712 million) which support the debt securities issued by the structured entities, the term advances related to covered bonds and other legal obligations are held by the Group.

10. Provisions for liabilities and charges

	Provisions for commitments £m	Payment Protection Insurance £m	Other regulatory provisions £m	Vacant leasehold property & Other £m	Total £m
Balance at 31 December 2017	3	947	807	262	2,019
Adjustment for IFRS 9	84				84
Balance at 1 January 2018	87				2,103
Exchange and other adjustments	1	(1)	1	(7)	(6)
Provisions applied	–	(399)	(224)	(42)	(665)
Charge/(release) for the year	(16)	175	70	25	254
At 30 June 2018	72	722	654	238	1,686

Payment protection insurance

The Group increased the provision for PPI costs by a further £175 million in the half year to 30 June 2018, of which £135 million was in the second quarter, bringing the total amount provided to £5,448 million.

The charge in the second quarter is largely driven by a potentially higher total volume of complaints and associated administration costs due to higher reactive complaint volumes received over the past six months and ongoing volatility.

At 30 June 2018 a provision of £722 million remained unutilised relating to complaints and associated administration costs. Total cash payments were £399 million during the six months to 30 June 2018.

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 including 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 also uncertainty around the impact of the regulatory changes, FCA media campaign and Claims Management Company and customer activity, and potential additional remediation arising from the continuous improvement of the Group's operational practices.

For every additional 1,000 reactive complaints per week from July 2018 through to the industry deadline of the end of August 2019, the Group would expect an additional charge of £140 million.

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 six months to 30 June 2018 the Group charged a further £70 million in respect of legal actions and other regulatory matters, the unutilised balance at 30 June 2018 was £654 million (31 December 2017: £807 million). The most significant items are as follows.

Arrears handling related activities

The Group has provided an additional £22 million (bringing the total provided to date to £422 million), for the costs of identifying and rectifying certain arrears management fees and activities. Following a review of the Group's arrears handling activities, Lloyds Banking 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 565,000 impacted customers.

10. Provisions for liabilities and charges (continued)

Packaged bank accounts

In the half-year to 30 June 2018, the Group provided an additional £4 million in respect of complaints relating to alleged mis-selling of packaged bank accounts raising the total amount provided to £195 million. A number of risks and uncertainties remain in particular with respect to future volumes.

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 Lloyds Banking Group in 2009. The Group 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 30 June 2018, the Group had made offers to 64 customers, which represents more than 85 per cent of the customers in the review.

11. Contingent liabilities and commitments

Interchange fees

With respect to multi-lateral interchange fees (MIFs), Lloyds Banking Group is not directly involved in the ongoing investigations and litigation (as described below) which involve card schemes such as Visa and MasterCard. However, Lloyds Banking 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 Lloyds Banking 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 Lloyds Banking Group may be subject under the LSA is capped at the cash consideration which was received by Lloyds Banking 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, Lloyds Banking 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 Lloyds Banking Group companies' submissions to the British Bankers' Association (BBA) London Interbank Offered Rate (LIBOR) and Sterling Repo Rate. Lloyds Banking Group continues to cooperate with various other government and regulatory authorities, including 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 Lloyds Banking 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 (subject to one appeal), and decisions are awaited on Lloyds Banking Group's motions to dismiss the Sterling LIBOR and BBSW claims.

Certain Lloyds Banking 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 Lloyds Banking 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 Lloyds Banking 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 Lloyds Banking Group's contractual arrangements, including their timing and scale.

UK shareholder litigation

In August 2014, Lloyds Banking 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 concluded on 5 March 2018 with judgment to follow. It is currently not possible to determine the ultimate impact on the Group (if any).

11. Contingent liabilities and commitments (continued)

Tax authorities

The Lloyds Banking 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 Lloyds Banking 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 Lloyds Banking Group's deferred tax asset of approximately £350 million (overall impact on the Group of £170 million). The Lloyds Banking 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, 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 Lloyds Banking 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. Lloyds Banking Group is implementing the Guidance and has now contacted most of the affected customers with any remaining customers being contacted during 2018.

Mortgage arrears handling activities

On 26 May 2016, Lloyds Banking Group was informed that an enforcement team at the FCA had commenced an investigation in connection with Lloyds Banking 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.

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.

11. Contingent liabilities and commitments (continued)

Contingent liabilities and commitments arising from the banking business

	At 30 June 2018 £m	At 31 Dec 2017 £m
Contingent liabilities		
Acceptances and endorsements	**1**	1
Other:		
Other items serving as direct credit substitutes	**37**	18
Performance bonds and other transaction-related contingencies	**70**	68
	107	86
Total contingent liabilities	**108**	87
Commitments		
Documentary credits and other short-term trade-related transactions	**1**	-
Forward asset purchases and forward deposits placed	**27**	31
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	**11,439**	9,847
Other commitments	**22,540**	21,961
	33,979	31,808
1 year or over original maturity	**2,709**	2,937
Total commitments	**36,716**	34,776

Of the amounts shown above in respect of undrawn formal standby facilities and other commitments to lend, £14,762 million (2017: £13,452 million) was irrevocable.

12. Fair values of financial assets and liabilities

The valuations of financial instruments have been classified into three levels according to the quality and reliability of information used to determine those fair values. Note 39 to the Group's 2017 financial statements describes the definitions of the three levels in the fair value hierarchy.

Valuation control framework
Key elements of the valuation control framework, which covers processes for all levels in the fair value hierarchy including level three portfolios, include model validation (incorporating pre-trade and post-trade testing), product implementation review and independent price verification. Formal committees meet quarterly to discuss and approve valuations in more judgemental areas.

Transfers into and out of level three portfolios
Transfers out of level three portfolios arise when inputs that could have a significant impact on the instrument's valuation become market observable; conversely, transfers into the portfolios arise when consistent sources of data cease to be available.

Valuation methodology
For level two and level three portfolios, there is no significant change to what was disclosed in the Group's 2017 Annual Report and Accounts in respect of the valuation methodology (techniques and inputs) applied to such portfolios.

The table below summarises the carrying values of financial assets and liabilities presented on the Group's balance sheet. The fair values presented in the table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

	30 June 2018		31 December 2017	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets				
Financial assets at fair value through profit or loss	**571**	**571**	50	50
Derivative financial instruments	**10,112**	**10,112**	11,634	11,634
Loans and advances to banks	**1,145**	**1,155**	518	513
Loans and advances to customers	**263,240**	**265,124**	268,657	270,542
Debt securities	**9**	**9**	137	136
Due from fellow Lloyds Banking Group undertakings	**57,137**	**57,137**	81,663	81,663
Financial assets at amortised cost:	**321,531**	**323,425**	350,975	352,854
Financial assets at fair value through other comprehensive income	**966**	**966**		
Available-for-sale financial assets			813	813
Financial liabilities				
Deposits from banks	**20,845**	**20,833**	21,183	21,178
Customer deposits	**167,969**	**167,664**	171,198	170,905
Due to fellow Lloyds Banking Group undertakings	**109,095**	**109,095**	130,502	130,502
Financial liabilities at fair value through profit or loss	**104**	**104**	50	50
Derivative financial instruments	**11,581**	**11,581**	11,026	11,026
Debt securities in issue	**11,541**	**11,589**	10,919	11,001
Subordinated liabilities	**6,794**	**6,884**	7,049	7,121

12. Fair values of financial assets and liabilities (continued)

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

The Group manages valuation adjustments for its derivative exposures on a net basis; the Group determines their fair values on the basis of their net exposures. In all other cases, fair values of financial assets and liabilities measured at fair value are determined on the basis of their gross exposures.

The following tables provide an analysis of the financial assets and liabilities of the Group that are carried at fair value in the Group's consolidated balance sheet, grouped into levels one to three based on the degree to which the fair value is observable.

Financial assets

	Level 1 £m	**Level 2 £m**	**Level 3 £m**	**Total £m**
At 30 June 2018				
Financial assets at fair value through profit or loss:				
Loans and advances to customers	**–**	**495**	**–**	**495**
Loans and advances to banks	**–**	**–**	**–**	**–**
Debt securities	**–**	**–**	**–**	**–**
Equity shares	**–**	**11**	**65**	**76**
Total financial assets at fair value through profit or loss	**–**	**506**	**65**	**571**
Financial assets at fair value through other comprehensive income:				
Debt securities	**–**	**831**	**128**	**959**
Equity shares	**–**	**–**	**7**	**7**
Total financial assets at fair value through other comprehensive income:	**–**	**831**	**135**	**966**
Derivative financial instruments	**–**	**10,112**	**–**	**10,112**
Total financial assets carried at fair value	**–**	**11,449**	**200**	**11,649**

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2017				
Financial assets at fair value through profit or loss:				
Loans and advances to customers	–	–	–	–
Equity shares	–	–	50	50
Total financial assets at fair value through profit or loss	–	–	50	50
Available-for-sale financial assets:				
Debt securities	–	786	–	786
Equity shares	–	7	20	27
Total available-for-sale financial assets	–	793	20	813
Derivative financial instruments	–	11,214	420	11,634
Total financial assets carried at fair value	–	12,007	490	12,497

12. Fair values of financial assets and liabilities (continued)

Financial liabilities

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 30 June 2018				
Financial liabilities at fair value through profit or loss:				
Liabilities held at fair value through profit or loss	**–**	**54**	**–**	**54**
Trading liabilities	**–**	**50**	**–**	**50**
Total financial liabilities at fair value through profit or loss	**–**	**104**	**–**	**104**
Derivative financial instruments	**–**	**11,581**	**–**	**11,581**
Total financial liabilities carried at fair value	**–**	**11,685**	**–**	**11,685**

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
At 31 December 2017				
Trading and other financial liabilities at fair value through profit or loss:				
Liabilities held at fair value through profit or loss	–	–	–	–
Trading liabilities	–	50	–	50
Total trading and other financial liabilities at fair value through profit or loss	–	50	–	50
Derivative financial instruments	–	10,972	54	11,026
Total financial liabilities carried at fair value	–	11,022	54	11,076

12. Fair values of financial assets and liabilities (continued)

Movements in level three portfolio

The tables below analyse movements in the level 3 financial assets portfolio.

	Financial assets at fair value through profit or loss £m	Financial assets at fair value through other comprehensive income £m	Available-for-sale financial assets £m	Derivative assets £m	Total financial assets carried at fair value £m
Balance at 31 December 2017	**50**		**20**	**420**	**490**
Adjustment for IFRS 9 (note 15)	**12**	**7**	**(20)**		**(1)**
Balance at 1 January 2018	**62**	**7**			**489**
Exchange and other adjustments	**1**	**–**		**–**	**1**
Gains (losses) recognised in the income statement within other income	**2**	**–**		**(2)**	**–**
Losses recognised in other comprehensive income within the revaluation reserve in respect of financial assets at fair value through other comprehensive income	**–**	**–**		**–**	**–**
Purchases	**–**	**–**		**–**	**–**
Sales	**–**	**–**		**(418)**	**(418)**
Transfers into the level 3 portfolio	**–**	**128**		**–**	**128**
Transfers out of the level 3 portfolio	**–**	**–**		**–**	**–**
At 30 June 2018	**65**	**135**		**–**	**200**
Gains (losses) recognised in the income statement within other income relating to those assets held at 30 June 2018	**9**	**–**		**(2)**	**7**

	Trading and other financial assets at fair value through profit or loss £m	Available-for-sale financial assets £m	Derivative assets £m	Total financial assets carried at fair value £m
At 1 January 2017	119	469	583	1,171
Exchange and other adjustments	–	(1)	13	12
Gains (losses) recognised in the income statement within other income	17	–	(137)	(120)
Losses recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	–	(101)	–	(101)
Purchases	–	24	–	24
Sales	(6)	(20)	–	(26)
Transfers into the level 3 portfolio	–	–	(44)	(44)
At 30 June 2017	130	371	415	916
Gains (losses) recognised in the income statement within other income relating to those assets held at 30 June 2017	19	–	(137)	(118)

12. Fair values of financial assets and liabilities (continued)

Movements in level three portfolio

The tables below analyse movements in the level three financial liabilities portfolio.

	Financial liabilities at fair value through profit or loss £m	**Derivative liabilities £m**	**Total financial liabilities carried at fair value £m**
At 1 January 2018	**–**	**54**	**54**
Exchange and other adjustments	**–**	**–**	**–**
Losses (gains) recognised in the income statement within other income	**–**	**–**	**–**
Redemptions	**–**	**(54)**	**(54)**
Transfers out of the level three portfolio	**–**	**–**	**–**
At 30 June 2018	**–**	**–**	**–**
Gains recognised in the income statement within other income relating to those liabilities held at 30 June 2018	**–**	**–**	**–**

	Trading and other financial liabilities at fair value through profit or loss £m	Derivative liabilities £m	Total financial liabilities carried at fair value £m
At 1 January 2017	2	57	59
Gains recognised in the income statement within other income	(2)	(7)	(9)
At 30 June 2017	–	50	50
Gains recognised in the income statement within other income relating to those liabilities held at 30 June 2017	–	(7)	(7)

12. Fair values of financial assets and liabilities (continued)

The tables below set out the effects of reasonably possible alternative assumptions for categories of level 3 financial assets and financial liabilities.

				At 30 June 2018		
					Effect of reasonably possible alternative assumptions[1]	
	Valuation technique(s)	**Significant unobservable inputs**	**Range[2]**	**Carrying value £m**	**Favourable changes £m**	**Unfavourable changes £m**
Financial assets at fair value through profit or loss:						
Equity and venture capital investments	Underlying asset/net asset value (incl. property prices)[3]	n/a	**n/a**	**65**	**6**	**(6)**
				65		
Financial assets at fair value through other comprehensive income				**135**	**4**	**(4)**
Financial assets carried at fair value				**200**		

[1] Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

[2] The range represents the highest and lowest inputs used in the level 3 valuations.

[3] Underlying asset/net asset values represent fair value.

12. Fair values of financial assets and liabilities (continued)

				At 31 December 2017		
					Effect of reasonably possible alternative assumptions[1]	
	Valuation technique(s)	Significant unobservable inputs	Range[2]	Carrying value £m	Favourable changes £m	Unfavourable changes £m
Trading and other financial assets at fair value through profit or loss:						
Equity and venture capital investments	Underlying asset/net asset value (incl. property prices)[3]	n/a	n/a	50	5	(5)
				50		
Available for sale financial assets				20	1	(1)
Derivative financial assets:						
Interest rate derivatives	Option pricing model	Interest rate volatility	0%/115%	420	1	(2)
				420		
Financial assets carried at fair value				490		
Derivative financial liabilities:						
Interest rate derivatives	Option pricing model	Interest rate volatility	0%/115%	54	–	–
				54		
Financial liabilities carried at fair value				54		

1 Where the exposure to an unobservable input is managed on a net basis, only the net impact is shown in the table.

2 The range represents the highest and lowest inputs used in the level 3 valuations.

3 Underlying asset/net asset values represent fair value.

Unobservable inputs

Significant unobservable inputs affecting the valuation of debt securities, unlisted equity investments and derivatives are unchanged from those described in the Group's 2017 financial statements.

Reasonably possible alternative assumptions

Valuation techniques applied to many of the Group's level three instruments often involve the use of two or more inputs whose relationship is interdependent. The calculation of the effect of reasonably possible alternative assumptions included in the table above reflects such relationships and are unchanged from those described in the Group's 2017 financial statements.

13. Related party transactions

Balances and transactions with Lloyds Banking Group plc and fellow Lloyds Banking Group undertakings

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

	At 30 June 2018 £m	At 31 Dec 2017 £m
Assets		
Derivative financial instruments	**6,552**	6,808
Due from fellow Lloyds Banking Group undertakings	**57,128**	81,663
Financial assets at fair value through profit or loss	**6**	–
Liabilities		
Due to fellow Lloyds Banking Group undertakings	**109,095**	130,502
Derivative financial instruments	**8,967**	8,160
Debt securities in issue	**83**	78
Subordinated liabilities	**5,590**	5,593

During the half-year ended 30 June 2018 the Group earned £207 million (half-year ended 30 June 2017: £181 million) of interest income and incurred £1,062 million (half-year ended 30 June 2017: £993 million) of interest expense on balances and transactions with Lloyds Banking Group plc and fellow Lloyds Banking Group undertakings.

In addition, during the half-year to 30 June 2018 the Group incurred expenditure of £37 million (half-year ended 30 June 2017: £39 million) on behalf of fellow Lloyds Banking Group undertakings which was recharged to those undertakings; and fellow Lloyds Banking Group undertakings incurred expenditure of £351 million (half-year ended 30 June 2017: £277 million) on behalf of the Group which has been recharged to the Group.

In May 2018, the Bank sold the element of its commercial banking businesses required to be transferred in order to ensure compliance with the Ring-fencing legislation to Lloyds Bank Corporate Markets plc, a fellow Lloyds Banking Group undertaking, for a total consideration of £2.3 billion; no profit or loss arose on transfer.

Other related party transactions

Other related party transactions for the half-year to 30 June 2018 are similar in nature to those for the year ended 31 December 2017.

14. Dividends on ordinary shares

The directors have approved an interim dividend of £1,500 million which will be paid in the second half of 2018.

The Bank paid a dividend of £1,500 million on 16 May 2018; the bank paid dividends of £1,200 million on 11 May 2017 and £900 million on 22 September 2017.

15. Implementation of IFRS 9 and IFRS 15

IFRS 9 *Financial Instruments*

The Group adopted IFRS 9 from 1 January 2018. In accordance with the transition requirements of IFRS 9, comparative information for 2017 has not been restated and transitional adjustments have been accounted for through retained earnings as at 1 January 2018, the date of initial application; and as a result shareholders' equity reduced by £349 million, driven by the effects of additional impairment provisions following the implementation of the expected credit loss methodology and fair value adjustments following the reclassification of certain financial assets to be measured at fair value rather than amortised cost. It is not practicable to quantify the impact of adoption of IFRS 9 in the results for the current period.

The following table summarises the impact of the transitional adjustment on the Group's loss allowances at 1 January 2018:

	IAS 39 allowance at 31 December 2017	Transitional adjustment in loss allowance	**IFRS 9 loss allowance at 1 January 2018**
	£m	£m	**£m**
Loans and advances to customers	2,125	342	**2,467**
Debt securities	11	–	**11**
Items due from other Lloyds Banking Group undertakings	–	22	**22**
Drawn balances	2,136	364	**2,500**
Provisions for undrawn commitments and financial guarantees	3	84	**87**
Total loss allowance	2,139	448	**2,587**

There were no impacts on the Group's loss allowances as a result of changes in the measurement category of financial assets at 1 January 2018.

15. Implementation of IFRS 9 and IFRS 15 (continued)

The following table summarises the adjustments arising on the adoption of IFRS 9 to the Group's balance sheet as at 1 January 2018.

	As at 31 December 2017 £m	Classification and measurement £m	Impairment £m	Adjusted as at 1 January 2018 £m
Assets				
Cash and balances at central banks	2,677	–	–	**2,677**
Items in course of collection from banks	260	–	–	**260**
Financial assets at fair value through profit or loss	50	811		**861**
Derivative financial instruments	11,634	(360)		**11,274**
Loans and advances to banks	518	–	–	**518**
Loans and advances to customers	268,657	(442)	(342)	**267,873**
Debt securities	137	(128)		**9**
Due from fellow Lloyds Banking Group undertakings	81,663	–	(22)	**81,641**
Financial assets at amortised cost	350,975	(570)	(364)	**350,041**
Financial assets at fair value through other comprehensive income		909	–	**909**
Available-for-sale financial assets	813	(813)	–	
Goodwill	325	–	–	**325**
Other intangible assets	112	–	–	**112**
Property, plant and equipment	823	–	–	**823**
Current tax recoverable	2	–	–	**2**
Deferred tax assets	1,829	20	112	**1,961**
Other assets	572	–	–	**572**
Total assets	370,072	(3)	(252)	**369,817**

15. Implementation of IFRS 9 and IFRS 15 (continued)

	As at 31 December 2017 £m	Classification and measurement £m	Impairment £m	Adjusted as at 1 January 2018 £m
Equity and liabilities				
Liabilities				
Deposits from banks	21,183	–	–	**21,183**
Customer deposits	171,198	–	–	**171,198**
Due to fellow Lloyds Banking Group undertakings	130,502	–	–	**130,502**
Items in course of transmission to banks	269	–	–	**269**
Financial liabilities at fair value through profit or loss	50	58	–	**108**
Derivative financial instruments	11,026	–	–	**11,026**
Notes in circulation	1,313	–	–	**1,313**
Debt securities in issue	10,919	(48)	–	**10,871**
Other liabilities	521	–	–	**521**
Current tax liabilities	503	–	–	**503**
Other provisions	2,019	–	84	**2,103**
Subordinated liabilities	7,049	–	–	**7,049**
Total liabilities	356,552	10	84	**356,646**
Equity				
Shareholders' equity	12,012	(13)	(336)	**11,663**
Other equity instruments	1,500	–	–	**1,500**
Non-controlling interests	8	–	–	**8**
Total equity	13,520	(13)	(336)	**13,171**
Total equity and liabilities	370,072	(3)	(252)	**369,817**

15. Implementation of IFRS 9 and IFRS 15 (continued)

Reclassifications

Balance sheet line item	**IFRS 9 Measurement category**	**In £m**	**Out £m**	**IFRS 9 allocation**	**Net reclassification £m**
Financial assets					
Financial assets at FVTPL	FVTPL	823	–	FVOCI	823
Derivative assets	FVTPL (Der)		(360)	FVTPL	(360)
Loans and advances					
− Customers	AC		(442)	FVTPL	(442)
− Debt securities	AC		(128)	FVOCI	(128)
			(570)		(570)
Financial assets at FVOCI	FVOCI	920	–		920
Available-for-sale assets			(21)	FVTPL	(21)
			(792)	FVOCI	(792)
			(813)		(813)
Financial liabilities					
Financial liabilities at FVTPL	FVTPL	48			48
Debt securities in issue	AC		(48)	FVTPL	(48)
Total		1,791	(1,791)		–

There has been a pre-tax charge of £33 million (£13 million net of tax) arising from the reclassification of financial assets and liabilities to fair value through profit or loss and fair value through other comprehensive income and consequent remeasurement to fair value.

IFRS 15 *revenue from contracts with customers*

The Group has adopted IFRS 15 from 1 January 2018. The Group's existing accounting policy was consistent with the requirements of IFRS 15 and consequently, the Group recognised no transitional adjustment as at 1 January 2018. There has been no impact of the adoption of IFRS 15 on the Group's results for the current period.

16. Future accounting developments

The following pronouncements are not applicable for the year ending 31 December 2018 and have not been applied in preparing these interim financial statements. Save as disclosed below, the impact of these accounting changes is still being assessed by the Group and reliable estimates cannot be made at this stage.

With the exception of IFRS 16 *Leases* as at 31 July 2018 these pronouncements are awaiting EU endorsement.

IFRS 16 *Leases*

IFRS 16 replaces IAS 17 *Leases* and is effective for annual periods beginning on or after 1 January 2019.

IFRS 16 requires lessees to recognise a right of use asset and a liability for future payments arising from a lease contract. Lessees will recognise a finance charge on the liability and a depreciation charge on the asset which could affect the timing of the recognition of expenses on leased assets. This change will mainly impact the properties that the Group currently accounts for as operating leases. Finance systems will need to be changed to reflect the new accounting rules and disclosures. Lessor accounting requirements remain aligned to the current approach under IAS 17.

Minor amendments to other accounting standards

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2019 (including IFRIC 23 Uncertainty over Income Tax Treatments). These revised requirements are not expected to have a significant impact on the Group.

17. Ultimate parent undertaking

Bank of Scotland plc's ultimate parent undertaking and controlling party is Lloyds Banking Group plc which is incorporated in Scotland. Lloyds Banking Group plc has published consolidated accounts for the year ended 31 December 2017 and copies may be obtained from Investor Relations, Lloyds Banking Group, 25 Gresham Street, London EC2V 7HN and are available for download from www.lloydsbankinggroup.com

18. Other information

The financial information included in these condensed consolidated half-year financial statements does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 December 2017 have been delivered to the Registrar of Companies. The auditors' report on those accounts was unqualified, did not include an emphasis of matter paragraph and did not include a statement under section 498 of the Companies Act 2006.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors listed below (being all the directors of Bank of Scotland plc) confirm that to the best of their knowledge these condensed consolidated half-year financial statements have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*, as adopted by the European Union, and that the half-year results herein includes a fair review of the information required by DTR 4.2.7R and DTR 4.2.8R, namely:

- an indication of important events that have occurred during the six months ended 30 June 2018 and their impact on the condensed consolidated half-year financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related party transactions in the six months ended 30 June 2018 and any material changes in the related party transactions described in the last annual report.

Signed on behalf of the board by

António Horta-Osório
Group Chief Executive
31 July 2018

Bank of Scotland plc board of directors:
António Horta-Osório (Group Chief Executive)
George Culmer (Chief Financial Officer)
Juan Colombás (Chief Risk Officer)
Lord Blackwell (Chairman)
Anita Frew (Deputy Chairman)
Alan Dickinson
Simon Henry
Lord Lupton CBE
Deborah McWhinney
Nicholas Prettejohn
Stuart Sinclair
Sara Weller CBE

INDEPENDENT REVIEW REPORT TO BANK OF SCOTLAND PLC

Report on the condensed consolidated half-year financial statements

Our conclusion

We have reviewed Bank of Scotland plc's condensed consolidated half-year financial statements (the "interim financial statements") in the 2018 half-year results of Bank of Scotland plc (the "Bank") for the six month period ended 30 June 2018. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the consolidated balance sheet as at 30 June 2018;
- the consolidated income statement and consolidated statement of comprehensive income for the period then ended;
- the consolidated cash flow statement for the period then ended;
- the consolidated statement of changes in equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the 2018 half-year results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 1 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The 2018 half-year results, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the 2018 half-year results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the 2018 half-year results based on our review. This report, including the conclusion, has been prepared for and only for the Bank for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the 2018 half-year results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
London
31 July 2018

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