# Bank of Scotland plc

2021 Half-Year Results

29 July 2021

Member of the Lloyds Banking Group

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## REVIEW OF PERFORMANCE

**Principal activities**

Bank of Scotland plc (the Bank) and its subsidiaries (together, the Group) provide a wide range of banking and financial services. 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 and loans and other products to commercial and corporate customers.

**Income statement**

The Group's profit before tax for the half-year to 30 June 2021 was £1,408 million, whilst total profit for the period was £1,463 million, both benefiting from solid business momentum and a net impairment credit in the context of the UK's improved macroeconomic outlook and robust credit performance. The Group's total profit for the period included a benefit of £433 million from the revaluation of deferred tax assets as a result of the revised corporation tax rate effective from 1 April 2023, substantively enacted in the second quarter.

Total income of £2,709 million was down 5 per cent on the first half of 2020, with slightly lower net interest income and significantly reduced other income.

Net interest income of £2,570 million was down 2 per cent compared to the first half of 2020, impacted by a reduction in net interest margins which more than offset the effects of higher average interest-earning assets. Net interest margins fell reflecting the lower rate environment. Average interest-earning assets were up on the first half of 2020, driven by strong growth in the Group's mortgage book.

Other income of £139 million was 34 per cent lower than the first half of 2020, driven by significant reductions in other operating income compared to the prior year. Other operating income in the period of £18 million was down £59 million largely due to the non-recurrence of a gain on disposal of business during the first half of 2020.

Operating expenses of £1,553 million were 13 per cent higher than in the first half of 2020, due to a higher regulatory provision charge and increased other operating expenses in the period. The charge for regulatory provisions increased to £235 million, driven by charges in respect of HBOS Reading as well as litigation costs and charges in relation to other ongoing legacy programmes. With respect to HBOS Reading, £150 million was incurred in the first half of 2021, including operational costs to provide for the likelihood of activities spanning across 2022 as well as the outcome to date of decisions from the independent panel re-review on direct and consequential losses. Further significant charges over 2021 and 2022 could be required as more panel decisions are published, but at this stage it is not possible to reliably estimate the potential impact or timings. Other operating costs in the period were up £46 million as reductions in staff, premises and equipment and depreciation and amortisation costs were more than offset by increases in amounts recharged by fellow Lloyds Banking Group undertakings.

The impairment charge in the first half of the year was a net credit of £252 million, compared to a net charge of £1,465 million in the first half of 2020. The net credit in the period was driven by a release of expected credit loss (ECL) allowances resulting from the UK's improved macroeconomic outlook. This was partially offset by a low run-rate impairment charge reflecting the continued benign credit environment. Observed credit performance remained robust in the period, with the flow of assets into arrears, defaults and write-offs remaining at low levels. The Group's ECL allowance reduced in the first half of the year by £431 million to £2,900 million.

The Group recognised a net tax credit of £55 million in the period compared to a net credit of £169 million in the first six months of 2020. In March 2021, the UK Government announced its intention to increase the rate of corporation tax from 19 per cent to 25 per cent with effect from 1 April 2023 and this was substantively enacted on 24 May 2021. As a result of this change in tax rate, the Group has recognised a £433 million deferred tax credit in the income statement and a £1 million debit within other comprehensive income, increasing the Group's net deferred tax asset by £432 million. Excluding the effects of the deferred tax uplift, the Group's effective tax rate was 27 per cent.

**REVIEW OF PERFORMANCE** (continued)

**Balance sheet**

The Group's balance sheet reflects healthy franchise growth. Total assets of £314,987 million were up 2 per cent compared to £310,328 million at 31 December 2020 driven by an increase in loans and advances to customers which was partly offset by reductions in amounts due from fellow Lloyds Banking Group undertakings. Loans and advances to customers were 5 per cent higher at £275,932 million compared to £263,766 million at 31 December 2020 driven by strong growth in the Group's mortgage book. Amounts due from fellow Lloyds Banking Group undertakings reduced by £5,568 million from £28,988 million at 31 December 2020 due to increased settlement activity in the period.

Total liabilities of £300,166 million were up 1 per cent compared to £296,940 million at 31 December 2020 driven by increased customer deposits and amounts due to fellow Lloyds Banking Group undertakings, which were partially offset by lower deposits from banks. Customer deposits of £169,941 million have increased by £6,940 million since the end of 2020, with continued inflows into the Group's trusted brands and significant growth seen in personal current accounts and savings balances since 2019. Amounts due to fellow Lloyds Banking Group undertakings have increased by £4,829 million in the period, funding the Group's growth in net customer lending since 31 December 2020.

Total equity increased by £1,433 million from £13,388 million at 31 December 2020 to £14,821 million at 30 June 2021 with total comprehensive income for the period of £1,472 million and capital contributions received of £15 million, partially offset by distributions on other equity instruments of £54 million.

**Capital**

The Bank's common equity tier 1 capital ratio remained stable at 15.5 per cent (31 December 2020: 15.5 per cent) due to profit in the period (net of the impact of the impairment credit and partial release of IFRS 9 transitional relief), offset by the foreseeable dividend accrual and an increase in risk-weighted assets. The tier 1 capital ratio decreased to 19.0 per cent (31 December 2020: 19.1 per cent) and the total capital ratio reduced to 21.1 per cent (31 December 2020: 22.1 per cent), largely reflecting the impact of movements in risk-weighted assets and rates and calls on regulatory tier 2 capital instruments.

Risk-weighted assets increased by £1,185 million, or 2 per cent, to £62,489 million at 30 June 2021 compared to £61,304 million at 31 December 2020, largely reflecting the limited impact of credit migration and retail model calibrations offset by the benefit of House Price Index increases.

**REVIEW OF PERFORMANCE** (continued)

**Capital position as at 30 June 2021**

The capital position of Bank of Scotland plc is presented on an unconsolidated basis.

The Bank's capital position as at 30 June 2021, applying CRD IV transitional rules and IFRS 9 transitional arrangements, is set out in the following section.

**Capital ratios of the Bank**

| | **At 30 June 2021** | At 31 Dec 2020 |
|---|---|---|
| **Capital resources (transitional)** | **£m** | £m |
| **Common equity tier 1** | | |
| Shareholders' equity per balance sheet | **12,231** | 10,770 |
| Adjustment to retained earnings for foreseeable dividends | **(700)** | — |
| Adjustment to retained earnings for IFRS 9 transitional arrangements | **554** | 773 |
| Cash flow hedging reserve and other adjustments | **46** | 43 |
| | **12,131** | 11,586 |
| **Less: deductions from common equity tier 1** | | |
| Goodwill and other intangible assets | **(514)** | (470) |
| Prudent valuation adjustment | **(82)** | (79) |
| Removal of defined benefit pension surplus | **(48)** | (50) |
| Deferred tax assets | **(1,827)** | (1,477) |
| **Common equity tier 1 capital[1]** | **9,660** | 9,510 |
| **Additional tier 1** | | |
| Additional tier 1 instruments | **2,220** | 2,221 |
| **Total tier 1 capital[1]** | **11,880** | 11,731 |
| **Tier 2** | | |
| Tier 2 instruments | **1,449** | 1,943 |
| Eligible provisions and other adjustments | **(168)** | (97) |
| **Total tier 2 capital** | **1,281** | 1,846 |
| **Total capital resources[1]** | **13,161** | 13,577 |
| **Risk-weighted assets** | **62,489** | 61,304 |
| **Common equity tier 1 capital ratio[2]** | **15.5%** | 15.5% |
| **Tier 1 capital ratio[2]** | **19.0%** | 19.1% |
| **Total capital ratio[2]** | **21.1%** | 22.1% |

1 Position at 31 December 2020 audited.

2 Reflecting the full impact of IFRS 9 at 30 June 2021, without the application of transitional arrangements, the Bank's common equity tier 1 capital ratio would be 14.5 per cent, the tier 1 capital ratio would be 18.1 per cent and the total capital ratio would be 20.8 per cent.

**REVIEW OF PERFORMANCE** (continued)

**Risk-weighted assets of the Bank**

| | **At 30 June 2021 £m** | At 31 Dec 2020 £m |
|---|---|---|
| Foundation Internal Ratings Based (IRB) Approach | **3,960** | 4,245 |
| Retail IRB Approach | **41,691** | 39,137 |
| Other IRB Approach | **1,727** | 1,958 |
| **IRB Approach** | **47,378** | 45,340 |
| Standardised Approach | **5,265** | 5,815 |
| **Credit risk** | **52,643** | 51,155 |
| Counterparty credit risk | **389** | 473 |
| Credit valuation adjustment risk | **76** | 100 |
| Operational risk | **8,599** | 8,801 |
| Market risk | **144** | 220 |
| **Risk-weighted assets** | **61,851** | 60,749 |
| Threshold risk-weighted assets | **638** | 555 |
| **Total risk-weighted assets** | **62,489** | 61,304 |

## PRINCIPAL RISKS AND UNCERTAINTIES

The significant risks faced by the Group are detailed below. There has been no change to the definition of these risks from those disclosed in the Group's 2020 Annual Report and Accounts.

The external risks faced by the Group may also impact the success of delivering against the Group's long-term strategic objectives. They include, but are not limited to the coronavirus pandemic, global macro-economic conditions and regulatory developments.

The coronavirus pandemic has had an impact on all risk types and continues to be a major area of focus. The Group responded quickly to the challenges faced, putting in place risk mitigation strategies and refining investment and strategic plans. Transition planning remains a key focus in ensuring that the Group continues to protect colleagues and services to customers as the situation continues to evolve and in ensuring that the lessons learned from the pandemic are embedded into future working practices.

The Lloyds Banking Group is participating in the 2021 Bank of England Biennial Exploratory Scenario on Climate (CBES) for delivery in October. The scope covers credit losses over a thirty year horizon, and how the Lloyds Banking Group would change its lending strategy to mitigate climate risk, under three different temperature scenarios. The CBES may be used to inform FPC and PRA supervision but will not be used to set capital requirements.

The Group's principal risks and uncertainties are reviewed and reported regularly to the Board of the Lloyds Banking Group in alignment with the Lloyds Banking Group's Enterprise Risk Management Framework.

**Climate –** The risk that the Group experiences losses and/or reputational damage as a result of climate change, either directly or through its customers. These losses may be realised from physical events, the required adaptation in transitioning to a low carbon economy, or as a consequence of the responses to managing these changes.

**Market –** The risk that the Group's capital or earnings profile is affected by adverse market rates or prices, in particular interest rates and credit spreads in the Banking business and credit spreads in the Group's defined benefit pension schemes.

**Credit –** The risk that parties with whom the Group has contracted fail to meet their financial obligations (both on and off-balance sheet).

**Funding and liquidity –** Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient. Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost.

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

**Change/execution –** The risk that, in delivering its change agenda, the Group fails to ensure compliance with laws and regulation, maintain effective customer service and availability and/or operation within the risk appetite of the Lloyds Banking Group.

**Conduct –** The risk of customer detriment across the customer lifecycle including: failures in product management, distribution and servicing activities; from other risks materialising, or other activities which could undermine the integrity of the market or distort competition, leading to unfair customer outcomes, regulatory censure, reputational damage or financial loss.

**Data –** The risk of the Group failing to effectively govern, manage and control its data (including data processed by third party suppliers), leading to unethical decisions, poor customer outcomes, loss of value to the Group and mistrust.

**PRINCIPAL RISKS AND UNCERTAINTIES** (continued)

**Governance –** The risk that the Group's organisational infrastructure fails to provide robust oversight of decision-making and the control mechanisms to ensure strategies and management instructions are implemented effectively.

**People –** The risk that the Group fails to provide an appropriate colleague and customer-centric culture, supported by robust reward and wellbeing policies and processes, effective leadership to manage colleague resources, effective talent and succession management and robust control to ensure all colleague-related requirements are met.

**Operational resilience –** The risk that the Group fails to design resilience into business operations, underlying infrastructure and controls (people, process, technology) so that it is able to withstand external or internal events which could impact the continuation of operations and fails to respond in a way which meets customer and stakeholder expectations and needs when the continuity of operations is compromised.

**Operational –** The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

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

**Regulatory and legal –** The risk of financial penalties, regulatory censure, criminal or civil enforcement action or customer detriment as a result of failure to identify, assess, correctly interpret, comply with, or manage regulatory and/or legal requirements.

**Strategic –** The risk which results from:

- Incorrect assumptions about internal or external operating environments
- Failure to respond or the inappropriate strategic response to material changes in the external or internal operating environments
- Failure to understand the potential impact of strategic responses and business plans on existing risk types

*Credit risk*

The economic outlook for the UK has improved as the country begins to show signs of exiting the COVID-19 crisis. Observed credit performance has seen the flow of assets into arrears, defaults and write-offs remain at low levels, in part due to the continued effectiveness of support schemes, including the Coronavirus Job Retention Scheme, provision of loans under the different government schemes, including the Bounce Back Loan Scheme (BBLS), Coronavirus Business Interruption Loan Scheme (CBILS), and payment holidays extended by the Group which have now largely matured. There are a number of headwinds which have the potential to further impact the Group's portfolios, including uncertainty around future UK and global economic conditions with the risk of an increase in unemployment and further business failures as the UK Government schemes wind down. In the context of this uncertainty, the Group's risk appetite and risk management approach continues to help ensure that timely and proactive actions are taken.

# CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS


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## CONSOLIDATED INCOME STATEMENT (UNAUDITED)

| | Note | **Half-year to 30 June 2021 £m** | Half-year to 30 June 2020 £m |
|---|---|---|---|
| Interest income | | **3,530** | 3,977 |
| Interest expense | | **(960)** | (1,343) |
| **Net interest income** | | **2,570** | 2,634 |
| Fee and commission income | | **262** | 237 |
| Fee and commission expense | | **(137)** | (107) |
| Net fee and commission income | 3 | **125** | 130 |
| Net trading income | | **(4)** | 5 |
| Other operating income | | **18** | 77 |
| **Other income** | | **139** | 212 |
| **Total income** | | **2,709** | 2,846 |
| Operating expenses | 4 | **(1,553)** | (1,370) |
| Impairment | 5 | **252** | (1,465) |
| **Profit before tax** | | **1,408** | 11 |
| Tax credit | 6 | **55** | 169 |
| **Profit for the period** | | **1,463** | 180 |
| | | | |
| Profit attributable to ordinary shareholders | | **1,409** | 100 |
| Profit attributable to other equity holders | | **54** | 80 |
| **Profit for the period** | | **1,463** | 180 |

The accompanying notes are an integral part of the condensed consolidated half-year financial statements.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

| | **Half-year to 30 June 2021 £m** | Half-year to 30 June 2020 £m |
|---|---|---|
| **Profit for the period** | **1,463** | 180 |
| **Other comprehensive income** | | |
| *Items that will not subsequently be reclassified to profit or loss:* | | |
| Post-retirement defined benefit scheme remeasurements | | |
| Remeasurements before tax | **1** | 31 |
| Tax | **(5)** | (9) |
| | **(4)** | 22 |
| *Items that may subsequently be reclassified to profit or loss:* | | |
| Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income: | | |
| Change in fair value | **1** | 9 |
| Income statement transfers in respect of disposals | **(1)** | 2 |
| Income statement transfers in respect of impairment | **—** | 1 |
| Tax | **11** | (4) |
| | **11** | 8 |
| Movements in cash flow hedging reserve: | | |
| Effective portion of changes in fair value taken to other comprehensive income | **(16)** | 15 |
| Net income statement transfers | **6** | 3 |
| Tax | **7** | (4) |
| | **(3)** | 14 |
| Movements in foreign currency translation reserve: | | |
| Currency translation differences (tax: £nil) | **5** | (9) |
| **Other comprehensive income for the period, net of tax** | **9** | 35 |
| **Total comprehensive income for the period** | **1,472** | 215 |
| | | |
| Total comprehensive income attributable to ordinary shareholders | **1,418** | 135 |
| Total comprehensive income attributable to other equity holders | **54** | 80 |
| **Total comprehensive income for the period** | **1,472** | 215 |

## CONSOLIDATED BALANCE SHEET

| | Note | At 30 June 2021 (unaudited) £m | At 31 Dec 2020 (audited) £m |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances at central banks | | **3,068** | 2,841 |
| Items in the course of collection from banks | | **56** | 42 |
| Financial assets at fair value through profit or loss | | **400** | 477 |
| Derivative financial instruments | | **4,801** | 7,423 |
| Loans and advances to banks | | **98** | 207 |
| Loans and advances to customers | | **275,932** | 263,766 |
| Due from fellow Lloyds Banking Group undertakings | | **23,420** | 28,988 |
| Financial assets at amortised cost | 7 | **299,450** | 292,961 |
| Financial assets at fair value through other comprehensive income | | **2,181** | 2,395 |
| Goodwill | | **325** | 325 |
| Other intangible assets | | **269** | 224 |
| Property, plant and equipment | | **1,166** | 1,230 |
| Current tax recoverable | | **876** | 356 |
| Deferred tax assets | | **2,081** | 1,721 |
| Retirement benefit assets | | **71** | 69 |
| Other assets | | **243** | 264 |
| **Total assets** | | **314,987** | 310,328 |
| **Liabilities** | | | |
| Deposits from banks | | **9,368** | 14,695 |
| Customer deposits | | **169,941** | 163,001 |
| Due to fellow Lloyds Banking Group undertakings | | **96,782** | 91,953 |
| Items in course of transmission to banks | | **84** | 98 |
| Financial liabilities at fair value through profit or loss | | **38** | 45 |
| Derivative financial instruments | | **6,058** | 8,672 |
| Notes in circulation | | **1,368** | 1,305 |
| Debt securities in issue | 8 | **7,586** | 8,297 |
| Other liabilities | | **1,831** | 1,389 |
| Current tax liabilities | | **2** | — |
| Other provisions | 9 | **517** | 521 |
| Subordinated liabilities | | **6,591** | 6,964 |
| **Total liabilities** | | **300,166** | 296,940 |
| **Equity** | | | |
| Share capital | | **5,847** | 5,847 |
| Other reserves | | **2,033** | 2,020 |
| Retained profits | | **4,733** | 3,313 |
| **Ordinary shareholders' equity** | | **12,613** | 11,180 |
| Other equity instruments | | **2,200** | 2,200 |
| **Total equity excluding non-controlling interests** | | **14,813** | 13,380 |
| Non-controlling interests | | **8** | 8 |
| **Total equity** | | **14,821** | 13,388 |
| **Total equity and liabilities** | | **314,987** | 310,328 |

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

| | Attributable to ordinary shareholders | | | | Other equity instruments | Non-controlling interests | Total |
|---|---|---|---|---|---|---|---|
| | Share capital £m | Other reserves £m | Retained profits £m | Total £m | £m | £m | £m |
| At 1 January 2021 | 5,847 | 2,020 | 3,313 | 11,180 | 2,200 | 8 | 13,388 |
| **Comprehensive income** | | | | | | | |
| Profit for the period | — | — | 1,409 | 1,409 | 54 | — | 1,463 |
| *Other comprehensive income* | | | | | | | |
| Post-retirement defined benefit scheme remeasurements, net of tax | — | — | (4) | (4) | — | — | (4) |
| Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax | — | 11 | — | 11 | — | — | 11 |
| Movements in cash flow hedging reserve, net of tax | — | (3) | — | (3) | — | — | (3) |
| Movements in foreign currency translation reserve, net of tax | — | 5 | — | 5 | — | — | 5 |
| **Total other comprehensive income** | — | 13 | (4) | 9 | — | — | 9 |
| **Total comprehensive income**[1] | — | 13 | 1,405 | 1,418 | 54 | — | 1,472 |
| **Transactions with owners** | | | | | | | |
| Distributions on other equity instruments | — | — | — | — | (54) | — | (54) |
| Capital contributions received | — | — | 15 | 15 | — | — | 15 |
| **Total transactions with owners** | — | — | 15 | 15 | (54) | — | (39) |
| **At 30 June 2021**[2] | 5,847 | 2,033 | 4,733 | 12,613 | 2,200 | 8 | 14,821 |

1 Total comprehensive income attributable to owners of the parent was £1,472 million.

2 Total equity attributable to owners of the parent was £14,813 million.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)** (continued)

| | Attributable to ordinary shareholders | | | | Other equity instruments | Non-controlling interests | Total |
|---|---|---|---|---|---|---|---|
| | Share capital £m | Other reserves £m | Retained profits £m | Total £m | £m | £m | £m |
| At 1 January 2020 | 5,847 | 2,019 | 2,516 | 10,382 | 2,700 | 8 | 13,090 |
| Comprehensive income | | | | | | | |
| Profit for the period | — | — | 100 | 100 | 80 | — | 180 |
| *Other comprehensive income* | | | | | | | |
| Post-retirement defined benefit scheme remeasurements, net of tax | — | — | 22 | 22 | — | — | 22 |
| Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax | — | 8 | — | 8 | — | — | 8 |
| Movements in cash flow hedging reserve, net of tax | — | 14 | — | 14 | — | — | 14 |
| Movements in foreign currency translation reserve, net of tax | — | (9) | — | (9) | — | — | (9) |
| Total other comprehensive income | — | 13 | 22 | 35 | — | — | 35 |
| Total comprehensive income[1] | — | 13 | 122 | 135 | 80 | — | 215 |
| Transactions with owners | | | | | | | |
| Distributions on other equity instruments | — | — | — | — | (80) | — | (80) |
| Capital contributions received | — | — | 22 | 22 | — | — | 22 |
| Total transactions with owners | — | — | 22 | 22 | (80) | — | (58) |
| At 30 June 2020[2] | 5,847 | 2,032 | 2,660 | 10,539 | 2,700 | 8 | 13,247 |

1 Total comprehensive income attributable to owners of the parent was £215 million.

2 Total equity attributable to owners of the parent was £13,239 million.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)** (continued)

| | Attributable to ordinary shareholders | | | | | | |
|---|---|---|---|---|---|---|---|
| | Share capital £m | Other reserves £m | Retained profits £m | Total £m | Other equity instruments £m | Non-controlling interests £m | Total £m |
| At 1 July 2020 | 5,847 | 2,032 | 2,660 | 10,539 | 2,700 | 8 | 13,247 |
| Comprehensive income | | | | | | | |
| Profit for the period | — | — | 649 | 649 | 84 | — | 733 |
| *Other comprehensive income* | | | | | | | |
| Post-retirement defined benefit scheme remeasurements, net of tax | — | — | (7) | (7) | — | — | (7) |
| Movements in revaluation reserve in respect of debt securities held at fair value through other comprehensive income, net of tax | — | 4 | — | 4 | — | — | 4 |
| Movements in cash flow hedging reserve, net of tax | — | (18) | — | (18) | — | — | (18) |
| Movements in foreign currency translation reserve, net of tax | — | 2 | — | 2 | — | — | 2 |
| Total other comprehensive income | — | (12) | (7) | (19) | — | — | (19) |
| Total comprehensive income[1] | — | (12) | 642 | 630 | 84 | — | 714 |
| Transactions with owners | | | | | | | |
| Distributions on other equity instruments | — | — | — | — | (84) | — | (84) |
| Issue of other equity instruments | — | — | — | — | 1,000 | — | 1,000 |
| Redemption of other equity instruments | — | — | — | — | (1,500) | — | (1,500) |
| Capital contributions received | — | — | 11 | 11 | — | — | 11 |
| Total transactions with owners | — | — | 11 | 11 | (584) | — | (573) |
| At 31 December 2020[2] | 5,847 | 2,020 | 3,313 | 11,180 | 2,200 | 8 | 13,388 |

1 Total comprehensive income attributable to owners of the parent was £714 million.

2 Total equity attributable to owners of the parent was £13,380 million.

## CONSOLIDATED CASH FLOW STATEMENT (UNAUDITED)

| | **Half-year to 30 June 2021 £m** | Half-year to 30 June 2020 £m |
|---|---|---|
| **Profit before tax** | **1,408** | 11 |
| Adjustments for: | | |
| Change in operating assets | **(3,415)** | 1,241 |
| Change in operating liabilities | **3,602** | (1,008) |
| Non-cash and other items | **(218)** | 1,104 |
| Tax paid | **(818)** | (421) |
| **Net cash provided by operating activities** | **559** | 927 |
| **Cash flows from investing activities** | | |
| Purchase of financial assets | **(72)** | (1,178) |
| Proceeds from sale and maturity of financial assets | **241** | 424 |
| Purchase of fixed assets | **(93)** | (64) |
| Proceeds from sale of fixed assets | **17** | 22 |
| **Net cash provided by (used in) investing activities** | **93** | (796) |
| **Cash flows from financing activities** | | |
| Distributions on other equity instruments | **(54)** | (80) |
| Interest paid on subordinated liabilities | **(81)** | (90) |
| Repayment of subordinated liabilities | **(333)** | — |
| **Net cash used in financing activities** | **(468)** | (170) |
| Effect of exchange rate changes on cash and cash equivalents | **—** | 2 |
| Change in cash and cash equivalents | **184** | (37) |
| Cash and cash equivalents at beginning of period | **849** | 759 |
| **Cash and cash equivalents at end of period** | **1,033** | 722 |

Cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months.

## NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS

### Note 1: Accounting policies

These condensed consolidated half-year financial statements as at and for the period to 30 June 2021 have been prepared in accordance with the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority (FCA) and with International Accounting Standard 34 (IAS 34), *Interim Financial Reporting* as adopted by the United Kingdom 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 2020 which complied with international accounting standards in conformity with the requirements of the Companies Act 2006, were prepared in accordance with International Financial Reporting Standards (IFRS) and were compliant with IFRS adopted pursuant to Regulation (EC) No 1606/2002 as it applies in the European Union. Copies of the 2020 Annual Report and Accounts are available on the 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 taken into account the continuing uncertainties affecting the UK economy post-pandemic and their potential effects upon the Group's performance and projected funding and capital position; the impact of further stress scenarios has also been considered. On this basis, the directors are satisfied that the Group will maintain adequate levels of funding and capital for the foreseeable future.

*Changes in accounting policy*

The Group adopted the Interest Rate Benchmark Reform Phase 2 amendments from 1 January 2021. These amendments require that changes to expected future cash flows that both arise as a direct result of IBOR Reform and are economically equivalent to the previous cash flows are accounted for as a change to the effective interest rate with no adjustment to the asset or liability's carrying amount; no immediate gain or loss is recognised. The new requirements also provide relief from the requirement to discontinue hedge accounting as a result of amending hedge documentation if the changes are required solely as a result of the IBOR Reform. The amendments do not have a material impact on the Group's comparatives, which have not been restated.

Except for the change above, the Group's accounting policies are consistent with those applied by the Group in its 2020 Annual Report and Accounts and there have been no changes in the Group's methods of computation.

*Future accounting developments*

The IASB has issued a number of minor amendments to IFRSs effective 1 January 2022 and in later years (including IFRS 9 Financial Instruments and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*). These amendments are not expected to have a significant impact on the Group.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 2: Critical accounting judgements and estimates**

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. The Group's significant judgements, estimates and assumptions are unchanged compared to those applied at 31 December 2020, except as detailed below.

**Allowance for expected credit losses**

The Group recognises an allowance for expected credit losses (ECLs) 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 commitment and financial guarantee contracts. At 30 June 2021 the Group's expected credit loss allowance was £2,900 million (31 December 2020: £3,331 million), of which £2,796 million (31 December 2020: £3,202 million) was in respect of drawn balances.

The calculation of the Group's expected credit loss allowances and provisions against loan commitments and guarantees under IFRS 9 requires the Group to make a number of judgements, assumptions and estimates. These are set out in detail in the Group's 2020 Annual Report and Accounts. The principal changes made in the period ended 30 June 2021 are as follows:

*Base Case and Economic Assumptions*

The Group's base case economic scenario has been revised in light of the continuing impact of the coronavirus pandemic in the UK and globally. The scenario reflects judgements of the net effect of government-mandated restrictions on economic activity, large-scale government interventions and behavioural changes by households and businesses that may persist beyond the rollout of coronavirus vaccination programmes.

As large-scale vaccination efforts compete with the emergence of new viral strains in the UK and globally, there remains considerable uncertainty about the pace and eventual extent of the post-pandemic recovery. The Group's updated base case scenario builds in three key conditioning assumptions. First, that rising infections in the UK's third COVID-19 wave do not lead to a re-imposition of restrictions. Second, that the rollout of vaccination programmes among the UK's trading partners will reinforce an improving global backdrop. Third, that domestic policy measures remain accommodative, with monetary policy looking through a transient rise in inflation.

Conditioned on these assumptions and taking note of improvements in economic indicators in the second quarter, the Group's base case outlook continues to assume a rise in the unemployment rate as furlough support ends alongside a deceleration in residential and commercial property price growth. Risks around this base case economic view lie in both directions and are partly captured by the alternative economic scenarios generated. But uncertainties relating to the key conditioning assumptions, including epidemiological developments, the efficacy of vaccine rollouts against emergent strains and the response of the economy in those circumstances are not specifically captured by these scenarios. These specific risks have been recognised outside the modelled scenarios with a central adjustment.

The Group has incorporated the latest available information at the reporting date in defining its base case scenario and generating alternative economic scenarios. The scenarios include forecasts for key variables in the second quarter of 2021, for which actuals may have since emerged prior to publication.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 2: Critical accounting judgements and estimates** (continued)

*Base case scenario by quarter*[1]

| At 30 June 2021 | First quarter 2021 % | Second quarter 2021 % | Third quarter 2021 % | Fourth quarter 2021 % | First quarter 2022 % | Second quarter 2022 % | Third quarter 2022 % | Fourth quarter 2022 % |
|---|---|---|---|---|---|---|---|---|
| Gross domestic product | **(1.5)** | **4.3** | **(0.3)** | **3.2** | **1.5** | **0.5** | **0.4** | **0.4** |
| UK Bank Rate | **0.10** | **0.10** | **0.10** | **0.10** | **0.10** | **0.10** | **0.10** | **0.10** |
| Unemployment rate | **4.8** | **5.0** | **5.4** | **6.6** | **6.4** | **6.2** | **6.1** | **5.9** |
| House price growth | **6.5** | **10.5** | **6.8** | **5.6** | **5.0** | **1.7** | **0.3** | **0.1** |
| Commercial real estate price growth | **(2.9)** | **1.3** | **1.5** | **0.4** | **(0.3)** | **(0.5)** | **0.4** | **1.0** |

| At 31 December 2020 | First quarter 2020 % | Second quarter 2020 % | Third quarter 2020 % | Fourth quarter 2020 % | First quarter 2021 % | Second quarter 2021 % | Third quarter 2021 % | Fourth quarter 2021 % |
|---|---|---|---|---|---|---|---|---|
| Gross domestic product | (3.0) | (18.8) | 16.0 | (1.9) | (3.8) | 5.6 | 3.6 | 1.5 |
| UK Bank Rate | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| Unemployment rate | 4.0 | 4.1 | 4.8 | 5.0 | 5.2 | 6.5 | 8.0 | 7.5 |
| House price growth | 2.8 | 2.6 | 7.2 | 5.9 | 5.5 | 4.7 | (1.6) | (3.8) |
| Commercial real estate price growth | (5.0) | (7.8) | (7.8) | (7.0) | (6.1) | (2.9) | (2.2) | (1.7) |

1 Gross domestic product presented quarter on quarter, house price growth and commercial real estate growth presented year on year - i.e. from the equivalent quarter the previous year. UK Bank Rate is presented end quarter.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 2: Critical accounting judgements and estimates** (continued)

*Scenarios by year*

Key annual assumptions made by the Group are shown below. Gross domestic product is presented as an annual change, house price growth and commercial real estate price growth are presented as the growth in the respective indices within the period. UK Bank Rate and unemployment rate are averages for the period. The upside, base case and downside scenarios are weighted at 30 per cent each, with the severe downside scenario weighted at 10 per cent.

| At 30 June 2021 | 2021 % | 2022 % | 2023 % | 2024 % | 2025 % | 2021–2025 average % |
|---|---|---|---|---|---|---|
| **Upside** | | | | | | |
| Gross domestic product | **6.1** | **5.5** | **1.4** | **1.4** | **1.2** | **3.1** |
| UK Bank Rate | **0.52** | **1.27** | **1.09** | **1.32** | **1.58** | **1.16** |
| Unemployment rate | **4.7** | **4.9** | **4.4** | **4.2** | **4.1** | **4.5** |
| House price growth | **6.8** | **3.4** | **4.6** | **3.9** | **3.4** | **4.4** |
| Commercial real estate price growth | **9.2** | **5.7** | **2.4** | **0.3** | **(0.3)** | **3.4** |
| **Base case** | | | | | | |
| Gross domestic product | **5.5** | **5.5** | **1.6** | **1.4** | **1.2** | **3.0** |
| UK Bank Rate | **0.10** | **0.10** | **0.25** | **0.50** | **0.75** | **0.34** |
| Unemployment rate | **5.4** | **6.1** | **5.4** | **5.0** | **4.8** | **5.4** |
| House price growth | **5.6** | **0.1** | **0.1** | **0.6** | **1.1** | **1.5** |
| Commercial real estate price growth | **0.4** | **1.0** | **0.6** | **0.3** | **0.5** | **0.6** |
| **Downside** | | | | | | |
| Gross domestic product | **4.8** | **4.2** | **1.3** | **1.4** | **1.4** | **2.6** |
| UK Bank Rate | **0.09** | **0.05** | **0.06** | **0.11** | **0.20** | **0.10** |
| Unemployment rate | **6.0** | **7.8** | **7.1** | **6.5** | **6.0** | **6.7** |
| House price growth | **3.5** | **(6.2)** | **(7.5)** | **(4.9)** | **(1.8)** | **(3.5)** |
| Commercial real estate price growth | **(5.3)** | **(5.3)** | **(2.8)** | **(1.5)** | **0.2** | **(3.0)** |
| **Severe downside** | | | | | | |
| Gross domestic product | **4.1** | **3.5** | **1.1** | **1.4** | **1.4** | **2.3** |
| UK Bank Rate | **0.06** | **0.00** | **0.01** | **0.02** | **0.03** | **0.02** |
| Unemployment rate | **7.0** | **9.9** | **9.1** | **8.3** | **7.6** | **8.4** |
| House price growth | **2.4** | **(11.0)** | **(13.2)** | **(9.6)** | **(5.1)** | **(7.5)** |
| Commercial real estate price growth | **(13.5)** | **(13.5)** | **(6.9)** | **(2.3)** | **0.5** | **(7.3)** |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 2: Critical accounting judgements and estimates** (continued)

| At 31 December 2020 | 2020 % | 2021 % | 2022 % | 2023 % | 2024 % | 2020–2024 average % |
|---|---|---|---|---|---|---|
| Upside | | | | | | |
| Gross domestic product | (10.5) | 3.7 | 5.7 | 1.7 | 1.5 | 0.3 |
| UK Bank Rate | 0.10 | 1.14 | 1.27 | 1.20 | 1.21 | 0.98 |
| Unemployment rate | 4.3 | 5.4 | 5.4 | 5.0 | 4.5 | 5.0 |
| House price growth | 6.3 | (1.4) | 5.2 | 6.0 | 5.0 | 4.2 |
| Commercial real estate price growth | (4.6) | 9.3 | 3.9 | 2.1 | 0.3 | 2.1 |
| Base case | | | | | | |
| Gross domestic product | (10.5) | 3.0 | 6.0 | 1.7 | 1.4 | 0.1 |
| UK Bank Rate | 0.10 | 0.10 | 0.10 | 0.21 | 0.25 | 0.15 |
| Unemployment rate | 4.5 | 6.8 | 6.8 | 6.1 | 5.5 | 5.9 |
| House price growth | 5.9 | (3.8) | 0.5 | 1.5 | 1.5 | 1.1 |
| Commercial real estate price growth | (7.0) | (1.7) | 1.6 | 1.1 | 0.6 | (1.1) |
| Downside | | | | | | |
| Gross domestic product | (10.6) | 1.7 | 5.1 | 1.4 | 1.4 | (0.4) |
| UK Bank Rate | 0.10 | 0.06 | 0.02 | 0.02 | 0.03 | 0.05 |
| Unemployment rate | 4.6 | 7.9 | 8.4 | 7.8 | 7.0 | 7.1 |
| House price growth | 5.6 | (8.4) | (6.5) | (4.7) | (3.0) | (3.5) |
| Commercial real estate price growth | (8.7) | (10.6) | (3.2) | (0.8) | (0.8) | (4.9) |
| Severe downside | | | | | | |
| Gross domestic product | (10.8) | 0.3 | 4.8 | 1.3 | 1.2 | (0.8) |
| UK Bank Rate | 0.10 | 0.00 | 0.00 | 0.01 | 0.01 | 0.02 |
| Unemployment rate | 4.8 | 9.9 | 10.7 | 9.8 | 8.7 | 8.8 |
| House price growth | 5.3 | (11.1) | (12.5) | (10.7) | (7.6) | (7.5) |
| Commercial real estate price growth | (11.0) | (21.4) | (9.8) | (3.9) | (0.8) | (9.7) |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 2: Critical accounting judgements and estimates** (continued)

The table below shows the Group's ECL for the upside, base case, downside and severe downside scenarios. The stage allocation for an asset is based on the overall scenario probability-weighted PD and, hence, the Stage 2 allocation is constant across all the scenarios. ECL applied through individual assessments and post-model adjustments is reported flat against each economic scenario, reflecting the basis on which they are evaluated. Judgements applied through changes to inputs are reflected in the scenario sensitivities. It therefore shows the extent to which a higher ECL allowance has been recognised to take account of multiple economic scenarios from the probability-weighted view relative to the base case. The uplift being £236 million as at 30 June 2021.

| ECL allowance | Probability-weighted £m | Upside £m | Base case £m | Downside £m | Severe downside £m |
|---|---|---|---|---|---|
| **At 30 June 2021** | **2,900** | **2,483** | **2,664** | **3,136** | **4,149** |

The impact of changes in the UK unemployment rate and House Price Index (HPI) have also been assessed. Although such changes would not be observed in isolation, as economic indicators tend to be correlated in a coherent scenario, this gives insight into the sensitivity of the Group's ECL to gradual changes in these two critical economic factors. The assessment has been made against the base case with the reported staging unchanged.

The table below shows the estimated impact on the Group's ECL in respect of UK mortgages resulting from a decrease/ increase in loss given default for a 10 percentage point (pp) increase or decrease in the UK House Price Index (HPI). The increase/decrease is presented based on the adjustment phased evenly over the first ten quarters of the base case scenario.

| | At 30 June 2021 | |
|---|---|---|
| | **10pp increase in HPI** | **10pp decrease in HPI** |
| **ECL impact, £m** | **(162)** | **235** |

The table below shows the estimated impact on the Group's ECL resulting from a 1 percentage point (pp) increase or decrease in the UK unemployment rate. The increase or decrease is presented based on the adjustment phased evenly over the first ten quarters of the base case scenario. An immediate increase or decrease would drive a more material ECL impact as it would be fully reflected in both 12 month and lifetime PDs.

| | At 30 June 2021 | |
|---|---|---|
| | **1pp increase in unemployment** | **1pp decrease in unemployment** |
| **ECL impact, £m** | **59** | **(54)** |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 2: Critical accounting judgements and estimates** (continued)

*Application of judgement in adjustments to modelled ECL*

Impairment models fall within the Lloyds Banking Group's Model Risk framework with model monitoring, periodic validation and back testing performed on model components (i.e. probability of default, exposure at default and loss given default). Limitations in the Group's impairment models or data inputs may be identified through the ongoing assessment and validation of the output of the models. In these circumstances, management make appropriate adjustments to the Group's allowance for impairment losses to ensure that the overall provision adequately reflects all material risks. These adjustments are determined by considering the particular attributes of exposures which have not been adequately captured by the impairment models and range from changes to model inputs and parameters, at account level, through to more qualitative post-model overlays.

Judgements are not typically assessed under each distinct economic scenario used to generate ECL, but instead are applied on the basis of final modelled ECL which reflects the probability-weighted view of all scenarios. All adjustments are reviewed quarterly and are subject to internal review and challenge, including by the Lloyds Banking Group Audit Committee, to ensure that amounts are appropriately calculated and that there are specific release criteria within a reasonable timeframe.

The coronavirus pandemic and the various support measures that have been put in place have resulted in an economic environment which differs significantly from the historical economic conditions upon which the impairment models have been built. As a result there is a greater need for management judgements to be applied, as seen in the continued elevated levels. The nature and overall scale of significant judgmental adjustments remain consistent with those presented at 31 December 2020:

**Management judgements in respect of COVID-19**

*Overlay in respect of economic uncertainty: £200 million (2020: £200 million)*

The Group's £200 million uncertainty overlay was added at year end in recognition of the risks to the conditioning assumptions around the base case scenario being markedly to the downside given the potential for a material delay in the vaccination programme or reduction in its effectiveness from further virus mutation and the corresponding delayed withdrawal of restrictions on social interaction or introduction of further lockdowns.

Although the outlook has improved in the first half, the Group still considers that the conditioning assumptions within the base case and associated scenarios do not necessarily capture the unprecedented risks that remain. The vaccine roll out has progressed well and has supported the planned easing of restrictions to date, however the increasing infection rate and hospitalisations from the Delta variant highlight the potential risk from further virus mutation and the resulting response which could be needed, potentially impacting on social and economic activity. The scale of the uncertainty is expected to diminish once the UK is fully vaccinated and infection levels have been sustained at low levels, with restrictions reduced and associated Government support wound down.

*Recognition of impact of support measures on personal customers: £198 million (2020: £109 million)*

The use of payment holidays along with subdued levels of consumer spending is judged to have temporarily reduced the flow of accounts into arrears and default and to have also improved average credit scores across portfolios. Management believes that the resulting position does not fully reflect the underlying credit risk in the portfolios. Adjustments have therefore been made to increase expected future rates of default and remove the impact of the observed improvement in average credit scores. An adjustment has also been made to reflect an increase in the time assumed between default and repossession as a result of the Group temporarily suspending the repossession of properties to support customers during the pandemic.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 2: Critical accounting judgements and estimates** (continued)

**Other Management judgements**

*Adjustment to modelled forecast parameters: £207 million (2020: £277 million)*

Adjustments to the estimated defaults used within the ECL calculation were introduced at year end following the adoption of new default forecast models. Work has progressed through the period with initial model changes identified which reduce the scale of adjustment required. The scale of the adjustment has also reduced as the impact of under-sensitivity lessens when applied to the improved economic outlook.

*End-of-term interest only: £212 million (2020: £225 million)*

The current definition of default used in the UK mortgages impairment model excludes past term interest only accounts that continue to make interest payments but have missed their capital payment upon maturity of the loan. This adjustment therefore mitigates the risk that the model understates the credit losses associated with interest-only accounts which have missed, or will potentially miss, their final capital payment. For those accounts that have reached end of term this adjustment manually overwrites PDs to 70 per cent or 100 per cent, thereby moving them into Stage 2, or Stage 3, depending on whether they are deemed performing, or non-performing respectively. For interest-only accounts with six years or less to maturity an appropriate incremental PD uplift is made to PDs based on the probability of missing a future capital payment, assessed through segmentation of behaviour score, debt-to-value and worst ever arrears status.

*Long-term defaults: £132 million (2020: £145 million)*

The Group suspended mortgage litigation activity between late 2014 and mid 2018 as changes were implemented to the treatment of amounts in arrears, interrupting the natural flow of accounts to possession. An adjustment is made to ensure adequate provision coverage considering the resulting build-up of accounts in long-term default. Coverage is uplifted to the equivalent levels of those accounts already in repossession on an estimated shortfall of balances expected to flow to possession. A further adjustment is made to mitigate for the risk that credit model provision understates the probability of possession for accounts which have been in default for more than 24 months, with an arrears balance increase in the last 6 months. These accounts have their probability of possession set to 95 per cent based on observed historical losses incurred on accounts that were of an equivalent status.

## NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (continued)

### Note 3: Net fee and commission income

| | **Half-year to 30 June 2021 £m** | Half-year to 30 June 2020 £m |
|---|---|---|
| Fee and commission income: | | |
| Current accounts | **104** | 101 |
| Credit and debit card fees | **105** | 89 |
| Other fees and commissions | **53** | 47 |
| Total fee and commission income | **262** | 237 |
| Fee and commission expense | **(137)** | (107) |
| **Net fee and commission income** | **125** | 130 |

### Note 4: Operating expenses

| | **Half-year to 30 June 2021 £m** | Half-year to 30 June 2020 £m |
|---|---|---|
| Administrative expenses: | | |
| Staff costs | **577** | 605 |
| Premises and equipment | **59** | 92 |
| Amounts paid to fellow Lloyds Banking Group undertakings and other expenses | **574** | 458 |
| | **1,210** | 1,155 |
| Depreciation and amortisation | **108** | 117 |
| Regulatory provisions (note 9) | **235** | 98 |
| **Total operating expenses** | **1,553** | 1,370 |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 5: Impairment**

| | **Half-year to 30 June 2021 £m** | Half-year to 30 June 2020 £m |
|---|---|---|
| Impact of transfers between stages | **86** | 367 |
| Other changes in credit quality | **(221)** | 1,126 |
| Additions (repayments) | **(119)** | (12) |
| Other items | **2** | (16) |
| | **(338)** | 1,098 |
| **Total impairment (credit) charge** | **(252)** | 1,465 |
| *In respect of:* | | |
| Loans and advances to customers | **(223)** | 1,296 |
| Due from fellow Lloyds Banking Group undertakings | **(4)** | 91 |
| Financial assets held at amortised cost | **(227)** | 1,387 |
| Loan commitments and financial guarantees | **(25)** | 77 |
| Financial assets at fair value through other comprehensive income | **—** | 1 |
| **Total impairment (credit) charge** | **(252)** | 1,465 |

The Group's impairment charge comprises the following:

*Impact of transfers between stages*

The net impact on the impairment charge of transfers between stages.

*Other changes in credit quality*

Changes in loss allowance as a result of movements in risk parameters that reflect changes in customer credit quality, but which have not resulted in a transfer to a different stage. This also contains the impact on the impairment charge of write-offs and recoveries, where the related loss allowances are reassessed to reflect the view of credit quality at the balance sheet date and therefore the ultimate realisable or recoverable value.

*Additions (repayments)*

Expected loss allowances are recognised on origination of new loans or further drawdowns of existing facilities. Repayments relate to the reduction of loss allowances resulting from the repayment of outstanding balances that have been provided against.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 6: Tax credit**

In accordance with IAS 34, the Group's income tax credit for the half-year to 30 June 2021 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 credit and accounting profit is set out below:

| | **Half-year to 30 June 2021 £m** | Half-year to 30 June 2020 £m |
|---|---|---|
| Profit before tax | **1,408** | 11 |
| UK corporation tax thereon at 19 per cent (2020: 19 per cent) | **(268)** | (2) |
| Impact of surcharge on banking profits | **(107)** | (7) |
| Non-deductible costs: conduct charges | **(3)** | (3) |
| Other non-deductible costs | **(8)** | (30) |
| Non-taxable income | **3** | 9 |
| Tax relief on coupons on other equity instruments | **10** | 15 |
| Remeasurement of deferred tax due to rate changes | **433** | 182 |
| Differences in overseas tax rates | **—** | 3 |
| Adjustments in respect of prior years | **(5)** | 2 |
| **Tax credit** | **55** | 169 |

The Finance Act 2021, which was substantively enacted on 24 May 2021, increases the rate of corporation tax from 19 per cent to 25 per cent with effect from 1 April 2023. The impact of this rate change is an increase in the Group's net deferred tax asset as at 30 June 2021 of £432 million, comprising a £433 million credit included in the income statement and a £1 million charge included in equity. The tax credit in the half-year to 30 June 2020 included an uplift in deferred tax assets following the announcement by the UK Government that it would maintain the corporation tax rate at 19 per cent.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 7: Financial assets at amortised cost**

**Half-year to 30 June 2021**

| | Gross carrying amount | | | | Allowance for expected credit losses | | | |
|---|---|---|---|---|---|---|---|---|
| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Total £m |
| **Loans and advances to banks** | **98** | **—** | **—** | **98** | **—** | **—** | **—** | **—** |
| **Allowance for impairment losses** | **—** | **—** | **—** | **—** | | | | |
| **Net carrying amount** | **98** | **—** | **—** | **98** | | | | |
| **Loans and advances to customers** | | | | | | | | |
| At 1 January 2021 | **226,746** | **34,437** | **5,775** | **266,958** | **486** | **1,146** | **1,560** | **3,192** |
| Exchange and other adjustments | **(17)** | **—** | **(31)** | **(48)** | **1** | **—** | **66** | **67** |
| Transfers to Stage 1 | **4,371** | **(4,366)** | **(5)** | **—** | **111** | **(110)** | **(1)** | **—** |
| Transfers to Stage 2 | **(5,934)** | **6,404** | **(470)** | **—** | **(23)** | **78** | **(55)** | **—** |
| Transfers to Stage 3 | **(122)** | **(951)** | **1,073** | **—** | **(4)** | **(91)** | **95** | **—** |
| Impact of transfers between stages | **(1,685)** | **1,087** | **598** | **—** | **(78)** | **94** | **72** | **88** |
| | | | | | **6** | **(29)** | **111** | **88** |
| Other changes in credit quality | | | | | **(24)** | **(126)** | **(49)** | **(199)** |
| Additions (repayments) | **14,236** | **(1,809)** | **(440)** | **11,987** | **(4)** | **(57)** | **(51)** | **(112)** |
| (Credit) charge to the income statement | | | | | **(22)** | **(212)** | **11** | **(223)** |
| Advances written off | | | **(203)** | **(203)** | | | **(203)** | **(203)** |
| Recoveries of advances written off in previous years | | | **28** | **28** | | | **28** | **28** |
| Discount unwind | | | | | | | **(71)** | **(71)** |
| **At 30 June 2021** | **239,280** | **33,715** | **5,727** | **278,722** | **465** | **934** | **1,391** | **2,790** |
| **Allowance for impairment losses** | **(465)** | **(934)** | **(1,391)** | **(2,790)** | | | | |
| **Net carrying amount** | **238,815** | **32,781** | **4,336** | **275,932** | | | | |
| **Due from fellow Lloyds Banking Group undertakings** | **23,425** | **—** | **—** | **23,425** | **5** | **—** | **—** | **5** |
| **Allowance for impairment losses** | **(5)** | **—** | **—** | **(5)** | | | | |
| **Net carrying amount** | **23,420** | **—** | **—** | **23,420** | | | | |
| **Total financial assets at amortised cost** | **262,333** | **32,781** | **4,336** | **299,450** | | | | |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 7: Financial assets at amortised cost** (continued)

Movements in allowance for expected credit losses in respect of undrawn balances were as follows:

| | Allowance for expected credit losses | | | |
|---|---|---|---|---|
| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Total £m |
| **Undrawn balances** | | | | |
| At 1 January 2021 | **54** | **69** | **6** | **129** |
| Transfers to Stage 1 | **14** | **(14)** | **—** | **—** |
| Transfers to Stage 2 | **(3)** | **3** | **—** | **—** |
| Transfers to Stage 3 | **—** | **(1)** | **1** | **—** |
| Impact of transfers between stages | **(11)** | **10** | **(1)** | **(2)** |
| | **—** | **(2)** | **—** | **(2)** |
| Other items credited to the income statement | **(7)** | **(11)** | **(5)** | **(23)** |
| Credit to the income statement | **(7)** | **(13)** | **(5)** | **(25)** |
| **At 30 June 2021** | **47** | **56** | **1** | **104** |

The Group's total impairment allowances were as follows:

| | Allowance for expected credit losses | | | |
|---|---|---|---|---|
| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Total £m |
| *In respect of:* | | | | |
| Loans and advances to customers | **465** | **934** | **1,391** | **2,790** |
| Debt securities | **—** | **—** | **1** | **1** |
| Due from fellow Lloyds Banking Group undertakings | **5** | **—** | **—** | **5** |
| Financial assets at amortised cost | **470** | **934** | **1,392** | **2,796** |
| Provisions in relation to loan commitments and financial guarantees | **47** | **56** | **1** | **104** |
| **Total** | **517** | **990** | **1,393** | **2,900** |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 7: Financial assets at amortised cost** (continued)

Year ended 31 December 2020

| | Gross carrying amount | | | | Allowance for expected credit losses | | | |
|---|---|---|---|---|---|---|---|---|
| | Stage 1 £m | Stage 2 £m | Stage 3 £m | Total £m | Stage 1 £m | Stage 2 £m | Stage 3 £m | Total £m |
| Loans and advances to banks | 207 | — | — | 207 | — | — | — | — |
| Allowance for impairment losses | — | — | — | — | | | | |
| Net carrying amount | 207 | — | — | 207 | | | | |
| Loans and advances to customers | | | | | | | | |
| At 1 January 2020 | 229,741 | 24,996 | 5,663 | 260,400 | 149 | 749 | 1,187 | 2,085 |
| Exchange and other adjustments | 94 | 1 | (2) | 93 | (2) | 1 | 24 | 23 |
| Transfers to Stage 1 | 3,011 | (3,004) | (7) | — | 52 | (51) | (1) | — |
| Transfers to Stage 2 | (15,009) | 15,731 | (722) | — | (63) | 120 | (57) | — |
| Transfers to Stage 3 | (401) | (1,598) | 1,999 | — | (6) | (108) | 114 | — |
| Impact of transfers between stages | (12,399) | 11,129 | 1,270 | — | (33) | 372 | 197 | 536 |
| | | | | | (50) | 333 | 253 | 536 |
| Other changes in credit quality | | | | | 367 | 88 | 587 | 1,042 |
| Additions (repayments) | 10,106 | (1,665) | (702) | 7,739 | 22 | (25) | (28) | (31) |
| Charge to the income statement | | | | | 339 | 396 | 812 | 1,547 |
| Disposal of business | (796) | (24) | — | (820) | — | — | — | — |
| Advances written off | | | (552) | (552) | | | (552) | (552) |
| Recoveries of advances written off in previous years | | | 98 | 98 | | | 98 | 98 |
| Discount unwind | | | | | | | (9) | (9) |
| At 31 December 2020 | 226,746 | 34,437 | 5,775 | 266,958 | 486 | 1,146 | 1,560 | 3,192 |
| Allowance for impairment losses | (486) | (1,146) | (1,560) | (3,192) | | | | |
| Net carrying amount | 226,260 | 33,291 | 4,215 | 263,766 | | | | |
| Due from fellow Lloyds Banking Group undertakings | 28,997 | — | — | 28,997 | 9 | — | — | 9 |
| Allowance for impairment losses | (9) | — | — | (9) | | | | |
| Net carrying amount | 28,988 | — | — | 28,988 | | | | |
| Total financial assets at amortised cost | 255,455 | 33,291 | 4,215 | 292,961 | | | | |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 7: Financial assets at amortised cost** (continued)

Movements in allowance for expected credit losses in respect of undrawn balances were as follows:

| | Allowance for expected credit losses | | | |
|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | Total |
| | £m | £m | £m | £m |
| Undrawn balances | | | | |
| At 1 January 2020 | 26 | 28 | 1 | 55 |
| Exchange and other adjustments | (1) | — | 1 | — |
| Transfers to Stage 1 | 8 | (8) | — | — |
| Transfers to Stage 2 | (3) | 3 | — | — |
| Transfers to Stage 3 | — | (3) | 3 | — |
| Impact of transfers between stages | (4) | 23 | 11 | 30 |
| | 1 | 15 | 14 | 30 |
| Other items charged to the income statement | 28 | 26 | (10) | 44 |
| Charge to the income statement | 29 | 41 | 4 | 74 |
| At 31 December 2020 | 54 | 69 | 6 | 129 |

The Group's total impairment allowances were as follows:

| | Allowance for expected credit losses | | | |
|---|---|---|---|---|
| | Stage 1 | Stage 2 | Stage 3 | Total |
| | £m | £m | £m | £m |
| *In respect of:* | | | | |
| Loans and advances to customers | 486 | 1,146 | 1,560 | 3,192 |
| Debt securities | — | — | 1 | 1 |
| Due from fellow Lloyds Banking Group undertakings | 9 | — | — | 9 |
| Financial assets at amortised cost | 495 | 1,146 | 1,561 | 3,202 |
| Provisions in relation to loan commitments and financial guarantees | 54 | 69 | 6 | 129 |
| Total | 549 | 1,215 | 1,567 | 3,331 |

The movement tables are compiled by comparing the position at the reporting date to that at the beginning of the year.

Transfers between stages are deemed to have taken place at the start of the reporting period, with all other movements shown in the stage in which the asset is held at the period end.

Additions (repayments) comprise new loans originated and repayments of outstanding balances throughout the reporting period. Loans which are written off in the period are first transferred to Stage 3 before acquiring a full allowance and subsequent write-off.

Loans and advances to customers include advances securitised under the Group's securitisation and covered bond programmes (see note 8).

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 8: Debt securities in issue**

| | **At 30 June 2021** | | | At 31 December 2020 | | |
|---|---|---|---|---|---|---|
| | **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 | **—** | **1,933** | **1,933** | — | 2,065 | 2,065 |
| Covered bonds | **—** | **3,057** | **3,057** | — | 3,243 | 3,243 |
| Securitisation notes | **38** | **2,596** | **2,634** | 45 | 2,989 | 3,034 |
| | **38** | **7,586** | **7,624** | 45 | 8,297 | 8,342 |

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 2021, external parties held £2,634 million (31 December 2020: £3,034 million) and the Group's subsidiaries held £19,685 million (31 December 2020: £23,199 million) of total securitisation notes in issue of £22,319 million (31 December 2020: £26,233 million). The notes are secured on loans and advances to customers and debt securities held at amortised cost amounting to £22,660 million (31 December 2020: £27,504 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 2021, external parties held £3,057 million (31 December 2020: £3,243 million) and the Group's subsidiaries held £nil (31 December 2020: £100 million) of total covered bonds in issue of £3,057 million (31 December 2020: £3,343 million). The bonds are secured on certain loans and advances to customers amounting to £3,638 million (31 December 2020: £4,056 million) that have been assigned to bankruptcy remote limited liability partnerships. These loans are retained on the Group's balance sheet.

Cash deposits of £2,083 million (31 December 2020: £1,485 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.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 9: Other provisions**

| | Provisions for financial commitments and guarantees £m | Regulatory provisions £m | Other £m | Total £m |
|---|---|---|---|---|
| At 1 January 2021 | **129** | **230** | **162** | **521** |
| Provisions applied | **—** | **(217)** | **(10)** | **(227)** |
| Charge for the period | **(25)** | **235** | **13** | **223** |
| **At 30 June 2021** | **104** | **248** | **165** | **517** |

**Regulatory provisions**

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 half-year to 30 June 2021 the Group charged a further £235 million in respect of legal actions and other regulatory matters.

The unutilised balance at 30 June 2021 was £248 million (31 December 2020: £230 million). The most significant items are as follows.

*Payment protection insurance*

The Group has made provisions for PPI costs over a number of years totalling £6,344 million. Good progress continues to be made towards ensuring operational completeness, with the final validation of information requests and complaints with third parties at an advanced stage, ahead of an orderly programme close.

In addition to the above provision, the Group continues to challenge PPI litigation cases, with mainly administration costs and some potential redress recognised within the first half regulatory provisions.

*HBOS Reading – review*

The Group completed its compensation assessment for those within the Customer Review in 2019 with more than £109 million of compensation paid, in addition to £15 million for ex-gratia payments and £6 million for the reimbursement of legal fees. The Group is applying the recommendations from Sir Ross Cranston's review, issued in December 2019, including a reassessment of direct and consequential losses by an independent panel, an extension of debt relief and a wider definition of de facto directors. Further details of the panel were announced on 3 April 2020 and the panel's full scope and methodology was published on 7 July 2020. The panel's stated objective is to consider cases via a non-legalistic and fair process and to make their decisions in a generous, fair and common-sense manner. Details of an appeal process for the further assessments of debt relief and de facto director status have also been announced.

In 2020 a charge of £159 million was recorded, bringing the lifetime cost to £435 million, covering both compensation payments and operational costs.

In the half-year to 30 June 2021 the Group has continued to make progress assessing further debt relief and de facto director status claims and has now completed 99 per cent of preliminary assessments. The independent panel has also started to issue its first outcomes.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 9: Other provisions** (continued)

The Group has charged £150 million in the half-year to 30 June 2021 for the independent panel and Dame Linda Dobbs review of the Group's handling of HBOS Reading between January 2009 and January 2017. A significant part of this charge relates to the actual and foreseeable future operational costs of these activities which are both now expected to extend into 2022, in addition to awards from the independent panel to date. The first half charge increases the lifetime cost to £585 million. The panel is continuing its assessment of awards which could result in further significant charges over 2021 and 2022 but it is not possible to reliably estimate the potential impact or timings at this stage. The Group is committed to implementing Sir Ross's recommendations in full.

*Arrears handling related activities*

To date the Group has provided a total of £676 million for arrears handling activities; the unutilised balance at 30 June 2021 was £15 million.

**Note 10: Related party transactions**

**Balances and transactions with 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 2021 £m** | At 31 Dec 2020 £m |
|---|---|---|
| **Assets, included within:** | | |
| Financial assets at amortised cost: due from fellow Lloyds Banking Group undertakings | **23,420** | 28,988 |
| Derivative financial instruments | **2,782** | 4,819 |
| **Liabilities, included within:** | | |
| Due to fellow Lloyds Banking Group undertakings | **96,782** | 91,953 |
| Derivative financial instruments | **5,067** | 7,374 |
| Debt securities in issue | **1,186** | 1,215 |
| Subordinated liabilities | **6,490** | 6,512 |

During the half-year to 30 June 2021 the Group earned £48 million (half-year to 30 June 2020: £260 million) of interest income and incurred £811 million (half-year to 30 June 2020: £1,018 million) of interest expense on balances and transactions with Lloyds Banking Group plc and fellow Group undertakings.

In addition, during the half-year to 30 June 2021 the Group incurred expenditure of £19 million (half-year ended 30 June 2020: £20 million) on behalf of fellow Lloyds Banking Group undertakings which was recharged to those undertakings; and fellow Lloyds Banking Group undertakings incurred expenditure of £381 million (half-year ended 30 June 2020: £331 million) on behalf of the Group which has been recharged to the Group.

**Other related party transactions**

Other related party transactions for the half-year to 30 June 2021 are similar in nature to those for the year ended 31 December 2020.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 11: Contingent liabilities, commitments and guarantees**

**Interchange fees**

With respect to multi-lateral interchange fees (MIFs), the Group is not involved in the ongoing litigation which involves the card schemes Visa and Mastercard (as described below). However, the Group is a member/licensee of Visa and Mastercard and other card schemes. The litigation in question is as follows:

- litigation brought by retailers against both Visa and Mastercard continues in the English Courts in which retailers are seeking damages on grounds that Visa and Mastercard’s MIFs breached competition law (this includes a judgment of the Supreme Court in June 2020 upholding the Court of Appeal's finding in 2018 that historic interchange arrangements of Mastercard and Visa infringed competition law); and
- litigation brought on behalf of UK consumers in the English Courts against Mastercard, which the Supreme Court has now confirmed can proceed in the lower courts.

Any impact on the Group of the litigation against Visa and Mastercard remains uncertain at this time, such that it is not practicable for the Group to provide an estimate of any potential financial effect. Insofar as Visa is required to pay damages to retailers for interchange fees set prior to June 2016, contractual arrangements to allocate liability have been agreed between various UK banks (including the Lloyds Banking Group) and Visa Inc, as part of Visa Inc’s acquisition of Visa Europe in 2016. These arrangements cap the maximum amount of liability to which the Lloyds Banking Group may be subject and this cap is set at the cash consideration received by the Lloyds Banking Group for the sale of its stake in Visa Europe to Visa Inc in 2016. In 2016, the Lloyds Banking Group received Visa preference stock as part of the consideration for the sale of its shares in Visa Europe. In 2020, some of these Visa preference shares were converted into Visa Inc Class A common stock (in accordance with the provisions of the Visa Europe sale documentation) and they were subsequently sold by the Lloyds Banking Group. The sale had no impact on this contingent liability.

**LIBOR and other trading rates**

Certain Lloyds Banking Group companies, together with other panel banks, have 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 London Interbank Offered Rate and the Australian BBSW reference rate. Certain of the plaintiffs' claims have been dismissed by the US Federal Court for the Southern District of New York (subject to appeals).

Certain Lloyds Banking Group companies are also named as defendants in (i) UK based claims; and (ii) two Dutch class actions, raising LIBOR manipulation allegations. A number of the claims against the Lloyds Banking Group in the UK relate to the alleged mis-sale of interest rate hedging products also include allegations of LIBOR manipulation.

It is currently not possible to predict the scope and ultimate outcome on the Group of any private lawsuits or any related challenges to the interpretation or validity of any of the Group's contractual arrangements, including their timing and scale. As such, it is not practicable to provide an estimate of any potential financial effect.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 11: Contingent liabilities, commitments and guarantees** (continued)

**Tax authorities**

The Group has an open matter in relation to a claim for group relief of losses incurred in its former Irish banking subsidiary, which ceased trading on 31 December 2010. In 2013, HMRC informed the Group that its interpretation of the UK rules means that the group relief is not available. In 2020, HMRC concluded their enquiry into the matter and issued a closure notice. The Group's interpretation of the UK rules has not changed and hence it has appealed to the First Tier Tax Tribunal, with a hearing expected in early 2022. If the final determination of the matter by the judicial process is that HMRC's position is correct, management estimate that this would result in an increase in current tax liabilities of approximately £175 million (including interest). The Group, 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 Lloyds Banking Group is in discussions with HMRC (including the tax treatment of certain costs arising from the divestment of TSB Banking Group plc), none of which is expected to have a material impact on the financial position of the Group.

**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. Where material, such 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 to properly 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. Where there is a contingent liability related to an existing provision the relevant disclosures are included within note 9.

## NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (continued)

### Note 11: Contingent liabilities, commitments and guarantees (continued)

**Contingent liabilities, commitments and guarantees**

| | At 30 June 2021 £m | At 31 Dec 2020 £m |
|---|---|---|
| **Contingent liabilities** | | |
| Items serving as direct credit substitutes | **1** | 18 |
| Performance bonds, including letters of credit, and other transaction-related contingencies | **198** | 189 |
| **Total contingent liabilities** | **199** | 207 |
| | | |
| **Commitments and guarantees** | | |
| Documentary credits and other short-term trade-related transactions | **1** | 1 |
| Forward asset purchases and forward deposits placed | **6** | 28 |
| | | |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | |
| Less than 1 year original maturity: | | |
| Mortgage offers made | **15,029** | 17,828 |
| Other commitments and guarantees | **25,994** | 26,203 |
| | **41,023** | 44,031 |
| 1 year or over original maturity | **2,887** | 3,512 |
| **Total commitments and guarantees** | **43,917** | 47,572 |

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend, £18,127 million (31 December 2020: £20,919 million) was irrevocable.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 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 2020 financial statements details 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 3 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 3 portfolios**

Transfers out of level 3 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 sources of data cease to be observable.

**Valuation methodology**

For level 2 and level 3 portfolios, there is no significant change to the valuation methodology (techniques and inputs) disclosed in the Group's 2020 Annual Report and Accounts applied to these 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.

| | **At 30 June 2021** | | At 31 December 2020 | |
|---|---|---|---|---|
| | **Carrying value** | **Fair value** | Carrying value | Fair value |
| | **£m** | **£m** | £m | £m |
| **Financial assets at amortised cost** | | | | |
| Loans and advances to banks | **98** | **98** | 207 | 207 |
| Loans and advances to customers | **275,932** | **277,908** | 263,766 | 265,635 |
| Due from fellow Lloyds Banking Group undertakings | **23,420** | **23,420** | 28,988 | 28,988 |
| **Financial liabilities at amortised cost** | | | | |
| Deposits from banks | **9,368** | **9,368** | 14,695 | 14,695 |
| Customer deposits | **169,941** | **170,007** | 163,001 | 163,148 |
| Due to fellow Lloyds Banking Group undertakings | **96,782** | **96,782** | 91,953 | 91,953 |
| Debt securities in issue | **7,586** | **7,721** | 8,297 | 8,622 |
| Subordinated liabilities | **6,591** | **6,618** | 6,964 | 6,990 |

Financial instruments classified as financial assets at fair value through profit or loss, derivative financial instruments, financial assets at fair value through other comprehensive income and financial liabilities at fair value through profit or loss are recognised at fair value.

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.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 12: Fair values of financial assets and liabilities** (continued)

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 1 to 3 based on the degree to which the fair value is observable. There were no significant transfers between level 1 and level 2 during the period.

| Financial assets carried at fair value | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **At 30 June 2021** | | | | |
| Loans and advances to customers at fair value through profit or loss | **—** | **—** | **400** | **400** |
| Debt securities at fair value through other comprehensive income | **—** | **2,181** | **—** | **2,181** |
| Derivative financial instruments | **—** | **4,790** | **11** | **4,801** |
| At 31 December 2020 | | | | |
| Loans and advances to customers at fair value through profit or loss | — | — | 477 | 477 |
| Debt securities at fair value through other comprehensive income | — | 2,395 | — | 2,395 |
| Derivative financial instruments | — | 7,411 | 12 | 7,423 |

| Financial liabilities carried at fair value | Level 1 £m | Level 2 £m | Level 3 £m | Total £m |
|---|---|---|---|---|
| **At 30 June 2021** | | | | |
| Financial liabilities designated at fair value through profit or loss | **—** | **—** | **38** | **38** |
| Derivative financial instruments | **—** | **5,852** | **206** | **6,058** |
| At 31 December 2020 | | | | |
| Financial liabilities designated at fair value through profit or loss | — | — | 45 | 45 |
| Derivative financial instruments | — | 8,401 | 271 | 8,672 |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 12: Fair values of financial assets and liabilities** (continued)

**Movements in level 3 portfolio**

The table below analyses movements in the level 3 financial assets portfolio.

| | Financial assets at fair value through profit or loss £m | Derivative assets £m | Total financial assets carried at fair value £m |
|---|---|---|---|
| At 1 January 2021 | **477** | **12** | **489** |
| Losses recognised in the income statement within other income | **(55)** | **(1)** | **(56)** |
| Purchases/increases to customer loans | **4** | **—** | **4** |
| Sales/repayments of customer loans | **(26)** | **—** | **(26)** |
| **At 30 June 2021** | **400** | **11** | **411** |
| Losses recognised in the income statement, within other income, relating to the change in fair value of those assets held at 30 June 2021 | **(52)** | **(1)** | **(53)** |
| At 1 January 2020 | 463 | — | 463 |
| Gains recognised in the income statement within other income | 18 | 2 | 20 |
| Sales/repayments of customer loans | (13) | — | (13) |
| Transfers into the level 3 portfolio | — | 11 | 11 |
| At 30 June 2020 | 468 | 13 | 481 |
| Gains recognised in the income statement, within other income, relating to the change in fair value of those assets held at 30 June 2020 | 9 | — | 9 |

The table below analyses movements in the level 3 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 2021 | **45** | **271** | **316** |
| Gains recognised in the income statement within other income | **(2)** | **(46)** | **(48)** |
| Redemptions | **(5)** | **(19)** | **(24)** |
| **At 30 June 2021** | **38** | **206** | **244** |
| Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 30 June 2021 | **(2)** | **(42)** | **(44)** |
| At 1 January 2020 | 47 | 297 | 344 |
| Losses recognised in the income statement within other income | 1 | 8 | 9 |
| Redemptions | (1) | (8) | (9) |
| At 30 June 2020 | 47 | 297 | 344 |
| Gains recognised in the income statement, within other income, relating to the change in fair value of those liabilities held at 30 June 2020 | — | — | — |

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 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.

| | | | | Effect of reasonably possible alternative assumptions[2] | |
|---|---|---|---|---|---|
| **At 30 June 2021** | **Valuation techniques** | **Significant unobservable inputs**[1] | | **Favourable changes** | **Unfavourable changes** |
| | | | | **£m** | **£m** |
| *Financial assets at fair value through profit or loss* | | | | | |
| Loans and advances to customers | Discounted cash flows | Interest rate spreads (+/- 6%) | **400** | **38** | **(35)** |
| *Derivative financial assets* | | | | | |
| Interest rate derivatives | Option pricing model | Interest rate volatility (28%/56%) | **11** | **—** | **—** |
| **Level 3 financial assets carried at fair value** | | | **411** | | |
| *Financial liabilities at fair value through profit or loss* | | | | | |
| Securitisation notes | Discounted cash flows | Interest rate spreads (+/- 50bps) | **38** | **2** | **(1)** |
| *Derivative financial liabilities* | | | | | |
| Shared appreciation rights | Market values – property valuation | HPI (+/- 1%) | **206** | **25** | **(23)** |
| **Level 3 financial liabilities carried at fair value** | | | **244** | | |
| At 31 December 2020 | | | | | |
| *Financial assets at fair value through profit or loss* | | | | | |
| Loans and advances to customers | Discounted cash flows | Interest rate spreads (-50bps/+106bps) | 477 | 36 | (34) |
| *Derivative financial assets* | | | | | |
| Interest rate derivatives | Option pricing model | Interest rate volatility (30%/60%) | 12 | — | — |
| Level 3 financial assets carried at fair value | | | 489 | | |
| *Financial liabilities at fair value through profit or loss* | | | | | |
| Securitisation notes | Discounted cash flows | Interest rate spreads (+/- 50bps) | 45 | 1 | (1) |
| *Derivative financial liabilities* | | | | | |
| Shared appreciation rights | Market values – property valuation | HPI (+/- 1%) | 271 | 24 | (22) |
| Level 3 financial liabilities carried at fair value | | | 316 | | |

1 Ranges represent the highest and lowest inputs used in the level 3 valuations.

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

**Unobservable inputs**

Significant unobservable inputs affecting the valuation of debt securities and derivatives are unchanged from those described in the Group's 2020 financial statements.

**Reasonably possible alternative assumptions**

Valuation techniques applied to many of the Group's level 3 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 note 39 to the Group's 2020 financial statements.

**NOTES TO THE CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS** (continued)

**Note 13: 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 to 31 December 2020 and copies may be obtained from Investor Relations, Lloyds Banking Group, 25 Gresham Street, London EC2V 7HN and available for download from www.lloydsbankinggroup.com.

**Note 14: Other information**

The financial information contained in this document does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006 (the Act). The statutory accounts for the year ended 31 December 2020 were approved by the directors on 11 March 2021 and were delivered to the Registrar of Companies on 28 April 2021. The auditors' report on those accounts was unqualified and did not include a statement under sections 498(2) (accounting records or returns inadequate or accounts not agreeing with records and returns) or 498(3) (failure to obtain necessary information and explanations) of the Act.

**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 UK adopted International Accounting Standard 34, Interim Financial Reporting, and that the half-year management report 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 2021 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 2021 and any material changes in the related party transactions described in the last annual report.

Signed on behalf of the Board by

William Chalmers
Interim Group Chief Executive
28 July 2021

Bank of Scotland plc Board of directors:

**Executive director:**
William Chalmers (Interim Group Chief Executive and Chief Financial Officer)

**Non-executive directors:**
Robin Budenberg CBE *(Chair)*
Alan Dickinson *(Deputy Chair)*
Sarah Bentley
Brendan Gilligan
Nigel Hinshelwood
Sarah Legg
Lord Lupton CBE
Amanda Mackenzie OBE
Nicholas Prettejohn
Stuart Sinclair
Catherine Woods

## FORWARD LOOKING STATEMENTS

This document contains certain forward looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934, as amended, and section 27A of the US Securities Act of 1933, as amended, with respect to the business, strategy, plans and/or results of Bank of Scotland plc together with its subsidiaries (the Group) and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical or current facts, including statements about the Group's or its directors' and/or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'achieves', 'anticipates', 'estimates', 'expects', 'targets', 'should', 'intends', 'aims', 'projects', 'plans', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'may', 'seek', 'estimate', 'probability', 'goal', 'objective', 'endeavour', 'prospects', 'optimistic' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. Examples of such forward looking statements include, but are not limited to, statements or guidance relating to: projections or expectations of the Group's future financial position including profit attributable to shareholders, provisions, economic profit, dividends, capital structure, portfolios, net interest margin, capital ratios, liquidity, risk-weighted assets (RWAs), expenditures or any other financial items or ratios; litigation, regulatory and governmental investigations; the Group's future financial performance; the level and extent of future impairments and write-downs; the Group's ESG targets and/or commitments; statements of plans, objectives or goals of the Group or its management including in respect of statements about the future business and economic environments in the UK and elsewhere including, but not limited to, future trends in interest rates, foreign exchange rates, credit and equity market levels and demographic developments; statements about competition, regulation, disposals and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such 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 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; any impact of the transition from IBORs to alternative reference rates; the ability to access sufficient sources of capital, liquidity and funding when required; changes to the credit ratings of the Group or any of the Group's immediate or ultimate parent entities (if applicable); the ability to derive cost savings and other benefits including, but without limitation as a result of any acquisitions, disposals and other strategic transactions; potential changes in dividend policy; the ability to achieve strategic objectives; changing customer behaviour including consumer spending, saving and borrowing habits; changes to borrower or counterparty credit quality impacting the recoverability and value of balance sheet assets; concentration of financial exposure; management and monitoring of conduct risk; exposure to counterparty risk (including but not limited to third parties conducting illegal activities without the Group's knowledge); instability in the global financial markets, including Eurozone instability, instability as a result of uncertainty surrounding the exit by the UK from the European Union (EU) and the EU-UK Trade and Cooperation Agreement, instability as a result of 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; political instability including as a result of any UK general election and any further possible referendum on Scottish independence; 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 (including but not limited to the COVID-19 pandemic) and other disasters, adverse weather and similar contingencies outside the control of the Group or any of the Group's immediate or ultimate parent entities (if applicable); inadequate or failed internal or external processes or systems; acts of war, other acts of hostility, terrorist acts and responses to those acts, or other such events; geopolitical unpredictability; risks relating to sustainability and climate change, including the Group's ability along with the government and other stakeholders to manage and mitigate the impacts of climate change effectively; changes in laws, regulations, practices and accounting standards or taxation, including as a result of the UK's exit from the EU; changes to regulatory capital or liquidity requirements (including regulatory measures to restrict distributions to address potential capital and liquidity stress) and similar contingencies outside the control of the Group or any of the Group's immediate or ultimate parent entities (if applicable); 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 laws, 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 Group's directors, management or employees including industrial action; changes in the Group's ability to develop sustainable finance products and the Group's capacity to measure the ESG impact from its financing activity, which may affect the Group's ability to achieve its climate ambition; changes to the Group's post-retirement defined benefit scheme obligations; 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 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 Bank plc with the US Securities and Exchange Commission (the SEC), which is available on the SEC's website at www.sec.gov, for a discussion of certain factors and risks. Lloyds Banking Group plc may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the SEC, Lloyds Banking Group plc annual reviews, half-year announcements, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds Banking Group plc to third parties, including financial analysts. 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 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 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.

## CONTACTS

For further information please contact:


**INVESTORS AND ANALYSTS**

Douglas Radcliffe
Group Investor Relations Director
020 7356 1571
douglas.radcliffe@lloydsbanking.com

Edward Sands
Director of Investor Relations
020 7356 1585
edward.sands@lloydsbanking.com

Eileen Khoo
Director of Investor Relations
07385 376435
eileen.khoo@lloydsbanking.com

Nora Thoden
Director of Investor Relations - ESG
020 7356 2334
nora.thoden@lloydsbanking.com

**CORPORATE AFFAIRS**

Grant Ringshaw
External Relations Director
020 7356 2362
grant.ringshaw@lloydsbanking.com

Matt Smith
Head of Media Relations
020 7356 3522
matt.smith@lloydsbanking.com



Copies of this News Release may be obtained from:
Investor Relations, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN
The statement can also be found on the Group's website – www.lloydsbankinggroup.com

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