Bank of Scotland plc

Interim Management Report

For the half-year to 30 June 2010

Member of the Lloyds Banking Group

FORWARD LOOKING STATEMENTS

This announcement contains forward looking statements with respect to the business, strategy and plans of Bank of Scotland plc, its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Bank of Scotland Group's or the Bank of Scotland Group's management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. The Bank of Scotland Group's actual future business, strategy, plans and/or results may differ materially from those expressed or implied in these forward looking statements as a result of a variety of risks, uncertainties and other factors, including, without limitation, UK domestic and global economic and business conditions; the ability to derive cost savings and other benefits, as well as the ability to integrate the HBOS Group successfully into the Lloyds Banking Group; the ability to access sufficient funding to meet the Bank of Scotland Group's liquidity needs; changes to Bank of Scotland plc's, Lloyds TSB Bank plc's or the Lloyds Banking Group plc's credit ratings; risks concerning borrower or counterparty credit quality; market related trends and developments; changing demographic trends; changes in customer preferences; changes to regulation, accounting standards or taxation, including changes to regulatory capital or liquidity requirements; the policies and actions of governmental or regulatory authorities in the UK, the European Union, or jurisdictions outside the UK, including other European countries and the US; the ability to attract and retain senior management and other employees; requirements or limitations imposed on the Bank of Scotland Group as a result of HM Treasury's investment in Lloyds Banking Group plc; the ability to complete satisfactorily the disposal of certain assets as part of the Lloyds Banking Group's EU state aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations; exposure to regulatory scrutiny, legal proceedings or complaints, actions of competitors and other factors. Please refer to Lloyds Banking Group plc's latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of such factors together with examples of forward looking statements. The forward looking statements contained in this announcement are made as at the date of this announcement, and the Bank of Scotland Group undertakes no obligation to update any of its forward looking statements.

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FINANCIAL REVIEW

Results

The consolidated income statement on page 7 shows a loss before tax of £1,458 million and a loss attributable to equity shareholders of £1,343 million for the half-year ended 30 June 2010.

Principal activities

Bank of Scotland plc (the Bank) and its subsidiaries (together, the Group) provides a range of banking and financial services through branches and offices in the UK and overseas.

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

Corporate structure

On 1 January 2010 Lloyds Banking Group plc changed its group corporate structure by transferring its holding in HBOS plc, the immediate parent of the Group, to Lloyds TSB Bank plc. Following this move Lloyds TSB Bank plc became the immediate parent of HBOS plc.

This transfer followed a review by management of the structure of Lloyds Banking Group and a programme to develop and implement a legal entity structure that is efficient from a financial, regulatory and capital perspective.

Review of results

The Group recorded a loss before tax of £1,458 million in the six months to 30 June 2010. This represented a reduction of £10,924 million or 88 per cent when compared to the loss before tax of £12,382 million (restated – see note 2) recorded for the six months ended 30 June 2009. This improvement was principally the result of a reduction in the impairment charge, which decreased by £6,719 million or 55 per cent to £5,595 million, an increase in the trading surplus of £3,615 million and a lower share of losses from joint ventures and associates.

Net interest income increased by £1,974 million or 83 per cent to £4,352 million as margins improved with more mortgage customers moving onto, and staying on, standard variable rate terms and significantly lower interest expense on debt securities in issue and repurchase (repo) transactions.

Net trading income increased by £1,139 million from a loss of £805 million to a gain of £334 million as a result of gains arising on assets and liabilities held at fair value reflecting movement in market prices. Other operating income increased as a result of the gain on capital transactions of £419 million recorded following a liability management exercise. Net fee and commission income remained broadly stable decreasing by just £4 million to £525 million.

Operating expenses decreased 7 per cent or £188 million to £2,354 million, principally attributable to savings in staff costs of £161 million due to a reduction in staff numbers; partially offset by impairment of tangible fixed assets relating to integration activities.

Impairment losses decreased by £6,719 million or 55 per cent to £5,595 million as a result of improved market conditions in line with expectations and generally reflect the stabilising economic environment although continued high levels of impairment charges were recognised in Ireland.

FINANCIAL REVIEW (continued)

The Group recorded a profit of £49 million in respect of the sale of various businesses during the period.

Loans and advances to customers decreased by £20,510 million, or 5 per cent, to £419,028 million at 30 June 2010. Loans and advances to customers before impairment provisions decreased by £17,798 million or 4 per cent to £443,012 million as customers continued to reduce their personal indebtedness and pay down unsecured debts. This movement includes the transfer during the period of certain elements of the Group's hire purchase – asset finance portfolio to Black Horse Finance Limited, another Lloyds Banking Group company. Customer deposits increased by £2,999 million, or 1 per cent, to £268,970 million. This includes an increase of £7,487 million in repos and a decrease of £3,185 million attributable to the sale of BOS International Limited to another Lloyds Banking Group company. As a result of these movements the customer loans to deposits ratio decreased from 165 per cent at 31 December 2009 to 156 per cent at 30 June 2010.

Loans and advances to banks decreased from £91,259 million to £74,796 million, while deposits from banks decreased from £174,338 million to £139,463 million, principally as a result of transactional activity with Lloyds TSB Bank plc.

Debt securities in issue decreased by £10,727 million to £108,430 million as the Group repositioned its funding through transactions with other Lloyds Banking Group subsidiaries.

Shareholders' equity has decreased by £647 million to £21,500 million due principally to the loss recorded in the six month period ended 30 June 2010 partially offset by the issuance of shares by the Bank to HBOS plc, valuation gains on available-for-sale financial assets and gains recorded on cash flow hedges. The Bank currently has no distributable reserves.

The Group's total capital resources for regulatory capital purposes have decreased by £1,265 million or 3 per cent to £35,773 million. The fall is largely due to losses incurred during the period. Total risk-weighted assets have decreased by £26,696 million or 8 per cent to £296,170 million due to a combination of lower asset volumes and reductions in average risk weights. This has resulted in the total capital ratio increasing by 60 basis points to 12.1 per cent, while the core tier 1 ratio and tier 1 capital ratio have increased by 40 basis points and 20 basis points respectively to 7.4 per cent and 7.6 per cent respectively.

PRINCIPAL RISKS AND UNCERTAINTIES

The principal risks and uncertainties facing the Group in the second half of 2010 are:

Economy

During the first half of 2010, the global economy has continued to recover from the deepest recession in 80 years. The UK economy has grown in line with its long-term average during the first half of 2010, however consumer confidence has fallen back slightly and the recent rise in house prices has stalled. Nevertheless, some key drivers of the Group's performance have continued to perform better than expected, with UK corporate insolvencies falling in the last three quarters of 2009 and, related to that, employment has held up relatively well. Although the Group expects corporate insolvencies to rise slightly further, the failure rate should peak at around just one third the level reached in the 1990's recession, and consequently unemployment may rise slightly but should already be close to its peak. The Group's central scenario is for the modest recovery in the UK to continue – the projection of 1.3 per cent GDP growth in 2010 and just over 2 per cent in 2011 is close to the consensus. However the risks to this scenario are skewed to the downside. The extent to which simultaneous fiscal tightening across Europe might undermine global and UK growth is unclear. A 'double-dip' scenario – a second recession following closely the one that the economy is just emerging from – would result in further significant increases in corporate failures and unemployment into 2011. Residential and commercial property would suffer a second period of falling prices, tenant defaults would increase and central banks would have limited ability to cushion the downturn.

Liquidity and funding

During the first half of 2010 liquidity and funding has remained a key area of focus for the Group and the industry as a whole. The Group's ability to successfully fund its balance sheet is dependent on the continued functioning of the money and capital markets; successful right-sizing of the Lloyds Banking Group balance sheet; the repayment of public facilities by Lloyds Banking Group in accordance with the terms agreed; limited further deterioration in the UK's, Lloyds Banking Group plc's and the Bank's credit rating; and no significant or sudden withdrawal of deposits. The Bank is dependent upon its ultimate parent, Lloyds Banking Group plc, and Lloyds TSB Bank plc to provide capital and funding.

The Group is reliant on both short-term wholesale funding and public and central bank facilities to support its balance sheet. During the first half of 2010, Lloyds Banking Group has chosen to repay a portion of the amounts drawn from these facilities, replacing them with debt issuance in the public and private markets as the balance sheet is right-sized. A shortening in maturity risk appetite of investors in the second quarter of 2010 has led to reduced short-term money market liquidity, however, Lloyds Banking Group has funded itself successfully with no material change its short-term maturity profile.

Lloyds Banking Group has also entered into a number of EU state aid related obligations to achieve reductions in certain parts of its balance sheet by the end of 2014. The requirement to meet this deadline may result in Lloyds Banking Group having to provide funding to support these asset reductions and/or disposals which may also result in a lower price being achieved.

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

Credit risk

The Group has seen a significant reduction in impairments in the first half of 2010, following the stabilisation of the wholesale portfolios and good retail affordability and performance; its total impairment charge levels have reduced in the first half of 2010 compared with both the first half of 2009 and the second half of 2009.

The Group remains cautious about the economic outlook, and in particular a 'double dip' recession is a key downside risk for the UK economy and consequently the Group. Notwithstanding the improved performance in the first half of the year, the Group's wholesale portfolios continue to be closely monitored, with robust and proactive risk management in place to help ensure timely risk mitigating actions. The Group retains some material single obligor concentrations on weaker credits, which are likely to continue to show vulnerability with the potential for increased impairments. Whilst a high percentage of real estate and real estate related investment lending is in the wholesale portfolio, sustainability of cash flow has been key to the relative resilience seen in the investment market to date. However, the portfolio remains sensitive to a rise in tenant defaults which could impact debt service capability. This could be exacerbated by price falls in the secondary and tertiary assets held in the real estate investment lending portfolio.

The Group expects further stress within certain portfolios as domestically focused names suffer the effects of reduced public sector expenditure, tighter working capital requirements and a weak recovery in demand. Under the Group's economic assumptions, 2010 is expected to continue to be difficult for these portfolios. Some early warning signs of asset deterioration are already evident in some portfolios (for example increasing delinquencies and adverse credit risk rating migrations). Refinancing will be a key issue with significant maturities due in the next few years, especially in the Group's real estate and real estate related portfolios as well as for leveraged loans.

Concerns also exist over the outlook for the Eurozone following the Greek crisis and subsequent contagion to Spain, Portugal and Ireland. This adds further uncertainty in asset valuations and could impede asset disposals. However, the Group has limited exposure to the weaker Eurozone economies and is monitoring them closely.

Market risk

Market uncertainty has continued during the first half of 2010. Equity markets have been volatile. Concerns about the scale of deficits in Ireland and southern European countries resulted in increased credit spreads in the areas affected, and fears of contagion impacted the Euro and widened spreads between official and interbank interest rates. The environment will continue to be uncertain and the Group will continue to take opportunities to reduce exposures where appropriate.

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

Legal and regulatory risk

The Financial Services Act 2010 received Royal Assent on 8 April 2010. The Act establishes a new consumer financial education body, amends the Financial Services and Markets Act to provide the FSA with a new financial stability statutory objective, gives the FSA powers to make rules on remuneration arrangements, short selling, living wills, consumer redress schemes, and extends its enforcement powers. In addition, the UK Government has announced plans to give the Bank of England macro- and micro-prudential supervisory powers over UK regulated banks and to create a new Customer Protection and Markets Authority to take over the FSA's conduct of business supervisory role, together with certain other duties from the FSA and other bodies. The Act and the Bank of England's proposed new supervisory powers could have significant ramifications for the FSA's approach to regulating the Group, particularly regarding the setting of capital and liquidity requirements and also conduct of business regulations.

Evolving capital and liquidity requirements continue to be monitored by the Group. In December 2009, the Basel Committee on Banking Supervision proposed a capital and liquidity reform package (Basel III) which would present a number of challenges to the Group. The UK Government has announced that a bank levy will be imposed on large UK banks and foreign banks operating in the UK from 1 January 2011 and has appointed an independent commission to review possible structural reforms to the banking system. The Treasury Select Committee has also announced its intention to conduct an examination of competition in retail banking and the future of free banking. It is too early to quantify the potential impact of these developments on the Group.

The Group may also be subject to legal and regulatory proceedings and Financial Ombudsman and other complaints brought against it in the UK High Court and elsewhere, and in jurisdictions outside the UK. The outcome of any investigation, proceeding or complaint is inherently uncertain.

A number of changes in regulation will come into effect in the short term that will affect the Group including implementation of new reverse stress testing requirements, the 31 December 2010 delivery deadline for the Single Customer View implementation and the EU's proposed changes to bank remuneration rules. The Group may also be subject to increased EU supervisory influence via the Committee of European Banking Supervisors, the Committee of European Insurance and Occupational Pensions Supervisors and the Committee of European Securities Regulators. From 2011 these bodies will become new EU Supervisory Authorities - the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority respectively.

The Group is currently assessing the impacts of these regulatory developments and is working closely with the Tripartite Authorities and industry associations so that it continues to identify and respond to regulatory and legislative changes.

Customer treatment

The FSA continues to drive focus on conduct of business activities and has established a new approach to supervision of Conduct Risk, particularly in relation to retail customers, in which they will seek to place greater emphasis on product governance. The FSA also published its review of Complaints Handling in Banking Groups in April 2010 in which they have identified a number of concerns across the industry and has indicated that they will complete a thematic review on the sale of packaged current accounts in the third quarter of 2010.

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

People

In the first half of 2010, as integration has continued, the Group has proactively managed the relationship with staff. The Group has published revised proposals to harmonise employee terms and conditions across the Group and is consulting with the various representative unions.

State aid

Lloyds Banking Group has made a number of undertakings to HM Treasury regarding both capital and funding support, including additional lending to certain mortgage and business sectors, corporate governance and staff remuneration.

In addition Lloyds Banking Group is subject to European state aid obligations in line with the restructuring plan agreed with HM Treasury and the EU College of Commissioners in November 2009, which is designed to support the long term viability of the Lloyds Banking Group and address any competition distortions arising from the benefits of state aid.

CONDENSED INTERIM FINANCIAL STATEMENTS (unaudited)

CONSOLIDATED INCOME STATEMENT

	Note	**Half-year to 30 June 2010 £ million**	Half-year to 30 June 2009[1] £ million
Interest and similar income		**9,194**	10,091
Interest and similar expense		**(4,842)**	(7,713)
Net interest income		**4,352**	2,378
Fee and commission income		**682**	639
Fee and commission expense		**(157)**	(110)
Net fee and commission income		**525**	529
Net trading income		**334**	(805)
Other operating income		**1,288**	970
Other income	3	**2,147**	694
Total income		**6,499**	3,072
Operating expenses	4	**(2,354)**	(2,542)
Trading surplus		**4,145**	530
Impairment	5	**(5,595)**	(12,314)
Share of results of joint ventures and associates		**(57)**	(502)
Profit (loss) on sale of businesses	6	**49**	(96)
Loss before tax		**(1,458)**	(12,382)
Taxation	7	**137**	2,793
Loss for the period		**(1,321)**	(9,589)
Profit attributable to non-controlling interests		**22**	5
Loss attributable to equity shareholders		**(1,343)**	(9,594)
Loss for the period		**(1,321)**	(9,589)

[1] Restated – see note 2.

CONDENSED INTERIM FINANCIAL STATEMENTS (unaudited)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Half-year to 30 June 2010 £ million	Half-year to 30 June 2009[1] £ million
Loss for the period	**(1,321)**	(9,589)
Other comprehensive income:		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value	**224**	1,180
Transferred to income statement in respect of disposals	**(112)**	15
Transferred to income statement in respect of impairment	**38**	1,459
Taxation	**(44)**	(729)
	106	1,925
Movement in cash flow hedging reserve:		
Effective portion of changes in fair value taken to other comprehensive income	**(413)**	(1,855)
Net transfers to the income statement	**690**	1,984
Taxation	**(77)**	(36)
	200	93
Currency translation differences	**9**	(45)
Other comprehensive income for the period, net of tax	**315**	1,973
Total comprehensive income for the period	**(1,006)**	(7,616)
Total comprehensive income attributable to non-controlling interests	**22**	5
Total comprehensive income attributable to equity shareholders	**(1,028)**	(7,621)
Total comprehensive income for the period	**(1,006)**	(7,616)

[1] Restated – see note 2.

CONDENSED INTERIM FINANCIAL STATEMENTS (unaudited)

CONSOLIDATED BALANCE SHEET

	Note	**As at 30 June 2010 £ million**	As at 31 Dec 2009 £ million
Assets			
Cash and balances at central banks		**2,394**	2,905
Items in course of collection from banks		**839**	534
Trading and other financial assets at fair value through profit or loss	8	**28,646**	27,867
Derivative financial instruments		**35,999**	30,222
Loans and receivables:			
Loans and advances to banks		**74,796**	91,259
Loans and advances to customers	9	**419,028**	439,538
Debt securities		**26,686**	31,211
		520,510	562,008
Available-for-sale financial assets		**17,035**	21,565
Investment properties		**480**	30
Investments in joint ventures and associates		**391**	423
Goodwill		**376**	376
Other intangible assets		**68**	91
Tangible fixed assets		**4,548**	4,903
Current tax recoverable		**671**	745
Deferred tax assets		**5,232**	5,153
Other assets		**2,239**	4,522
Total assets		**619,428**	661,344

CONDENSED INTERIM FINANCIAL STATEMENTS (unaudited)

CONSOLIDATED BALANCE SHEET (continued)

Equity and liabilities	Note	As at 30 June 2010 £ million	As at 31 Dec 2009[1] £ million
Liabilities			
Deposits from banks		**139,463**	174,338
Customer deposits		**268,970**	265,971
Items in course of transmission to banks		**525**	495
Trading and other financial liabilities at fair value through profit or loss		**24,203**	27,372
Derivative financial instruments		**33,953**	27,452
Notes in circulation		**999**	981
Debt securities in issue	12	**108,430**	119,157
Other liabilities		**5,012**	6,291
Current tax liabilities		**15**	3
Other provisions		**237**	247
Subordinated liabilities	13	**15,903**	16,684
Total liabilities		**597,710**	638,991
Equity			
Share capital	14	**5,847**	5,847
Share premium account	14, 15	**27,065**	26,684
Other reserves	15	**217**	(517)
Retained profits	15	**(11,629)**	(9,867)
Shareholders' equity		**21,500**	22,147
Non-controlling interests		**218**	206
Total equity		**21,718**	22,353
Total equity and liabilities		**619,428**	661,344

[1] Restated – see note 2.

CONDENSED INTERIM FINANCIAL STATEMENTS (unaudited)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Non-controlling interests £ million	Total £ million
Balance at 1 January 2009:						
As previously stated	12,342	(4,694)	4,013	11,661	264	11,925
Prior year adjustment (note 2)	–	1,065	(1,065)	–	–	–
Restated	12,342	(3,629)	2,948	11,661	264	11,925
Total comprehensive income[1]	–	1,973	(9,594)	(7,621)	5	(7,616)
Dividends	–	–	–	–	(11)	(11)
Issue of ordinary shares	16,351	–	–	16,351	–	16,351
Repayment of capital to non-controlling interests	–	–	–	–	(23)	(23)
Balance at 30 June 2009[1]	28,693	(1,656)	(6,646)	20,391	235	20,626
Total comprehensive income[1]	–	1,076	(3,158)	(2,082)	8	(2,074)
Dividends	–	–	–	–	(1)	(1)
Issue of ordinary shares	3,838	–	–	3,838	–	3,838
Capital redemption reserve	–	63	(63)	–	–	–
Extinguishment of non-controlling interests	–	–	–	–	(36)	(36)
Balance at 31 December 2009[1]	32,531	(517)	(9,867)	22,147	206	22,353
Total comprehensive income	**–**	**315**	**(1,343)**	**(1,028)**	**22**	**(1,006)**
Dividends	**–**	**–**	**–**	**–**	**(6)**	**(6)**
Issue of ordinary shares	**381**	**–**	**–**	**381**	**–**	**381**
Capital redemption reserve	**–**	**419**	**(419)**	**–**	**–**	**–**
Extinguishment of non-controlling interests	**–**	**–**	**–**	**–**	**(4)**	**(4)**
Balance at 30 June 2010	**32,912**	**217**	**(11,629)**	**21,500**	**218**	**21,718**

[1] Restated – see note 2.

CONDENSED INTERIM FINANCIAL STATEMENTS (unaudited)

CONSOLIDATED CASH FLOW STATEMENT

	Half-year to 30 June 2010 £ million	Half-year to 30 June 2009[1] £ million
Loss before tax	**(1,458)**	(12,382)
Adjustments for:		
Change in operating assets	**6,635**	3,177
Change in operating liabilities	**(40,502)**	1,652
Non-cash and other items	**3,509**	1,580
Tax (paid) received	**(14)**	82
Net cash used in operating activities	**(31,830)**	(5,891)
Cash flows from investing activities		
Purchase of available-for-sale financial assets	**(563)**	(7,261)
Proceeds from sale and maturity of available-for-sale financial assets	**4,413**	8,250
Purchase of fixed assets	**(447)**	(87)
Proceeds from sale of fixed assets	**277**	46
Acquisition of businesses, net of cash acquired	**(39)**	(84)
Disposal of businesses, net of cash disposed	**57**	130
Net cash provided by investing activities	**3,698**	994
Cash flows from financing activities		
Dividends paid to non-controlling interests	**(6)**	(11)
Interest paid on subordinated liabilities	**(206)**	(485)
Proceeds from issue of ordinary shares	**–**	16,351
Repayment of subordinated liabilities	**–**	(903)
Repayment of capital to non-controlling interests	**–**	(23)
Net cash (used in) provided by financing activities	**(212)**	14,929
Effects of exchange rate changes on cash and cash equivalents	**36**	74
Change in cash and cash equivalents	**(28,308)**	10,106
Cash and cash equivalents at beginning of period	**76,391**	7,986
Cash and cash equivalents at end of period	**48,083**	18,092

[1] Restated – see note 2.

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

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1. Basis of preparation

The directors consider that it is appropriate to continue to adopt the going concern basis in preparing the condensed interim financial statements. In reaching this assessment, the directors have considered projections for the Group's capital and funding position and have had regard to the factors set out in Principal Risks and Uncertainties: Liquidity and funding on page 3. The Bank is dependent upon its ultimate parent, Lloyds Banking Group plc, and Lloyds TSB Bank plc to provide capital and funding.

2. Accounting policies, presentation and estimates

These condensed interim financial statements as at and for the half-year to 30 June 2010 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and with International Accounting Standard (IAS) 34 *Interim Financial Reporting*, as adopted by the European Union. 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 2009 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Copies of the 2009 annual report and accounts can be found on the Lloyds Banking Group's website, www.lloydsbankinggroup.com, or are available upon request from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.

Accounting policies

The accounting policies are consistent with those applied by the Group in its 2009 annual report and accounts, except as described below.

During 2010, the International Financial Reporting Interpretations Committee clarified the treatment of amounts previously recognised in equity in respect of assets that were transferred from the available-for-sale category to the loans and receivables category. When an impairment loss is recognised in respect of such transferred financial assets, the unamortised balance of any available-for-sale reserve that remains in equity should be transferred to the income statement and recorded as part of the impairment loss.

The Group has changed its accounting policy to reflect this clarification. Under the Group's previous accounting policy, when such a transferred financial asset became impaired, not all of the unamortised amounts previously transferred to equity were recycled to the income statement and therefore continued to be accreted over the expected remaining life of the financial asset. The change is applied retrospectively and the effect has been to reduce retained profits and increase available-for-sale reserves by £1,065 million at 1 January 2009; shareholders' equity is unchanged. The effect on the first half of 2009 has been to increase the impairment charge by £937 million (year ended 31 December 2009: increase £937 million); increase net interest income by £78 million (year ended 31 December 2009: increase £186 million); and increase available-for-sale reserve by £618 million (year ended 31 December 2009: increase £512 million). There has been no impact on other income in the first half of 2009 (full year ended 31 December 2009: increase of £39 million). The financial statements and capital ratios have been restated accordingly.

In addition, and as reported in the report and accounts at 31 December 2009, interest and similar income and interest and similar expense have been restated in the half year to 30 June 2009, for certain derivative income amounts available for offset onto a net basis (£1,466 million).

2. Accounting policies, presentation and estimates (continued)

The preparation of interim 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 be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. There have been no significant changes in the basis upon which estimates have been determined, compared to those applied at 31 December 2009.

In accordance with IAS 34, the Group's income tax expense for the six months ended 30 June 2010 is based on the best estimate of the weighted-average annual income tax rate expected for the full financial year. This best estimate does not take into account the impact of changes announced in the June 2010 UK Budget which were not substantively enacted by 30 June 2010.

New accounting pronouncements

The Group has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2010. None of these standards or amendments have had a material impact on these condensed interim financial statements.

(i) IFRS 3 *Business Combinations*. The revised standard continues to require the use of the acquisition method of accounting for business combinations. All payments to purchase a business are to be recorded at fair value at the acquisition date, some contingent payments are subsequently remeasured at fair value through income, goodwill may be calculated based on the parent's share of net assets or it may include goodwill related to the non-controlling interest, and all transaction costs are expensed.

(ii) IAS 27 *Consolidated and Separate Financial Statements*. Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control; any remaining interest in an investee is re-measured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.

(iii) IFRIC 17 *Distributions of Non-cash Assets to Owners*. Provides accounting guidance for non-reciprocal distributions of non-cash assets to owners (and those in which owners may elect to receive a cash alternative).

(iv) Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – 'Eligible Hedged Items'*. Clarifies how the principles underlying hedge accounting should be applied in particular situations.

(v) *Improvements to IFRSs* (issued April 2009). Sets out minor amendments to IFRS standards as part of the annual improvements process.

Future accounting developments

The following pronouncements will be relevant to the Group but are not applicable for the year ending 31 December 2010 and have not been applied in preparing these condensed interim financial statements. The full impact of these accounting changes is currently being assessed by the Group.

2. Accounting policies, presentation and estimates (continued)

(i) IFRS 9 *Financial Instruments*. Replaces those parts of IAS 39 *Financial Instruments: Recognition and Measurement* dealing with the classification and measurement of financial assets. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument. Available-for-sale financial asset and held-to-maturity categories in the existing IAS 39 will be eliminated.

IFRS 9 is the initial stage of the project to replace IAS 39. Future stages are expected to result in amendments to IFRS 9 to deal with changes to the classification and measurement of financial liabilities, impairment of financial assets measured at amortised cost and hedge accounting. Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39. The effective date of the standard is annual periods beginning on or after 1 January 2013.

(ii) Amendment to IAS 32 *Financial instruments: Presentation – 'Classification of Rights Issues'*. Requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated. The amendment is effective for annual periods beginning on or after 1 February 2010.

(iii) IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*. Clarifies that when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the debtor issuing its own equity instruments to the creditor, a gain or loss is recognised in the income statement representing the difference between the carrying value of the financial liability and the fair value of the equity instruments issued; the fair value of the financial liability is used to measure the gain or loss where the fair value of the equity instruments cannot be reliably measured. The interpretation is effective for annual periods beginning on or after 1 July 2010 and is consistent with the Group's accounting policy.

(iv) *Improvements to IFRSs* (issued May 2010). Sets out minor amendments to IFRS standards as part of the annual improvements process. The effective dates vary on a standard by standard basis but none are effective any earlier than annual periods beginning on or after 1 July 2010.

(v) Amendment to IFRIC 14 *Prepayments of a Minimum Funding Requirement*. Applies when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements and permits such an entity to treat the benefit of such an early payment as an asset. The amendment is effective for annual periods beginning on or after 1 January 2011.

(vi) IAS 24 *Related Party Disclosures*. The revised standard simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities. The revised standard is effective for annual periods beginning on or after 1 January 2011.

At the date of this report, IFRS 9 and Improvements to IFRSs (issued May 2010) are awaiting EU endorsement.

The ultimate parent undertaking, Lloyds Banking Group plc, produces consolidated accounts which set out the basis of the segments through which it manages performance and allocates resources across the consolidated Lloyds Banking Group.

Other matters

No significant events, other than those disclosed within this document, have occurred between 30 June 2010 and the date of approval of these condensed interim financial statements.

3. Other income

	Half-year to 30 June 2010 £m	Half-year to 30 June 2009 £m
Fee and commission income:		
Current account fees	**125**	182
Credit and debit card fees	**112**	125
Other fees and commissions	**445**	332
	682	639
Fee and commission expense	**(157)**	(110)
Net fee and commission income	**525**	529
Net trading income	**334**	(805)
Gains on capital transactions	**419**	62
Other	**869**	908
Other operating income	**1,288**	970
Total other income	**2,147**	694

In March 2010, the Bank redeemed £800 million of preference shares in exchange for the issue of ordinary shares, resulting in a gain of £419 million.

4. Operating expenses

	Half-year to 30 June 2010 £m	Half-year to 30 June 2009 £m
Administrative expenses:		
Staff costs	**1,166**	1,327
Premises and equipment	**236**	178
Other expenses	**443**	463
	1,845	1,968
Depreciation and amortisation:		
Tangible assets	**121**	113
Intangible assets	**13**	16
Operating lease assets	**323**	425
	457	554
Impairment of tangible fixed assets	**52**	–
Goodwill impairment	**–**	20
Total operating expenses	**2,354**	2,542

5. Impairment

	Half-year to 30 June 2010 £m	Half-year to 30 June 2009[1] £m
Impairment losses on:		
Loans and advances to customers	**5,551**	10,053
Debt securities classified as loans and receivables	**1**	828
Impairment losses on loans and receivables (note 10)	**5,552**	10,881
Impairment of available-for-sale financial assets	**43**	1,428
Other credit risk provisions	**–**	5
Total impairment charged to the income statement	**5,595**	12,314

[1] Restated – see note 2.

6. Profit (loss) on sale of businesses

	Half-year to 30 June 2010 £m	Half-year to 30 June 2009 £m
Profit on sale of Employee Equity Solutions business	**21**	–
Profit on sale of BOS International Limited	**16**	–
Profit on sale of Bank of Scotland Portfolio Management Service business	**12**	–
Loss on sale of Bank of Western Australia Limited and St. Andrews Australia Pty Limited	**–**	(96)
	49	(96)

7. Taxation

A reconciliation of the credit that would result from applying the standard UK corporation tax rate to the loss before tax to the tax credit is given below:

	Half-year to 30 June 2010 £m	Half-year to 30 June 2009[1] £m
Loss before tax	**(1,458)**	(12,382)
Tax credit thereon at UK corporation tax rate of 28% (2009: 28%)	**408**	3,467
Factors affecting credit:		
Goodwill impairment	**–**	(3)
Disallowed and non-taxable items	**113**	(33)
Overseas tax rate differences	**(235)**	(111)
Gains exempted or covered by capital losses	**7**	–
Adjustments in respect of previous periods	**(10)**	(23)
Effect of loss in joint ventures and associates	**(16)**	(141)
Tax losses where no deferred tax provided	**(116)**	(347)
Other items	**(14)**	(16)
Tax credit	**137**	2,793

[1] Restated – see note 2.

8. Trading and other financial assets at fair value through profit or loss

	As at 30 June 2010 £m	As at 31 Dec 2009 £m
Trading assets	**28,235**	27,611
Other financial assets at fair value through profit or loss:		
Debt securities	**11**	4
Equity shares	**400**	252
	411	256
	28,646	27,867

9. Loans and advances to customers

	As at 30 June 2010 £m	As at 31 Dec 2009 £m
Agriculture, forestry and fishing	**800**	772
Energy and water supply	**995**	1,129
Manufacturing	**5,310**	6,836
Construction	**10,224**	11,169
Transport, distribution and hotels	**23,307**	21,496
Postal and telecommunications	**1,419**	1,449
Property companies	**60,486**	65,144
Financial, business and other services	**69,484**	72,076
Personal:		
Mortgages	**249,182**	252,745
Other	**15,040**	19,518
Lease financing	**4,682**	4,990
Hire purchase	**2,083**	3,486
	443,012	460,810
Allowance for impairment losses on loans and advances (note 10)	**(23,984)**	(21,272)
Total loans and advances to customers	**419,028**	439,538

Loans and advances to customers include advances securitised under the Group's securitisation and covered bond programmes. Further details are given in note 11.

10. Allowance for impairment losses on loans and receivables

	Half-year to 30 June 2010 £m	Year ended 31 Dec 2009 £m
Balance at 1 January	**23,187**	11,616
Exchange and other adjustments	**3**	(10)
Advances written off	**(2,877)**	(7,494)
Recoveries of advances written off in previous years	**29**	36
Unwinding of discount	**(153)**	(391)
Charge for the half-year to 30 June	**5,552**	10,881
Charge for the half-year to 31 December		8,549
Charge to the income statement	**5,552**	19,430
Disposal of subsidiary undertakings	**(89)**	–
Balance at end of period	**25,652**	23,187
In respect of:		
Loans and advances to customers	**23,984**	21,272
Debt securities classified as loans and receivables	**1,668**	1,915
Balance at end of period	**25,652**	23,187

11. Securitisation and covered bonds

The Group's principal securitisation and covered bond programmes, together with the balances of the loans subject to notes in issue at 30 June 2010, are listed below.

	As at 30 June 2010		As at 31 December 2009	
Securitisation programmes	**Gross assets securitised £m**	**Notes in issue £m**	Gross assets securitised £m	Notes in issue £m
UK residential mortgages	**104,497**	**82,632**	104,257	95,228
US residential mortgage-backed securities	**7,971**	**7,997**	7,897	7,897
Irish residential mortgages	**5,889**	**6,008**	6,522	6,585
Credit card receivables	**4,913**	**2,168**	5,155	2,699
Dutch residential mortgages	**4,275**	**4,364**	4,812	4,834
Personal loans	**3,327**	**2,613**	3,730	2,613
Commercial loans	**813**	**811**	928	976
Motor vehicle loans	**338**	**361**	443	470
	132,023	**106,954**	133,744	121,302
Less held by the Group		**(76,204)**		(87,359)
Total securitisation programmes (note 12)		**30,750**		33,943
Covered bond programmes				
Residential mortgage-backed	**58,407**	**47,968**	61,537	49,644
Social housing loan-backed	**3,363**	**2,543**	3,407	2,976
	61,770	**50,511**	64,944	52,620
Less held by the Group		**(22,361)**		(23,060)
Total covered bond programmes (note 12)		**28,150**		29,560
Total securitisations and covered bond programmes		**58,900**		63,503

Securitisation programmes

Loans and advances to customers and debt securities classified as loans and receivables include advances securitised under the Group's securitisation programmes, the majority of which have been sold by subsidiary companies to bankruptcy remote special purpose entities (SPEs). As the SPEs are funded by the issue of debt on terms whereby the majority of the risks and rewards of the portfolio are retained by the subsidiary, the SPEs are consolidated fully and all of these loans are retained on the Group's balance sheet, with the related notes in issue included within debt securities in issue. In addition to the SPEs detailed above the Group sponsors two conduit programmes, Grampian and Landale.

Covered bond programmes

Certain loans and advances to customers have been assigned to bankruptcy remote limited liability partnerships to provide security to issues of covered bonds by the Group. The Group retains all of the risks and rewards associated with these loans and the partnerships are consolidated fully with the loans retained on the Group's balance sheet; the related covered bonds in issue included within debt securities in issue.

Cash deposits of £24,205 million (31 December 2009: £24,271 million) held by the Group are restricted in use to repayment of the debt securities issued by the SPEs, covered bonds issued by Bank of Scotland plc and other legal obligations.

11. Securitisation and covered bonds (continued)

The Group has purchased the loan notes in issue relating to certain issuances for £98,565 million (31 December 2009: £110,419 million); the mortgage and other assets securitised through these transactions were £117,844 million (31 December 2009: £129,900 million). These transactions do not lead to any derecognition of the assets as the Group has retained all of the risks and rewards associated with the assets.

12. Debt securities in issue

	As at 30 June 2010 £m	As at 31 Dec 2009 £m
Certificates of deposit	**4,746**	6,413
Medium-term notes	**30,295**	36,455
Covered bonds (note 11)	**28,150**	29,560
Commercial paper	**14,489**	12,786
Securitisation notes (note 11)	**30,750**	33,943
	108,430	119,157

Included within commercial paper above is £11,230 million (31 December 2009: £9,330 million) issued by the Grampian conduit and £107 million (31 December 2009: £138 million) issued by the Landale conduit.

13. Subordinated liabilities

The movement in subordinated liabilities during the period was as follows:

	Half-year to 30 June 2010 £m
At 1 January 2010	**16,684**
Repurchases and redemptions during the period	**(800)**
Foreign exchange and other movements	**19**
At 30 June 2010	**15,903**

The Group redeemed £800 million of preference shares in exchange for the issue of ordinary shares to its immediate parent, HBOS plc. This transaction gave rise to the transfer of £419 million from the Bank's distributable reserves to the capital redemption reserve (note 15).

There were no issuances of subordinated debt during the period.

14. Share capital

During the period the Bank issued 381,026 £0.25 ordinary shares to HBOS plc at £1,000 per share creating £95,257 of share capital and £381 million of share premium.

15. Reserves

		Other reserves				
	Share premium £m	Available-for-sale reserve £m	Cash flow hedging reserve £m	Merger and other reserves £m	Total £m	Retained profits £m
At 1 January 2010:						
As previously stated	**26,684**	**(2,972)**	**(839)**	**1,717**	**(2,094)**	**(8,290)**
Prior year adjustment[1]	**–**	**1,577**	**–**	**–**	**1,577**	**(1,577)**
Restated	**26,684**	**(1,395)**	**(839)**	**1,717**	**(517)**	**(9,867)**
Issue of ordinary shares	**381**	**–**	**–**	**–**	**–**	**–**
Redemption of preference shares	**–**	**–**	**–**	**419**	**419**	**(419)**
Loss for the period	**–**	**–**	**–**	**–**	**–**	**(1,343)**
Change in fair value of available-for-sale assets (net of tax)	**–**	**160**	**–**	**–**	**160**	**–**
Change in fair value of hedging derivatives (net of tax)	**–**	**–**	**(297)**	**–**	**(297)**	**–**
Transfers to income statement (net of tax)	**–**	**(54)**	**497**	**–**	**443**	**–**
Exchange and other adjustments	**–**	**–**	**–**	**9**	**9**	**–**
At 30 June 2010	**27,065**	**(1,289)**	**(639)**	**2,145**	**217**	**(11,629)**

[1] See note 2.

16. Contingent liabilities and commitments

	As at 30 June 2010 £m	As at 31 Dec 2009 £m
Contingent liabilities		
Acceptances and endorsements	**2**	5
Other:		
Other items serving as direct credit substitutes	**105**	99
Performance bonds and other transaction-related contingencies	**534**	1,251
	639	1,350
Total contingent liabilities	**641**	1,355
Commitments		
Documentary credits and other short-term trade related transactions	**40**	69
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers	**6,240**	6,188
Other commitments	**26,178**	30,130
	32,418	36,318
1 year or over original maturity	**13,651**	17,665
Total commitments	**46,109**	54,052

17. Capital ratios

	As at 30 June 2010 £m	As at 31 Dec 2009[1] £m
Capital resources		
Core tier 1		
Ordinary share capital and reserves	**21,500**	22,147
Available-for-sale revaluation reserve	**1,289**	1,395
Cash flow hedging reserve	**639**	839
Other items	**235**	150
	23,663	24,531
Deductions from core tier 1		
Goodwill and other intangible assets	**(472)**	(565)
Excess expected loss	**(879)**	(920)
Other deductions	**(434)**	(556)
	(1,785)	(2,041)
Core tier 1 capital	**21,878**	22,490
Preference share capital	**–**	800
Innovative tier 1 capital	**698**	698
Total tier 1 capital	**22,576**	23,988
Tier 2		
Available-for-sale revaluation reserve in respect of equities	**240**	22
Undated subordinated debt	**5,196**	5,206
Eligible provisions	**1,728**	1,669
Dated subordinated debt	**8,456**	8,691
Deductions from tier 2		
Excess expected loss	**(879)**	(920)
Other deductions	**(434)**	(556)
Total tier 2 capital	**14,307**	14,112
Supervisory deductions		
Unconsolidated investments	**(1,110)**	(1,062)
Total capital resources	**35,773**	37,038
Risk-weighted assets[2]	**296,170**	322,866
Core tier 1 ratio[2]	**7.4%**	7.0%
Tier 1 capital ratio[2]	**7.6%**	7.4%
Total capital ratio[2]	**12.1%**	11.5%

[1] Restated to reflect a prior year adjustment to available-for-sale revaluation reserve (see note 2).

[2] Outside the scope of PricewaterhouseCoopers LLP's independent review report.

18. Legal and regulatory matters

Interchange fees

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

Unarranged overdraft charges

In April 2007, the OFT commenced an investigation into the fairness of personal current accounts and unarranged overdraft charges. At the same time, it commenced a market study into wider questions about competition and price transparency in the provision of personal current accounts.

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

The OFT however continued to discuss its concerns in relation to the personal current account market with the banks, consumer groups and other organisations under the auspices of its Market Study into personal current accounts. In October 2009, the OFT published voluntary initiatives agreed with the industry and consumer groups to improve transparency of the costs and benefits of personal current accounts and improvements to the switching process. On 16 March 2010 the OFT published a further update announcing several further voluntary industry wide initiatives to improve a customer's ability to control whether they used an unarranged overdraft and to assist those in financial difficulty. However, in light of the progress it noted in the unarranged overdraft market since July 2007 and the progress it expects to see over the next two years, it has decided to take no further action at this time and will review the unarranged overdraft market again in 2012.

18. Legal and regulatory matters (continued)

Payment protection insurance

In January 2009, the UK Competition Commission (Competition Commission) completed its formal investigation into the supply of Payment Protection Insurance (PPI) services (except store card PPI) to non-business customers in the UK and published its final report setting out its remedies including a prohibition on the active sale of PPI by a distributor to a customer within seven days of the distributor's sale of credit to that customer. Prior to this the Group had made the commercial decision to sell only regular monthly premium PPI to its personal loan customers. Recently the Group ceased to offer PPI products to customers although some existing applications will be honoured for a limited period.

On 16 October 2009, the Competition Appeal Tribunal referred the proposed prohibition back to the Competition Commission. On 14 May 2010, the Competition Commission published its provisional decision retaining in almost all material aspects the proposed point of sale prohibition. A final decision is expected in due course and Lloyds Banking Group continues to liaise with the Competition Commission on this issue.

On 1 July 2008, the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. The Group has been working with other industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints.

On 29 September 2009, the FSA issued a consultation paper on PPI complaints handling. The FSA has escalated its regulatory activity in relation to past PPI sales generally and has proposed new guidance on the fair assessment of a complaint and the calculation of redress and a new rule requiring firms to reassess historically rejected complaints. On 9 March 2010, the FSA issued a further consultation paper on this area, the consultation period for which closed on 22 April (the Group has responded to this consultation). The FSA's proposals are materially the same, although it has placed the new rule requiring firms to reassess historically rejected claims on hold for the present. The ultimate impact on the Group of the FSA's complaints handling proposals can only be known on the publication of the FSA's final rules.

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

18. Legal and regulatory matters (continued)

Other legal actions

In the ordinary course of its business, the Group is engaged in discussions with the FSA in relation to a range of conduct of business matters, especially in relation to retail products including packaged bank accounts, mortgages, structured products and pensions. The Group is keen to ensure that any regulatory concerns regarding product governance or contract terms are understood and addressed. The ultimate impact on the Group of these discussions can only be known at the conclusion of such discussions.

In addition, during the ordinary course of business the Group is subject to other threatened and actual legal proceedings, regulatory investigations, regulatory challenges and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases, it will not be possible to form a view, either because the facts are unclear or because further time is needed properly to assess the merits of the matter and no provisions are held against such cases. However the Group does not currently expect the final outcome of any such case to have a material adverse effect on its financial position.

19. Related party transactions

There have been no material changes to the related party transactions during the interim period under review.

There were no material transactions between the Group and HM Treasury during the half-year ended 30 June 2010 that were not made in the ordinary course of business or that are unusual in their nature or conditions.

20. June 2010 Budget statement

A number of the measures announced in the UK Government's June 2010 Budget statement will affect the Group.

The Finance (No. 2) Act 2010 includes legislation to reduce the main rate of corporation tax from 28 per cent to 27 per cent with effect from 1 April 2011. The legislation was substantively enacted in July 2010 and as a result it is expected that the Group's deferred tax asset will reduce by approximately £170 million in the second half of the year resulting in a charge to the income statement of approximately £140 million and a charge to other comprehensive income of approximately £30 million. In addition, following the triggering of relevant tax variation clauses, the reduction in future rental income within the Group's leasing business will result in an additional charge to the income statement which is not expected to be material.

The proposed further reductions in the rate of corporation tax by 1 per cent per annum to 24 per cent by 1 April 2014 are expected to be enacted separately each year starting in 2011. The effect of these further changes upon the Group's deferred tax balances and leasing business cannot be reliably quantified at this stage.

The Government also announced its intention to introduce a bank levy from 1 January 2011. HM Treasury has commenced a consultation to seek views on the detailed implementation of the bank levy prior to drafting legislation to effect the proposed change. At this stage in the process it is not possible to reliably quantify the impact of the introduction of the bank levy on the Group.

21. Events after the balance sheet date

On 5 July 2010, Lloyds Banking Group plc announced that, subject to regulatory approval and certain other conditions, the sale of a portfolio of private equity investments held by the Bank of Scotland Integrated Finance business to a new joint venture. The Group will retain an interest in the private equity investments through a holding of approximately 30 per cent in the joint venture vehicle. The sale is expected to complete in the third quarter of 2010 and values the portfolio at a small premium to the current book value. The impact of the sale on the Group's results is not expected to be material.

22. Ultimate parent undertaking

The Bank's ultimate parent undertaking and controlling party is Lloyds Banking Group plc which is incorporated in Scotland. Lloyds Banking Group plc has published consolidated accounts for the year ended 31 December 2009 and copies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN or downloaded via www.lloydsbankinggroup.com.

23. Other information

The financial information included in this news release does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 December 2009 were approved by the directors on 25 February 2010 and were delivered to the Registrar of Companies following publication on 26 March 2010. The auditors' report on these accounts was unqualified, did not contain an emphasis of matter paragraph and did not include any statements under section 498 of the Companies Act 2006.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

- an indication of important events that have occurred during the six months ended 30 June 2010 and their impact on the condensed interim financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year.

Signed on behalf of the board by

J Eric Daniels
Chief Executive
3 August 2010

Bank of Scotland plc board of directors:
Sir Winfried Bischoff
J Eric Daniels
Sir Julian Horn-Smith
Archie G Kane
Lord Leitch
Glen R Moreno
David L Roberts
T Timothy Ryan, Jr
Martin A Scicluna
G Truett Tate
Tim J W Tookey
Anthony Watson
Helen A Weir

INDEPENDENT REVIEW REPORT TO BANK OF SCOTLAND PLC

Introduction

We have been engaged by the Bank to review the condensed interim financial statements in the interim management report for the six months ended 30 June 2010, which comprise the consolidated income statement, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity, consolidated cash flow statement and related notes. We have read the other information contained in the interim management report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed interim financial statements.

Directors' responsibilities

The interim management report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the interim management report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

As disclosed in note 2, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the European Union. The condensed interim financial statements included in the interim management report have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Bank a conclusion on the condensed interim financial statements in the interim management report based on our review. This report, including the conclusion, has been prepared for and only for the Bank for the purpose of the Disclosure and Transparency Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

INDEPENDENT REVIEW REPORT TO BANK OF SCOTLAND PLC (continued)

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed interim financial statements in the interim management report for the six months ended 30 June 2010 are not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

PricewaterhouseCoopers LLP
Chartered Accountants
Edinburgh
3 August 2010

Notes:

(a) The maintenance and integrity of the Lloyds Banking Group website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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