

# Bank of Scotland plc

Half-Year Management Report

For the half-year to 30 June 2013

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 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 future events and circumstances that will or may occur. 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 factors, including UK domestic and global economic and business conditions; the ability to derive cost savings and other benefits, including as a result of the Lloyds Banking Group's Simplification programme and to access sufficient funding to meet the Bank of Scotland Group's liquidity needs; changes to Bank of Scotland plc's, HBOS plc's, Lloyds TSB Bank plc's or Lloyds Banking Group plc's credit ratings; risks concerning borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability and the impact of any sovereign credit rating downgrade or other sovereign financial issues; market-related risks including changes in interest rates and exchange rates; changing demographic and market related trends; changes in customer preferences; changes to laws, 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 other jurisdictions in which the Group operates, including the US; the implementation of the Recovery and Resolution Directive and banking reform following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; requirements or limitations imposed on Lloyds Banking Group plc, Lloyds TSB Bank plc and the Bank of Scotland Group as a result of HM Treasury's investment in Lloyds Banking Group plc; the ability to satisfactorily dispose of certain assets or otherwise meet the Lloyds Banking Group's EC state aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; the effects of competition and the actions of competitors, including non-bank financial services and lending companies; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints, 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 certain 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

### Principal activities

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

During the half-year to 30 June 2013, the Group earned revenue through interest and fees on a broad range of financial services products including current and savings accounts, personal loans, credit cards and mortgages within the retail market; loans and capital market products to commercial, corporate and asset finance customers; and private banking.

### Review of results

The Group recorded a profit before tax of £1,031 million for the half year to 30 June 2013 compared to a loss before tax of £660 million for the half year to 30 June 2012.

Total income increased by £666 million, or 19 per cent, to £4,164 million for the half year to 30 June 2013 from £3,498 million in the half year to 30 June 2012.

Net interest income decreased by £105 million, or 3 per cent, to £3,296 million in the half year to 30 June 2013 compared to £3,401 million in the same period in 2012. This decrease reflected lower lending volumes; however the net interest margin on relationship lending and similar interest-earning assets improved.

Other income increased by £771 million to £868 million in the half year to 30 June 2013, compared to £97 million in the same period in 2012, largely due to a £253 million improvement in net trading income and a £536 million improvement in other operating income. The improvement in net trading income was driven by the impact of market conditions relative to the half year to 30 June 2012. Net fee and commission income was £18 million, or 5 per cent, lower at £351 million in the half year to 30 June 2013 compared to £369 million in the half-year to 30 June 2012. Fees and commission receivable were £26 million, or 5 per cent, lower at £500 million in the half year to 30 June 2013 compared to £526 million in the same period in 2012. A £3 million increase in credit and debit card fees was more than offset by a £9 million decrease in current account fees and an £18 million decrease in other fees receivable. Fees and commissions payable were £8 million, or 5 per cent, lower at £149 million in the half year to 30 June 2013 compared to £157 million in the same period in 2012. Other operating income was £536 million higher at £264 million in the half year to 30 June 2013 compared to a deficit of £272 million in the same period in 2012, with the deficit in 2012 reflecting losses on sale of assets which were outside of the Group's risk appetite.

Total operating expenses decreased by £338 million, or 18 per cent, to £1,538 million in the half year to 30 June 2013 compared to £1,876 million in the half year to 30 June 2012; partly reflecting a reduced regulatory provisions charge of £52 million in the half year to 30 June 2013 compared to £240 million in the same period in 2012. Excluding regulatory provisions, other operating expenses decreased by £150 million, or 9 per cent, to £1,486 million in the half year to 30 June 2013 compared to £1,636 million in the half year to 30 June 2012 as a result of cost savings arising from the rundown of portfolios of assets which are outside of the Group's risk appetite.

Impairment losses decreased by £687 million, or 30 per cent, to £1,595 million in the half year to 30 June 2013 compared to £2,282 million in the half year to 30 June 2012. The lower charge reflected the substantial reductions in the portfolios of assets which are outside of the Group's risk appetite.

On the balance sheet, total assets were flat at £561,978 million at 30 June 2013, compared to £561,433 million at 31 December 2012, as funds released by the continuing rundown of assets which are outside of the Group's risk appetite were placed with fellow Lloyds Banking Group subsidiaries. Loans and advances to customers decreased by £24,327 million, or 7 per cent, from £329,636 million at 31 December 2012 to £315,309 million at 30 June 2013, reflecting the rundown of assets outside of the Group's risk appetite. Shareholders' equity increased by £831 million, from £18,114 million at 31 December 2012 to £18,945 million at 30 June 2013, principally as a result of the profit attributable to equity shareholders.

The Group's core tier 1 capital ratio increased to 12.2 per cent at the end of June 2013 from 9.8 per cent at the end of December 2012, principally driven by a reduction in risk-weighted assets and the retained profit for the period. The total capital ratio increased to 21.7 per cent from 17.4 per cent at 31 December 2012.

**FINANCIAL REVIEW** (continued)**Capital ratios**

	<b>At 30 June 2013 £m</b>	<b>At 31 Dec 2012 £m</b>
<b>Capital resources</b>		
<b>Core tier 1</b>		
Shareholders' equity per balance sheet	18,945	18,114
Non-controlling interests per balance sheet	20	20
Regulatory adjustments:		
Regulatory adjustments to non-controlling interests	(4)	7
Unrealised reserve on available-for-sale debt securities	14	178
Unrealised reserve on available-for-sale equity investments	(32)	(33)
Cash flow hedging reserve	(1,121)	(1,238)
	<u>17,822</u>	<u>17,048</u>
<b>Less: deductions from core tier 1</b>		
Goodwill	(385)	(374)
Intangible assets	(83)	(92)
50 per cent excess of expected losses over impairment provisions	(164)	(550)
50 per cent of securitisation positions	(15)	(113)
	<u>17,175</u>	<u>15,919</u>
<b>Core tier 1 capital</b>		
Preferred securities <sup>1</sup>	709	700
<b>Less: deductions from tier 1</b>		
50 per cent of material holdings	(36)	(3)
	<u>17,848</u>	<u>16,616</u>
<b>Tier 2</b>		
Undated subordinated debt	4,816	4,776
Dated subordinated debt	7,615	7,530
Unrealised gains on available for sale equity investments	32	33
Eligible provisions	692	942
<b>Less: deductions from tier 2</b>		
50 per cent excess of expected losses over impairment provisions	(164)	(550)
50 per cent of securitisation positions	(15)	(113)
50 per cent of material holdings	(36)	(3)
	<u>12,940</u>	<u>12,615</u>
<b>Total tier 2 capital</b>		
<b>Supervisory deductions</b>		
Unconsolidated investments <sup>2</sup>	–	(64)
Connected lending of a capital nature <sup>2</sup>	(106)	(855)
	<u>(106)</u>	<u>(919)</u>
<b>Total supervisory deductions</b>		
	<u>30,682</u>	<u>28,312</u>
<b>Total capital resources</b>		
Risk-weighted assets	141,236	162,582
Core tier 1 capital ratio	12.2%	9.8%
Tier 1 capital ratio	12.6%	10.2%
Total capital ratio	21.7%	17.4%

<sup>1</sup> Covered by grandfathering provisions issued by FSA.

<sup>2</sup> Comparatives have been represented to reflect the reanalysis of connected lending amounts which were previously incorporated within unconsolidated investments.

## PRINCIPAL RISKS AND UNCERTAINTIES

At present the most significant risks faced by the Group are:

### CREDIT RISK

#### Principal risks

Adverse changes in the credit quality or behaviour of the Group's borrowers and counterparties would be expected to reduce the value of the Group's assets and increase the Group's write-downs and allowances for impairment losses. Credit risk can be affected by a range of macroeconomic, environment and other factors, including, inter alia, increased unemployment, reduced asset values (including residential and commercial real estate), lower consumer spending, increased consumer indebtedness, increased personal or corporate insolvency levels, reduced corporate profits, increased interest rates and/or higher tenant defaults. The Group has exposure to commercial customers in both the UK and internationally, including Europe and Ireland, particularly related to commercial real estate lending, where the Group has a high level of lending secured on secondary and tertiary assets. The Group's portfolios may be impacted by some or all of these factors and the possibility of further economic downside risk remains.

#### Mitigating actions

The Group takes many mitigating actions with respect to this principal risk. The Group manages its credit risk in a variety of ways such as:

- through prudent and through the cycle credit risk appetite and policies;
- clearly defined levels of authority (including, independently sanctioned and controlled credit limits for commercial customers and counterparties, sound credit scoring models and credit policies for retail customers);
- robust credit processes and controls, including those governing forbearance; and
- well-established Group and Divisional committees that ensure distressed and impaired loans are identified, considered, controlled and appropriately escalated and appropriately impaired (taking account of the Group's latest view of current and expected market conditions, as well as refinancing risk).

Reviews are undertaken at least quarterly and incorporate internal and external audit review and challenge.

### CONDUCT RISK

#### Principal risks

As a provider of a wide range of financial services products distributed through numerous channels to a broad and varied customer base, and as a participant in market activities the Group faces significant conduct risks, such as: products or services not meeting the needs of its customers; sales processes which could result in selling products to customers which do not meet their needs; failure to deal with a customer's complaint effectively where the Group has got it wrong and not met customer expectations; and behaviours which do not meet market standards. Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain aspects of the Group's current or historic business may be determined by the Financial Conduct Authority (FCA) and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion. The Group may also be liable for damages to third parties harmed by the conduct of its business.

**PRINCIPAL RISKS AND UNCERTAINTIES** (continued)**Mitigating actions**

The Group takes a range of mitigating actions with respect to this principal risk with clear and visible leadership from the top. These actions are being developed within the Group's Conduct Strategy initiative, including:

- To support the Group's strategy to be the best bank for customers: the Group is enhancing its approach to business strategy and planning, with the customer at the heart; it is continuing its journey to industry-leading complaints performance; its simplification programme is making customer interactions easy and straightforward.
- To support the transparency and simplification of the Group's products: the Group is enhancing its conduct risk appetite statements, with detailed supporting MI and customer analytics to track continuous improvement, and a robust product governance framework; it is developing its framework for rectifying and undertaking root-cause analysis of conduct issues where they arise; it is improving how it keeps a record of the delivery of fair outcomes for customers.
- To support how colleagues deliver the right outcomes for customers: the Group is enhancing recruitment and training and how it manages performance with clearer customer accountabilities; it is reviewing and developing how rewards and incentives drive customer-centric behaviours; it is strengthening sales processes and frameworks to deliver consistently fair outcomes for customers.
- This is supported by policies and standards in key areas, including product governance, customer treatment, sales, responsible lending, customers in financial difficulties, claims and complaints handling. The Group develops colleagues' awareness of these and other expected standards of conduct through these and other policies and standards and codes of responsibility.
- The Group actively engages with regulatory bodies and other stakeholders in developing its understanding of current customer treatment concerns to ensure that the implementation of the Group's Conduct Strategy meets evolving stakeholder expectations.

**MARKET RISK****Principal risks**

The Group has a number of market risks, the principal one being:

- Interest rate risk: This risk to the Group's banking income arises from competitive pressures on product terms in existing loans and deposits, which sometimes restrict the Group in its ability to change interest rates applying to customers in response to changes in interbank and central bank rates. A further related risk arises from the level of interest rates and the margin of interbank rates over central bank rates.

**Mitigating actions**

Market risk is managed within a Board approved framework using a range of metrics to monitor the Group's profile against its stated appetite and potential market conditions.

High level market risk exposure is reported regularly to appropriate committees for monitoring and oversight by senior management.

A variety of risk measures are used such as:

- Sensitivity based measures (e.g. sensitivity to 100 basis points move in interest rates)
- Percentile based measures (e.g. Value at Risk)
- Scenario/stress based measures (e.g. single factor stresses, macroeconomic scenarios)

In addition, profit and loss triggers are used in the Trading Books in order to ensure that mitigating action is discussed if profit and loss becomes volatile.

**PRINCIPAL RISKS AND UNCERTAINTIES** (continued)

- Interest rate risk: Exposure arising from the different repricing characteristics of the Group's non-trading assets and liabilities, and from the mismatch between interest rate sensitive assets and interest rate sensitive liabilities, is managed centrally. Matching assets and liabilities are offset against each other and interest rate swaps are also used to manage the residual exposure to within the non-traded market risk appetite. Exposure arising from the margin of interbank rates over central bank rates is monitored and managed within the non-traded market risk appetite through appropriate hedging activity.

**OPERATIONAL RISK****Principal risks**

The principal operational risks in the Group are:

- IT systems and resilience: The risk of customer impact and/or loss to the Group resulting from failure to develop, deliver or maintain effective IT solution.
- Information security: The risk of information leakage, loss or theft.
- External fraud: The risk of loss to the Group and/or its customers resulting from an act of deception or omission.
- Customer process: The risk of new issues, process weaknesses and control deficiencies within the Group's customer facing processes.

**Mitigating actions**

The Group operates a robust control environment with regular review and investment. Contingency plans are maintained for a range of potential scenarios with a regime of regular disaster recovery exercises, both Group specific and industry wide. Significant investment has been, and continues to be made in IT infrastructure and systems to ensure their resilience, security and to enhance the services they support.

The Group adopts a risk based approach to mitigate the external fraud risk it faces, reflecting the current and emerging external fraud risks within the market. This approach drives an annual programme of enhancements to the Group's technology, process and people related controls; with emphasis on preventative controls, supported by real time detective controls wherever feasible. Through Group-wide policies and operational control frameworks the Group has developed robust fraud operating model with centralised accountability. Over the past six months the Group has revised and enhanced its incident management capability to increase its speed of response to customer impacting incidents.

Material operational risks are reported regularly to appropriate committees, attracting senior management visibility, and are managed via a range of strategies – avoidance, mitigation, transfer (including insurance), and acceptance.

**PEOPLE RISK****Principal risks**

The Group's management of material people risks is critical to its capacity to deliver against its strategic objectives and achieve Lloyd's Banking Group's aim to be the best bank for customers. Over the coming six months the Group's ability to manage people risks successfully is likely to be affected by the following factors:

- The ongoing pace of change may disrupt the Group's ability to lead and manage its people effectively in some areas;
- The developing and increasingly rigorous and intrusive regulatory environment may challenge the Group's people strategy, remuneration practices and retention; and
- Negative political and media attention on banking sector culture, sales practices and ethical conduct may impact colleague engagement, investor sentiment and the Group's cost base.

**PRINCIPAL RISKS AND UNCERTAINTIES** (continued)**Mitigating actions**

The Group takes many mitigating actions with respect to people risk. Key examples include:

- Strengthening the risk and customer focused culture amongst colleagues by developing and delivering a number of initiatives that reinforce behaviours to generate the best possible long-term outcomes for customers and colleagues;
- Continuing to ensure strong management of the impact of organisational change and consolidation on colleagues;
- Embedding the Group's Codes of Personal and Business Responsibility across the Group;
- Reviewing and developing incentives continually to ensure they promote colleagues' behaviours that meet customer needs and regulatory expectations;
- Focusing on leadership and colleague engagement, through delivery of strategies to attract, retain and develop high calibre people together with implementation of rigorous succession planning;
- Maintaining focus on people risk management across the Group; and
- Ensuring compliance with legal and regulatory requirements related to Approved Persons and the Remuneration Code, and embedding compliant and appropriate colleague behaviours in line with Group policies, values and its people risk priorities.

**LIQUIDITY AND FUNDING RISK****Principal risks**

Lloyds Banking Group is dependent on confidence in the short and long-term wholesale funding markets. Should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding, its ability to fund its financial obligations could be impacted. The key dependencies on successfully funding the Group's balance sheet include:

- continued functioning of the money and capital markets;
- the continuation of Lloyds Banking Group's strategy of right-sizing the balance sheet and development of the retail deposit base which has led to a significant reduction in the wholesale funding requirement;
- limited further deterioration in the UK's and the Group's credit rating; and
- no significant or sudden withdrawal of customer deposits.

**Mitigating actions**

Liquidity and funding risk appetite for the banking business is set by the Board and this statement of the Group's overall appetite for liquidity risk is reviewed and approved annually by the Board.

- The Group's liquidity and funding position is underpinned by its significant customer deposit base, and has been supported by stable funding from the wholesale markets with a reduced dependence on short-term wholesale funding;
- Daily monitoring and control processes are in place to address regulatory liquidity requirements. The Group monitors a range of market and internal early warning indicators on a daily basis for early signs of liquidity risk in the market or specific to the Group;
- The Group carries out stress testing of its liquidity position against a range of scenarios, including those prescribed by the Prudential Regulatory Authority (PRA) on an ongoing basis. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics; and
- The Group has a contingency funding plan embedded within the Group Liquidity Policy which has been designed to identify emerging liquidity concerns at an early stage, so that mitigating actions can be taken to avoid a more serious crisis developing.



**PRINCIPAL RISKS AND UNCERTAINTIES** (continued)**STATE FUNDING AND STATE AID****Principal risks**

HM Treasury currently holds 38.7 per cent of Lloyds Banking Group's ordinary share capital. United Kingdom Financial Investments Limited (UKFI), as manager of HM Treasury's shareholding, continues to operate in line with the framework document between UKFI and HM Treasury, managing the investment in Lloyds Banking Group on a commercial basis without interference in day-to-day management decisions. There is a risk that a change in Government priorities could result in the framework agreement currently in place being replaced leading to interference in the operations of the Group.

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. This has placed a number of requirements on Lloyds Banking Group including an asset reduction target from a defined pool of assets by the end of 2014 (Project Atlantic), and the disposal of certain portions of its Retail business by the end of November 2013 (Project Verde). There is a risk that if the Group does not deliver its divestment commitments by then, a Divestiture Trustee would be appointed to dispose of the divestment, which could be sold at a negative price.

**Mitigating actions**

Lloyds Banking Group has received no indications that the Government intends to change the existing operating arrangements with regard to the role of UKFI and engagement with the Group.

Lloyds Banking Group continues to make good progress in respect to its State Aid commitments. In line with the strengthening of the balance sheet, the Group has made excellent progress against its asset reduction commitment and reached the reduction total required in December 2012, two years ahead of the mandated completion date. The European Commission confirmed in May 2013 to HM Treasury that the Group had satisfied and therefore was formally released from this commitment.

As announced on 24 April 2013, following the withdrawal of the Co-Operative Group from the sale process Lloyds Banking Group now intends to divest Verde through an IPO, subject to regulatory and EU Commission approval, having maintained this option throughout the process to ensure best value for shareholders and certainty for customers and colleagues. The Group has already made good progress in the creation of Verde as a stand-alone bank with a strong management team already in place and good progress made in delivering segregated IT systems on the proven Lloyds Banking Group platform. Detailed plans are in place to rebrand the business as TSB which will be visible on the high street from September this year, at which point the TSB Bank (Verde) will operate as a separate business within Lloyds Banking Group. As a result of the Co-op's withdrawal, the Group will not meet the November 2013 deadline and is currently in discussions regarding a revised timeline for disposal via an IPO, with the EU Commission and HM Treasury. To date, the Group has received no indication that the EU Commission intends to appoint a Divestiture Trustee post November 2013.

The Group continues to work closely with the PRA, FCA, EU Commission, HM Treasury and the Monitoring Trustee appointed by the EU Commission to ensure the successful implementation of the Restructuring Plan and mitigate customer impact.

## CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)

## CONSOLIDATED INCOME STATEMENT

	Note	Half-year to 30 June 2013 £ million	Half-year to 30 June 2012 £ million
Interest and similar income		7,072	8,057
Interest and similar expense		(3,776)	(4,656)
<b>Net interest income</b>		<b>3,296</b>	<b>3,401</b>
Fee and commission income		500	526
Fee and commission expense		(149)	(157)
Net fee and commission income		351	369
Net trading income		253	–
Other operating income		264	(272)
<b>Other income</b>	2	<b>868</b>	<b>97</b>
<b>Total income</b>		<b>4,164</b>	<b>3,498</b>
Regulatory provisions	14	(52)	(240)
Other operating expenses		(1,486)	(1,636)
<b>Total operating expenses</b>	3	<b>(1,538)</b>	<b>(1,876)</b>
<b>Trading surplus</b>		<b>2,626</b>	<b>1,622</b>
Impairment	4	(1,595)	(2,282)
<b>Profit (loss) before tax</b>		<b>1,031</b>	<b>(660)</b>
Taxation	5	(218)	71
<b>Profit (loss) for the period</b>		<b>813</b>	<b>(589)</b>
Profit attributable to non-controlling interests		–	–
Profit (loss) attributable to equity shareholders		813	(589)
<b>Profit (loss) for the period</b>		<b>813</b>	<b>(589)</b>

**CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

	<b>Half-year to 30 June 2013 £ million</b>	Half-year to 30 June 2012 £ million
<b>Profit (loss) for the period</b>	<b>813</b>	(589)
<b>Other comprehensive income:</b>		
<b>Items that may subsequently be reclassified to profit or loss:</b>		
Movements in revaluation reserve in respect of available-for-sale financial assets:		
Change in fair value	<b>216</b>	338
Income statement transfers in respect of disposals	<b>(28)</b>	(140)
Income statement transfers in respect of impairment	<b>23</b>	333
Taxation	<b>(48)</b>	(128)
	<b>163</b>	403
Movements in cash flow hedging reserve:		
Effective portion of changes in fair value	<b>62</b>	408
Net income statement transfers	<b>(214)</b>	29
Taxation	<b>35</b>	(94)
	<b>(117)</b>	343
Currency translation differences (tax: nil)	<b>(28)</b>	37
<b>Other comprehensive income for the period, net of tax</b>	<b>18</b>	783
<b>Total comprehensive income for the period</b>	<b>831</b>	194
Total comprehensive income attributable to non-controlling interests	–	–
Total comprehensive income attributable to equity shareholders	<b>831</b>	194
<b>Total comprehensive income for the period</b>	<b>831</b>	194

**CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED BALANCE SHEET**

	Note	At 30 June 2013 £ million	At 31 Dec 2012 £ million
<b>Assets</b>			
Cash and balances at central banks		7,291	6,084
Items in course of collection from banks		488	416
Trading and other financial assets at fair value through profit or loss	6	33,843	32,585
Derivative financial instruments		27,576	35,863
Loans and receivables:			
Loans and advances to banks		161,898	138,207
Loans and advances to customers	7	315,309	329,636
Debt securities		688	4,600
		477,895	472,443
Available-for-sale financial assets		2,930	3,572
Investment properties		624	705
Goodwill		385	385
Other intangible assets		83	92
Tangible fixed assets		1,673	1,701
Current tax recoverable		13	873
Deferred tax assets		3,645	3,640
Other assets		5,532	3,074
<b>Total assets</b>		<b>561,978</b>	<b>561,433</b>

**CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED BALANCE SHEET** (continued)

	Note	At 30 June 2013 £ million	At 31 Dec 2012 £ million
<b>Equity and liabilities</b>			
<b>Liabilities</b>			
Deposits from banks		187,194	170,118
Customer deposits		229,035	235,051
Items in course of transmission to banks		473	518
Trading liabilities		35,008	33,610
Derivative financial instruments		25,576	33,272
Notes in circulation		1,354	1,198
Debt securities in issue	10	43,764	49,508
Other liabilities		6,233	4,415
Current tax liabilities		6	59
Deferred tax liabilities		28	–
Other provisions		912	1,146
Subordinated liabilities	11	13,430	14,404
<b>Total liabilities</b>		<b>543,013</b>	<b>543,299</b>
<b>Equity</b>			
Share capital	12	5,847	5,847
Share premium account	13	27,479	27,479
Other reserves	13	3,092	3,074
Retained profits	13	(17,473)	(18,286)
<b>Shareholders' equity</b>		<b>18,945</b>	<b>18,114</b>
Non-controlling interests		20	20
<b>Total equity</b>		<b>18,965</b>	<b>18,134</b>
<b>Total equity and liabilities</b>		<b>561,978</b>	<b>561,433</b>

## CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED) (continued)

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity shareholders			Total £ million	Non- controlling interests £ million	Total £ million
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million			
Balance at 1 January 2013	33,326	3,074	(18,286)	18,114	20	18,134
<b>Comprehensive income</b>						
Profit for the period	–	–	813	813	–	813
<i>Other comprehensive income</i>						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	163	–	163	–	163
Movements in cash flow hedging reserve, net of tax	–	(117)	–	(117)	–	(117)
Currency translation differences (tax: nil)	–	(28)	–	(28)	–	(28)
<b>Total other comprehensive income</b>	–	18	–	18	–	18
<b>Total comprehensive income</b>	–	18	813	831	–	831
<b>Transactions with owners</b>						
Change in non-controlling interests	–	–	–	–	–	–
<b>Balance at 30 June 2013</b>	<b>33,326</b>	<b>3,092</b>	<b>(17,473)</b>	<b>18,945</b>	<b>20</b>	<b>18,965</b>

**CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY** (continued)

	Attributable to equity shareholders				Non-controlling interests £ million	Total £ million
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million		
Balance at 1 January 2012	33,326	2,275	(17,204)	18,397	16	18,413
Comprehensive income						
Loss for the period	–	–	(589)	(589)	–	(589)
<i>Other comprehensive income</i>						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	403	–	403	–	403
Movements in cash flow hedging reserve, net of tax	–	343	–	343	–	343
Currency translation differences (tax: nil)	–	37	–	37	–	37
Total other comprehensive income	–	783	–	783	–	783
Total comprehensive income	–	783	(589)	194	–	194
Transactions with owners						
Change in non-controlling interests	–	–	–	–	4	4
Balance at 30 June 2012	33,326	3,058	(17,793)	18,591	20	18,611
Comprehensive income						
(Loss) profit for the period	–	–	(493)	(493)	3	(490)
<i>Other comprehensive income</i>						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(31)	–	(31)	–	(31)
Movements in cash flow hedging reserve, net of tax	–	34	–	34	–	34
Currency translation differences (tax: nil)	–	13	–	13	–	13
Total other comprehensive income	–	16	–	16	–	16
Total comprehensive income	–	16	(493)	(477)	3	(474)
Transactions with owners						
Dividends paid	–	–	–	–	(3)	(3)
Balance at 31 December 2012	33,326	3,074	(18,286)	18,114	20	18,134

**CONDENSED CONSOLIDATED HALF-YEAR FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED CASH FLOW STATEMENT**

	<b>Half-year to 30 June 2013 £ million</b>	Half-year to 30 June 2012 £ million
<b>Profit (loss) before tax</b>	<b>1,031</b>	(660)
Adjustments for:		
Change in operating assets	<b>1,091</b>	(2,456)
Change in operating liabilities	<b>1,048</b>	2,547
Non-cash and other items	<b>(2,670)</b>	(841)
Tax received (paid)	<b>631</b>	(7)
<b>Net cash provided by (used in) operating activities</b>	<b>1,131</b>	(1,417)
<b>Cash flows from investing activities</b>		
Purchase of available-for-sale financial assets	<b>(816)</b>	(996)
Proceeds from sale and maturity of available-for-sale financial assets	<b>1,743</b>	4,925
Purchase of fixed assets	<b>(512)</b>	(160)
Proceeds from sale of fixed assets	<b>898</b>	463
Acquisition of businesses, net of cash acquired	<b>(2)</b>	(10)
Disposal of businesses, net of cash disposed	<b>35</b>	5
<b>Net cash provided by investing activities</b>	<b>1,346</b>	4,227
<b>Cash flows from financing activities</b>		
Change in non-controlling interests	<b>–</b>	4
Interest paid on subordinated liabilities	<b>(243)</b>	(115)
Repayment of subordinated liabilities	<b>(951)</b>	–
<b>Net cash used in financing activities</b>	<b>(1,194)</b>	(111)
Effects of exchange rate changes on cash and cash equivalents	<b>–</b>	(1)
Change in cash and cash equivalents	<b>1,283</b>	2,698
Cash and cash equivalents at beginning of period	<b>7,451</b>	4,918
<b>Cash and cash equivalents at end of period</b>	<b>8,734</b>	7,616

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



**NOTES**

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## 1. Accounting policies, presentation and estimates

These condensed consolidated half-year financial statements as at and for the period to 30 June 2013 have been prepared in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority (FCA) and with International Accounting Standard 34 (IAS 34), *Interim Financial Reporting* as adopted by the European Union and comprise the results of Bank of Scotland plc (the Bank) together with its subsidiaries (the Group). They do not include all of the information required for full annual financial statements and should be read in conjunction with the Group's consolidated financial statements as at and for the year ended 31 December 2012 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Copies of the 2012 annual report and accounts are available on the Lloyds Banking Group's website and are available upon request from Investor Relations, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.

The directors consider that it is appropriate to continue to adopt the going concern basis in preparing the condensed consolidated half-year financial statements. In reaching this assessment, the directors have considered projections for the Group's capital and funding position and have had regard to the factors set out in Principal risks and uncertainties: Liquidity and funding on page 6.

As the Group's share of results of joint ventures and associates is no longer significant, this is now included within other operating income and the related asset reported within other assets; comparatives have been re-presented on a consistent basis.

The accounting policies are consistent with those applied by the Group in its 2012 annual report and accounts except as described below.

On 1 January 2013 the Group adopted the following new accounting standards and amendments to standards:

### *IFRS 10 Consolidated Financial Statements*

IFRS 10 supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* and establishes the principles for when the Group controls another entity and is therefore required to consolidate the other entity in the Group's financial statements. Under IFRS 10, the Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through the exercise of power. IFRS 10 has been applied retrospectively, and in accordance with the transitional provisions included in the standard, the Group re-assessed its control conclusions as at 1 January 2013 and determined that it was not necessary to consolidate any entities that were not previously consolidated nor to deconsolidate any entities which were already consolidated.

### *IFRS 13 Fair value measurement*

IFRS 13 has been applied with effect from 1 January 2013. IFRS 13 defines fair value as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date. IFRS 13 requires that the fair value of a non-financial asset is determined based on the highest and best use of the asset, and that the fair value of a liability reflects its non-performance risk. These changes had no significant impact on the measurement of the Group's assets and liabilities. The IFRS 13 disclosures required by IAS 34 are given in note 16.

### *Amendments to IAS 1 Presentation of Financial Statements – 'Presentation of Items of Other Comprehensive Income'*

The amendments to IAS 1 require entities to group items presented in other comprehensive income on the basis of whether they may potentially be reclassified to profit or loss subsequently. The statement of other comprehensive income in these condensed consolidated half-year financial statements has been revised to reflect the new requirements.

### *Amendments to IFRS 7 Financial Instruments: Disclosures – 'Disclosures - Offsetting Financial Assets and Financial Liabilities'*

The amendments to IFRS 7 require entities to disclose information to enable users of the financial statements to evaluate the effect or potential effect of netting arrangements on the balance sheet. These disclosures will be made in the Group's financial statements for the year ended 31 December 2013.

**1. Accounting policies, presentation and estimates** (continued)*IFRS 12 Disclosure of Interests in Other Entities*

IFRS 12 requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. These disclosures will be made in the Group's financial statements for the year ended 31 December 2013.

***Future accounting developments***

Details of those IFRS pronouncements which will be relevant to the Group but which will not be effective at 31 December 2013 and which have not been applied in preparing these condensed consolidated half-year financial statements are set out in note 18.

***Critical accounting estimates and judgements***

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that impact the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may include amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. There have been no significant changes in the basis upon which estimates have been determined, compared to that applied at 31 December 2012.

**2. Other income**

	<b>Half-year to 30 June 2013 £m</b>	Half-year to 30 June 2012 £m
Fee and commission income:		
Current account fees	138	149
Credit and debit card fees	134	131
Other fees and commissions	228	246
	<b>500</b>	526
Fee and commission expense	<b>(149)</b>	(157)
Net fee and commission income	<b>351</b>	369
Net trading income	<b>253</b>	–
Other operating income	<b>264</b>	(272)
<b>Total other income</b>	<b>868</b>	97

**3. Operating expenses**

	<b>Half-year to 30 June 2013 £m</b>	Half-year to 30 June 2012 £m
Administrative expenses:		
Staff	859	884
Premises and equipment	187	183
Other expenses	311	435
	<b>1,357</b>	1,502
Depreciation and amortisation	<b>129</b>	134
<b>Total operating expenses, excluding regulatory provisions</b>	<b>1,486</b>	1,636
Regulatory provisions (note 14)	<b>52</b>	240
<b>Total operating expenses</b>	<b>1,538</b>	1,876

**4. Impairment**

	<b>Half-year to 30 June 2013 £m</b>	Half-year to 30 June 2012 £m
Impairment losses on loans and receivables:		
Loans and advances to customers	1,617	2,221
Debt securities classified as loans and receivables	(24)	33
<b>Impairment losses on loans and receivables</b> (note 8)	<b>1,593</b>	2,254
Impairment of available-for-sale financial assets	<b>2</b>	28
<b>Total impairment charged to the income statement</b>	<b>1,595</b>	2,282

## 5. Taxation

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

	<b>Half-year to 30 June 2013 £m</b>	Half-year to 30 June 2012 £m
Profit (loss) before tax	<u>1,031</u>	<u>(660)</u>
Tax (charge) credit thereon at UK corporation tax rate of 23.25 per cent (2012: 24.5 per cent)	<b>(240)</b>	162
Factors affecting tax credit:		
UK corporation tax rate change	–	(156)
Disallowed and non-taxable items	<b>(67)</b>	16
Overseas tax rate differences	<b>97</b>	44
Gains exempted or covered by capital losses	<b>8</b>	2
Tax losses where no deferred tax recognised	–	(25)
Deferred tax on losses not previously recognised	<b>43</b>	–
Adjustments in respect of previous years	<b>(59)</b>	24
Effect of results in joint ventures and associates	–	3
Other items	–	1
<b>Tax (charge) credit</b>	<u><b>(218)</b></u>	<u>71</u>

In accordance with IAS 34, the Group's income tax expense for the half-year to 30 June 2013 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.

The Finance Act 2013 (the "Act") was substantively enacted on 2 July 2013. The Act further reduces the rate of corporation tax to 21 per cent with effect from 1 April 2014 and 20 per cent with effect from 1 April 2015. The impact of the corporation tax reductions to 21 and 20 per cent will be accounted for in the second half of 2013. The effect of these rate reductions on the Group's deferred tax balance is estimated to be a reduction in the net deferred tax asset of £0.3 billion.

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

	<b>At 30 June 2013 £m</b>	At 31 Dec 2012 £m
Trading assets	<b>33,475</b>	32,201
Other financial assets at fair value through profit or loss:		
Loans and advances to customers	<b>23</b>	22
Debt securities	<b>14</b>	15
Equity shares	<b>331</b>	347
	<u><b>368</b></u>	<u>384</u>
<b>Total trading and other financial assets at fair value through profit or loss</b>	<u><b>33,843</b></u>	<u>32,585</u>

**7. Loans and advances to customers**

	<b>At 30 June 2013 £m</b>	<b>At 31 Dec 2012 £m</b>
Agriculture, forestry and fishing	588	501
Energy and water supply	708	1,200
Manufacturing	1,544	1,842
Construction	3,367	3,956
Transport, distribution and hotels	12,129	14,898
Postal and communications	179	297
Property companies	26,357	30,163
Financial, business and other services	14,021	14,419
Personal:		
Mortgages	237,976	237,466
Other	12,680	13,302
Lease financing	2,541	2,953
Hire purchase	361	506
Due from fellow Group undertakings	19,703	26,014
	<u>332,154</u>	<u>347,517</u>
Allowance for impairment losses on loans and advances (note 8)	<u>(16,845)</u>	<u>(17,881)</u>
<b>Total loans and advances to customers</b>	<u><b>315,309</b></u>	<u><b>329,636</b></u>

Loans and advances to customers include advances securitised under the Group's securitisation and covered bond programmes. Further details are given in note 9.

**8. Allowance for impairment losses on loans and receivables**

	<b>Half-year to 30 June 2013 £m</b>	<b>Year ended 31 Dec 2012 £m</b>
At 1 January	18,869	24,499
Exchange and other adjustments	483	(346)
Advances written off	(3,914)	(9,723)
Recoveries of advances written off in previous years	82	499
Unwinding of discount	(126)	(329)
Charge for the half-year to 30 June (note 4)	1,593	2,254
Charge for the half-year to 31 December	-	2,015
Charge to the income statement	1,593	4,269
<b>At end of period</b>	<u><b>16,987</b></u>	<u><b>18,869</b></u>
In respect of:		
Loans and advances to customers (note 7)	16,845	17,881
Debt securities	142	988
<b>At end of period</b>	<u><b>16,987</b></u>	<u><b>18,869</b></u>

## 9. Securitisations and covered bonds

The Group's principal securitisation and covered bond programmes, together with the balances of the loans subject to these arrangements and the carrying value of the notes in issue, are listed in the table below.

	At 30 June 2013		At 31 December 2012	
	Loans and advances securitised £m	Notes in issue £m	Loans and advances securitised £m	Notes in issue £m
<i>Securitisation programmes</i>				
UK residential mortgages	41,536	31,272	44,647	32,201
US residential mortgage-backed securities	–	–	3,909	5,237
Irish residential mortgages	5,374	3,598	5,194	3,509
Credit card receivables	6,017	2,889	7,001	3,794
Dutch residential mortgages	4,632	4,765	4,551	4,692
Commercial loans	643	643	675	675
Motor vehicle loans	715	762	1,039	1,086
	<b>58,917</b>	<b>43,929</b>	<b>67,016</b>	<b>51,194</b>
Less held by the Group		<b>(28,946)</b>		<b>(33,570)</b>
<b>Total securitisation programmes</b> (note 10)		<b>14,983</b>		<b>17,624</b>
<i>Covered bond programmes</i>				
Residential mortgage-backed	43,486	32,425	46,311	33,414
Social housing loan-backed	2,747	1,800	2,934	2,400
	<b>46,233</b>	<b>34,225</b>	<b>49,245</b>	<b>35,814</b>
Less held by the Group		<b>(9,682)</b>		<b>(10,226)</b>
<b>Total covered bond programmes</b> (note 10)		<b>24,543</b>		<b>25,588</b>
<b>Total securitisation and covered bond programmes</b>		<b>39,526</b>		<b>43,212</b>

### *Securitisation programmes*

Loans and advances to customers and debt securities classified as loans and receivables include loans 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 (note 10).

### *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, and the related covered bonds in issue included within debt securities in issue (note 10).

Cash deposits of £12,462 million (31 December 2012: £12,710 million) held by the Group are restricted in use to repayment of the debt securities issued by the SPEs and other legal obligations.

### *Asset-backed conduit*

In addition to the SPEs detailed above, the Group sponsors an asset-backed conduit, Grampian, which invests in debt securities.

**10. Debt securities in issue**

	At 30 June 2013 £m	At 31 Dec 2012 £m
Medium-term notes issued	4,112	5,611
Covered bonds (note 9)	24,543	25,588
Certificates of deposit	1	29
Securitisation notes (note 9)	14,983	17,624
Commercial paper	–	121
	<u>43,639</u>	<u>48,973</u>
Amounts due to fellow Group undertakings	125	535
<b>Total debt securities in issue</b>	<u><b>43,764</b></u>	<u><b>49,508</b></u>

**11. Subordinated liabilities**

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

	Half-year to 30 June 2013 £m	Year ended 31 Dec 2012 £m
At 1 January	14,404	15,155
Repurchases and redemptions during the period	(951)	(649)
Foreign exchange and other movements	(23)	(102)
<b>At end of period</b>	<u><b>13,430</b></u>	<u><b>14,404</b></u>

**12. Share capital**

Ordinary share capital in issue is as follows:

	Number of shares (millions)	£m
<b>Ordinary shares of 25 pence each</b>		
At 1 January and 30 June 2013	<u><b>23,388</b></u>	<u><b>5,847</b></u>

**13. Reserves**

	Share premium £m	Other reserves			Total £m	Retained profits £m
		Available- for-sale £m	Cash flow hedging £m	Merger and other £m		
At 1 January 2013	27,479	(145)	1,238	1,981	3,074	(18,286)
Profit for the period	–	–	–	–	–	813
Change in fair value of available-for-sale assets (net of tax)	–	172	–	–	172	–
Change in fair value of hedging derivatives (net of tax)	–	–	48	–	48	–
Transfers to income statement (net of tax)	–	(9)	(165)	–	(174)	–
Exchange and other adjustments	–	–	–	(28)	(28)	–
<b>At 30 June 2013</b>	<u><b>27,479</b></u>	<u><b>18</b></u>	<u><b>1,121</b></u>	<u><b>1,953</b></u>	<u><b>3,092</b></u>	<u><b>(17,473)</b></u>



## 14. Provision for liabilities and charges

### ***Payment protection insurance***

Following the unsuccessful legal challenge by the British Bankers' Association against the FSA and the Financial Ombudsman Service, the Group held discussions with the FSA with a view to seeking clarity around the detailed implementation of the FSA Policy Statement which set out evidential provisions and guidance on the fair assessment of a complaint and the calculation of redress in respect of payment protection insurance (PPI) sales standards. As a result, the Group concluded that there are certain circumstances where customer redress will be appropriate. Accordingly the Group made provisions totalling £2,005 million during 2011 and 2012 in respect of the anticipated costs of such redress, including administrative expenses.

The volume of PPI complaints has continued to fall in line with expectations, with monthly complaint volumes in the first half of 2013 on average 40 per cent below the level experienced in the second half of 2012. However, costs have been higher than expected due to the acceleration of the settlement of cases currently held with the Financial Ombudsman Service, a VAT ruling and higher uphold and settlement rates. The Group has also increased its estimate of future administration costs. In view of this, the Group is increasing the provision by £47 million with approximately £26 million relating to redress costs and approximately £21 million to additional administration costs.

In addition the Group has been informed that it has been referred to the Enforcement Team of the Financial Conduct Authority for investigation over the governance of a third party supplier and failings in the PPI complaint handling process. A provision of £5 million has been made in respect of the likely administration costs of this exercise.

These provisions will bring the total amount provided to £2,057 million (of which £210 million relates to administration costs). In the first half of 2013 total costs incurred were £269 million including approximately £36 million of administration costs, leaving approximately £534 million of the provision unutilised at 30 June 2013. This represents the Group's current best estimate of the likely future costs, but a number of risks and uncertainties remain and it is possible that the eventual outcome may differ materially from the current estimate resulting in a further provision being required.

The provision has been based on a number of subjective assumptions, which are discussed below including the effect on the provision if actual future experience differs from that assumed:

- The scope of the proactive mailing exercise covers 0.9 million policies, mailing is due to commence in the second half of 2013 and some customers have already contacted the Group. If the scope of the proactive mailing was 50,000 higher than that assumed in the provision, the additional provision would be approximately £14 million;
- If the future response rate was 1 per cent higher than the 20 per cent assumed in the provision, the additional provision would be approximately £9 million;
- The number of customer initiated complaints received to date, where a PPI policy existed, is 0.8 million. If the future level of complaints was 40,000 higher than that assumed in the provision, the additional provision would be approximately £60 million;
- The average uphold rate per policy in the last six months, excluding those customers with no PPI policy, is 61 per cent. If the future uphold rate was 1 per cent higher than the 70 per cent assumed in the provision, the additional provision would be approximately £4 million; and
- The average redress rate per policy in the last six months was £1,700. If the future average redress was £100 higher than the £1,500 assumed in the provision, (which is lower than the average over the last six months due to the expected mix of future complaints), the additional provision would be approximately £26 million.

The Group will reassess the continued appropriateness of the assumptions underlying its analysis at each reporting date in light of current experience and other relevant evidence.

#### 14. Provision for liabilities and charges (continued)

##### **Other regulatory provisions**

###### *Interest rate hedging products*

In June 2012, a number of banks, including the Lloyds Banking Group, reached agreement with the FSA (now FCA) to carry out a review of sales made since 1 December 2001 of interest rate hedging products (IRHP) to certain small and medium-sized businesses. The Lloyds Banking Group agreed that on conclusion of this review it would provide redress to any of these customers where appropriate.

Following the completion of a pilot review of a sample of IRHP sales to small and medium-sized businesses and a supplemental agreement reached with the FSA on 30 January 2013 on the principles to be adopted during the course of the wider review, the Group provided £139 million in its accounts for the year ended 31 December 2012 for the estimated cost of redress and related administration costs. At 31 December 2012, £10 million of the provision had been utilised; no further amounts have been utilised in the half-year to 30 June 2013. A number of uncertainties remain as to the eventual costs given the inherent difficulties in determining the number of customers within the scope of the review and the amount of any redress to be provided to customers.

###### *Other regulatory matters*

In the course of its business, the Group is engaged in discussions with the PRA, FCA and other regulators in relation to a range of matters. In 2012 a provision of £50 million was made in respect of certain UK retail and other matters; this provision has remained unchanged during the first half of the year. The ultimate impact on the Group of these discussions can only be known at the conclusion of such discussions.

#### 15. Contingent liabilities and commitments

##### **Interchange fees**

On 24 May 2012, the General Court of the European Union (the General Court) upheld the European Commission's 2007 decision that an infringement of EU competition law had arisen from arrangements whereby MasterCard issuers charged a uniform fallback multilateral interchange fee (MIF) in respect of cross border transactions in relation to the use of a MasterCard or Maestro branded payment card.

MasterCard has appealed the General Court's judgment to the Court of Justice of the European Union. MasterCard is supported by several card issuers, including the Lloyds Banking Group. Judgment is not expected until late 2013 or later.

In parallel:

- the European Commission is also considering further action, and has proposed legislation to regulate interchange fees, following its 2012 Green Paper (Towards an integrated European market for cards, internet and mobile payments) consultation;
- the European Commission has consulted on commitments proposed by VISA to settle an investigation into whether arrangements adopted by VISA for the levying of the MIF in respect of cross-border credit card payment transactions also infringe European Union competition laws. VISA has proposed *inter alia* to reduce the level of interchange fees on cross-border credit card transactions to the interim level (30 basis points) also agreed by Mastercard. VISA has previously reached an agreement (which expires in 2014) with the European Commission to reduce the level of interchange fees for cross-border debit card transactions to the interim levels agreed by MasterCard;
- the Office of Fair Trading (OFT) has placed on hold its examination of whether the levels of interchange fees paid by retailers in respect of MasterCard and VISA credit cards, debit cards and charge cards in the UK infringe competition law. The OFT has placed the investigation on hold pending the outcome of the Mastercard appeal to the Court of Justice of the European Union; and
- the UK Government held a consultation in 2013, *Opening Up UK Payments*. The consultation included a proposal to legislate to introduce a new economic regulator with responsibility for payment systems, including three and four party card schemes, and a role in setting or approving interchange fees.

## 15. Contingent liabilities and commitments (continued)

The ultimate impact of the investigations and any regulatory developments on the Lloyds Banking Group can only be known at the conclusion of these investigations and any relevant appeal proceedings and once regulatory or legislative proposals are more certain.

### ***Interbank offered rate setting investigations***

A number of government agencies in the UK, US and elsewhere, including the UK Financial Services Authority, the US Commodity Futures Trading Commission, the US Securities and Exchange Commission, the US Department of Justice and a number of State Attorneys General, as well as the European Commission, are conducting investigations into submissions made by panel members to the bodies that set various interbank offered rates including the BBA London Interbank Offered Rates (LIBOR) and the European Banking Federation's Euribor. Certain Lloyds Banking Group companies were (at the relevant times) and remain members of various panels whose members make submissions to these bodies including the BBA LIBOR panels. No Lloyds Banking Group company is or was a member of the Euribor panel. Certain Lloyds Banking Group companies have received subpoenas and requests for information from certain government agencies and the Lloyds Banking Group is co-operating with their investigations. In addition 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 with regard to the setting of LIBOR. It is currently not possible to predict the scope and ultimate outcome of the various regulatory investigations or private lawsuits, including the timing and scale of the potential impact of any investigations and private lawsuits on the Lloyds Banking Group.

### ***Financial Services Compensation Scheme***

The Financial Services Compensation Scheme (FSCS) is the UK's independent statutory compensation fund of last resort for customers of authorised financial services firms and pays compensation if a firm is unable or likely to be unable to pay claims against it. The FSCS is funded by levies on the authorised financial services industry. The levies raised may comprise a management expenses levy and a compensation costs levy.

Following the default of a number of deposit takers in 2008, the FSCS borrowed funds from HM Treasury to meet the compensation costs for customers of those firms. The interest rate on the borrowings with HM Treasury, which totalled approximately £17 billion at 31 March 2013, is 12 month LIBOR plus 100 basis points. Each deposit-taking institution contributes towards the FSCS levies in proportion to their share of total protected deposits on 31 December of the year preceding the scheme year, which runs from 1 April to 31 March.

The substantial majority of the principal balance of the £17 billion loan between the FSCS and HM Treasury will be repaid from funds the FSCS receives from asset sales, surplus cash flow or other recoveries in relation to the assets of the firms that defaulted. In July 2013, the FSCS confirmed that it expects to raise compensation costs levies of approximately £1.1 billion on all deposit-taking participants over a three year measurement period from 2012 to 2014 to enable it to repay an HM Treasury loan which matures in 2016. The amount of future compensation costs levies payable by the Group depends on a number of factors including participation in the market at 31 December, the level of protected deposits and the population of deposit-taking participants.

### ***FSA investigation into Bank of Scotland and report on HBOS***

The FSA's enforcement investigation into Bank of Scotland plc's Corporate division between 2006 and 2008 concluded with the publication of a Final Notice on 9 March 2012. No financial penalty was imposed on the Group or Bank of Scotland plc. On 12 September 2012 the FSA confirmed it was starting work on a public interest report on HBOS. That report is expected to be published in 2013.

### ***Shareholder complaints***

In November 2011 the Lloyds Banking Group and two former members of the Lloyds Banking Group's Board of Directors were named as defendants in a purported securities class action filed in the United States District Court for the Southern District of New York. The complaint asserted claims under the Securities Exchange Act of 1934 in connection with alleged material omissions from statements made in 2008 in connection with the acquisition of HBOS. No quantum is specified. In October 2012 the court dismissed the complaint. An appeal against this decision has been filed. The Lloyds Banking Group continues to consider that the allegations are without merit.

**15. Contingent liabilities and commitments (continued)****Other legal actions and regulatory matters**

In addition, during the ordinary course of business the Lloyds Banking Group is subject to other threatened and actual legal proceedings (which may include class action lawsuits brought on behalf of customers, shareholders or other third parties), regulatory challenges, investigations, and enforcement actions, both in the UK and overseas. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Lloyds Banking 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 case and no provisions are held against such matters. However the Lloyds Banking 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.

**Contingent liabilities and commitments arising from the banking business**

	<b>At 30 June 2013 £m</b>	<b>At 31 Dec 2012 £m</b>
<b>Contingent liabilities</b>		
Acceptances and endorsements	2	2
Other:		
Other items serving as direct credit substitutes	25	28
Performance bonds and other transaction-related contingencies	485	565
	510	593
<b>Total contingent liabilities</b>	<b>512</b>	<b>595</b>
<b>Commitments</b>		
Documentary credits and other short-term trade-related transactions	4	4
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	8,438	6,346
Other commitments	19,842	20,828
	28,280	27,174
1 year or over original maturity	4,570	7,664
<b>Total commitments</b>	<b>32,854</b>	<b>34,842</b>

## 16. 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 the fair values.

### *Level 1 portfolios*

Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 predominantly comprise equity shares, treasury bills and other government securities.

### *Level 2 portfolios*

Level 2 valuations are those where quoted market prices are not available, for example where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data. Examples of such financial instruments include most over-the-counter derivatives, financial institution issued securities, certificates of deposit and certain asset-backed securities.

### *Level 3 portfolios*

Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include the Group's venture capital and unlisted equity investments which are valued using various valuation techniques that require significant management judgement in determining appropriate assumptions, including earnings multiples and estimated future cash flows. Certain of the Group's asset-backed securities and derivatives, principally where there is no trading activity in such securities, are also classified as level 3.

### **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 consistent sources of data cease to be available.

### **Valuation methodology**

Loans and advances and debt securities measured at fair value through profit or loss and classified as level 2 are valued by discounting expected cash flows using an observable credit spread applicable to the particular instrument. The fair value of non-derivative liabilities measured at fair value through profit or loss and classified as level 2 is calculated in a similar way.

For other level 2 and level 3 portfolios, there is no significant change to what was disclosed in the Group's 2012 annual report and accounts in respect of the valuation methodology (techniques and inputs) applied to such portfolios.

**16. Fair values of financial assets and liabilities** (continued)

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

	30 June 2013		31 December 2012 <sup>1</sup>	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
<b>Financial assets</b>				
Cash and balances at central banks	7,291	7,291	6,084	6,084
Items in the course of collection from banks	488	488	416	416
Trading and other financial assets at fair value through profit or loss	33,843	33,843	32,585	32,585
Derivative financial instruments	27,576	27,576	35,863	35,863
Loans and receivables:				
Loans and advances to banks	161,898	161,916	138,207	138,208
Loans and advances to customers	315,309	307,523	329,636	320,236
Debt securities	688	557	4,600	4,784
Available-for-sale financial instruments	2,930	2,930	3,572	3,572
<b>Financial liabilities</b>				
Deposits from banks	187,194	187,251	170,118	170,192
Customer deposits	229,035	230,056	235,051	236,641
Items in course of transmission to banks	473	473	518	518
Trading liabilities	35,008	35,008	33,610	33,610
Derivative financial instruments	25,576	25,576	33,272	33,272
Notes in circulation	1,354	1,354	1,198	1,198
Debt securities in issue	43,764	43,969	49,508	50,015
Financial guarantees	16	16	14	14
Subordinated liabilities	13,430	12,750	14,404	13,359

<sup>1</sup> Restated – see note 1.

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 table provides 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.

**16. Fair values of financial assets and liabilities** (continued)

Valuation hierarchy

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>At 30 June 2013</b>				
Trading and other financial assets at fair value through profit or loss:				
Loans and advances to customers	–	25,985	–	25,985
Loans and advances to banks	–	3,903	–	3,903
Debt securities:				
Government securities	361	–	–	361
Bank and building society certificates of deposit	–	2,501	–	2,501
Corporate and other debt securities	–	638	14	652
	361	3,139	14	3,514
Equity shares	156	–	177	333
Treasury and other bills	108	–	–	108
<b>Total trading and other financial assets at fair value through profit or loss</b>	<b>625</b>	<b>33,027</b>	<b>191</b>	<b>33,843</b>
Available-for-sale financial assets:				
Debt securities:				
Government securities	30	–	–	30
Bank and building society certificates of deposit	–	26	–	26
Asset-backed securities:				
Mortgage-backed securities	–	773	–	773
Other asset-backed securities	–	406	–	406
Corporate and other debt securities	21	1,274	–	1,295
	51	2,479	–	2,530
Equity shares	–	33	367	400
<b>Total available-for-sale financial assets</b>	<b>51</b>	<b>2,512</b>	<b>367</b>	<b>2,930</b>
Derivative financial instruments	37	27,103	436	27,576
<b>Total financial assets carried at fair value</b>	<b>713</b>	<b>62,642</b>	<b>994</b>	<b>64,349</b>
Trading liabilities:				
Liabilities in respect of securities sold under repurchase agreements	–	33,191	–	33,191
Short positions in securities	1,817	–	–	1,817
	1,817	33,191	–	35,008
<b>Total trading liabilities</b>	<b>1,817</b>	<b>33,191</b>	<b>–</b>	<b>35,008</b>
Derivative financial instruments	–	25,520	56	25,576
Financial guarantees	–	–	16	16
<b>Total financial liabilities carried at fair value</b>	<b>1,817</b>	<b>58,711</b>	<b>72</b>	<b>60,600</b>

There were no transfers between level 1 and level 2 during the period.

**16. 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.

	Trading and other financial assets at fair value through profit or loss £m	Available- for-sale financial assets £m	Derivative assets £m	Total financial assets carried at fair value £m
At 1 January 2013	163	428	172	763
Exchange and other adjustments	1	16	–	17
Gains (losses) recognised in the income statement within other income	26	(1)	87	112
Gains recognised in other comprehensive income within the revaluation reserve in respect of available-for-sale financial assets	–	31	–	31
Purchases	6	27	1	34
Sales	(5)	(114)	(5)	(124)
Transfers into the level 3 portfolio	–	1	187	188
Transfers out of the level 3 portfolio	–	(21)	(6)	(27)
<b>At 30 June 2013</b>	<b>191</b>	<b>367</b>	<b>436</b>	<b>994</b>
<b>Gains recognised in the income statement within other income attributable to the change in unrealised gains (losses) relating to those assets held at 30 June 2013</b>	<b>11</b>	<b>2</b>	<b>84</b>	<b>97</b>

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

	Derivative liabilities £m	Financial guarantees £m	Total financial liabilities carried at fair value £m
At 1 January 2013	54	14	68
Exchange and other adjustments	–	–	–
Gains (losses) recognised in the income statement within other income	(30)	2	(28)
Additions	–	–	–
Redemptions	(17)	–	(17)
Transfers into the level 3 portfolio	49	–	49
<b>At 30 June 2013</b>	<b>56</b>	<b>16</b>	<b>72</b>
<b>Gains (losses) recognised in the income statement within other income attributable to the change in unrealised gains (losses) relating to those liabilities held at 30 June 2013</b>	<b>28</b>	<b>(2)</b>	<b>26</b>



**16. Fair values of financial assets and liabilities** (continued)**Sensitivity of level 3 valuations**

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 below reflects such relationships.

The following information relates to significant unobservable inputs in respect of derivatives and debt investments shown in the table that follows:

- Interest rates and inflation rates are referenced in some derivatives where the payoff that the holder of the derivative receives depends on the behaviour of those underlying references through time.
- Credit spreads represent the premium above the benchmark reference instrument required to compensate for lower credit quality; higher spreads lead to a lower fair value.
- Volatility parameters represent key attributes of option behaviour; higher volatilities typically denote a wider range of possible outcomes.

The fair values of certain equity investments, mainly those in the Group's venture capital businesses, are determined by identifying the earnings multiple for comparable companies and applying this multiple to the earnings of the entity whose value is being estimated; a higher earnings multiple will result in a higher fair value.

**Reasonably possible alternative assumptions**

The following information relates to reasonably possible alternative assumptions shown in the table that follows.

*Debt securities*

Reasonably possible alternative assumptions have been determined in respect of the Group's structured credit investment by flexing credit spreads to a range between 685 basis points and 1,016 basis points.

*Derivatives*

- (i) In respect of the embedded equity conversion feature of the Enhanced Capital Notes, the sensitivity was based on the absolute difference between the actual price of the Enhanced Capital Note and the closest, alternative broker quote available plus the impact of applying a 10 basis points increase/decrease in the market yield used to derive a market price for similar bonds without the conversion feature. The effect of interdependency of the assumptions is not material to the effect of applying reasonably possible alternative assumptions to the valuations of derivative financial instruments.
- (ii) Uncollateralised inflation swaps are valued using appropriate discount spreads for such transactions. These spreads are not generally observable for longer maturities. The reasonably possible alternative valuations reflect flexing of the spreads for the differing maturities to alternative values of between 75 basis points and 230 basis points.
- (iii) Swaptions are priced using industry standard option pricing models. Such models require interest rate volatilities which may be unobservable at longer maturities. To derive reasonably possible alternative valuations these volatilities have been flexed within a range of 1 per cent to 118 per cent.

*Equity and venture capital investments*

The valuation techniques used for unlisted equities and venture capital investments vary depending on the nature of the investment. Reasonably possible alternative valuations for these investments have been calculated as follows:

- for valuations derived from earnings multiples, a 10 per cent increase/decrease in the earnings multiple has been applied; and
- for fund investment portfolios, the values of underlying investments have been flexed in line with International Private Equity and Venture Capital Guidelines.

## 16. Fair values of financial assets and liabilities (continued)

				At 30 June 2013		
				Effect of reasonably possible alternative assumptions <sup>2</sup>		
	Valuation technique(s)	Significant unobservable inputs	Range <sup>1</sup>	Carrying value £m	Favourable changes £m	Unfavourable changes £m
<b>Trading and other financial assets at fair value through profit or loss</b>						
Equity and venture capital investments	Underlying asset/net asset value (incl. property prices) <sup>3</sup>	n/a	n/a	191	41	(20)
				<b>191</b>		
<b>Available-for-sale financial assets</b>						
Equity and venture capital investments	Underlying asset/net asset value (incl. property prices) <sup>3</sup>	n/a	n/a	367	19	(10)
				<b>367</b>		
<b>Derivative financial assets</b>						
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (bps)	54/189	246	66	(24)
	Option pricing model	Interest rate volatility	26%/121%	190	–	–
				<b>436</b>		
				<b>994</b>		
<b>Financial assets carried at fair value</b>						
<b>Derivative financial liabilities</b>						
Interest rate derivatives	Discounted cash flow	Inflation swap rate – funding component (bps)	54/189	7	–	–
	Option pricing model	Interest rate volatility	26%/121%	49	–	–
				<b>56</b>		
				<b>16</b>		
				<b>72</b>		
<b>Financial guarantees</b>						
<b>Financial liabilities carried at fair value</b>						

<sup>1</sup> The range represents the highest and lowest inputs used in the level 3 valuations.

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

<sup>3</sup> Underlying asset/net asset values represent fair value.

**17. Related party transactions****Balances and transactions with Lloyds Banking Group plc and fellow 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 Group undertakings of the Bank. These are included on the balance sheet as follows:

	<b>At 30 June 2013 £m</b>	<b>At 31 Dec 2012 £m</b>
<b>Assets</b>		
Derivative financial instruments	<b>7,033</b>	6,811
Loans and advances to banks	<b>159,157</b>	135,316
Loans and advances to customers	<b>19,703</b>	26,014
Trading and other financial assets at fair value through profit or loss	<b>12,771</b>	14,761
Other	<b>1,086</b>	1,574
<b>Liabilities</b>		
Deposits from banks	<b>183,134</b>	163,005
Customer deposits	<b>22,458</b>	29,782
Trading liabilities	<b>6,948</b>	8,479
Derivative financial instruments	<b>9,048</b>	9,165
Debt securities in issue	<b>708</b>	535
Subordinated liabilities	<b>11,207</b>	11,140
Other	<b>390</b>	27

During the half-year ended 30 June 2013 the Group earned £876 million (half-year ended 30 June 2012: £770 million) of interest income and incurred £1,621 million (half-year ended 30 June 2012: £1,858 million) of interest expense on balances and transactions with Lloyds Banking Group plc and fellow Group undertakings.

**UK Government**

In January 2009, the UK Government through HM Treasury became a related party of Lloyds Banking Group plc, the Bank's ultimate parent company, following its subscription for ordinary shares issued under a placing and open offer. As at 30 June 2013, HM Treasury held a 38.7 per cent (31 December 2012: 39.2 per cent) interest in Lloyds Banking Group plc's ordinary share capital and consequently HM Treasury remained a related party of Lloyds Banking Group plc, and therefore of the Group, during the half-year to 30 June 2013.

In accordance with IAS 24, UK Government-controlled entities are related parties of the Group. The Group regards the Bank of England and entities controlled by the UK Government, including The Royal Bank of Scotland Group plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

The Lloyds Banking Group has participated in a number of schemes operated by the UK Government and central banks and made available to eligible banks and building societies.

*National Loan Guarantee Scheme*

The Lloyds Banking Group is participating in the UK Government's National Loan Guarantee Scheme, which was launched on 20 March 2012. Through the scheme, the Lloyds Banking Group expects to provide eligible UK businesses with discounted funding over the next two years, subject to continuation of the scheme and its financial benefits, and based on the Lloyds Banking Group's existing lending criteria. Eligible businesses who take up the funding will benefit from a 1 per cent discount on their funding rate for a certain period of time.

**17. Related party transactions (continued)***Business Growth Fund*

In May 2011 the Lloyds Banking Group agreed, together with The Royal Bank of Scotland plc (and three other non-related parties), to commit up to £300 million of equity investment by subscribing for shares in the Business Growth Fund plc which is the company created to fulfil the role of the Business Growth Fund as set out in the British Bankers' Association's Business Taskforce Report of October 2010. As at 30 June 2013, the Lloyds Banking Group had invested £54 million (31 December 2012: £50 million) in the Business Growth Fund and carried the investment at a fair value of £44 million (31 December 2012: £44 million).

*Big Society Capital*

In January 2012 the Lloyds Banking Group agreed, together with The Royal Bank of Scotland plc (and two other non-related parties), to commit up to £50 million each of equity investment into the Big Society Capital Fund. The Fund, which was created as part of the Project Merlin arrangements, is a UK social investment fund. The Fund was officially launched on 3 April 2012 and the Lloyds Banking Group had invested £12 million in the Fund by 31 December 2012 and invested a further £4 million during the half-year to 30 June 2013.

*Funding for Lending*

In August 2012 the Lloyds Banking Group announced its support for the UK Government's Funding for Lending Scheme and confirmed its intention to participate in the scheme; and in June 2013 the Lloyds Banking Group accepted the UK Government's invitation to take part in the extension of the scheme until the end of January 2015. The Funding for Lending Scheme represents a further source of cost effective secured term funding available to the Lloyds Banking Group. The initiative supports a broad range of UK based customers, providing householders with more affordable housing finance and businesses with cheaper finance to invest and grow. The Lloyds Banking Group drew down £3.0 billion during the year ended 31 December 2012; there have been no further drawings in the half-year to 30 June 2013.

*Central bank facilities*

In the ordinary course of business, the Lloyds Banking Group may from time to time access market-wide facilities provided by central banks.

*Other government-related entities*

There were no significant transactions with other UK Government-controlled entities (including UK Government-controlled banks) during the period that were not made in the ordinary course of business or that were unusual in their nature or conditions.

**Other related party transactions**

Other related party transactions for the half-year to 30 June 2013 are similar in nature to those for the year ended 31 December 2012.

## 18. Future accounting developments

The following pronouncements may have a significant effect on the Group's condensed consolidated half-year financial statements but are not applicable for the year ending 31 December 2013 and have not been applied in preparing these financial statements. Save as disclosed below, the full impact of these accounting changes is being assessed by the Group.

<b>Pronouncement</b>	<b>Nature of change</b>	<b>IASB effective date</b>
Amendments to IAS 32 <i>Financial Instruments: Presentation – 'Offsetting Financial Assets and Financial Liabilities'</i>	Provides additional application guidance to address inconsistencies identified in applying the offsetting criteria used in the standard. Some gross settlement systems may qualify for offsetting where they exhibit certain characteristics akin to net settlement.	Annual periods beginning on or after 1 January 2014.
IFRS 9 <i>Financial Instruments</i> <sup>1</sup>	Replaces those parts of IAS 39 <i>Financial Instruments: Recognition and Measurement</i> relating to the classification, measurement and derecognition of financial assets and liabilities. IFRS 9 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 instruments and eliminates the available-for-sale financial asset and held-to-maturity investment categories in IAS 39. The requirements for derecognition are broadly unchanged from IAS 39. The standard also retains most of the IAS 39 requirements for financial liabilities except for those designated at fair value through profit or loss whereby that part of the fair value change attributable to an entity's own credit risk is recorded in other comprehensive income.	Annual periods beginning on or after 1 January 2015.

<sup>1</sup> As at 31 July 2013, this pronouncement is awaiting EU endorsement. 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 impairment of financial assets measured at amortised cost and hedge accounting, as well as a reconsideration of classification and measurement. 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.

## 19. 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 2012 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](http://www.lloydsbankinggroup.com)

## 20. Other information

The financial information in these condensed consolidated half-year financial statements does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 December 2012 have been delivered to the Registrar of Companies. The auditors' report on those accounts was unqualified, did not include an emphasis of matter paragraph and did not include a statement under section 498 of the Companies Act 2006.

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The directors listed below (being all the directors of Bank of Scotland plc) confirm that to the best of their knowledge these condensed consolidated half-year financial statements have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting*, as adopted by the European Union, and that the half-year 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 2013 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 2013 and any material changes in the related party transactions described in the last annual report.

Signed on behalf of the board by

António Horta-Osório  
Group Chief Executive  
31 July 2013

**Bank of Scotland plc board of directors:**

Sir Winfried Bischoff (Chairman)  
António Horta-Osório (Chief Executive)  
George Culmer (Finance Director)  
Lord Blackwell  
Carolyn Fairbairn  
Anita Frew  
Nicholas Luff  
David Roberts  
Anthony Watson CBE  
Sara Weller

## INDEPENDENT REVIEW REPORT TO BANK OF SCOTLAND PLC

### Introduction

We have been engaged by the Bank to review the condensed consolidated half-year financial statements in the half-year management report for the six months ended 30 June 2013, 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 half-year management report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed consolidated half-year financial statements.

### Directors' responsibilities

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

As disclosed in note 1, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the European Union. The condensed consolidated half-year financial statements included in the half-year 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 consolidated half-year financial statements in the half-year 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 Rules and Transparency Rules of the Financial Conduct 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.

### Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated half-year financial statements in the half-year management report for the six months ended 30 June 2013 are not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure Rules and Transparency Rules of the United Kingdom's Financial Conduct Authority.

PricewaterhouseCoopers LLP  
Chartered Accountants  
London  
31 July 2013

#### Notes:

- a) The maintenance and integrity of the Lloyds Banking Group plc website is the responsibility of the Group 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.

## CONTACTS

For further information please contact:

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