

# HBOS plc

Interim Management Report

For the half-year to 30 June 2009

Member of the Lloyds Banking Group

## FORWARD LOOKING STATEMENTS

This announcement contains forward looking statements with respect to the business, strategy and plans of HBOS plc, its current goals and expectations relating to its future financial condition and performance. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. HBOS Group's actual future results may differ materially from the results 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 as well as to mitigate exposures from the integration with the Lloyds Banking Group, risks concerning borrower credit quality, market related trends and developments, changing demographic trends, changes in customer preferences, changes to regulation, the policies and actions of Governmental and regulatory authorities in the UK or jurisdictions outside the UK, including other European countries and the US, exposure to regulatory scrutiny, legal proceedings or complaints, competition and other factors. Please refer to the latest Lloyds Banking Group plc annual report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of such factors. The forward looking statements contained in this announcement are made as at the date of this announcement, and HBOS Group undertakes no obligation to update any of its forward looking statements.

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## FINANCIAL REVIEW

### Results

The consolidated income statement of HBOS plc on page 5 shows a loss before tax of £9,492 million and a loss attributable to equity shareholders for the six month period ended 30 June 2009 of £7,080 million.

### Principal activities

HBOS plc (the Company) and its subsidiaries (together the Group) provide a range of banking and financial services through branches and offices in the UK and overseas.

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

### Review of results

The loss before tax of £9,492 million for the half-year ended 30 June 2009 compares to a profit before tax of £848 million for the corresponding half-year to 30 June 2008. The decrease in profit arises principally as a result of an increase in the impairment charge, which reflects the recent credit environment and current economic conditions.

Net interest income decreased by 43 per cent to £2,266 million. During the period, the Group reviewed its effective interest rate methodology (see note 2) and as a result recognised an additional charge of £945 million. Excluding this charge, net interest income decreased by £774 million, or 19 per cent, as both interest income and interest expense fell in response to the historically low interest rate environment that has prevailed throughout the first half of the current year. Declines in fee and commission income and expense reflect lower volumes of new business. The net trading income loss, which includes the impact of changes in value of financial instruments held at fair value, decreased by £3,193 million compared with the corresponding period. Insurance premium income increased by 12 per cent despite the sale of the Group's Australian insurance operation, St. Andrews in the last quarter of 2008. Other operating income increased by £1,945 million and the half-year to 30 June 2009 includes £2,085 million of gains arising on the repurchase of own debt. Accordingly, total income increased by £3,433 million to £5,824 million from £2,391 million.

Operating expenses decreased 7 per cent or £215 million from £3,177 million to £2,962 million, as administrative expenses fell by £135 million and depreciation charges decreased by £107 million of which £83 million is attributable to operating lease assets. The Group's share of losses from its joint ventures increased to £508 million from £24 million and an additional loss of £96 million was booked during the period in respect of the disposal of the Australian businesses, BankWest and St. Andrews. This arose from variations in the consideration arising from certain conditions incorporated into the sale contract. No further adjustments are anticipated.

Impairment losses increased by £9,922 million to £11,377 million in the period to 30 June 2009 from £1,455 million in the corresponding period last year. The increase includes £8,743 million in respect of loans and advances to customers and £1,174 million for losses on debt securities classified as loans and receivables and the impairment of available-for-sale financial assets and reflects the substantial deterioration in the credit environment between the first half of last year and the current period.

**FINANCIAL REVIEW** (continued)

Loans and receivables have decreased by 1 per cent to £500,945 million from £506,270 million at 31 December 2008; loans and advances to customers (before impairment provisions) fell by £17,271 million, loans and advances to banks increased by £21,639 million with deposits from banks increasing by £18,505 million. Customer deposits grew by £27,154 million from £237,449 million to £264,603 million at 30 June 2009. Debt securities in issue decreased by £53,120 million of which £26,976 million reflects a reduction in certificates of deposit in issue and £13,360 million is attributable to the net repayment of secured notes under the Group's securitisation and covered bond programmes. The volume of medium-term notes in issue decreased by £9,846 million. The balance sheet changes since December 2008 reflect improved conditions in the funding and liquidity markets as well as the impact of the acquisition of the Group by Lloyds Banking Group that has also enabled the acquisition of own debt reflected in the reduction of £9,145 million in subordinated liabilities.

Shareholders' equity has increased following the capital injections of £16,339 million made by the UK Government and Lloyds Banking Group. During the period the Government's shareholdings and the Group's other preference shares have been replaced by shares issued to Lloyds Banking Group.

## PRINCIPAL RISKS AND UNCERTAINTIES

The most significant risks likely to be faced by the Group in the second half of the year are:

**Economy:** The economy continues to be an important driver of the Group's financial performance. The downturn in late 2008 and early 2009 was worse than predicted and this has impacted the Group's business in the first half of 2009. However, economic forecasts are now, for the first time in a year, being revised upwards, and the risk of a severe and prolonged downturn is receding. It appears likely that during the next 18 months there will be a gradual return to economic growth. Nevertheless, the Group remains cautious on the outlook. The Group also expects to see prices for residential and commercial property stabilise during this time.

**Intended participation in the Government Asset Protection Scheme:** The Group is working with HM Treasury to finalise the detailed terms and conditions and the operational mechanics of its intended participation in the Government Asset Protection Scheme (GAPS). The operation of the scheme and its impact on the Group's business (and the consequential impact on its lending and the wider economy) is complex. The Group expects to conclude these discussions and agree terms and conditions which are in the interest of shareholders.

**State aid:** As a result of the placing and open offer completed in January 2009, which is considered to constitute state aid under EU rules, the Group is required to submit a restructuring plan to the European Commission. Although the state aid process is formally one between HM Treasury and the Commission, both prior to and since the submission of the plan on 15 July 2009, the Group has been working closely with HM Treasury and this will continue throughout the process in order to reach an agreement which is acceptable to all parties.

**Credit:** Over the last six months the banking crisis has continued to impact the financial services industry resulting in high profile losses and write-downs. This market dislocation has also been accompanied by recessionary conditions and adverse trends in many economies throughout the world, including the United Kingdom. The Group is impacted by the economic downturn and a further worsening of the business environment could adversely impact earnings during the next six months. This poses a major risk to the Group and its lending businesses where rising unemployment impacts the ability of customers to meet repayment dates on unsecured lending and leads to a consequent increase in arrears; the downturn in the housing market reduces collateral values for residential property and this impacts upon the quality of secured lending and increases impairment losses; and companies are facing increasingly difficult conditions, resulting in corporate default levels rising and leading to increases in corporate impairment.

**Liquidity and funding risk:** liquidity risk arises to the extent that the Lloyds Banking Group is unable to attract and retain traditional sources of funding such as retail and wholesale deposits or issue debt securities. Throughout the last six months the Lloyds Banking Group, including HBOS plc has maintained a satisfactory liquidity position reinforced by actively participating in the support initiative of the Bank of England, other central banking and HM Treasury. A reduction in the availability of these sources could materially adversely affect the Group ability to meet its financial obligations as they fall due.

**PRINCIPAL RISKS AND UNCERTAINTIES** (continued)

Legal and Regulatory risk: The Group is subject to stringent regulation in the UK, including a recent increase in the level of government intervention in the sector due to the declining market environment. The Turner Review, published by the FSA in March 2009, indicates that banks can also expect a shift from a 'light touch' principles based regime to an intensive and interventionist regime and considers a wide range of proposals to address the severe financial problems experienced by banks at the end of 2008. Future changes in regulation, fiscal or other policies are unpredictable, beyond the control of the Group and could materially adversely affect Group business. Recently proposed changes to capital and liquidity requirements could have a substantial impact on the scale of bank's business models. Changes to the regulatory regimes in other jurisdictions where the Group has a presence are expected and may have an impact on the Group's operations.

The Group is also subject to legal or regulatory proceedings or other complaints brought against it in the High Court, elsewhere, or in jurisdictions outside the UK, including other EU countries and the US. For example, a major focus of US governmental policy relating to financial institutions in recent years has been combating money laundering and terrorist financing and enforcing compliance with US economic sanctions. The outcome of any proceeding or complaint is inherently uncertain and could have a material adverse effect on the Group's operations and/or financial condition, especially to the extent the scope of any such proceeding expands beyond its original focus. Failure to manage these risks adequately could impact the Group adversely, both financially and reputationally through an adverse impact on the Group's brands.

## CONDENSED INTERIM FINANCIAL STATEMENTS

## CONSOLIDATED INCOME STATEMENT (unaudited)

	Half-year to 30 June 2009	Half-year to 30 June 2008 (restated) <sup>(1)</sup>
	£m	£m
Interest and similar income	11,186	18,602
Interest and similar expense	(8,920)	(14,617)
<b>Net interest income</b>	<b>2,266</b>	<b>3,985</b>
Fee and commission income	784	1,037
Fee and commission expense	(543)	(546)
Net fee and commission income	241	491
Net trading income	(1,988)	(5,181)
Insurance premium income	2,547	2,283
Other operating income	2,758	813
<b>Other income</b>	<b>3,558</b>	<b>(1,594)</b>
<b>Total income</b>	<b>5,824</b>	<b>2,391</b>
Insurance claims	(373)	3,113
<b>Total income, net of insurance claims</b>	<b>5,451</b>	<b>5,504</b>
Operating expenses	(2,962)	(3,177)
<b>Trading surplus</b>	<b>2,489</b>	<b>2,327</b>
Impairment	(11,377)	(1,455)
Share of losses of jointly controlled entities and associates	(508)	(24)
Loss on sale of businesses	(96)	-
<b>Profit (loss) before tax</b>	<b>(9,492)</b>	<b>848</b>
Taxation	2,460	102
<b>Profit (loss) for the period</b>	<b>(7,032)</b>	<b>950</b>
Profit attributable to minority interests	48	19
Profit (loss) attributable to equity shareholders	(7,080)	931
<b>Profit (loss) for the period</b>	<b>(7,032)</b>	<b>950</b>

<sup>(1)</sup> See note 20.

## CONDENSED INTERIM FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (unaudited)

	Half-year to 30 June 2009 £m	Half-year to 30 June 2008 £m
<b>Profit (loss) for the period</b>	<b>(7,032)</b>	950
<b>Other comprehensive income:</b>		
Movements in available-for-sale financial assets, net of tax:		
Change in fair value	864	(1,954)
Transferred to income statement in respect of disposals	11	34
Transferred to income statement in respect of impairment	432	60
	<b>1,307</b>	<b>(1,860)</b>
Movement in cash flow hedges, net of tax:		
Effective portion of changes in fair value taken to equity	(1,336)	486
Net gains transferred to the income statement	1,429	(51)
	<b>93</b>	<b>435</b>
Currency translation differences	(49)	48
<b>Other comprehensive income for the period, net of tax</b>	<b>1,351</b>	<b>(1,377)</b>
<b>Total comprehensive income for the period</b>	<b>(5,681)</b>	<b>(427)</b>
Total comprehensive income attributable to minority interests	48	19
Total comprehensive income attributable to equity shareholders	<b>(5,729)</b>	<b>(446)</b>
<b>Total comprehensive income for the period</b>	<b>(5,681)</b>	<b>(427)</b>



## CONDENSED INTERIM FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEET (unaudited)

	As at 30 June 2009 £m	As at 31 Dec 2008 (restated) <sup>(1)</sup> £m
<b>Assets</b>		
Cash and balances at central banks	2,072	2,502
Items in course of collection from banks	635	445
Trading and other financial assets designated at fair value through profit or loss	94,346	89,691
Derivative financial instruments	33,513	51,810
Loans and receivables:		
Loans and advances to customers	427,121	450,421
Loans and advances to banks	38,435	16,796
Debt securities	35,389	39,053
	500,945	506,270
Available-for-sale financial assets	23,465	28,048
Investment property	2,478	3,045
Investments in jointly controlled entities and associates	603	1,161
Goodwill	1,534	1,556
Value of in-force business	2,712	3,284
Other intangible assets	484	527
Tangible fixed assets	5,155	5,400
Current tax recoverable	842	983
Deferred tax assets	4,652	2,605
Retirement benefit asset	35	46
Other assets	15,704	7,208
<b>Total assets</b>	689,175	704,581

<sup>(1)</sup> See note 20.

## CONDENSED INTERIM FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEET (unaudited)

	As at 30 June 2009 £m	As at 31 Dec 2008 (restated) <sup>(1)</sup> £m
<b>Equity and liabilities</b>		
Deposits from banks	115,655	97,150
Customer deposits	264,603	237,449
Items in course of transmission to banks	650	521
Notes in circulation	956	957
Trading and other financial liabilities at fair value through profit or loss	15,943	18,851
Derivative financial instruments	30,968	38,905
Debt securities in issue	135,328	188,448
Liabilities arising from insurance contracts and participating investment contracts	35,468	36,873
Liabilities arising from non-participating investment contracts	29,116	29,057
Unallocated surplus within insurance businesses	412	551
Other liabilities	15,069	12,151
Retirement benefit obligations	540	562
Current tax liabilities	-	58
Other provisions	100	147
Subordinated liabilities	20,974	30,119
<b>Total liabilities</b>	<b>665,782</b>	<b>691,799</b>
<b>Equity</b>		
Share capital	3,921	1,550
Share premium account	11,209	6,709
Other reserves	5,203	(5,616)
Retained profits	1,765	8,839
<b>Shareholders' equity</b>	<b>22,098</b>	<b>11,482</b>
Minority interests	1,295	1,300
<b>Total equity</b>	<b>23,393</b>	<b>12,782</b>
<b>Total equity and liabilities</b>	<b>689,175</b>	<b>704,581</b>

<sup>(1)</sup> See note 20.

## CONDENSED INTERIM FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

	Attributable to equity shareholders				Total £m
	Share capital and premium £m	Other reserves £m	Retained profits £m	Minority interests £m	
<b>Balance as at 31 December 2007 (as previously stated)</b>	4,128	154	17,567	385	22,234
Prior year adjustment (note 2)	-	-	(149)	-	(149)
<b>Balance as at 31 December 2007 (restated)</b>	4,128	154	17,418	385	22,085
Total comprehensive income	-	(1,377)	931	19	(427)
Dividends	-	-	(1,256)	(11)	(1,267)
Issue of ordinary and preference shares	93	-	-	750	843
Movement in own shares	-	-	105	-	105
Movement in share-based compensation reserve	-	-	47	-	47
Repayment of capital to minority shareholders	-	-	-	(110)	(110)
<b>Balance as at 30 June 2008</b>	4,221	(1,223)	17,245	1,033	21,276
Total comprehensive income	-	(4,393)	(8,430)	64	(12,759)
Dividends	-	-	(30)	(44)	(74)
Issue of ordinary and preference shares	4,038	-	-	-	4,038
Movement in own shares	-	-	(17)	-	(17)
Movement in share-based compensation reserve	-	-	71	-	71
Repayment of capital to minority shareholders	-	-	-	242	242
Other	-	-	-	5	5
<b>Balance as at 31 December 2008</b>	8,259	(5,616)	8,839	1,300	12,782
Total comprehensive income	-	1,351	(7,080)	48	(5,681)
Dividends	-	-	(52)	(53)	(105)
Issue of ordinary and preference shares	6,871	9,468	-	-	16,339
Movement in own shares	-	-	(48)	-	(48)
Movement in share-based compensation reserve	-	-	106	-	106
<b>Balance as at 30 June 2009</b>	<b>15,130</b>	<b>5,203</b>	<b>1,765</b>	<b>1,295</b>	<b>23,393</b>

## CONDENSED INTERIM FINANCIAL STATEMENTS

## CONSOLIDATED CASH FLOW STATEMENT (unaudited)

	Half-year to 30 June 2009 £m	Half-year to 30 June 2008 (restated) <sup>(1)</sup> £m
<b>Profit (loss) before tax</b>	<b>(9,492)</b>	848
Adjustments for:		
Change in operating assets	359	(13,372)
Change in operating liabilities	6,005	12,741
Non-cash and other items	1,632	344
Tax paid	84	(631)
<b>Net cash provided by (used in) operating activities</b>	<b>(1,412)</b>	(70)
<b>Cash flows from investing activities</b>		
Purchase of available-for-sale financial assets	(7,261)	(6,047)
Proceeds from sale and maturity of available-for-sale financial assets	8,250	7,295
Purchase of fixed assets	(439)	(435)
Proceeds from sale of fixed assets	368	87
Capital subscriptions in jointly controlled entities	(95)	(186)
Capital redemptions and disposal of businesses, net of cash disposed	130	92
<b>Net cash provided by investing activities</b>	<b>953</b>	806
<b>Cash flows from financing activities</b>		
Dividends paid to equity shareholders	(52)	(1,256)
Dividends paid to minority interests	(53)	(11)
Interest paid on subordinated liabilities	(960)	(673)
Proceeds from issue of subordinated liabilities	-	1,144
Proceeds from issue of ordinary shares	13,500	93
Proceeds from issue of preference shares	2,839	750
Proceeds from disposal of own shares	-	167
Repayment of subordinated liabilities	(5,090)	-
Repayment of capital to minority shareholders	-	(110)
Purchase of own shares	(15)	(62)
<b>Net cash provided by financing activities</b>	<b>10,169</b>	42
Effects of exchange rate changes on cash and cash equivalents	86	(111)
Change in cash and cash equivalents	9,796	667
Cash and cash equivalents at beginning of period	12,103	6,185
<b>Cash and cash equivalents at end of period</b>	<b>21,899</b>	6,852

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.

<sup>(1)</sup> Mandatory reserve deposits of £373 million at 1 January 2008 have been reclassified from loans and advances to banks to cash and balances at central banks. In addition, total cash and cash equivalents at 1 January 2008 have been restated to include certain cash deposits held with the Central Bank of Ireland of £853 million and cash held at the central bank as collateral against notes in circulation of £881 million which are available to finance the Group's day to day operations. The cash flow statement has been adjusted accordingly.

## NOTES

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## **1. Basis of preparation**

The ongoing global upheaval in the financial markets has been characterised by a systemic reduction in wholesale markets liquidity. The steps taken in 2008 by HM Treasury, through the introduction of the Government guarantee scheme for senior funding, and the Bank of England, through extended long-term repo and US Dollar repo facilities and the new discount window facility, have continued to provide assurance of liquidity support to the banking markets. Despite some improvement in market liquidity during the second quarter of 2009, the Group continues to be partly reliant upon these facilities in order to maintain its wholesale funding position.

In the context of continued uncertainty in the financial markets and the deterioration in economic conditions in the UK, further steps have been, and are being, taken to strengthen the Group's capital position. In March 2009, the Lloyds Banking Group, the ultimate parent company, announced its intention to participate in the Government Asset Protection Scheme (GAPS) which could result in a significant improvement in the Group's capital position.

There is a risk that market conditions deteriorate once more leading to a renewed contraction in wholesale funding sources. The key dependencies on successfully funding the Group's balance sheet include the continued functioning of the money and capital markets at their current levels; the continued access of the Group to central bank and Government sponsored liquidity facilities; limited further deterioration in the Group's credit ratings; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or Government support schemes. In addition, a prolonged economic downturn in the UK may result in greater strain being placed upon the Group's capital resources.

Based upon projections prepared by management which assume the continued availability of the Government sponsored funding scheme and other actions to strengthen the Group's capital position, the directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. Accordingly, these condensed interim financial statements have been prepared on a going concern basis.

## **2. Accounting policies and estimates**

These condensed interim financial statements as at and for the half-year to 30 June 2009 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and with International Accounting Standard (IAS) 34, 'Interim Financial Reporting', as adopted by the European Union. They do not include all of the information required for full annual financial statements, and should be read in conjunction with the Group's consolidated financial statements as at and for the year ended 31 December 2008 (2008 annual report and accounts), which were prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

### **Balance sheet presentation**

To provide a more relevant presentation of the Group's financial instruments, an additional line has been added to the consolidated balance sheet to separately show debt securities classified as loans and receivables. In addition, certain amounts have been reclassified to present these statements on a basis consistent with the presentation practices adopted by Lloyds Banking Group (see note 20).

Comparatives have been reclassified to conform to the revised presentation.

## 2. Accounting policies and estimates (continued)

### **Accounting policies and estimates**

Except as described below, the accounting policies, significant judgements made by management in applying them and key sources of estimation uncertainty in these condensed interim financial statements are the same as those applied by the Group in its 2008 annual report and accounts.

#### *Taxation*

As required by IAS 34, the Group's income tax expense for the six months ended 30 June 2009 is based on the best estimate of the weighted-average annual income tax rate expected for the full financial year.

#### *Effective interest rate*

The Group accounts for its revenue on loans and receivables on an effective interest rate (EIR) basis. This approach takes into account interest received or paid and fees and commission paid or received that are integral to the yield as well as incremental transaction costs and all other premiums and discounts. Following the acquisition of HBOS plc by Lloyds Banking Group plc on 16 January 2009, the Group reviewed the EIR methodology applied to the Group's mortgage portfolio. As a result of this methodology review, the Group has revised the period over which the fees, commissions and costs are spread into the yield. This change in accounting estimate has resulted in an additional charge to the income statement of £945 million in the period to 30 June 2009.

#### *Defined benefit pension scheme*

Prior to the acquisition of the Group by Lloyds Banking Group, HBOS plc accounted for its defined benefit pension scheme using the full recognition method with any actuarial gains and losses arising being recognised immediately through other comprehensive income.

Lloyds Banking Group accounts for its defined benefit pension schemes using the 'corridor' approach under which actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities. In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives.

Following the acquisition on 16 January 2009, the Group has aligned its accounting policy for defined benefit pension schemes to that of Lloyds Banking Group to provide consistency and more relevant information for the enlarged Lloyds Banking Group. This change in accounting policy has resulted in a restatement of previous years' net assets as previously recognised actuarial gains and losses are not recognised using the 'corridor' method. The prior year adjustment reduces the net assets of the Group as at 1 January 2008 by £149 million from £22,234 million to £22,085 million; the actuarial gains and losses of £568 million in 2008 are unrecognised. No adjustment has been made to the 2008 income statement as the amount is not material.

In accordance with IAS 19 'Employee Benefits', and the Group's normal practice, the pension scheme valuation will be formally updated at the year end. No adjustment has therefore been made to the valuation at 30 June 2009.

## 2. Accounting policies and estimates (continued)

The following new standards and amendments to standards are effective for financial years beginning on or after 1 January 2009 and have impacted these condensed interim financial statements as at and for the half-year to 30 June 2009.

*IAS 1 (revised), 'Presentation of Financial Statements'*. The revised standard prohibits the presentation of items of income and expense (that is non-owner changes in equity) in the statement of changes in equity, requiring non-owner changes in equity to be presented separately from owner changes in equity. All non-owner changes in equity are required to be shown in a performance statement. Entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the income statement and statement of comprehensive income). The Group has elected to present two statements: an income statement and a statement of comprehensive income. The interim financial statements have been prepared under the revised disclosure requirements.

*IFRS 8 'Operating Segments'*. The new standard replaces IAS 14 'Segment Reporting' and requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally. The chief operating decision maker has been identified as the Group Executive Committee (GEC). The Group is managed on an entity basis and not by segment, and the GEC does not assess performance and allocate resources across any segments; accordingly no segmental information is provided. A brief overview of its sources of income is provided in the Financial review.

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

The Group reviews goodwill held in the Group's balance sheet for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place.

The goodwill impairment charge of £29 million recognised in the six months ended 30 June 2009 arose principally from the write-down of goodwill previously recognised on the acquisition of certain asset finance businesses in Ireland. The write-down was triggered by deteriorating economic conditions.

The preparation of interim financial statements requires management to make judgements, estimates and assumptions that impact the application of accounting policies and the reported amounts of assets, liabilities, income and expense. Actual results may differ from these estimates.

### **Reclassification of financial assets**

In respect of assets previously transferred from available-for-sale to loans and advances, an impairment charge of £191 million has been recognised in the income statement. In accordance with IAS 39 this amount has been transferred from the available-for-sale reserve.

In January 2009, the Group reclassified £1,825 million of debt securities classified as held for trading to debt securities classified as loans and receivables on the basis that there was no longer an active market for those assets, which are therefore more appropriately managed as loans. During the period impairment losses of £90 million have been charged to the income statement. If these assets had not been reclassified during the period an additional loss before tax of £44 million would have been recognised in the income statement.



**2. Accounting policies and estimates** (continued)

In January 2009, the Group reclassified £649 million of securities classified as available-for-sale to debt securities classified as loans and receivables on the basis that there was no longer an active market for those assets, which are therefore more appropriately managed as loans. If these assets had not been reclassified during the period additional negative adjustment of £2 million would have been recognised in the available-for-sale reserve.

**Other matters**

No significant events, other than those disclosed within this document, have occurred between 30 June 2009 and the date of approval of these condensed interim financial statements. Full details of the Group's related party transactions for the year to 31 December 2008, share-based payment schemes and contingent liabilities and commitments entered into in the normal course of business can be found in the Group's 2008 annual report and accounts.

**3. Other income**

	<b>Half-year to 30 June 2009</b>	Half-year to 30 June 2008
	£m	£m
Fee and commission income:		
Current account fees	<b>80</b>	195
Insurance broking	<b>(51)</b>	9
Card services	<b>125</b>	112
Other fees and commissions	<b>630</b>	721
	<b>784</b>	1,037
Fees and commission expense	<b>(543)</b>	(546)
Net fee and commission income	<b>241</b>	491
Net trading income	<b>(1,988)</b>	(5,181)
Insurance premium income	<b>2,547</b>	2,283
Other operating income	<b>2,758</b>	813
Total other income	<b>3,558</b>	(1,594)
Insurance claims	<b>(373)</b>	3,113
<b>Total other income, net of insurance claims</b>	<b>3,185</b>	1,519

**4. Operating expenses**

	<b>Half-year to 30 June 2009</b>	Half-year to 30 June 2008
	£m	£m
<b>Administrative expenses</b>		
Staff	1,561	1,584
Premises and equipment	191	244
Other expenses	572	631
<b>Administrative expenses</b>	<b>2,324</b>	2,459
<b>Depreciation and amortisation</b>		
Property and equipment	62	104
Operating leases	425	508
Intangible assets	122	104
<b>Depreciation and amortisation</b>	<b>609</b>	716
<b>Goodwill Impairment</b>	<b>29</b>	2
<b>Total operating expenses</b>	<b>2,962</b>	3,177

**5. Impairment losses**

	<b>Half-year to 30 June 2009</b>	Half-year to 30 June 2008
	£m	£m
Impairment losses on loans and advances to customers	10,053	1,310
Impairment losses on debt securities	828	61
<b>Impairment of loans and receivables</b>	<b>10,881</b>	1,371
Other credit risk provisions	5	-
Impairment of available-for-sale financial assets	491	84
<b>Total impairment charge</b>	<b>11,377</b>	1,455

**6. Loss on sale of businesses**

On 8 October 2008 the HBOS Group agreed the sale of part of its Australian operations, principally Bank of Western Australia Ltd and St. Andrews Australia Pty Ltd, to Commonwealth Bank of Australia Ltd.

The sale completed on 19 December 2008 and resulted in an estimated pre-tax loss on disposal of £845 million (including goodwill written-off of £240 million) which was included as non-operating income within the loss on sale of businesses for the year.

The agreement provided for adjustments to the consideration received in certain circumstances and as a result a further loss of £96 million has been recognised in the current period.

## 7. Taxation

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

	Half-year to 30 June 2009	Half-year to 30 June 2008
	£m	£m
Profit (loss) before tax	<u>(9,492)</u>	<u>848</u>
Tax credit (charge) thereon at UK corporation tax rate of 28.0% (2008: 28.5%)	2,658	(242)
Factors affecting charge:		
Disallowed expenses and non taxable income	492	(29)
Overseas tax rate differences	(134)	(20)
Gains exempted or covered by capital losses	-	35
Policyholder interests	(6)	322
Adjustments in respect of previous periods	(44)	83
Impairment on investment securities	(53)	(35)
Effect of loss in jointly controlled entities	(143)	-
Tax losses where no deferred tax recognised	(300)	-
Other items	(10)	(12)
Tax credit	<u>2,460</u>	<u>102</u>

The tax charge/(credit) recognised on other comprehensive income is shown below:

### Half-year to 30 June 2009

	Before-tax amount	Tax (expense) benefit	Net of tax amount
	£m	£m	£m
Movements in available-for-sale financial assets:			
Change in fair value	1,180	(316)	864
Transferred to income statement in respect of disposals	15	(4)	11
Transferred to income statement in respect of impairment	600	(168)	432
	<u>1,795</u>	<u>(488)</u>	<u>1,307</u>
Movements in cash flow hedges:			
Effective portion of changes in fair value taken to equity	(1,855)	519	(1,336)
Net gains transferred to the income statement	1,984	(555)	1,429
	<u>129</u>	<u>(36)</u>	<u>93</u>
Currency translation differences	(49)	-	(49)
	<u>1,875</u>	<u>(524)</u>	<u>1,351</u>

**7. Taxation** (continued)

Half-year to 30 June 2008

	Before-tax amount £m	Tax (expense) benefit £m	Net of tax amount £m
Movements in available-for-sale financial assets:			
Change in fair value	(2,734)	780	(1,954)
Transferred to income statement in respect of disposals	47	(13)	34
Transferred to income statement in respect of impairment	84	(24)	60
	(2,603)	743	(1,860)
Movements in cash flow hedges:			
Effective portion of changes in fair value taken to equity	676	(190)	486
Net gains transferred to the income statement	(71)	20	(51)
	605	(170)	435
Currency translation differences	48	-	48
	<u>(1,950)</u>	<u>573</u>	<u>(1,377)</u>

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

	As at 30 June 2009 £m	As at 31 Dec 2008 £m
Trading	27,153	22,571
Other financial assets designated at fair value through profit or loss:		
Loans and advances to banks	598	849
Debt securities	28,172	27,785
Equity shares	38,423	38,486
	<u>67,193</u>	<u>67,120</u>
	<u>94,346</u>	<u>89,691</u>

**9. Derivative financial instruments**

	<b>As at 30 June 2009</b>		<b>As at 31 Dec 2008</b>	
	<b>Fair value of assets</b>	<b>Fair value of liabilities</b>	Fair value of assets	Fair value of liabilities
	<b>£m</b>	<b>£m</b>	£m	£m
<b>Trading</b>				
Exchange rate contracts	<b>5,427</b>	<b>2,866</b>	5,353	4,897
Interest rate contracts	<b>15,621</b>	<b>17,834</b>	22,021	23,687
Credit derivatives	<b>425</b>	<b>20</b>	748	33
Equity and other contracts	<b>1,761</b>	<b>864</b>	1,606	991
	<b>23,234</b>	<b>21,584</b>	29,728	29,608
<b>Hedging</b>				
Derivatives designated as fair value hedges	<b>3,993</b>	<b>1,123</b>	13,601	812
Derivatives designated as cash flow hedges	<b>6,286</b>	<b>8,261</b>	8,481	8,485
	<b>10,279</b>	<b>9,384</b>	22,082	9,297
	<b>33,513</b>	<b>30,968</b>	51,810	38,905

The Group reduces exposure to credit risk by using master netting agreements and by obtaining cash collateral. At 30 June 2009, £21,863 million (2008: £37,369 million) of the derivative assets held are available for offset under master netting arrangements. These do not meet the criteria under IAS 32 to enable derivative assets to be presented net of these balances. Of the net derivative assets of £11,650 million (2008: £14,441 million), cash collateral of £93 million (2008: £nil) was held and a further £4,044 million (2008: £5,802 million) was due from Organisation for Economic Co-operation and Development (OECD) banks.

**10. Loans and advances to customers**

	<b>As at 30 June 2009</b>	As at 31 Dec 2008 <sup>(1)</sup>
	£m	£m
Agriculture, forestry and fishing	<b>780</b>	854
Energy and water supply	<b>1,030</b>	890
Manufacturing	<b>6,782</b>	7,436
Construction	<b>10,738</b>	11,456
Transport, distribution and hotels	<b>20,909</b>	22,664
Postal and communications	<b>1,027</b>	958
Property companies	<b>60,894</b>	63,807
Financial, business and other services	<b>50,278</b>	55,196
Personal - mortgages	<b>257,894</b>	263,644
- other	<b>24,559</b>	23,854
Lease financing	<b>5,806</b>	5,655
Hire purchase	<b>3,146</b>	4,700
	<b>443,843</b>	461,114
Allowance for impairment losses on loans and advances	<b>(16,722)</b>	(10,693)
<b>Total loans and advances to customers</b>	<b>427,121</b>	450,421

<sup>(1)</sup> The industry classification of loans and advances has been reclassified to ensure consistency with Lloyds Banking Group.

Loans and advances to customers include advances securitised under the Group's securitisation and covered bonds programmes. Further details are given in note 12.

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

	<b>As at 30 June 2009</b>	As at 31 Dec 2008
	£m	£m
Balance at start of the period	<b>11,616</b>	3,658
Exchange and other adjustments	<b>(295)</b>	106
Advances written off	<b>(4,009)</b>	(1,398)
Recoveries of advances written off in previous periods	<b>29</b>	43
Unwinding of discount	<b>(179)</b>	(87)
Charge to the income statement in the six month period	<b>10,881</b>	9,409
Disposal of subsidiary undertakings	<b>-</b>	(115)
<b>Balance at end of the period</b>	<b>18,043</b>	11,616
Loans and advances to customers	<b>16,722</b>	10,693
Debt securities	<b>1,321</b>	923
	<b>18,043</b>	11,616

## **12. Securitisation and covered bonds**

### *Securitisation*

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

### *Covered bonds*

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 substantially all of the risks and rewards associated with these loans and the partnerships are consolidated fully and the loans retained on the Group's balance sheet, and the related covered bonds in issue included within debt securities in issue.

The Group's principal securitisation and covered bonds programmes, together with the balances of the advances subject to notes in issue are listed below.

**12. Securitisation and covered bonds** (continued)

		<b>As at 30 June 2009</b>		<b>As at 31 Dec 2008</b>	
<b>Type of loan</b>		<b>Gross assets securitised</b>	<b>Notes in issue</b>	<b>Gross assets securitised</b>	<b>Notes in issue</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<i>Securitisation</i>					
Permanent	UK residential mortgages	<b>29,233</b>	<b>32,169</b>	32,613	38,490
Mound	UK residential mortgages	<b>7,551</b>	<b>7,485</b>	8,063	8,238
Handbridge	Personal loans	<b>4,048</b>	<b>2,622</b>	-	-
Candide	Dutch residential mortgages	<b>4,781</b>	<b>4,881</b>	5,569	5,704
Prominent	Commercial loans	<b>964</b>	<b>1,003</b>	1,053	1,149
Pendeford	UK residential mortgages	<b>9,888</b>	<b>9,766</b>	9,888	9,870
Balliol	UK residential mortgages	<b>12,773</b>	<b>12,641</b>	12,701	12,549
Brae	UK residential mortgages	<b>9,125</b>	<b>9,881</b>	9,213	9,955
Dakota	UK residential mortgages	<b>3,896</b>	<b>3,814</b>	3,988	3,885
Deva	UK residential mortgages	<b>6,794</b>	<b>6,721</b>	6,747	6,703
Penarth	Credit card receivables	<b>4,300</b>	<b>2,699</b>	4,189	2,633
Tioba	UK residential mortgages	<b>2,403</b>	<b>2,588</b>	2,647	2,568
Trinity	UK residential mortgages	<b>12,293</b>	<b>12,158</b>	12,975	12,638
Wolfhound	Irish residential mortgages	<b>3,640</b>	<b>3,662</b>	4,083	4,107
Other	UK residential mortgages	<b>66</b>	<b>175</b>	68	179
		<b>111,755</b>	<b>112,265</b>	113,797	118,668
<i>Covered bonds</i>					
Covered bonds	UK residential mortgages	<b>65,481</b>	<b>54,883</b>	51,756	49,408
Social housing covered bonds	UK residential mortgages	<b>3,481</b>	<b>2,979</b>	3,475	2,919
		<b>68,962</b>	<b>57,862</b>	55,231	52,327
<b>Total securitisation and covered bonds</b>		<b>180,717</b>	<b>170,127</b>	169,028	170,995
Less held by the Group			<b>(106,757)</b>		(94,265)
<b>Total</b>			<b>63,370</b>		76,730

Cash deposits of £18,981 million (2008: £12,423 million) held by the Group are restricted in use to repayment of the debt securities issued by the SPEs and other legal obligations.

In total the Group has securitised £119,914 million of mortgage assets under certain securitisation and covered bond programmes and purchased all of the loan notes in issue relating to those issuances for £106,757 million. In addition to the balances reported above, during the period, the Group arranged two new securitisation transactions. In total £5,921 million of US residential mortgage backed securities were re-securitised with the Group purchasing all the newly issued notes. These transactions do not lead to any derecognition of the mortgage or other assets as the Group has retained all of the risks and rewards associated with the loan notes.



**13. Debt securities in issue**

	<b>As at 30 June 2009</b>	As at 30 Dec 2008
	<b>£m</b>	£m
<b>At amortised cost</b>		
Certificates of deposits	<b>23,980</b>	50,956
Medium term notes	<b>38,784</b>	48,630
Covered bonds (note 12)	<b>28,528</b>	34,022
Commercial paper	<b>9,194</b>	12,132
Securitisation (note 12)	<b>34,842</b>	42,708
	<b><u>135,328</u></b>	<u>188,448</u>

Included within commercial paper above is £4,810 million (2008: £2,979 million) issued by the Grampian conduit and £245 million (2008: £nil million) issued by Landale conduit.

**14. Share capital**

On 15 January 2009 there was a placing and open offer with the UK Government through HM Treasury which raised £8,499 million, comprising £1,870 million of ordinary shares and £6,629 million being taken to a merger reserve. In addition, there was an issue to the UK Government through HM Treasury of three million 25 pence equity preference shares which raised £3,000 million, comprising £750,000 of equity preference shares and £2,839 million (net of £160 million of placing costs) being taken to a merger reserve. Following the acquisition, these shares are held entirely by the Lloyds Banking Group.

On 26 June 2009, £5,000 million was raised through a capital injection by Lloyds Banking Group, comprising £500 million of ordinary shares and £4,500 million of share premium.

**15. Capital transactions**

During the period, the Group was involved in a number of transactions which were designed to improve the overall capital structure of the Lloyds Banking Group. The Group exchanged some of its upper tier 2 debt instruments for non-capital debt securities and also exchanged some of its upper tier 2 debt instruments for innovative tier 1 capital securities.

The profits generated by these transactions increased the Group's core tier 1 capital as new security issuances are required to be recognised at the fair value of the securities issued, while the redemption of securities results in the derecognition of instruments carried at amortised cost.

The accounting carrying value of the securities exchanged was greater than the fair value of the securities issued, and, as a result, the transactions generated a profit of £1,265 million, which was recognised by the Group in the period.

The impact of the above transactions on capital was to increase the Group's core tier 1 capital by £1,265 million and reduce its total capital by £2,737 million.

**16. Contingent liabilities and commitments**

	<b>As at 30 June 2009 £m</b>	<b>As at 31 Dec 2008 £m</b>
<b>Contingent liabilities</b>		
Acceptances and endorsements	2	-
Other:		
Other items serving as direct substitutes	109	73
Performance bonds and other transaction-related contingencies	989	1,241
	1,098	1,314
	1,100	1,314
<b>Commitments</b>		
Documentary credits and other short-term trade related transactions	85	137
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Mortgage offers	11,330	14,917
Other commitments	55,906	68,403
	67,236	83,320
	67,321	83,457

## 17. Legal and regulatory matters

HBOS along with Lloyds TSB Bank plc and six other financial institutions has been involved in legal proceedings with the Office of Fair Trading (OFT), regarding the legal status and enforceability of unarranged overdraft charges. The proceedings to date have been concerned with whether certain of the financial institutions' terms and conditions are subject to the fairness test in the Unfair Terms in Consumer Contract Regulations 1999 and whether they are capable of being 'penalties' at common law. The High Court previously confirmed that the relevant financial institutions' then current terms and conditions were not capable of being penalties at common law but were assessable for fairness under the Regulations (please see note 48 of the Lloyds Banking Group 2008 annual report and accounts for further details of the history of the proceedings, including the status of proceedings relating to historic terms and conditions).

On 26 February 2009, the Court of Appeal dismissed the appeal against the High Court's judgment made by the relevant financial institutions and held that unarranged overdraft charges are assessable for fairness under the Unfair Terms in Consumer Contract Regulations 1999. The House of Lords gave the relevant financial institutions permission to appeal this judgment. The hearing before the House of Lords took place on 23 to 25 June 2009. The judgment is awaited.

The OFT continues to investigate the fairness of specific bank charges, but has yet to determine whether the charges are fair. On 31 March 2009 the OFT announced that it is to streamline its investigation into unarranged overdraft charges by focusing on the terms of three banks, including Lloyds TSB Bank plc but not HBOS. The OFT has stated that the aim of this is to progress the investigation in the shortest and most efficient way possible. The OFT has stated that it believes that the terms of the three selected banks provide the best representative selection of all the relevant financial institutions' unarranged overdraft charging terms, and therefore the outcome of this more focused investigation will be relevant to the assessment of other relevant financial institutions' terms. The OFT has stated that it should not be assumed that the OFT is more or less likely to find the three banks' terms unfair than those of the other banks. The investigation into the other banks' terms is merely on hold.

On 22 July 2009, the FSA announced that it was granting to the relevant financial institutions (including HBOS) a further waiver until 26 January 2010. The waiver permits the relevant entities to continue suspending the handling of complaints related to the level, fairness or lawfulness of unarranged overdraft charges. Cases before the Financial Ombudsman Service and the County Courts are currently stayed pending the outcome of the legal proceedings initiated by the OFT.

The Group intends to continue to defend its position strongly. No provision in relation to the outcome of this litigation has been made. A range of outcomes is possible, some of which could have a significant financial impact on the Group. The ultimate impact of the litigation on the Group can only be known at its conclusion.

On 1 July 2008 the Financial Ombudsman Service referred concerns regarding the handling of PPI complaints to the FSA as an issue of wider implication. HBOS and other industry members and trade associations have made submissions to the FSA regarding this referral. The matter was considered at the FSA Board meeting on 25 September 2008. HBOS has been working with other industry members and trade associations in preparing an industry response to address regulatory concerns regarding the handling of PPI complaints. The FSA has now indicated that it will issue formal handbook guidance and/or rules on PPI complaint handling by the end of 2009 and a consultation paper which builds on the proposals put forward by the industry members, trade associations and other relevant parties is expected during the second half of 2009.

**17. Legal and regulatory matters (continued)**

On 30 September 2008 the FSA published a statement arising from its ongoing thematic review of PPI sales. In the statement, which was directed at the industry generally, the FSA highlighted certain concerns and indicated that it was escalating its regulatory intervention and considering appropriate action to deal with ongoing non-compliant sales practices and to remedy non-compliant past sales. The FSA plans indicate that an update on the third phase of the thematic work would be published during 2009. In recent months the FSA has also written to a number of trade associations and firms on an industry wide basis raising issues in relation to mortgage PPI variation and cancellation terms, and the disclosure of these during a sale. Those industry discussions are ongoing and HBOS is participating in those discussions. No provision in relation to the outcome of this issue has been made as the ultimate impact on the Group is not yet known.

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

**18. Capital structure**

	<b>As at 30 June 2009</b>	As at 31 Dec 2008
	£m	£m
<b>Capital Resources</b>		
<b>Core tier 1</b>		
Ordinary share capital	3,722	1,352
Eligible reserves	19,584	15,227
Minority interests	355	381
	<b>23,661</b>	16,960
<b>Deductions from tier 1</b>		
Goodwill and other intangible assets	(2,114)	(2,475)
Excess expected loss	(413)	(536)
Other deductions	(885)	(446)
	<b>(3,412)</b>	(3,457)
<b>Perpetual non-cumulative preference shares</b>		
Preference share capital	5,322	3,195
<b>Innovative tier 1</b>		
Preferred securities	4,327	3,092
<b>Total tier 1 capital</b>	<b>29,898</b>	19,790
<b>Upper tier 2</b>		
Undated subordinated debt	2,281	8,096
Collectively assessed impairment provisions	1,184	1,454
<b>Lower tier 2</b>		
Dated subordinated debt	10,227	10,306
<b>Deductions from tier 2</b>		
Excess expected loss	(413)	(536)
Other deductions	(774)	(287)
<b>Total tier 2 capital</b>	<b>12,505</b>	19,033
<b>Supervisory deductions</b>		
Unconsolidated investments – life	(4,191)	(4,562)
– other	(657)	(482)
<b>Total supervisory deductions</b>	<b>(4,848)</b>	(5,044)
<b>Total capital resources</b>	<b>37,555</b>	33,779
<b>Risk weighted assets<sup>(1)</sup></b>	<b>316,974</b>	328,023
Core tier 1 ratio <sup>(1)</sup>	6.4%	4.1%
Tier 1 capital ratio <sup>(1)</sup>	9.4%	6.0%
<b>Total capital ratio<sup>(1)</sup></b>	<b>11.8%</b>	10.3%

<sup>(1)</sup> Outside the scope of PwC review

**19. Related party transactions**

On 16 January 2009 the Lloyds TSB acquisition of HBOS plc was completed and Lloyds TSB Group plc was renamed Lloyds Banking Group plc. Following the acquisition the Group's ultimate parent undertaking and controlling party is Lloyds Banking Group plc which is incorporated in Scotland.

The Group transacts with Lloyds Banking Group and related entities during the ordinary course of business. Details of transactions and outstanding balances as at and for the period ended 30 June 2009 are detailed below.

	<b>Period to 30 June 2009</b>
	<b>£m</b>
<b>Net income</b>	
Interest income earned	70
Interest expense paid	(426)
Other income	115
Dividends paid	(52)
	<b>As at 30 June 2009</b>
	<b>£m</b>
<b>Outstanding balances</b>	
<i>Assets</i>	
Loans and advances to banks	32,043
Loans and advances to customers	14
Loans and receivables - debt securities	737
Other assets	77
<i>Liabilities</i>	
Deposits from banks	(77,274)
Debt securities in issue	(2,136)
Net derivative liability	(242)
Other liabilities	(97)

As a result of the acquisition of the Company by Lloyds Banking Group plc, HM Treasury became a related party of the Group from 13 January 2009. During the period between 13 January 2009 and 30 June 2009 Lloyds Banking Group plc entered into an Open Offer Agreement, a Pre-Accession Commitments Deed and a Lending Commitments Deed with the UK Government. Details of each of these agreements are summarised on pages 7 to 9 of the Lloyds Banking Group's annual report on Form 20-F for the year ended 31 December 2008. The Open Offer Agreement was amended on 18 May 2009 to allow a compensatory element to be provided to non-accepting shareholders. Lloyds Banking Group plc also amended the Registration Rights agreement with HM Treasury with effect from 10 June 2009 and entered into a Re-sale Rights Agreement with HM Treasury with effect from 11 June 2009, in both cases as required under the Open Offer Agreement. There were no other material transactions between the Lloyds Banking Group and the UK Government during the period between 13 January 2009 and 30 June 2009 that were not made in the ordinary course of business or that are unusual in their nature or conditions.

**20. Prior year reclassifications**

The following table sets out the balance sheet as at 31 December 2008 as presented in the 2008 financial statements of the Group and the income statement for the six months ended 30 June 2008 as presented in the 2008 interim results for the Group with reclassifications made to present these statements on a basis consistent with the presentation practices adopted by Lloyds Banking Group:

Consolidated balance sheet as at 31 December 2008

		Adjustments		Restated £m
		As previously presented £m	Prior year adjustments £m	
<b>Assets</b>				
Cash and balances at central banks		2,502	-	2,502
Items in course of collection from banks		445	-	445
Trading and other assets designated at fair value through profit or loss	(i)	22,571	-	89,691
Derivative financial instruments		51,810	-	51,810
Loans and receivables:				
Loans and advances to banks	(i)	17,645	-	16,796
Loans and advances to customers	(v)	435,223	-	450,421
Debt securities	(i)	-	-	39,053
		452,868	-	506,270
Investment securities	(i)	133,372	-	-
Available-for-sale financial assets	(i)	-	-	28,048
Investment property		3,045	-	3,045
Interests in jointly controlled entities and associates		1,161	-	1,161
Goodwill and other intangible assets	(iv)	2,375	-	-
Goodwill	(iv)	-	-	1,556
Value of in-force long-term assurance business	(iv)	2,992	-	3,284
Other intangible assets	(iv)	-	-	527
Property and equipment/tangible fixed assets	(ii)	1,433	-	5,400
Operating lease assets	(ii)	3,967	-	-
Deferred costs	(iii)	1,181	-	-
Current tax assets		983	-	983
Deferred tax assets		2,556	49	2,605
Retirement benefit asset		629	(583)	46
Other assets	(iii)	4,851	-	7,208
Prepayments and accrued income	(iii)	1,176	-	-
<b>Total assets</b>		<b>689,917</b>	<b>(534)</b>	<b>704,581</b>

**20. Prior year reclassifications** (continued)

Consolidated balance sheet as at 31 December 2008

		Adjustments		Restated £m
		As previously presented £m	Prior year Adjustments £m	
<b>Liabilities</b>				
Deposits from banks		97,150	-	97,150
Customer accounts	(v)	222,251	-	237,449
Items in course of transmission to banks	(vi)	-	-	521
Notes in circulation		957	-	957
Trading and other financial liabilities at fair value through profit or loss		18,851	-	18,851
Derivative financial instruments		38,905	-	38,905
Debt securities in issue		188,448	-	188,448
Insurance contract liabilities	(vii)	30,712	-	(30,712)
Investment contract liabilities	(vi)(vii)	39,482	-	(39,482)
Liabilities arising from insurance contracts and participating investment contracts	(vii)	-	-	36,873
Liabilities arising from non-participating investment contracts	(vi)(vii)	-	-	29,057
Unallocated surplus within insurance businesses		551	-	551
Other liabilities	(vi)(vii)	5,109	-	7,042
Retirement benefit obligations		152	410	562
Current tax liabilities		58	-	58
Deferred tax liabilities		227	(227)	-
Accruals and deferred income	(vi)	3,099	-	(3,099)
Other provisions	(vi)	347	-	(200)
Subordinated liabilities/other borrowed funds		30,119	-	30,119
<b>Total liabilities</b>		<b>676,418</b>	<b>183</b>	<b>691,799</b>
<b>Net assets</b>		<b>13,499</b>	<b>(717)</b>	<b>12,782</b>

The significant balance sheet reclassifications (none of which require the remeasurement of an asset or liability) are in relation to:

- (i) the reclassification of investment securities (£133,372 million) and certain loans and advances to banks (£849 million) to trading and other financial assets designated at fair value (£67,120 million); available for sale financial assets (£28,048 million), and debt securities (classified as loans and receivables) (£39,053 million);
- (ii) the reclassification of operating lease assets (£3,967 million) to tangible fixed assets;
- (iii) the reclassification of deferred costs (£1,181 million) and prepayments and accrued income (£1,176 million) to other assets;
- (iv) the reclassification of goodwill and intangible assets into their separate components, and the reclassification of purchased value of in-force investment contracts to value of in-force long-term insurance business;
- (v) the representation of certain customer deposit amounts (£15,198 million) available for offset onto a gross basis;



**20. Prior year reclassifications** (continued)

- (vi) the reclassification of accruals and deferred income (£3,099 million) to other liabilities, the reclassification of other liabilities (£521 million) to items in the course of transmission to banks. The reclassification of other provisions (£200 million) to other liabilities, and the reclassification of investment contracts related to collective investment schemes (£4,264 million) within investment contract liabilities, to other liabilities; and
- (vii) the reclassification of insurance contract liabilities (£30,712 million) to liabilities arising from insurance contracts and participating investment contracts, the reclassification of participating investment contracts (£6,161 million) from investment contract liabilities to liabilities arising from insurance contracts and participating investment contracts, the reclassification of non-participating investment contracts (£29,057 million) to liabilities arising from non-participating investment contracts and the remainder of investment contract liabilities (£4,264 million) to other liabilities.

**20. Prior year reclassifications** (continued)

Consolidated income statement for the half-year to 30 June 2008

		As previously presented	Reclassifi- cations	Restated
		£m	£m	£m
Interest and similar income		18,456	146	18,602
Interest payable		(14,595)	(22)	(14,617)
Fees and commission income		1,149	(112)	1,037
Fees and commission expense		(546)	-	(546)
Net earned premiums on insurance contracts/insurance premium income		2,276	7	2,283
Net trading income	(i)	(910)	(4,271)	(5,181)
Change in value of in force long-term assurance business		36	(36)	-
Net investment income related to insurance and investment business	(i)	(4,571)	4,571	-
Other operating income		1,055	(242)	813
Change in investment contract liabilities	(ii)	2,734	(2,734)	-
Net claims incurred on insurance contracts	(ii)	(1,721)	1,721	-
Net change in insurance contract liabilities	(ii)	1,854	(1,854)	-
Insurance claims	(ii)	-	3,113	3,113
Operating expenses	(iii)	-	(3,177)	(3,177)
Change in unallocated surplus	(ii)	231	(231)	-
Administrative expenses	(iii)	(2,459)	2,459	-
Depreciation and amortisation:				
Intangible assets other than goodwill	(iii)	(104)	104	-
Property and equipment	(iii)	(104)	104	-
Operating lease assets	(iii)	(508)	508	-
		(716)	716	-
Goodwill impairment	(iii)	(2)	2	-
Impairment losses on loans and advances	(iv)	(1,310)	1,310	-
Impairment on investment securities	(iv)	(145)	145	-
Impairment	(iv)	-	(1,455)	(1,455)
Share of profits of jointly controlled entities		13	(13)	-
Share of losses of associated undertakings		(37)	37	-
Share of losses of jointly controlled entities and associates		-	(24)	(24)
Non-operating income/profit on disposal of businesses		56	(56)	-
<b>Profit before taxation</b>		<b>848</b>	<b>-</b>	<b>848</b>
Tax on loss		102	-	102
<b>Profit for the period</b>		<b>950</b>	<b>-</b>	<b>950</b>

**20. Prior year reclassifications (continued)**

Certain income statement captions and presentations have been aligned to those used by Lloyds Banking Group for consistency purposes. The significant income statement reclassifications are in relation to:

- (i) the reclassification of net investment income (£4,571 million) to net trading income;
- (ii) the reclassification of change in investment contract liabilities (£2,734 million), net claims incurred on insurance contracts (£1,721 million), net change in insurance contract liabilities (£1,854 million), change in unallocated surplus (£231 million) to insurance claims;
- (iii) the reclassification of administrative expenses (£2,459 million), depreciation and amortisation (£716 million) and goodwill impairment (£2 million) to operating expenses; and
- (iv) the reclassification of impairment losses on loans and advances (£1,310 million) and investment securities (£145 million) to impairment losses.

**21. Ultimate parent undertaking**

HBOS plc's ultimate parent undertaking and controlling party is Lloyds Banking Group plc (formerly Lloyds TSB Group plc) which is incorporated in Scotland. Lloyds Banking Group plc will produce consolidated accounts for the year ended 31 December 2009. Copies of the annual report and accounts of Lloyds Banking Group plc and HBOS plc for the year ended 31 December 2008 may be obtained from the Company Secretary's Department, Lloyds Banking Group, 25 Gresham Street, London EC2V 7HN or downloaded via [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com).

**22. Other information**

The financial information included in this news release does not constitute statutory accounts within the meaning of section 434 of the Companies Act 2006. Statutory accounts for the year ended 31 December 2008 were approved by the directors on 26 February 2009 and have been delivered to the Registrar of Companies. The auditors' report on these accounts was unqualified and did not include a statement under sections 237(2) (accounting records or returns inadequate or accounts not agreeing with records and returns) or 237(3) (failure to obtain necessary information and explanations) of the Companies Act 1985.

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors listed below (being all the directors of HBOS plc) confirm that to the best of their knowledge this condensed set of financial statements has been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting, as adopted by the European Union, and that the Interim Management Report herein includes a fair review of the information required by DTR 4.2.7 and DTR 4.2.8, namely:

- an indication of important events that have occurred during the six months ended 30 June 2009 and their impact on the condensed interim financial statements, and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
- material related party transactions in the six months ended 30 June 2009 and any material changes in the related party transactions described in the last annual report.

Signed on behalf of the board by

J Eric Daniels  
Chief Executive  
4 August 2009

### **HBOS plc board of directors:**

Sir Victor Blank (Chairman)  
J Eric Daniels (Chief Executive)  
Tim JW Tookey (Finance Director)  
Wolfgang CG Berndt  
Philip N Green  
Sir Julian Horn-Smith  
Archie G Kane  
Lord Leitch  
Sir David Manning  
Carolyn J McCall  
T Timothy Ryan, Jr  
Martin A Scicluna  
G Truett Tate  
Anthony Watson  
Helen A Weir

## INDEPENDENT REVIEW REPORT TO HBOS PLC

### Introduction

We have been engaged by the company to review the condensed set of financial statements in the Interim Management Report for the six months ended 30 June 2009, which comprises 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 with the exception of the risk-weighted asset and capital ratio information in note 18. We have read the other information contained in the Interim Management Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

### Directors' responsibilities

The Interim Management Report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim Management Report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority. As disclosed in note 2, the annual financial statements of the Group are prepared in accordance with International Financial Reporting Standards as adopted by the European Union. The condensed set of financial statements included in this Interim Management Report has 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 company a conclusion on the condensed set of financial statements in the Interim Management Report based on our review. This report, including the conclusion, has been prepared for and only for the company for the purpose of the Disclosure and Transparency Rules of the Financial Services Authority and for no other purpose. We do not, in producing this report, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### Scope of review

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

**INDEPENDENT REVIEW REPORT TO HBOS PLC** (continued)

**Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim Management Report for the six months ended 30 June 2009 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

PricewaterhouseCoopers LLP  
Chartered Accountants  
Edinburgh  
4 August 2009

Notes:

- a) The maintenance and integrity of the Lloyds Banking Group website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website, and
- b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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For further information please contact:-

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