

# 2011 HALF-YEAR RESULTS

## News Release

LLOYDS  
BANKING  
GROUP



## BASIS OF PRESENTATION

This report covers the results of Lloyds Banking Group plc (the Company) together with its subsidiaries (the Group) for the half-year ended 30 June 2011.

### Statutory basis

Statutory results are set out on pages 136 to 175. However, a number of factors have had a significant effect on the comparability of the Group's financial position and results. As a result, comparison on a statutory basis of the 2011 results with 2010 is of limited benefit.

### Combined businesses basis

In order to provide more meaningful and relevant comparatives, the results of the Group and divisions are presented on a 'combined businesses' basis. The key principles adopted in the preparation of the combined businesses basis of reporting are described below.

- In order to reflect the impact of the acquisition of HBOS, the amortisation of purchased intangible assets has been excluded; and the unwind of acquisition-related fair value adjustments is shown as one line in the combined businesses income statement.
- In order to better present the business performance the following items, not related to acquisition accounting, have also been excluded:
  - integration costs;
  - volatility arising in insurance businesses;
  - curtailment gains and losses in respect of the Group's defined benefit pension schemes;
  - customer goodwill payments provision;
  - payment protection insurance provision;
  - sale costs in respect of the EU mandated retail business disposal; and
  - loss on disposal of businesses.

To enable a better understanding of the Group's core business trends and outlook, certain income statement, balance sheet and regulatory capital information is analysed between core and non-core portfolios. The non-core portfolios consist of businesses which deliver below-hurdle returns, which are outside the Group's risk appetite or may be distressed, are subscale or have an unclear value proposition, or have a poor fit with the Group's customer strategy. The EU mandated retail business disposal (Project Verde) is included in core portfolios.

The Group's core and non-core activities are not managed separately and the preparation of this information requires management to make estimates and assumptions that impact the reported income statements, balance sheet, regulatory capital related and risk amounts analysed as core and as non-core.

The Group uses a methodology that categorises income and expenses as non-core only where management expect that the income or expense will cease to be earned or incurred when the associated asset or liability is divested or run-off, and allocates operational costs to the core portfolio unless they are directly related to non-core activities. This results in the reported operating costs for the non-core portfolios being less than would be required to manage these portfolios on a stand-alone basis. Due to the inherent uncertainty in making estimates, a different methodology or a different estimate of the allocation might result in a different proportion of the Group's income or expenses being allocated to the core and non-core portfolios, different assets and liabilities being deemed core or non-core and accordingly a different allocation of the regulatory effects.

During 2011, the Group has reassessed its non-core activities and a number of portfolio changes have been made within the Wholesale, Commercial and International portfolios; it is not intended that any further changes will be made to the composition of these non-core portfolios. The disclosures for the half-years ended 30 June 2010 and 31 December 2010 have been restated on this basis.

Unless otherwise stated income statement commentaries throughout this document compare the half-year to 30 June 2011 to the half-year to 30 June 2010, and the balance sheet analysis compares the Group balance sheet as at 30 June 2011 to the Group balance sheet as at 31 December 2010.

## FORWARD LOOKING STATEMENTS

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

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## KEY HIGHLIGHTS

'We delivered a resilient first half performance, despite the ongoing challenges of economic and regulatory uncertainty, and have made substantial progress in restructuring and de-risking the Group. I expect the actions we are taking, as detailed in our Strategic Review announcement, to enable us to create a high performance organisation over time and deliver the best from our franchise for both our customers and our shareholders.'

António Horta-Osório  
*Group Chief Executive*

### FURTHER PROGRESS IN THE HALF-YEAR IN REDUCING THE GROUP'S RISK

- £31 billion reduction in non-core assets to £162 billion.
- Excellent progress against term funding objectives with £25 billion of wholesale term issuance in the half.
- Further growth in customer relationship deposits of 3 per cent.
- Total customer balances of £963 billion (31 December 2010: £972 billion), primarily reflecting non-core asset reduction, partly offset by deposit growth.
- Loan to deposit ratio of 144 per cent (31 December 2010: 154 per cent).
- Accelerated £60 billion reduction in government and central bank facilities to £37 billion.
- Robust core tier 1 capital ratio of 10.1 per cent, broadly unchanged since the year end.

### RESILIENT COMBINED BUSINESSES PERFORMANCE, IN LINE WITH OUR EXPECTATIONS

- Performance reflects subdued UK economy, further risk reduction, and high wholesale funding costs.
- Profit before tax of £1,104 million (first half of 2010: £1,603 million).
- Underlying profit before tax (excluding liability management and ECN effects totalling £851 million) increased 36 per cent to £1,340 million (first half of 2010: £988 million).
- Core business profit before tax of £2,660 million (first half of 2010: £3,691 million).
- Underlying total income, net of insurance claims, decreased by 12 per cent to £10,414 million, due to non-core asset reduction and subdued lending markets. Excluding losses on disposal of treasury assets of £670 million, underlying total income fell 7 per cent principally as a result of a 6 per cent decrease in average interest-earning assets.
- Banking net interest margin of 2.07 per cent (second half of 2010: 2.12 per cent), reflecting continued high funding costs, repayment of government and central bank facilities, and competitive deposit markets.
- Costs slightly down. Underlying cost:income ratio of 51.2 per cent (first half of 2010: 45.8 per cent).
- Integration programme on track to deliver annual run-rate savings of £2 billion by the end of 2011.
- Further 17 per cent reduction in the impairment charge to £5,422 million.

### STATUTORY RESULTS INCLUDE PPI PROVISION

- Statutory loss before tax of £3,251 million (first half of 2010: profit of £1,296 million), after £3,200 million PPI provision.
- Loss attributable to equity shareholders of £2,305 million (first half of 2010: profit of £596 million).
- Loss per share of 3.4 pence (first half of 2010: earnings per share of 0.9 pence).

### SUPPORTING THE UK'S ECONOMIC RECOVERY

- On track to deliver full year contribution to Merlin lending agreement; £21.2 billion of committed gross lending to businesses in first half, of which £6.7 billion for SMEs.

### 2011 GUIDANCE AND 2014 FINANCIAL TARGETS UNCHANGED

- No change to 2011 guidance and 2014 financial targets as set out in Strategic Review announcement.
- Continue to monitor economic conditions closely, and remain mindful of regulatory challenges.
- Well positioned to realise the Group's full potential over time, and to achieve strong, stable and sustainable returns for shareholders.

## SUMMARY OF RESULTS

Results	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change since 30 June 2010 %	Half-year to 31 Dec 2010 £m
	<b>Statutory</b>			
Total income, net of insurance claims	<b>10,854</b>	12,591	<b>(14)</b>	12,365
Total operating expenses	<b>(9,628)</b>	(5,811)	<b>(66)</b>	(7,459)
Trading surplus	<b>1,226</b>	6,780	<b>(82)</b>	4,906
Impairment	<b>(4,491)</b>	(5,423)	<b>17</b>	(5,529)
(Loss) profit before tax	<b>(3,251)</b>	1,296		(1,015)
(Loss) profit attributable to equity shareholders	<b>(2,305)</b>	596		(916)
(Loss) earnings per share	<b>(3.4)p</b>	0.9p		(1.3)p
<b>Combined businesses basis (note 1, page 80)</b>				
Total income, net of insurance claims	<b>10,178</b>	12,481	<b>(18)</b>	10,963
Underlying total income, net of insurance claims <sup>1</sup>	<b>10,414</b>	11,866	<b>(12)</b>	11,775
Operating expenses <sup>2</sup>	<b>(5,332)</b>	(5,435)	<b>2</b>	(5,493)
Trading surplus	<b>4,846</b>	6,896	<b>(30)</b>	5,470
Impairment	<b>(5,422)</b>	(6,554)	<b>17</b>	(6,627)
Profit before tax	<b>1,104</b>	1,603	<b>(31)</b>	609
Underlying profit before tax <sup>1</sup>	<b>1,340</b>	988	<b>36</b>	1,421
Banking net interest margin	<b>2.07%</b>	2.08%		2.12%
Banking asset margin	<b>1.43%</b>	1.55%		1.57%
Banking liability margin	<b>1.05%</b>	0.98%		0.97%
Cost:income ratio <sup>2,3</sup>	<b>52.4%</b>	43.5%		50.1%
Underlying cost:income ratio <sup>1,2,3</sup>	<b>51.2%</b>	45.8%		46.6%
Impairment as a % of average advances <sup>4</sup>	<b>1.77%</b>	2.01%		2.02%
<b>Combined businesses basis – core</b>				
Total income, net of insurance claims	<b>9,250</b>	10,571	<b>(12)</b>	9,062
Underlying total income, net of insurance claims	<b>9,486</b>	9,956	<b>(5)</b>	9,874
Operating expenses	<b>(4,860)</b>	(4,908)	<b>1</b>	(4,976)
Trading surplus	<b>4,390</b>	5,663	<b>(22)</b>	4,086
Impairment	<b>(1,636)</b>	(1,653)	<b>1</b>	(1,959)
Profit before tax	<b>2,660</b>	3,691	<b>(28)</b>	2,071
Underlying profit before tax	<b>2,896</b>	3,076	<b>(6)</b>	2,883
Banking net interest margin	<b>2.35%</b>	2.28%		2.33%
Cost:income ratio <sup>3</sup>	<b>52.5%</b>	46.4%		54.9%
Underlying cost:income ratio <sup>1,3</sup>	<b>51.2%</b>	49.3%		50.4%
Impairment as a % of average advances <sup>4</sup>	<b>0.72%</b>	0.70%		0.81%

<sup>1</sup> Excluding a reduction in the fair value of the equity conversion feature of the Group's Enhanced Capital Notes of £236 million (half-year to 30 June 2010: gain of £192 million; half-year to 31 December 2010: reduction of £812 million) and, in the half-year to 30 June 2010, liability management gains of £423 million.

<sup>2</sup> Excluding impairment of tangible fixed assets of £150 million in the half-year to 30 June 2010.

<sup>3</sup> Operating expenses divided by total income, net of insurance claims.

<sup>4</sup> Impairment on loans and advances to customers divided by average loans and advances to customers, excluding reverse repo transactions, gross of allowance for impairment losses.

**SUMMARY OF RESULTS** (continued)

	As at 30 June 2011	As at 31 Dec 2010	<i>Change since 31 Dec 2010 %</i>
<b>Capital and balance sheet</b>			
<b>Statutory</b>			
Loans and advances to customers <sup>1</sup>	<b>£587.8bn</b>	£592.6bn	<b>(1)</b>
Customer deposits <sup>2</sup>	<b>£399.9bn</b>	£393.6bn	<b>2</b>
Loans and advances to customers excl reverse repurchase agreements (repos)	<b>£568.1bn</b>	£589.5bn	<b>(4)</b>
Customer deposits excl repos	<b>£394.9bn</b>	£382.5bn	<b>3</b>
Total customer balances <sup>3</sup>	<b>£963.0bn</b>	£972.0bn	<b>(1)</b>
Loan to deposit ratio <sup>4</sup>	<b>144%</b>	154%	
Funds under management <sup>5</sup>	<b>£193.3bn</b>	£192.0bn	<b>1</b>
Wholesale funding (see page 96)	<b>£295.6bn</b>	£298.0bn	<b>(1)</b>
Wholesale funding >1 year maturity	<b>49%</b>	50%	
Funded assets (see page 95)	<b>£612.0bn</b>	£655.0bn	<b>(7)</b>
Primary liquidity portfolio (see page 95)	<b>£100.9bn</b>	£97.5bn	<b>3</b>
Risk-weighted assets	<b>£383.3bn</b>	£406.4bn	<b>(6)</b>
Core tier 1 capital ratio	<b>10.1%</b>	10.2%	
Net tangible assets per share	<b>57.2p</b>	59.2p	
Leverage ratio	<b>18 times</b>	17 times	
<b>Core</b>			
Loans and advances to customers excl reverse repos	<b>£443.3bn</b>	£454.2bn	<b>(2)</b>
Reverse repos	<b>£19.7bn</b>	£3.1bn	
Loans and advances to banks	<b>£27.9bn</b>	£29.9bn	<b>(7)</b>
Debt securities	<b>£0.2bn</b>	£0.3bn	<b>(33)</b>
Available-for-sale financial assets	<b>£19.7bn</b>	£20.9bn	<b>(6)</b>
Other assets	<b>£305.8bn</b>	£289.5bn	<b>6</b>
<b>Total core assets</b>	<b>£816.6bn</b>	£797.9bn	<b>2</b>
Customer deposits excl repos	<b>£390.4bn</b>	£377.0bn	<b>4</b>
Total customer balances	<b>£833.7bn</b>	£831.2bn	
Loan to deposit ratio <sup>4</sup>	<b>114%</b>	120%	
Risk-weighted assets	<b>£254.6bn</b>	£262.5bn	<b>(3)</b>
<b>Non-core</b>			
Loans and advances to customers excl reverse repos	<b>£124.8bn</b>	£135.3bn	<b>(8)</b>
Loans and advances to banks	<b>£0.3bn</b>	£0.4bn	<b>(25)</b>
Debt securities	<b>£15.3bn</b>	£25.4bn	<b>(40)</b>
Available-for-sale financial assets	<b>£13.1bn</b>	£22.1bn	<b>(41)</b>
Other assets	<b>£8.9bn</b>	£10.5bn	<b>(15)</b>
<b>Total non-core assets</b>	<b>£162.4bn</b>	£193.7bn	<b>(16)</b>
Customer deposits excl repos	<b>£4.5bn</b>	£5.5bn	<b>(18)</b>
Risk-weighted assets	<b>£128.7bn</b>	£143.9bn	<b>(11)</b>

<sup>1</sup> Includes reverse repos of £19.7 billion (31 December 2010: £3.1 billion).

<sup>2</sup> Includes repos of £5.0 billion (31 December 2010: £11.1 billion).

<sup>3</sup> Total customer balances are the aggregate of loans and advances to customers excluding reverse repos and customer deposits excluding repos.

<sup>4</sup> Excludes repos of £5.0 billion (31 December 2010: £11.1 billion) and reverse repos of £19.7 billion (31 December 2010: £3.1 billion).

<sup>5</sup> Funds under management within Wealth and International division.

## GROUP CHIEF EXECUTIVE'S STATEMENT

### Summary

The Group performed in line with our expectations in the first half of 2011, despite the ongoing challenges of economic and regulatory uncertainty, the effects of which, including subdued loan demand, financial market volatility, and increasing regulatory capital and liquidity requirements, are reflected in these results.

We have taken a series of rapid, focused actions since I became Group Chief Executive on 1 March to strengthen the Group and ensure we are better positioned for the future. These actions included the Strategic Review, the outcome of which was announced on 30 June, in which we set out our UK-focused strategy to support our core customers.

We continue to monitor economic conditions closely, notably in the UK and Eurozone, and remain mindful of the challenges of continuing regulatory uncertainty, particularly ahead of the final report of the Independent Commission on Banking in September.

However, given the actions we have taken and the strategy we are now implementing, we are well positioned to realise over time the full potential of our organisation, brands and capabilities, and to achieve strong, stable and sustainable returns for shareholders.

### Results overview

The Group reported a combined businesses profit before tax of £1,104 million in the first half of 2011, with the core business delivering profit before tax of £2,660 million.

While Group combined businesses profit before tax represented a reduction of 31 per cent from £1,603 million in the first half of 2010, when movements in the value of the equity conversion feature of the Enhanced Capital Notes (ECNs) and liability management gains reported in the first half of last year are excluded, combined businesses profit before tax increased by 36 per cent. This primarily reflected, at a divisional level, a significant improvement in Wholesale performance, where profit more than doubled, partly offset by a 20 per cent increase in losses in our International business. The higher International losses mainly reflected an increased impairment charge relating to our Irish portfolio in the first half of this year compared to the same period in 2010, although this charge was a third lower than in the second half of 2010.

In the core business, profit before tax fell 28 per cent, but excluding liability management and ECN effects the decline was 6 per cent, principally as a result of a 5 per cent fall in average interest-earning assets. In the non-core business, reductions in impairment and costs were partly offset by lower income as a result of further non-core asset reductions and resulted in a reduced loss before tax of £1,556 million (first half of 2010: loss of £2,088 million).

On a statutory basis, the Group reported a loss before tax of £3,251 million in the first half of the year, which included a non-recurring provision for Payment Protection Insurance (PPI) contact and redress costs of £3,200 million and a charge for integration costs of £642 million (first half of 2010: £804 million).

Underlying income, which excludes liability management and ECN effects, decreased by 12 per cent. This reflected further non-core asset reductions (including losses on sales of treasury assets of £670 million which were broadly offset by a related accelerated fair value unwind of £649 million), subdued customer lending demand and continued customer deleveraging. Our net interest margin was 2.07 per cent, with the decline from 2.12 per cent in the second half of 2010 reflecting continued high wholesale funding costs, the refinancing of a significant amount of government and central bank facilities, and competitive deposit markets.

## **GROUP CHIEF EXECUTIVE'S STATEMENT** (continued)

Operating expenses were slightly down at £5,332 million, with further integration-related savings partly offset by increased employers' National Insurance contributions, and higher VAT, inflation and other costs.

The Group achieved a further reduction in the impairment charge in the first half of 2011, which, at £5,422 million, was 17 per cent lower than in the first half of 2010, with a deterioration in International (principally Ireland) more than offset by improvements elsewhere in the Group, particularly in Wholesale.

Against a backdrop of ongoing economic and regulatory uncertainty, we focused on continuing to reduce the Group's risk profile in the half-year through a further reduction in non-core assets of £31.3 billion to £162.4 billion, and through improving our funding position, with £25 billion of term funding raised in the first half. Together with growth in customer deposits (excluding repos) of 3 per cent in the half-year, these actions facilitated further substantial reductions in liquidity support from government and central bank facilities, with £37.1 billion outstanding at the end of the half against £96.6 billion at the 2010 year end. We also continued to maintain a robust core tier 1 capital ratio, which was broadly unchanged since the 2010 year end at 10.1 per cent.

### **Our actions since 1 March**

Since 1 March, we have taken a series of rapid, focused actions, including a number of strategic initiatives, such as accelerating the retail business disposal required by the EU (Project Verde), and have improved the Group's organisational structure and further strengthened its balance sheet. We have also refocused the Group's franchise on a multi-brand retail strategy, on active support for small and medium-sized enterprises (SMEs), and on improvement in customer satisfaction. A number of these initiatives are described in further detail below.

### **Management and organisation**

Following my appointment, we have strengthened businesses and functions with a number of additions to the Group's Executive Committee (GEC), including Juan Colombás as Chief Risk Officer, Antonio Lorenzo as Director, Wealth and Retail Products and Marketing, and Matt Young as Group Corporate Affairs Director.

We have also made a number of internal appointments who report directly to me and attend GEC including: John Maltby as Managing Director, Commercial; David Nicholson as Managing Director, Halifax Community Bank; Martyn Scrivens as Group Audit Director; and Harry Baines as Company Secretary and General Counsel.

In addition, we have announced a number of other senior appointments who will join the Group shortly: Alison Brittain as Group Director, Lloyds TSB and Bank of Scotland community banks; Toby Strauss as Group Director for Insurance; and, joining early next year, Nathan Bostock as Chief Executive, Wholesale.

We have also put in place a new, more agile organisation to support the implementation of our strategy. The new organisation has a flatter structure, which results in the leadership team being closer to our customers and having improved co-operation between businesses. As part of this new organisation, the heads of the Lloyds TSB and Halifax community banks, and Retail Products and Marketing, now all report directly to me. In order to ensure that the Group provides greater focus on SMEs, the Commercial business, previously part of Wholesale, now also reports directly to me. Also, all divisional functions, such as Finance, Risk, Audit, Human Resources, Legal and Communications, report directly to central functions.



**GROUP CHIEF EXECUTIVE'S STATEMENT** (continued)

**Our commitment to supporting our customers and the UK economic recovery**

The Group continues to prioritise active support for the UK's economic recovery, including through the range of services we provide to our business and mortgage customers. We also participate in a wide range of other measures designed to support our customers and the wider economy, both on our own initiative and in participation with industry and Government, including delivering the recommendations of the Business Finance Taskforce.

In addition, in the Merlin agreement with the UK Government, the Group and four other major UK banks announced in February the intention to enhance support for the UK economic recovery by delivering increased gross business lending in 2011 compared to 2010. The Merlin banks further agreed to provide the capacity to support additional gross new lending of up to £190 billion to creditworthy UK businesses, including £76 billion for SMEs, if sufficient demand emerges.

Based on performance in the first half of 2011, the Group is on track to deliver its full year contribution to the Merlin lending agreement, subject to sufficient demand for finance being maintained in the current economic climate. The Group actively looks at all opportunities to support UK businesses and we continue to innovate in the market to meet our customers' needs. These efforts are directly reflected in our once again being voted 'Bank of the Year' for businesses, as described in the 'Awards' section of this review. To the end of June 2011, we have provided £21.2 billion of committed gross lending to UK businesses, of which £6.7 billion has been to SMEs.

The year-on-year growth in net advances in our core Commercial business was 2 per cent as at the end of June 2011 which continues to compare favourably with the negative growth in SME lending across the industry reported in the latest available market statistics from the Bank of England.

The Group achieved a market share of over 20 per cent of gross mortgage lending in the first half of 2011, including supporting over 24,000 customers in buying their first home.

As part of our strategy to become the best bank for customers we publicly committed to reduce the level of FSA reportable complaints we receive by 20 per cent, between the first half of 2010 and the first half of 2011, excluding PPI complaints. We achieved a 24 per cent reduction, which has reduced our complaints per 1,000 accounts to only 1.7. This has been accomplished through the success of our phone-a-friend service and the training we have provided to our 40,000 front line colleagues. As a result of these initiatives, we are now resolving over 90 per cent of complaints at first touch.

In the second half of the year we are rolling out an externally accredited complaint handling qualification to all of our complaint handlers, making us the first financial services organisation to have professionally qualified complaint handlers. In addition we are also extending the opening hours of the specialist teams so they can deal with complaints 24 hours a day, 7 days a week, ensuring customers get the right outcome faster.

By putting customers at the heart of our business, we have reached some key milestones and outlined further strategic initiatives to strengthen this commitment. We have made over 100 changes to simplify our systems and processes to help serve our customers more quickly and efficiently. We have enhanced our internet banking offering to enable our retail customers to do more online, and extended the innovative Lloyds TSB Lend a Hand Mortgage to help customers purchase a home with the help of their local authority.

**GROUP CHIEF EXECUTIVE'S STATEMENT** (continued)

To strengthen our strategy of being the best bank for SMEs, we launched our Best for Business campaign, reaffirmed our continued support for the SME Charter to respond to 90 per cent of lending appeals within 15 days which will exceed the industry standard of 30 days, and maintained our leading part in the Business Growth Fund which is the latest initiative from the Business Finance Taskforce.

**Integration programme on track**

Our integration programme is one of the largest ever in financial services. In the first half of 2011, we continued to make excellent progress, and as we near the end of this three year journey we have been particularly focused on the completion of a number of system alignments. Key milestones in the first half included the completion of a programme to move Bank of Scotland ATMs on to the Lloyds TSB platform, the roll-out of an integrated Mortgage Sales Platform to Cheltenham & Gloucester colleagues, and the creation of a single claims management system within our General Insurance business.

We are now in the final stages of the core systems integration which will create single platforms supporting Halifax, Bank of Scotland and Lloyds TSB brands, across savings, current accounts, mortgages, general insurance and life & pensions for our personal customers and lending to small businesses. In the second half of this year we will complete the migration of these customer accounts to these platforms, while continuing to ensure that customers receive a seamless service throughout and colleagues are fully supported.

We achieved £1.75 billion of run-rate cost synergies by the end of the first half, and integration is on track to deliver the promised £2 billion of run-rate cost synergies by the end of this year.

**Our strategy to deliver for customers and shareholders**

On 30 June, following a detailed and extensive review of our business, we set out our UK-focused strategy to support our core customers and outlined the key actions we will take to deliver strong, stable and sustainable returns for shareholders. Our strategy and our financial targets are summarised in this half-year results announcement; further detail on the outcome of Strategic Review is given in our announcement of 30 June, which is available on our website [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com).

As part of our strategy, we will refocus our business portfolio to fit our assets, capabilities and risk appetite. We will focus on attractive UK customer segments, reduce our international presence, and continue our disciplined reduction of non-core assets, to ensure sustainable, predictable returns on equity above our cost of equity.

We will also simplify the Group to improve service and target the delivery of a further £1.5 billion of annual savings in 2014 (£1.7 billion of run-rate savings by end 2014), through better end-to-end processes and IT platforms, a de-layered management structure and simpler legal structure, centralised support functions, and more efficient sourcing and cost control. These savings will be incremental to savings achieved under the integration programme, and will imply the reduction of 15,000 roles throughout the Group by the end of 2014. The total cost of the programme is expected to be approximately £2.3 billion (including capital expenditure), of which around £1.5 billion is expected to be expensed through the income statement and reported outside of the Group's combined businesses results over the next few years.

**GROUP CHIEF EXECUTIVE'S STATEMENT** (continued)

The cost savings are expected to enable an additional £2 billion of investment over the period 2011 to 2014 to grow our core customer franchise. The annual income statement charge is expected to increase to around £500 million by 2014, equivalent to approximately one-third of the annual expenses benefit from the simplification programme. These investments will include:

- In **Retail**, we will revitalise Halifax as a leading challenger brand in UK retail banking and invest in Lloyds TSB and Bank of Scotland as leading relationship brands. We have also made a commitment to keep total branch numbers at the same levels (excluding the EU mandated business sale) through the period, and not to offshore further UK permanent operational roles.
- **Bancassurance** will be a core part of our proposition, through our multi-brand retail strategy, with a compelling product range and specialised advisor teams to better address our customers' needs.
- In **Wealth**, we will build our UK proposition for mass affluent, affluent and high net worth customers, and refocus our international business.
- **Wholesale's** focus will be on developing deeper client relationships and building transactional banking and fixed income capabilities to support our UK customers.
- **Commercial** will continue to focus on SME lending, whilst broadening its offering, on a business and individual basis, across a wider product range to include Wealth and Insurance.

We will also streamline our International presence, from 30 countries to less than half that number, by 2014.

We will continue to strengthen the Group's balance sheet, funding and liquidity position to ensure a robust core tier 1 capital ratio and a stable funding base, to meet the challenges of economic and regulatory uncertainty. We are targeting a core tier 1 capital ratio prudently in excess of 10 per cent in 2013 when the transition period to Basel 3 commences. We have also made a commitment to recommence progressive dividend payments after the EU restriction expires, as soon as the financial position of the Group and market conditions permit, and after regulatory capital requirements are defined and prudently met.

**Economic outlook**

We expect that a period of subdued economic recovery in the UK will be accompanied by a period of modest growth in our markets, and that this will be sustained for several years. We anticipate continued deleveraging by consumers and businesses, and slow growth in deposits as a result of the pressure on consumers' disposable incomes from ongoing high inflation and cuts in welfare benefits.

We expect UK GDP growth of 1.5 per cent in 2011, normalising above 2 per cent in 2012, with UK base rates increasing from the second half of 2011, unemployment improving from the second half of 2011, and property values stabilising.

**GROUP CHIEF EXECUTIVE'S STATEMENT** (continued)

**Provision for Payment Protection Insurance contact and redress**

On 20 April 2011, the High Court dismissed the application of the British Bankers' Association (BBA) to seek judicial review against the Financial Services Authority (FSA) and the Financial Ombudsman Service (FOS) regarding the handling of PPI complaints. After publication of the judgment, the Group entered into discussions with the FSA with a view to seeking clarity around the detailed implementation of the FSA Policy Statement of 10 August 2010, which sets out evidential provisions and guidance on the fair assessment of customer complaints and the calculation of redress, and concluded that there are certain circumstances where customer contact and/or redress is appropriate. While there remain a number of uncertainties as to the eventual costs from any such contact and/or redress, the Group has made a provision of £3,200 million in the first half of 2011, which has been excluded from the combined businesses results.

**Independent Commission on Banking (ICB)**

We have considered and responded to the ICB's interim report. We have presented evidence to demonstrate that the UK retail banking market is competitive, with considerable customer churn, a strong intermediary sector, and the growth of the internet channel and comparison sites. The interim report did not identify any significant competition concerns in savings, credit cards, unsecured personal loans and mortgages. On this basis, the ICB's competition concerns appear to be with personal and business current accounts.

We agree with the ICB that improving transparency and the ease of switching are key measures to further improve competition in business and personal current accounts. We are working on switching proposals with the ICB and others including the UK Payments Council, which we consider, when combined with greater transparency, will transform customers' perception and experience of moving their business or personal current accounts.

We are continuing to engage with the ICB and will do so through to the publication of the final report in September. We think this engagement has been constructive, particularly with regard to the Group's EU mandated retail business disposal (Project Verde), and since the ICB's Interim Report, we have made considerable progress in relation to the funding requirements of the Verde business.

The Verde business will have strong brands, a branch network of a similar size to that of the Halifax Community Bank and a full product range including savings, loans, credit cards and mortgages as well as current accounts. We believe that Verde will be a strong competitor in UK retail banking.

The Group has received a number of credible initial approaches for the Verde business and we are working closely with the potential buyers with the aim of identifying a purchaser by the end of the year.

In terms of financial stability, we believe a 'multi-pillar approach' consisting of improved recovery and resolution (including ring-fencing), better regulation and improved capital and liquidity requirements will significantly improve financial stability. We have discussed with the ICB the possible cost and the potential impact on the banking sector's capacity to support the economy's recovery and its long run growth potential.

As such, we believe a thorough analysis of the costs and benefits of the different reforms – alone and in combination – is required. The conclusions from such analysis should allow regulators to find the optimum level of reform that ensures the appropriate flow of credit to the economy and safeguards economic growth.

**GROUP CHIEF EXECUTIVE'S STATEMENT** (continued)

**Our people**

We are committed to making the Group the best bank for our people, one where all colleagues are proud to work, and one which takes its commitments to customers, colleagues and our communities seriously. We are fortunate to have high-quality committed people across the organisation whose capabilities will support us in delivering our strategy. The Strategic Review had the additional advantage of aligning all of our senior leadership group and their teams firmly behind its initiatives.

We take the training and development of our people very seriously and are strengthening our learning and development resources that everyone in the Group can access, for example, through our academies programme.

We also value feedback from our colleagues, and are putting in place a new survey aligned to our strategy and commitments to our customers. From this, we expect to gain vital feedback on how well we are delivering on what we have set out to do for the Group.

Finally, we recognise that our colleagues regularly go beyond what is expected both professionally and in their activities outside of work and we have several award schemes to recognise the extraordinary efforts they make more broadly for our customers and communities.

**Awards**

I am very pleased with the significant number of awards Lloyds Banking Group received in the first half of this year, and am particularly proud of the broad range of external recognition achieved across the Group. This reflects the outstanding contribution of our people right across the Group, as we strive to be the best bank for our customers.

The awards we have received so far this year include 'Bank of the Year' at the Real FD/CBI Excellence Awards, which we have won for the seventh year running in recognition of our continued support of UK businesses; 'Best UK Private Bank of the Year' at the Financial Times and Investors Chronicle Wealth Management Awards, recognising Bank of Scotland Private Banking's commitment to customers; and five awards at the Euroweek awards for our funding achievements.

Our long-running commitment to community investment was also recognised, including the Group being awarded the Business in the Community 'CommunityMark' recognising excellence in community investment, and a Platinum rating in the Corporate Responsibility Index, a benchmark as to how well companies integrate responsible business practices.

**GROUP CHIEF EXECUTIVE'S STATEMENT** (continued)

**Outlook**

Our guidance given in our Strategic Review announcement on 30 June 2011 remains unchanged. Further detail on our 2011 guidance and 2014 financial targets is given in the Group Finance Director's Review of Financial Performance and Outlook.

We continue to monitor economic conditions closely, notably in the UK and Eurozone, and remain mindful of the challenges of continuing regulatory uncertainty, particularly ahead of the final report of the Independent Commission on Banking in September.

Given the series of rapid, focused actions we have taken since March, and the progress made in the half-year in strengthening our balance sheet, we are well positioned to realise over time the full potential of our organisation, brands and capabilities, and to achieve strong, stable and sustainable returns for shareholders.

António Horta-Osório  
*Group Chief Executive*

**COMBINED BUSINESSES INFORMATION**

The analysis and commentary that is set out on pages 13 to 88 is presented on a combined businesses basis. The basis of preparation of the combined businesses results is set out on page 80.

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## COMBINED BUSINESSES CONSOLIDATED INCOME STATEMENT

	Half-year to 30 June 2011 £ million	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
Net interest income	6,378	6,911	6,911
Other income	3,998	5,831	4,333
<b>Total income</b>	<b>10,376</b>	<b>12,742</b>	<b>11,244</b>
Insurance claims	(198)	(261)	(281)
<b>Total income, net of insurance claims</b>	<b>10,178</b>	<b>12,481</b>	<b>10,963</b>
Costs:			
Operating expenses	(5,332)	(5,435)	(5,493)
Impairment of tangible fixed assets	–	(150)	–
	<b>(5,332)</b>	<b>(5,585)</b>	<b>(5,493)</b>
<b>Trading surplus</b>	<b>4,846</b>	<b>6,896</b>	<b>5,470</b>
Impairment	(5,422)	(6,554)	(6,627)
Share of results of joint ventures and associates	12	(62)	(29)
<b>(Loss) profit before tax and fair value unwind</b>	<b>(564)</b>	<b>280</b>	<b>(1,186)</b>
Fair value unwind	1,668	1,323	1,795
<b>Profit before tax – combined businesses</b>	<b>1,104</b>	<b>1,603</b>	<b>609</b>

The basis of preparation of the combined businesses income statement is set out on the inside front cover.

RECONCILIATION OF COMBINED BUSINESSES PROFIT BEFORE TAX TO  
STATUTORY (LOSS) PROFIT BEFORE TAX FOR THE HALF-YEAR

	Half-year to 30 June 2011 £ million	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
<b>Profit before tax – combined businesses</b>	<b>1,104</b>	<b>1,603</b>	<b>609</b>
Integration costs	(642)	(804)	(849)
Volatility arising in insurance businesses (note 5, page 86)	(177)	(199)	505
Amortisation of purchased intangibles	(289)	(323)	(306)
Customer goodwill payments provision	–	–	(500)
Pension curtailment gain (loss) (note 4, page 153)	–	1,019	(109)
Payment protection insurance provision (note 22, page 165)	(3,200)	–	–
EU mandated retail business disposal costs	(47)	–	–
Loss on disposal of businesses	–	–	(365)
<b>(Loss) profit before tax – statutory</b>	<b>(3,251)</b>	<b>1,296</b>	<b>(1,015)</b>



## COMBINED BUSINESSES CONSOLIDATED INCOME STATEMENT

	Half-year to 30 June 2011 £ million	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
<b>Core</b>			
Net interest income	5,353	5,614	5,420
Other income	4,095	5,218	3,923
<b>Total income</b>	<b>9,448</b>	<b>10,832</b>	<b>9,343</b>
Insurance claims	(198)	(261)	(281)
<b>Total income, net of insurance claims</b>	<b>9,250</b>	<b>10,571</b>	<b>9,062</b>
Costs:			
Operating expenses	(4,860)	(4,908)	(4,976)
Impairment of tangible fixed assets	–	–	–
	<b>(4,860)</b>	<b>(4,908)</b>	<b>(4,976)</b>
<b>Trading surplus</b>	<b>4,390</b>	<b>5,663</b>	<b>4,086</b>
Impairment	(1,636)	(1,653)	(1,959)
Share of results of joint ventures and associates	3	2	12
<b>Profit before tax and fair value unwind</b>	<b>2,757</b>	<b>4,012</b>	<b>2,139</b>
Fair value unwind	(97)	(321)	(68)
<b>Profit before tax – core</b>	<b>2,660</b>	<b>3,691</b>	<b>2,071</b>
<b>Non-core</b>			
Net interest income	1,025	1,297	1,491
Other income	(97)	613	410
<b>Total income</b>	<b>928</b>	<b>1,910</b>	<b>1,901</b>
Insurance claims	–	–	–
<b>Total income, net of insurance claims</b>	<b>928</b>	<b>1,910</b>	<b>1,901</b>
Costs:			
Operating expenses	(472)	(527)	(517)
Impairment of tangible fixed assets	–	(150)	–
	<b>(472)</b>	<b>(677)</b>	<b>(517)</b>
<b>Trading surplus</b>	<b>456</b>	<b>1,233</b>	<b>1,384</b>
Impairment	(3,786)	(4,901)	(4,668)
Share of results of joint ventures and associates	9	(64)	(41)
<b>Loss before tax and fair value unwind</b>	<b>(3,321)</b>	<b>(3,732)</b>	<b>(3,325)</b>
Fair value unwind	1,765	1,644	1,863
<b>Loss before tax – non-core</b>	<b>(1,556)</b>	<b>(2,088)</b>	<b>(1,462)</b>
<b>Profit before tax – combined businesses</b>	<b>1,104</b>	<b>1,603</b>	<b>609</b>

The basis of preparation of the core and non-core income statement is set out on the inside front cover.

**COMBINED BUSINESSES PROFIT (LOSS) ANALYSIS BY DIVISION**

	<b>Half-year to 30 June 2011 £ million</b>	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
Retail	<b>2,200</b>	2,495	2,221
Wholesale	<b>1,429</b>	585	2,333
Commercial <sup>1</sup>	<b>262</b>	157	182
Wealth and International	<b>(2,080)</b>	(1,609)	(3,215)
Insurance	<b>543</b>	469	633
Group Operations and Central items:			
Group Operations	<b>(62)</b>	(56)	(7)
Central items	<b>(1,188)</b>	(438)	(1,538)
	<b>(1,250)</b>	(494)	(1,545)
<b>Profit before tax</b>	<b>1,104</b>	1,603	609

<sup>1</sup> Given the importance of the Group's role in the UK's economic recovery through actively supporting SME lending, the Group is now reporting Commercial separately. Commercial comprises the Group's SME business and was previously part of Wholesale. Comparatives have been restated accordingly.

**COMBINED BUSINESSES PROFIT (LOSS) ANALYSIS BY DIVISION** (continued)

	<b>Half-year to 30 June 2011 £ million</b>	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
<b>Core</b>			
Retail	<b>1,986</b>	2,209	1,934
Wholesale	<b>1,004</b>	1,264	891
Commercial	<b>250</b>	141	169
Wealth and International	<b>150</b>	127	98
Insurance	<b>520</b>	444	524
Group Operations and Central items	<b>(1,250)</b>	(494)	(1,545)
<b>Profit before tax – core</b>	<b>2,660</b>	3,691	2,071
<b>Non-core</b>			
Retail	<b>214</b>	286	287
Wholesale	<b>425</b>	(679)	1,442
Commercial	<b>12</b>	16	13
Wealth and International	<b>(2,230)</b>	(1,736)	(3,313)
Insurance	<b>23</b>	25	109
Group Operations and Central items	<b>–</b>	–	–
<b>Loss before tax – non-core</b>	<b>(1,556)</b>	(2,088)	(1,462)
<b>Profit before tax – combined</b>	<b>1,104</b>	1,603	609

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK****Performance in line with our expectations**

In the first half of 2011, the Group delivered a combined businesses performance in line with our expectations. The fall in underlying income reflected a smaller balance sheet primarily driven by a further reduction of non-core assets, and a lower net interest margin than in the second half of 2010, mainly as a result of continued high wholesale funding costs, the refinancing of a significant amount of government and central bank facilities and competitive deposit markets. Costs were slightly down, as further gains from integration were mostly offset by higher employers' National Insurance contributions, VAT, inflation and other costs. The impairment charge reduced, as improvements in Wholesale and Retail more than offset the higher impairment charge in Ireland. We continued to further strengthen our balance sheet, by increasing customer deposits, making excellent progress against our funding objectives and on the continued reduction of non-core assets, allowing a substantial repayment of government and central bank facilities. Our core tier 1 capital ratio stands at 10.1 per cent (31 December 2010: 10.2 per cent), with the effect of the £3,200 million provision relating to Payment Protection Insurance (PPI), which has been excluded from our combined businesses results, largely offset by a reduction in risk-weighted assets of £23 billion.

On a combined businesses basis, profit before tax decreased to £1,104 million in the first half of 2011, compared to £1,603 million in the first half of 2010, a reduction of 31 per cent. This reflected the absence this year of £423 million of gains from liability management exercises which had benefited the first half of 2010, and £236 million of mark-to-market losses arising from the equity conversion feature of the Group's Enhanced Capital Notes (ECNs) in the first half of 2011, compared to gains of £192 million in the first half of 2010 ('liability management and ECN effects'). Excluding these effects, combined businesses profit before tax increased by 36 per cent, with a significant improvement in Wholesale performance partly offset by an increased loss in our International business.

Retail profit before tax decreased to £2,200 million from £2,495 million in the first half of 2010, primarily driven by higher funding costs and continued subdued demand for credit. Wholesale increased profit before tax to £1,429 million in the first half of 2011, compared to £585 million in the first half of 2010, mainly as a result of a significant reduction in the impairment charge. Commercial profit before tax increased to £262 million, compared to £157 million in the first half of 2010, largely reflecting increased deposit balances and lower impairment. Wealth and International reported a loss before tax of £2,080 million compared to a £1,609 million loss in the first half of 2010, primarily due to a higher impairment charge predominantly relating to the Irish portfolio. Insurance profit before tax increased to £543 million in the first half of 2011 compared to £469 million in the first half of 2010, which after excluding a non-recurring charge of £70 million in the first half of 2010 was broadly flat. The benefits of the change in mix towards more profitable protection business in Life, Pensions and Investments and improved claims experience in General Insurance were offset by lower PPI income and lower income from reduced shareholder net assets. Group Operations and Central items made a loss before tax of £1,250 million compared to a loss of £494 million in the first half of 2010, primarily due to an absence of gains on liability management, an adverse change in the mark-to-market valuation of the equity conversion feature on the ECNs and a decrease in the fair value of derivatives not mitigated through hedge accounting.

Statutory loss before tax was £3,251 million in the first half of the year. While this was a reduction from £1,296 million profit before tax in the first half of 2010, the loss in the first half of 2011 principally reflected the PPI provision of £3,200 million. The reduction from the first half of 2010 also reflects liability management and ECN effects and the pension curtailment gain of £1,019 million in the first half of 2010, partially offset by lower integration costs. After a tax credit of £973 million (see note 7 on page 155) and after allowing for profit attributable to non-controlling interests of £27 million, the loss attributable to equity shareholders was £2,305 million and the loss per share amounted to 3.4 pence.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)

To enable a better understanding of the Group's core business trends and outlook, we have provided an enhanced disclosure on the split of our core and non-core businesses including more detailed cost and divisional financial information.

**Core and non-core profit before tax**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Core	<b>2,660</b>	3,691	<b>(28)</b>	2,071
Non-core	<b>(1,556)</b>	(2,088)	<b>25</b>	(1,462)
<b>Total</b>	<b>1,104</b>	1,603	<b>(31)</b>	609

Core business profit before tax was £2,660 million compared to £3,691 million in the first half of 2010. Excluding liability management and ECN effects, core business profit before tax decreased by 6 per cent, principally reflecting higher funding costs and a decline in average interest-earning assets as a result of subdued market conditions. Non-core loss before tax was £1,556 million (first half of 2010: £2,088 million), with the improvement principally driven by reductions in impairment and costs, partly offset by lower income as a result of further non-core asset reductions.

**Further progress in reducing the Group's risk**

We continued to further reduce the inherent risk in our balance sheet in line with our strategy. We maintained a robust core tier 1 capital ratio and liquidity position and made further significant improvements in our funding position during the half-year. Our core tier 1 capital ratio stands at 10.1 per cent (31 December 2010: 10.2 per cent), and our loan to deposit ratio, excluding repos, improved to 144 per cent (31 December 2010: 154 per cent), and to 114 per cent in our core business (31 December 2010: 120 per cent). We also made substantial further progress in reducing liquidity support from government and central bank facilities, which reduced from £96.6 billion at 31 December 2010 to £37.1 billion at 30 June 2011. This was achieved through excellent progress in term wholesale funding issuance during the first half of the year, which totalled £25 billion, further growth of 3 per cent in customer deposits (excluding repos) and the reduction in our non-core assets.

We also continue to closely monitor and control our exposures to certain European countries. The Group's aggregate direct exposure to the national and local governments of Spain, Italy, Portugal, Ireland, Greece and Belgium totalled £189 million. Further information on our exposures to these countries, including to banking groups, asset backed securities, and corporate, retail and other exposures, is given on pages 103 to 106 of this release.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Combined businesses results summary – income**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>6,378</b>	6,911	<b>(8)</b>	6,911
Other income:				
Underlying other income	<b>4,234</b>	5,216	<b>(19)</b>	5,145
Liability management gains	<b>–</b>	423		–
Change in fair value of equity conversion feature of ECNs	<b>(236)</b>	192		(812)
	<b>3,998</b>	5,831	<b>(31)</b>	4,333
<b>Total income</b>	<b>10,376</b>	12,742	<b>(19)</b>	11,244
Insurance claims	<b>(198)</b>	(261)	<b>24</b>	(281)
<b>Total income, net of insurance claims</b>	<b>10,178</b>	12,481	<b>(18)</b>	10,963
<b>Underlying income</b>				
Net interest income	<b>6,378</b>	6,911	<b>(8)</b>	6,911
Underlying other income	<b>4,234</b>	5,216	<b>(19)</b>	5,145
Insurance claims	<b>(198)</b>	(261)	<b>24</b>	(281)
<b>Underlying income, net of insurance claims</b>	<b>10,414</b>	11,866	<b>(12)</b>	11,775

**Group income performance**

Total income, net of insurance claims, decreased by 18 per cent to £10,178 million, with the change including a £428 million increase in the mark-to-market losses arising from the equity conversion feature of the Group's Enhanced Capital Notes. The total mark-to-market loss relating to the ECNs in the first half of 2011 was £236 million, and comprised a loss of £398 million in the first quarter of the year and a gain of £162 million in the second quarter (first half of 2010: £192 million gain). In addition, liability management gains arose on transactions undertaken in the first half of 2010 as part of the Group's management of capital which exchanged certain debt securities for ordinary shares or other debt instruments. These transactions resulted in a gain of £423 million in the first half of 2010 with no comparable transactions in the first half of 2011.

Underlying income, net of insurance claims, decreased by 12 per cent reflecting further asset sales, including losses on disposals of treasury assets of £670 million which were broadly offset by a related accelerated fair value unwind of £649 million, subdued lending demand and continued customer deleveraging. Excluding the losses on disposals of treasury assets, underlying income fell 7 per cent, principally as a result of a 6 per cent reduction in average interest-earning assets.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)

Group net interest income decreased by £533 million, or 8 per cent, to £6,378 million. The net interest margin in our banking businesses was 2.07 per cent, with the decline from 2.12 per cent in the second half of 2010 principally reflecting continued high wholesale funding costs, a competitive deposit market and the effect of refinancing a significant amount of government and central bank facilities. The banking asset margin decreased by 14 basis points to 1.43 per cent, and the banking liability margin increased by 8 basis points to 1.05 per cent, reflecting the change in the cost of deposits relative to wholesale funding rates, compared to the second half of 2010.

Other income decreased by 31 per cent to £3,998 million. Excluding liability management and ECN effects, underlying other income decreased by 19 per cent to £4,234 million. This decrease reflected a targeted reduction in the balance sheet, including the losses on disposals of treasury assets mentioned above. Excluding these losses, underlying other income decreased by 6 per cent.

**Core and non-core underlying income performance**

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change since 30 June 2010 %	Half-year to 31 Dec 2010 £m
Core	9,486	9,956	(5)	9,874
Non-core	928	1,910	(51)	1,901
<b>Total underlying income, net of insurance claims</b>	<b>10,414</b>	<b>11,866</b>	<b>(12)</b>	<b>11,775</b>

**Core and non-core net interest margin**

	Half-year to 30 June 2011	Half-year to 30 June 2010	Half-year to 31 Dec 2010
Core	2.35%	2.28%	2.33%
Non-core	1.23%	1.50%	1.52%
<b>Group net interest margin</b>	<b>2.07%</b>	<b>2.08%</b>	<b>2.12%</b>

	Half-year to 30 June 2011 £bn	Half-year to 30 June 2010 £bn	Change since 30 June 2010 %	Half-year to 31 Dec 2010 £bn
Average interest-earning assets – core	454.2	476.0	(5)	468.7
Average interest-earning assets – non-core	150.6	168.7	(11)	161.5
<b>Total average interest-earning assets</b>	<b>604.8</b>	<b>644.7</b>	<b>(6)</b>	<b>630.2</b>

Core underlying income decreased by 5 per cent, principally reflecting subdued new lending demand and continued customer deleveraging.

The 51 per cent fall in non-core underlying income reflects the loss of income as a result of the significant reductions achieved in the non-core portfolio, and the losses on disposals of treasury assets of £670 million in the first half of 2011. Excluding the losses on disposals of treasury assets, non-core underlying income decreased by 16 per cent.

Core net interest margin increased, mainly reflecting the improved funding mix in the core business, with the benefit of increased customer deposits more than offsetting higher wholesale funding costs. Non-core net interest margin decreased, primarily as a result of higher wholesale funding costs and the strain from increased impaired assets.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)

***Outlook – income***

*2011 guidance*

We currently expect a Group net interest margin of around 2 per cent for the second half of 2011 which would result in a full year margin just above 2 per cent. We expect non-core reductions to further reduce balance sheet size and therefore income. Full year core income is expected to continue to be slightly down as a result of the lower margin and the reduction in the size of the core balance sheet given the effects of continued customer deleveraging and subdued new lending demand.

*2014 targets*

In the medium term, we expect to build customer-driven diversified income with additional discretionary investment in core customer franchises. We expect core income to grow faster than nominal GDP growth over the period to the end of 2014, primarily driven by other operating income growth. Other operating income (net of insurance claims) is targeted to increase to approximately 50 per cent of total income by the end of 2014 from 41 per cent in 2010.

By the end of 2014, we are targeting a net interest margin of between 2.15 per cent and 2.30 per cent, based on our current business and macro-economic assumptions, including, as we stated at the time of our Strategic Review announcement on 30 June, that base rates will be lower for longer than we previously anticipated. The core net interest margin is expected to be higher than Group net interest margin by the end of 2014.

We assume that over time, although probably not initially, the Group will benefit from UK base rate increases, and we also recognise that the competition for deposits is currently strong. We expect our reduced wholesale issuance needs to facilitate greater control over our funding costs in the future, with our improved funding position allowing greater flexibility over the mix of funding sources, resulting in tighter issuance spreads. As previously reported, we expect a negative effect on our net interest margin from increasing liquidity requirements.



**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Combined businesses results summary – costs**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Operating expenses	<b>5,332</b>	5,435	<b>2</b>	5,493
Impairment of tangible fixed assets <sup>1</sup>	<b>–</b>	150		–
Total costs	<b>5,332</b>	5,585	<b>5</b>	5,493
Integration synergies run rate	<b>1,750</b>	1,084	<b>61</b>	1,379
Underlying cost:income ratio	<b>51.2%</b>	45.8%		46.6%

<sup>1</sup> Further detail is given in note 4, page 153.

**Further progress in delivering integration savings**

During the first half of 2011, operating expenses decreased by 2 per cent to £5,332 million, mainly as a result of further integration-related savings and lower levels of operating lease depreciation in Wholesale, partially offset by increased employers' National Insurance contributions, and higher VAT, inflation and other costs.

Under legislation, the Group will only become liable to pay the Bank Levy at 31 December 2011 and, as a result, has not accrued for this cost in the first half of 2011. However, we continue to expect the cost of the Bank Levy for the full year to be approximately £260 million. If the Bank Levy had been accrued for in the half, costs would have been broadly flat, excluding the charge for impairment of tangible fixed assets in the first half of 2010.

Our underlying cost:income ratio was 51.2 per cent, with the increase reflecting the reduction in income in the half-year.

We have continued to make significant progress with the integration programme with annual run-rate savings totalling £1,750 million achieved as at 30 June 2011. We are on schedule to deliver run-rate cost synergies and other operating efficiencies of £2 billion per annum by the end of 2011.

On 1 March 2011, we announced that, in order to meet our obligations under EU state aid commitments and to ensure that we retain maximum flexibility, we would accelerate the start of the retail business disposal as required by the EU (Project Verde). Costs attributable to Project Verde in the first half of 2011 were modest at £47 million and, as previously advised, costs related to the disposal are excluded from combined businesses results.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Core and non-core operating expenses**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
<b>Core</b>				
Operating expenses	<b>4,860</b>	4,908	<b>1</b>	4,976
Underlying cost:income ratio	<b>51.2%</b>	49.3%		50.4%
<b>Non-core</b>				
Operating expenses	<b>472</b>	527	<b>10</b>	517
Impairment of tangible fixed assets	<b>–</b>	150		–
	<b>472</b>	677	<b>30</b>	517

As noted in the basis of presentation on the inside front cover, costs apportioned to non-core represent only those that are expected to cease to be incurred at the point these portfolios, assets, or liabilities are divested or run off, and operational costs are allocated to the core book unless they are directly related to non-core activities. This results in the reported operating costs for the non-core portfolio being lower than would be required to manage these portfolios on a stand-alone basis.

Operating expenses in the core business reduced 1 per cent, with further integration-related savings and lower levels of operating lease depreciation in Wholesale, partially offset by increased employers' National Insurance contributions, and higher VAT, inflation and other costs.

Non-core operating expenses reduced by 10 per cent, reflecting the elimination of certain costs of supporting the non-core portfolios.

**Outlook – expenses**

As outlined in the Strategic Review, as integration nears completion, we have commenced a simplification programme to deliver further cost savings in the period to the end of 2014, through better end-to-end processes and IT platforms, a de-layered management structure and simpler legal structure, centralised support functions, and a reduction of 15,000 roles.

As advised at the end of June 2011, we expect a slight decline in costs in 2011, due to the benefits from the integration programme and simplification cost actions already being taken, partially offset by costs resulting from the introduction of the Bank Levy (which is expected to cost around £260 million in 2011) and a combined cost in the region of £100 million of the recent rise in VAT and employers' National Insurance contributions.

In order to achieve positive operating jaws from the simplification programme, we are targeting annual cost savings to amount to £1.5 billion in 2014 and run-rate cost savings to be £1.7 billion per annum by the end of 2014. Including the cost of the Bank Levy, the Group is targeting a cost:income ratio of 42 to 44 per cent by the end of 2014 (equivalent to 39 to 41 per cent when adjusted to include the net of operating lease income and depreciation in Group income).

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Combined businesses results summary – impairment charge**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
<b>Retail</b>				
Secured	295	53		239
Unsecured	878	1,282		1,173
	<b>1,173</b>	1,335	<b>12</b>	1,412
<b>Wholesale</b>	<b>1,557</b>	2,801	<b>44</b>	1,263
<b>Commercial</b>	<b>160</b>	190	<b>16</b>	192
<b>Wealth and International</b>				
Ireland	1,779	1,557	<b>(14)</b>	2,707
Other	753	671	<b>(12)</b>	1,053
	<b>2,532</b>	2,228	<b>(14)</b>	3,760
<b>Impairment charge</b>	<b>5,422</b>	6,554	<b>17</b>	6,627

**Further reductions in the impairment charge**

The Group saw a reduction in the impairment charge in the first half of 2011. The impairment charge of £5,422 million was 17 per cent lower than the £6,554 million charge in the first half of 2010, with higher charges in Ireland and Australasia more than offset by improvements elsewhere in the Group, particularly the substantial fall in the Wholesale division's impairment charge compared to the first half of 2010.

Impaired loans increased by 1 per cent compared to December 2010 to £65.5 billion, representing 10.6 per cent of closing advances, driven by an increase in impaired loans in International, partially offset by decreases in Retail and Wholesale. The Group's coverage ratio reduced by 0.7 per cent to 45.2 per cent.

Retail's impairment charge reduced by 12 per cent, driven by the unsecured portfolio, supported by prudent risk management, improved business quality, and a stabilising economy. Credit performance remained strong with fewer assets entering arrears compared to the second half of 2010, in both the secured and unsecured portfolios. As a percentage of average advances, the impairment charge decreased to 0.65 per cent, from 0.76 per cent in the second half of 2010.

As expected, the secured impairment charge increased, reflecting less favourable house price forecasts. The proportion of the mortgage portfolio with an indexed loan-to-value of greater than 100 per cent decreased to 12.2 per cent. The value of the portfolio with an indexed loan-to-value greater than 100 per cent and more than three months in arrears decreased slightly by £0.1 billion and is now £3.1 billion, but still represents 0.9 per cent of the portfolio. The number of mortgage customers new to arrears decreased in the last six months.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)

Impairment provisions held against secured lending in Retail reflect management's view of appropriate allowance for incurred losses, including appropriate impairment provisions for customers who are experiencing financial difficulty, either on a forbearance arrangement or who are able to maintain their repayments while interest rates are low.

The unsecured impairment charge decreased by 32 per cent, reflecting improved quality of new business and effective portfolio management. Unsecured impaired loans decreased by £0.3 billion to £2.7 billion as a result of tightening credit policy across the credit lifecycle, including stronger controls on customer affordability. Impairment provisions as a percentage of impaired loans decreased to 48.5 per cent from 50.6 per cent, as a consequence of fewer assets entering collections, coupled with the continuing write-down of charged-off assets to their net realisable values.

The Wholesale impairment charge reduced materially from £2,801 million in the first half of 2010 to £1,557 million in the first half of 2011. The impairment charge as a percentage of average loans and advances to customers improved significantly to 2.02 per cent in the first half of 2011 compared to 3.11 per cent in the first half of 2010.

The decrease in this period has continued to be primarily driven by lower impairment from the HBOS heritage corporate real estate and real estate related asset portfolios, together with the stabilising UK and US economic environment in 2010 and so far in 2011 a low interest rate environment helping to maintain defaults at a relatively lower level. This was partly offset by increased impairment on leveraged acquisition finance exposures.

In Commercial, the impairment charge decreased by £30 million, or 16 per cent, due to an improvement in the overall credit quality of the portfolio, and the stabilisation of the economy, which led to an overall reduction in the level of defaults.

In Wealth and International, impairment charges totalled £2,532 million, an increase of 14 per cent from £2,228 million in the first half of 2010. This was predominantly as a result of our Irish portfolio where we have allowed for further falls in commercial real estate prices, which resulted in the impairment charge being approximately £500 million above our expectations at the beginning of the year, as well as weakness in our Australasian portfolio.

In Ireland in the first half of this year, a further 11 per cent of the £27.6 billion loans became impaired, resulting in 64.1 per cent of the Irish portfolio now being impaired. Provisions as a percentage of impaired Irish loans were 55.8 per cent at the end of June 2011 (31 December 2010: 53.7 per cent). In Australasia, although economic performance has been robust overall, the Group's portfolio has significant geographical and sector concentrations and these assets continue to be a concern. The Group also took a charge of £70 million in the first half of this year as a result of losses arising from the earthquake in New Zealand.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Core and non-core impairment performance**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Core	<b>1,636</b>	1,653	<b>1</b>	1,959
Non-core	<b>3,786</b>	4,901	<b>23</b>	4,668
<b>Total impairment</b>	<b>5,422</b>	6,554	<b>17</b>	6,627

The core impairment charge decreased, principally reflecting a reduction in the Retail impairment charge driven by the unsecured portfolio, partly offset by an increase in Wholesale, primarily due to two significant loans being impaired.

The non-core impairment charge reduced, principally as a result of a material reduction in the Wholesale impairment charge, driven by the same factors as the overall Wholesale impairment charge, partly offset by an increased impairment charge in Wealth and International, principally as a result of our Irish portfolio.

Non-core loans and advances to customers generated 77.2 per cent of the Group's impaired loans reflecting their higher risk profile, with a coverage ratio of 46.7 per cent at 30 June 2011.

**Outlook – impairment**

We are targeting the reduction of non-core assets and the prudent management of risk to result in an improvement in the Group's asset quality ratio (as a percentage of average gross loans and advances to customers) to 50 to 60 basis points by the end of 2014, with the core business expected to be at the bottom end of this range.

Overall, and based on our current economic assumptions for the UK and Ireland, including unemployment and property valuations, we continue to expect further reductions in impairment losses in 2011, compared to 2010, and beyond.

In **Retail**, given our expectations for the UK economy, including a 2 per cent reduction in house prices in 2011, we continue to expect that there will be a modest reduction in the overall impairment charge for the full year. The rate of improvement is, however, expected to be significantly slower than in 2010, with the improving performance of the unsecured book more than offsetting additional secured charges.

In **Wholesale**, depending upon UK economic conditions, we continue to expect a modest reduction for the full year compared to 2010 as a whole. We expect the UK environment to remain subdued in the second half of the year, which could affect trading sectors such as retail and leisure businesses. It may also adversely impact our corporate real estate property lending portfolio which is vulnerable to tenant defaults, although against our base case economic assumptions, we continue to expect a reduction in impairment charges in our corporate real estate and real estate related portfolios in 2011 as a whole. We remain vigilant in monitoring changes in economic conditions and to individual lending positions.

In **Commercial**, the impairment charge is trending better than 2011 expectations. However, given the subdued UK economic environment, the impairment outlook for the second half of 2011 is cautious, and we therefore expect the impairment charge for the full year 2011 to be broadly similar to that in the full year 2010.

We expect to see a reduction in the **Wealth and International** impairment charge in 2011, although we anticipate that conditions will remain difficult, and we will continue to monitor international markets closely.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Capital resources**

	<b>As at 30 June 2011</b>	As at 31 Dec 2010
Risk-weighted assets	<b>£383.3bn</b>	£406.4bn
Core tier 1 capital ratio	<b>10.1%</b>	10.2%
Tier 1 capital ratio	<b>11.6%</b>	11.6%
Total capital ratio	<b>15.0%</b>	15.2%

**Stable capital ratios**

Our core tier 1 capital ratio was 10.1 per cent at the end of June (31 December 2010: 10.2 per cent), reflecting the effect of the statutory loss, broadly offset by a reduction in risk-weighted assets of £23.1 billion. The total capital ratio reduced to 15.0 per cent, also reflecting the increase in the excess of expected losses over impairment losses, reflecting the gradual reduction of legacy lending that is subject to very high provision levels and replacement with new lending.

Risk-weighted assets reduced 6 per cent to £383.3 billion in the first half, driven by the run-down of our non-core asset portfolio within the Wholesale division. We do not expect further risk-weighted asset reductions in the second half of the year, given that the effect of the implementation of the new Capital Requirements Directive (CRD) 2 and 3 rule changes are expected to offset the effect of further risk-weighted asset reductions.

**Outlook – effects of Basel 3 and capital resources outlook**

The Basel Committee on Banking Supervision has substantially refined the details of the so called Basel 3 reforms for an enhanced global capital accord. These include increased minimum levels of capital, increased quality standards for capital, increased risk-weighting of assets, and the introduction of a minimum leverage ratio, as well as the timing and transitional arrangements for implementation. The final details are still to be clarified, particularly as the reforms are implemented within the European and UK regulations, which may include a countercyclical buffer, requiring higher levels of capital to be held at certain points of the economic cycle, and higher capital requirements for systemically important financial institutions.

We are targeting a core tier 1 capital ratio prudently in excess of 10 per cent in 2013 when the transition period to Basel 3 commences. We expect the implementation of CRD 2 and 3 changes noted above and the remaining measures together to have a negative effect of approximately 0.8 per cent on our core tier 1 capital ratio by the end of 2013.

The phasing in of new core tier 1 deductions over five years, which commences in January 2014, is expected to further affect our core tier 1 capital ratio in relation to our insurance operations, excess expected loss, and any residual deferred tax assets relating to trading losses that may still be on the Group's balance sheet at that time.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)

In July 2011, we have completed further capital restructurings which will contribute to reducing the total core tier 1 deduction under Basel 3 relating to our insurance operations by just over £2 billion. This significant mitigation is equivalent to approximately 50 basis points of core tier 1 capital ratio under full Basel 3 and will reduce the transitional rules impact from insurance to approximately 20 basis points per annum. The transitional adjustment in respect of excess expected loss is likely to have a similar annual effect to the insurance impact.

Non-core asset disposals, and the EU mandated retail business disposal (which is required to complete by the end of November 2013), are expected to reduce risk-weighted assets, and therefore benefit our capital ratios, over this period.

**Outlook – return on equity outlook**

We expect that the disciplined and high-return investments in our business will contribute to us delivering a sustainable statutory return on equity of between 12.5 and 14.5 per cent by 2014, despite ongoing poor returns from non-core assets, and still with positive earnings momentum into 2015. We expect that these returns will be in excess of our cost of equity.

**Balance sheet**

	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn
Funded assets <sup>1</sup>	<b>612.0</b>	655.0
Non-core assets <sup>2</sup>	<b>162.4</b>	193.7
Non-core risk-weighted assets	<b>128.7</b>	143.9

<sup>1</sup> Further analysis is set out on page 95.

<sup>2</sup> Further analysis is set out on page 3.

**Further progress on balance sheet reduction plans**

Total Group funded assets decreased to £612 billion from £655 billion at 31 December 2010, substantially driven by reductions in non-core portfolios across the four banking divisions, continued customer deleveraging and de-risking and subdued demand in lending markets. We are pleased with the progress made on our balance sheet reduction plans in the period, given challenging market conditions in the first half of 2011. In the first half of 2011, we achieved a substantial reduction in the non-core portfolio of £31 billion, resulting in the portfolio at 30 June 2011 amounting to £162 billion.

**Outlook – balance sheet**

On 30 June 2011, we updated our guidance on our strategy to reduce the non-core portfolio. We set a new target to reduce the balance to be equal to, or less than, £90 billion by the end of 2014, from £194 billion at the end of 2010. We expect the remaining non-core portfolio to account for less than or equal to £65 billion of risk-weighted assets by the end of 2014. We are also targeting non-core run-off and disposals to be net capital generative over the period 2012 to 2014.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Liquidity and funding**

	<b>As at 30 June 2011</b>	As at 31 Dec 2010
Customer deposits <sup>1</sup>	<b>£394.9bn</b>	£382.5bn
Wholesale funding	<b>£295.6bn</b>	£298.0bn
Loan to deposit ratio <sup>2</sup>	<b>144%</b>	154%
Core business loan to deposit ratio <sup>2</sup>	<b>114%</b>	120%
Government and central bank facilities	<b>£37.1bn</b>	£96.6bn
Proportion of wholesale funding with maturity of greater than one year	<b>49%</b>	50%

<sup>1</sup> Excluding repos of £5.0 billion (31 December 2010: £11.1 billion).

<sup>2</sup> Excluding repos and reverse repos.

***Further strengthening of our liquidity and funding position***

The Group made excellent progress against its funding objectives in the first half of 2011 and further enhanced its liquidity position which is supported by a robust and stable customer deposit base. Customer deposits excluding repos increased by 3 per cent, reflecting good growth in relationship deposits in Retail and in Wealth and International.

By the end of the first half of 2011, our loan to deposit ratio, excluding repos and reverse repos, had improved to 144 per cent. Strong term issuance in the first half of 2011 also allowed the Group to maintain its maturity profile of wholesale funding with 49 per cent of wholesale funding having a maturity date greater than one year at 30 June 2011.

We made excellent progress in the first half of 2011 on our term funding issuance plans, achieving £18 billion of publicly placed term issuance in the period. In addition, the Group issued a further £7 billion of term funding during the period via a series of privately placed funding transactions. As a result, the Group is in a position to be more selective as to which products and markets it will participate in during the second half of 2011.

The Group also made excellent progress on reducing its liquidity support from governmental and central bank sources, achieving a reduction of £59.5 billion in the first half of this year leaving £37.1 billion outstanding at the end of June. This liquidity support has various maturity dates, the last of which is in October 2012, and current plans assume that the remaining facilities will be repaid in line with contractual maturity dates.



**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)

***Outlook – liquidity and funding***

We will continue to strengthen the Group's balance sheet, liquidity and funding position, through the combination of growth in customer deposits, further wholesale term issuance and reductions in assets from non-core asset reduction plans over the next three years.

As stated above we have made excellent progress in wholesale funding against our previous guidance of public issuance of £20 billion to £25 billion this year. We expect to issue new funding of between £5 billion and £10 billion over the second half of this year across all public and private issuance programmes.

Our annual wholesale term issuance requirement has now fallen, and we expect a public term issuance requirement of £15 billion to £20 billion per annum as part of a total private and public programme of approximately £25 billion per annum in the future.

With a reduction in our overall wholesale funding requirement and in our non-core assets, and further growth in our relationship customer deposits, we are targeting an improvement in our Group loan to deposit ratio from 144 per cent currently to 130 per cent or below by the end of 2014 and our core business loan to deposit ratio to be 120 per cent or below by the same time.

The European Commission published its latest proposals on CRD 4 during July. The Group has constructed its funding plan to ensure compliance with the Liquidity Leverage Ratio (LCR) before the effective date of 2015. However, we note that the measure is subject to analysis of any unintended consequences with possible changes to the calculation before the implementation date. We will continue to develop models to calculate LCR as changes are introduced.

The funding plan also delivers compliance with Net Stable Funding Ratio based on the current definition. As set out in the CRD 4 document, we note that the Commission will use the longer Basel observation period (to 2018) to prepare a legislative proposal.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**Reconciliation of combined businesses results to statutory results**

	<b>Half-year to 30 June 2011 £ million</b>	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
<b>Profit before tax – combined businesses</b>	<b>1,104</b>	1,603	609
Integration costs	<b>(642)</b>	(804)	(849)
Volatility arising in insurance businesses	<b>(177)</b>	(199)	505
Amortisation of purchased intangibles	<b>(289)</b>	(323)	(306)
Customer goodwill payments provision	–	–	(500)
Pension curtailment gain (loss)	–	1,019	(109)
Payment protection insurance provision	<b>(3,200)</b>	–	–
EU mandated retail business disposal costs	<b>(47)</b>	–	–
Loss on disposal of businesses	–	–	(365)
<b>(Loss) profit before tax – statutory</b>	<b>(3,251)</b>	1,296	(1,015)
<b>Taxation</b>	<b>973</b>	(630)	91
<b>(Loss) profit for the period</b>	<b>(2,278)</b>	666	(924)
<b>(Loss) earnings per share</b>	<b>(3.4)p</b>	0.9p	(1.3)p

**Integration costs**

Integration costs of £642 million were incurred in the first half of 2011. The integration costs relate to severance, IT and business costs of implementation.

**Volatility arising in insurance businesses**

A large proportion of the funds held by the Group's insurance businesses are invested in assets which are expected to be held on a long-term basis and which are inherently subject to short-term investment market fluctuations. Whilst it is expected that these investments will provide enhanced returns over the longer term, the short-term effect of investment market volatility can be significant. The negative insurance and policyholder interests volatility of £177 million in the first half of 2011 reflects less optimistic economic forecasts and lower cash returns compared to long-term expectations.

**Taxation**

The tax credit for the half-year to 30 June 2011 was £973 million. This reflects a higher effective tax rate than the UK statutory rate primarily due to the recognition of tax losses previously unrecognised and policyholder tax, net of the effect on deferred tax of the further reduction in the UK corporation tax rate from 28 per cent to 26 per cent with effect from 1 April 2011.

**Acquisition related balance sheet adjustments**

Profit before tax includes the unwind of £1,668 million of acquisition related fair value adjustments. This is ahead of our previous expectations due to the accelerated release of amounts held against the Group's securities portfolios following disposals during the first half of the year. In the second half of 2011, we expect a further benefit of some £1 billion. Thereafter, over the medium term, declining benefits are expected to accrue.

**GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE AND OUTLOOK** (continued)**EU mandated retail business disposal (Project Verde)**

The Verde business comprises a network of 632 branches, and the TSB and Intelligent Finance brands, and serves approximately 5.5 million customers. The table below shows an illustration of the full year effects of the Verde disposal on the Lloyds Banking Group financials, based on current financial information and the term sheet presented to potential buyers in line with the base EU requirements. However, it is expected that the final profile at the time of expected legal completion in 2013 will be different.

**Income statement**

Income	c£1.2 billion
Expenses	c£0.5 billion
Impairment charge	c£0.2 billion
Profit before tax	c£0.5 billion

**Balance sheet**

Risk-weighted assets	c£16 billion
Assets	c£64 billion
Liabilities	c£32 billion

The implementation costs of the disposal will vary depending on the nature of the buyer, but could be up to £1 billion. These costs will be excluded from our combined businesses results.

**Summary**

In the first half of 2011, the Group delivered a combined businesses performance in line with our expectations and the guidance given in our Strategic Review announcement on 30 June 2011 remains unchanged.

We are well positioned to realise over time the full potential of our organisation, brands and capabilities, and to achieve strong, stable and sustainable returns for shareholders.

Tim Tookey  
*Group Finance Director*

## COMBINED BUSINESSES SEGMENTAL ANALYSIS

Half-year to 30 June 2011	Retail £m	Wholesale £m	Commercial £m	Wealth and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	4,163	1,401	649	509	(142)	(202)	6,378
Other income	884	1,337	218	631	1,319	(391)	3,998
<b>Total income</b>	<b>5,047</b>	<b>2,738</b>	<b>867</b>	<b>1,140</b>	<b>1,177</b>	<b>(593)</b>	<b>10,376</b>
Insurance claims	-	-	-	-	(198)	-	(198)
<b>Total income, net of insurance claims</b>	<b>5,047</b>	<b>2,738</b>	<b>867</b>	<b>1,140</b>	<b>979</b>	<b>(593)</b>	<b>10,178</b>
Operating expenses	(2,221)	(1,312)	(471)	(792)	(415)	(121)	(5,332)
<b>Trading surplus</b>	<b>2,826</b>	<b>1,426</b>	<b>396</b>	<b>348</b>	<b>564</b>	<b>(714)</b>	<b>4,846</b>
Impairment	(1,173)	(1,557)	(160)	(2,532)	-	-	(5,422)
Share of results of joint ventures and associates	3	9	-	-	-	-	12
<b>Profit (loss) before tax and fair value unwind</b>	<b>1,656</b>	<b>(122)</b>	<b>236</b>	<b>(2,184)</b>	<b>564</b>	<b>(714)</b>	<b>(564)</b>
Fair value unwind <sup>1</sup>	544	1,551	26	104	(21)	(536)	1,668
<b>Profit (loss) before tax</b>	<b>2,200</b>	<b>1,429</b>	<b>262</b>	<b>(2,080)</b>	<b>543</b>	<b>(1,250)</b>	<b>1,104</b>
Banking net interest margin <sup>2</sup>	2.26%	1.64%	4.35%	1.47%			2.07%
Cost:income ratio <sup>3</sup>	44.0%	47.9%	54.3%	69.5%	42.4%		52.4%
Impairment as a % of average advances (annualised) <sup>4</sup>	0.65%	2.02%	1.07%	7.89%			1.77%

**Key balance sheet and  
other items**

As at 30 June 2011	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excl reverse repos	357.8	130.1	28.7	51.1		0.4	568.1
Customer deposits excl repos	242.3	81.0	32.7	38.9			394.9
Total customer balances	600.1	211.1	61.4	90.0		0.4	963.0
Risk-weighted assets	109.6	176.6	26.8	56.4		13.9	383.3

<sup>1</sup> The net credit in the first half of 2011 of £1,668 million is mainly attributable to a reduction in the impairment charge of £931 million as losses reflected in the acquisition balance sheet valuations of the lending and securities portfolios have been incurred.

<sup>2</sup> The calculation basis for banking net interest margins is set out in note 2 on page 83.

<sup>3</sup> Operating expenses divided by total income net of insurance claims.

<sup>4</sup> Impairment on loans and advances to customers divided by average loans and advances to customers, excluding reverse repurchase transactions, gross of allowance for impairment losses.

**COMBINED BUSINESSES SEGMENTAL ANALYSIS** (continued)

Half-year to 30 June 2010	Retail £m	Wholesale £m	Commercial £m	Wealth and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	4,636	1,576	571	596	(136)	(332)	6,911
Other income	836	1,988	227	605	1,320	855	5,831
Total income	5,472	3,564	798	1,201	1,184	523	12,742
Insurance claims	–	–	–	–	(261)	–	(261)
Total income, net of insurance claims	5,472	3,564	798	1,201	923	523	12,481
Costs:							
Operating expenses	(2,233)	(1,401)	(481)	(744)	(423)	(153)	(5,435)
Impairment of tangible fixed assets	–	(150)	–	–	–	–	(150)
	(2,233)	(1,551)	(481)	(744)	(423)	(153)	(5,585)
Trading surplus	3,239	2,013	317	457	500	370	6,896
Impairment	(1,335)	(2,801)	(190)	(2,228)	–	–	(6,554)
Share of results of joint ventures and associates	8	(60)	–	(2)	(10)	2	(62)
Profit (loss) before tax and fair value unwind	1,912	(848)	127	(1,773)	490	372	280
Fair value unwind	583	1,433	30	164	(21)	(866)	1,323
Profit (loss) before tax	2,495	585	157	(1,609)	469	(494)	1,603
Banking net interest margin	2.44%	1.51%	3.82%	1.65%			2.08%
Cost:income ratio	40.8%	39.3%	60.3%	61.9%	45.8%		43.5%
Impairment as a % of average advances (annualised)	0.72%	3.11%	1.28%	6.56%			2.01%
Key balance sheet and other items							
As at 30 June 2010	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excl reverse repos	368.0	155.1	28.7	57.6		1.9	611.3
Customer deposits excl repos	230.7	83.4	30.8	30.3		0.1	375.3
Total customer balances	598.7	238.5	59.5	87.9		2.0	986.6
Risk-weighted assets	106.8	251.5	29.2	59.3		16.4	463.2

**COMBINED BUSINESSES SEGMENTAL ANALYSIS** (continued)

	Retail £m	Wholesale £m	Commercial £m	Wealth and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Half-year to 31 Dec 2010							
Net interest income	4,742	1,675	604	580	(127)	(563)	6,911
Other income	771	1,691	230	555	1,494	(408)	4,333
Total income	5,513	3,366	834	1,135	1,367	(971)	11,244
Insurance claims	–	–	–	–	(281)	–	(281)
Total income, net of insurance claims	5,513	3,366	834	1,135	1,086	(971)	10,963
Operating expenses	(2,411)	(1,351)	(511)	(792)	(431)	3	(5,493)
Trading surplus	3,102	2,015	323	343	655	(968)	5,470
Impairment	(1,412)	(1,263)	(192)	(3,760)	–	–	(6,627)
Share of results of joint ventures and associates	9	(35)	–	(6)	–	3	(29)
Profit (loss) before tax and fair value unwind	1,699	717	131	(3,423)	655	(965)	(1,186)
Fair value unwind	522	1,616	51	208	(22)	(580)	1,795
Profit (loss) before tax	2,221	2,333	182	(3,215)	633	(1,545)	609
Banking net interest margin	2.49%	1.54%	3.93%	1.61%			2.12%
Cost:income ratio	43.7%	40.1%	61.3%	69.8%	39.7%		50.1%
Impairment as a % of average advances (annualised)	0.76%	1.31%	1.19%	11.29%			2.02%
Key balance sheet and other items							
As at 31 December 2010	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excl reverse repos	363.7	141.5	28.6	55.3		0.4	589.5
Customer deposits excl repos	235.6	82.8	31.3	32.8		–	382.5
Total customer balances	599.3	224.3	59.9	88.1		0.4	972.0
Risk-weighted assets	109.3	196.1	26.6	58.7		15.7	406.4

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## DIVISIONAL PERFORMANCE

### RETAIL

#### Key highlights

- **Profit before tax decreased to £2,200 million**, compared to £2,495 million in the first half of 2010.
- **Profit before tax and fair value unwind was £1,656 million**, a reduction of 13 per cent compared with the first half of 2010, driven by higher funding costs and muted demand for credit.
- **Total income decreased by 8 per cent, driven by lower net interest income**, largely as a result of higher funding costs, muted demand for credit, the continued impact from previous de-risking of the lending portfolio with a corresponding reduction in impairments and increased competition for deposits while we continued to reduce our funding gap.
- **Operating expenses reduced by 1 per cent compared with the first half of 2010**. However the cost:income ratio increased to 44.0 per cent, as a result of the reduction in income. Operating expenses benefited from cost synergies partly offset by investment in our digital platforms, improvements to complaints handling processes and inflation.
- **The impairment charge reduced to £1,173 million**, down by 12 per cent, particularly driven by the reduction in the unsecured charge reflecting the impact of our prudent risk appetite with improved new business quality and effective portfolio management. Credit performance across the business also continues to be supported by prudent risk management, a continued subdued UK economic recovery and low interest rates.
- **Core business profit before tax and fair value unwind was £1,566 million** a reduction of 8 per cent compared to the first half of 2010. This was driven by a reduction in core income of 7 per cent, due to the same factors as the combined business. The reduction in trading surplus was partially offset by significant improvements in impairments which decreased by 18 per cent compared with the first half of 2010.
- **Customer deposit growth continued to strengthen during the first half of 2011**, with balances increasing by £6.7 billion, or 3 per cent, from 31 December 2010 (more than three times the growth in the market). This growth was largely driven by strong tax-free cash ISA balance growth where Retail achieved growth significantly above its share of balances outstanding.
- **Loans and advances to customers decreased by £5.9 billion**, or 2 per cent, from 31 December 2010 as customers continued to reduce their personal indebtedness. In particular, customers continued to pay down unsecured debts. In the first half of 2011 gross mortgage lending was £12.9 billion, which was equivalent to a market share of over 20 per cent, as Retail continued to support the housing market and first time buyers.



## RETAIL (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change since 30 June 2010 %	Half-year to 31 Dec 2010 £m
Net interest income	4,163	4,636	(10)	4,742
Other income	884	836	6	771
Total income	5,047	5,472	(8)	5,513
Operating expenses	(2,221)	(2,233)	1	(2,411)
Trading surplus	2,826	3,239	(13)	3,102
Impairment	(1,173)	(1,335)	12	(1,412)
Share of results of joint ventures and associates	3	8	(63)	9
<b>Profit before tax and fair value unwind</b>	<b>1,656</b>	<b>1,912</b>	<b>(13)</b>	<b>1,699</b>
Fair value unwind	544	583	(7)	522
<b>Profit before tax</b>	<b>2,200</b>	<b>2,495</b>	<b>(12)</b>	<b>2,221</b>
Banking net interest margin	2.26%	2.44%		2.49%
Cost:income ratio	44.0%	40.8%		43.7%
Impairment as a % of average advances (annualised)	0.65%	0.72%		0.76%

	As at 30 June 2011 £bn	As at 31 Dec 2010 £bn	Change since 31 Dec 2010 %
<b>Loans and advances to customers</b>			
Secured	333.1	337.3	(1)
Unsecured	24.7	26.4	(6)
	357.8	363.7	(2)
<b>Customer deposits</b>			
Savings	202.3	195.3	4
Current accounts	40.0	40.3	(1)
	242.3	235.6	3
<b>Total customer balances</b>	<b>600.1</b>	<b>599.3</b>	
<b>Risk-weighted assets</b>	<b>109.6</b>	<b>109.3</b>	

**RETAIL** (continued)**Financial performance**

Profit before tax decreased to £2,200 million compared to £2,495 million in the first half of 2010, a reduction of £295 million.

Profit before tax and fair value unwind decreased to £1,656 million, a reduction of 13 per cent compared with the first half of 2010, driven by higher funding costs and the muted demand for credit.

Total income decreased by £425 million, or 8 per cent, to £5,047 million. This was driven by a reduction in net interest income of £473 million, partially offset by an increase in other income of £48 million.

Net interest income reduced by 10 per cent when compared with the first half of 2010. One of the main drivers was the increase in wholesale funding costs which were not matched by average customer rates, particularly as mortgage standard variable rates remained constant over the period. Income growth was also constrained by muted demand for both secured and unsecured credit. Previous de-risking of the lending portfolio, with a relative reduction in unsecured balances, also contributed to the reduction in income albeit with a corresponding reduction in impairment. Finally, increased competition for deposits resulted in an increase in the average rate paid on customer deposits while we continued to reduce our reliance on wholesale funding.

Other income increased by 6 per cent in the first half of 2011 to £884 million from £836 million largely as a result of the sale of Visa Inc shares which resulted in a profit of £41 million in the first half 2011.

Total income is analysed as follows and reflects the trends discussed above:

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Mortgages and Savings	<b>2,151</b>	2,294	<b>(6)</b>	2,445
Consumer Banking	<b>2,896</b>	3,178	<b>(9)</b>	3,068
<b>Total income</b>	<b>5,047</b>	5,472	<b>(8)</b>	5,513

Operating expenses fell by 1 per cent compared with the first half of 2010 (8 per cent compared with the second half of 2010) and the cost:income ratio was 44.0 per cent. Operating expenses benefited from cost synergies partly offset by investment in our digital platforms, improvements to the complaints handling processes and inflation. During the first half of the year Retail successfully completed the consolidation of the branch counters and the ATM network onto one IT system significantly simplifying its infrastructure.

The impairment charge on loans and advances decreased by £162 million, or 12 per cent, to £1,173 million largely driven by reductions in the unsecured charge (when compared to the second half of 2010 the reduction was £239 million, or 17 per cent). The unsecured impairment charge reduced to £878 million from £1,282 million in the first half of 2010 reflecting the impact of our prudent risk appetite with improved new business quality, effective portfolio management and a reduction in unsecured balances. Credit performance across the business also continued to be supported by prudent risk management, a continued subdued economic recovery in the UK and low interest rates. The secured impairment charge increased to £295 million from £53 million in the first half of 2010 largely reflecting a less favourable outlook for house prices compared with our outlook at the end of the first half of 2010.

**RETAIL** (continued)

The fair value unwind net credit of £544 million compared with £583 million in the first half of 2010. The net impact of the unwind was slightly smaller than in the first half of 2010. This reflected a lower net credit related to the mortgage portfolios as fewer mortgages reached the end of their product term and moved to standard variable rate products, which was broadly offset by an increase in the impairment unwind which resulted from the higher secured impairment charge.

**Balance sheet progress**

Total loans and advances to customers decreased by £5.9 billion, or 2 per cent, to £357.8 billion, compared to 31 December 2010. This was driven by reduced customer demand for new credit and existing customers continuing to reduce their personal indebtedness. The reduction in lending to customers was in part due to the repayment of unsecured debt where balances reduced by £1.7 billion, or 6 per cent. Secured balances reduced by £4.2 billion, or 1 per cent, of which £1.0 billion was a reduction in non-core mortgage balances. The proportion of mortgages on standard variable rate, or equivalent products, now stands at 52 per cent and is expected to rise only modestly during the remainder of 2011.

The UK mortgage market for both house purchase and re-mortgaging in the first half of 2011 was broadly flat compared with the first half of 2010, with gross market lending of £64.0 billion compared to £64.1 billion, respectively. Retail's gross mortgage lending was £12.9 billion in the first half of 2011. Retail's new mortgage lending continued to be focused on supporting the housing market with 70 per cent of lending being for house purchase rather than re-mortgaging. Retail remains the largest lender to first time buyers, helping over 24,000 customers buy their first home in the first half of 2011. It also continues to be an industry leader in its support for shared equity and shared ownership schemes.

During the first half of 2011 Retail continued to develop its mortgage offering to support customers. This included rolling out a new mortgage sales platform that has improved the processing of mortgage applications and significantly simplified the mortgage application process for both customers and advisors. In addition, it ensures that customer data only needs to be entered onto one system, so reducing the potential for error. We have also further developed our market-leading products including the Lend a Hand mortgage, which now allows local authorities to act as the 'helper' and enables first-time buyers to get onto the housing ladder with just a 5 per cent deposit.

Risk-weighted assets increased by £0.3 billion to £109.6 billion compared to 31 December 2010. This reflected the impact of lower lending balances being offset by the impact of a less favourable outlook for house prices compared with the end of 2010.

Total customer deposits increased by £6.7 billion, or 3 per cent, to £242.3 billion in the first six months of 2011. This increase was largely driven by strong growth in tax free cash ISA balances. Retail continues to perform well in the savings market despite the high levels of competition, with a strong stable of savings brands providing customers with an award winning range of products to meet their savings needs.

Retail has continued to invest in products and services to support our customers in better managing their finances. A great example of this is the recently launched Lloyds TSB Money Manager which is available online and gives customers an interactive way to review their spending habits and plan for the future. The Halifax ISA promise continues to deliver a clear service promise that has resonated with customers and helped support a record new business performance in the first half of 2011. Retail achieved cash ISA balance growth significantly above our share of balances outstanding.

## RETAIL (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change since 30 June 2010 %	Half-year to 31 Dec 2010 £m
<b>Core</b>				
Net interest income	3,959	4,380	(10)	4,464
Other income	875	823	6	760
Total income	4,834	5,203	(7)	5,224
Operating expenses	(2,218)	(2,229)	1	(2,408)
Trading surplus	2,616	2,974	(12)	2,816
Impairment	(1,052)	(1,286)	18	(1,343)
Share of results of joint ventures and associates	2	8	(75)	9
<b>Profit before tax and fair value unwind</b>	<b>1,566</b>	<b>1,696</b>	<b>(8)</b>	<b>1,482</b>
Fair value unwind	420	513	(18)	452
<b>Profit before tax – core</b>	<b>1,986</b>	<b>2,209</b>	<b>(10)</b>	<b>1,934</b>
<b>Non-core</b>				
Net interest income	204	256	(20)	278
Other income	9	13	(31)	11
Total income	213	269	(21)	289
Operating expenses	(3)	(4)	25	(3)
Trading surplus	210	265	(21)	286
Impairment	(121)	(49)		(69)
Share of results of joint ventures and associates	1	–		–
Profit before tax and fair value unwind	90	216	(58)	217
Fair value unwind	124	70	77	70
<b>Profit before tax – non-core</b>	<b>214</b>	<b>286</b>	<b>(25)</b>	<b>287</b>
<b>Profit before tax – combined</b>	<b>2,200</b>	<b>2,495</b>	<b>(12)</b>	<b>2,221</b>
<b>Banking net interest margin</b>				
Core	2.34%	2.52%		2.56%
Non-core	1.36%	1.57%		1.75%
<b>Cost:income ratio</b>				
Core	45.9%	42.8%		46.1%
<b>Impairment as a % of average advances (annualised)</b>				
Core	0.63%	0.76%		0.79%
Non-core	0.81%	0.30%		0.43%

**RETAIL** (continued)

<b>Key balance sheet and other items</b>	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Core</b>			
Loans and advances to customers	<b>328.9</b>	333.7	<b>(1)</b>
Customer deposits	<b>242.3</b>	235.6	<b>3</b>
Risk-weighted assets	<b>98.0</b>	98.0	
<b>Non-core</b>			
Loans and advances to customers	<b>28.9</b>	30.0	<b>(4)</b>
Customer deposits	<b>–</b>	–	
Risk-weighted assets	<b>11.6</b>	11.3	<b>(3)</b>

Non-core operations consist of assets that are outside of Retail's risk appetite. These broadly comprise of specialist mortgages (self-certified and sub-prime), and selected third-party branded loans and credit cards. At 30 June 2011, these activities included loans and advances to customers of £28.9 billion (31 December 2010: £30.0 billion), with risk-weighted assets of £11.6 billion (31 December 2010: £11.3 billion). The run-off of these balances continued in line with expectations. In the first half of 2011 non-core total income decreased to £213 million (compared to £269 million in the first half of 2010). The impairment charge was £121 million compared to £49 million in the first half of 2010. In addition to the reduction of non-core assets, Retail continued to implement plans to divest other retail assets and liabilities in line with the state aid obligations (Project Verde). Further detail on the shape of this business is provided on page 32 of this News Release.

## WHOLESALE

### Key highlights

- **Profit before tax was £1,429 million compared to a profit before tax of £585 million in the first half of 2010.**
- **Loss before tax and fair value unwind was £122 million**, an improvement of £726 million mainly reflecting significantly decreased impairments and lower costs, offset by reduced income.
- **Net interest income decreased by 11 per cent to £1,401 million.** This largely reflects a lower asset balance sheet. The banking net interest margin improved as a result of the increased market value of deposits, partly offset by a lower asset margin.
- **Other income decreased to £1,337 million**, as targeted balance sheet reductions resulted in losses of £670 million on treasury asset sales within Corporate Markets, broadly offset by a related accelerated fair value unwind of £649 million, and a lower level of operating lease asset income in Asset Finance.
- **Operating expenses decreased by 6 per cent to £1,312 million**, reflecting reduced levels of operating lease depreciation and further cost savings achieved from the integration programme, partially offset by additional staff related costs in Corporate Markets and continued investment in customer facing resource and systems.
- **Impairment charges decreased significantly to £1,557 million**, compared to £2,801 million in the first half of 2010. The total impairment charge is 44 per cent lower than the first half of last year and continues to be driven by the HBOS heritage corporate real estate and real estate related asset portfolios, but with increased impairment on leveraged acquisition finance exposures.
- **Assets decreased by 9 per cent to £192.2 billion, compared to December 2010.** This reflects the targeted reduction in the non-core balance sheet, particularly in treasury assets. However, despite gross new lending to customers continuing to meet our lending commitments, net lending to core customers (excluding reverse repos) also reduced as a result of weak demand and continued customer deleveraging.
- **Customer deposits excluding repos decreased 2 per cent, since the end of the prior year, to £81.0 billion** as a small increase in deposits in Corporate Markets was more than offset by a decline in more price sensitive deposits in Treasury and Trading.
- **Risk-weighted assets reduced by £19.5 billion to £176.6 billion compared to December 2010**, in line with the reduction on the balance sheet.

**WHOLESALE** (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	1,401	1,576	(11)	1,675
Other income	1,337	1,988	(33)	1,691
Total income	<u>2,738</u>	<u>3,564</u>	<u>(23)</u>	<u>3,366</u>
Costs:				
Operating expenses	(1,312)	(1,401)	6	(1,351)
Impairment of tangible fixed assets	-	(150)		-
	<u>(1,312)</u>	<u>(1,551)</u>	<u>15</u>	<u>(1,351)</u>
Trading surplus	1,426	2,013	(29)	2,015
Impairment	(1,557)	(2,801)	44	(1,263)
Share of results of joint ventures and associates	9	(60)		(35)
<b>(Loss) profit before tax and fair value unwind</b>	<u>(122)</u>	<u>(848)</u>	<u>86</u>	<u>717</u>
Fair value unwind	1,551	1,433	8	1,616
<b>Profit before tax</b>	<u>1,429</u>	<u>585</u>		<u>2,333</u>
Corporate Markets	(527)	(1,212)		257
Treasury and Trading	255	259		169
Asset Finance	150	105		291
<b>(Loss) profit before tax and fair value unwind</b>	<u>(122)</u>	<u>(848)</u>		<u>717</u>
Banking net interest margin	1.64%	1.51%		1.54%
Cost:income ratio (excl. impairment of tangible fixed assets)	47.9%	39.3%		40.1%
Impairment as a % of average advances (annualised)	2.02%	3.11%		1.31%
<b>Key balance sheet and other items</b>		<b>As at 30 June 2011 £bn</b>	<b>As at 31 Dec 2010 £bn</b>	<b>Change since 31 Dec 2010 %</b>
Loans and advances to customers excl reverse repos		130.1	141.5	(8)
Reverse repos		19.7	3.1	
Loans and advances to customers		<u>149.8</u>	<u>144.6</u>	4
Loans and advances to banks		10.2	12.4	(18)
Debt securities		15.5	25.8	(40)
Available-for-sale financial assets		16.7	29.5	(43)
		<u>192.2</u>	<u>212.3</u>	(9)
Customer deposits excluding repos		81.0	82.8	(2)
Repos		4.0	10.2	
<b>Customer deposits including repos</b>		<u>85.0</u>	<u>93.0</u>	(9)
Risk-weighted assets		176.6	196.1	(10)

**WHOLESALE** (continued)

**Financial performance**

Profit before tax was £1,429 million compared to a profit before tax of £585 million in the first half of 2010. A reduction of £826 million in total income was more than offset by a significant decrease in the impairment charge which reduced by £1,244 million to £1,557 million, reflecting the stabilising UK economic climate.

Loss before tax and fair value unwind of £122 million improved £726 million on the loss of £848 million in the first half of 2010, primarily driven by the significant decrease in the impairment charge.

Total income decreased by £826 million, or 23 per cent, to £2,738 million, mainly driven by a 33 per cent decrease in other operating income. This was primarily a result of the £670 million loss on disposal of treasury assets, which was broadly offset by a related accelerated fair value unwind of £649 million.

Net interest income decreased by £175 million, or 11 per cent, to £1,401 million. The decrease reflects lower interest-earning asset balances in line with the Group's targeted balance sheet reduction, mainly in loans and advances to customers, debt securities and available-for-sale positions. This was offset by an increase in banking net interest margin resulting from the increased market value of deposits.

Net banking margin increased by 13 basis points to 1.64 per cent, with banking net interest income, which excludes trading activity, decreasing by £105 million, to £1,179 million primarily as a result of a reduced balance sheet. However, this income reduction was partly offset by an increase in deposit margins and income largely reflecting the higher market value of deposits and selective repricing. Asset margins decreased as the benefit of higher customer rates was offset by the increased cost of funding.

Other income decreased by £651 million, or 33 per cent, to £1,337 million, primarily reflecting the effect of the asset disposals from the Group's targeted balance sheet reduction in Corporate Markets, and a lower asset base and associated income in Asset Finance. This was partially offset by valuation gains and profits on disposals in the Equity business within Corporate Markets and the recovery of assets previously written down in Treasury and Trading.

Operating expenses decreased by £89 million, or 6 per cent, to £1,312 million primarily from a reduction in the level of operating lease depreciation in Asset Finance and a continued focus on cost management including savings attributable to the integration programme. This was partially offset by additional staff costs and continued investment in customer facing resource and systems.

The impairment charge decreased by £1,244 million to £1,557 million in the first half of 2011, reflecting a sustained decrease since the peak in the first half 2009. As a percentage of average loans and advances to customers, the impairment charge improved to 2.02 per cent in the first half of 2011 compared to 3.11 per cent in the first half of 2010. This was due to the stabilising economic environment, continued low interest rates which helped to maintain defaults at a reduced level, and the stabilisation of corporate real estate prices.

The share of results from joint ventures and associates comprised a small profit of £9 million, an improvement of £69 million, due to a lower level of impairments and share of losses than in the previous year.

Fair value unwind increased £118 million to £1,551 million, mainly due to asset disposals (including treasury asset disposals) and favourable exchange rate movements. This was partially offset by a decrease in the fair value unwind relating to HBOS loans and receivables that were acquired on acquisition, reflecting lower impairments.



**WHOLESALE** (continued)

**Balance sheet progress**

The division's asset balances (comprising loans and advances to customers and banks, debt securities and available-for-sale financial assets) reduced by £20.1 billion, or 9 per cent, to £192.2 billion, primarily reflecting deleveraging by customers and continuing active de-risking of the balance sheet by either selling down or reducing holdings in debt securities and available-for-sale positions, offset by an increase in reverse repo balances as liquidity was invested in high quality primary liquid assets on a secured basis.

Loans and advances to customers increased £5.2 billion, or 4 per cent to £149.8 billion. In Corporate Markets, balances decreased by £10.0 billion, or 8 per cent, as demand for new corporate lending and refinancing of existing facilities were more than offset by the level of maturities, reflecting a continued trend of subdued corporate lending, customer deleveraging and asset sales in non-core sectors. Available-for-sale financial asset balances reduced by £12.8 billion, or 43 per cent, to £16.7 billion and debt securities decreased by £10.3 billion, or 40 per cent, to £15.5 billion, as Corporate Markets reduced the non-core balance sheet through treasury and other asset sales or not replenishing holdings after amortisations or maturities. Loans and advances to banks decreased by £2.2 billion, or 18 per cent, as the division refocused the balance sheet.

Customer deposits excluding repos decreased by 2 per cent to £81.0 billion, due to a reduction in price sensitive customer deposits in Treasury and Trading, partially offset by an increase in deposits in Corporate Markets in line with the Group's funding strategy.

Risk-weighted assets decreased by £19.5 billion, or 10 per cent, to £176.6 billion, primarily reflecting the balance sheet reductions including treasury asset sales and the run down in other non-core asset portfolios, but also the impact of subdued corporate lending.

**WHOLESALE** (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	<i>Change since 30 June 2010</i> %	Half-year to 31 Dec 2010 £m
<b>Core</b>				
Net interest income	888	998	(11)	882
Other income	<u>1,608</u>	<u>1,524</u>	6	<u>1,492</u>
Total income	<u>2,496</u>	<u>2,522</u>	(1)	<u>2,374</u>
Operating expenses	<u>(1,093)</u>	<u>(1,108)</u>	1	<u>(1,083)</u>
Trading surplus	<u>1,403</u>	<u>1,414</u>	(1)	<u>1,291</u>
Impairment	(409)	(162)		(414)
Share of results of joint ventures and associates	–	3		(1)
<b>Profit before tax and fair value unwind</b>	<u>994</u>	<u>1,255</u>	(21)	<u>876</u>
Fair value unwind	<u>10</u>	<u>9</u>	11	<u>15</u>
<b>Profit before tax – core</b>	<u>1,004</u>	<u>1,264</u>	(21)	<u>891</u>
<b>Non-core</b>				
Net interest income	513	578	(11)	793
Other income	<u>(271)</u>	<u>464</u>		<u>199</u>
Total income	<u>242</u>	<u>1,042</u>	(77)	<u>992</u>
Costs:				
Operating expenses	<u>(219)</u>	<u>(293)</u>	25	<u>(268)</u>
Impairment of tangible fixed assets	<u>–</u>	<u>(150)</u>		<u>–</u>
	<u>(219)</u>	<u>(443)</u>	51	<u>(268)</u>
Trading surplus	23	599	(96)	724
Impairment	<u>(1,148)</u>	<u>(2,639)</u>	56	<u>(849)</u>
Share of results of joint ventures and associates	9	(63)		(34)
<b>Loss before tax and fair value unwind</b>	<u>(1,116)</u>	<u>(2,103)</u>	47	<u>(159)</u>
Fair value unwind	<u>1,541</u>	<u>1,424</u>	8	<u>1,601</u>
<b>Profit (loss) before tax – non-core</b>	<u>425</u>	<u>(679)</u>		<u>1,442</u>
<b>(Loss) profit before tax and fair value unwind – combined</b>	<u>(122)</u>	<u>(848)</u>	86	<u>717</u>
<b>Profit before tax – combined</b>	<u>1,429</u>	<u>585</u>		<u>2,333</u>
<b>Banking net interest margin</b>				
Core	1.86%	1.51%		1.53%
Non-core	1.36%	1.51%		1.56%
<b>Cost:income ratio (excl. impairment of tangible fixed assets)</b>				
Core	43.8%	43.9%		45.6%
Non-core	90.5%	28.1%		27.0%
<b>Impairment as a % of average advances (annualised)</b>				
Core	0.96%	0.34%		0.82%
Non-core	3.36%	6.80%		1.92%

**WHOLESALE** (continued)

	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Key balance sheet and other items</b>			
<b>Core</b>			
Loans and advances to customers excl reverse repos	78.9	85.4	(8)
Reverse repos	19.7	3.1	
Loans and advances to customers	<u>98.6</u>	88.5	11
Loans and advances to banks	9.9	12.0	(18)
Debt securities	0.2	0.4	(50)
Available-for-sale financial assets	<u>3.6</u>	7.4	(51)
	<u>112.3</u>	<u>108.3</u>	4
Customer deposits excluding repos	78.1	78.8	(1)
Repos	<u>4.0</u>	<u>10.2</u>	(61)
<b>Customer deposits including repos</b>	<u>82.1</u>	<u>89.0</u>	(8)
Risk-weighted assets	106.9	112.3	(5)
	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Non-core</b>			
Loans and advances to customers excl reverse repos	51.2	56.1	(9)
Reverse repos	–	–	
Loans and advances to customers	<u>51.2</u>	56.1	(9)
Loans and advances to banks	0.3	0.4	(25)
Debt securities	15.3	25.4	(40)
Available-for-sale financial assets	<u>13.1</u>	22.1	(41)
	<u>79.9</u>	<u>104.0</u>	(23)
Customer deposits excluding repos	2.9	4.0	(28)
Repos	<u>–</u>	<u>–</u>	
<b>Customer deposits including repos</b>	<u>2.9</u>	<u>4.0</u>	(28)
Risk-weighted assets	69.7	83.8	(17)

**WHOLESALE** (continued)

**Core business**

Core business profit before tax and fair value unwind decreased by 21 per cent to £994 million, compared to £1,255 million in the first half of 2010.

Total core income decreased by £26 million, or 1 per cent. Net interest income was £110 million, or 11 per cent lower, due to the lower asset balance sheet, partly offset by higher net banking margins from better deposit margins. Other operating income was £84 million, or 6 per cent higher, primarily reflecting the settlement of a claim associated with a sizeable financial services company failure, partly offset by lower level of client income due to subdued lending activity.

Operating expenses were £15 million, or 1 per cent lower, however impairment increased by £247 million primarily due to two significant loans being impaired.

**Non-core business**

Non-core consists of businesses and/or business lines that are inconsistent with Wholesale's relationship-focused strategic vision of capital and liquidity efficient growth, driven by broad and deep customer relationships and within a prudent risk framework.

Non-core loss before tax and fair value unwind improved £987 million, primarily reflecting the decrease in impairment charges year-on-year in relation to the non-core portfolios.

Non-core income decreased by £800 million, primarily reflecting the effects of asset disposals from the Group's targeted balance sheet reduction in Corporate Markets, a lower asset base in Asset Finance and associated income, and the non-core portfolio's share of higher wholesale funding costs. This was partially offset by the benefits of valuation gains and profits on disposals within the Equity business within Corporate Markets.

Non-core net interest income decreased by £65 million due to the reduced balance sheet. The banking net interest margin fell 15 basis points to 1.36 per cent as non-core asset margins reduced due to higher funding costs.

Non-core operating expenses decreased by £74 million, or 25 per cent, reflecting a reduction in the level of operating lease depreciation in Asset Finance. There was also a favourable variance of £150 million for non-core impairment of tangible fixed assets, which was incurred on assets held on the balance sheet as a result of the consolidation of certain entities over which the Group exercised control in the first half of 2010.

Non-core impairments decreased by £1,491 million, primarily reflecting the significantly lower charges in the corporate real estate and real estate related asset portfolios as the economy and related prices stabilised.

Non-core fair value unwind increased by £117 million, primarily due to the treasury asset disposals in Corporate Markets, partly offset by a reduction in fair value unwind relating to HBOS loans and receivables reflecting lower impairments.

The total level of non-core assets, which includes some other minor asset categories, decreased by £25.2 billion or 23 per cent to £84.5 billion. This primarily reflects the sale and maturity of treasury assets totalling £19.7 billion.

**WHOLESALE** (continued)**Corporate Markets**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>1,076</b>	1,170	<b>(8)</b>	1,324
Other income	<b>528</b>	1,129	<b>(53)</b>	885
Total income	<b>1,604</b>	2,299	<b>(30)</b>	2,209
Costs:				
Operating expenses	<b>(697)</b>	(691)	<b>(1)</b>	(727)
Impairment of tangible fixed assets	<b>–</b>	(150)		–
	<b>(697)</b>	(841)	<b>17</b>	(727)
Trading surplus	<b>907</b>	1,458	<b>(38)</b>	1,482
Impairment	<b>(1,442)</b>	(2,609)	<b>45</b>	(1,191)
Share of results of joint ventures and associates	<b>8</b>	(61)		(34)
<b>(Loss) profit before tax and fair value unwind</b>	<b>(527)</b>	(1,212)	<b>57</b>	257
Cost:income ratio (excl. impairment of tangible fixed assets)	<b>43.5%</b>	30.1%		32.9%
Impairment as a % of average advances (annualised)	<b>2.00%</b>	3.13%		1.32%

<b>Key balance sheet items</b>	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
Loans and advances to customers	<b>121.6</b>	131.6	<b>(8)</b>
Customer deposits	<b>63.0</b>	61.3	<b>3</b>
Risk-weighted assets	<b>156.7</b>	175.5	<b>(11)</b>

Loss before tax and fair value unwind decreased by £685 million to £527 million, due to a significant decrease in the impairment charge, which more than offset the decrease in income. Net interest income decreased by £94 million, or 8 per cent. This reflected lower interest-earning asset balances as a result of the ongoing focus on reducing the balance sheet and also higher wholesale funding costs. Despite the increased funding costs, net interest income benefited from improved deposit margins from the increased market value of deposits.

Other income was £601 million lower, or 53 per cent, also reflecting the effects of disposals from the Group's targeted balance sheet reduction in Wholesale Markets. This was partially offset by valuation gains and profits on disposals in the Equity business.

Operating expenses were in line with prior year, which included increased costs in Wholesale Markets from continued investment in customer facing resource and systems, offset by decreases in other areas as the synergy benefits from integration are being realised.

The impairment charge decreased by £1,167 million to £1,442 million in the first half of 2011 reflecting a sustained decrease since the peak in the first half of 2009. This was due to the stabilising economic environment, low interest rates which helped to maintain defaults at reduced levels and the stabilisation of UK real estate prices.

A favourable variance of £150 million occurred on impairment of tangible fixed assets, which was incurred on assets held on the balance sheet as a result of the consolidation of certain entities over which the Group exercised control in the first half of 2010.

**WHOLESALE** (continued)**Treasury and Trading**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>133</b>	188	<b>(29)</b>	136
Other income	<b>241</b>	167	<b>44</b>	155
Total income	<b>374</b>	355	<b>5</b>	291
Operating expenses	<b>(119)</b>	(96)	<b>(24)</b>	(122)
<b>Profit before tax and fair value unwind</b>	<b>255</b>	259	<b>(2)</b>	169
Cost:income ratio	<b>31.8%</b>	27.0%		41.9%

	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Key balance sheet and other items</b>			
Loans and advances to customers <sup>1</sup>	<b>20.7</b>	4.1	
Customer deposits <sup>2</sup>	<b>22.0</b>	31.7	<b>(31)</b>
Risk-weighted assets	<b>9.1</b>	8.6	<b>6</b>

<sup>1</sup> Of which reverse repos represent £19.7 billion (31 December 2010: £3.1 billion).

<sup>2</sup> Of which repos represent £4.0 billion (31 December 2010: £10.2 billion).

Profit before tax and fair value unwind decreased by £4 million to £255 million.

Total income increased by £19 million, or 5 per cent. Income benefited primarily from the settlement of a claim which originated from losses booked in 2008 associated with a number of high profile financial services company failures, offset by lower performance in the underlying business as a result of difficult markets and reduced customer activity. Trading flows are managed with the overriding aim of providing a service to customers, whilst maintaining Treasury and Trading's conservative risk appetite.

Operating expenses increased by £23 million to £119 million reflecting the continued and controlled investment in people and systems, in particular the back office infrastructure, to support internal risk management and the growth ambitions in the larger customer franchise business. Operating costs in the first half of 2011 were marginally lower than in the second half of 2010.

**WHOLESALE** (continued)**Asset Finance**

	<b>Half-year to 30 June 2011 £m</b>	Half- year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>192</b>	218	<b>(12)</b>	215
Other income	<b>568</b>	692	<b>(18)</b>	651
Total income	<b>760</b>	910	<b>(16)</b>	866
Operating expenses	<b>(496)</b>	(614)	<b>19</b>	(502)
Trading surplus	<b>264</b>	296	<b>(11)</b>	364
Impairment	<b>(115)</b>	(192)	<b>40</b>	(72)
Share of results of joint ventures and associates	<b>1</b>	1		(1)
<b>Profit before tax and fair value unwind</b>	<b>150</b>	105	<b>43</b>	291
Cost:income ratio	<b>65.3%</b>	67.5%		58.0%
Impairment as a % of average advances (annualised)	<b>2.51%</b>	3.20%		1.37%

<b>Key balance sheet and other items</b>	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
Loans and advances to customers	<b>7.5</b>	8.9	<b>(16)</b>
Operating lease assets	<b>2.7</b>	3.0	<b>(10)</b>
Risk-weighted assets	<b>10.8</b>	12.0	<b>(10)</b>

Profit before tax and fair value unwind was £150 million, compared to £105 million in the first half of 2010. The £45 million improvement was due to lower costs and impairment charges, which were partially offset by lower income.

Total income decreased by £150 million, or 16 per cent, to £760 million as a result of lower business volumes, including assets held under operating leases, the benefit of VAT claims settled last year and a £21 million loss on disposal of Hill Hire plc. The lower business volumes are in-line with a targeted reduction in this asset class and were partly offset by stronger margins.

Operating expenses decreased by £118 million, or 19 per cent, to £496 million. This reflected an £85 million, or 20 per cent, decrease in depreciation charges on assets held under operating leases due to lower fleet size and a year-on-year improvement in used car values. Other costs decreased by £33 million, or 18 per cent, reflecting strong cost management and savings achieved from integration.

The impairment charge decreased by £77 million to £115 million, reflecting a stabilising economic environment and an improvement in market conditions for both the retail and non-retail consumer finance businesses. The lower impairment charge has been driven by a reduction in new cases entering arrears, the reduced book size and a better mix in the credit quality of new business being written.

## COMMERCIAL

### Key highlights

- **Profit before tax was £262 million compared to £157 million in the first half of 2010.**
- **Profit before tax and fair value unwind was £236 million** compared to £127 million in the first half of 2010, driven by higher income and reduced impairments.
- **Net interest income increased by 14 per cent to £649 million**, mainly reflecting the growth in deposit balances over the period and the value of attracting and retaining working capital credit balances at attractive margins.
- **Other income decreased by 4 per cent to £218 million** which reflects the subdued trading activity in the early part of the year and the greater use of electronic banking facilities by customers.
- **Operating expenses decreased by 2 per cent to £471 million** through cost efficiency and a reducing fraud loss exposure from improvements implemented at the end of 2010 in online security.
- **Impairment charges on financial assets have decreased to £160 million** compared to £190 million in the first half of 2010. There has been an overall improvement in the credit quality of the portfolio and a reduction in overall defaults as the UK economy has steadied and the continuing programme of process improvements is delivering results.
- **Core assets have increased by 2 per cent since the end of 2010.** This reflects the pro-active promotion and continuing support of small and medium-sized businesses by Commercial through 1,500 local relationship managers operating from 500 locations throughout the UK.
- **Customer deposits have also increased by 4 per cent since the end of 2010.** This increase reflects the ongoing success in the recruitment and retention of customers combined with targeted support in various customer segments especially education and legal.
- **Focus continues on strengthening customer relationships through deepening and understanding individual business requirements.** Commercial Finance, our invoice discounting, factoring and equipment finance business, enjoyed positive net growth of circa 10 per cent compared to an industry norm of 8 per cent. We have generated in excess of 50,000 referrals for a business insurance product and have grown our foreign exchange and international payments facility for small and medium-sized businesses.



**COMMERCIAL** (continued)

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>649</b>	571	<b>14</b>	604
Other income	<b>218</b>	227	<b>(4)</b>	230
Total income	<b>867</b>	798	<b>9</b>	834
Operating expenses	<b>(471)</b>	(481)	<b>2</b>	(511)
Trading surplus	<b>396</b>	317	<b>25</b>	323
Impairment	<b>(160)</b>	(190)	<b>16</b>	(192)
<b>Profit before tax and fair value unwind</b>	<b>236</b>	127	<b>86</b>	131
Fair value unwind	<b>26</b>	30	<b>(13)</b>	51
<b>Profit before tax</b>	<b>262</b>	157	<b>67</b>	182
Banking net interest margin	<b>4.35%</b>	3.82%		3.93%
Cost:income ratio	<b>54.3%</b>	60.3%		61.3%
Impairment as a % of average advances (annualised)	<b>1.07%</b>	1.28%		1.19%
		<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Key balance sheet and other items</b>				
Loans and advances to customers		<b>28.7</b>	28.6	
Customer deposits		<b>32.7</b>	31.3	<b>4</b>
Risk-weighted assets		<b>26.8</b>	26.6	<b>1</b>

**COMMERCIAL** (continued)

**Financial performance**

Profit before tax was £262 million compared to a profit of £157 million for the comparable period in 2010. The improvement of £105 million was predominantly due to higher net interest income, good cost management and a reduced level of impairments as the UK economy stabilises and improves.

Total income increased by £69 million, or 9 per cent, mainly driven by a 14 per cent increase in net interest income.

Net interest income grew by 14 per cent, or £78 million, principally as a result of increased deposit balances and the market value of higher levels of working capital credit balances.

Other income reduced by 4 per cent, or £9 million, due to the growing use by customers of electronic banking facilities and other reduced cost account services.

Operating expenses remain well controlled and decreased by 2 per cent, or £10 million, primarily as a result of productivity and efficiency gains and the higher use of electronic banking coupled with the implementation of increased online fraud prevention security.

The impairment charge decreased by £30 million, or 16 per cent, due to an increase in the overall credit quality of the portfolio and the stabilisation of the UK economy and consequently an overall reduction in the level of defaults.

**Balance sheet progress**

Commercial's asset balances (comprising loans and advances to customers) increased by £0.1 billion since December 2010 reflecting a fall of £0.3 billion in the non-core real estate portfolio (see below) more than offset by an increase in term lending and asset-based finance of £0.4 billion where Commercial has attracted new SME customers with term lending and invoice finance requirements to switch from other providers, and has also successfully encouraged existing SME customers to invest in their businesses with financial support from us. Significant effort in promoting support has included running nearly 400 customer events in the first half of 2011.

Customer deposits increased by £1.4 billion since December 2010 reflecting the attractiveness of our savings products as well as our customers' desire to retain liquidity and be cautious about investment.

Risk-weighted assets increased by £0.2 billion to £26.8 billion since December 2010 primarily reflecting the growth in assets.

**COMMERCIAL** (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
<b>Core</b>				
Net interest income	635	551	15	588
Other income	217	226	(4)	229
Total income	852	777	10	817
Operating expenses	(468)	(477)	2	(507)
Trading surplus	384	300	28	310
Impairment	(160)	(189)	15	(192)
<b>Profit before tax and fair value unwind</b>	224	111		118
Fair value unwind	26	30	(13)	51
<b>Profit before tax – core</b>	250	141	77	169
<b>Non-core</b>				
Net interest income	14	20	(30)	16
Other income	1	1		1
Total income	15	21	(29)	17
Operating expenses	(3)	(4)	25	(4)
Trading surplus	12	17	(29)	13
Impairment	–	(1)		–
<b>Profit before tax and fair value unwind</b>	12	16	(25)	13
Fair value unwind	–	–		–
<b>Profit before tax – non-core</b>	12	16	(25)	13
<b>Profit before tax – combined</b>	262	157	67	182
<b>Banking net interest margin</b>				
Core	4.50%	3.97%		4.06%
Non-core	1.76%	1.85%		1.88%
<b>Cost:income ratio</b>				
Core	54.9%	61.4%		62.1%
<b>Impairment as a % of average advances (annualised)</b>				
Core	1.14%	1.39%		1.29%
Non-core	0.00%	0.10%		0.00%

**COMMERCIAL** (continued)

<b>Key balance sheet and other items</b>	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Core</b>			
Loans and advances to customers	<b>27.0</b>	26.6	<b>2</b>
Customer deposits	<b>32.4</b>	31.0	<b>5</b>
Risk-weighted assets	<b>25.0</b>	24.5	<b>2</b>
<b>Non-core</b>			
Loans and advances to customers	<b>1.7</b>	2.0	<b>(15)</b>
Customer deposits	<b>0.3</b>	0.3	
Risk-weighted assets	<b>1.8</b>	2.1	<b>(14)</b>

Non-core comprises the real estate business inherited from HBOS where there is no opportunity to place the customer in a full banking relationship. At the end of June 2011 the portfolio stood at £1.7 billion of lending assets down from £2.0 billion at the end of 2010 in line with the run-down strategy for this portfolio.

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## WEALTH AND INTERNATIONAL

### Key highlights

- **Loss before tax increased to £2,080 million compared to £1,609 million in the first half of 2010.**
- **Loss before tax and fair value unwind increased by £411 million to £2,184 million**, compared to £1,773 million in the first half of 2010, due to lower income, higher costs and a higher impairment charge in International.
- **Core profit before tax and fair value unwind increased by 29 per cent to £146 million**, due to higher income partly offset by higher operating expenses, principally within the International deposit business.
- **In Wealth, profit before tax decreased by 11 per cent to £139 million but increased by 39 per cent to £170 million in core Wealth** and in International (which is predominantly non-core) the loss before tax increased by 20 per cent to £2,323 million. Excluding non-recurring gains on sale of non-core businesses that were recognised in the first half of 2010, profit before tax and fair value unwind increased by 19 per cent.
- **Net interest income decreased by 15 per cent to £509 million**, reflecting lower lending volumes and a 18 basis point reduction in the banking net interest margin, partly offset by the favourable impact of foreign currency movements, particularly the Australian dollar, higher deposit balances and improving deposit margins.
- **Other income increased by 4 per cent to £631 million**, with foreign exchange benefits in International and increasing funds under management in the Wealth businesses, partly offset by the impact of non-recurring gains on the sale of non-core businesses in Wealth recognised in the first half of 2010.
- **Operating expenses increased by 6 per cent to £792 million**, due to higher regulatory costs in the Wealth businesses, investment in growth in our Wealth businesses and our International on-line deposit taking operation and the effect of stronger foreign currency rates, partly offset by benefits from cost saving initiatives across all businesses.
- **The impairment charge amounted to £2,532 million**, compared to £2,228 million in the first half of 2010, reflecting the continued deterioration in real estate values in Ireland and in Australasian property markets to which the Group is exposed.
- **Loans and advances to customers decreased by £4.2 billion, or 8 per cent, to £51.1 billion**, reflecting net repayments of £3.7 billion and additional impairment provisions in the International businesses, partly offset by foreign exchange movements of £2.0 billion.
- **Customer deposits increased by £6.1 billion, or 19 per cent, to £38.9 billion**, in the main due to continued strong inflows in our Wealth and International on-line deposit business.

**WEALTH AND INTERNATIONAL** (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change since 30 June 2010 %	Half-year to 31 Dec 2010 £m
Net interest income	509	596	(15)	580
Other income	631	605	4	555
Total income	1,140	1,201	(5)	1,135
Operating expenses	(792)	(744)	(6)	(792)
Trading surplus	348	457	(24)	343
Impairment	(2,532)	(2,228)	(14)	(3,760)
Share of results of joint ventures and associates	–	(2)		(6)
<b>Loss before tax and fair value unwind</b>	<b>(2,184)</b>	<b>(1,773)</b>	<b>(23)</b>	<b>(3,423)</b>
Fair value unwind	104	164	(37)	208
<b>Loss before tax</b>	<b>(2,080)</b>	<b>(1,609)</b>	<b>(29)</b>	<b>(3,215)</b>
Wealth	139	156	(11)	113
International	(2,323)	(1,929)	(20)	(3,536)
<b>Loss before tax and fair value unwind</b>	<b>(2,184)</b>	<b>(1,773)</b>	<b>(23)</b>	<b>(3,423)</b>
Banking net interest margin	1.47%	1.65%		1.61%
Cost:income ratio	69.5%	61.9%		69.8%
Impairment as a % of average advances (annualised)	7.89%	6.56%		11.29%
		As at 30 June 2011 £bn	As at 31 Dec 2010 £bn	Change since 31 Dec 2010 %
<b>Key balance sheet and other items</b>				
Loans and advances to customers		51.1	55.3	(8)
Customer deposits		38.9	32.8	19
Total customer balances		90.0	88.1	2
Risk-weighted assets		56.4	58.7	(4)

## **WEALTH AND INTERNATIONAL** (continued)

### **Financial performance**

Loss before tax and fair value unwind increased by 23 per cent to £2,184 million due to lower income, higher costs and a higher impairment charge in International, predominantly in Ireland.

Total income decreased by 5 per cent to £1,140 million. Net interest income decreased by 15 per cent, reflecting lower lending balances and the increased strain of impaired lending in International, partly offset by higher deposit balances, improving deposit margins in Wealth and the impact of the stronger Australian dollar in International. Other income increased by 4 per cent, mainly due to foreign exchange benefits in International and increasing funds under management partly offset by non-recurring gains on sale of non-core businesses recognised in the first half of 2010 in Wealth.

Operating expenses increased by 6 per cent, due to increased investment in the International deposit business, the impact of the stronger Australian dollar and additional investment and regulatory costs in Wealth. Despite increased investment in Wealth, and in International deposit gathering, the cost:income ratio overall improved by 2.4 per cent in our core business.

The impairment charge increased by 14 per cent to £2,532 million; this reflects actual and anticipated further falls in the commercial real estate market in Ireland and a further decline in valuations in Australasian property markets to which the Group is exposed.

### **Balance sheet progress**

Loans and advances to customers decreased by £4.2 billion to £51.1 billion, reflecting net repayments of £3.7 billion and additional impairment provisions in the International businesses, partly offset by foreign exchange movements of £2.0 billion.

Customer deposits increased by £6.1 billion to £38.9 billion mainly due to continued strong deposit inflows in our Wealth and International on-line deposit businesses.



**WEALTH AND INTERNATIONAL** (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change since 30 June 2010 %	Half-year to 31 Dec 2010 £m
<b>Core</b>				
Net interest income	221	158	40	182
Other income	504	503		487
Total income	725	661	10	669
Operating expenses	(565)	(531)	(6)	(578)
Trading surplus	160	130	23	91
Impairment	(15)	(16)	6	(10)
Share of results of joint ventures and associates	1	(1)		1
<b>Profit before tax and fair value unwind</b>	<b>146</b>	<b>113</b>	<b>29</b>	<b>82</b>
Fair value unwind	4	14	(71)	16
<b>Profit before tax – core</b>	<b>150</b>	<b>127</b>	<b>18</b>	<b>98</b>
<b>Non-core</b>				
Net interest income	288	438	(34)	398
Other income	127	102	25	68
Total income	415	540	(23)	466
Operating expenses	(227)	(213)	(7)	(214)
Trading surplus	188	327	(43)	252
Impairment	(2,517)	(2,212)	(14)	(3,750)
Share of results of joint ventures and associates	(1)	(1)		(7)
<b>Loss before tax and fair value unwind</b>	<b>(2,330)</b>	<b>(1,886)</b>	<b>(24)</b>	<b>(3,505)</b>
Fair value unwind	100	150	(33)	192
<b>Loss before tax – non-core</b>	<b>(2,230)</b>	<b>(1,736)</b>	<b>(28)</b>	<b>(3,313)</b>
<b>Loss before tax – combined</b>	<b>(2,080)</b>	<b>(1,609)</b>	<b>(29)</b>	<b>(3,215)</b>
<b>Banking net interest margin</b>				
Core	4.50%	3.05%		3.32%
Non-core	1.01%	1.44%		1.34%
<b>Cost:income ratio</b>				
Core	77.9%	80.3%		86.4%
<b>Impairment as a % of average advances (annualised)</b>				
Core	0.36%	0.39%		0.25%
Non-core	9.01%	7.45%		12.80%

**WEALTH AND INTERNATIONAL** (continued)

<b>Key balance sheet and other items</b>	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Core</b>			
Loans and advances to customers	<b>8.1</b>	8.1	
Customer deposits	<b>37.6</b>	31.6	<b>19</b>
Risk-weighted assets	<b>10.8</b>	12.0	<b>(10)</b>
<b>Non-core</b>			
Loans and advances to customers	<b>43.0</b>	47.2	<b>(9)</b>
Customer deposits	<b>1.3</b>	1.2	<b>8</b>
Risk-weighted assets	<b>45.6</b>	46.7	<b>(2)</b>

Core profit before tax and fair value unwind increased by 29 per cent to £146 million, due to higher income partly offset by higher operating expenses.

Core total income increased by 10 per cent to £725 million. Net interest income increased by 40 per cent reflecting growing deposit balances and strong margin management. Other income is largely in line with the first half of 2010 at £504 million.

Core operating expenses increased by 6 per cent to £565 million, with benefits from cost saving initiatives across all core businesses more than offset by higher investment and regulatory costs in core Wealth and investment in International's on-line deposit business. Despite investment in growing the Wealth business and in marketing costs associated with International on-line deposit gathering (which now has balances of over €10 billion), the cost:income ratio overall improved by 2.4 per cent.

Consistent with the division's strategic approach to maximising value in the medium term, a number of businesses are considered to be non-core, predominantly within International. In 2010, the Group completed the merger of the business carried on by Bank of Scotland (Ireland) Limited with Bank of Scotland plc, to support the efficient run-down of the Irish portfolio. In Australia, the Corporate and Asset Finance businesses are of scale and profitable, operating in a strong and developed economy that has good growth prospects. These ongoing businesses will continue to be managed for maximum value whilst maintaining a tight focus on running off the legacy commercial property exposures.

Non-core loss before tax and fair value unwind increased by 24 per cent to £2,330 million, due to lower income and higher International impairment charges predominantly in Ireland.

Non-core total income decreased by 23 per cent to £415 million, reflecting lower lending volumes due to the focus on rightsizing the International balance sheet partly offset by foreign exchange gains.

**WEALTH AND INTERNATIONAL** (continued)**Wealth**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>181</b>	161	<b>12</b>	184
Other income	<b>500</b>	539	<b>(7)</b>	479
Total income	<b>681</b>	700	<b>(3)</b>	663
Operating expenses	<b>(513)</b>	(520)	<b>1</b>	(527)
Trading surplus	<b>168</b>	180	<b>(7)</b>	136
Impairment	<b>(29)</b>	(23)	<b>(26)</b>	(23)
Share of results of joint ventures and associates	<b>–</b>	(1)	<b>–</b>	–
<b>Profit before tax and fair value unwind</b>	<b>139</b>	156	<b>(11)</b>	113
Cost:income ratio	<b>75.3%</b>	74.3%		79.5%
Impairment as a % of average advances (annualised)	<b>0.63%</b>	0.49%		0.47%

<b>Key balance sheet and other items</b>	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
Loans and advances to customers	<b>9.0</b>	9.1	<b>(1)</b>
Customer deposits	<b>27.3</b>	26.8	<b>2</b>
Risk-weighted assets	<b>9.3</b>	10.4	<b>(11)</b>

Profit before tax and fair value unwind decreased by 11 per cent to £139 million mainly due to lower income. Excluding non-recurring gains on sale of non-core businesses which were recognised in the first half of 2010, profit before tax and fair value unwind increased by 19 per cent.

Total income decreased by 3 per cent to £681 million. Excluding non-recurring gains on sale, which were recognised in the first half of 2010, income increased by 3 per cent. Net interest income increased by 12 per cent, reflecting higher deposit balances and improving deposit margins. Other income decreased by 7 per cent, mainly due to non-recurring gains on sale of non-core businesses recognised in the first half of 2010 (excluding these gains, income was in line with the first half of 2010).

Operating expenses decreased by 1 per cent, with benefits from cost saving initiatives partly offset by increased regulatory costs.

The impairment charge increased by 26 per cent reflecting increased impairment losses on the non-core portfolio.

**WEALTH AND INTERNATIONAL** (continued)**Funds under management**

	<b>As at 30 June 2011 £bn</b>	As at 30 June 2010 £bn	As at 31 Dec 2010 £bn
Scottish Widows Investment Partnership (SWIP)			
Internal	120.7	110.9	118.2
External	26.7	25.5	28.0
	<b>147.4</b>	136.4	146.2
Other Wealth:			
St James's Place	29.1	22.4	27.0
Invista Real Estate	2.5	5.4	5.3
Private and International Banking	14.3	14.3	13.5
Closing funds under management	<b>193.3</b>	178.5	192.0
	<b>Half-year to 30 June 2011 £bn</b>	Half-year to 30 June 2010 £bn	Half-year to 31 Dec 2010 £bn
<b>Opening funds under management</b>	<b>192.0</b>	184.1	178.5
Inflows:			
SWIP			
– internal	1.0	1.1	0.9
– external	0.7	2.0	6.9
Other	3.8	3.7	3.0
	<b>5.5</b>	6.8	10.8
Outflows:			
SWIP			
– internal	(4.4)	(0.5)	(5.1)
– external	(1.8)	(6.6)	(6.7)
Other	(2.1)	(2.1)	(3.0)
	<b>(8.3)</b>	(9.2)	(14.8)
Investment return, expenses and commission	4.1	(2.5)	17.6
Net operating increase (decrease) in funds	1.3	(4.9)	13.6
Sale of Bank of Scotland Portfolio Management Service	–	(0.7)	(0.1)
<b>Closing funds under management</b>	<b>193.3</b>	178.5	192.0

Funds under management of £193.3 billion increased by £1.3 billion. Net outflows of £8.3 billion reflect withdrawals from insurance funds impacting SWIP, partially offset by strong net inflows in St. James's Place plc and Private Banking. Increases in global equity values increased funds under management by a further £4.1 billion.

**WEALTH AND INTERNATIONAL** (continued)**International**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>328</b>	435	<b>(25)</b>	396
Other income	<b>131</b>	66	<b>98</b>	76
Total income	<b>459</b>	501	<b>(8)</b>	472
Operating expenses	<b>(279)</b>	(224)	<b>(25)</b>	(265)
Trading surplus	<b>180</b>	277	<b>(35)</b>	207
Impairment	<b>(2,503)</b>	(2,205)	<b>(14)</b>	(3,737)
Share of results of joint ventures and associates	<b>–</b>	(1)		(6)
<b>Loss before tax and fair value unwind</b>	<b>(2,323)</b>	(1,929)	<b>(20)</b>	(3,536)
Cost:income ratio	<b>60.8%</b>	44.7%		56.1%
Impairment as a % of average advances (annualised)	<b>9.09%</b>	7.54%		13.13%

	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change since 31 Dec 2010 %</b>
<b>Key balance sheet and other items</b>			
Loans and advances to customers	<b>42.1</b>	46.2	<b>(9)</b>
Customer deposits	<b>11.6</b>	6.0	<b>93</b>
Risk-weighted assets	<b>47.1</b>	48.3	<b>(2)</b>

Loss before tax and fair value unwind increased by £394 million to £2,323 million mainly as a result of a higher impairment charge, reflecting an increase of £222 million in Ireland and £132 million in Australia.

Total income decreased by 8 per cent, but was 18 per cent lower in constant currency, reflecting lower interest-earning assets and the increased strain of higher impaired assets.

Operating expenses increased by 25 per cent in both actual and constant currency terms, reflecting the continued development of International's on-line deposit business partly offset by cost saving initiatives across the International business.

The impairment charge and loans and advances to customers are summarised by key geography in the following table.

**WEALTH AND INTERNATIONAL** (continued)**International** (continued)

	<b>Impairment charges</b>			<b>Loans and advances to customers</b>	
	<b>Half-year to 30 June 2011</b> £m	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m	<b>As at 30 June 2011</b> £bn	As at 31 Dec 2010 £bn
Ireland	<b>1,779</b>	1,557	2,707	<b>17.7</b>	19.6
Australia	<b>586</b>	454	908	<b>10.6</b>	12.3
Wholesale Europe	<b>111</b>	145	65	<b>6.5</b>	6.9
Latin America/Middle East	<b>23</b>	43	54	<b>0.4</b>	0.6
Netherlands	<b>4</b>	6	3	<b>6.9</b>	6.8
	<b>2,503</b>	2,205	3,737	<b>42.1</b>	46.2

The impairment charge increased by £298 million, or 14 per cent, to £2,503 million due to increased impairment charges in Ireland, reflecting actual and anticipated further falls in the commercial real estate market in Ireland.

**Balance sheet progress**

Loans and advances to customers decreased by £4.1 billion or 9 per cent, to £42.1 billion due to net repayments of £3.7 billion across all businesses and further impairment provisions, partly offset by an increase due to foreign exchange movements of £2.0 billion. The division is focused on de-risking and right-sizing the balance sheet, focusing on key Group relationships, as well as reducing concentrations in Commercial Real Estate.

Customer deposits increased by £5.6 billion, or 93 per cent, to £11.6 billion driven by continued strong performance in our International on-line deposit business.

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## INSURANCE

### Key highlights

- **Profit before tax increased by 16 per cent to £543 million**, compared to £469 million in the first half of 2010.
- **Profit before tax and fair value unwind increased by 15 per cent to £564 million**, although the first half of 2010 included a non-recurring charge of £70 million in respect of the Group's decision to cease writing new payment protection insurance (PPI) business. Excluding this charge, profit before tax and fair value unwind was in line with the first half of 2010.
- **Total income, net of insurance claims, increased by £56 million to £979 million.** This reflects the non-recurrence of the £70 million charge as detailed above, lower PPI related income, partially offset by the continued change in mix within Life, Pensions and Investments UK (LP&I UK) towards more profitable protection business and improved claims experience within General Insurance (GI).
- **Operating expenses decreased by 2 per cent or £8 million to £415 million** due mainly to a continued focus on cost management and delivery of integration synergies.
- **LP&I UK margin increased to 4.2 per cent from 3.5 per cent in 2010.** The improved margin reflects the continued focus on value and the strategic choices made in respect of product and channel propositions, in particular the higher proportion of protection business now sold. The Internal Rate of Return (IRR) on new business has continued to increase in the first half of 2011 and is in excess of 16 per cent.
- **LP&I UK sales of £5,595 million (PVNBP) reduced by 9 per cent**, partly reflecting the continuing change in mix away from savings products towards more profitable protection business, following the launch of our integrated bancassurance proposition in June 2010. Sales through our Intermediary channel have increased by 17 per cent to £3,407 million reflecting strong sales of Corporate Pensions.
- **General Insurance profits increased by 10 per cent to £214 million** primarily due to lower unemployment and freeze claims year-on-year after taking account of continuing lower income resulting from the Group ceasing to write new PPI business in 2010.
- **Capital management initiatives in 2011 have resulted in £2.3 billion** mitigation of the potential impact of Basel 3. This includes capital restructuring within the business that occurred in July 2011 which reduced the Group's estimated total core tier 1 impact of Basel 3 by just over £2 billion.



**INSURANCE** (continued)

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	(142)	(136)	(4)	(127)
Other income	<u>1,319</u>	<u>1,320</u>		<u>1,494</u>
Total income	<b>1,177</b>	1,184	<b>(1)</b>	1,367
Insurance claims	<u>(198)</u>	<u>(261)</u>	<b>24</b>	<u>(281)</u>
Total income, net of insurance claims	<b>979</b>	923	<b>6</b>	1,086
Operating expenses	<b>(415)</b>	(423)	<b>2</b>	(431)
Share of results of joint ventures and associates	<u>-</u>	<u>(10)</u>		<u>-</u>
<b>Profit before tax and fair value unwind</b>	<b>564</b>	490	<b>15</b>	655
Fair value unwind	<u>(21)</u>	<u>(21)</u>		<u>(22)</u>
<b>Profit before tax</b>	<u><b>543</b></u>	<u>469</u>	<b>16</b>	<u>633</u>
<b>Profit before tax and fair value unwind by business unit</b>				
Life, Pensions and Investments:				
UK business	<b>347</b>	273	<b>27</b>	410
European business	<b>10</b>	19	<b>(47)</b>	91
General Insurance	<b>214</b>	195	<b>10</b>	177
Other <sup>1</sup>	<u>(7)</u>	<u>3</u>		<u>(23)</u>
<b>Profit before tax and fair value unwind</b>	<u><b>564</b></u>	<u>490</u>	<b>15</b>	<u>655</u>
<b>EEV new business margin</b>	<b>4.1%</b>	3.4%		3.7%

<sup>1</sup> Includes certain Group and divisional costs and income not allocated to business units, as well as the division's share of results of joint ventures and associates. The half-year to 30 June 2010 included an accounting gain on disposal of £13 million from the sale of the Group's joint venture investment in esure.

**INSURANCE** (continued)

**Financial performance**

Profit before tax and fair value unwind increased by 15 per cent to £564 million, although the first half of 2010 included a non-recurring charge of £70 million in respect of the Group's decision to cease writing new PPI business. Excluding this charge profit before tax and fair value unwind is in line with the first half of 2010.

Total income, net of insurance claims, increased by £56 million to £979 million which reflects the non-recurrence of the £70 million charge as detailed above, lower PPI related income, partially offset by the continued change in mix within LP&I UK towards more profitable protection business, and improved claims experience within GI.

The continued focus on cost management and delivery of integration synergies resulted in a decrease in operating expenses.

***Capital management and operational efficiency***

Following the significant work undertaken in 2010 to optimise the Insurance division's contribution to Group capital, this work has remained a major focus during 2011. Capital management initiatives in 2011 have resulted in £2.3 billion mitigation of the potential impact of Basel 3. This includes capital restructuring within the business that occurred in July 2011 which reduced the Group's estimated total core tier 1 impact of Basel 3 by just over £2 billion, bringing the total expected mitigation to £4.6 billion since the start of 2010. The Insurance division remains well capitalised as assessed using the Insurance Groups Directive (IGD) regulatory measure of surplus capital. The division is progressing well with its implementation of Solvency II requirements.

The Insurance division continues to focus on cost reduction with operating expenses decreasing by 2 per cent in the first half of 2011. Efficiencies have been achieved without compromising the quality of customer service and customer satisfaction scores have remained robust across the division.

In July 2011 all the legal entities in the Insurance division were brought under one common holding company to create a single insurance group.

**INSURANCE** (continued)**Life, Pensions and Investments****UK business**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
Net interest income	<b>(123)</b>	(116)	<b>(6)</b>	(111)
Other income	<b>727</b>	645	<b>13</b>	763
Total income	<b>604</b>	529	<b>14</b>	652
Operating expenses	<b>(257)</b>	(256)		(242)
<b>Profit before tax and fair value unwind</b>	<b>347</b>	273	<b>27</b>	410
<b>Profit before tax and fair value unwind by business unit</b>				
New business profit – insurance business <sup>1</sup>	<b>201</b>	166	<b>21</b>	166
– investment business <sup>1</sup>	<b>(33)</b>	(34)	<b>3</b>	(31)
Total new business profit	<b>168</b>	132	<b>27</b>	135
Existing business profit	<b>178</b>	234	<b>(24)</b>	230
Experience and assumption changes	<b>1</b>	(93)		45
<b>Profit before tax and fair value unwind</b>	<b>347</b>	273	<b>27</b>	410
EEV new business margin (UK)	<b>4.2%</b>	3.5%		4.0%
<b>Life, Pensions and Investments sales (PVNBP)</b>	<b>5,595</b>	6,151	<b>(9)</b>	4,165

<sup>1</sup> As required under IFRS, products are split between insurance and investment contracts depending on the level of insurance risk contained. For insurance contracts, the new business profit includes the net present value of profits expected to emerge over the lifetime of the contract, including profits anticipated in periods after the year of sale; for investment contracts the figure reflects the profit in the year of sale only, after allowing for the deferral of initial income and expenses. Consequently the recognition of profit for investment contracts is deferred relative to insurance contracts.

**INSURANCE** (continued)

Life, Pensions and Investments UK (LP&I UK) delivered profit growth, before tax and fair value unwind, of £74 million, or 27 per cent, although the first half of 2010 included a non-recurring £70 million charge from the Group's decision to cease writing new PPI business. Excluding this charge, profit before tax and fair value unwind increased by £4 million or 1 per cent.

Total new business profit increased by £36 million, or 27 per cent, to £168 million. The increase is primarily attributable to the focus on value over volume initiated as part of the post-integration strategy. The integration of the intermediary sales forces in 2009, including the repositioning of the product set, is now resulting in strong Corporate Pensions sales which have increased by 62 per cent on a PVNBP basis in the period. The launch of the integrated bancassurance proposition in June 2010 has resulted in the continuing change in mix within the bancassurance channel away from savings products towards more profitable protection business.

LP&I UK margin on an EEV basis increased to 4.2 per cent in the first half of 2011 from 3.5 per cent in the first half of 2010. The improved margin reflects the strategic choices made in respect of product and channel propositions combined with a continued focus on value across the business. The IRR on new business has continued to increase in the first half of 2011 and is in excess of 16 per cent.

Existing business profit decreased by £56 million, or 24 per cent, to £178 million. The decrease predominantly reflects the impact of the Group's decision to cease writing new PPI business in the second half of 2010, a reduction in the assumed rate of return, and a lower volume of shareholder net assets earning returns as a result of capital repatriation initiatives in 2010.

The charge in respect of experience and assumption changes reduced from a charge of £93 million in the first half of 2010 to a credit of £1 million in the first half of 2011. The reduction mainly reflects the absence of the £70 million charge in 2010 from the Group's decision to cease writing new PPI business. The absence of the 2010 charge was partially offset by a degree of adverse short-term persistency experience in the period.

The capital positions of the UK life insurance companies within the Insurance division remain robust. The estimated Insurance Groups Directive (IGD) capital surplus for the Scottish Widows insurance group was £1.2 billion (31 December 2010: £1.3 billion), and the estimated IGD capital surplus for the HBOS insurance group was £1.7 billion (31 December 2010: £1.6 billion).

**European business**

Profit before tax decreased by £9 million, 47 per cent, to £10 million. The reduction was driven largely by non-recurring benefits from a modelling change in the first half of 2010.

Although sales (PVNBP) have decreased by 7 per cent from first half of 2010, the campaign 'Heidelberger Leben Goes Mainstream Market' which was launched in April 2010, and which aims to position HLE as a key provider for independent brokers, resulted in a doubling of sales in this segment in the first half of the year compared to the first half of 2010.

**INSURANCE** (continued)**New business**

New business margins have improved from 3.4 per cent in the first half of 2010 to 4.1 per cent in the half-year to 30 June 2011. Sales (PVNBP) reduced by 9 per cent to £5,763 million. These outcomes largely reflect the continuing focus of the business on value, and a change in mix away from large single premium savings products to lower premium, higher margin, protection business, and resulted in total new business profit within LP&I UK increasing by £36 million, or 27 per cent to £168 million.

In the bancassurance channel the reduction reflects a change in mix away from savings products towards more profitable protection business. Sales of OEICs were further adversely affected by a reduction in the volume of capital protected product sales. However, sales of protection products increased by 33 per cent and the new business margin has increased.

Within the intermediary channel the increase of £474 million, or 15 per cent, mainly reflects strong sales of corporate pensions in LP&I UK.

The direct channel, although relatively small at this time, is performing well and is being developed for future growth.

An analysis of the present value of new business premiums for business written by the Insurance division, split between the UK and European Life, Pensions and Investments businesses is given below:

Analysis by product	Half-year to 30 June 2011			Half-year to 30 June 2010			Change since 30 June 2010	Half-year to 31 Dec 2010
	UK £m	Europe £m	Total £m	UK £m	Europe £m	Total £m	%	Total £m
Protection	376	18	394	280	16	296	33	334
Payment protection	11	–	11	54	–	54	(80)	16
Savings and investments	633	99	732	925	112	1,037	(29)	895
Individual pensions	780	51	831	942	52	994	(16)	753
Corporate and other pensions	2,350	–	2,350	1,437	–	1,437	64	1,313
Retirement income	394	–	394	536	–	536	(26)	353
Managed fund business	58	–	58	70	–	70	(17)	107
Life and pensions	4,602	168	4,770	4,244	180	4,424	8	3,771
OEICs	993	–	993	1,907	–	1,907	(48)	726
<b>Total</b>	<b>5,595</b>	<b>168</b>	<b>5,763</b>	<b>6,151</b>	<b>180</b>	<b>6,331</b>	<b>(9)</b>	<b>4,497</b>
<b>Analysis by channel</b>								
Bancassurance	1,850	–	1,850	2,956	–	2,956	(37)	1,476
Intermediary	3,407	168	3,575	2,921	180	3,101	15	2,776
Direct	338	–	338	274	–	274	23	245
<b>Total</b>	<b>5,595</b>	<b>168</b>	<b>5,763</b>	<b>6,151</b>	<b>180</b>	<b>6,331</b>	<b>(9)</b>	<b>4,497</b>

**INSURANCE** (continued)**Funds under management**

The table below shows the funds of the Life, Pensions and Investment companies within the Insurance division. These funds are predominantly managed within the Group by the Wealth and International division.

	<b>Half-year to 30 June 2011 £bn</b>	Half-year to 30 June 2010 £bn	Half-year to 31 Dec 2010 £bn
<b>Opening funds under management</b>	<b>133.1</b>	122.1	123.2
<b>UK business</b>			
Premiums	<b>5.6</b>	6.3	4.9
Claims and surrenders	<b>(7.5)</b>	(8.1)	(6.8)
Net outflow of business	<b>(1.9)</b>	(1.8)	(1.9)
Investment return, expenses and commission	<b>2.3</b>	(0.6)	11.1
Other movements <sup>1</sup>	<b>–</b>	4.1	0.2
<b>Net movement</b>	<b>0.4</b>	1.7	9.4
<b>European business</b>			
Net movement	<b>0.1</b>	(0.1)	0.5
<b>Dividends and capital repatriation</b>	<b>(0.3)</b>	(0.5)	–
<b>Closing funds under management</b>	<b>133.3</b>	123.2	133.1
<b>Managed by the Group</b>	<b>107.6</b>	103.4	109.3
<b>Managed by third parties</b>	<b>25.7</b>	19.8	23.8
<b>Closing funds under management</b>	<b>133.3</b>	123.2	133.1

<sup>1</sup> Other movements in funds under management incorporate alignment changes and the inclusion of managed pension funds.

**INSURANCE** (continued)**General Insurance**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change %</b>	Half-year to 31 Dec 2010 £m
<b>Home insurance</b>				
Underwriting income (net of reinsurance)	449	455	(1)	467
Commission receivable	38	35	9	40
Commission payable	(67)	(70)	4	(65)
	<b>420</b>	420		442
<b>Payment protection insurance</b>				
Underwriting income <sup>1</sup>	185	292	(37)	252
Commission receivable	38	(23)		50
Commission payable	(152)	(134)	(13)	(184)
	<b>71</b>	135	(47)	118
<b>Other</b>				
Underwriting income (net of reinsurance)	2	3	(33)	3
Commission receivable	13	22	(41)	28
Commission payable	(2)	(9)	78	(6)
Other (including investment income)	4	(9)		(25)
	<b>17</b>	7		-
<b>Net operating income</b>	<b>508</b>	562	(10)	560
Claims paid on insurance contracts (net of reinsurance)	(198)	(261)	24	(281)
<b>Operating income, net of claims</b>	<b>310</b>	301	3	279
Operating expenses	(96)	(106)	9	(102)
<b>Profit before tax and fair value unwind</b>	<b>214</b>	195	10	177
Combined ratio	<b>73%</b>	77%		80%

<sup>1</sup> The Group ceased writing new PPI business on 23 July 2010. Underwriting income therefore relates primarily to existing business.

Profit before tax and fair value unwind from General Insurance increased by 10 per cent to £214 million. The increase was primarily due to improved unemployment and freeze claims period-on-period, after taking account of continuing lower income as a result of the Group ceasing to write new PPI business on 23 July 2010.

Total income for home insurance was in line with the first half of 2010 at £420 million and reflects the maturity and competitiveness of the market.

Reduced claims of £198 million, 24 per cent lower than in the first half of 2010, mainly reflect lower unemployment claims combined with favourable experience on the home book as the freeze events in January 2011 were less severe than those of January 2010. Claims continue to be positively impacted by a reduction in the size of the book which has resulted in lower claims overall.

Operating expenses decreased by £10 million, or 9 per cent, to £96 million primarily as a result of the continuing delivery of integration savings and a continued focus on cost management.

**INSURANCE** (continued)

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	<b>Change since 30 June 2010 %</b>	Half-year to 31 Dec 2010 £m
<b>Core</b>				
Net interest income	(148)	(141)	(5)	(133)
Other income	1,282	1,287		1,363
Total income	1,134	1,146		1,230
Insurance claims	(198)	(261)	24	(281)
Total income, net of insurance claims	936	885	6	949
Operating expenses	(395)	(410)	4	(403)
Share of results of joint ventures and associates	–	(10)		–
<b>Profit before tax and fair value unwind</b>	<b>541</b>	465	<b>16</b>	546
Fair value unwind	(21)	(21)		(22)
<b>Profit before tax – core</b>	<b>520</b>	444	<b>17</b>	524
<b>Non-core</b>				
Net interest income	6	5	20	6
Other income	37	33	12	131
Total income	43	38	13	137
Insurance claims	–	–		–
Total income, net of insurance claims	43	38	13	137
Operating expenses	(20)	(13)	(54)	(28)
Share of results of joint ventures and associates	–	–		–
<b>Profit before tax and fair value unwind</b>	<b>23</b>	25	<b>(8)</b>	109
Fair value unwind	–	–		–
<b>Profit before tax – non-core</b>	<b>23</b>	25	<b>(8)</b>	109
<b>Profit before tax – combined</b>	<b>543</b>	469	<b>16</b>	633

The core focus of Insurance division continues to be the UK market. In addition we have a limited presence in Europe which, despite not being subject to further significant investment, will continue to focus on meeting the needs of customers.



## GROUP OPERATIONS

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 <sup>1</sup> £m	Change since 30 June 2010 %	Half-year to 31 Dec 2010 <sup>1</sup> £m
Net interest income	(29)	(36)	19	(36)
Other income	23	15	53	34
Total income	(6)	(21)	71	(2)
Direct costs:				
Information technology	(551)	(609)	10	(598)
Operations	(303)	(319)	5	(319)
Property	(467)	(486)	4	(483)
Procurement	(28)	(30)	7	(29)
Support functions	(48)	(52)	8	(56)
	(1,397)	(1,496)	7	(1,485)
<b>Result before recharges to divisions</b>	<b>(1,403)</b>	<b>(1,517)</b>	<b>8</b>	<b>(1,487)</b>
Total net recharges to divisions	1,341	1,460	(8)	1,478
Share of results of joint ventures and associates	–	1		2
<b>Loss before tax</b>	<b>(62)</b>	<b>(56)</b>	<b>(11)</b>	<b>(7)</b>

<sup>1</sup> 2010 comparative figures have been amended to reflect the impact of centralising operations across the Group as part of the integration programme.

**Financial performance**

2011 direct costs decreased by £99 million, or 7 per cent, to £1,397 million reflecting the continued focus on cost management and the delivery of integration synergy savings.

Information Technology costs decreased by 10 per cent, with integration savings offsetting inflationary rises.

Operations costs decreased by 5 per cent, through the continuing rationalisation of our major Operations functions.

Group Property costs decreased by 4 per cent, with the continuing consolidation of the heritage property portfolios delivering further integration benefits.

Procurement costs decreased by 7 per cent, reflecting the impact of negotiated lower third party costs on centrally managed contracts. In addition, Procurement has helped to deliver Group-wide synergies.

## CENTRAL ITEMS

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
Net interest expense	(173)	(296)	(527)
Other income	(414)	840	(442)
Total income	(587)	544	(969)
Operating expenses	(65)	(117)	10
Trading surplus	(652)	427	(959)
Share of results of joint ventures and associates	–	1	1
<b>(Loss) profit before tax and fair value unwind</b>	<b>(652)</b>	<b>428</b>	<b>(958)</b>
Fair value unwind	(536)	(866)	(580)
<b>Loss before tax</b>	<b>(1,188)</b>	<b>(438)</b>	<b>(1,538)</b>

Central items include income and expenditure not recharged to the divisions, including the costs of certain central and head office functions and the financial impact of hedge accounting.

Net interest expense improved by £123 million to £173 million. This improvement came primarily from other interest rate risk management activities in the banking book and a lower unwind expense from terminated hedge relationships, offset by an increase in unrecovered wholesale funding costs.

Other income decreased by £1,254 million to £(414) million. Liability management gains of £423 million arose on transactions undertaken in 2010 as part of the Group's management of capital, which exchanged certain debt securities for ordinary shares or other debt instruments. There were no comparable transactions in 2011. In addition, there was a £428 million adverse change in the mark-to-market movement arising from the equity conversion feature of the Group's Enhanced Capital Notes, along with a £497 million adverse movement within Banking Volatility.

Operating expenses reduced by £52 million to £65 million primarily due to lower pension costs held centrally.

Fair value unwind reduced by £330 million to £(536) million primarily due to the effect of liability management transactions and deal maturities leading to a reduced amortisation rate.

## ADDITIONAL INFORMATION ON A COMBINED BUSINESSES BASIS

### 1. Basis of preparation of combined businesses information

Comparisons of results on a statutory basis are of limited benefit due to a number of factors. In order to provide more meaningful and relevant comparatives, the results of the Group and divisions are presented on a 'combined businesses' basis. The key principles adopted in the preparation of the combined businesses basis of reporting are described below.

- In order to reflect the impact of the acquisition of HBOS, the following adjustments have been made:
  - the amortisation of purchased intangible assets has been excluded; and
  - the unwind of acquisition-related fair value adjustments is shown as one line in the combined businesses income statement.
  
- In order to better present the business performance the following items, not related to acquisition accounting, have also been excluded:
  - integration costs;
  - insurance and policyholder interests volatility;
  - curtailment gains and losses in respect of the Group's defined benefit pension schemes;
  - the customer goodwill payments provision;
  - the payment protection insurance provision;
  - sale costs in respect of the EU mandated retail business disposal (Project Verde); and
  - loss on disposal of businesses.

## 1. Basis of preparation of combined businesses information (continued)

The tables below set out a reconciliation from the published statutory results to the combined businesses results:

Half-year to 30 June 2011	Removal of:						Combined businesses £m
	Lloyds Banking Group statutory £m	Acquisition related items <sup>1</sup> £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Payment protection insurance provision £m	Fair value unwind £m	
Net interest income	5,989	-	(10)	102	-	297	6,378
Other income	10,214	-	187	(5,332)	-	(1,071)	3,998
<b>Total income</b>	<b>16,203</b>	<b>-</b>	<b>177</b>	<b>(5,230)</b>	<b>-</b>	<b>(774)</b>	<b>10,376</b>
Insurance claims	(5,349)	-	-	5,151	-	-	(198)
<b>Total income, net of insurance claims</b>	<b>10,854</b>	<b>-</b>	<b>177</b>	<b>(79)</b>	<b>-</b>	<b>(774)</b>	<b>10,178</b>
Operating expenses	(9,628)	978	-	79	3,200	39	(5,332)
<b>Trading surplus (deficit)</b>	<b>1,226</b>	<b>978</b>	<b>177</b>	<b>-</b>	<b>3,200</b>	<b>(735)</b>	<b>4,846</b>
Impairment	(4,491)	-	-	-	-	(931)	(5,422)
Share of results of joint ventures and associates	14	-	-	-	-	(2)	12
Fair value unwind		-	-	-	-	1,668	1,668
<b>(Loss) profit before tax</b>	<b>(3,251)</b>	<b>978</b>	<b>177</b>	<b>-</b>	<b>3,200</b>	<b>-</b>	<b>1,104</b>

<sup>1</sup> Comprises integration costs (£642 million) and the amortisation of purchased intangibles (£289 million) and EU mandated retail business disposal costs (£47 million).

Half-year to 30 June 2010	Removal of:						Combined businesses £m
	Lloyds Banking Group statutory £m	Acquisition related items including pension curtailment gain <sup>1</sup> £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Fair value unwind £m		
Net interest income	7,038	-	11	(321)	183	6,911	
Other income	8,742	-	188	(2,686)	(413)	5,831	
<b>Total income</b>	<b>15,780</b>	<b>-</b>	<b>199</b>	<b>(3,007)</b>	<b>(230)</b>	<b>12,742</b>	
Insurance claims	(3,189)	-	-	2,926	2	(261)	
<b>Total income, net of insurance claims</b>	<b>12,591</b>	<b>-</b>	<b>199</b>	<b>(81)</b>	<b>(228)</b>	<b>12,481</b>	
Costs:							
Operating expenses	(5,609)	56	-	81	37	(5,435)	
Impairment of tangible fixed assets	(202)	52	-	-	-	(150)	
	(5,811)	108	-	81	37	(5,585)	
<b>Trading surplus (deficit)</b>	<b>6,780</b>	<b>108</b>	<b>199</b>	<b>-</b>	<b>(191)</b>	<b>6,896</b>	
Impairment	(5,423)	-	-	-	(1,131)	(6,554)	
Share of results of joint ventures and associates	(61)	-	-	-	(1)	(62)	
Fair value unwind		-	-	-	1,323	1,323	
<b>Profit before tax</b>	<b>1,296</b>	<b>108</b>	<b>199</b>	<b>-</b>	<b>-</b>	<b>1,603</b>	

<sup>1</sup> Comprises integration costs (£804 million), the amortisation of purchased intangibles (£323 million) and the pension curtailment gain (£1,019 million).

## 1. Basis of preparation of combined businesses information (continued)

Half-year to 31 Dec 2010	Removal of:							Combined businesses £m
	Lloyds Banking Group statutory £m	Acquisition related items including pension curtailment loss <sup>1</sup> £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Customer goodwill payments provision and loss on disposal of businesses £m	Fair value unwind £m		
Net interest income	5,508	–	15	1,270	–	118	6,911	
Other income	22,179	–	(520)	(16,476)	–	(850)	4,333	
Total income	27,687	–	(505)	(15,206)	–	(732)	11,244	
Insurance claims	(15,322)	–	–	15,041	–	–	(281)	
Total income, net of insurance claims	12,365	–	(505)	(165)	–	(732)	10,963	
Operating expenses	(7,459)	1,264	–	165	500	37	(5,493)	
Trading surplus (deficit)	4,906	1,264	(505)	–	500	(695)	5,470	
Impairment	(5,529)	–	–	–	–	(1,098)	(6,627)	
Share of results of joint ventures and associates	(27)	–	–	–	–	(2)	(29)	
Loss on disposal of businesses	(365)	–	–	–	365	–	–	
Fair value unwind		–	–	–	–	1,795	1,795	
(Loss) profit before tax	(1,015)	1,264	(505)	–	865	–	609	

<sup>1</sup> Comprises integration costs (£849 million), the amortisation of purchased intangibles (£306 million) and the pension curtailment loss (£109 million).

**2. Banking net interest margin**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
<b>Banking net interest margin</b>			
Banking net interest income	<b>6,211</b>	6,646	6,740
Average interest-earning assets	<b>604,804</b>	644,701	630,190
Average interest-bearing liabilities	<b>367,049</b>	347,402	357,913
Banking net interest margin	<b>2.07%</b>	2.08%	2.12%
Banking asset margin	<b>1.43%</b>	1.55%	1.57%
Banking liability margin	<b>1.05%</b>	0.98%	0.97%
<b>Core</b>			
Banking net interest margin	<b>2.35%</b>	2.28%	2.33%
Banking net interest income	<b>5,292</b>	5,392	5,503
<b>Non-core</b>			
Banking net interest margin	<b>1.23%</b>	1.50%	1.52%
Banking net interest income	<b>919</b>	1,254	1,237

Banking net interest income is analysed for asset and liability margins based on interest earned and paid on average assets and average liabilities respectively, adjusted for Funds Transfer Pricing, which prices intra-group funding and liquidity. Centrally held wholesale funding costs and related items are included in the Group banking asset margin.

Average interest-earning assets, which are calculated gross of related impairment allowances, and average interest-bearing liabilities relate solely to customer and product balances in the banking businesses on which interest is earned or paid. Funding and capital balances including debt securities in issue, subordinated debt, repos and shareholders' equity are excluded from the calculation of average interest-bearing liabilities. However, the cost of funding these balances allocated to the banking businesses is included in banking net interest income.

A reconciliation of banking net interest income to Group net interest income showing the items that are excluded in determining banking net interest income follows:

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
<b>Banking net interest income – combined businesses</b>	<b>6,211</b>	6,646	6,740
Insurance division	<b>(142)</b>	(136)	(127)
Other net interest income (including trading activity)	<b>309</b>	401	298
<b>Group net interest income – combined businesses</b>	<b>6,378</b>	6,911	6,911
Fair value unwind	<b>(297)</b>	(183)	(118)
Insurance gross up	<b>(102)</b>	321	(1,270)
Volatility arising in insurance businesses	<b>10</b>	(11)	(15)
<b>Group net interest income – statutory</b>	<b>5,989</b>	7,038	5,508

### 3. Integration costs and benefits

The Group is on schedule to substantially complete the integration programme in the autumn of this year, and to deliver run-rate cost synergies and other operating efficiencies of £2 billion per annum from the programme by the end of 2011.

The sustainable run-rate synergies achieved as at 30 June 2011 totalled £1,750 million, excluding a number of one-off savings. The table below analyses the run-rate synergies as at 30 June 2011 by division and the 2011 target run-rate of £2 billion.

	2011			Target run-rate by market facing division £m
	Synergy run-rate as at 30 June 2011 £m	Allocation of Group Operations run-rate to divisions £m	Run-rate by market facing division £m	
Retail	319	346	665	867
Wholesale and Commercial	293	197	490	532
Wealth and International	263	30	293	242
Insurance	179	52	231	239
Group Operations	657	(657)	–	–
Central items	39	32	71	120
<b>Total</b>	<b>1,750</b>	<b>–</b>	<b>1,750</b>	<b>2,000</b>

Cost synergies continue to be delivered through the integration of HBOS operations, processes and IT systems. These synergies arise through procurement; property; IT cost savings and job reductions, of which 28,000 have been announced to date.

A key final step to completing the programme is the migration of HBOS retail and commercial customer accounts to the Lloyds TSB IT platform. This significant programme is now in the final stages of testing and is expected to be completed in the autumn. The completion of integration moves the Group to a single platform which is a key enabler for many of the transformational initiatives announced as part of the Strategic Review at the end of June 2011.

Integration costs of £642 million were incurred in the half-year and have been excluded from the combined businesses results. This brings the total integration costs since the HBOS acquisition to £3,391 million.

**4. Impairment charge**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
Retail:			
Secured	295	53	239
Unsecured	878	1,282	1,173
<b>Total Retail</b>	<b>1,173</b>	1,335	1,412
Wholesale	1,509	2,748	1,107
Commercial	159	189	182
Wealth and International	2,528	2,227	3,758
<b>Total impairment losses on loans and advances to customers</b>	<b>5,369</b>	6,499	6,459
Loans and advances to banks	–	(6)	(7)
Debt securities classified as loans and receivables	17	15	42
Available-for-sale financial assets	32	49	66
Other credit risk provisions	4	(3)	67
<b>Total impairment charge</b>	<b>5,422</b>	6,554	6,627
Charge for impairment losses on loans and advances to customers as % of average lending (annualised):			
Retail:			
Secured	0.18%	0.03%	0.14%
Unsecured	6.46%	8.27%	7.94%
<b>Total Retail</b>	<b>0.65%</b>	0.72%	0.76%
Wholesale	2.02%	3.11%	1.31%
Commercial	1.07%	1.28%	1.19%
Wealth and International	7.89%	6.56%	11.29%
<b>Total</b>	<b>1.77%</b>	2.01%	2.02%
<b>Impairment charge:</b>			
Core	1,636	1,653	1,959
Non-core	3,786	4,901	4,668
<b>Total impairment charge</b>	<b>5,422</b>	6,554	6,627
Charge for impairment losses on loans and advances to customers as % of average lending (annualised):			
Core	0.72%	0.70%	0.81%
Non-core	4.87%	5.68%	5.41%
<b>Total</b>	<b>1.77%</b>	2.01%	2.02%



## 5. Volatility arising in insurance businesses

The Group's statutory result is affected by insurance volatility, caused by movements in financial markets, and policyholder interests volatility, which primarily reflects the gross up of policyholder tax included in the Group's tax charge.

In the first half of 2011 the Group's statutory loss before tax included negative insurance and policyholder interests volatility totalling £177 million compared to negative volatility of £199 million in the first half of 2010.

Volatility comprises the following:

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m
Insurance volatility	<b>(69)</b>	(162)
Policyholder interests volatility <sup>1</sup>	<b>(106)</b>	(91)
Total volatility	<b>(175)</b>	(253)
Insurance hedging arrangements	<b>(2)</b>	54
<b>Total</b>	<b>(177)</b>	(199)

<sup>1</sup> Includes volatility relating to the Group's interest in St James's Place.

### Insurance volatility

The Group's insurance businesses have liability products that are supported by substantial holdings of investments, including equities, property and fixed interest investments, all of which are subject to variations in their value. The value of the liabilities does not move exactly in line with changes in the value of the investments, yet IFRS requires that the changes in both the value of the liabilities and investments be reflected within the income statement. As these investments are substantial and movements in their value can have a significant impact on the profitability of the Group, management believes that it is appropriate to disclose the division's results on the basis of an expected return in addition to results based on the actual return.

The expected sterling investment returns used to determine the normalised profit of the business, which are based on prevailing market rates and published research into historical investment return differentials, are set out below:

United Kingdom (Sterling)	<b>2011</b>	2010	2009
	%	%	%
Gilt yields (gross)	<b>3.99</b>	4.45	3.74
Equity returns (gross)	<b>6.99</b>	7.45	6.74
Dividend yield	<b>3.00</b>	3.00	3.00
Property return (gross)	<b>6.99</b>	7.45	6.74
Corporate bonds in unit-linked and with-profit funds (gross)	<b>4.59</b>	5.05	4.34
Fixed interest investments backing annuity liabilities (gross)	<b>4.78</b>	5.30	5.72

The impact on the results due to the actual return on these investments differing from the expected return (based upon economic assumptions made at the beginning of the year) is included within insurance volatility. Changes in market variables also affect the realistic valuation of the guarantees and options embedded within the With Profits Funds, the value of the in-force business and the value of shareholders' funds.

## **5. Volatility arising in insurance businesses (continued)**

The negative insurance volatility during the six months ended 30 June 2011 in the Insurance division was £69 million, primarily reflecting lower cash returns compared to long-term expectations. The more adverse charge in the first half of 2010 was primarily driven by a deterioration in equity markets which has not been experienced in the current period.

### **Group hedging arrangements**

To protect against further deterioration in equity market conditions, and the consequent negative impact on the value of in-force business on the Group balance sheet, the Group purchased put option contracts in 2010, financed by selling some upside potential from equity market movements. These expired on 21 January 2011. The charge for these options was £4 million. New protection against significant market falls was acquired in January 2011 to replace the expired contracts. There was no initial cost associated with these hedging arrangements. On a mark-to-market valuation basis a gain of £2 million was recognised in relation to the new contracts in 2011. The 2011 option contracts expire on 20 January 2012.

### **Policyholder interests volatility**

The application of accounting standards results in the introduction of other sources of significant volatility into the pre-tax profits of the life, pensions and investments business. In order to provide a clearer representation of the performance of the business, and consistent with the way in which it is managed, adjustments are made to remove this volatility from underlying profits. The effect of these adjustments is separately disclosed as policyholder interests volatility; there is no impact upon profit attributable to equity shareholders over the long term.

The most significant of these additional sources of volatility is policyholder tax. Accounting standards require that tax on policyholder investment returns should be included in the Group's tax charge rather than being offset against the related income. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge. Over the longer term the charges levied to policyholders to cover policyholder tax on investment returns and the related tax provisions are expected to offset. In practice timing and measurement differences exist between provisions for tax and charges made to policyholders. Consistent with the normalised approach taken in respect of insurance volatility, differences in the expected levels of the policyholder tax provision and policyholder charges are adjusted through policyholder interests volatility. Other sources of volatility include the minorities' share of the profits earned by investment vehicles which are not wholly owned by the long-term assurance funds.

During the six months to 30 June 2011, the statutory results before tax in both the Insurance and Wealth and International divisions included a charge to other income which relates to policyholder interests volatility totalling £106 million (half-year to 30 June 2010: £91 million charge). This charge included the impact of deferred tax asset impairments due to less optimistic economic forecasts and changes in expected policyholder tax provisions. Policyholder tax liabilities decreased during the first half of 2011 and led to a tax credit during the period.

**6. Number of employees (full-time equivalent)**

	<b>As at 30 June 2011</b>	As at 31 Dec 2010
Retail	<b>54,714</b>	53,839
Wholesale	<b>11,376</b>	12,067
Commercial	<b>6,110</b>	6,034
Wealth and International	<b>8,307</b>	8,348
Insurance	<b>9,433</b>	9,764
Group Operations	<b>19,564</b>	18,465
Central items	<b>2,841</b>	2,881
	<b>112,345</b>	111,398
Agency staff (full-time equivalent)	<b>(8,486)</b>	(7,168)
<b>Total number of employees (full-time equivalent)</b>	<b>103,859</b>	104,230

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## RISK MANAGEMENT

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The income statement numbers in this section have been presented on a combined businesses basis.

## **RISK MANAGEMENT APPROACH**

There have been no material changes to the Group's approach to risk management as described in the risk management report within the Lloyds Banking Group annual report and accounts for the year ended 31 December 2010.

## **PRINCIPAL RISKS AND UNCERTAINTIES**

The principal risks and uncertainties facing the Group for the remaining six months of the year are set out below, together with details of how they have evolved during the first half of the 2011 and continue to be actively managed by the Group.

## Economy

The global economic recovery has slowed in the first half of 2011. Sharp increases in the price of oil and other commodities across the turn of the year, driven by emerging market strength in 2010, have hit consumers' disposable incomes across the world and led to tighter monetary policy in emerging markets. Earlier fiscal stimulus in the US economy has now come to an end, and fiscal tightening is underway across Europe, particularly sharply in the most highly indebted countries. Whilst many advanced economies need an improvement in their net external trade position to offset weak consumer and government spending, current emerging market economic policies are not fully geared towards providing a strong engine of global growth through raising their own domestic demand. Highly indebted Eurozone countries are struggling to generate the growth needed to put their debt levels on a sustainable path given the scale of near-term austerity measures also required and the lack of help in the adjustment from interest rates or the exchange rate. Greece has required a second bail-out, agreed at the 21 July Eurozone summit meeting, but it is still unclear that it will be able eventually to service all its debt, so financial markets remain volatile and risk of contagion to other countries is unlikely to dissipate near-term.

All these factors together suggest that the global recovery is likely to continue to be weak and hesitant in comparison to other post-war recoveries. The degree of weakness in early 2011 was also exacerbated by the Japanese earthquake and tsunami, which has disrupted global manufacturing supply chains and caused some loss of production.

Current data show that the UK economy experienced very little underlying growth over the nine months to end of the second quarter of 2011. Consumer confidence and spending was hit by the fall in real disposable incomes. House prices have been falling gradually and commercial property prices have flattened off. Nevertheless, employment has continued to rise and our customers' current account transactions suggest that the underlying trend in households' income growth began to improve during the second quarter of 2011.

The Group's central scenario is for modest recovery to continue, assuming the recent Eurozone agreement on sovereign debt is enacted quickly and followed up by further measures for Greece. For the UK, the current projection reflected in our outlook, of 1.5 per cent Gross Domestic Product (GDP) growth in 2011 and 2.3 per cent in 2012 is broadly in line with consensus. Households' real spending growth should begin to improve as the squeeze from high inflation begins to reduce towards the end of the year. Net exports should continue to rise, reflecting the weakness of sterling. Unemployment should decline slowly, with companies reducing cost ratios through continued low wage growth. But with underlying inflationary pressures higher than before the recession, as the economy becomes more stable interest rates will need to rise gradually, and will act as a restraint on the recovery. Further improvements in the corporate failure rate are expected to be only gradual to the end of 2012. Both residential and commercial property prices are expected to end this year 2 per cent lower than at the end of 2010, and then rise only very slowly.

The US economic recovery is assumed to continue in the second half of 2011, as production recovers from the impacts of the Japanese earthquake, and in the Eurozone there is expected to be a continuing wide divergence between recovery in the stronger low-deficit countries and the higher deficit countries that will struggle to grow at all. The Irish economy, to which we have exposure, is expected to be only flat in 2011, and will not return to its pre-recession growth rate. House prices there are expected to fall by 10 per cent during 2011 and slightly further in 2012; commercial property prices are expected to fall further during 2011, but be flat over 2012.

## **Economy (continued)**

Downside risks around this scenario remain significant. Further increases in inflation could damage already weak consumer confidence, or result in earlier increases in interest rates if wage growth started to respond. Financial markets may remain unstable and continue to put extra pressure on other Eurozone economies outside Greece, given that current measures may fall short of solving Greece's problems. Since any shock to growth would also worsen the outlook for both public finances and bank capital and funding, a relatively small initial shock could throw economies onto a much weaker path as governments are forced to tighten fiscal policy even further or financial institutions are constrained in their ability to lend. A 'double-dip' scenario – a second shallower recession following closely the one that the economy is just emerging from – would result in further significant increases in corporate failures and unemployment during late 2011 and through 2012. In addition, residential and commercial property would suffer a second period of falling prices, tenant defaults would increase and central banks would have limited ability to cushion the downturn.

### ***Impact on our markets***

Mortgage market balances outstanding grew by just 0.2 per cent in the year to May, after 0.4 per cent growth in the year to end 2010. Unsecured consumer borrowing has, however, begun to pick up slightly from its extremely weak levels of 2010, although it is still very weak compared to longer term trends. Deposit market growth has also remained low, with growth in balances slowing to 2.1 per cent in May 2011 from 3 per cent at end 2010, as deteriorating disposable incomes have squeezed savings flows.

Businesses also continue to reduce their indebtedness. Non-financial corporations have continued to reduce borrowing so far in 2011. Rising profits and weak investment spending boosted companies' deposit growth in the latter part of 2009 and the first half of 2010, but deposits are now declining slowly.

Low interest rates have been a key benefit to consumers and businesses. Arrears and defaults rose by much less during the recession than in previous recessions, and began to improve in 2010 despite the weakness of the recovery in the economy. The number of individual insolvencies during the second half of 2010 was 8.9 per cent lower than a year earlier, and 15.5 per cent lower than a year earlier in the first quarter of 2011. The number of company liquidations in England and Wales rose in the first quarter of 2011, however, by 3.7 per cent from the fourth quarter of 2010 level, although they remain almost 18 per cent down from the mid 2009 peak and the failure of active companies has remained flat at 0.7 per cent.

We expect that a continuation of subdued economic recovery will be accompanied by a period of modest growth in our core markets for several years. Consumers and businesses will continue to deleverage slowly. Retail deposit growth will be limited by the pressure on consumers' disposable incomes from relatively high inflation and cuts in welfare benefits. Arrears trends should continue to improve, but less quickly than in 2010.



## Liquidity and funding

Liquidity and funding continues to remain a key area of focus for the Group and the industry as a whole. Like all major banks, the 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 combination of right-sizing the balance sheet and continued development of the retail deposit base has seen the Group's wholesale funding requirement significantly reduce in the past two years. The progress the Group has made to date in diversifying its funding sources has further strengthened its funding base.

During the first half of 2011 the Group accelerated term funding initiatives and the run down of certain non-core asset portfolios allowing a further reduction in total Government and central bank facilities. The ratio of customer loans to deposits improved to 144 per cent compared with 154 per cent at 31 December 2010. Loans and advances reduced by £21.4 billion and customer deposits increased by £12.4 billion.

The second quarter of 2011 has seen funding markets' risk appetite reduce as a result of escalating European sovereign concerns. During this period the Group has continued to fund successfully with no material change to the Group's short-term maturity profile. The Group anticipates that wholesale markets will remain vulnerable to periods of disruption and to mitigate this risk has deliberately pre-funded much of the year's term funding requirement during the first half.

The Group term funding ratio (wholesale funding with a remaining life of over one year as a percentage of total wholesale funding) of 49 per cent was broadly stable (50 per cent at 31 December 2010). The wholesale funding position includes debt issued under the legacy Government Credit Guarantee Scheme, for which the last maturity will occur in October 2012.

The Group has maintained its liquidity levels in excess of the ILG regulatory minimum (FSA's Individual Liquidity Adequacy Standards) at all times. Funding projections show the Group will achieve the proposed Basel 3 liquidity and funding metrics in advance of expected implementation dates. The Liquidity Coverage Ratio is due to be implemented on 1 January 2015 and the Net Stable Funding Ratio has a 1 January 2018 implementation date.

The key dependencies on successfully funding the Group's balance sheet include the continued functioning of the money and capital markets; successful right-sizing of the Group's balance sheet; the repayment of the Government Credit Guarantee Scheme facilities in accordance with the agreed terms; no more than limited further deterioration in the UK's and the Group's credit rating; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets. Additionally, the Group has entered into a number of EU state aid related obligations to achieve reductions in certain parts of its balance sheet by the end of 2014. These are assumed within the Group's funding plan. The requirement to meet this deadline may result in the Group having to provide funding to support these asset reductions and/or disposals and may also result in a lower price being achieved.

**Liquidity and funding** (continued)**Group funding position**

	<b>As at 30 June 2011 £bn</b>	As at 31 Dec 2010 £bn	<b>Change %</b>
<b>Funding Requirement</b>			
Loans and advances to customers <sup>1</sup>	568.1	589.5	(4)
Loans and advances to banks <sup>2</sup>	9.0	10.5	(14)
Debt securities	15.5	25.7	(40)
Available-for-sale financial assets – secondary <sup>3</sup>	16.2	25.7	(37)
Cash balances <sup>4</sup>	3.2	3.6	(11)
<b>Funded assets</b>	<b>612.0</b>	<b>655.0</b>	<b>(7)</b>
<b>On balance sheet primary liquidity assets<sup>5</sup></b>			
Reverse repos	23.3	7.3	
Balances at central banks – primary <sup>4</sup>	52.0	34.5	51
Available-for-sale financial assets – primary	16.6	17.3	(4)
Held to maturity	7.8	7.9	(1)
Trading and other financial assets	1.2	–	
	<b>100.9</b>	67.0	<b>51</b>
Other assets <sup>6</sup>	266.1	269.6	(1)
<b>Total Group assets</b>	<b>979.0</b>	<b>991.6</b>	<b>(1)</b>
Less: Other liabilities <sup>6</sup>	(228.6)	(229.1)	
<b>Funding requirement</b>	<b>750.4</b>	<b>762.5</b>	<b>(2)</b>
<b>Funded by</b>			
Customer deposits <sup>7</sup>	394.9	382.5	3
Wholesale funding	295.6	298.0	(1)
<b>Group funding</b>	<b>690.5</b>	<b>680.5</b>	<b>1</b>
Repos	14.4	35.1	(59)
Total equity	45.5	46.9	(3)
<b>Total funding</b>	<b>750.4</b>	<b>762.5</b>	<b>(2)</b>

<sup>1</sup> Excludes £19.7 billion (31 December 2010: £3.1 billion) of reverse repos.

<sup>2</sup> Excludes £15.3 billion (31 December 2010: £15.6 billion) of loans and advances to banks within the insurance businesses and £3.9 billion (31 December 2010: £4.2 billion) of reverse repos.

<sup>3</sup> Secondary liquidity assets comprise a diversified pool of highly rated unencumbered collateral (including retained issuance).

<sup>4</sup> Cash balances and Balances at central banks – primary are combined in the Group's balance sheet.

<sup>5</sup> Primary liquidity assets are FSA eligible liquid assets including UK Gilts, US Treasuries, Euro AAA government debt and unencumbered cash balances held at central banks.

<sup>6</sup> Other assets and other liabilities primarily include balances in the Group's insurance businesses and the fair value of derivative assets and liabilities.

<sup>7</sup> Excluding repos of £5.0 billion (31 December 2010: £11.1 billion).

**Liquidity and funding** (continued)**Group funding by type**

	<b>As at 30 June 2011 £bn</b>	<b>As at 30 June 2011 %</b>	As at 31 Dec 2010 £bn	As at 31 Dec 2010 %
Deposits from banks <sup>1</sup>	21.9	3.2	26.4	3.9
Debt securities in issue: <sup>1</sup>				
Certificates of deposit	46.4	6.7	42.4	6.2
Commercial paper	27.3	4.0	32.5	4.8
Medium-term notes <sup>2</sup>	86.6	12.5	87.7	12.9
Covered bonds	39.1	5.6	32.1	4.7
Securitisation	37.1	5.4	39.0	5.7
	<b>236.5</b>	<b>34.2</b>	233.7	34.3
Subordinated liabilities <sup>1</sup>	<b>37.2</b>	<b>5.4</b>	37.9	5.6
Total wholesale funding <sup>3</sup>	<b>295.6</b>	<b>42.8</b>	298.0	43.8
Customer deposits	<b>394.9</b>	<b>57.2</b>	382.5	56.2
<b>Total Group funding<sup>4</sup></b>	<b>690.5</b>	<b>100.0</b>	680.5	100.0

<sup>1</sup> A reconciliation to the Group's balance sheet is provided on page 98.

<sup>2</sup> Medium term notes include £37.1 billion of funding from the Credit Guarantee scheme.

<sup>3</sup> The Group's definition of wholesale funding aligns with that used by other international market participants; including interbank deposits, debt securities in issue and subordinated liabilities.

<sup>4</sup> Excluding repos and total equity.

Total wholesale funding is analysed by residual maturity as follows:

	<b>As at 30 June 2011 £bn</b>	<b>As at 30 June 2011 %</b>	As at 31 Dec 2010 £bn	As at 31 Dec 2010 %
Less than one year	151.7	51.3	148.6	49.9
One to two years	29.4	9.9	46.8	15.7
Two to five years	60.6	20.5	52.3	17.6
More than five years	53.9	18.3	50.3	16.8
<b>Total wholesale funding</b>	<b>295.6</b>	<b>100.0</b>	298.0	100.0

**Liquidity and funding** (continued)**Term issuance**

Going into 2011 the Group anticipated that periods of market volatility (as experienced in 2010) could recur and therefore leave the wholesale markets vulnerable to disruption. To mitigate this, the Group deliberately pre-funded much of the Group's term funding requirement in the first quarter. At the half-year, the Group has completed in excess of three-quarters of its targeted annual wholesale term issuance for 2011 targeting periods when markets were open and receptive to new issues and using a broad mix of products and currencies. As a result of this the Group is in position to be more selective as to which products and markets in which it will participate during the second half of 2011.

	Sterling £bn	US Dollar £bn	Euro £bn	Other currencies £bn	Total £bn
Covered bonds	1.3	–	2.2	–	3.5
Securitisation	1.3	2.1	1.7	0.2	5.3
Medium-term notes	0.2	4.3	2.6	2.5	9.6
Private placements <sup>1</sup>	2.5	0.4	3.5	0.4	6.8
<b>Total Issuance</b>	<b>5.3</b>	<b>6.8</b>	<b>10.0</b>	<b>3.1</b>	<b>25.2</b>

<sup>1</sup> Private placements include structured bonds and term repos.

**Liquidity portfolio**

The table below illustrates the Group's holding of highly liquid unencumbered assets. This liquidity is available for deployment at immediate notice, subject to complying with regulatory requirements, and is a key component of the Group's liquidity management process.

	As at 30 June 2011 £bn	As at 31 Dec 2010 £bn
Primary liquidity <sup>1</sup>	100.9	97.5
Secondary liquidity <sup>2</sup>	117.5	62.4
<b>Total</b>	<b>218.4</b>	<b>159.9</b>

<sup>1</sup> Primary liquidity is defined as FSA eligible liquid assets (UK Gilts, US Treasuries, Euro AAA government debt; unencumbered cash balances held at central banks).

<sup>2</sup> Secondary liquidity comprises a diversified pool of highly rated unencumbered collateral (including retained issuance).

Following the introduction of the FSA's Individual Liquidity Guidance under ILAS (Individual Liquidity Adequacy Standard), the Group now manages its liquidity position as a coverage ratio (proportion of stressed outflows covered by primary liquid assets) rather than by reference to a quantum of liquid assets; the liquidity position reflects a buffer over the regulatory minimum. The Group receives no recognition under ILAS for assets held for secondary liquidity purposes.

In addition to primary liquidity holdings the Group has significant capacity to apply for the Discount Window facility in the event of future liquidity problems.

**Liquidity and funding** (continued)

The following tables reconcile figures reported on page 96

	Included in funding analysis (above) £bn	Repos £bn	As at 30 June 2011	
			Fair value and other accounting methods £bn	Balance sheet £bn
Deposits from banks	21.9	9.4	–	31.3
Debt securities in issue	236.5	–	(5.3)	231.2
Subordinated liabilities	37.2	–	(1.6)	35.6
Total wholesale funding	295.6	9.4		
Customer deposits	394.9	5.0	–	399.9
<b>Total</b>	<b>690.5</b>	<b>14.4</b>		

  

	Included in funding analysis (above) £bn	Repos £bn	As at 31 December 2010	
			Fair value and other accounting methods £bn	Balance sheet £bn
Deposits from banks	26.4	24.0	–	50.4
Debt securities in issue	233.7	–	(4.8)	228.9
Subordinated liabilities	37.9	–	(1.7)	36.2
Total wholesale funding	298.0	24.0		
Customer deposits	382.5	11.1	–	393.6
Total	680.5	35.1		

## Credit risk – Group

As at 30 June 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Retail	362,441	9,390	2.6	3,003	32.0
Wholesale	143,983	29,249	20.3	12,811	43.8
Commercial	29,694	2,993	10.1	933	31.2
Wealth and International	64,119	23,836	37.2	12,824	53.8
Hedging and other items	20,176	–	–	–	–
	<b>620,413</b>	<b>65,468</b>	<b>10.6</b>	<b>29,571</b>	<b>45.2</b>
Impairment provisions	(29,571)				
Fair value adjustments	(2,999)				
<b>Total Group</b>	<b>587,843</b>				
As at 31 December 2010					
Retail	368,981	9,750	2.6	3,096	31.8
Wholesale	158,002	31,658	20.0	14,863	46.9
Commercial	29,649	2,856	9.6	992	34.7
Wealth and International	66,368	20,342	30.7	10,684	52.5
Hedging and other items	3,378	–	–	–	–
	<b>626,378</b>	<b>64,606</b>	<b>10.3</b>	<b>29,635</b>	<b>45.9</b>
Impairment provisions	(29,635)				
Fair value adjustments	(4,146)				
<b>Total Group</b>	<b>592,597</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

Total impairment charge	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change %	Half-year to 31 Dec 2010 £m
Retail	1,173	1,335	12	1,412
Wholesale	1,557	2,801	44	1,263
Commercial	160	190	16	192
Wealth and International	2,532	2,228	(14)	3,760
<b>Total impairment charge</b>	<b>5,422</b>	<b>6,554</b>	<b>17</b>	<b>6,627</b>

Total impairment charge comprises:

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change %	Half-year to 31 Dec 2010 £m
Total impairment losses on loans and advances to customers	5,369	6,499	17	6,459
Loans and advances to banks	–	(6)	(7)	(7)
Debt securities classified as loans and receivables	17	15	(13)	42
Available-for-sale financial assets	32	49	35	66
Other credit risk provisions	4	(3)		67
<b>Total impairment charge</b>	<b>5,422</b>	<b>6,554</b>	<b>17</b>	<b>6,627</b>

## Credit risk – Group (continued)

## Core

As at 30 June 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Retail	332,848	7,670	2.3	2,575	33.6
Wholesale	81,396	3,982	4.9	2,394	60.1
Commercial	28,025	2,968	10.6	915	30.8
Wealth and International	8,364	281	3.4	79	28.1
Hedging and other items	20,176	–	–	–	–
	<b>470,809</b>	<b>14,901</b>	<b>3.2</b>	<b>5,963</b>	<b>40.0</b>
Impairment provisions	(5,963)				
Fair value adjustments	(1,643)				
<b>Total Group</b>	<b>463,203</b>				
As at 31 December 2010					
Retail	338,174	8,067	2.4	2,715	33.7
Wholesale	87,892	4,430	5.0	2,323	52.4
Commercial	27,618	2,835	10.3	976	34.4
Wealth and International	8,435	202	2.4	74	36.6
Hedging and other items	3,378	–	–	–	–
	<b>465,497</b>	<b>15,534</b>	<b>3.3</b>	<b>6,088</b>	<b>39.2</b>
Impairment provisions	(6,088)				
Fair value adjustments	(2,138)				
<b>Total Group</b>	<b>457,271</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

## Total impairment charge – core

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change %	Half-year to 31 Dec 2010 £m
Retail	1,052	1,286	18	1,343
Wholesale	409	162		414
Commercial	160	189	15	192
Wealth and International	15	16	6	10
<b>Total impairment charge</b>	<b>1,636</b>	<b>1,653</b>	<b>1</b>	<b>1,959</b>

## Credit risk – Group (continued)

## Non-core

As at 30 June 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Retail	29,593	1,720	5.8	428	24.9
Wholesale	62,587	25,267	40.4	10,417	41.2
Commercial	1,669	25	1.5	18	72.0
Wealth and International	55,755	23,555	42.2	12,745	54.1
Hedging and other items	–	–	–	–	–
	<b>149,604</b>	<b>50,567</b>	<b>33.8</b>	<b>23,608</b>	<b>46.7</b>
Impairment provisions	(23,608)				
Fair value adjustments	(1,356)				
<b>Total Group</b>	<b>124,640</b>				
As at 31 December 2010					
Retail	30,807	1,683	5.5	381	22.6
Wholesale	70,110	27,228	38.8	12,540	46.1
Commercial	2,031	21	1.0	16	76.2
Wealth and International	57,933	20,140	34.8	10,610	52.7
Hedging and other items	–	–	–	–	–
	<b>160,881</b>	<b>49,072</b>	<b>30.5</b>	<b>23,547</b>	<b>48.0</b>
Impairment provisions	(23,547)				
Fair value adjustments	(2,008)				
<b>Total Group</b>	<b>135,326</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

## Total impairment charge – non-core

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change %	Half-year to 31 Dec 2010 £m
Retail	121	49		69
Wholesale	1,148	2,639	56	849
Commercial	–	1		–
Wealth and International	2,517	2,212	(14)	3,750
<b>Total impairment charge</b>	<b>3,786</b>	<b>4,901</b>	<b>23</b>	<b>4,668</b>



## Credit risk – Group (continued)

### Overview

- The Group achieved a reduction in its core impairment charge in the first half of 2011 to £1,636 million (from £1,653 million in the first half of 2010 and £1,959 million in the second half of 2010), due to the stabilisation of the UK economic environment (including UK corporate real estate prices), together with continued low UK interest rates and effective portfolio management.
- The non-core impairment charge also reduced materially from £4,901 million in the first half of 2010 and £4,668 million in the second half of 2010 to £3,786 million in the first half of 2011. The reduction from the first half of 2010 largely reflected the stabilisation of the UK and US economic environment, low interest rates and the heritage HBOS wholesale portfolio appropriately impaired against our base case economic assumptions. This was slightly offset by further new provisions on the Irish book.
- Prudent, 'through the cycle' credit policies and procedures are in place throughout the Group, focusing on development of enduring client relationships. As a result of this approach, the credit quality of new lending remains strong. Very little new origination took place outside the UK.
- The Group's current level of impairment is being managed successfully in the current challenging economic environment by the Wholesale business support units and Retail collection and recovery units.
- The Group's exposure to Ireland is being closely managed. In the first half, we have taken additional provisions in Ireland due to further falls in the commercial real estate market as previously anticipated. We believe that further vulnerability exists. A dedicated UK-based business support team is in place to manage the winding down of the Irish book.

### Outlook – Group

Based on its latest economic assumptions of a continued modest UK recovery from recession, as set out on page 92, the Group expects an improved impairment charge in 2011 compared with 2010. However, there are material downside risks to impairment charges, with a number of factors potentially causing cashflow stress and higher levels of default amongst wholesale customers into 2012. These include, in the UK, fragile consumer and business confidence, potential interest rate and inflation rises and reduced consumer spending. A 'double-dip' scenario – a second shallower recession following closely the one from which the economy is just emerging – also remains a downside risk. This is because it would result in further significant increases in corporate failures and unemployment during late 2011 and through 2012, as well as causing a second period of falling prices for residential and commercial property and a likely rise in tenant defaults.

Downside risks from financial market instability are also significant. Uncertainty over the best way forward for highly indebted Eurozone countries could keep financial markets volatile and the risk of contagion to other Eurozone countries is unlikely to dissipate near term.

We continue to monitor closely liquidity and economic conditions in our key overseas markets of Ireland and Australasia. In Ireland, the fragility of the economy and political system could still cause further credit quality deterioration within our book as it winds down. Australia, while benefiting from a commodities export boom, continues to be affected by deteriorating property markets in the geographic areas and property classes where the Group is exposed.

**Credit risk – Group** (continued)**Exposures to Selected Eurozone Countries**

On 15 July 2011 the European Banking Authority (EBA) announced the results of its EU-wide stress test conducted in cooperation with the FSA, the European Central Bank, the European Commission and the European Systemic Risk Board. The EU-wide stress test, carried out across 90 banks covering over 65 per cent of the EU banking system total assets, sought to assess the resilience of European banks to severe shocks and their specific solvency in hypothetical stress events under certain restrictive conditions. The Group's core tier 1 capital ratio, when stressed in accordance with the EBA's defined methodology, at 7.7 per cent, remains well above the capital benchmark required.

At about the same time as the EBA announcement, the FSA published draft proposals for disclosures to be made by UK banks at 30 June 2011 on direct sovereign debt and related exposures, to be shown by reference to accounting values; the Group has sought to adopt these proposals.

The Group has direct exposure to certain European countries which have been identified on the basis of their higher bond yields compared to the rest of the Eurozone and the UK – Belgium, Greece, Ireland, Italy, Portugal and Spain. This is consistent with the countries recommended for disclosure by the FSA.

The Group manages its exposures to individual countries through authorised country limits which take into account economic, financial, political and social factors. In addition the Group manages its indirect risks to the selected countries by establishing and monitoring risk limits for individual banks and financial institutions outside of these countries where they have direct exposures to the selected countries. The profiles of these banks and financial institutions are monitored on a regular basis and exposures managed accordingly.

**Sovereigns, Banking Groups and Asset Backed Securities**

<b>As at 30 June 2011</b>	<b>Direct Sovereign £m</b>	<b>Banking Groups £m</b>	<b>Asset Backed Securities £m</b>	<b>Total £m</b>
Belgium	87	318	–	405
Greece	–	–	70	70
Ireland	–	366	373	739
Italy	35	1,780	48	1,863
Portugal	–	241	424	665
Spain	67	2,136	450	2,653
<b>Total</b>	<b>189</b>	<b>4,841</b>	<b>1,365</b>	<b>6,395</b>

Approximately half of the overall positions of £6.4 billion relate to structures where there are underlying assets securing the obligations (ABS or Covered Bonds); the balance are generally floating rate notes or short term unsecured money market exposures or general banking facilities.

*Direct Sovereign (including Central Banks)*

As at 30 June 2011, the Group had minimal exposure, in aggregate, which could be considered to be direct recourse to the sovereign risk of Belgium, Greece, Ireland, Italy, Portugal and Spain. This includes the national governments and central banks in these countries. Direct sovereign exposures include those to the Export Credit Agencies for Italy and Spain. Since 2009, the Group has proactively managed and reduced limits and exposures to these countries.

Undrawn committed facilities and contingents total £110 million. Derivatives with sovereigns and sovereign referenced credit default swaps are immaterial.

**Credit risk – Group** (continued)*Banking Groups*

Exposures are to banking groups headquartered in these countries and their major subsidiaries and comprise:

<b>As at 30 June 2011</b>	<b>Fixed and floating rate notes £m</b>	<b>Covered bonds £m</b>	<b>Money market, short-term and other exposures £m</b>	<b>Derivatives £m</b>	<b>Total £m</b>
Belgium	242	–	77	(1)	318
Greece	–	–	–	–	–
Ireland	–	145	220	1	366
Italy	216	–	1,542	22	1,780
Portugal	–	150	90	1	241
Spain	163	1,584	370	19	2,136
<b>Total</b>	<b>621</b>	<b>1,879</b>	<b>2,299</b>	<b>42</b>	<b>4,841</b>

The Fixed and Floating Rate Notes (FRNs) are all classified as available-for-sale financial assets and have an overall weighted maturity of less than two years. They are all rated A- or better. Further, in respect of the Spanish exposures a quarter matures in the autumn and the balance is government guaranteed. They are shown at fair value with a charge of £6 million having been taken to available-for-sale reserves; no impairments have been recognised. There have been significant reductions in FRN positions during the first half of 2011 from £2,701 million at 31 December 2010 to £621 million at 30 June 2011. The reductions have been a result of asset sales and maturities.

The Covered Bonds are ultimately secured on a pool of mortgage assets in the countries concerned; 80 per cent are AA- rated or better. The bonds benefit from over-collateralisation and are all classified as available-for-sale financial assets, with an overall weighted maturity of approximately five years. They are shown at fair value with a charge of £262 million having been taken to available-for-sale reserves; no impairments have been recognised.

Money market, short-term and other exposures are to major banks in the countries concerned. These are predominantly short-term and include general banking facilities, money market and repo facilities. No impairments are held against these exposures. In addition there are unutilised money market lines and repo facilities of approximately £2.5 billion predominantly in respect of Spanish and Italian banks. Bank limits have been closely monitored with amounts and tenors reduced where appropriate. Of the exposures:

- Italy – approximately 90 per cent of the exposure is to institutions rated at least A-.
- Spain – approximately 80 per cent of the exposure is to institutions rated at least A-.

Derivatives are shown at fair value adjusted where master netting agreements exist and net of collateral of £191 million. There are no credit default swap positions in place where the counterparty bank is domiciled in one of the selected Eurozone countries. There are credit default swap positions referenced to banking groups domiciled in Italy (net long of £10 million) and Spain (net long of £2 million and net short of £6 million).

**Credit risk – Group** (continued)*Asset Backed Securities*

Asset Backed Securities where the underlying assets are located in the countries concerned are analysed between those which are included in loans and receivables and those which are included in available-for-sale financial assets. In the majority of cases the underlying assets are residential mortgages and the securities are predominantly A rated or higher.

	<u>Loans and receivables</u>		<u>Available-for-sale financial assets</u>	<u>Total carrying value</u> £m	<u>Weighted average maturity</u>
	<u>Current carrying value</u> £m	<i>Fair value</i> £m	<u>Current carrying value</u> £m		<u>Years</u>
Belgium	–	–	–	–	–
Greece	36	23	34	70	6
Ireland	170	135	203	373	8
Italy	33	36	15	48	2
Portugal	232	194	192	424	9
Spain	246	208	204	450	8
<b>Total</b>	<b>717</b>	<b>596</b>	<b>648</b>	<b>1,365</b>	<b>8</b>

The loans and receivables are held at amortised cost, net of £4 million impairment allowances. The available-for-sale financial assets are shown at fair value with a charge of £202 million having been taken to available-for-sale reserves. Significant reductions have been achieved during the first half of 2011 with the overall portfolio of Asset Backed Securities relevant to the selected countries reducing from £2,677 million at 31 December 2010 to £1,365 million at 30 June 2011 predominantly through asset sales.

**Financial Assets held for Trading and Assets held by Insurance Businesses**

<b>As at 30 June 2011</b>	<b>Financial assets held for trading</b> £m	<b>Assets held by Insurance businesses</b> £m	<b>Total</b> £m
Belgium	1	477	478
Greece	–	–	–
Ireland	3	79	82
Italy	221	143	364
Portugal	21	–	21
Spain	149	211	360
<b>Total</b>	<b>395</b>	<b>910</b>	<b>1,305</b>

*Financial Assets held for Trading*

These exposures are a direct result of flows within the Credit Trading Market-Making business. The exposure is made up of £85 million of Corporates (predominantly utility companies), and £310 million financial positions. These positions are managed on a relative value basis, held at fair value, marked to market with movements being taken through the profit and loss on a daily basis. All positions are liquid and in line with Trading Policy.

**Credit risk – Group** (continued)*Assets held by Insurance businesses*

Within the Group's insurance businesses, related exposures of £910 million are held outside the with profits and unit linked funds. Approximately £250 million of these exposures relate to direct investments where the issuer is resident in Belgium, Spain, Italy or Ireland and the credit rating is consistent with the tight credit criteria defined under the appropriate investment mandate. The remaining exposures relate to interests in two funds administered by SWIP (the Global Liquidity Fund and the Short Term Fund) where in line with the investment mandates, cash is invested in the money markets.

**Corporate and Retail Exposures**

The Group's corporate and retail exposures to Belgium, Greece, Ireland, Italy, Portugal and Spain are classified as loans and receivables, and exclude undrawn commitments:

As at 30 June 2011	Corporate exposures			Retail exposures		
	Loans and advances to customers £m	Impairment provisions £m	Net exposure £m	Loans and advances to customers £m	Impairment provisions £m	Net exposure £m
Belgium	563	7	556	–	–	–
Greece	773	–	773	–	–	–
Ireland	17,210	7,958	9,252	7,920	886	7,034
Italy	173	1	172	–	–	–
Portugal	146	–	146	10	–	10
Spain	2,050	124	1,926	1,835	30	1,805
<b>Total</b>	<b>20,915</b>	<b>8,090</b>	<b>12,825</b>	<b>9,765</b>	<b>916</b>	<b>8,849</b>

*Greek Exposures*

The exposures in Greece principally relate to shipping loans to Greek shipping companies where the assets are generally secured and the vessels operate in international waters; repayment is mainly dependent on international trade and the industry is less sensitive to the Greek economy.

*Irish Exposures*

The gross exposure in Ireland excludes Irish lending to customers domiciled in the UK. Further details on Irish exposures are provided on page 129.

*Spanish Corporate Exposures*

The corporate exposure in Spain is mainly local lending (85 per cent of the total Spanish exposures) comprising corporate loans and project finance facilities (77 per cent) and commercial real estate (23 per cent). The corporate loans and project finance facilities have impaired lending of 3 per cent which is fully provided. The commercial real estate is 22 per cent impaired, with a coverage ratio of 49 per cent. The remaining 15 per cent represents loans extended by the Wholesale Division to corporate and commercial real estate clients domiciled in Spain, with an impairment provision of £37 million.

*Spanish Retail Exposures*

The Spanish exposures are predominantly secured residential mortgages, where about half of the borrowers are expatriates. The average marked-to-market loan-to-value is 63 per cent and impaired loans represent 5 per cent of the total exposures, with a coverage ratio of 30 per cent.

## Credit risk – Retail

As at 30 June 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing loans and advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Secured	336,446	6,695	2.0	1,697	25.3
Unsecured	25,995	2,695	10.4	1,306	48.5
Total gross lending	362,441	9,390	2.6	3,003	32.0
Impairment provisions	(3,003)				
Fair value adjustments	(1,642)				
<b>Total Retail</b>	<b>357,796</b>				
As at 31 December 2010					
Secured	341,069	6,769	2.0	1,589	23.5
Unsecured	27,912	2,981	10.7	1,507	50.6
Total gross lending	368,981	9,750	2.6	3,096	31.8
Impairment provisions	(3,096)				
Fair value adjustments	(2,154)				
<b>Total Retail</b>	<b>363,731</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

	As at 30 June 2011 £m	As at 31 Dec 2010 £m
Secured		
Mainstream	260,805	265,368
Buy to let	47,272	46,356
Specialist	28,369	29,345
	<b>336,446</b>	341,069
Unsecured		
Credit cards	10,543	11,207
Personal loans	12,915	13,881
Bank accounts	2,537	2,624
Others, including joint ventures	–	200
	<b>25,995</b>	27,912
<b>Total Retail gross lending</b>	<b>362,441</b>	368,981

## Credit risk – Retail (continued)

## Core

As at 30 June 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing loans and advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Secured	307,863	5,112	1.7	1,302	25.5
Unsecured	24,985	2,558	10.2	1,273	49.8
Total gross lending	332,848	7,670	2.3	2,575	33.6
Impairment provisions	(2,575)				
Fair value adjustments	(1,361)				
<b>Total Retail</b>	<b>328,912</b>				
As at 31 December 2010					
Secured	311,500	5,231	1.7	1,247	23.8
Unsecured	26,674	2,836	10.6	1,468	51.8
Total gross lending	338,174	8,067	2.4	2,715	33.7
Impairment provisions	(2,715)				
Fair value adjustments	(1,755)				
Total Retail	333,704				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

## Non-core

As at 30 June 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing loans and advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Secured	28,583	1,583	5.5	395	25.0
Unsecured	1,010	137	13.6	33	24.1
Total gross lending	29,593	1,720	5.8	428	24.9
Impairment provisions	(428)				
Fair value adjustments	(281)				
<b>Total Retail</b>	<b>28,884</b>				
As at 31 December 2010					
Secured	29,569	1,538	5.2	342	22.2
Unsecured	1,238	145	11.7	39	26.9
Total gross lending	30,807	1,683	5.5	381	22.6
Impairment provisions	(381)				
Fair value adjustments	(399)				
Total Retail	30,027				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

**Credit risk – Retail** (continued)**Overview**

- The Retail impairment charge was £1,173 million, a decrease of £239 million, or 17 per cent, from the second half of 2010 and a decrease of £162 million, or 12 per cent, from the first half of 2010.
- The decrease in the Retail impairment charge was driven by the unsecured portfolio as a result of the improved quality of new business and effective portfolio management. The Retail impairment charge for loans and advances to customers, as a percentage of average loans and advances to customers, decreased to 0.65 per cent from 0.76 per cent in the second half of 2010.
- Average loan-to-value on new mortgage lending in the first half of the year was 61.3 per cent (60.9 per cent for 2010) whilst the average indexed loan-to-value on the mortgage portfolio was 55.6 per cent (55.6 per cent at 31 December 2010).
- The overall assets entering arrears in the first half of 2011, compared to the second half of 2010, was lower in both unsecured and secured lending.

**Impairment charge**

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change %	Half-year to 31 Dec 2010 £m
Secured	295	53		239
Unsecured	878	1,282		1,173
<b>Total impairment charge</b>	<b>1,173</b>	<b>1,335</b>	<b>12</b>	<b>1,412</b>
Core:				
Secured	202	51		199
Unsecured	850	1,235		1,144
	1,052	1,286	18	1,343
Non-core:				
Secured	93	2		40
Unsecured	28	47		29
	121	49		69
<b>Total impairment charge</b>	<b>1,173</b>	<b>1,335</b>	<b>12</b>	<b>1,412</b>

Retail's impairment charge decreased by £239 million to £1,173 million in the first half of 2011, compared with the second half of 2010, and decreased by £162 million, compared with the first half of 2010. This improvement was driven primarily by the improved quality of new business and effective portfolio management, combined with the continued slow recovery of the economy. Across Retail in the first half of 2011, there were fewer assets going into arrears compared to the second half of 2010. The impairment charge on loans and advances to customers, as a percentage of average loans and advances to customers, decreased to 0.65 per cent from 0.76 per cent in the second half of 2010.

**Impaired loans and provisions**

Retail impaired loans decreased by £0.4 billion to £9.4 billion compared with 31 December 2010 and, as a percentage of closing loans and advances to customers, remained stable at 2.6 per cent compared to 31 December 2010. Impairment provisions, as a percentage of impaired loans, increased to 32.0 per cent from 31.8 per cent at 31 December 2010.



**Credit risk – Retail** (continued)**Secured impairment charge**

The secured impairment charge increased by £56 million, to £295 million, compared to the second half of 2010 and increased by £242 million compared with the first half of 2010. The low impairment charge in the first half of 2010 was driven by rising house prices and a then favourable outlook for house prices against a background of stable arrears. Our current outlook is less favourable which has resulted in an increase in the impairment charge in the first half of 2011. The impairment charge for loans and advances to customers, as a percentage of average loans and advances to customers, increased to 0.18 per cent from 0.14 per cent in the second half of 2010.

Impairment provisions held against secured assets reflect management's view of appropriate allowance for incurred losses. The Group holds appropriate impairment provisions for customers who are experiencing financial difficulty, either on a forbearance arrangement or who are able to maintain their repayments whilst interest rates are very low.

**Secured impaired loans**

Impaired loans decreased to £6.7 billion at 30 June 2011 from £6.8 billion at 31 December 2010 and, as a percentage of closing loans and advances to customers, remained stable at 2.0 per cent compared to 31 December 2010.

The number of customers going into arrears was lower in the first half of 2011 in comparison with the second half of 2010. Specialist lending remains closed to new business and this book has been in run-off since 2009.

**Secured arrears**

The percentage of mortgage cases greater than three months in arrears (excluding repossessions) remained stable at 2.3 per cent at 30 June 2011 compared to 31 December 2010.

**Greater than three months in arrears (excluding repossessions)**

	Number of cases		Total mortgage accounts %		Value of debt <sup>1</sup>		Total mortgage balances %	
	30 June 2011	31 Dec 2010	30 June 2011	31 Dec 2010	30 June 2011	31 Dec 2010	30 June 2011	31 Dec 2010
	Cases	Cases	%	%	£m	£m	%	%
Mainstream	53,890	55,675	2.0	2.1	6,056	6,247	2.3	2.4
Buy to let	7,839	7,577	1.8	1.8	1,163	1,157	2.5	2.5
Specialist	13,693	12,582	7.2	6.4	2,416	2,262	8.5	7.7
<b>Total</b>	<b>75,422</b>	<b>75,834</b>	<b>2.3</b>	<b>2.3</b>	<b>9,635</b>	<b>9,666</b>	<b>2.9</b>	<b>2.8</b>

<sup>1</sup> Value of debt represents total book value of mortgages in arrears but not repossessed.

The stock of repossession cases increased from 3,043 at 31 December 2010 to 3,176 at 30 June 2011 but decreased against the stock of repossessions as at 30 June 2010 of 3,195. This still represents a relatively low proportion of the portfolio and is broadly consistent with prior years.

**Credit risk – Retail** (continued)**Secured loan-to-value analysis**

The average loan-to-value ratio (LTV) for new mortgages written in the first half of 2011 was 61.3 per cent compared with 60.9 per cent for 2010. The mortgage portfolio with an indexed LTV in excess of 100 per cent decreased to 12.2 per cent (£41.0 billion) as at 30 June 2011, compared with 13.2 per cent (£44.9 billion) at 31 December 2010. The tables below show LTVs across the principal mortgage portfolios.

The increased average LTVs for impaired Buy to let mortgages is driven by the seasoning of higher risk lending that was closed at the start of 2009.

<b>As at 30 June 2011</b>	<b>Mainstream</b>	<b>Buy to let</b>	<b>Specialist<sup>1</sup></b>	<b>Total</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Less than 60%	<b>33.0</b>	<b>12.0</b>	<b>14.4</b>	<b>28.4</b>
60% to 70%	<b>12.4</b>	<b>12.2</b>	<b>9.6</b>	<b>12.1</b>
70% to 80%	<b>17.1</b>	<b>24.1</b>	<b>17.0</b>	<b>18.1</b>
80% to 90%	<b>15.5</b>	<b>17.5</b>	<b>20.4</b>	<b>16.2</b>
90% to 100%	<b>11.4</b>	<b>17.8</b>	<b>19.2</b>	<b>13.0</b>
Greater than 100%	<b>10.6</b>	<b>16.4</b>	<b>19.4</b>	<b>12.2</b>
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Average loan-to-value:				
Stock of residential mortgages	<b>51.9</b>	<b>74.5</b>	<b>72.6</b>	<b>55.6</b>
New residential lending	<b>60.4</b>	<b>66.1</b>	<b>n/a</b>	<b>61.3</b>
Impaired mortgages	<b>72.3</b>	<b>99.4</b>	<b>87.0</b>	<b>78.4</b>
<b>As at 31 December 2010</b>	<b>Mainstream</b>	<b>Buy to let</b>	<b>Specialist<sup>1</sup></b>	<b>Total</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Less than 60%	33.0	11.4	14.0	28.5
60% to 70%	12.1	11.1	9.4	11.7
70% to 80%	16.1	21.9	15.9	16.8
80% to 90%	15.3	18.0	21.3	16.2
90% to 100%	11.9	19.1	20.0	13.6
Greater than 100%	11.6	18.5	19.4	13.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Average loan-to-value:				
Stock of residential mortgages	51.9	75.6	72.9	55.6
New residential lending	60.0	66.5	n/a	60.9
Impaired mortgages	72.3	97.8	87.3	78.0

<sup>1</sup> Specialist lending is closed to new business and is in run-off.

**Credit risk – Retail** (continued)

**Unsecured**

In the first half of 2011 the impairment charge on unsecured loans and advances to customers reduced by £295 million to £878 million compared with the second half of 2010 and reduced by £404 million compared with the first half of 2010. This reflected a continuation of improving portfolio trends resulting from the Group's prudent risk appetite, with a focus on lending towards existing customers, combined with stable unemployment.

A combination of reduced demand from customers for personal unsecured borrowing and the Group's prudent risk policy contributed to loans and advances to customers reducing by £1.9 billion to £26.0 billion in the six months ended 30 June 2011.

Impaired loans decreased by £0.3 billion in the half-year to £2.7 billion which represented 10.4 per cent of loans and advances to customers at 30 June 2011, compared with 10.7 per cent at 31 December 2010. The reduction in impaired loans is a result of tightening credit policy across the credit lifecycle, including stronger controls on customer affordability. Retail's exposure to revolving credit products has been actively managed to ensure that it is appropriate to customers' changing financial circumstances. The portfolios show a level of early arrears for accounts acquired since 2009 which are at pre-recession levels, highlighting an underlying improvement in the risk profile of the business.

Impairment provisions decreased by £0.2 billion in the half-year, compared with 31 December 2010, to £1.3 billion. Impairment provisions, as a percentage of impaired loans, decreased to 48.5 per cent at 30 June 2011 from 50.6 per cent at 31 December 2010. Provision coverage reduced as a consequence of fewer assets entering collections coupled with continued write down of charged off assets to their net realisable value.

## Credit risk – Wholesale

As at 30 June 2011	Balance £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Corporate Markets					
Corporate	73,760	5,750	7.8	3,252	56.6
Corporate Real Estate BSU	23,673	16,212	68.5	6,263	38.6
Wholesale Equity	140	114	81.4	110	96.5
Wholesale Markets	36,843	5,561	15.1	2,177	39.1
Total Corporate Markets	134,416	27,637	20.6	11,802	42.7
Treasury and Trading	1,021	–	–	–	–
Asset Finance	8,546	1,612	18.9	1,009	62.6
Total Wholesale	143,983	29,249	20.3	12,811	43.8
Reverse repos	19,690				
Impairment provisions	(12,811)				
Fair value adjustments	(1,094)				
<b>Loans and advances to customers</b>	<b>149,768</b>				
<b>Loans and advances to banks</b>	<b>10,193</b>				
<b>Debt securities<sup>2</sup></b>	<b>15,524</b>				
<b>Available-for-sale financial assets<sup>3</sup></b>	<b>16,655</b>				

## As at 31 December 2010

Corporate Markets					
Corporate <sup>4</sup>	80,670	6,635	8.2	3,629	54.7
Corporate Real Estate BSU	26,151	17,518	67.0	8,092	46.2
Wholesale Equity	140	108	77.1	107	99.1
Wholesale Markets	40,042	5,718	14.3	1,992	34.8
Total Corporate Markets	147,003	29,979	20.4	13,820	46.1
Treasury and Trading	1,050	–	–	–	–
Asset Finance	9,949	1,679	16.9	1,043	62.1
Total Wholesale	158,002	31,658	20.0	14,863	46.9
Reverse repos	3,096				
Impairment provisions	(14,863)				
Fair value adjustments	(1,562)				
Loans and advances to customers	144,673				
Loans and advances to banks	12,401				
Debt securities	25,779				
Available-for-sale financial assets	29,458				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

<sup>2</sup> Of which Wholesale Markets is £15,026 million, Wholesale Equity £339 million, Treasury and Trading £150 million, Asset Finance £7 million, and Corporate £2 million.

<sup>3</sup> Of which Wholesale Markets is £11,585 million, Wholesale Equity £1,916 million, Treasury and Trading £3,129 million and Corporate £25 million.

<sup>4</sup> 2010 figures for Corporate have been restated for transfers to Commercial.

**Credit risk – Wholesale** (continued)**Core**

<b>As at 30 June 2011</b>	<b>Balance £m</b>	<b>Impaired loans £m</b>	<b>Impaired loans as a % of closing advances %</b>	<b>Impairment provisions<sup>1</sup> £m</b>	<b>Impairment provisions as a % of impaired loans %</b>
Total Wholesale	<b>81,396</b>	<b>3,982</b>	<b>4.9</b>	<b>2,394</b>	<b>60.1</b>
Reverse repos	<b>19,690</b>				
Impairment provisions	<b>(2,394)</b>				
Fair value adjustments	<b>(75)</b>				
<b>Loans and advances to customers</b>	<b>98,617</b>				
<b>Loans and advances to banks</b>	<b>9,870</b>				
<b>Debt securities</b>	<b>183</b>				
<b>Available-for-sale financial assets</b>	<b>3,553</b>				
<b>As at 31 December 2010</b>					
Total Wholesale	87,892	4,430	5.0	2,323	52.4
Reverse repos	3,096				
Impairment provisions	(2,323)				
Fair value adjustments	(136)				
<b>Loans and advances to customers</b>	<b>88,529</b>				
Loans and advances to banks	11,994				
Debt securities	402				
Available-for-sale financial assets	7,377				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

**Credit risk – Wholesale** (continued)**Non-core**

<b>As at 30 June 2011</b>	<b>Balance £m</b>	<b>Impaired loans £m</b>	<b>Impaired loans as a % of closing advances %</b>	<b>Impairment provisions<sup>1</sup> £m</b>	<b>Impairment provisions as a % of impaired loans %</b>
Total Wholesale	<b>62,587</b>	<b>25,267</b>	<b>40.4</b>	<b>10,417</b>	<b>41.2</b>
Reverse repos	–				
Impairment provisions	<b>(10,417)</b>				
Fair value adjustments	<b>(1,019)</b>				
<b>Loans and advances to customers</b>	<b>51,151</b>				
<b>Loans and advances to banks</b>	<b>323</b>				
<b>Debt securities</b>	<b>15,341</b>				
<b>Available-for-sale financial assets</b>	<b>13,102</b>				
<b>As at 31 December 2010</b>					
Total Wholesale	70,110	27,228	38.8	12,540	46.1
Reverse repos	–				
Impairment provisions	(12,540)				
Fair value adjustments	(1,426)				
<b>Loans and advances to customers</b>	<b>56,144</b>				
Loans and advances to banks	407				
Debt securities	25,377				
Available-for-sale financial assets	22,081				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

**Credit risk – Wholesale** (continued)**Overview**

- Impairment losses have fallen significantly over the last 12 months to £1,557 million in the first half of 2011 from £2,801 million for the first half of 2010. Impairments in the second half of 2010 were lower at £1,263 million reflecting the benefit of a number of writebacks due to asset disposals and impairment releases in that period.
- The decrease in the underlying impairment charge in the first half of 2011 reflects stabilising UK economic conditions (including UK corporate real estate prices), together with the continuing low interest rate environment but offset by higher charges in leveraged finance.
- Compared to the first half of 2010, the reduction has been driven primarily by lower impairments experienced in corporate real estate and real estate related portfolios.
- Since the onset of the Greek debt crisis, the Group has proactively managed down banking and trading book exposures to peripheral Eurozone countries. Divestment strategy was focused on balance sheet reduction and disposing of higher risk positions.
- A robust credit risk management and control framework is in place across the combined portfolios and a prudent risk appetite approach (based on Lloyds TSB's model) has been embedded across the division. Significant resources have been deployed into the Business Support Units focused on key and vulnerable obligors and asset classes.

**Impairment charge**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change %</b>	Half-year to 31 Dec 2010 £m
Corporate Markets	<b>1,442</b>	2,609	<b>45</b>	1,191
Asset Finance	<b>115</b>	192	<b>40</b>	72
<b>Total impairment charge</b>	<b>1,557</b>	2,801	<b>44</b>	1,263
Core	<b>409</b>	162		414
Non-core	<b>1,148</b>	2,639	<b>56</b>	849
<b>Total impairment charge</b>	<b>1,557</b>	2,801	<b>44</b>	1,263

Wholesale's total impairment charge decreased by £1,244 million, or 44 per cent, to £1,557 million compared to £2,801 million for the first half of 2010. Against the background of the stabilising UK and US economic environment in 2010 and in the first half of 2011, a low interest rate environment helping to maintain defaults at a lower level and an appropriately impaired heritage HBOS portfolio against our base case economic assumptions, impairment charges have decreased substantially compared with the first half of 2010. The increase from the second half of 2010 reflects the benefit in that period of the disposal of certain assets and a number of releases. Impairment charges as an annualised percentage of average loans and advances to customers reduced to 2.02 per cent from 3.11 per cent in the first half of 2010.

Corporate Markets impairment charge reduced by £1,167 million, or 45 per cent, to £1,442 million compared to £2,609 million for the first half of 2010, reflecting a stabilisation of UK economic conditions and UK corporate real estate prices.

**Credit risk – Wholesale** (continued)

In Asset Finance, the impairment charge reduced by £77 million, or 40 per cent, to £115 million compared to £192 million for the first half of 2010, reflecting a stabilising UK economy, low interest rate environment and improving asset quality. Against the second half of 2010, the impairment charge in the first half of 2011 is £43 million higher. The increase is a result of exceptional releases and recoveries in the second half of 2010 relating to a number of writebacks in non retail and VAT reclaims.

***Impairment charge – core***

Core impairments in the first half of 2011 were slightly lower than in the second half of 2010 reflecting a stabilising UK environment, although partly offset by increased impairments in our core leveraged portfolio. However, the first half 2011 impairment charge was higher than the first half of 2010, primarily due to two significant loans being impaired.

Core impairment charges as an annualised percentage of average core loans and advances to customers rose in the first half of 2011 to 0.96 per cent against the second half of 2010 of 0.82 per cent as a result of assets reducing faster than impairments. Against the first half of 2010 outcome of 0.34 per cent, the ratio in the first half of 2011 was also higher, for reasons noted above.

***Impairment charge – non-core***

Non-core impairments in the first half of 2011 were higher than the second half of 2010, primarily reflecting a reduced benefit from a number of writebacks on asset sales, particularly in the Corporate Real Estate Business Support Unit and in Wholesale Markets as well as higher charges in the non-core leveraged finance portfolio.

Non-core impairments in the first half of 2010 were significant as a result of the scale and pace of deterioration in the property sector and poorer quality heritage HBOS lending.

Non-core impairment charges as an annualised percentage of average non-core loans and advances to customers increased in the first half of 2011 to 3.36 per cent against 1.92 per cent in the second half of 2010. This was as a result of a lower level of writebacks on asset sales and other releases compared to the second half of 2010. Against the first half of 2010 outcome of 6.80 per cent, the ratio was materially lower as a result of significantly reduced impairment levels, especially in the Corporate Real Estate Business Support Unit.

**Impaired loans and provisions**

Wholesale's impaired loans reduced by £2,409 million to £29,249 million compared with 31 December 2010. The reduction is due primarily to write-offs on irrecoverable assets and the sale of previously impaired assets, partly offset by new impaired assets, mainly in the Corporate Real Estate Business Support Unit (CRE BSU). Impairment provisions also reduced as a result of the write-offs and new impaired assets in the corporate real estate related portfolios impairing at a lower impairment rate. As a result, impairment provisions as a percentage of impaired loans reduced to 43.8 per cent from 46.9 per cent at 31 December 2010. As a percentage of closing advances, impaired loans increased to 20.3 per cent from 20.0 per cent at 31 December 2010. This increase is essentially a factor of the reducing level of total loans and advances to customers as at 30 June 2011 compared with 31 December 2010. We continue to monitor our vulnerable portfolios within Wholesale and, where appropriate, remedial risk mitigating actions are being undertaken.



**Credit risk – Wholesale** (continued)

***Impaired loans and provisions – core***

Core impaired loans reduced by £448 million to £3,982 million compared with 31 December 2010. The reduction primarily is due to improved trading in one significant asset which is no longer impaired and lower core leveraged impaired loans, offset by an increase in asset based finance impaired loans. Impairment provisions increased slightly primarily as a result of higher impairment provisions being required on impaired loans in the core leveraged finance portfolio. As a result, core impairment provisions as a percentage of core impaired loans increased to 60.1 per cent from 52.4 per cent at 31 December 2010. As a percentage of closing core advances, core impaired loans reduced slightly to 4.9 per cent from 5.0 per cent at 31 December 2010. This is essentially a factor of core impaired loans reducing faster than the level of core advances during the first half of 2011. As for non-core, the core impaired loan portfolio is managed by the dedicated Business Support team.

***Impaired loans and provisions – non-core***

Non-core impaired loans reduced by £1,961 million to £25,267 million compared with 31 December 2010. The reduction is due to write-offs on irrecoverable assets and the sale of previously impaired assets, partly offset by new impaired assets mainly in the real estate and real estate related, and leveraged finance portfolios. Impairment provisions also reduced as a result of these write-offs and sales. New impaired assets have generally impaired at a lower impairment rate than the existing impaired loan portfolios, noticeably in the real estate and real estate related portfolios.

As a result, non-core impairment provisions as a percentage of non-core impaired loans reduced to 41.2 per cent from 46.1 per cent at 31 December 2010. As a percentage of closing non-core advances, impaired loans increased to 40.4 per cent from 38.8 per cent at 31 December 2010. This is essentially a factor of impaired loans reducing more slowly than total non-core advances.

Non-core impairment provisions as a percentage of non-core impaired assets are lower at 41.2 per cent compared to 60.1 per cent for core, mainly a factor of the asset mix, where the non-core portfolios are heavily weighted toward real estate and real estate related portfolios where security is often a larger influence on the impairment outcome.

**Credit risk – Wholesale** (continued)

**Corporate**

The £73,760 million of loans and advances to customers in the Corporate portfolio is structured across a number of different portfolios and sectors as discussed below:

*UK Corporate* – Major corporate balance sheets remained relatively stable during the first half of 2011 with corporates continuing to reduce debt and build up liquidity reserves. There is some evidence of mergers and acquisition activity but some consumer related sectors in the UK are now seeing signs of a slowdown in spending.

*US Corporate* – The balance sheets of the US Major Corporates continue to be strong with good levels of liquidity and there is evidence of some mergers and acquisition activity. The reduction in the non-core corporate portfolio has continued through secondary sales, refinancings, and realisation of property assets. The overall impairment position is one of modest net write backs with new impairments on existing cases more than offset by recoveries.

*Mid-market Corporate* – Customers in the corporate mid-market are predominantly UK-focused and heavily dependent on the domestic economy. As such, many continue to experience challenging trading conditions, particularly in sectors driven by discretionary expenditure, where sentiment is weighed down by concerns over job security, public sector austerity measures, higher tax levels and inflation-related declines in spending power. Businesses with access to international markets have held up more strongly and this includes not only direct exporters but also sectors such as retail, hotels and leisure able to access a more international customer base, with such businesses tending to be geographically concentrated in London and the South East.

*Corporate Real Estate* – Outside of London and the South East, activity in the Corporate Real Estate market remains weak, in part due to declining values and the focus on prime properties and prime tenants. Rental growth, where achievable by our clients in the regions, is slow. Market demand for debt is low, with little demand seen for new facilities from our core customers, despite messaging that we are open for business which meets our lending criteria. Customers are adopting a 'wait and see' approach, de-gearing where they can, and conserving cash. In addition, with a significant proportion of our assets supporting property investments, tenant default is an area of continuing vulnerability especially where the lending is underpinned by secondary or tertiary assets. With a continuing high level of loan maturities due over the next few years, refinancing risk remains an issue.

*Financial Institutions* – Corporate maintains relationships with many major financial institutions throughout the world. These relationships are either client focused or held to support the Group's funding, liquidity and general hedging requirements. Continuing concerns over sovereign fiscal deficits and public sector debt levels have necessitated increased scrutiny and risk reduction of the European banking sector, in particular banks domiciled in the weaker eurozone peripheral countries. Trading exposures are in large part either short term or collateralised and inter bank activity is mainly with high investment grade counterparties.

**Credit risk – Wholesale** (continued)

**Corporate Real Estate Business Support Unit**

The Corporate Real Estate Business Support Unit has continued to make good progress executing on its active asset management programme for the complex portfolio of over 1,800 cases it manages. Despite the market for capital values improving 17.3 per cent from its trough in 2009, we have seen this improving trend in the market begin to weaken for all but prime or central London based real estate. With the exception of prime or central London real estate, the Group remains cautious on its outlook for property.

The management of the portfolio has focused on continuing to support its long term customers and at the same time reduce the exposure to real estate via managed sales, building on the successful realisation of over £4 billion of cash receipts in 2010. During the first six months of this year, the team have achieved £1.8 billion of additional real estate sales. Subject to property market conditions, further significant sales are anticipated in the second half.

**Wholesale Equity**

The Wholesale Equity portfolio (assets representing 'Equity Risk' including ordinary equity, preference shares and debt securities) totals £5.3 billion (split £4.2 billion on balance sheet commitments and £1.1 billion as yet undrawn, the majority of which relates to the Funds Investment business). The portfolio comprises the two core businesses, Lloyds Development Capital (LDC) and Project Finance with the remaining businesses (Joint Ventures Equity, BSU Investment portfolios and Fund Investments) all now categorised as non-core.

The valuation of the portfolio has shown a positive trend in the first half of 2011 despite volatility in some sectors. Whilst private equity transaction volumes have increased in the first half of 2011 against the second half of 2010, LDC continues with its cautious and robust approach to assessment of opportunities. Value recovery is still seen as fragile although there are some increasing signs of growing investor confidence.

**Wholesale Markets**

Loans and advances to customers of £36.8 billion largely comprise balances in the Structured Corporate Finance portfolio, which includes Acquisition Finance (leveraged lending), Project Finance and asset based finance (in the main rail, aviation and shipping). The leveraged finance portfolio continues to be affected by the economic environment, although the rate of new problem loans abated during 2010 and this trend has continued during the first half of 2011. However, a number of sectors remain vulnerable, especially retail, leisure and healthcare, and refinancing risk is also an issue for Acquisition Finance, with significant loan maturities due in the next few years. In Ship Finance, the container sector has strengthened, following a sharp downturn in 2009, but the tankers and dry bulk sectors remain fragile.

Wholesale Markets is also responsible for the Treasury Assets portfolio which mainly encompasses a portfolio of Asset-Backed Securities and financial institution Floating Rate Note positions. Further details of Wholesale Division's Asset-Backed Securities portfolio is provided in note 16 on page 161 of the Statutory Information. The size of the Treasury Assets portfolio continues to be actively reduced through asset sales and from bond maturities.

**Credit risk – Wholesale** (continued)

**Treasury and Trading**

Treasury and Trading acts as the link between the wholesale markets and the Group's balance sheet management activities and provides pricing and risk management solutions to both internal and external clients.

The portfolio comprises £8.6 billion of loans and advances to banks, £3.1 billion of available-for-sale debt securities and £1.0 billion of loans and advances to customers (excluding reverse repos).

The majority of Treasury and Trading's funding and risk management activity is transacted with investment grade counterparties and Sovereign central banks and much of it is on a short-term or secured basis, such as repos. Derivative transactions with wholesale counterparties are typically collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement. Treasury and Trading has reduced its government bond portfolio in response to growing concern over market conditions in Europe. The credit quality of the government bond portfolio is almost solely AAA rated sovereign debt.

**Asset Finance**

The credit quality of the retail portfolios has improved marginally during the first half of the year. Impairments in the first half of 2011 were lower than anticipated, particularly in the Personal Financial Services unsecured portfolio and the retail motor loans portfolio. Asset quality also continues to improve in response to the continuing strategy to enhance the quality of new business written (especially Motor Finance) and following the closure of Personal Financial Services to new business. The credit quality profile across the non-retail portfolios also continues to be relatively stable, and impairment levels have reduced against both the first and second half of 2010, reflecting a material slow down in new default cases. Exposures to the Fleet Operator sector, particularly a small number of daily/flexi rental operators, continue to require intensive management to support customers through their financial difficulties.

**Credit risk – Commercial**

	Balance £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Commercial	<b>29,694</b>	<b>2,993</b>	<b>10.1</b>	<b>933</b>	<b>31.2</b>
Impairment provisions	(933)				
Fair value adjustments	(77)				
<b>Loans and advances to customers</b>	<b>28,684</b>				
As at 31 December 2010					
Commercial <sup>2</sup>	29,649	2,856	9.6	992	34.7
Impairment provisions	(992)				
Fair value adjustments	(103)				
Loans and advances to customers	28,554				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

<sup>2</sup> 2010 figures have been restated for transfers from Corporate.

## Credit risk – Commercial (continued)

## Core

As at 30 June 2011	Balance £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Commercial	28,025	2,968	10.6	915	30.8
Impairment provisions	(915)				
Fair value adjustments	(77)				
<b>Loans and advances to customers</b>	<b>27,033</b>				
As at 31 December 2010					
Commercial	27,618	2,835	10.3	976	34.4
Impairment provisions	(976)				
Fair value adjustments	(103)				
<b>Loans and advances to customers</b>	<b>26,539</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

## Non-core

As at 30 June 2011	Balance £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Commercial	1,669	25	1.5	18	72.0
Impairment provisions	(18)				
Fair value adjustments	–				
<b>Loans and advances to customers</b>	<b>1,651</b>				
As at 31 December 2010					
Commercial	2,031	21	1.0	16	76.2
Impairment provisions	(16)				
Fair value adjustments	–				
<b>Loans and advances to customers</b>	<b>2,015</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

**Credit risk – Commercial** (continued)**Overview**

- Impairment losses have fallen over the last 12 months to £160 million in the first half of 2011 from £190 million for the first half of 2010, and from £192 million in the second half of 2010.
- The decrease in impairments in the first half of 2011 reflects a stabilising although uncertain UK economic environment, together with the continuing low interest rate environment.
- Portfolio metrics including delinquencies and assets under close monitoring, whilst improving through supportive management actions, remain above benign levels, although there has been a reduction in the level of flows into Business Support.
- Commercial continue to operate rigorous processes to enhance control and monitoring activities which play a crucial role in identifying customers showing early signs of financial distress and bringing them into our support model.

**Impairment charge**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change %</b>	Half-year to 31 Dec 2010 £m
<b>Total impairment charge</b>	<b>160</b>	190	<b>16</b>	192
Core	<b>160</b>	189	<b>15</b>	192
Non-core	<b>–</b>	1		–
<b>Total impairment charge</b>	<b>160</b>	190	<b>16</b>	192

Commercial's impairment charge decreased £30 million, or 16 per cent, compared to £190 million for the first half of 2010 reflecting stabilising UK economic conditions and a low interest rate environment helping to maintain defaults at a lower level and the application of a prudent credit risk appetite approach for new business. Impairment charges as an annualised percentage of average loans and advances to customers reduced to 1.07 per cent from 1.28 per cent in the first half of 2010. The majority of Commercial's assets are considered core.

**Impaired loans and provisions**

Commercial's impaired loans increased by £137 million to £2,993 million compared with 31 December 2010. The small increase is mainly due to deterioration of cases in Business Support Unit. Impairment provisions reduced as a result of lower default rates in the £0-2m collective impaired portfolio. As a result, impairment provisions as a percentage of impaired loans reduced to 31.2 per cent from 34.7 per cent at 31 December 2010. As a percentage of closing loans and advances to customers, impaired loans increased to 10.1 per cent from 9.6 per cent at 31 December 2010.

## Credit risk – Wealth and International

As at 30 June 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions <sup>1</sup> £m	Impairment provisions as a % of impaired loans %
Wealth	9,226	434	4.7	125	28.8
International					
Ireland	27,574	17,672	64.1	9,858	55.8
Australia	12,915	4,540	35.2	2,295	50.6
Wholesale Europe	6,956	952	13.7	429	45.1
Other	7,448	238	3.2	117	49.2
	<u>54,893</u>	<u>23,402</u>	<u>42.6</u>	<u>12,699</u>	<u>54.3</u>
Wealth and International	<u>64,119</u>	<u>23,836</u>	<u>37.2</u>	<u>12,824</u>	<u>53.8</u>
Impairment provisions	(12,824)				
Fair value adjustments	(186)				
<b>Total</b>	<u><b>51,109</b></u>				
As at 31 December 2010					
Wealth	9,472	353	3.7	116	32.9
International					
Ireland	27,428	14,445	52.7	7,763	53.7
Australia	14,587	4,187	28.7	2,208	52.7
Wholesale Europe	7,322	1,007	13.8	420	41.7
Other	7,559	350	4.6	177	50.6
	<u>56,896</u>	<u>19,989</u>	<u>35.1</u>	<u>10,568</u>	<u>52.9</u>
Wealth and International	<u>66,368</u>	<u>20,342</u>	<u>30.7</u>	<u>10,684</u>	<u>52.5</u>
Impairment provisions	(10,684)				
Fair value adjustments	(327)				
<b>Total</b>	<u><b>55,357</b></u>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

## Impairment charge

	Half-year to 30 June 2011 £m	Half-year to 30 June 2010 £m	Change %	Half-year to 31 Dec 2010 £m
Wealth	29	23	(26)	23
International				
Ireland	1,779	1,557	(14)	2,707
Australia	586	454	(29)	908
Wholesale Europe	111	145	23	65
Other International	27	49	45	57
	<u>2,503</u>	<u>2,205</u>	<u>(14)</u>	<u>3,737</u>
<b>Total impairment charge</b>	<u><b>2,532</b></u>	<u><b>2,228</b></u>	<u><b>(14)</b></u>	<u><b>3,760</b></u>



**Credit risk – Wealth and International** (continued)**Core**

<b>As at 30 June 2011</b>	<b>Loans and advances to customers £m</b>	<b>Impaired loans £m</b>	<b>Impaired loans as a % of closing advances %</b>	<b>Impairment provisions<sup>1</sup> £m</b>	<b>Impairment provisions as a % of impaired loans %</b>
Wealth	5,268	281	5.3	79	28.1
International	3,096	–	–	–	–
Wealth and International	8,364	281	3.4	79	28.1
Impairment provisions	(79)				
Fair value adjustments	(130)				
<b>Total</b>	<b>8,155</b>				
As at 31 December 2010					
Wealth	5,513	202	3.7	74	36.6
International	2,922	–	–	–	–
Wealth and International	8,435	202	2.4	74	36.6
Impairment provisions	(74)				
Fair value adjustments	(144)				
<b>Total</b>	<b>8,217</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

**Impairment charge – core**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change %</b>	Half-year to 31 Dec 2010 £m
Wealth	15	16	6	10
International	–	–	–	–
<b>Total impairment charge</b>	<b>15</b>	<b>16</b>	<b>6</b>	<b>10</b>

**Credit risk – Wealth and International** (continued)**Non-core**

<b>As at 30 June 2011</b>	<b>Loans and advances to customers £m</b>	<b>Impaired loans £m</b>	<b>Impaired loans as a % of closing advances %</b>	<b>Impairment provisions<sup>1</sup> £m</b>	<b>Impairment provisions as a % of impaired loans %</b>
Wealth	3,958	153	3.9	46	30.1
International	51,797	23,402	45.2	12,699	54.3
Wealth and International	55,755	23,555	42.2	12,745	54.1
Impairment provisions	(12,745)				
Fair value adjustments	(56)				
<b>Total</b>	<b>42,954</b>				
As at 31 December 2010					
Wealth	3,959	151	3.8	42	27.8
International	53,974	19,989	37.0	10,568	52.9
Wealth and International	57,933	20,140	34.8	10,610	52.7
Impairment provisions	(10,610)				
Fair value adjustments	(183)				
<b>Total</b>	<b>47,140</b>				

<sup>1</sup> Impairment provisions include collective unimpaired provisions.

**Impairment charge – non-core**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	<b>Change %</b>	Half-year to 31 Dec 2010 £m
Wealth	14	7	(100)	13
International	2,503	2,205	(14)	3,737
<b>Total impairment charge</b>	<b>2,517</b>	<b>2,212</b>	<b>(14)</b>	<b>3,750</b>

**Credit risk – Wealth and International** (continued)

**Overview**

- Impairment charges have fallen significantly compared to the second half of 2010. However material losses continue to be incurred due to further provisioning requirements in non-core portfolios in Ireland and Australasia.
- The Group's Irish portfolio has continued to deteriorate with a further 11 per cent of the portfolio being classified as impaired in the period.
- Impairment coverage has increased in Ireland due to further falls in the commercial real estate market as previously anticipated. We believe that further vulnerability exists.
- A dedicated UK-based Business Support Unit credit team is now in place to manage the wind down of the Irish book; however the Irish market is extremely illiquid with limited opportunities for disposals in the short term.
- The Group's portfolio in Australasia is exposed to real estate concentrations in specific regions where market conditions remain challenging and asset valuations continue to decline.

**Impairment charges**

Wealth and International's impairment charge in the first half of 2011 almost entirely related to non-core portfolios. The impairment charge increased by £304 million to £2,532 million compared with the first half of 2010 and reduced by £1,228 million compared with the second half of 2010. Impairment charges as an annualised percentage of average loans and advances to customers increased to 7.89 per cent from 6.56 per cent in the first half of 2010 but decreased from 11.29 per cent compared with the second half of 2010.

**Impaired loans and provisions**

Total impaired loans increased by £3,494 million to £23,836 million compared with £20,342 million at 31 December 2010 and as a percentage of closing loans and advances to customers increased to 37.2 per cent from 30.7 per cent at 31 December 2010. The increase in impaired loans predominantly relates to the Group's non-core book in Ireland where a further 11 per cent of the portfolio became impaired during the first six months of 2011 reflecting ongoing difficulties in the economy and an illiquid market. Impaired loans in the Australasian book increased by 8 per cent in the first half as write offs were more than offset by the migration of further cases to impaired status.

Impairment provisions as a percentage of impaired loans increased to 53.8 per cent from 52.5 per cent at 31 December 2010. The increase in impaired coverage in the Group's portfolio in Ireland reflects an allowance for further falls in commercial real estate and a continuing decline in residential real estate prices. Impaired coverage in Australia has reduced slightly due to the impact of write offs and new impaired cases in the period requiring lower provisioning levels.

**Credit risk – Wealth and International** (continued)**Wealth**

Total impaired loans increased by £81 million, or 23 per cent, to £434 million compared with £353 million at 31 December 2010 and as a percentage of closing loans and advances increased to 4.7 per cent from 3.7 per cent at 31 December 2010. This increase is mainly attributable to a deterioration in a small number of large single exposures. Impairment charges increased by £6 million to £29 million compared with both the first half of 2010 and the second half of 2010. Impairment charges as an annualised percentage of average loans and advances to customers increased to 0.6 per cent from 0.5 per cent in both the first half of 2010 and the second half of 2010.

**Ireland**

Total impaired loans increased by £3,227 million, or 22 per cent, to £17,672 million compared with £14,445 million at 31 December 2010 and as a percentage of closing loans and advances increased to 64.1 per cent from 52.7 per cent at 31 December 2010. Impairment charges increased by £222 million to £1,779 million compared to the first half of 2010 but decreased by £928 million compared to the second half of 2010. Impairment charges as an annualised percentage of average loans and advances to customers increased to 13.2 per cent from 11.1 per cent in the first half of 2010 but decreased from 20.0 per cent compared with the second half of 2010.

Continuing weakness in the Irish economy resulted in an increase in impaired wholesale loans in the first six months of 2011. Wholesale coverage levels have been increased due to further falls in the commercial real estate market. The majority of Irish retail provisions relate to a residential mortgage portfolio where impairment charges have increased in relation the second half of 2010 due to a continued decline in residential property prices and higher arrears levels, including customers on a forbearance arrangement. Although the portfolio is in non-core, current levels of redemptions and recoveries are low due to a severe lack of liquidity.

	As at 30 June 2011			As at 31 December 2010		
	Gross loans £m	Impaired loans £m	Provisions £m	Gross loans £m	Impaired loans £m	Provisions £m
Commercial Real Estate	11,869	10,831	5,943	11,685	9,232	4,791
Corporate	7,785	5,597	3,029	8,070	4,343	2,356
Retail	7,920	1,244	886	7,673	870	616
<b>Total</b>	<b>27,574</b>	<b>17,672</b>	<b>9,858</b>	<b>27,428</b>	<b>14,445</b>	<b>7,763</b>

The most significant contribution to impairment in Ireland is the commercial real estate portfolio. Impairment provisions provide 55 per cent coverage on impaired commercial real estate loans. Mortgage lending at the half-year comprised 96 per cent of the retail portfolio with impaired loans of £1.2 billion and impairment coverage of 65 per cent.

**Credit risk – Wealth and International** (continued)

**Australia**

In Australia, the Corporate and Asset Finance businesses are of scale and profitable, operating in a strong and developed economy that has good growth prospects. These ongoing businesses will continue to be managed for maximum value whilst maintaining a tight focus on running off the legacy commercial property exposures.

Total impaired loans increased by £353 million, or 8 per cent, to £4,540 million compared with £4,187 million at 31 December 2010. The increase in impaired loans in the period reflects further deterioration in the commercial real estate portfolio and the migration to impaired of a material corporate exposure which was partly offset by write offs. Total impaired loans as a percentage of closing loans and advances increased to 35.2 per cent from 28.7 per cent at 31 December 2010 reflecting higher impaired loans and a high level of redemptions on the performing book.

Impairment charges increased by £132 million to £586 million compared to the first half of 2010 but decreased by £322 million compared to the second half of 2010. Impairment charges as an annualised percentage of average loans and advances to customers increased to 8.8 per cent from 6.3 per cent in the first half of 2010 but decreased from 12.3 per cent compared with the second half of 2010.

Impairment on the Group's commercial real estate portfolio in Australasia was the main contributor to the half-year charge. This portfolio is heavily exposed to Australian non-metropolitan and New Zealand real estate markets where market conditions remain challenging and asset valuations continue to decline. A specific charge of £70 million was also incurred in the period as a result of losses arising from the earthquake in New Zealand.

**Wholesale Europe**

Total impaired loans decreased by £55 million, or 5 per cent, to £952 million compared with £1,007 million at 31 December 2010 and as a percentage of closing loans and advances decreased to 13.7 per cent from 13.8 per cent at 31 December 2010. Impairment charges decreased by £34 million to £111 million compared to the first half of 2010 but increased by £46 million compared to the second half of 2010. Impairment charges as an annualised percentage of average loans and advances to customers decreased to 3.1 per cent from 3.7 per cent in the first half of 2010 but increased from 1.7 per cent compared with the second half of 2010. Commercial real estate was the primary driver of the impairment charge in Wholesale Europe reflecting provisions on a small number of specific transactions.

**Other International**

Total impaired loans decreased by £112 million, or 32 per cent, to £238 million compared with £350 million at 31 December 2010 and as a percentage of closing loans and advances decreased to 3.2 per cent from 4.6 per cent at 31 December 2010. Impaired loans predominantly relate to a limited number of corporate exposures and the reduction in impaired balances primarily reflects write offs in respect of two loans that have been exited in the period. Impairment charges decreased by £22 million to £27 million compared to the first half of 2010 and by £30 million compared to the second half of 2010. Impairment charges as an annualised percentage of average loans and advances to customers decreased to 0.7 per cent from 1.2 per cent in the first half of 2010 and from 1.5 per cent in the second half of 2010.

## **Market risk**

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.

The principal market risks are as follows:

- There is a risk to the Group's banking income arising from the level of interest rates and the margin of interbank rates over central bank rates. A further banking risk 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.
- The main equity market risks arise in the life assurance companies and staff pension schemes. Credit spread risk arises in the life assurance companies, pension schemes and banking businesses. Equity market movements and changes in credit spreads impact the Group's results.

Continuing concerns about the fiscal position in peripheral Eurozone countries resulted in increased credit spreads in the areas affected, and fears of contagion affected the Euro and widened spreads between central bank and interbank rates.

The Group's trading activity is small relative to our peers and is not considered to be a principal risk. The average 95 per cent 1-day trading Value at Risk (VaR) was £8 million for the six months to 30 June 2011.

## **Insurance risk**

The major sources of insurance risk are within the insurance businesses and the staff defined benefit pension schemes.

Insurance risk is inherent in the insurance business and can be affected by customer behaviour. Insurance risks accepted relate primarily to mortality, longevity, morbidity, persistency, expenses, property and unemployment.

The primary insurance risk carried by the Group's defined benefit pension schemes is related to longevity.

Insurance risks typically, and longevity in particular, crystallise gradually over time. Actuarial assumption setting for financial reporting and liability management requires expert judgement as to when evidence of an emerging trend is sufficient to require an alteration to long-run assumptions.

## Legal and regulatory

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation within the UK and overseas with which the Group has to comply, along with new or proposed legislation and regulation which needs to be reviewed, assessed and embedded into day-to-day operational and business practices across the Group as a whole. This is particularly the case in the current market environment, which continues to witness high levels of government and regulatory intervention in the banking sector.

Lloyds Banking Group faces increased political and regulatory scrutiny as a result of the Group's perceived size and systemic importance following the acquisition of HBOS Group. At the time of the acquisition, the Office of Fair Trading (OFT) identified some competition concerns in the UK personal current accounts and mortgages markets and for SME banking in Scotland. The OFT reiterated that it would keep these under review and consider whether to refer any banking markets to the Competition Commission if it identifies any prevention, restriction or distortion of competition.

The UK Government appointed an Independent Commission on Banking (ICB) to review possible structural measures to reform the banking system and promote stability and competition. The ICB has announced that it intends to publish its final report on the 12 September 2011. The Government has indicated its support for initial proposals put forward by the ICB that would require capital ring-fencing of the retail activities of banks from their investment banking activities. The Interim Report also referenced a desire to see the EU state aid mandated retail business divestment 'substantially enhanced'. We continue to play a constructive role in the debate and to consult with the ICB. The Treasury Select Committee is also conducting an examination of competition in retail banking. It is too early to quantify the potential impact of these developments on the Group.

In April 2011, the FSA commenced an internal reorganisation as a first step in a process towards the formal transition of regulatory and supervisory powers from the FSA to the new Financial Conduct Authority (FCA) for conduct of business supervision and the Prudential Regulatory Authority (PRA) for capital and liquidity supervision in 2012. Until this time the responsibility for regulating and supervising the activities of the Lloyds Banking Group and its subsidiaries will remain with the FSA. In addition, the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority as new EU Supervisory Authorities are likely to have greater influence on regulatory approaches across the EU. These could lead to changes in how the Group is regulated and supervised on a day-to-day basis.

Evolving capital and liquidity requirements continue to be a priority for the Group. In September 2010 and further updated in June 2011, the Basel Committee on Banking Supervision put forward proposals for a reform package which changes the regulatory capital and liquidity standards, the definition of 'capital', introduces new definitions for the calculation of counterparty credit risk and leverage ratios, additional capital buffers and development of a global liquidity standard. Implementation of these changes is expected to be phased in between 2012 and 2018.

Other notable regulatory initiatives include the Dodd-Frank Act in the US (which affects the financial services industry by addressing, among other issues, systemic risk oversight, bank capital standards, the liquidation of failing systemically significant financial institutions, over-the-counter derivatives, the ability of banking entities to engage in proprietary trading activities and invest in hedge funds and private equity (these restrictions are known as the 'Volcker Rule'), consumer and investor protection, hedge fund registration, securitisation, investment advisors, shareholder 'say on pay', the role of credit-rating agencies, and more) and the Foreign Account Tax Compliance Act (FATCA) which is intended to ensure the US government can determine the ownership of US assets in foreign accounts and which will require non-US financial institutions to enter into disclosure compliance agreements with the US Treasury and all non-financial non-US entities to report and/or certify their ownership or be subject to 30 per cent withholding.

## **Legal and regulatory** (continued)

The Group is currently assessing the impacts of these regulatory developments which could have a material effect on the Group and will participate in the consultation and calibration processes to be undertaken by the various regulatory bodies during 2011. The Insurance division is progressing its plans to achieve Solvency II compliance. The Group continues to work closely with the regulatory authorities and industry associations to ensure that it is able to identify and respond to proposed regulatory changes and mitigate against risks to the Group and its stakeholders.

## **Customer treatment**

Customer treatment and how the Group manages its customer relationships affects all aspects of the Group's operations and is closely aligned with achievement of the Group's strategic aim – to create deep long lasting relationships with its customers. Our conduct risk strategy has been developed to support achievement of this strategic aim, by placing the customer, and ensuring we consistently get the right outcomes for them, at the heart of what we do. There remains a high level of scrutiny regarding the treatment of customers by financial institutions from the press, politicians and regulatory bodies.

The FSA continues to drive focus on conduct of business activities through its new approach to supervision of Conduct Risk, replacing the previous 'Treating Customers Fairly' initiative for retail customers. Under this new regime the FSA is placing greater emphasis on product governance and contract terms in general, and increasingly will seek to intervene much earlier in the product lifecycle to prevent customer detriment. The FSA also continues to carry out thematic reviews on a variety of issues across the industry as a whole, for example complaints handling. The Group actively engages with the regulatory authorities and other stakeholders on these key customer treatment challenges, which includes for example, Payment Protection Insurance (PPI) (see note 22 on page 165 of the statutory information).

The Group has policies, procedures and governance arrangements in place to facilitate the fair treatment of customers. Since the acquisition of HBOS, the Group has aligned its Treating Customers Fairly approach, governance and management information arrangements, with customer impact being a key factor in assessing every integration proposition. The Group regularly reviews its product range to ensure that it meets regulatory requirements and is competitive in the market place. Nonetheless there is a risk that certain aspects of the Group's business may be determined by the authorities or the courts as not being conducted in accordance with applicable laws or regulations, or with what is fair and reasonable in their opinion. The Group may also be liable for damages to third parties harmed by the conduct of its business.

## **People**

The people risk profile is being driven principally by the factors outlined below:

- The scale and pace of organisational, legislative, and regulatory change
- Integration and other strategic initiatives
- The implementation of EU State Aid requirements
- The Independent Commission on Banking's (ICB) proposals for banking reform.

Failure to manage the related people risks would significantly impact Group's ability to deliver against its strategic objectives.

The factors above may result in greater uncertainty for colleagues and increased stretch, particularly for senior talent and key subject matter experts, as well as potentially increasing retention risk in key colleague populations. The Group continues to proactively mitigate these risks, closely engaging with the EU and ICB, and actively managing union and regulatory relationships, through this period of significant organisational and transformational change.



## **Integration**

The integration of the two heritage organisations is now in its final stages. The Group's Integration Execution Board, chaired by the Group Operations Director, continues to oversee the integration process and progress is regularly reviewed by the Group Executive Committee and Group Board. While there continue to be delivery risks to the remaining elements of the programme, the Group has now completed more than two years of integration activity and has a fully functioning governance framework to manage the associated risks. There is a clear understanding of the remaining deliverables to ensure the ongoing consistent provision of good quality service to our customers, together with effective delivery against our integration objectives.

## **State funding and state aid**

HM Treasury currently holds approximately 40.2 per cent of the 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 the 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, although there have been no indications that the Government intends to change the existing operating arrangements.

The Group made a number of undertakings to HM Treasury arising from the capital and funding support, including the provision of additional lending to certain mortgage and business sectors for the two years to 28 February 2011, and other matters relating to corporate governance and colleague remuneration. The lending commitments were subject to prudent commercial lending and pricing criteria, the availability of sufficient funding and sufficient demand from creditworthy customers. These lending commitments were delivered in full in the second year. A new agreement between five major UK banks (including the Group) and the Government in relation to gross business lending capacity in the 2011 calendar year is subject to a similar set of criteria.

In addition, the Group is subject to European state aid obligations in line with the restructuring plan agreed with HM Treasury and the EU College of Commissioners in November 2009, which is designed to support the long-term viability of the Group and address any competition distortions arising from the benefits of state aid. This has placed a number of requirements on the Group including asset reductions in certain parts of its balance sheet by the end of 2014 and the disposal of certain portions of its business by the end of November 2013, including in particular the disposal of some parts of its retail banking business. The Group is working closely with the EU Commission, HM Treasury and the Monitoring Trustee appointed by the EU Commission.

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## CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)

## CONSOLIDATED INCOME STATEMENT

	Note	Half-year to 30 June 2011 £ million	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
Interest and similar income		13,437	14,661	14,679
Interest and similar expense		(7,448)	(7,623)	(9,171)
<b>Net interest income</b>		<b>5,989</b>	<b>7,038</b>	<b>5,508</b>
Fee and commission income		2,153	2,219	2,196
Fee and commission expense		(690)	(812)	(870)
Net fee and commission income		1,463	1,407	1,326
Net trading income		3,118	1,245	14,479
Insurance premium income		4,125	4,300	3,848
Other operating income		1,508	1,790	2,526
<b>Other income</b>	3	<b>10,214</b>	<b>8,742</b>	<b>22,179</b>
<b>Total income</b>		<b>16,203</b>	<b>15,780</b>	<b>27,687</b>
Insurance claims		(5,349)	(3,189)	(15,322)
<b>Total income, net of insurance claims</b>		<b>10,854</b>	<b>12,591</b>	<b>12,365</b>
Payment protection insurance provision		(3,200)	–	–
Other operating expenses		(6,428)	(5,811)	(7,459)
<b>Total operating expenses</b>	4	<b>(9,628)</b>	<b>(5,811)</b>	<b>(7,459)</b>
<b>Trading surplus</b>		<b>1,226</b>	<b>6,780</b>	<b>4,906</b>
Impairment	5	(4,491)	(5,423)	(5,529)
Share of results of joint ventures and associates		14	(61)	(27)
Loss on disposal of businesses	6	–	–	(365)
<b>(Loss) profit before tax</b>		<b>(3,251)</b>	<b>1,296</b>	<b>(1,015)</b>
Taxation	7	973	(630)	91
<b>(Loss) profit for the period</b>		<b>(2,278)</b>	<b>666</b>	<b>(924)</b>
Profit (loss) attributable to non-controlling interests		27	70	(8)
(Loss) profit attributable to equity shareholders		(2,305)	596	(916)
<b>(Loss) profit for the period</b>		<b>(2,278)</b>	<b>666</b>	<b>(924)</b>
<b>Basic (loss) earnings per share</b>	8	<b>(3.4)p</b>	0.9p	(1.3)p
<b>Diluted (loss) earnings per share</b>	8	<b>(3.4)p</b>	0.9p	(1.3)p
<b>Dividend per share for the period</b>		–	–	–
<b>Dividend for the period</b>		–	–	–

## CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED) (continued)

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	<b>Half-year to 30 June 2011 £ million</b>	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
<b>(Loss) profit for the period</b>	<b>(2,278)</b>	666	(924)
<b>Other comprehensive income:</b>			
Movements in revaluation reserve in respect of available-for-sale financial assets:			
Change in fair value	437	1,255	(24)
Income statement transfers in respect of disposals	52	(147)	(252)
Income statement transfers in respect of impairment	29	36	78
Other income statement transfers	25	(185)	75
Taxation	(123)	(357)	14
	<b>420</b>	602	(109)
Movement in cash flow hedging reserve:			
Effective portion of changes in fair value	516	(535)	(513)
Net income statement transfers	103	312	620
Taxation	(176)	73	(43)
	<b>443</b>	(150)	64
Currency translation differences:			
Currency translation differences, before tax	(77)	95	(224)
Taxation	-	(1)	1
	<b>(77)</b>	94	(223)
<b>Other comprehensive income for the period, net of tax</b>	<b>786</b>	546	(268)
<b>Total comprehensive income for the period</b>	<b>(1,492)</b>	1,212	(1,192)
Total comprehensive income attributable to non-controlling interests	25	67	(10)
Total comprehensive income attributable to equity shareholders	<b>(1,517)</b>	1,145	(1,182)
<b>Total comprehensive income for the period</b>	<b>(1,492)</b>	1,212	(1,192)

**CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED BALANCE SHEET**

<b>Assets</b>	Note	<b>As at 30 June 2011 £ million</b>	<b>As at 31 December 2010 £ million</b>
Cash and balances at central banks		<b>55,240</b>	38,115
Items in course of collection from banks		<b>1,392</b>	1,368
Trading and other financial assets at fair value through profit or loss	9	<b>155,181</b>	156,191
Derivative financial instruments	10	<b>45,256</b>	50,777
Loans and receivables:			
Loans and advances to banks		<b>28,170</b>	30,272
Loans and advances to customers	11	<b>587,843</b>	592,597
Debt securities	14	<b>15,521</b>	25,735
		<b>631,534</b>	648,604
Available-for-sale financial assets	15	<b>32,793</b>	42,955
Held-to-maturity investments		<b>7,842</b>	7,905
Investment properties		<b>6,441</b>	5,997
Investments in joint ventures and associates		<b>427</b>	429
Goodwill		<b>2,016</b>	2,016
Value of in-force business		<b>7,482</b>	7,367
Other intangible assets		<b>3,257</b>	3,496
Tangible fixed assets		<b>7,874</b>	8,190
Current tax recoverable		<b>558</b>	621
Deferred tax assets		<b>5,122</b>	4,164
Retirement benefit assets		<b>845</b>	736
Other assets		<b>15,691</b>	12,643
<b>Total assets</b>		<b>978,951</b>	991,574

**CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED BALANCE SHEET**

	Note	As at 30 June 2011 £ million	As at 31 December 2010 £ million
<b>Equity and liabilities</b>			
<b>Liabilities</b>			
Deposits from banks		31,294	50,363
Customer deposits	17	399,919	393,633
Items in course of transmission to banks		1,312	802
Trading and other financial liabilities at fair value through profit or loss		27,290	26,762
Derivative financial instruments	10	36,049	42,158
Notes in circulation		1,048	1,074
Debt securities in issue	18	231,194	228,866
Liabilities arising from insurance contracts and participating investment contracts		80,274	80,729
Liabilities arising from non-participating investment contracts		52,823	51,363
Unallocated surplus within insurance businesses		649	643
Other liabilities		30,899	29,696
Retirement benefit obligations		400	423
Current tax liabilities		105	149
Deferred tax liabilities		412	247
Other provisions		4,152	1,532
Subordinated liabilities	19	35,585	36,232
<b>Total liabilities</b>		<b>933,405</b>	<b>944,672</b>
<b>Equity</b>			
Share capital	20	6,881	6,815
Share premium account	21	16,541	16,291
Other reserves	21	12,363	11,575
Retained profits	21	9,124	11,380
<b>Shareholders' equity</b>		<b>44,909</b>	<b>46,061</b>
Non-controlling interests		637	841
<b>Total equity</b>		<b>45,546</b>	<b>46,902</b>
<b>Total equity and liabilities</b>		<b>978,951</b>	<b>991,574</b>

## CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED) (continued)

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	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 2011	23,106	11,575	11,380	46,061	841	46,902
<b>Comprehensive income</b>						
(Loss) profit for the period	-	-	(2,305)	(2,305)	27	(2,278)
<i>Other comprehensive income</i>						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	-	422	-	422	(2)	420
Movements in cash flow hedging reserve, net of tax	-	443	-	443	-	443
Currency translation differences, net of tax	-	(77)	-	(77)	-	(77)
<b>Total other comprehensive income</b>	-	788	-	788	(2)	786
<b>Total comprehensive income</b>	-	788	(2,305)	(1,517)	25	(1,492)
<b>Transactions with owners</b>						
Dividends	-	-	-	-	(22)	(22)
Issue of ordinary shares	316	-	-	316	-	316
Movement in treasury shares	-	-	(282)	(282)	-	(282)
Value of employee services:						
Share option schemes	-	-	146	146	-	146
Other employee award schemes	-	-	185	185	-	185
Change in non-controlling interests	-	-	-	-	(207)	(207)
<b>Total transactions with owners</b>	316	-	49	365	(229)	136
<b>Balance at 30 June 2011</b>	<b>23,422</b>	<b>12,363</b>	<b>9,124</b>	<b>44,909</b>	<b>637</b>	<b>45,546</b>



**CONDENSED INTERIM 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 2010	24,944	7,217	11,117	43,278	829	44,107
<b>Comprehensive income</b>						
Profit for the period	–	–	596	596	70	666
<i>Other comprehensive income</i>						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	605	–	605	(3)	602
Movements in cash flow hedging reserve, net of tax	–	(150)	–	(150)	–	(150)
Currency translation differences, net of tax	–	94	–	94	–	94
Total other comprehensive income	–	549	–	549	(3)	546
Total comprehensive income	–	549	596	1,145	67	1,212
<b>Transactions with owners</b>						
Dividends	–	–	–	–	(8)	(8)
Issue of ordinary shares	2,237	–	–	2,237	–	2,237
Redemption of preference shares	11	(11)	–	–	–	–
Movement in treasury shares	–	–	22	22	–	22
Value of employee services:						
Share option schemes	–	–	64	64	–	64
Other employee award schemes	–	–	27	27	–	27
Change in non-controlling interests	–	–	–	–	(5)	(5)
Total transactions with owners	2,248	(11)	113	2,350	(13)	2,337
Balance at 30 June 2010	27,192	7,755	11,826	46,773	883	47,656

**CONDENSED INTERIM 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 July 2010	27,192	7,755	11,826	46,773	883	47,656
<b>Comprehensive income</b>						
Loss for the period	–	–	(916)	(916)	(8)	(924)
<i>Other comprehensive income</i>						
Movements in revaluation reserve in respect of available-for-sale financial assets, net of tax	–	(107)	–	(107)	(2)	(109)
Movements in cash flow hedging reserve, net of tax	–	64	–	64	–	64
Currency translation differences, net of tax	–	(223)	–	(223)	–	(223)
Total other comprehensive income	–	(266)	–	(266)	(2)	(268)
Total comprehensive income	–	(266)	(916)	(1,182)	(10)	(1,192)
<b>Transactions with owners</b>						
Dividends	–	–	–	–	(39)	(39)
Cancellation of deferred shares	(4,086)	4,086	–	–	–	–
Movement in treasury shares	–	–	(2)	(2)	–	(2)
Value of employee services:						
Share option schemes	–	–	90	90	–	90
Other employee award schemes	–	–	382	382	–	382
Change in non-controlling interests	–	–	–	–	7	7
Total transactions with owners	(4,086)	4,086	470	470	(32)	438
Balance at 31 December 2010	23,106	11,575	11,380	46,061	841	46,902

**CONDENSED INTERIM FINANCIAL STATEMENTS (UNAUDITED)** (continued)**CONSOLIDATED CASH FLOW STATEMENT**

	<b>Half-year to 30 June 2011 £ million</b>	Half-year to 30 June 2010 £ million	Half-year to 31 Dec 2010 £ million
<b>(Loss) profit before tax</b>	<b>(3,251)</b>	1,296	(1,015)
Adjustments for:			
Change in operating assets	<b>19,532</b>	11,662	20,198
Change in operating liabilities	<b>(12,712)</b>	(3,538)	(42,145)
Non-cash and other items	<b>5,443</b>	2,286	8,887
Tax (paid) received	<b>(74)</b>	(141)	473
<b>Net cash provided by (used in) operating activities</b>	<b>8,938</b>	11,565	(13,602)
<b>Cash flows from investing activities</b>			
Purchase of financial assets	<b>(14,196)</b>	(17,521)	(29,369)
Proceeds from sale and maturity of financial assets	<b>24,390</b>	18,555	27,444
Purchase of fixed assets	<b>(1,354)</b>	(1,059)	(2,157)
Proceeds from sale of fixed assets	<b>713</b>	928	426
Acquisition of businesses, net of cash acquired	<b>(8)</b>	(7)	(66)
Disposal of businesses, net of cash disposed	<b>238</b>	239	189
<b>Net cash provided by (used in) investing activities</b>	<b>9,783</b>	1,135	(3,533)
<b>Cash flows from financing activities</b>			
Dividends paid to non-controlling interests	<b>(22)</b>	(8)	(39)
Interest paid on subordinated liabilities	<b>(1,230)</b>	(1,047)	(895)
Proceeds from issue of subordinated liabilities	<b>–</b>	1,968	1,269
Repayment of subordinated liabilities	<b>(924)</b>	–	(684)
Change in non-controlling interests	<b>(10)</b>	(5)	7
<b>Net cash (used in) provided by financing activities</b>	<b>(2,186)</b>	908	(342)
Effects of exchange rate changes on cash and cash equivalents	<b>10</b>	181	298
Change in cash and cash equivalents	<b>16,545</b>	13,789	(17,179)
Cash and cash equivalents at beginning of period	<b>62,300</b>	65,690	79,479
<b>Cash and cash equivalents at end of period</b>	<b>78,845</b>	79,479	62,300

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.

## 1. Accounting policies, presentation and estimates

These condensed consolidated interim financial statements as at and for the half-year to 30 June 2011 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority (FSA) and with International Accounting Standard 34 (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 2010 which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Copies of the 2010 annual report and accounts are available on the Group's website and are available upon request from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.

In September 2010, the British Bankers' Association published a Code for Financial Reporting Disclosure (the Disclosure Code) which sets out disclosure principles together with supporting guidance in respect of the financial statements of UK banks. The Group and other major UK banks have voluntarily adopted the Disclosure Code and these condensed interim financial statements have been prepared in compliance with the Disclosure Code's principles. Terminology used in these condensed interim financial statements is consistent with that used in the 2010 annual report and accounts where a glossary of terms can be found.

The directors consider that it is appropriate to continue to adopt the going concern basis in preparing the condensed interim financial statements. In reaching this assessment, the directors have considered projections for the Group's capital and funding position and have had regard to the factors set out in Principal risks and uncertainties: Liquidity and funding on page 94.

### **Accounting policies**

The accounting policies are consistent with those applied by the Group in its 2010 annual report and accounts.

In accordance with IAS 34, the Group's income tax expense for the half-year to 30 June 2011 is based on the best estimate of the weighted-average annual income tax rate expected for the full financial year. This best estimate takes into account the reduction in the main rate of corporation tax from 28 per cent to 26 per cent that was effective from 1 April 2011 but does not take into account the impact of the further reduction to 25 per cent which was substantively enacted on 5 July 2011 and will be effective from 1 April 2012.

In accordance with IAS 19 *Employee Benefits* and the Group's normal practice, the valuation of the Group's pension schemes will be formally updated at the year end. No valuation adjustment has therefore been made at 30 June 2011.

### **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 be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Save for the estimates detailed below, there have been no significant changes in the basis upon which estimates have been determined, compared to that applied at 31 December 2010.

**1. Accounting policies, presentation and estimates** (continued)

*Payment protection insurance*

The Group has recognised a provision of £3,200 million in respect of payment protection insurance (PPI) policies as a result of discussions with the FSA and a judgment handed down by the UK High Court (see note 22 on page 165 for more information). The provision represents management's best estimate of the anticipated costs of related customer contact and/or redress, including administration expenses. However, there are still a number of uncertainties as to the eventual costs from any such contact and/or redress given the inherent difficulties of assessing the impact of detailed implementation of the FSA Policy Statement of 10 August 2010 for all PPI complaints, uncertainties around the ultimate emergence period for complaints, the availability of supporting evidence and the activities of claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs.

The provision requires significant judgement by management in determining appropriate assumptions, which include the level of complaints, uphold rates, proactive contact and response rates, Financial Ombudsman Service referral and uphold rates as well as redress costs for each of the many different populations of customers identified by the Group in its analyses used to determine the best estimate of the anticipated costs of redress. If the level of complaints had been one percentage point higher (lower) than estimated for all policies open within the last six years then the provision made in 2011 would have increased (decreased) by approximately £100 million. However it should be noted that there are a large number of inter-dependent assumptions under-pinning the provision; this sensitivity assumes that all assumptions, other than the level of complaints, remain constant.

The Group will re-evaluate the assumptions underlying its analysis at each reporting date as more information becomes available. As noted above, there is inherent uncertainty in making estimates; actual results in future periods may differ from the amount provided.

***New accounting pronouncements***

The Group has adopted the following new standards and amendments to standards which became effective for financial years beginning on or after 1 January 2011. None of these standards or amendments to standards have had a material impact on these condensed interim financial statements.

- (i) Amendment to IAS 32 *Financial Instruments: Presentation – 'Classification of Rights Issues'*. Requires rights issues denominated in a currency other than the functional currency of the issuer to be classified as equity regardless of the currency in which the exercise price is denominated.
- (ii) IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*. Clarifies that when an entity renegotiates the terms of its debt with the result that the liability is extinguished by the debtor issuing its own equity instruments to the creditor, a gain or loss is recognised in the income statement representing the difference between the carrying value of the financial liability and the fair value of the equity instruments issued; the fair value of the financial liability is used to measure the gain or loss where the fair value of the equity instruments cannot be reliably measured.
- (iii) *Improvements to IFRSs* (issued May 2010). Sets out minor amendments to IFRS standards as part of the annual improvements process.

**1. Accounting policies, presentation and estimates** (continued)

- (iv) Amendment to IFRIC 14 *Prepayments of a Minimum Funding Requirement*. Applies when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements and permits such an entity to treat the benefit of such an early payment as an asset.
- (v) IAS 24 *Related Party Disclosures (Revised)*. Simplifies the definition of a related party and provides a partial exemption from the requirement to disclose transactions and outstanding balances with the government and government-related entities. The Group has taken advantage of this exemption which requires the Group to provide details of only significant transactions with the government and government-related entities. Details of related party transactions are disclosed in note 25 on page 173.

## 2. Segmental analysis

Lloyds Banking Group provides a wide range of banking and financial services in the UK and in certain locations overseas.

The Group Executive Committee (GEC) has been determined to be the chief operating decision maker for the Group. The Group's operating segments reflect its organisational and management structures. GEC reviews the Group's internal reporting based around these segments in order to assess performance and allocate resources. This assessment includes a consideration of each segment's net interest revenue and consequently the total interest income and expense for all reportable segments is presented on a net basis. The segments are differentiated by the type of products provided, by whether the customers are individuals or corporate entities and by the geographical location of the customer.

The segmental results and comparatives are presented on a combined businesses basis, the basis reviewed by the chief operating decision maker; during the half-year ended 30 June 2011 the chief operating decision maker has commenced reviewing the results of the Group's Commercial business separately to the Wholesale segment. As a consequence, the Group's activities are now organised into five financial reporting segments: Retail, Wholesale, Commercial, Wealth and International, and Insurance.

Retail offers a broad range of retail financial service products in the UK, including current accounts, savings, personal loans, credit cards and mortgages. It is also a major general insurance and bancassurance distributor, selling a wide range of long-term savings, investment and general insurance products.

The Wholesale division serves businesses with turnover above £15 million with a range of propositions segmented according to customer need. The division comprises Corporate Markets, Treasury and Trading and Asset Finance.

Commercial serves in excess of a million small and medium-sized enterprises and community organisations with a turnover of up to £15 million. Customers range from start-up enterprises to established corporations, with a range of propositions aligned to customer needs. Commercial comprises Commercial Banking and Commercial Finance, the invoice discounting and factoring business.

Wealth and International was created in 2009 to give increased focus and momentum to the Group's private banking and asset management activities and to closely co-ordinate the management of its international businesses. Wealth comprises the Group's private banking, wealth and asset management businesses in the UK and overseas. International comprises corporate, commercial, asset finance and retail businesses, principally in Australia and Continental Europe.

The Insurance division provides long-term savings, investment and protection products distributed through bancassurance, intermediary and direct channels in the UK. It is also a distributor of home insurance in the UK with products sold through the retail branch network, direct channels and strategic corporate partners. The division consists of three business units: Life, Pensions and Investments UK; Life Pensions and Investments Europe; and General Insurance.

Other includes the results of managing the Group's technology platforms, branch and head office property estate, operations (including payments, banking operations and collections) and procurement services, the costs of which are predominantly recharged to the other divisions. It also reflects other items not recharged to the divisions, including hedge ineffectiveness and certain capital and wholesale liquidity funding costs.

## 2. Segmental analysis (continued)

Inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds.

For those derivative contracts entered into by business units for risk management purposes, the business unit retains the amount that would have been recognised on an accrual accounting basis (an amount equal to the interest element of the next payment on the swap) and transfers the remainder of the fair value of the swap to the central group segment where the resulting accounting volatility is managed through the establishment of hedge accounting relationships. Any change in fair value of the hedged instrument attributable to the hedged risk is also recorded within the central group segment. This allocation of the fair value of the swap and change in fair value of the hedged instrument attributable to the hedged risk avoids accounting asymmetry in segmental results and records volatility in the central group segment where it is managed.

Half-year to 30 June 2011	Net interest income £m	Other income £m	Total income £m	Profit (loss) before tax £m	External revenue £m	Inter-segment revenue £m
Retail	4,163	884	5,047	2,200	6,359	(1,312)
Wholesale	1,401	1,337	2,738	1,429	1,512	1,226
Commercial	649	218	867	262	675	192
Wealth and International	509	631	1,140	(2,080)	1,092	48
Insurance	(142)	1,319	1,177	543	1,635	(458)
Other	(202)	(391)	(593)	(1,250)	(897)	304
<b>Group – combined businesses basis</b>	<b>6,378</b>	<b>3,998</b>	<b>10,376</b>	<b>1,104</b>	<b>10,376</b>	<b>–</b>
Insurance grossing adjustment	(102)	5,332	5,230	–		
Integration costs	–	–	–	(642)		
Volatility arising in insurance businesses	10	(187)	(177)	(177)		
Fair value unwind	(297)	1,071	774	–		
Amortisation of purchased intangibles	–	–	–	(289)		
EU mandated retail business disposal costs	–	–	–	(47)		
Payment protection insurance provision	–	–	–	(3,200)		
<b>Group – statutory</b>	<b>5,989</b>	<b>10,214</b>	<b>16,203</b>	<b>(3,251)</b>		



**2. Segmental analysis (continued)**

	<b>As at 30 June 2011 £m</b>	<b>As at 31 Dec 2010<sup>1</sup> £m</b>
<b>Segment external assets</b>		
Retail	<b>362,840</b>	369,170
Wholesale <sup>2</sup>	<b>319,146</b>	327,055
Commercial <sup>2</sup>	<b>28,902</b>	28,938
Wealth and International	<b>82,538</b>	85,508
Insurance	<b>144,078</b>	143,300
Other	<b>41,447</b>	37,603
<b>Total Group</b>	<b>978,951</b>	991,574
<b>Segment customer deposits</b>		
Retail	<b>242,342</b>	235,591
Wholesale <sup>2</sup>	<b>84,999</b>	92,951
Commercial <sup>2</sup>	<b>32,702</b>	31,311
Wealth and International	<b>38,906</b>	32,784
Other	<b>970</b>	996
<b>Total Group</b>	<b>399,919</b>	393,633

<sup>1</sup> Segment total assets as at 31 December 2010 have been restated to reflect the reclassification of certain central adjustments.

<sup>2</sup> As explained on page 148, the Group's Commercial business is now reviewed as a separate segment to Wholesale; comparative figures have been restated accordingly.

	<b>As at 30 June 2011 £m</b>
<b>Segment external liabilities</b>	
Retail	<b>279,178</b>
Wholesale	<b>250,811</b>
Commercial	<b>33,303</b>
Wealth and International	<b>73,106</b>
Insurance	<b>132,738</b>
Other	<b>164,269</b>
<b>Total Group</b>	<b>933,405</b>

No comparatives have been provided in respect of segment external liabilities as this information has not previously been provided to the chief operating decision maker.

**2. Segmental analysis** (continued)

Half-year to 30 June 2010	Net interest income £m	Other income £m	Total income £m	Profit (loss) before tax £m	External revenue £m	Inter-segment revenue £m
Retail	4,636	836	5,472	2,495	7,208	(1,736)
Wholesale <sup>1</sup>	1,576	1,988	3,564	585	1,484	2,080
Commercial <sup>1</sup>	571	227	798	157	790	8
Wealth and International	596	605	1,201	(1,609)	1,617	(416)
Insurance	(136)	1,320	1,184	469	1,454	(270)
Other	(332)	855	523	(494)	189	334
Group – combined businesses basis	6,911	5,831	12,742	1,603	12,742	–
Insurance grossing adjustment	321	2,686	3,007	–		
Integration costs	–	–	–	(804)		
Volatility arising in insurance businesses	(11)	(188)	(199)	(199)		
Fair value unwind	(183)	413	230	–		
Amortisation of purchased intangibles	–	–	–	(323)		
Pension curtailment gain	–	–	–	1,019		
Group – statutory	7,038	8,742	15,780	1,296		

<sup>1</sup> As explained on page 148, the Group's Commercial business is now reviewed as a separate segment to Wholesale; comparative figures have been restated accordingly.

Half-year to 31 December 2010	Net interest income £m	Other income £m	Total income £m	Profit (loss) before tax £m	External Revenue £m	Inter-segment revenue £m
Retail	4,742	771	5,513	2,221	6,395	(882)
Wholesale <sup>1</sup>	1,675	1,691	3,366	2,333	1,107	2,259
Commercial <sup>1</sup>	604	230	834	182	588	246
Wealth and International	580	555	1,135	(3,215)	1,383	(248)
Insurance	(127)	1,494	1,367	633	1,726	(359)
Other	(563)	(408)	(971)	(1,545)	45	(1,016)
Group – combined businesses basis	6,911	4,333	11,244	609	11,244	–
Insurance grossing adjustment	(1,270)	16,476	15,206	–		
Integration costs	–	–	–	(849)		
Volatility arising in insurance businesses	(15)	520	505	505		
Fair value unwind	(118)	850	732	–		
Amortisation of purchased intangibles	–	–	–	(306)		
Pension curtailment loss	–	–	–	(109)		
Customer goodwill payments provision	–	–	–	(500)		
Loss on disposal of businesses	–	–	–	(365)		
Group – statutory	5,508	22,179	27,687	(1,015)		

<sup>1</sup> As explained on page 148, the Group's Commercial business is now reviewed as a separate segment to Wholesale; comparative figures have been restated accordingly.

**3. Other income**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
Fee and commission income:			
Current account fees	530	506	580
Credit and debit card fees	402	407	405
Other fees and commissions	1,221	1,306	1,211
	<b>2,153</b>	2,219	2,196
Fee and commission expense	<b>(690)</b>	(812)	(870)
Net fee and commission income	<b>1,463</b>	1,407	1,326
Net trading income	<b>3,118</b>	1,245	14,479
Insurance premium income	<b>4,125</b>	4,300	3,848
Gains on capital transactions <sup>1</sup>	-	423	-
Other	<b>1,508</b>	1,367	2,526
Other operating income	<b>1,508</b>	1,790	2,526
<b>Total other income</b>	<b>10,214</b>	8,742	22,179

<sup>1</sup> During 2010, as part of the Group's management of capital, the Group exchanged certain existing subordinated debt securities for new subordinated debt securities and ordinary shares. These exchanges resulted in a gain on extinguishment of the existing liabilities of £423 million in the half-year to 30 June 2010, being the difference between the carrying amount of the securities extinguished and the fair value of the new securities issued together with related fees and costs.

**4. Operating expenses**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 <sup>1</sup> £m	Half-year to 31 Dec 2010 <sup>1</sup> £m
<b>Administrative expenses</b>			
Staff costs:			
Salaries	2,294	2,139	2,181
Social security costs	214	192	204
Pensions and other post-retirement benefit schemes:			
Net curtailment (gains) losses <sup>2</sup>	–	(1,019)	109
Other	209	347	281
	209	(672)	390
Restructuring costs	15	70	49
Other staff costs	439	563	506
	<b>3,171</b>	<b>2,292</b>	<b>3,330</b>
Premises and equipment:			
Rent and rates	282	312	290
Hire of equipment	11	11	7
Repairs and maintenance	93	97	102
Other	146	149	209
	<b>532</b>	<b>569</b>	<b>608</b>
Other expenses:			
Communications and data processing	530	575	551
Advertising and promotion	210	172	190
Professional fees	327	257	485
Customer goodwill payments provision	–	–	500
Other	489	524	583
	<b>1,556</b>	<b>1,528</b>	<b>2,309</b>
	<b>5,259</b>	<b>4,389</b>	<b>6,247</b>
<b>Depreciation and amortisation</b>	<b>1,104</b>	<b>1,220</b>	<b>1,212</b>
<b>Impairment of tangible fixed assets<sup>3</sup></b>	<b>65</b>	<b>202</b>	<b>–</b>
<b>Total operating expenses, excluding payment protection insurance provision</b>	<b>6,428</b>	<b>5,811</b>	<b>7,459</b>
Payment protection insurance provision (note 22)	3,200	–	–
<b>Total operating expenses</b>	<b>9,628</b>	<b>5,811</b>	<b>7,459</b>

<sup>1</sup> During 2011, the Group has reviewed the analysis of certain cost items and as a result has reclassified some items of expenditure; comparatives for 2010 have been restated accordingly.

<sup>2</sup> Following changes by the Group to the terms of its UK defined benefit pension schemes in the half-year to 30 June 2010, all future increases to pensionable salary are capped each year at the lower of: Retail Prices Index inflation; each employee's actual percentage increase in pay; and 2 per cent of pensionable pay. These changes led to a curtailment gain of £1,019 million recognised in the income statement in the half-year to 30 June 2010.

During the second half of 2010 there was a change in commutation factors in certain defined benefit schemes; this led to a curtailment loss of £109 million recognised in the income statement in the half-year to 31 December 2010.

<sup>3</sup> £65 million (half-year to 30 June 2010: £52 million) of the impairment of tangible fixed assets related to integration activities.

**5. Impairment**

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
Impairment losses on loans and receivables:			
Loans and advances to banks	–	(6)	(7)
Loans and advances to customers	4,441	5,378	5,349
Debt securities classified as loans and receivables	16	9	48
<b>Impairment losses on loans and receivables (note 12)</b>	<b>4,457</b>	5,381	5,390
Impairment of available-for-sale financial assets	32	45	61
Other credit risk provisions	2	(3)	78
<b>Total impairment charged to the income statement</b>	<b>4,491</b>	5,423	5,529

**6. Loss on disposal of businesses**

In the second half of 2010, the Group reached agreement to dispose of its interests in two wholly-owned subsidiary companies through which an oil drilling rig construction business acquired through a previous lending relationship operated; the sale was completed in January 2011. These companies, which had gross assets of £860 million, were sold to Seadrill Limited; a loss of £365 million arose on disposal, which was recognised in the half-year to 31 December 2010.

## 7. Taxation

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

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
(Loss) profit before tax	<u>(3,251)</u>	<u>1,296</u>	<u>(1,015)</u>
Tax credit (charge) thereon at UK corporation tax rate of 26.5 per cent (2010: 28 per cent)	<b>862</b>	(363)	284
Factors affecting tax charge:			
UK corporation tax rate change	<b>(175)</b>	–	(137)
Disallowed and non-taxable items	<b>34</b>	131	(126)
Overseas tax rate differences	<b>15</b>	(267)	401
Gains exempted or covered by capital losses	<b>51</b>	22	43
Policyholder interests	<b>99</b>	(8)	(219)
Tax losses where deferred tax not previously recognised	<b>148</b>	(123)	(364)
Adjustments in respect of previous years	<b>(63)</b>	32	186
Effect of profit (loss) in joint ventures and associates	<b>4</b>	(17)	(8)
Other items	<u>(2)</u>	<u>(37)</u>	<u>31</u>
<b>Tax credit (charge)</b>	<u><b>973</b></u>	<u>(630)</u>	<u>91</u>

On 23 March 2011, the Government announced that the corporation tax rate applicable from 1 April 2011 would be 26 per cent. This change passed into legislation on 29 March 2011. The enacted reduction in the main rate of corporation tax from 28 per cent to 27 per cent with effect from 1 April 2011 had been incorporated in the Group's deferred tax calculations as at 31 December 2010. The additional change in the main rate of corporation tax from 27 per cent to 26 per cent has resulted in a further reduction in the Group's net deferred tax asset at 30 June 2011 of £181 million, comprising the £175 million charge included in the income statement and a £6 million charge included in equity.

The proposed further reductions in the rate of corporation tax by 1 per cent per annum to 23 per cent by 1 April 2014 are expected to be enacted separately each year starting in the second half of 2011. The effect of these further changes upon the Group's deferred tax balances and leasing business cannot be reliably quantified at this stage.

**8. (Loss) earnings per share**

	<b>Half-year to 30 June 2011</b>	Half-year to 30 June 2010	Half-year to 31 Dec 2010
<b>Basic</b>			
(Loss) profit attributable to equity shareholders	<b>£(2,305)m</b>	£596m	£(916)m
Weighted average number of ordinary shares in issue	<b>68,220m</b>	66,151m	68,067m
(Loss) earnings per share	<b>(3.4)p</b>	0.9p	(1.3)p
<b>Fully diluted</b>			
(Loss) profit attributable to equity shareholders	<b>£(2,305)m</b>	£596m	£(916)m
Weighted average number of ordinary shares in issue	<b>68,220m</b>	66,425m	68,067m
(Loss) earnings per share	<b>(3.4)p</b>	0.9p	(1.3)p

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

	<b>As at 30 June 2011 £m</b>	As at 31 Dec 2010 £m
Trading assets	<b>22,291</b>	23,707
Other financial assets at fair value through profit or loss:		
Loans and advances to customers	<b>121</b>	325
Debt securities	<b>41,369</b>	41,946
Equity shares	<b>91,400</b>	90,213
	<b>132,890</b>	132,484
<b>Total trading and other financial assets at fair value through profit or loss</b>	<b>155,181</b>	156,191

Included in the above is £130,060 million (31 December 2010: £129,702 million) of assets relating to the insurance businesses.

**10. Derivative financial instruments**

	<b>As at 30 June 2011</b>		<b>As at 31 December 2010</b>	
	<b>Fair value of assets £m</b>	<b>Fair value of liabilities £m</b>	<b>Fair value of assets £m</b>	<b>Fair value of liabilities £m</b>
<b>Hedging</b>				
Derivatives designated as fair value hedges	<b>5,046</b>	<b>834</b>	4,972	1,235
Derivatives designated as cash flow hedges	<b>2,455</b>	<b>2,766</b>	2,432	3,163
Derivatives designated as net investment hedges	<b>2</b>	<b>–</b>	2	–
	<b>7,503</b>	<b>3,600</b>	7,406	4,398
<b>Trading and other</b>				
Exchange rate contracts	<b>7,993</b>	<b>3,861</b>	8,811	4,551
Interest rate contracts	<b>26,516</b>	<b>26,876</b>	31,131	31,670
Credit derivatives	<b>110</b>	<b>124</b>	256	207
Embedded equity conversion feature	<b>941</b>	<b>–</b>	1,177	–
Equity and other contracts	<b>2,193</b>	<b>1,588</b>	1,996	1,332
	<b>37,753</b>	<b>32,449</b>	43,371	37,760
<b>Total recognised derivative assets/liabilities</b>	<b>45,256</b>	<b>36,049</b>	50,777	42,158

The Group reduces exposure to credit risk by using master netting agreements and by obtaining cash collateral. Of the derivative assets of £45,256 million at 30 June 2011 (31 December 2010: £50,777 million), £28,008 million (31 December 2010: £31,740 million) 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 remaining derivative assets of £17,248 million (31 December 2010: £19,037 million), cash collateral of £3,498 million (31 December 2010: £1,429 million) was held and a further £9,445 million (31 December 2010: £8,385 million) was due from Organisation for Economic Co-operation and Development (OECD) banks.

The embedded equity conversion feature of £941 million (31 December 2010: £1,177 million) reflects the value of the equity conversion feature contained in the Enhanced Capital Notes issued by the Group in 2009; the loss of £236 million arising from the change in fair value in the half-year to 30 June 2011 (half-year to 30 June 2010: gain of £192 million; half-year to 31 December 2010: loss of £812 million) is included within net trading income.



**11. Loans and advances to customers**

	<b>As at 30 June 2011 £m</b>	As at 31 Dec 2010 £m
Agriculture, forestry and fishing	<b>5,674</b>	5,558
Energy and water supply	<b>3,850</b>	3,576
Manufacturing	<b>11,925</b>	11,495
Construction	<b>9,369</b>	7,904
Transport, distribution and hotels	<b>33,752</b>	34,176
Postal and communications	<b>1,554</b>	1,908
Property companies	<b>70,239</b>	78,263
Financial, business and other services	<b>69,942</b>	59,363
Personal:		
Mortgages	<b>353,724</b>	356,261
Other	<b>32,452</b>	36,967
Lease financing	<b>8,145</b>	8,291
Hire purchase	<b>6,420</b>	7,208
	<b>607,046</b>	610,970
Allowance for impairment losses on loans and advances (note 12)	<b>(19,203)</b>	(18,373)
<b>Total loans and advances to customers</b>	<b>587,843</b>	592,597

Loans and advances to customers include advances securitised under the Group's securitisation and covered bond programmes. Further details are given in note 13 on page 159.

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

	<b>Half-year to 30 June 2011 £m</b>	Half-year to 30 June 2010 £m	Half-year to 31 Dec 2010 £m
Opening balance	<b>18,951</b>	15,380	17,216
Exchange and other adjustments	<b>693</b>	(97)	209
Advances written off	<b>(4,555)</b>	(3,406)	(3,719)
Recoveries of advances written off in previous years	<b>123</b>	86	130
Unwinding of discount	<b>(112)</b>	(128)	(275)
Charge to the income statement (note 5)	<b>4,457</b>	5,381	5,390
<b>Balance at end of period</b>	<b>19,557</b>	17,216	18,951
In respect of:			
Loans and advances to banks	<b>14</b>	94	20
Loans and advances to customers (note 11)	<b>19,203</b>	16,688	18,373
Debt securities (note 14)	<b>340</b>	434	558
<b>Balance at end of period</b>	<b>19,557</b>	17,216	18,951

**13. 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.

	As at 30 June 2011		As at 31 December 2010	
	Gross assets securitised £m	Notes in issue £m	Gross assets securitised £m	Notes in issue £m
<i>Securitisation programmes</i>				
UK residential mortgages	138,443	105,003	146,200	114,428
Commercial loans	12,456	9,925	11,860	8,936
Irish residential mortgages	6,067	6,348	6,007	6,191
Credit card receivables	6,661	4,931	7,327	3,856
Dutch residential mortgages	4,308	4,211	4,526	4,316
Personal loans	–	–	3,012	2,011
PPP/PFI and project finance loans	802	115	776	110
Motor vehicle loans	1,628	1,697	926	975
	<b>170,365</b>	<b>132,230</b>	<b>180,634</b>	<b>140,823</b>
Less held by the Group		<b>(93,664)</b>		<b>(100,081)</b>
<b>Total securitisation programmes (note 18)</b>		<b>38,566</b>		<b>40,742</b>
<i>Covered bond programmes</i>				
Residential mortgage-backed	89,085	65,566	93,651	73,458
Social housing loan-backed	3,220	2,192	3,317	2,181
	<b>92,305</b>	<b>67,758</b>	<b>96,968</b>	<b>75,639</b>
Less held by the Group		<b>(28,504)</b>		<b>(43,489)</b>
<b>Total covered bond programmes (note 18)</b>		<b>39,254</b>		<b>32,150</b>
<b>Total securitisation and covered bond programmes</b>		<b>77,820</b>		<b>72,892</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. In addition to the SPEs detailed above, the Group sponsors four conduit programmes: Argento, Cancara, Grampian and Landale.

**Covered bond programmes**

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

Cash deposits of £41,621 million (31 December 2010: £36,579 million) held by the Group are restricted in use to repayment of the debt securities issued by the SPEs, the term advances relating to covered bonds and other legal obligations.

**14. Debt securities classified as loans and receivables**

Debt securities classified as loans and receivables comprise:

	<b>As at 30 June 2011 £m</b>	As at 31 Dec 2010 £m
Asset-backed securities:		
Mortgage-backed securities	<b>8,282</b>	11,650
Other asset-backed securities	<b>6,659</b>	12,827
Corporate and other debt securities	<b>920</b>	1,816
	<b>15,861</b>	26,293
Allowance for impairment losses (note 12)	<b>(340)</b>	(558)
<b>Total</b>	<b>15,521</b>	25,735

**15. Available-for-sale financial assets**

	<b>As at 30 June 2011 £m</b>	As at 31 Dec 2010 £m
Asset-backed securities	<b>4,869</b>	9,512
Other debt securities:		
Bank and building society certificates of deposit	<b>552</b>	407
Government securities	<b>15,789</b>	12,552
Other public sector securities	<b>37</b>	29
Corporate and other debt securities	<b>7,180</b>	12,132
	<b>23,558</b>	25,120
Equity shares	<b>2,012</b>	2,255
Treasury bills and other bills	<b>2,354</b>	6,068
<b>Total</b>	<b>32,793</b>	42,955

**16. Credit market exposures**

The Group's credit market exposures primarily relate to asset-backed securities exposures held in the Wholesale division. These exposures are classified as loans and receivables, available-for-sale financial assets or trading and other financial assets at fair value through profit or loss depending on the nature of the investment.

	Loans and receivables £m	Available- for-sale £m	Fair value through profit or loss £m	Net exposure at 30 June 2011 £m	Net exposure at 31 Dec 2010 £m
Mortgage-backed securities					
US residential	4,125	–	–	4,125	4,242
Non-US residential	2,594	2,508	92	5,194	7,898
Commercial	1,456	798	–	2,254	3,516
	8,175	3,306	92	11,573	15,656
Collateralised debt obligations	1,644	531	141	2,316	5,180
Federal family education loan programme student loans (FFELP)	4,026	150	–	4,176	7,777
Personal sector	654	463	–	1,117	3,967
Other asset-backed securities	285	383	12	680	1,035
Total uncovered asset-backed securities	14,784	4,833	245	19,862	33,615
Negative basis <sup>1</sup>	–	36	169	205	1,109
<b>Total Wholesale asset-backed securities</b>	<b>14,784</b>	<b>4,869</b>	<b>414</b>	<b>20,067</b>	<b>34,724</b>
Direct	10,921	1,850	414	13,185	22,296
Conduits	3,863	3,019	–	6,882	12,428
<b>Total Wholesale asset-backed securities</b>	<b>14,784</b>	<b>4,869</b>	<b>414</b>	<b>20,067</b>	<b>34,724</b>

<sup>1</sup> Negative basis means bonds held with separate matching credit default swap (CDS) protection.

**Exposures to monolines**

At 30 June 2011, the Group had no direct exposure to sub-investment grade monolines on credit default swap (CDS) contracts. Its exposure to investment grade monolines through CDS contracts was £9 million (gross exposure: £182 million) and through wrapped loans and receivables was £187 million (gross exposure: £288 million).

The exposure to monolines arising from negative basis trades is calculated as the mark-to-market of the CDS protection purchased from the monoline insurer after credit valuation adjustments. The exposure to monolines on wrapped loans and receivables and bonds is the internal assessment of amounts that will be recovered on interest and principal shortfalls.

In addition, the Group has £1,558 million (31 December 2010: £1,985 million) of monoline wrapped bonds and £267 million (31 December 2010: £425 million) of monoline liquidity commitments on which the Group currently places no reliance on the guarantor.

**16. Credit market exposures** (continued)**Credit ratings**

An analysis of external credit ratings as at 30 June 2011 of the Wholesale division's asset-backed security portfolio by asset class is provided below.

<b>Asset class</b>	<b>Net exposure £m</b>	<b>AAA £m</b>	<b>AA £m</b>	<b>A £m</b>	<b>BBB £m</b>	<b>BB £m</b>	<b>B £m</b>	<b>Below B £m</b>
Mortgage-backed securities								
US residential								
Prime	789	238	403	88	47	11	2	-
Alt-A	3,336	1,587	767	585	311	72	14	-
Sub-prime	-	-	-	-	-	-	-	-
	<u>4,125</u>	<u>1,825</u>	<u>1,170</u>	<u>673</u>	<u>358</u>	<u>83</u>	<u>16</u>	<u>-</u>
Non-US residential	5,194	3,004	949	1,116	54	71	-	-
Commercial	2,254	137	786	835	405	86	-	5
	<u>11,573</u>	<u>4,966</u>	<u>2,905</u>	<u>2,624</u>	<u>817</u>	<u>240</u>	<u>16</u>	<u>5</u>
Collateralised debt obligations	2,316	437	689	530	224	256	148	32
FFELP	4,176	4,072	-	46	40	18	-	-
Personal sector	1,117	805	12	238	62	-	-	-
Other asset-backed securities	680	63	42	253	83	238	-	1
Total uncovered asset-backed securities	<u>19,862</u>	<u>10,343</u>	<u>3,648</u>	<u>3,691</u>	<u>1,226</u>	<u>752</u>	<u>164</u>	<u>38</u>
Negative basis <sup>2</sup>								
Monolines	169	-	169	-	-	-	-	-
Banks	36	36	-	-	-	-	-	-
	<u>205</u>	<u>36</u>	<u>169</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Total as at 30 June 2011</b>	<u><b>20,067</b></u>	<u><b>10,379</b></u>	<u><b>3,817</b></u>	<u><b>3,691</b></u>	<u><b>1,226</b></u>	<u><b>752</b></u>	<u><b>164</b></u>	<u><b>38</b></u>
Total as at 31 Dec 2010	34,724	20,805	7,310	3,713	1,764	763	147	222

<sup>1</sup> Collateralised loan obligations.

<sup>2</sup> The external credit rating is based on the bond ignoring the benefit of the CDS.

**17. Customer deposits**

	<b>As at 30 June 2011 £m</b>	As at 31 Dec 2010 £m
Sterling:		
Non-interest bearing current accounts	<b>20,370</b>	21,516
Interest bearing current accounts	<b>73,388</b>	73,859
Savings and investment accounts	<b>223,498</b>	215,733
Other customer deposits	<b>49,184</b>	50,414
Total sterling	<b>366,440</b>	361,522
Currency	<b>33,479</b>	32,111
<b>Total</b>	<b>399,919</b>	393,633

Included above are liabilities of £5,013 million (31 December 2010: £11,145 million) in respect of securities sold under repurchase agreements.

**18. Debt securities in issue**

	<u>As at 30 June 2011</u>			<u>As at 31 December 2010</u>		
	At fair value through profit or loss £m	At amortised cost £m	Total £m	At fair value through profit or loss £m	At amortised cost £m	Total £m
Medium-term notes issued	7,485	77,445	84,930	6,665	80,975	87,640
Covered bonds (note 13)	–	39,254	39,254	–	32,150	32,150
Certificates of deposit	–	46,580	46,580	–	42,276	42,276
Securitisation notes (note 13)	–	38,566	38,566	–	40,742	40,742
Commercial paper	–	29,349	29,349	–	32,723	32,723
	<b>7,485</b>	<b>231,194</b>	<b>238,679</b>	6,665	228,866	235,531

**19. Subordinated liabilities**

The Group's subordinated liabilities are comprised as follows:

	<b>As at 30 June 2011 £m</b>	<b>As at 31 Dec 2010 £m</b>
Preference shares	1,109	1,165
Preferred securities	4,614	4,538
Undated subordinated liabilities	2,048	2,002
Enhanced capital notes	9,174	9,235
Dated subordinated liabilities	<u>18,640</u>	<u>19,292</u>
<b>Total subordinated liabilities</b>	<u><b>35,585</b></u>	<u><b>36,232</b></u>

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

	<b>£m</b>
At 1 January 2011	<b>36,232</b>
Repurchases and redemptions during the period	<b>(924)</b>
Foreign exchange and other movements	<u><b>277</b></u>
<b>At 30 June 2011</b>	<u><b>35,585</b></u>

**20. Share capital**

Movements in share capital during the period were as follows:

	<b>Number of shares (million)</b>	<b>£m</b>
<b>Ordinary shares of 10p each</b>		
At 1 January 2011	68,074	6,807
Issued in the period	<u>652</u>	<u>66</u>
At 30 June 2011	<u><b>68,726</b></u>	<u><b>6,873</b></u>
<b>Limited voting ordinary shares of 10p each</b>		
At 1 January and 30 June 2011	<u>81</u>	<u>8</u>
<b>Total share capital</b>		<u><b>6,881</b></u>

The shares issued in the period were in respect of employee share schemes.

**21. 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 2011	16,291	(285)	(391)	12,251	11,575	11,380
Issue of ordinary shares	250	-	-	-	-	-
Loss for the period	-	-	-	-	-	(2,305)
Movement in treasury shares	-	-	-	-	-	(282)
Value of employee services	-	-	-	-	-	331
Change in fair value of available-for-sale assets (net of tax)	-	374	-	-	374	-
Change in fair value of hedging derivatives (net of tax)	-	-	364	-	364	-
Transfers to income statement (net of tax)	-	48	79	-	127	-
Exchange and other	-	-	-	(77)	(77)	-
<b>At 30 June 2011</b>	<b>16,541</b>	<b>137</b>	<b>52</b>	<b>12,174</b>	<b>12,363</b>	<b>9,124</b>

**22. Payment protection insurance**

There has been extensive scrutiny of the Payment Protection Insurance (PPI) market in recent years.

In October 2010, the UK Competition Commission confirmed its decision to prohibit the active sale of PPI by a distributor to a customer within seven days of a sale of credit. This followed the completion of its formal investigation into the supply of PPI services (other than store card PPI) to non-business customers in the UK in January 2009 and a referral of the proposed prohibition to the Competition Appeal Tribunal. The Competition Commission consulted on the wording of a draft Order to implement its findings from October 2010, and published the final Order on 24 March 2011 which became effective on 6 April 2011. Following an earlier decision to stop selling single premium PPI products, the Group ceased to offer PPI products to its customers in July 2010.

On 29 September 2009 the FSA announced that several firms had agreed to carry out reviews of past sales of single premium loan protection insurance. Lloyds Banking Group agreed in principle that it would undertake a review in relation to sales of single premium loan protection insurance made through its branch network since 1 July 2007. That review will now form part of the ongoing PPI work referred to below.

On 1 July 2008, the Financial Ombudsman Service (FOS) referred concerns regarding the handling of PPI complaints to the Financial Services Authority (FSA) as an issue of wider implication. On 29 September 2009 and 9 March 2010, the FSA issued consultation papers on PPI complaints handling. The FSA published its Policy Statement on 10 August 2010, setting out evidential provisions and guidance on the fair assessment of a complaint and the calculation of redress, as well as a requirement for firms to reassess historically rejected complaints which had to be implemented by 1 December 2010.

On 8 October 2010, the British Bankers' Association (BBA), the principal trade association for the UK banking and financial services sector, filed an application for permission to seek judicial review against the FSA and the FOS. The BBA sought an order quashing the FSA Policy Statement and an order quashing the decision of the FOS to determine PPI sales in accordance with the guidance published on its website in November 2008.



## **22. Payment protection insurance (continued)**

The Judicial Review hearing was held in late January 2011 and on 20 April 2011 judgment was handed down by the High Court dismissing the BBA's application. On 9 May 2011, the BBA confirmed that the banks and the BBA did not intend to appeal the judgment.

Since publication of the judgment, the Group has been in discussions with the FSA with a view to seeking clarity around the detailed implementation of the Policy Statement. As a result, and given the initial analysis that the Group has conducted of compliance with applicable sales standards, which is continuing, the Group has concluded that there are certain circumstances where customer contact and/or redress will be appropriate. Accordingly the Group has made a provision in its income statement for the half-year to 30 June 2011 of £3,200 million in respect of the anticipated costs of such contact and/or redress, including administration expenses. There are still a number of uncertainties as to the eventual costs from any such contact and/or redress given the inherent difficulties of assessing the impact of detailed implementation of the Policy Statement for all PPI complaints, uncertainties around the ultimate emergence period for complaints, the availability of supporting evidence and the activities of claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs.

## **23. Contingent liabilities and commitments**

### ***Interchange fees***

The European Commission has adopted a formal decision finding that an infringement of European Commission competition laws has arisen from arrangements whereby MasterCard issuers charged a uniform fallback interchange fee in respect of cross-border transactions in relation to the use of a MasterCard or Maestro branded payment card. The European Commission has required that the fee be reduced to zero for relevant cross-border transactions within the European Economic Area. This decision has been appealed to the General Court of the European Union (the General Court). Lloyds TSB Bank plc and Bank of Scotland plc (along with certain other MasterCard issuers) have successfully applied to intervene in the appeal in support of MasterCard's position that the arrangements for the charging of a uniform fallback interchange fee are compatible with European Union competition laws. The OFT has also intervened in the General Court appeal supporting the European Commission position. An oral hearing took place on 8 July 2011 but judgment is not expected for six to twelve months. MasterCard has reached an understanding with the European Commission on a new methodology for calculating intra-European Economic Area multi-lateral interchange fees on an interim basis pending the outcome of the appeal.

Meanwhile, the European Commission is pursuing an investigation with a view to deciding whether arrangements adopted by Visa for the levying of uniform fallback interchange fees in respect of cross-border payment transactions also infringe European Union competition laws. In this regard Visa reached an agreement with the European Commission to reduce the level of interchange for cross-border debit card transactions to the interim levels agreed by MasterCard. The UK's OFT has also commenced similar investigations relating to the interchange fees in respect of domestic transactions in relation to both the MasterCard and Visa payment schemes. The ultimate impact of the investigations on the Group can only be known at the conclusion of these investigations and any relevant appeal proceedings.

**23. Contingent liabilities and commitments (continued)**

***US sanctions***

In January 2009 Lloyds TSB Bank plc announced the settlement it had reached with the US Department of Justice and the New York County District Attorney's Office in relation to their investigations into historic US dollar payment practices involving countries, persons or entities subject to the economic sanctions administered by the US Office of Foreign Assets Control (OFAC). On 22 December 2009 OFAC announced the settlement it had reached with Lloyds TSB Bank plc in relation to its investigation and confirmed that the settlement sum due to OFAC had been fully satisfied by Lloyds TSB Bank plc's payment to the Department of Justice and the New York District Attorney's Office. No further enforcement actions are expected in relation to the matters set out in the settlement agreements.

On 26 February 2009, a purported shareholder filed a derivative civil action in the Supreme Court of New York, Nassau County against certain current and former directors, and nominally against Lloyds TSB Bank plc and Lloyds Banking Group plc, seeking various forms of relief. The derivative action is at an early stage and settlement is being discussed and the ultimate outcome is not expected to have a material impact on the Group.

***Interbank offered rate setting investigations***

Several government agencies in the UK, US and overseas, including the US Commodity Futures Trading Commission, the US SEC, the US Department of Justice and the FSA as well as the European Commission, are conducting investigations into submissions made by panel members to the bodies that set various interbank offered rates. The Group, and/or its subsidiaries, were (at the relevant time) and remain members of various panels that submit data to these bodies. The Group has received requests from some government agencies for information and is co-operating with their investigations. In addition, recently the Group has been named in private purported class action suits in the US with regard to the setting of London interbank offered rates (LIBOR) by members of the LIBOR setting panel. It is currently not possible to predict the scope and ultimate outcome of the various regulatory investigations or purported private class action suits, including the timing and scale of the potential impact of any investigations and class action suits on the Group.

***Financial Services Compensation Scheme (FSCS)***

The FSCS is the UK's independent statutory compensation fund for customers of authorised financial services firms and pays compensation if a firm is unable to pay claims against it. The FSCS is funded by levies on the industry (and recoveries and borrowings where appropriate). The levies raised comprise both management expenses levies and, where necessary, compensation levies on authorised firms.

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 borrowings with HM Treasury, which total circa £20 billion, are on an interest-only basis until 31 March 2012 and the FSCS and HM Treasury are currently discussing the terms for refinancing these borrowings to take effect from 1 April 2012.

Whilst it is expected that the substantial majority of the principal 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, to the extent that there remains a shortfall, the FSCS will raise compensation levies on all deposit-taking participants. The amount of any future compensation levies also depends on a number of factors including the level of protected deposits and the population of deposit-taking participants and will be determined at a later date. As such, although the Group's share of such compensation levies could be significant, the Group has not recognised a provision in respect of them in these financial statements.

**23. Contingent liabilities and commitments (continued)**

***Litigation in relation to insurance branch business in Germany***

Clerical Medical Investment Group Limited is subject to claims in the German courts, relating to a number of aspects of with-profits policies issued by Clerical Medical but sold by independent intermediaries in Germany, principally during the late 1990s and early 2000s. Where appropriate the Group is defending the claims and any subsequent appeals, including appeals to the Federal Court of Justice. It is not currently practicable to reliably estimate the potential financial effects, which could be significant, as these can only be known after the final determination of the proceedings, the timing of which remains uncertain.

***FSA investigation into Bank of Scotland***

As previously disclosed, in 2009 the FSA commenced a supervisory review into HBOS. The supervisory review has now been superseded as the FSA has commenced enforcement proceedings against Bank of Scotland plc in relation to its Corporate division pre 2009. The proceedings are ongoing and the Group is co-operating fully. It is too early to predict the outcome or estimate reliably any potential financial effects of the enforcement proceedings but they are not currently expected to be material.

***Other legal actions and regulatory matters***

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

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

**23. Contingent liabilities and commitments** (continued)**Contingent liabilities and commitments arising from the banking business**

	<b>As at 30 June 2011 £m</b>	<b>As at 31 Dec 2010 £m</b>
<b>Contingent liabilities</b>		
Acceptances and endorsements	<b>55</b>	48
Other:		
Other items serving as direct credit substitutes	<b>1,297</b>	1,319
Performance bonds and other transaction-related contingencies	<b>2,762</b>	2,812
	<b>4,059</b>	4,131
<b>Total contingent liabilities</b>	<b>4,114</b>	4,179
<b>Commitments</b>		
Documentary credits and other short-term trade-related transactions	<b>172</b>	255
Forward asset purchases and forward deposits placed	<b>716</b>	887
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	<b>9,360</b>	8,113
Other commitments	<b>58,146</b>	60,528
	<b>67,506</b>	68,641
1 year or over original maturity	<b>41,518</b>	47,515
<b>Total commitments</b>	<b>109,912</b>	117,298

**24. Capital ratios**

	<b>As at 30 June 2011 £m</b>	<b>As at 31 Dec 2010 £m</b>
<b>Capital resources</b>		
<b>Core tier 1</b>		
Shareholders' equity	<b>44,909</b>	46,061
Regulatory adjustments:		
Non-controlling interests	<b>110</b>	317
Regulatory post-retirement benefit adjustments	<b>(625)</b>	(1,052)
Available-for-sale revaluation reserve	<b>(137)</b>	285
Cash flow hedging reserve	<b>(52)</b>	391
Other items	<b>(208)</b>	(11)
	<b>43,997</b>	45,991
<b>Less: deductions from core tier 1</b>		
Goodwill and other intangible assets	<b>(4,295)</b>	(4,406)
Excess of expected losses over impairment allowances at 50 per cent	<b>(627)</b>	–
Securitisation positions at 50 per cent	<b>(191)</b>	(214)
<b>Core tier 1 capital</b>	<b>38,884</b>	41,371
Preference share capital <sup>1</sup>	<b>1,545</b>	1,507
Preferred securities <sup>1</sup>	<b>4,365</b>	4,338
<b>Less: deductions from tier 1</b>		
Material holdings in financial companies at 50 per cent	<b>(233)</b>	(69)
<b>Total tier 1 capital</b>	<b>44,561</b>	47,147
<b>Tier 2</b>		
Available-for-sale revaluation reserve in respect of equities	<b>308</b>	462
Undated subordinated debt	<b>1,951</b>	1,968
Eligible provisions	<b>1,506</b>	2,468
Dated subordinated debt	<b>22,806</b>	23,167
<b>Less: deductions from tier 2</b>		
Excess of expected losses over impairment allowances at 50 per cent	<b>(627)</b>	–
Securitisation positions at 50 per cent	<b>(191)</b>	(214)
Material holdings in financial companies at 50 per cent	<b>(233)</b>	(69)
<b>Total tier 2 capital</b>	<b>25,520</b>	27,782
<b>Supervisory deductions</b>		
Unconsolidated investments – life	<b>(10,113)</b>	(10,042)
Unconsolidated investments – general insurance and other	<b>(2,308)</b>	(3,070)
<b>Total supervisory deductions</b>	<b>(12,421)</b>	(13,112)
<b>Total capital resources</b>	<b>57,660</b>	61,817
<b>Risk-weighted assets</b>	<b>383,267</b>	406,372
<b>Core tier 1 capital ratio</b>	<b>10.1%</b>	10.2%
<b>Tier 1 capital ratio</b>	<b>11.6%</b>	11.6%
<b>Total capital ratio</b>	<b>15.0%</b>	15.2%

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

**24. Capital ratios** (continued)**Tier 1 capital**

Core tier 1 capital has decreased by £2,487 million largely reflecting losses in the period, partially offset by a decrease in respect of the post-retirement benefits adjustment which is now based on the accounting balance sheet. In addition there has been an increase in excess of expected losses over impairment losses, reflecting the gradual reduction of legacy lending that is subject to very high provision levels and replacement with new lending.

**Tier 2 capital**

Tier 2 capital has decreased in the period by £2,262 million reflecting the increase in excess of expected losses over impairment losses, as noted above, and a reduction in eligible provisions.

**Supervisory deductions**

Supervisory deductions mainly consist of investments in subsidiary undertakings that are not within the banking group for regulatory purposes. These investments are primarily the Scottish Widows and Clerical Medical life and pensions businesses together with general insurance business. Also included within deductions for other unconsolidated investments are investments in non-financial entities that are held by the Group's private equity (including venture capital) businesses. During the period there has been a decrease in supervisory deductions primarily due to reduced holdings in private equity businesses, and in some cases changes to the level and/or nature of investments resulting in a reclassification as material holdings.

The movements in core tier 1 and total capital in the year are shown below:

	<b>Core tier 1 £m</b>	<b>Total £m</b>
At 1 January 2011	41,371	61,817
Loss attributable to ordinary shareholders	(2,305)	(2,305)
Decrease in regulatory post-retirement benefit adjustments	427	427
Decrease in goodwill and intangible assets deductions	111	111
Increase in excess of expected losses over impairment losses	(627)	(1,254)
Increase in material holding deduction	–	(328)
Decrease in eligible provisions	–	(962)
Decrease in supervisory deductions from total capital	–	691
Other movements	(93)	(537)
<b>At 30 June 2011</b>	<b>38,884</b>	<b>57,660</b>

**24. Capital ratios (continued)**

	<b>As at 30 June 2011 £m</b>	As at 31 Dec 2010 £m
<b>Risk-weighted assets</b>		
<b>Divisional analysis of risk-weighted assets:</b>		
Retail	<b>109,624</b>	109,254
Wholesale <sup>1</sup>	<b>176,581</b>	196,164
Commercial <sup>1</sup>	<b>26,798</b>	26,552
Wealth and International	<b>56,351</b>	58,714
Group Operations and Central items	<b>13,913</b>	15,688
	<b><u>383,267</u></b>	<u>406,372</u>
<b>Risk type analysis of risk-weighted assets:</b>		
Foundation IRB	<b>98,468</b>	114,490
Retail IRB	<b>106,522</b>	105,475
Other IRB	<b>6,628</b>	14,483
Advanced approach	<b>211,618</b>	234,448
Standardised approach	<b>124,125</b>	124,492
Credit risk	<b>335,743</b>	358,940
Operational risk	<b>31,650</b>	31,650
Market and counterparty risk	<b>15,874</b>	15,782
<b>Total risk-weighted assets</b>	<b><u>383,267</u></b>	<u>406,372</u>

<sup>1</sup> As explained on page 148, the Group's Commercial business is now reviewed as a separate segment to Wholesale; comparative figures have been restated accordingly.

Risk-weighted assets decreased by £23,105 million to £383,267 million. Retail risk-weighted assets remained broadly stable in the period, with the impact of lower lending balances being offset by the impact of a less favourable outlook for house prices compared with the end of 2010. The reduction in Wholesale risk-weighted assets of £19,583 million primarily reflects the balance sheet reductions including treasury asset sales and the run down in other non-core asset portfolios, but also the impact of subdued corporate lending. Risk-weighted assets within Wealth and International have reduced as a result of asset run-off, partly offset by foreign exchange movements.

## **25. Related party transactions**

### **UK Government**

In January 2009, the UK Government through HM Treasury became a related party of the Company following its subscription for ordinary shares issued under a placing and open offer. As at 30 June 2011, HM Treasury held a 40.2 per cent (31 December 2010: 40.6 per cent) interest in the Company's ordinary share capital and consequently HM Treasury remained a related party of the Company during the half-year to 30 June 2011.

From 1 January 2011, in accordance with IAS 24 (Revised), UK Government-controlled entities became related parties of the Group. The Group regards the Bank of England and banks controlled by the UK Government, comprising The Royal Bank of Scotland Group plc, Northern Rock plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

Since 31 December 2010, the Group has had the following significant transactions with the UK Government or UK Government-related entities:

#### ***Government and central bank facilities***

During the half-year to 30 June 2011, the Group has participated in HM Treasury's Credit Guarantee Scheme and the Bank of England's UK Special Liquidity Scheme. HM Treasury's Credit Guarantee Scheme charges a commercial fee for the guarantee of new short and medium-term debt issuance; the fee payable to HM Treasury on guaranteed issues is based on a per annum rate of 50 basis points plus the median five-year credit default swap spread. Further details of the UK Special Liquidity Scheme, including the fees payable to the Bank of England by participants, are available on the Bank of England's website.

At 30 June 2011 the Group had £37,096 million of debt issued under the aforementioned schemes (31 December 2010: £94,925 million). The facilities have various maturity dates, the last of which is in the fourth quarter of 2012. During the half-year to 30 June 2011, the Group repaid £57,829 million under the aforementioned schemes.

#### ***Lending commitments***

The formal lending commitments entered into in connection with the Group's proposed participation in the Government Asset Protection Scheme have now expired and in February 2011, the Company (together with Barclays, Royal Bank of Scotland, HSBC and Santander) announced, as part of the 'Project Merlin' agreement with HM Treasury, its capacity and willingness to increase business lending (including to small and medium-sized enterprises) during 2011.

#### ***Business Growth Fund***

In May 2011 the Group agreed, together with The Royal Bank of Scotland plc (and three other non-related parties), to subscribe 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.

#### ***Other government-related entities***

Other than the transactions referred to above, there were no other significant transactions with the UK Government and 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***

Except as noted above, other related party transactions for the half-year to 30 June 2011 are similar in nature to those for the year ended 31 December 2010.



## 26. Future accounting developments

The following pronouncements will be relevant to the Group but are not applicable for the year ending 31 December 2011 and have not been applied in preparing these condensed interim financial statements. The full impact of these accounting changes is currently being assessed by the Group.

### **Effective for the Group for the year ending 31 December 2012**

- (i) Amendments to IFRS 7 *Financial Instruments Disclosures – Transfers of Financial Assets*. Requires additional disclosures in respect of risk exposures arising from transferred financial assets.
- (ii) Amendments to IAS 12 *Income Taxes – Deferred Tax: Recovery of Underlying Assets*. Introduces a rebuttable presumption that investment property measured at fair value is recovered entirely through sale and that deferred tax in respect of such investment property is recognised on that basis.

### **Effective for the Group for the year ending 31 December 2013**

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

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 impairment of financial assets measured at amortised cost and hedge accounting. Although the effective date of IFRS 9 is currently annual periods beginning on or after 1 January 2013, the IASB has not yet finalised the replacement of IAS 39 and is expected to propose changing the effective date of IFRS 9 to annual periods beginning on or after 1 January 2015 to facilitate the adoption of the entire replacement of IAS 39. 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.

- (ii) Amendments to IAS 1 *Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income*. Requires entities to group items presented in other comprehensive income on the basis of whether they are potentially reclassified to profit or loss subsequently.
- (iii) IFRS 10 *Consolidated Financial Statements*. Supersedes IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities* and establishes principles for the preparation of consolidated financial statements when an entity controls one or more entities.
- (iv) IFRS 11 *Joint Arrangements*. Supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* and establishes principles for financial reporting by parties to a joint arrangement.
- (v) IFRS 12 *Disclosure of Interests in Other Entities*. 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.

**26. Future accounting developments (continued)**

- (vi) IFRS 13 *Fair Value Measurement*. The standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements and applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements.
- (vii) Amendment to IAS 27 *Separate Financial Statements*. Contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity presents separate financial statements. The standard no longer deals with consolidated financial statements which are dealt with in IFRS 10.
- (viii) Amendment to IAS 28 *Investments in Associates and Joint Ventures*. Prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.
- (ix) IAS 19 *Employee Benefits (Revised)*. Prescribes the accounting and disclosure by employers for employee benefits. Actuarial gains and losses (remeasurements) in respect of defined benefit pension schemes are no longer deferred using the corridor approach and are recognised immediately in other comprehensive income.

As at 3 August 2011, all of these pronouncements were awaiting EU endorsement.

**27. Events after the balance sheet date**

The Finance (No. 3) Bill 2011, which included the legislation in respect of the Bank Levy, received Royal Assent on 19 July 2011. Under the legislation, the Group will only become liable to pay the Bank Levy at 31 December 2011 and, as a result, the Group has not accrued for this cost during the first half of 2011. The Group expects that the cost of the Bank Levy for 2011 will be approximately £260 million.

**28. Other information**

The financial information included in these condensed interim 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 2010 were approved by the directors on 24 February 2011 and were delivered to the Registrar of Companies following publication on 30 March 2011. The auditors' report on those accounts was unqualified and did not include a statement under sections 498(2) (accounting records or returns inadequate or accounts not agreeing with records and returns) or 498(3) (failure to obtain necessary information and explanations) of the Companies Act 2006.

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors listed below (being all the directors of Lloyds Banking Group plc) confirm that to the best of their knowledge these condensed interim financial statements have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting, as adopted by the European Union, and that the interim 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 2011 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 2011 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  
3 August 2011

Lloyds Banking Group plc board of directors:

**Executive directors:**

António Horta-Osório (Group Chief Executive)  
G Truett Tate  
Tim J W Tookey

**Non-executive directors:**

Sir Winfried Bischoff (Chairman)  
Lord Leitch (Deputy Chairman)  
Sir Julian Horn-Smith  
Anita Frew  
Glen R Moreno  
David L Roberts  
T Timothy Ryan, Jr  
Martin A Scicluna  
Anthony Watson

## INDEPENDENT REVIEW REPORT TO LLOYDS BANKING GROUP PLC

### Introduction

We have been engaged by the Company to review the condensed consolidated interim financial statements in the half-year results for the six months ended 30 June 2011, 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 results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed consolidated interim financial statements.

### Directors' responsibilities

The half-year results are the responsibility of, and have been approved by, the directors. The directors are responsible for preparing the half-year results in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Services 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 interim financial statements included in the half-year results 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 Company a conclusion on the condensed consolidated interim financial statements in the half-year results 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 LLOYDS BANKING GROUP PLC** (continued)

**Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated interim financial statements in the half-year results for the six months ended 30 June 2011 are not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

PricewaterhouseCoopers LLP  
Chartered Accountants  
London  
3 August 2011

Notes:

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

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Copies of this news release may be obtained from Investor Relations, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN. The full news release can also be found on the Group's website – [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com).