



16 March 2012

## BANK OF SCOTLAND PLC – ANNUAL REPORT AND ACCOUNTS FOR THE YEAR ENDING 31 DECEMBER 2011

In accordance with Listing Rule 9.6.1, Bank of Scotland plc has submitted today the above document to the National Storage Mechanism.

The document will shortly be available for inspection at [www.hemscott.com/nsm.do](http://www.hemscott.com/nsm.do)

A copy of the document is available on the Lloyds Banking Group plc website [www.lloydsbankinggroup.com.com](http://www.lloydsbankinggroup.com.com)

This announcement also contains additional information for the purposes of compliance with the Disclosure and Transparency Rules, including principal risk factors, details of related party transactions and a responsibility statement. This information is extracted, in full unedited text, from the Bank of Scotland plc Annual Report 2011 (the 'Annual Report'). References to page numbers and notes to the accounts made in the following Appendices, refer to page numbers and notes to the accounts in the Annual Report.

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## **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 including, without limitation, as a result of the integration of HBOS and the Group's simplification programme; 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 including Eurozone instability; 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 certain factors together with examples of forward looking statements. The forward looking statements contained in this announcement are made as at the date of this announcement, and the Group undertakes no obligation to update any of its forward looking statements.

## **Appendix 1 – Risk Factors**

The principal risks and uncertainties relating to Bank of Scotland plc are set out on pages 8 to 14 of the Annual Report. The following is extracted in full and unedited form from the Annual Report.

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

### **LIQUIDITY AND FUNDING**

#### **Risk Definition**

Liquidity risk is defined as the risk that the Group has insufficient financial resources to meet its commitments as they fall due, or can only secure them at excessive cost.

Funding risk is defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.

#### **Principal Risks**

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 Lloyds Banking Group balance sheet and continued development of the retail deposit base has seen the Lloyds Banking Group's wholesale funding requirement reduce in the past year. The progress Lloyds Banking Group has made to date in diversifying its funding sources has further strengthened its funding base.

During the first half of 2011 the Lloyds Banking 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. Lloyds Banking Group repaid its remaining drawings under the Bank of England SLS scheme in full during 2011. Outstandings under the Credit Guarantee Scheme reduced in line with their contractual maturities, with £23.5 billion remaining at end December. The outstanding amount matures during 2012.

The second half of 2011 has seen more difficult funding markets as investor confidence was impacted by concerns over the US debt ceiling and subsequent downgrade. This was followed by increased fears over Eurozone sovereign debt levels, downgrades and possible defaults and concerns are ongoing over the potential downside effects from financial market volatility. Despite this Lloyds Banking Group continued to fund adequately, maintaining a broadly stable stock of primary liquid assets during the year and meeting its regulatory liquidity ratio targets at all times.

Liquidity is managed at the aggregate Lloyds Banking Group level, with active monitoring at both business unit and Group level. Monitoring and control processes are in place to address both internal and regulatory requirements. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the stress event.

The Lloyds Banking Group carries out stress testing of its liquidity position against a range of scenarios, including those prescribed by the FSA. Lloyds Banking Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

Lloyds Banking Group's stress testing framework considers these factors, including the impact of a range of economic and liquidity stress scenarios over both short and longer term horizons. Internal stress testing results at 31 December 2011 show that Lloyds Banking Group has liquidity resources representing more than 130 per cent of modelled outflows from all wholesale funding sources, corporate deposits and rating dependent contracts under the Group's severe liquidity stress scenario. In 2011, Lloyds Banking 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 Lloyds Banking Group will achieve the proposed Basel 3 liquidity and funding requirements in advance of expected implementation dates.

Lloyds Banking Group's stress testing shows that further credit rating downgrades may reduce investor appetite for some of the Group's liability classes and therefore funding capacity. In the fourth quarter of 2011, Lloyds Banking Group experienced downgrades in its long-term rating of between one and two notches from three of the major rating agencies. The impact that Lloyds Banking Group experienced following the downgrades was consistent with the Group's modelled outcomes based on the stress testing framework. Lloyds Banking Group has materially reduced its wholesale funding in recent years and operates a well diversified funding platform which together lessen the impact of stress events.

Lloyds Banking Group's borrowing costs and issuance in the capital markets are dependent on a number of factors, and increased cost or reduction of capacity could materially adversely affect the Group's results of operations, financial condition and prospects. In particular, reduction in the credit rating of Lloyds Banking Group or deterioration in the capital markets' perception of the Group's financial resilience, could significantly increase its borrowing costs and limit its issuance capacity in the capital markets. The impact on the Lloyds Banking Group's funding cost is subject to a number of assumptions and uncertainties and is therefore impossible to quantify precisely.

The downgrades that Lloyds Banking Group experienced in the fourth quarter of 2011, did not significantly change its borrowing costs, reduce its issuance capacity or require significant collateral posting. Lloyds Banking Group notes the recent announcements from Moody's placing the ratings of 114 European financial institutions, including Lloyds Banking Group, on review for downgrade. Even in the case of a simultaneous two notch downgrade from all rating agencies, the Group would remain investment grade.

At 31 December, Lloyds Banking Group had £202 billion of highly liquid unencumbered assets in its liquidity portfolio which are available to meet cash and collateral outflows. 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.

### **Mitigating Actions**

The Group takes many mitigating actions with respect to this principal risk, key examples include:

Lloyds Banking 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 that Lloyds Banking Group will achieve the proposed Basel III liquidity and funding metrics in advance of expected implementation dates. The Liquidity Coverage Ratio (LCR) is due to be implemented on 1 January 2015 and the Net Stable Funding Ratio (NSFR) has a 1 January 2018 implementation date. The European Commission released its proposal for implementing Basel III into Europe (CRDIV) in July 2011 and we note that discussions over the final detail are ongoing.

Lloyds Banking Group carries out monthly stress testing of its liquidity position against a range of scenarios, including those prescribed by the FSA. The Group's liquidity risk appetite is also calibrated against a number of stressed liquidity metrics.

The key dependencies on successfully funding the Lloyds Banking Group's balance sheet include the continued functioning of the money and capital markets; successful right-sizing of Lloyds Banking 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 Lloyds Banking Group's credit rating; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets. Additionally, Lloyds Banking 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 Lloyds Banking Group's funding plan. The requirement to meet this deadline may result in Lloyds Banking Group having to provide funding to support these asset reductions and/or disposals and may also result in a lower price being achieved.

## **CREDIT**

### **Risk Definition**

The risk of reductions in earnings and/or value, through financial loss, as a result of the failure of the party with whom the Group has contracted to meet its obligations (both on and off balance sheet).

### **Principal Risks**

Arising in the retail, wholesale, commercial and wealth and international operations, reflecting the risks inherent in the Group's lending activities. Adverse changes in the credit quality of the Group's UK and/or international borrowers and counterparties, or in their behaviour, would be expected to reduce the value of the Group's assets and materially increase the Group's write-downs and allowances for impairment losses. Credit risk can be affected by a range of factors, including, inter alia, increased unemployment, reduced asset values, lower consumer spending, increased personal or corporate insolvency levels, reduced corporate profits, increased interest rates or higher tenant defaults. Over the last four years, the global banking crisis and economic downturn has driven cyclically high bad debt charges. These have arisen from the Group's lending to:

- Wholesale customers (including those in wealth and international): where companies continue to face difficult business conditions. Impairment levels have reduced materially since the peak of the economic downturn and more aggressive risk appetite when elevated corporate default levels and illiquid commercial property markets resulted in heightened impairment charges. The UK economy remains fragile. Consumer and business confidence is low, consumer spending has been falling over the past year, the reduction in public sector spending is deepening and exports are failing to offset domestic weakness. The possibility of further economic weakness remains. Financial market instability represents an additional downside risk. The Group has exposure in both the UK and internationally, including Europe, Ireland, USA and Australia, particularly in commercial real estate lending, where we have a high level of lending secured on secondary and tertiary assets.
- Retail customers: This portfolio will remain strongly linked to the economic environment, with inter alia house price falls, unemployment increases, consumer over-indebtedness and rising interest rates possible impacts to the secured and unsecured retail exposures.

### **Mitigating Actions**

The Group takes many mitigating actions with respect to this principal risk, key examples being that the Group follows a relationship based business model with risk management processes, appetites and experienced staff in place.

## **REGULATORY**

### **Risk Definition**

Regulatory risk is the risk of reductions in earnings and/ or value, through financial or reputational loss, from failing to comply with the applicable laws, regulations or codes.

## **Principal Risks**

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. 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.

### *Independent Commission on Banking*

The Government appointed an independent Commission on Banking (ICB) to review possible measures to reform the banking system and promote stability and competition. The ICB published its final report on 12 September 2011 putting forward recommendations to require ring-fencing of the retail activities of banks from their investment banking activities and additional capital requirements beyond those required under current drafts of the Capital Requirements Directive IV. The Report also makes recommendations in relation to the competitiveness of the UK banking market, including enhancing the competition remit of the new Financial Conduct Authority (FCA), implementing a new industry-wide switching solution by September 2013, and improving transparency. The ICB, which following the final report was disbanded, had the authority only to make recommendations, which the Government could choose to accept or reject.

The ICB specifically recommended in relation to Lloyds Banking Group's EU mandated branch disposal (Project Verde), that, to create a strong challenger in the UK banking market, the entity which results from the divestiture should have a share of the personal current account (PCA) market of at least 6 per cent (although this does not need to arise solely from the current accounts acquired from the Company) and a funding position at least as strong as its peers. The ICB did not specify a definitive timeframe for the divested entity to achieve a 6 per cent market share of PCAs but recommended that a market investigation should be carefully considered by competition authorities if 'a strong and effective challenger' has not resulted from Lloyds Banking Group's divestiture by 2015. The ICB did not recommend explicitly that Lloyds Banking Group should increase the size of the Project Verde disposal agreed with the European Commission but recommended that the Government prioritise the emergence of a strong new challenger over reducing market concentration through a 'substantially enhanced' divestiture by Lloyds Banking Group.

The Government published its response to the ICB recommendations on 19 December 2011. The Government supported the recommendation that an entity with a larger share of the PCA market than the 4.6 per cent originally proposed might produce a more effective competitor. In relation to Lloyds Banking Group's announcement that it was to pursue exclusive negotiations with the Co-operative Group, the Government commented that such a transaction would deliver a significant enhancement of the PCA market share, with the share divested by Lloyds Banking Group combining with the Co-operative Group's existing share to create a competitor with approximately 7-8 per cent. The Government also stated that the execution of the divestment is a commercial matter, and it has no intention of using its shareholding to deliver an enhancement.

### *New Regulatory Regime*

On 27 January 2012, the Government published the Financial Services Bill. The proposed new UK regulatory architecture will see the transition of regulatory and supervisory powers from the FSA to the new Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA). The PRA will be responsible for supervising banks, building societies and other large firms. The FCA will focus on consumer protection and market regulation. The Bill is also proposing new responsibilities and powers for the FCA. The most noteworthy are the proposed greater powers for the FCA in relation to competition and the proposal to widen its scope to include consumer credit. The Bill is expected to take effect in early 2013.

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 FCA and PRA in 2013. Until this time the responsibility for regulating and supervising the activities of the Group and its subsidiaries will remain with the FSA. On 2 April the FSA will introduce a new 'twin peaks' model and the intention is to move the FSA as close as possible to the new style of regulation outlined in the Bill. There will be two independent groups of supervisors for banks, insurers and major investment firms covering prudential and conduct. (All other firms (those not dual regulated) will be solely supervised by the conduct supervisors).

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 matters across the EU.

#### *Capital and Liquidity*

Evolving capital and liquidity requirements continue to be a priority for Lloyds Banking Group. The Basel Committee on Banking Supervision has 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 2013 and 2018.

#### *Anti Bribery*

The Bribery Act 2010 came fully into force on 1 July 2011. It enhances previous laws on bribery and is supported by some detailed guidance issued by the Ministry of Justice on the steps a business needs to take to embed 'adequate procedures' to prevent bribery. A company convicted of failing to have 'adequate procedures' to prevent bribery could receive an unlimited fine. The Group operates a Group-wide Anti-Bribery Policy, applicable to all of its businesses, operations and employees, which incorporates the requirements of the UK Bribery Act 2010.

#### **Sanctions**

The Group takes very seriously its responsibilities for complying with legal and regulatory sanctions requirements in all the jurisdictions in which it operates. In order to assist adherence to relevant economic sanctions legislation, the Group has enhanced its internal compliance processes including those associated with customer and payment screening. The Group has continued the delivery of a programme of staff training regarding policies and procedures for detecting and preventing economic sanctions non-compliance.

#### *US Regulation*

Significant regulatory initiatives from the US impacting the Group include the Dodd-Frank Act (which imposes specific requirements for systemic risk oversight, securities market conduct and oversight, bank capital standards, arrangements for the liquidation of failing systemically significant financial institutions and restrictions to the ability of banks to engage in proprietary trading activities known as the 'Volcker Rule'). The Act will have both business and operational implications for the Group within and beyond the US. In addition the Foreign Account Tax Compliance Act (FATCA) requires non-US financial institutions to enter into disclosure agreements with the US Treasury and all non-financial non-US entities to report and or certify their ownership of US assets in foreign accounts or be subject to 30 per cent withholding tax.

#### *European Regulation*

At a European level, the pace of regulatory reform has increased with a number of new directives or changes to existing directives planned in the next 12 months including a revised Markets in Financial Instruments Directive, Transparency Directive, Insurance Mediation Directive and a Fifth Undertakings in Collective Investments in Transferable Securities Directive as well as a proposed Directive regulating Packaged Retail Investment Products.

## **Mitigating Actions**

The Group takes many mitigating actions with respect to this principal risk, key examples include:

### *Independent Commission on Banking*

Lloyds Banking Group continues to play a constructive role in the debate with the Government and other stakeholders on all issues under consideration in relation to the ICB's recommendations.

### *New Regulatory Regime*

Lloyds Banking Group continues to work closely with the regulatory authorities and industry associations to ensure that it is able to identify and respond to regulatory changes and mitigate against risks to the Group and its stakeholders.

### *Capital and Liquidity*

Lloyds Banking Group is continuously assessing the impacts of regulatory developments which could have a material effect on the Group and is progressing its plans to implement regulatory changes and directives through change management programmes.

### *Anti Bribery*

The Group has no appetite for bribery and explicitly prohibits the payment, offer, acceptance or request of a bribe, including 'facilitation payments'.

The Group has enhanced its internal compliance processes including those associated with payment screening, colleague training and hospitality.

### *US and European Regulation*

Lloyds Banking Group is continuously assessing the impacts of regulatory developments which could have a material effect on the Group and is progressing with its plans to implement regulatory changes and directives through change management programmes.

## **MARKET RISK**

### **Risk Definition**

The risk of reductions in earnings and/or value, through financial or reputational loss, from unfavourable market moves; including changes in, and increased volatility of, interest rates, market-implied inflation rates, credit spreads, foreign exchange rates, equity, property and commodity prices.

### **Principal Risks**

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

– 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.

Continuing concerns about the fiscal position in 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.

### **Mitigating Actions**

The Group takes many mitigating actions with respect to this principal risk, key examples include:

Market risk is managed within a Lloyds Banking Group Board approved framework using a range of metrics to monitor against stated appetite and potential market conditions.

Market Risk is reported regularly to appropriate committees.

The Group's trading activity is small relative to our peers and is not considered to be a principal risk.



## **CUSTOMER TREATMENT**

### **Risk Definition**

The risk of regulatory censure and/or a reduction in earnings/value, through financial or reputational loss, from inappropriate or poor customer treatment.

### **Principal Risks**

Customer treatment and how the Group manages its customer relationships affect all aspects of the Group's operations and are closely aligned with achievement of Lloyds Banking Group's strategic vision to be the best bank for customers. As a provider of a wide range of financial services products and numerous distribution channels to an extremely broad and varied customer base, we face significant conduct risks, such as: products or services not meeting the needs of our customers; sales processes which could result in selling products to customers which do not meet their needs; failure to deal with a customer's complaint effectively where we have got it wrong and not met customer expectations.

There remains a high level of scrutiny regarding the treatment of customers by financial institutions from regulatory bodies, the press and politicians. The FSA in particular continues to drive focus on conduct of business activities through its supervision activity.

There is a risk that certain aspects of the Group's business may be determined by regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable in their opinion. The Group may also be liable for damages to third parties harmed by the conduct of its business.

### **Mitigating Actions**

The Group takes many mitigating actions with respect to this principal risk, key examples include:

Lloyds Banking Group's Conduct Risk Strategy and supporting framework have been designed to support our vision and strategic aim to put the customer at the heart of everything we do. Lloyds Banking Group have developed and implemented a framework to enable us to deliver the right outcomes for our customers, which is supported by Policies and Standards in key areas, including product governance, sales, responsible lending, customers in financial difficulties, claims and complaints handling.

Lloyds Banking Group actively engages with regulatory bodies and other stakeholders in developing its understanding of current customer treatment concerns.

## **PEOPLE**

### **Risk Definition**

The risk of reductions in earnings or value through financial or reputational loss arising from ineffectively leading colleagues responsibly and proficiently, managing people resource, supporting and developing colleague talent, or meeting regulatory obligations related to our people.

### **Principal Risks**

The quality and effectiveness of our people are fundamental to its success. Consequently, the Group's management of material people risks is critical to its capacity to deliver against its long-term strategic objectives. Over the next year the Group's ability to manage people risks successfully may be affected by the following key drivers:

- Lloyds Banking Group's continuing structural consolidation and the sale of part of our branch network under Project Verde may result in disruption to our ability to lead and manage our people effectively
- The continually changing, more rigorous regulatory environment may impact people strategy, remuneration practices and retention
- Macroeconomic conditions and negative media attention on the banking sector may impact retention, colleague sentiment and engagement.

## **Mitigating Actions**

The Group takes many mitigating actions with respect to this principal risk, key examples include:

- Strong focus on leadership and colleague engagement, through delivery of strategies to attract, retain and develop high calibre staff together with implementation of rigorous succession planning
- A continued focus on people risk management across the Group
- Ensuring compliance with regulatory requirements related to Approved Persons and the FSA Remuneration Code, and embedding compliant and appropriate colleague behaviours in line with Group policies, values and people risk priorities
- Strengthening risk management culture and capability across the Group, together with further embedding of risk objectives in the colleague performance and reward process.

## **State funding and state aid**

HM Treasury currently holds approximately 40.2 per cent of Lloyds Banking Group plc's ordinary share capital. United Kingdom Financial Investments Limited (UKFI) as manager of HM Treasury's shareholding continues to operate in line with the framework document between UKFI and HM Treasury managing the investment in Lloyds Banking Group plc 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 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.

Lloyds Banking 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.

The subsequent agreement (known as 'Merlin') between five major UK banks (including Lloyds Banking Group) and the Government in relation to gross business lending capacity in the 2011 calendar year was subject to a similar set of criteria. Lloyds Banking Group delivered in full its share of the commitments by the five banks, both in respect of lending to Small and Medium Sized Enterprises (SMEs) and in respect of overall gross business lending. Lloyds Banking Group has made a unilateral lending pledge for 2012 as part of its publicly announced SME charter.

In addition, Lloyds Banking Group is subject to European state aid obligations in line with the Restructuring Plan agreed with HM Treasury and the EU College of Commissioners in November 2009, which is designed to support the long-term viability of the Group and remedy any distortion of competition and trade in the European Union (EU) arising from the State aid given to Lloyds Banking Group.

This has placed a number of requirements on the Lloyds Banking Group including an asset reductions target from a defined pool of assets by the end of 2014 and the disposal of a certain portion of its retail business by the end of November 2013. In June 2011 Lloyds Banking Group issued an Information Memorandum to potential bidders of this retail banking business, which the European Commission confirmed met the requirements to commence the formal sale process for the sale no later than 30 November 2011. On 14 December 2011 Lloyds Banking Group announced that having reviewed the formal offers made, its preferred option was for a direct sale and that it was entering into exclusive discussions with The Co-operative Group. Lloyds Banking Group is also continuing to progress an Initial Public Offering (IPO) in parallel. Lloyds Banking Group continues to work closely with the EU Commission, HM Treasury and the Monitoring Trustee appointed by the EU Commission to ensure the successful implementation of the Restructuring Plan

## Appendix 2 – Related Party Transactions

The following statements regarding related party transactions of Bank of Scotland plc are set out on pages 64 to 66 of the Annual Report. The following is extracted in full and unedited form from the Annual Report.

### 43 Related party transactions

#### Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity. At 31 December 2011 and 2010, the Group's key management personnel are the members of the Lloyds Banking Group plc Group Executive Committee together with its Non-Executive Directors.

The table below details, on an aggregated basis, key management personnel compensation which has been allocated to the Bank on an estimated basis.

<b>Compensation</b>	<b>2011</b> <b>£m</b>	<b>2010</b> <b>£m</b>
Share-based payments	<u>4</u>	<u>3</u>
	<u>4</u>	<u>3</u>

The aggregate of the emoluments of the directors for qualifying services to the Bank, on an estimated basis, in 2011 was £3.4 million (2010: £4.2 million). The total for the highest paid director (António Horta-Osório) was £1,646,000 (2010: (J E Daniels) £1,029,000).

<b>Share option plans over Lloyds Banking Group plc shares</b>	<b>2011</b> <b>million</b>	<b>2010</b> <b>million</b>
At 1 January	6	2
Granted, including certain adjustments <sup>1</sup> (includes entitlements of appointed directors)	20	4
Exercised/lapsed (includes entitlements of former directors)	<u>(4)</u>	<u>–</u>
<b>At 31 December</b>	<u>22</u>	<u>6</u>

<sup>1</sup> 2010 includes adjustments, using a standard HMRC formula, to negate the dilutionary impact of the Lloyds Banking Group's 2009 capital raising activities.

<b>Share plans settled in Lloyds Banking Group plc shares</b>	<b>2011</b> <b>million</b>	<b>2010</b> <b>million</b>
At 1 January	56	19
Granted, including certain adjustments <sup>1</sup> (includes entitlements of appointed directors)	35	39
Exercised/lapsed (includes 31 million entitlements of former directors)	<u>(33)</u>	<u>(2)</u>
<b>At 31 December</b>	<u>58</u>	<u>56</u>

<sup>1</sup> 2010 includes adjustments, using a standard HMRC formula, to negate the dilutionary impact of the Lloyds Banking Group's 2009 capital raising activities.

The tables below detail, on an aggregated basis, balances outstanding at the year end and related income and expense, together with information relating to other transactions between Lloyds Banking Group and its key management personnel:

	<b>2011</b>	2010
<b>Loans</b>	<b>£m</b>	£m
At 1 January	<b>3</b>	2
Advanced (includes loans of appointed directors)	<b>1</b>	2
Repayments (includes loans of former directors)	<b>(1)</b>	(1)
<b>At 31 December</b>	<b>3</b>	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 1.09 per cent and 27.5 per cent in 2011 (0.50 per cent and 17.90 per cent in 2010).

No provisions have been recognised in respect of loans given to key management personnel.

	<b>2011</b>	2010
<b>Deposits</b>	<b>£m</b>	£m
At 1 January	<b>4</b>	4
Placed (includes deposits of appointed directors)	<b>17</b>	12
Withdrawn (includes deposits of former directors)	<b>(15)</b>	(12)
<b>At 31 December</b>	<b>6</b>	4

Deposits placed by key management personnel attracted interest rates of up to 5 per cent in 2011 (2010: 4.25 per cent).

At 31 December 2011 and 2010, the Group did not provide any guarantees in respect of key management personnel.

At 31 December 2011, transactions, arrangements and agreements entered into by the Lloyds Banking Group's banking subsidiaries with directors and connected persons of the Group included amounts outstanding in respect of loans and credit card transactions of £3 million with four directors and three connected persons (2010: £2 million with six directors and four connected persons).

### **Balances and transactions with fellow Lloyds Banking Group undertakings**

#### *Balances and transactions between members of the Bank of Scotland group*

In accordance with IAS 27, transactions and balances between the Bank and its subsidiary undertakings, and between those subsidiary undertakings, have all been eliminated on consolidation and thus are not reported as related party transactions of the Group.

The Bank, as a result of its position as parent of a banking group, has a large number of transactions with various of its subsidiary undertakings; these are included on the balance sheet of the Bank as follows:

	2011 £m	2010 £m
Assets, included within:		
Derivative financial instruments	19	22
Loans and receivables:		
Loans and advances to banks	–	–
Loans and advances to customers	32,654	39,085
Debt securities	6,188	375
Other	–	67
	<u>38,861</u>	<u>39,549</u>
Liabilities, included within:		
Deposits from banks	1	–
Customer deposits	29,712	36,547
Derivative financial instruments	81	109
Debt securities in issue	21,304	14,157
Subordinated liabilities	469	66
	<u>51,567</u>	<u>50,879</u>

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2011 the Bank earned interest income on the above asset balances of £1,710 million (2010: £2,548 million) and incurred interest expense on the above liability balances of £2,356 million (2010: £2,245 million).

*Balances and transactions with Lloyds Banking Group plc and fellow subsidiaries of the Lloyds Banking Group*

The Bank and its subsidiaries have balances due to and from the Bank's ultimate parent company, Lloyds Banking Group plc and fellow subsidiaries of the Lloyds Banking Group. These are included on the balance sheet as follows:

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Assets, included within:				
Derivative financial instruments	4,226	1,497	4,208	1,495
Loans and receivables:				
Loans and advances to banks	85,800	55,053	85,800	55,053
Loans and advances to customers	30,943	34,365	29,527	33,322
Trading and other financial assets at fair value through profit or loss	7,739	3,998	7,739	3,998
Other	1,171	3,196	310	429
	<u>129,879</u>	<u>98,109</u>	<u>127,584</u>	<u>94,297</u>

	The Group		The Bank	
	2011 £m	2010 £m	2011 £m	2010 £m
Liabilities, included within:				
Deposits from banks	144,502	131,138	144,502	131,138
Customer deposits	35,267	40,949	30,020	35,065
Derivative financial instruments	8,562	4,196	8,546	4,196
Subordinated liabilities	11,151	11,266	11,195	12,216
Debt securities in issue	1,559	2,498	458	186
Trading liabilities	6,690	3,294	6,690	3,294
Other liabilities	–	145	–	145
	<b>207,731</b>	<b>193,486</b>	<b>201,411</b>	<b>186,240</b>

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2011 the Group earned £853 million and the Bank earned £1,196 million of interest income on the above asset balances (2010: £1,147 million for the Group and £923 million for the Bank); the Group incurred £2,296 million and the Bank incurred £2,967 million of interest expense on the above liability balances (2010: £2,565 million for the Group and £2,532 million for the Bank).

### UK Government

In January 2009, the UK Government through HM Treasury became a related party of Lloyds Banking Group plc, the Bank's ultimate parent company, following its subscription for ordinary shares issued under a placing and open offer. As at 31 December 2011, HM Treasury held a 40.2 per cent (31 December 2010: 40.6 per cent) interest in Lloyds Banking Group plc's ordinary share capital and consequently HM Treasury remained a related party of the Bank during the year ended 31 December 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 entities controlled by the UK Government, including The Royal Bank of Scotland Group plc, Northern Rock (Asset Management) plc and Bradford & Bingley plc, as related parties.

Since 1 January 2011, the Group has had the following significant transactions with the UK Government or UK Government-related entities:

#### *Government and central bank facilities*

During the year ended 31 December 2011, the Lloyds Banking Group participated in a number of schemes operated by the UK Government, and central banks and made available to eligible banks and building societies.

#### *Special liquidity scheme and credit guarantee scheme*

The Bank of England's UK Special Liquidity Scheme was launched in April 2008 to allow financial institutions to swap temporarily illiquid assets for treasury bills, with fees charged based on the spread between 3-month LIBOR and the 3-month gilt repo rate. The scheme will operate for up to three years after the end of the drawdown period (30 January 2009) at the Bank of England's discretion. At 31 December 2011, the Lloyds Banking Group did not utilise the Special Liquidity Scheme.

HM Treasury launched the Credit Guarantee Scheme in October 2008 as part of a range of measures announced by the UK Government intended to ease the turbulence in the UK banking system. It charged a commercial fee for the guarantee of new short and medium term debt issuance. The fee payable to HM Treasury on guaranteed issues was based on a per annum rate of 50 basis points plus the median five-year credit default swap spread. The drawdown window for the Credit Guarantee Scheme closed for new issuance at the end of February 2010. At 31 December 2011, the Lloyds Banking Group had £23.5 billion of debt in issue under the Credit Guarantee Scheme (31 December 2010: £45.4 billion). During the year, fees of £28 million paid to HM Treasury in respect of guaranteed funding were included in the Lloyds Banking Group's income statement.

#### *Lending commitments*

The formal lending commitments entered into in connection with the Lloyds Banking Group's proposed participation in the Government Asset Protection Scheme have now expired and in February 2011, Lloyds Banking Group plc (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 Lloyds Banking 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. During 2011, the Lloyds Banking Group has incurred sunk costs of £4 million which have been written off.

As at 31 December 2011, the Lloyds Banking Group's investment in the Business Growth Fund was £20 million.

#### *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 disclosures**

#### *Joint Ventures and Associates*

The Group provides both administration and processing services to its principal joint venture Sainsbury's Bank plc. The amounts receivable by the Group during the year were £21 million (2010: £31 million), of which £10 million was outstanding at the year end (2010: £8 million). At 31 December 2011, Sainsbury's Bank plc also had balances with the Group and the Bank that were included in loans and advances to banks of £1,173 million (2010: £1,277 million), deposits by banks of £780 million (2010: £1,358 million) and trading liabilities of £340 million (2010: nil).

The Group has a number of associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2011, these companies had total assets of approximately £7,330 million (2010: £4,713 million), total liabilities of approximately £6,528 million (2010: £4,199 million) and for the year ended 31 December 2011 had turnover of approximately £3,950 million (2010: £744 million) and made a net loss of approximately £86 million (2010: net profit of £164 million). In addition, the Group has provided £4,588 million (2010: £1,406 million) of financing to these companies on which it received £27 million (2010: £19 million) of interest income in the year.

Banking transactions are entered into by the Bank with its subsidiaries in the normal course of business and are at normal commercial terms. These include loans, deposits and foreign currency transactions.

At 31 December 2011 the Group had loans and advances to customers of £5,185 million (2010: £5,660 million), the Bank had loans and advances to customers of £5,168 million (2010: £5,628 million), and the Group and Bank had outstanding balances within customer accounts of £88 million (2010: £151 million) relating to joint ventures and associated undertakings.

#### *Pension Funds*

During 2011, the Group sold at fair value certain non-government bonds, equities and alternative assets to Lloyds TSB Group Pension Scheme No 1 for £79 million and to Lloyds TSB Group Pension Scheme No 2 for £43 million.

#### *Taxation*

Group relief was surrendered for no payment as per note 12.



### **Appendix 3 – Directors' Responsibility Statement**

The following statement is extracted from page 5 of the Annual Report. This statement relates solely to the Annual Report and is not connected to the extracted information set out in this announcement or the 2011 Results News Release dated 24 February 2011.

Each of the current directors, whose names are shown on page 6 of this annual report, confirms that, to the best of his or her knowledge:

- the financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities and financial position of the Bank and Group and the profit or loss of the Group;
- the business review includes a fair review of the development and performance of the business and the position of the Bank and Group; and
- the principal risks and uncertainties faced by the Bank and the Group are set out on pages 8 to 14.