Lloyds Banking Group plc
Form 6-K
June 29, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16
under the Securities Exchange Act of 1934
For the date of June 28 2010

Lloyds Banking Group plc

25 Gresham Street, London EC2V 7HN

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F X Form 40-F ___

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ___ No X

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-________

THIS REPORT ON FORM 6-K SHALL BE DEEMED TO BE INCORPORATED BY REFERENCE IN THE REGISTRATION STATEMENT ON FORM F-3 (FILE NO. 333-167844) OF LLOYDS BANKING GROUP PLC AND TO BE A PART THEREOF FROM THE DATE ON WHICH THIS REPORT IS FURNISHED, TO THE EXTENT NOT SUPERSEDED BY DOCUMENTS OR REPORTS SUBSEQUENTLY FILED OR FURNISHED.

Lloyds Banking Group plc

Lloyds Banking Group plc hereby incorporates by reference the following information into its Registration Statement on Form F-3 (File No. 333-167844).

2

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorised.

Lloyds Banking Group plc
(Registrant)

Date: 28 June 2010

By: /s/ Tim J. W. Tookey
Tim J. W. Tookey
Group Finance Director
Lloyds Banking Group plc

3

HBOS plc
F3 Accounts
2008

Independent auditors’ report to the members of HBOS plc

The Board of Directors
HBOS plc

We have audited the accompanying consolidated balance sheets of HBOS plc and its subsidiary companies (the Group) as of December 31, 2008 and 2007, and the related consolidated income statements, statements recognised income and expense and cash flows for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (U.S.). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

As discussed in the Accounting Policies section of the consolidated financial statements, the Group has changed its method of accounting for certain financial assets in the year ended 31 December 2008 following the adoption of ‘Reclassification of Financial Assets (Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures).

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Edinburgh

26 February 2009

Consolidated Income Statements
For the years ended 31 December

	Notes	2008 £m	2007 £m	2006 £m
Interest income		37,411	35,012	29,742
Interest expense		(29,240)	(27,708)	(22,342)
Net interest income	1	8,171	7,304	7,400
Fees and commission income		2,305	2,378	2,175
Fees and commission expense		(1,178)	(1,118)	(1,012)
Net earned premiums on insurance contracts	5	5,344	5,616	5,648
Net trading (expense)/income	2	(2,878)	178	292
Change in value of in-force long term assurance business		(300)	16	282
Net investment (expense)/income related to insurance and investment business		(9,524)	4,613	6,445
Other operating income		1,672	2,304	1,484
Net operating income	3	3,612	21,291	22,714
Change in investment contract liabilities	6	12,816	(2,538)	(2,910)
Net claims incurred on insurance contracts	5	(3,703)	(2,952)	(2,328)
Net change in insurance contract liabilities		(3,863)	(2,244)	(3,894)
Change in unallocated surplus	32	942	50	(569)
Administrative expenses	7	(5,114)	(4,979)	(4,623)
Depreciation and amortisation:				
Intangible assets other than goodwill	23	(209)	(193)	(161)
Property and equipment	24	(221)	(224)	(219)
Operating lease assets	26	(1,178)	(985)	(812)
		(1,608)	(1,402)	(1,192)
Goodwill impairment	23	(158)	(5)	(55)
Operating expenses		(688)	(14,070)	(15,571)
Impairment losses on loans and advances	12(a)	(9,857)	(2,012)	(1,742)
Impairment losses on investment securities	12(b)	(2,193)	(60)	(71)
Operating (loss)/profit		(9,126)	5,149	5,330
Share of (loss)/profit of jointly controlled entities	21	(669)	234	112
Share of (loss)/profit of associates	21	(287)		14
(Loss)/profit on sale of businesses	4	(743)	91	250
(Loss)/profit before taxation	11	(10,825)	5,474	5,706
Tax on (loss)/profit	13	3,409	(1,365)	(1,772)
(Loss)/profit after taxation		(7,416)	4,109	3,934
Profit of subsidiary acquired with a view to resale			4	5
(Loss)/profit for the year		(7,416)	4,113	3,939
Attributable to:				
Parent company shareholders		(7,499)	4,045	3,879
Minority interests		83	68	60
		(7,416)	4,113	3,939

Earnings per ordinary share	14		reclassified	reclassified
- Basic		(167.8)p	103.4p	98.0p
- Diluted		(167.8)p	102.8p	97.0p

The notes to the accounts on pages F-7 to F-115 form an integral part of these financial statements.

F-2

Consolidated Balance Sheets
As at 31 December

	Notes	2008 £m	2007 £m
Assets			
Cash and balances at central banks	53	2,502	2,945
Items in course of collection		445	945
Financial assets held for trading	16	22,571	54,681
Derivative assets	17	51,810	14,141
Loans and advances to banks		17,645	7,683
Loans and advances to customers	18	435,223	430,007
Investment securities	20	133,372	127,659
Interests in jointly controlled entities	21	938	1,351
Interests in associates	21	223	373
Goodwill and other intangible assets	23	2,375	2,790
Property and equipment	24	1,433	1,494
Investment properties	25	3,045	4,731
Operating lease assets	26	3,967	4,643
Deferred costs	27	1,181	1,101
Retirement benefit asset	33	629	
Value of in-force long term assurance business	28	2,992	3,184
Other assets	29	4,851	7,468
Current tax assets		983	
Deferred tax assets	34	2,556	70
Prepayments and accrued income		1,176	1,751
Total Assets		689,917	667,017
Liabilities			
Deposits by banks		97,150	41,513
Customer accounts		222,251	243,221
Financial liabilities held for trading	16	18,851	22,705
Derivative liabilities	17	38,905	12,311
Notes in circulation		957	881
Insurance contract liabilities	30	30,712	26,864
Investment contract liabilities	31	39,482	52,828
Unallocated surplus	32	551	1,493
Retirement benefit liabilities	33	152	347
Current tax liabilities		58	370
Deferred tax liabilities	34	227	2,600
Other liabilities	35	5,109	5,072
Accruals and deferred income		3,099	3,630
Provisions	36	347	175
Debt securities in issue	37	188,448	206,520
Other borrowed funds	38	30,119	24,253
Total Liabilities		676,418	644,783

The notes to the accounts on pages F-7 to F-115 form an integral part of these financial statements.

Consolidated Balance Sheets
As at 31 December 2008

	Notes	2008 £m	2007 £m
Shareholders' Equity			
Issued share capital	39	1,550	1,131
Share premium	41	6,709	2,997
Other reserves	41	(5,616)	154
Retained earnings	41	9,556	17,567
Shareholders' Equity (excluding minority interests)		12,199	21,849
Minority interests	41	1,300	385
Total Shareholders' Equity	41	13,499	22,234
Total Liabilities and Shareholders' Equity		689,917	667,017

The notes to the accounts on pages F-7 to F-115 form an integral part of these financial statements.

Consolidated Statements of Recognised Income and Expense
For the years ended 31 December

	2008 £m	2007 £m	2006 £m
Net actuarial gain from defined benefit plans (net of tax)	568	312	163
Foreign exchange translation	187	2	(23)
Available for sale investments:			
Net change in fair value (net of tax)	(5,897)	(333)	190
Net gains transferred to the income statement (net of tax)	(17)	(201)	(171)
Impairment recognised in income statement (net of tax)	915	17	
Cash flow hedges:			
Effective portion of changes in fair value taken to equity (net of tax)	(2,802)	(216)	209
Net losses/(gains) transferred to the income statement (net of tax)	1,844	(292)	86
Revaluation of existing net assets upon acquisition of jointly controlled entity			(15)
Net (expense)/income recognised directly in equity	(5,202)	(711)	439
(Loss)/profit for the year	(7,416)	4,113	3,939
Total recognised income and expense	(12,618)	3,402	4,378
Attributable to:			
Parent company shareholders	(12,701)	3,334	4,318
Minority interests	83	68	60
	(12,618)	3,402	4,378

Consolidated Cash Flow Statements
For the years ended 31 December

	Notes	2008 £m	2007 £m	2006 £m
(Loss)/profit before taxation		(10,825)	5,474	5,706
Adjustments for:				
Impairment losses on loans and advances		9,857	2,012	1,742
Impairment losses on investment securities		2,193	60	
Impairment losses on property under construction		10		
Depreciation and amortisation		1,608	1,402	1,192
Goodwill impairment		158	5	55
Interest on other borrowed funds		1,579	1,229	1,157
Pension charge for defined benefit schemes		171	146	164
Cash contribution to defined benefit schemes		(225)	(295)	(860)
Exchange differences1		1,311	(769)	3,157
Movement in derivatives held for trading		1,193	(1,487)	4,081
Other non-cash items		4,276	45	(902)
Net change in operating assets		(14,265)	(78,714)	(59,966)
Net change in operating liabilities		7,468	68,470	44,743
Net cash flows from operating activities before tax		4,509	(2,422)	269
Income taxes paid		(797)	(895)	(991)
Cash flows from operating activities		3,712	(3,317)	(722)

Cash flows from investing activities		863	(289)	(1,643)
Cash flows from financing activities		1,343	298	(2,106)
Net increase/(decrease) in cash and cash equivalents		5,918	(3,308)	(4,471)
Opening cash and cash equivalents		6,185	9,493	13,964
Closing cash and cash equivalents	53	12,103	6,185	9,493

1 Adjustment to bring changes between opening and closing balance sheet amounts to average rates. This is not done on a line-by-line basis, as details cannot be determined without unreasonable expense.

The notes to the accounts on pages F-7 to F-115 form an integral part of these financial statements.

Consolidated Cash Flow Statements
For the years ended 31 December

Investing Activities

	2008	2007	2006
	£m	£m	£m
Sale of other intangible assets	409	31	27
Purchase of other intangible assets	(306)	(249)	(194)
Sale of property and equipment	185	182	60
Purchase of property and equipment	(410)	(307)	(280)
Purchase of investment properties	(129)		
Sale of investment properties	398	58	2
Investment in subsidiaries		(41)	(1,241)
Disposal of subsidiaries	1,110	115	87
Investment in jointly controlled entities and associates	(489)	(396)	(202)
Disposal of jointly controlled entities and associates	75	176	29
Dividends received from jointly controlled entities	12	132	57
Dividends received from associates	8	10	12
Cash flows from investing activities	863	(289)	(1,643)

Financing Activities

	2008	2007	2006
	£m	£m	£m
Issue of ordinary shares	4,131	146	548
Issue of equity preference shares to minority shareholders	750		
Share capital buyback		(500)	(982)
Purchase of own shares	(189)	(212)	(99)
Disposal of own shares	101	35	52
Issue of other borrowed funds	2,285	4,742	1,571
Repayments of other borrowed funds	(3,021)	(928)	(777)
Interest on other borrowed funds relating to the servicing of finance	(1,505)	(1,199)	(1,153)
Minority interest acquired	242		287
Minority interest disposed			(30)
Repayment of capital to minority interests	(110)		
Equity dividends paid	(1,286)	(1,747)	(1,501)
Dividends paid to minority shareholders in subsidiaries	(55)	(39)	(22)
Cash flows from financing activities	1,343	298	(2,106)

The notes to the accounts on pages F-7 to F-115 form an integral part of these financial statements.

Notes to the Financial Statements

Accounting Policies

Financial Statements

The financial statements of HBOS plc comprise the Consolidated Income Statement and the Consolidated Balance Sheets, Cash Flow Statements and Statements of Recognised Income and Expense together with the related Notes to the Financial Statements. These disclosures are required under IAS 1 ‘Presentation of Financial Statements’ relating to the management of capital and IFRS 7 ‘Financial Instruments: Disclosures’ relating to the nature of risks and their management. These disclosures form an integral part of the financial statements and are prefaced as such on the respective pages.

Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the IASB, and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

Basis of Preparation

a) Principles Underlying Going Concern Assumption

During 2008, global financial markets experienced difficult conditions which have been characterised by a marked reduction in liquidity. As a consequence of this, governments and central banks carried out a series of actions to address the lack of liquidity within their respective banking systems. In the UK these actions have included the introduction by the Bank of England of liquidity support, through schemes (collectively “Bank of England facilities”) such as the extended Long–Term Repo open market operations and the Special Liquidity Scheme (SLS) whereby banks and building societies can exchange eligible securities for UK treasury bills; and the creation of a credit guarantee scheme by HM Treasury, providing a government guarantee for certain short and medium term senior debt securities issued by eligible banks. During 2008 the Group has made use of these measures in order to maintain and improve a stable funding position. The Group’s management of liquidity and funding risks is described in Note 57 Risk Management.

In the context of this continued turbulence and uncertainty in the financial markets, combined with a deteriorating global economic outlook, the Group has also taken steps to strengthen its capital position in order to provide a buffer against further shocks arising from the financial systems and to ensure that it remains competitive. On 15 January 2009, in conjunction with the takeover of the Group by Lloyds TSB Group plc (Note 58), the Group raised £11,345m (net after costs) in preference and ordinary share capital (Note 39).

On 16 January 2009, following completion of the acquisition of the Group by Lloyds Banking Group plc, the Group became a wholly owned subsidiary and became dependent upon the ultimate parent and its banking subsidiaries for its capital, liquidity and funding needs.

There is a risk despite the substantial measures taken so far by governments, that further deterioration in the markets could occur. In addition the economic conditions in the UK are deteriorating more quickly than previously anticipated placing further strain on the Lloyds Banking Group’s capital resources. The key dependencies on successfully funding the Lloyds Banking Group’s balance sheet include the continued functioning of the money and capital markets at their current levels; the continued access of the Lloyds Banking Group to central bank and Government sponsored liquidity facilities including access to HM Treasury’s credit guarantee scheme and access to the Bank of England’s various facilities; limited further deterioration in the Lloyds Banking Group’s credit ratings; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets or Government support schemes.

Based upon projections prepared by Lloyds Banking Group plc management which take into account the completion of the acquisition on 16 January 2009 of the Group (Note 59) and together with the Lloyds Banking Group's current ability to fund in the market and assumption that announced Government sponsored schemes will continue to be available, the Directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. The Group has received confirmation that it is the current intention of Lloyds Banking Group plc to ensure that the Group's subsidiaries should have at all times for the foreseeable future access to adequate resources to continue to trade and meet their liabilities as they fall due. Accordingly, the financial statements of the Group have been prepared on a going concern basis.

b) Basis of Measurement
The financial statements have been prepared under the historical cost basis, except that the following assets and liabilities are stated at their fair values: derivatives, financial instruments held for trading, financial instruments designated at fair value through the income statement, financial instruments classified as available for sale and investment properties. In addition insurance contracts, investment contracts with discretionary participation features and value of in-force long term assurance business included in the insurance and investment business are prepared on the basis set out in the applicable accounting policy.

IFRS Applied in 2008
The following IFRS amendments have been applied in 2008:

Amendments to IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 7 'Financial Instruments: Disclosures'
In view of the ongoing market dislocation and the deterioration of the world's financial markets, the Group transferred certain asset backed securities (ABS) and floating rate notes (FRNs) from the 'held for trading' classification to the 'available for sale' classification with effect from 1 July 2008 at their fair values at that date. Subsequently, in light of increasing illiquidity in the markets for ABS, the Group changed the classification of ABS from 'available for sale' to 'loans and receivables' with effect from 1 November 2008. There have been no other reclassifications in the year. Thereafter the recognition and measurement principles of IAS 39 are followed. Disclosure of these reclassifications is given in Note 45.

The following IFRIC interpretations have been applied in 2008:

IFRIC 11 IFRS2 'Group and Treasury Share Transactions'
IFRIC 11 provides guidance on accounting in the separate financial statements of subsidiaries for transactions where a parent grants rights to its equity instruments directly to the employees of subsidiaries and where the subsidiary grants to its employees rights to the equity instruments of the parent. The application of this interpretation has not affected the consolidated financial statements as costs are recharged to the subsidiaries on the basis prescribed in the interpretation.

IFRIC 14 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'
This interpretation has been applied in full within these financial statements. However, due to the financial rules of the Group's defined benefit schemes, its application has not impacted upon the Group's recognition or measurement of pension assets and liabilities under IAS 19 'Employee Benefits', nor is it expected to at future reporting dates.

Notes to the Financial Statements
continued

The accounting policies below have been consistently applied to all periods presented in these financial statements. Certain comparative amounts have been reclassified to conform to the current year's presentation.

Basis of Consolidation
The consolidated financial statements include the results of the Company and its subsidiary undertakings, (and, where appropriate, special purpose vehicles), together with the Group's interests in associates and jointly controlled entities.

The financial statements of entities controlled by the Group are consolidated in the Group financial statements commencing on the date control is obtained until the date control ceases. Control is defined as being where the Group has power, directly or indirectly, to govern the financial and operating policies of such entities so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. When assessing whether or not a special purpose entity (SPE) that has been sponsored by the Group should be consolidated or not, the Group considers the indicators of control that are included in the Standing Interpretations Committee (SIC) Interpretation 12 'Consolidation – Special Purpose Entities' and if these are met the SPE is included in the consolidation.

Open Ended Investment Companies (OEICs) where the Group, through the Group's life funds, has a controlling interest are consolidated. The unit holders' interest is reported in investment contract liabilities.

All intra-group balances, transactions, income and expenses are eliminated on consolidation.

Recognition and Derecognition of Financial Assets and Liabilities
The Group recognises loans and advances to customers and banks, deposits by banks, customer accounts, debt securities in issue, other borrowed funds and other financial assets and liabilities upon origination.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire or it transfers the right to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in the transferred financial asset that is created or retained by the Group is recognised as a separate asset.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expired.

Derivatives
Derivatives are measured at fair value and initially recognised on the date the contract is entered into. Where the fair value of a derivative is positive, it is carried as a derivative asset and where negative, as a derivative liability. The gain or loss from changes in fair value is taken to net trading income, except for interest from derivatives used for economic hedging purposes that do not qualify for hedge accounting treatment which is taken to net interest income, insurance and investment related derivatives which are taken to net investment income related to insurance and investment business or when cash flow hedge accounting is employed.

Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of the same. At inception of the hedge relationship formal documentation is drawn up specifying the hedging strategy, the component transactions and the methodology that will be used to measure effectiveness.

Monitoring of hedge effectiveness is undertaken continually. A hedge is regarded as effective if the change in fair value or cash flows of the hedge instrument and the hedged item are negatively correlated within a range of 80% to 125%, either for the period since effectiveness was last tested or cumulatively since inception.

The Group uses three hedge accounting methods:

Firstly, fair value hedge accounting offsets the change in the fair value of the hedging instrument against the change in the fair value of the hedged item in respect of the risk being hedged. The hedged item is adjusted for the fair value of the risk being hedged irrespective of its financial instrument classification. These changes in fair value are recognised in the income statement through net trading income. Adjustments made to the carrying amount of the hedged item for fair value hedges will be amortised on an effective interest rate basis over the remaining expected life in line with the presentation of the underlying hedged item. If the hedge is highly effective the net impact on the income statement is minimised.

Secondly, cash flow hedge accounting matches the cash flows of hedged items against the corresponding cash flow of the hedging derivative. The effective part of any gain or loss on a hedging instrument is recognised directly in equity in the cash flow hedge reserve and the hedged item is accounted for in accordance with the policy for that financial instrument. Any ineffective portion of the hedging instrument's fair value is recognised immediately in the income statement through net trading income. The amount deferred in reserves remains until the designated transaction occurs at which time it is released and accounted for in the income statement in line with the treatment of the hedged item. Where the hedge relationship subsequently proves ineffective, or where the hedged item is settled early or is terminated, the associated gains and losses that were recognised directly in reserves are reclassified to the income statement through net trading income. Where the hedging instrument expires or is terminated before the forecast transaction occurs, the associated gains and losses recognised in reserves remain deferred until the forecast transaction occurs.

Thirdly, hedging of net investments in foreign operations is discussed within the foreign currencies accounting policy.

A derivative may be embedded in another financial instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract, the embedded derivative is separated from the host and held separately on the balance sheet at fair value, except for those instruments that have been designated at fair value through the income statement, where the derivative is not separated from the host instrument. Changes in fair value are taken to the income statement through net trading income, and the host contract is accounted for in accordance with the policy for that class of financial instrument.

If quoted or market values are not available then derivative fair values are determined using valuation techniques that are consistent with techniques commonly used by market participants to price these instruments. These techniques include discounted cash flow analysis and other pricing models. The fair values calculated from these models are regularly compared with prices obtained in actual market transactions to ensure reliability. In all material instances

Notes to the Financial Statements
continued

these techniques use only observable market data.

Loans and Advances
Loans and advances held for trading principally consist of reverse repurchase agreements, are carried at fair value and are classified as financial assets held for trading. Gains, losses and related income are taken to net trading income as they arise.

All other loans and advances are classified as loans and receivables. They are initially recognised at the draw down date at the fair value on the commitment date plus directly attributable incremental transaction costs. They are subsequently carried at amortised cost using the effective interest method less provision for impairment.

The fair value of loans and advances to customers is measured at the commitment date and calculated by discounting anticipated cash flows, including interest, at a current market rate of interest. The fair value of floating rate loans and advances and overnight deposits is considered by the Group to be equal to the carrying value as these loans and advances are accounted for at current interest rates and credit risk is assessed in the impairment review. The fair value of fixed interest bearing accounts is based on cash flows discounted using current money market interest rates for debts with similar maturity and credit risk characteristics.

Loans and advances that are performing in accordance with the underlying contract are classified as neither past due nor impaired. If a customer fails to make a payment that is contractually due, or if the loan is in excess of facility limit, the loan is classified as past due.

If subsequently all contractually due payments are made or if the loan continues to operate within limit, the loan reverts to its neither past due nor impaired status.

The Group assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and individually or collectively for assets that are not significant. The estimation involved in these impairment assessments is considered a critical accounting estimate.

Objective evidence that a financial asset is impaired includes significant difficulty of the customer, breach of contract such as interest or principal payments being missed, the loan being in excess of facility limit for a sustained period or the likelihood that the borrower will enter bankruptcy. Objective evidence may also arise from wider economic and financial market indicators including factors that pertain to a particular industry sector or local economy.

The amount of any impairment is calculated by comparing the net present value of estimated future cash flows, discounted at the loan's original effective interest rate, with the carrying value of the loan. If impaired, the carrying value is adjusted via the provision and the additional provision is charged to the income statement.

The written down value of the impaired loan is compounded back to the net realisable balance over time using the original effective interest rate. This is reported through interest income in the income statement and represents the unwinding of the discount.

A write-off is made when it is not possible or economically viable to collect all or part of a claim. Write-offs are offset against the release of a previously established impairment provision or directly through the income statement.

Loans with no identified evidence of individual impairment are subject to collective impairment assessment. This is to quantify impairment losses which exist at the balance sheet date, but which have not yet been individually identified. Collective assessment is carried out for groups of assets that share similar risk characteristics. Collective impairment is assessed using a methodology based on existing risk conditions or events that have a strong correlation with a tendency to default.

Terms and conditions for past due or impaired loans and advances may be renegotiated. When the renegotiated contract becomes effective, the loan is subsequently classified as past due, impaired or neither past due nor impaired according to its performance under the renegotiated terms.

Loans and advances to customers include advances that are subject to non-returnable finance arrangements following securitisation of portfolios of mortgages and other advances. The principal benefits of these advances are acquired by special purpose securitisation entities that fund their purchase primarily through the issue of debt securities in issue.

Syndications

Syndication activity is undertaken as part of the Group’s risk management strategy specifically with the intention of transferring credit risk and obtaining financing as distinct from trading.

The Group considers that loan commitments and subsequent draw down form one contract and the loan is therefore recognised at the date of the draw down at the fair value as measured at the commitment date plus directly attributable and incremental transaction costs. Loans pending syndication are classified as loans and receivables and derecognised upon sell down when the risks and rewards are transferred to a third party.

Finance Leases and Operating Leases

Assets leased to customers that transfer substantially all the risks and rewards incidental to ownership to the customer are classified as finance leases. They are recorded at an amount equal to the net investment in the lease, less any provisions for impairment, within loans and advances to customers.

The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the pre-tax net investment method, which reflects a constant periodic rate of return on the net investment.

All other assets leased to customers that do not transfer substantially all the risks and rewards of ownership are classified as operating leases. These assets, less any provision for impairment, are separately disclosed in the balance sheet and are recorded at cost less accumulated depreciation, which is calculated on a straight-line basis over their estimated useful lives. Operating lease rentals are recognised in operating income on a straight-line basis over the lease term. Finance and operating lease assets are regularly reviewed for impairment.

Leases entered into by the Group as lessee are primarily operating leases. Operating lease rentals payable are recognised as an expense in the income statement on a straight-line basis over the term unless a more systematic basis is more appropriate.

Investment Securities

Investment securities held for trading are classified as financial assets held for trading and are carried at fair value. Gains, losses and related income are taken to net trading income as they arise. Investment securities designated at fair value through

F-9

Notes to the Financial Statements
continued

the income statement are carried at fair value. Gains, losses and related income are taken to other operating income as they arise, except for those related to insurance and investment business which are taken to net investment income related to insurance and investment business.

Debt securities other than those held for trading or designated at fair value and for which there is no active market at inception are classified as loans and receivables. They are initially recognised at fair value plus directly related incremental transaction costs and are subsequently carried on the balance sheet at amortised cost using the effective interest rate method less provision for impairment.

All other investment securities are classified as available for sale. They are initially recognised at fair value plus directly related incremental transaction costs and are subsequently carried on the balance sheet at fair value. Unrealised gains or losses arise from changes in the fair values and are recognised directly in equity in the available for sale reserve, except for impairment losses or foreign exchange gains or losses related to debt securities, which are recognised immediately in the income statement in impairment on investment securities or other operating income respectively. Income on debt securities is recognised on an effective interest rate basis and taken to interest income through the income statement. Income from equity shares is credited to other operating income, with income on listed equity shares being credited on the ex-dividend date and income on unlisted equity shares being credited on an equivalent basis. On sale or maturity, previously unrealised gains and losses are recognised in other operating income.

Investment securities classified as available for sale are continually reviewed at the specific investment level for impairment. Impairment is recognised when there is objective evidence that a specific financial asset is impaired. Objective evidence of impairment might include a significant or prolonged decline in market value below the original cost of a financial asset and, in the case of debt securities, including those reclassified as loans and receivables, non-receipt of due interest or principal repayment, a breach of covenant within the security's terms and conditions or a measurable decrease in the estimated future cash flows since their initial recognition.

Impairment losses on available for sale equity instruments are not reversed through the income statement. Any increase in the fair value of an available for sale equity instrument after an impairment loss has been recognised is treated as a revaluation and recognised directly in equity. An impairment loss on an available for sale debt instrument is reversed through the income statement, if there is evidence that the increase in fair value is due to an event that occurred after the impairment loss was recognised.

The fair values of investment securities trading in active markets are based on market prices or broker/dealer valuations. Where quoted prices on instruments are not readily and regularly available from a recognised broker, dealer or pricing service, or available prices do not represent regular transactions in the market, the fair values are estimated using quoted market prices for securities with similar credit, maturity and yield characteristics or similar valuation models. Investment securities, principally asset backed securities (ABS) not traded in an active market are valued using valuation models that include non-market observable inputs. These models use observed issuance prices in related asset classes, market correlations, prepayment assumptions and external credit ratings. Additional assessments are then made on possible deterioration in credit risk for each individual security and on additional liquidity considerations for particular asset classes.

The Group uses trade date accounting when recording the purchase and sale of investment securities.

Jointly Controlled Entities and Associates
Jointly controlled entities are entities over which the Group has joint control under a contractual arrangement with other parties.

Associates are entities over which the Group has significant influence, but not control over the financial and operating policies. Significant influence is the power to participate in the financial and operating policy decisions of the entity but is not control over those policies.

The venture capital exemption is taken for investments where significant or joint control is present and the investing area operates as a venture capital business. These investments are designated at fair value through the income statement. Otherwise, the Group's share of results of associates and jointly controlled entities, generally based on audited accounts, are included in the consolidated financial statements using the equity method of accounting. The share of any losses is restricted to a level that reflects an obligation to fund such losses.

Goodwill
The excess of the cost of a business combination over the interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the date of acquisition of a business is capitalised as goodwill. The goodwill is allocated to the cash-generating units or groups of cash-generating units that are expected to benefit from the acquisitions concerned.

In most cases, the cash-generating units represent the business acquired.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Cash-generating units to which goodwill is allocated are subject to a semi-annual impairment review at 31 March and 30 September and whenever there is an indication that the unit may be impaired. This compares the recoverable amount, being the higher of a cash generating units' fair value less costs to sell and its value in use, with the carrying value. When this indicates that the carrying value of goodwill is not recoverable, it is irrevocably written down through the income statement by the amount of any impaired loss identified. Further details of the calculation are given in the critical accounting estimates and in Note 23.

IFRS 3 'Business Combinations' has not been applied retrospectively to business combinations that occurred before 1 January 2004.

Software
Costs associated with the development of software for internal use, subject to de minimis limits, are capitalised if the software is technically feasible and the Group has both the intent and sufficient resources to complete the development. Costs are only capitalised if the asset can be reliably measured and will generate future economic benefits to the Group either through sale or use.

Only costs that are directly attributable to bringing the asset into working condition for its intended use are capitalised. These costs include all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in a manner intended by management. Other development expenditure is recognised in the income statement as an

Notes to the Financial Statements
continued

expense as incurred.

Capitalised development expenditure and purchased software is stated at cost less accumulated amortisation and impairment losses. Once the software is ready for use, the capitalised costs are amortised over their expected lives, generally four years. Capitalised software is assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The amortisation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

Subsequent expenditure is only capitalised when it increases the future economic benefits embodied in the specific asset to which it relates.

Purchased Value of In-Force Investment Contracts
The Group's contractual rights to benefits from providing investment management services in relation to investment contracts acquired in business combinations and portfolio transfers are measured at fair value at the time of acquisition. The resulting asset is referred to as purchased value of in-force investment contracts (PVIF) and is amortised over the estimated lives of the contracts on a systematic basis. At each reporting date an assessment is made to determine if there is any indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The amortisation charge is then adjusted to reflect the revised carrying amount.

Property, Plant and Equipment
Property, plant and equipment is stated at cost less accumulated depreciation and impairment losses.

Freehold land is not depreciated. Freehold and leasehold property, other than freehold investment properties, is stated at cost and depreciated over fifty years or the length of the lease term if shorter. Improvements to leasehold properties are stated at cost and are depreciated in equal instalments over the lesser of the remaining life of the lease or eight years. Premiums are amortised over the period of the lease.

The cost of equipment, which includes fixtures and fittings, vehicles and computer hardware, less estimated residual value, is written off in equal instalments over the expected lives of the assets, generally between three and eight years.

Subsequent costs are included in the asset's carrying amount, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

Property and equipment is assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The depreciation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

Investment Properties
Investment properties comprise freehold and leasehold property that are held, either to earn rental income or for capital appreciation or both. They are initially recognised at cost and are fair valued annually. Rental income from investment properties is recognised on a straight-line basis over the term of the lease and any gains or losses arising

from a change in the fair value are recognised in the income statement in the period that they occur through other operating income, except for those relating to insurance and investment business, which are taken through net investment income related to insurance and investment business.

Disposal Group

Assets and liabilities of a disposal group are classified as held for sale where the carrying amount will be recovered principally through a sale transaction as opposed to continuing use. This applies where the assets and liabilities are available for sale in their present condition, subject only to the terms that are usual and customary for the sale of such assets and liabilities, and when a sale is highly probable and expected to complete within one year of being classified as a disposal group. Disposal groups are measured at the lower of carrying amount and fair value less costs to sell.

Deposits by Banks and Customer Accounts

Deposits by banks and customer accounts held for trading are classified as financial liabilities held for trading and are carried at fair value. Gains, losses and related income are taken to net trading income as they arise. All other customer accounts and deposits by banks are held at amortised cost using the effective interest method.

The fair value of customer deposits with no stated maturity date is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings with no quoted market price is calculated using a cash flow model discounted using interest rates for debts with similar maturities.

Repurchase Agreements

Securities sold subject to repurchase agreements are retained within the balance sheet where the Group retains substantially all of the risks and rewards of ownership. Funds received under these arrangements are included within deposits by banks, customer accounts or financial liabilities held for trading. Conversely, securities acquired under commitments to resell are not recognised in the balance sheet as debt securities where substantially all the risks and rewards do not pass to the Group. In this case, the purchase price is included within loans and advances to banks, loans and advances to customers, or financial assets held for trading. The difference between sale and repurchase prices for such transactions is reflected in the income statement over the lives of the transactions, within interest payable or interest receivable as appropriate.

General Insurance Business

The Group underwrites general insurance products. For each general insurance policy underwritten, premiums (net of refunds) are credited to net earned premiums on insurance contracts over the period of risk coverage of the insurance policy.

The cost of claims notified but not settled and claims incurred but not reported at the balance sheet date are estimated and provided for. Claims incurred comprise the settlement and handling costs of paid and outstanding claims arising from events occurring during the financial year together with adjustments to prior year claims provisions. Estimates are based upon an assessment of the likely costs taking account of all known facts. Where the outcome of outstanding cases is unclear, statistical techniques are used which take into account the cost of recent similar claim settlements.

Costs related to the acquisition of new insurance contracts (including commissions paid to intermediaries and other related administration costs) are capitalised as deferred acquisition costs (DAC) and amortised on the same basis that premiums are recognised.

Notes to the Financial Statements
continued

Where the expected value of claims and expenses attributable to unexpired risk periods exceed the value of unearned premiums less DAC, at the balance sheet date, additional provisions are made for the anticipated losses.

The accounting policies set out above in respect of the measurement of the insurance contract liabilities include liability adequacy testing that meets the requirements of IFRS 4 'Insurance Contracts'.

Insurance and Investment Product Classification
The Group has classified its long term insurance and investment business in accordance with IFRS 4 'Insurance Contracts' as follows:

Insurance contracts are contracts containing significant insurance risk. Such contracts remain insurance contracts until all rights and obligations are extinguished or expired;

Investment contracts with a discretionary participation feature (DPF) are contracts that do not contain significant insurance risk but that contain discretionary participation features, which for the Group are its with-profit contracts; and

Investment contracts are contracts that have neither significant insurance risk nor a DPF.

General insurance business only issues insurance contracts.

Value of In-force Long Term Assurance Business (VIF)
The Group places a value on the long term insurance contracts and investment contracts with DPF, which represents the present value of future cash flows attributable to the Group with respect to these contracts. The change in VIF is accounted for as revenue.

In-force business is defined as all policies where the first premium has been paid. For traditional with-profit business, the surplus attributable to the Group equates to one ninth of the cost of the bonuses declared in any year. The level of assumed future bonuses is calculated by projecting the portfolio of with-profit business forward and applying reversionary and terminal bonus rates so as to exhaust the projected surplus of assets attributable to with-profit policyholders.

Insurance Contracts and Investment Contracts with DPF
As permitted by IFRS 4 'Insurance Contracts', the Group applies accounting policies that are usual and customary in the insurance industry. In particular the Group applies the UK guidance set out in FRS 27 'Life Assurance'.

Insurance contracts and investment contracts with DPF liabilities written within the with-profit fund, including both traditional and unitised with-profit contracts, are calculated with reference to the expected payout using realistic and, where applicable, market consistent assumptions. Insurance contract liabilities within the non-profit funds are calculated in accordance with the Prudential Sourcebook for insurers (INSPRU) issued by the UK Financial Services Authority. For insurance contracts, premiums are recognised as revenue when due from the policyholder and claims payable are recorded when notified or due. For unitised with-profit contracts, where the policyholder has the choice to invest in a unit-linked investment fund, deposits and withdrawals are accounted for directly on the balance sheet. Similarly, for investment contracts with DPF, deposits and withdrawals are accounted for directly in the balance sheet.

At each reporting date an assessment is made of whether liabilities are adequate using current estimates of future cash flows and taking into account the value of any related VIF asset.

Any deficiency is immediately charged to the income statement by establishing a provision on the balance sheet.

Costs related to the acquisition of new long-term insurance and investment with DPF contracts are expensed as incurred.

Investment Contracts
The Group's investment contracts, which include collective investment schemes, are primarily unit-linked. These contracts are managed and evaluated on a fair value basis in accordance with the terms of the contracts as benefits are linked to the fair value of the assets supporting the contracts. Accordingly, the investment contract liabilities have been designated at fair value through the income statement with fair value changes recognised through change in investment contract liabilities. The fair value of the liabilities is estimated using a valuation technique. In accordance with this technique the liability is established as the bid value of the assets held to match the liability, less an allowance in relation to deductions made to the liability for capital gains tax on the gains relating to the matching assets. Deposits and withdrawals are accounted for directly in the balance sheet as adjustments to the liability with other changes recognised in the income statement.

Revenue in relation to investment management services is recognised as the services are provided. Incremental costs directly attributable to securing the Group's contractual right to benefit from providing investment management services in relation to investment contracts, other than through a business combination or portfolio transfer (refer to the accounting policy for intangible assets), are recognised as an asset if it is probable that they will be recovered. Incremental costs include commissions paid to intermediaries and other similar costs. This asset, referred to as deferred origination costs, is amortised as the related investment management revenue is recognised, and its recoverability assessed at each balance sheet date on a portfolio basis.

Unallocated Surplus
The unallocated surplus is accounted for as a liability as permitted by IFRS 4. The carrying value of the unallocated surplus is determined as the residual assets of the with-profit fund after providing for the with-profit liabilities in accordance with the policies described above.

Reinsurance
Contracts entered into with reinsurers under which the Group is compensated for losses on insurance contracts issued by the Group, and that meet the classification requirements for insurance contracts, are classified as reinsurance contracts held. The benefits to which the Group is entitled under these contracts are recognised as reinsurance assets. These assets consist of short term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts, in accordance with the terms of each reinsurance contract, and are regularly reviewed for impairment.

Post Retirement Schemes
The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan. The net obligation represents the present value of the future benefits owed to employees in return for their service in the current and prior periods, after the deduction of the fair value of any plan assets.

The discount rate used is the market yield on high quality

F-12

Notes to the Financial Statements
continued

corporate bonds at the balance sheet date that have maturity dates approximating to the terms of the Group's obligation. The calculation is performed by a qualified actuary using the projected unit credit method. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately through the statement of recognised income and expense.The charge to the income statement for defined benefit schemes includes current service cost, past service cost, the interest cost of the scheme liabilities and the expected return on scheme assets.

The cost of contributions to defined contribution pension schemes are recognised as an expense in the income statement as incurred.

Taxation
Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

The tax charge is analysed between tax that is payable in respect of policyholder returns and tax that is payable on shareholders' equity returns. This allocation is based on an assessment of the effective rate of tax that is applicable to shareholders' equity for the year.

Deferred tax is provided in full using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following differences are not provided: goodwill not deductible for tax purposes, the initial recognition of assets and liabilities that affects neither accounting nor taxable profit, and overseas earnings where both remittance is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, based on tax rates that are enacted or substantially enacted at the balance sheet date.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Provisions
The Group recognises a provision if there is a present obligation as a consequence of either a legal or a constructive obligation resulting from a past event. To recognise this it should be probable that an outflow of economic resources, that can be reliably measured, will be required to settle the obligation. Provisions are measured as the discounted expected future cash flows taking account of the risks and uncertainties associated with the specific liability where appropriate.

A constructive obligation is only deemed to exist in respect of restructuring provisions once a detailed restructuring plan has been formally approved and the plan has been announced publicly or work on the restructure has commenced.

Provision is made for undrawn loan commitments which have become onerous.

As explained under critical accounting judgements, if the Group assesses that a constructive obligation for a regulatory provision exists then a provision is established. Where the provisioning criteria are met, the Group makes provision for the estimated cost of making redress payments to customers in respect of past product sales where the sales processes have been deficient. To calculate the provision the Group estimates the number of cases requiring redress and the average cost per case. These are dependent upon, inter alia, the volume of claims, the actions of regulators and, as appropriate, the performance of investments. As progress is made in settling claims, if necessary, the Group revises its judgements and estimates based on the emerging trends.

Debt Securities in Issue

Debt securities in issue held for trading are classified as financial liabilities held for trading and are carried at fair value. Gains, losses and related expense are taken to net trading income as they arise. Debt securities in issue designated at fair value through the income statement are carried at fair value. Gains, losses and related expense are taken to other operating income as they arise, except for those related to insurance and investment business which are taken to net investment income related to insurance and investment business. All other debt securities in issue are held at amortised cost. They are initially recognised at fair value plus directly related incremental transaction costs and are subsequently carried on the balance sheet at amortised cost using the effective interest method.

Fair values are calculated based on quoted market prices. Where quoted market prices are not available, a cash flow model is used, discounted using an appropriate current yield curve for the remaining term to maturity.

Other Borrowed Funds

Other borrowed funds comprises preference shares that are classified as debt, preferred securities and subordinated liabilities, all of which are held at amortised cost, using the effective interest method.

Preference shares are classified as debt where they are redeemable on a specific date, or at the option of the shareholders, or if dividend payments are not discretionary. Dividends on preference shares classified as debt are recognised in the income statement through interest expense.

Preferred securities are issued at or close to market values. These are classified as debt where they are redeemable on a specific date, or at the option of the holders, or if interest payments are not discretionary. The interest payable on such securities is recognised in the income statement through interest expense.

Subordinated liabilities consist of dated and undated loan capital. The interest payable is recognised in the income statement through interest expense.

Share Capital

Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

Netting

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of offset and there is an intention and ability to settle on a net or simultaneous basis.

Where master netting agreements allow for offset only on

F-13

Notes to the Financial Statements
continued

default by one of the parties, the Group presents the disclosures on a gross basis.

Foreign Currencies
The consolidated financial statements are presented in sterling which is the Group's functional and presentation currency.

Foreign currency transactions are translated into sterling at the exchange rate prevailing at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are translated at balance sheet date exchange rates. Exchange differences arising, including those from changes in the amortised cost of foreign currency monetary available for sale assets, are recognised in the income statement except for differences arising from hedges of net investments in foreign operations and derivatives related to cash flow hedges which are recognised directly in equity.

Non-monetary assets and liabilities carried at historical cost are translated using the historical exchange rate.

Non-monetary assets and liabilities carried at fair value are translated at exchange rates on the date the fair value is determined. Exchange differences arising are recognised in the income statement except those relating to available for sale financial assets (equity investments), which are recognised directly in reserves.

The results and financial position of all Group entities that have a functional currency different from sterling are translated into sterling as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of the balance sheet;

- goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign entity and translated at the closing rate; and

- income and expenses are translated at the average exchange rates for the period (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions).

All resulting exchange differences are recognised as a separate component of other reserves within equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to equity where the hedge is deemed to be effective. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale. The ineffective portion of any net investment hedge is recognised in the income statement immediately.

Cumulative translation differences for all foreign operations are deemed to be zero at 1 January 2004. Any gain or loss on the subsequent disposal of a foreign operation will exclude translation differences that arose before 1 January 2004, but include later translation differences.

Cash and Cash Equivalents
Cash and cash equivalents consist of cash and balances at central banks that are freely available, and loans and advances to banks with an original maturity of three months or less excluding financial assets that are held for trading purposes.

Share-based Payments
The Group predominantly operates equity-settled share-based compensation schemes in exchange for employee services received. The fair values of options or shares granted are determined at the date of grant and expensed over the vesting period. The fair values of the options or shares granted are measured using various models, taking into account the terms and conditions upon which the options and shares were granted. Market conditions are taken into account to set the fair value at grant and are not updated. Non-market vesting conditions, including non-market performance conditions, are not reflected in the grant date fair value but are reflected within estimates of the number of options or shares expected to vest. Any adjustments required as a result of updating these estimates are taken to the income statement over the remaining vesting period. Modifications are assessed at the date of modification and any incremental charges required are charged to the income statement over any remaining vesting period. For share-based compensation schemes settled by the Group a recharge equal to the cost during the period is made to subsidiary companies.

Effective Interest Rate
Revenue on financial instruments classified as loans and receivables, available for sale and expense on financial liabilities at amortised cost, are recognised on an effective interest rate basis. This calculation takes into account interest received or paid and fees and commissions paid or received that are integral to the yield as well as incremental transaction costs and all other premiums and discounts. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial instrument at initial recognition. These calculations are undertaken on a portfolio basis other than in respect of significant balances, relating principally to larger corporate customers, which are assessed individually. In applying the portfolio basis, the Group makes use of various statistical modelling techniques which are specific to different portfolios to estimate redemption profiles and derive the expected cash flows. A number of relevant considerations are taken into account to estimate the cash flows of individually significant corporate balances, including previous experience of customer behaviour, credit scoring of the customer and anticipated future market conditions at the date of acquisition. The impact of the assumption related to the expected life of the instruments is considered under critical accounting estimates.

Fees and Commission
Fees and commission income and expense is recognised in the income statement as the related service is provided except those that are integral to the effective interest rate calculations or to investment contract deferred origination costs.

Fees and commission recognised in the income statement include service fees, agency and management fees, transaction fees, guarantee fees, letter of credit fees, asset management fees and non-utilisation fees.

Syndication and underwriting fees are spread over the expected term of the sell down. In the event of the loan not being sold down then no fees are recognised.

Fees and commission included in the effective interest calculation are those that are incremental and directly attributable to the origination of the product and which are integral to the yield of the product. These include arrangement fees, incentives such as cash backs, intermediary fees and commissions, high loan to value fees and procurement fees.

F-14

Notes to the Financial Statements
continued

Guarantees
Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantees are initially recognised at fair value on the date the guarantee was given. Subsequent to initial recognition, the Group's liabilities under such guarantees are measured at the higher of the amount determined under the Group's accounting policy on provisions and the amount initially recognised less cumulative amortisation recognised to record any fee income earned in the period.

Critical Accounting Judgements and Estimates
The preparation of financial statements requires management to make judgements, estimates and assumptions that affect 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 on amounts which differ from those estimates. Judgements, estimates 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. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

a) Critical Accounting Judgements
The preparation of the financial statements necessarily requires the exercise of judgement in the application of accounting policies which are set out above. These judgements are continually reviewed and evaluated based on historical experience and other factors. The principal critical accounting judgements made by the Group that have a material financial impact on the financial statements are as follows:

Designation of Financial Instruments
The Group has classified its financial instruments in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'. In some instances the classification is prescribed whilst in others the Group is able to exercise judgement in determining the classification as follows:

Non-derivative financial assets, other than those held for trading, where there is no active market and which have fixed or determinable payments are classified as 'loans and receivables';

The Group's 'trading' portfolio is classified as 'held for trading'. The Group exercises judgement in determining which financial instruments form part of its trading book. This is determined at acquisition by the purpose for which the instrument is acquired;

The Group exercised judgement when determining that the ongoing market dislocation and deterioration of the world's financial markets that occurred during the third quarter of 2008 was a sufficiently rare circumstance to warrant a reclassification of certain financial assets from 'held for trading' to 'available for sale' for which the Group has the intention and ability to hold these assets for the foreseeable future. The Group also subsequently reclassified certain financial assets from 'available for sale' to 'loans and receivables'. In both cases, the Group had the intention and ability to hold the financial assets for the foreseeable future and the financial assets transferred met the classification criteria of loans and receivables;

Derivative instruments are automatically classified as 'at fair value through the income statement' unless they form part of an effective hedging relationship. The Group's accounting policy for hedge accounting is described under the policy for derivatives;

Instruments that are deemed by the Group on initial recognition to eliminate a measurement mismatch or where they contain an embedded derivative which is not separated from the host contract are designated on initial recognition as 'at fair value through the income statement'. In addition portfolios of assets, liabilities or both that are managed and the performance evaluated on a fair value basis in accordance with a documented risk or investment management strategy are designated on initial recognition 'at fair value through the income statement';

In addition the venture capital exemption is taken for investments where significant influence or joint control is present and the investing area operates as a venture capital business. These investments are designated 'at fair value through the income statement'. This policy is applied consistently across the Group's portfolios. Judgement is applied when determining whether or not a business area operates as a venture capital business. The judgement is based on consideration of whether, in particular, the primary business activity is investing for current income, capital appreciation or both; whether the investment activities are clearly and objectively distinct from any other activities of the Group; and whether the investee operates as a separate business autonomous from the Group;

Assets in support of the general insurance and long term assurance businesses are designated by the Group, as 'at fair value through the income statement';

Investment contracts within the long term assurance business are designated by the Group as 'at fair value through the income statement';

The Group has chosen not to designate any financial assets as 'held to maturity';

All other financial assets are classified as 'available for sale'; and

All other financial liabilities are classified as 'at amortised cost'.

The accounting treatment of these financial instruments is set out in the relevant accounting policy.

Active markets
Asset backed securities not traded in an active market are valued using models. An active market is one where prices are readily and regularly available from an exchange, broker, pricing service, industry group or regulator and these prices represent actual and regularly occurring transactions on an arm's length basis. Where there are no regular transactions occurring (significant liquid markets) the market is not described as active. A significant increase in the spread between the amount sellers are 'asking' and buyers are 'bidding' or the presence of a relatively small number of 'bidding' parties, are indicators that a market may be inactive. The determination of whether a market is inactive requires judgement.

More details of the models used to value the securities not traded in an active market is given in the section in 'fair values' in critical accounting estimates below.

Notes to the Financial Statements
continued

Impairment of Investment Securities
As explained in the accounting policy, investment securities are reviewed at the specific investment level for impairment. Impairment is recognised when there is objective evidence that a specific financial asset is impaired. Objective evidence of impairment might include a significant or prolonged decline in market value below the original cost of a financial asset and, in the case of debt securities, including those reclassified as loans and receivables, non-receipt of due interest or principal repayment, a breach of covenant within the security's terms and conditions or a measurable decrease in the estimated future cash flows since their initial recognition.

The disappearance of active markets, declines in market value and ratings downgrades do not in themselves constitute objective evidence of impairment and, unless a default has occurred on a debt security, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement.

Unarranged Overdraft Charges
The Group's accounting policy in respect of regulatory provisions is given in the section on provisions. In the absence of a legal obligation, judgement is necessary in determining the existence of a constructive obligation. In respect of the claims made for refunds of unarranged overdraft charges, the judgement of the Group is that there is no constructive obligation pending the outcome of the legal case.

Syndications
As explained in the accounting policy on syndications, the Group has elected to treat loans and advances pending syndication as loans and receivables rather than account for them as trading assets. Accordingly these are initially recognised at the draw down date at the fair value as at the commitment date plus directly attributable incremental transaction costs.

Deferred Tax
Deferred tax assets and liabilities require management judgement in determining the amounts to be recognised. In particular, when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing, nature and level of future taxable income. The recognition of deferred tax assets relating to tax losses carried forward relies on profit projections and taxable profit forecasts prepared by management, where a number of assumptions are required based on the levels of growth in profits and the reversal of deferred tax balances.

b) Critical Accounting Estimates
The preparation of the financial statements requires the Group to make estimations where uncertainty exists. The principal critical accounting estimates made by the Group are considered below. Disclosures about estimates and the related assumptions are also included in the appropriate Note to the Financial Statements.

Fair Values
The designation of financial instruments for measurement purposes is set out under the critical accounting judgements above and the valuation methodologies for financial instruments remain as disclosed in this accounting policy section.

Derivatives and other financial instruments classified as at fair value through the income statement or available for sale are recognised at fair value.

Debt securities measured at fair value and not traded in an active market, principally comprising asset backed securities (ABS) in the Treasury division, are valued using valuation models that include non-market observable inputs. These models use observed issuance prices in related asset classes, market correlations, prepayment assumptions and external credit ratings. For each asset class within the ABS portfolio, the implied spread arrived at by using this methodology is applied to the securities within that asset class. Additional assessments are then made on possible deterioration in credit risk for each individual security and on additional liquidity considerations for particular asset classes.

Of the total debt securities carried at fair value on the balance sheet, the fair values of those calculated using models with inputs that are not observable in the market is £3,054m (2007 £17,790m).

For debt securities valuations using non-market observable inputs, the effect of a one hundred basis point move in credit spreads (which based upon experience is the only key sensitivity) would result in a pre-tax movement of £163m (2007 £185m) for assets classified at fair value through the income statement and a post-tax movement of £nil (2007 £351m), recognised in equity reserves, on assets classified as available for sale.

On ABS that were valued using models with non-observable market inputs, a £1,056m (2007 £78m) pre-tax negative fair value adjustment was recognised in the income statement within net trading income and a post-tax negative fair value adjustment of £3,572m (2007 £158m) on ABS classified as available for sale was recognised in equity reserves.

Retirement Benefit Obligations

The expected cash flows used in the calculation of the defined benefit schemes' liabilities include a number of assumptions around mortality, inflation rates applicable to defined benefits and the average expected service lives of the employees. The selection of these assumptions and the selection of the discount rate have a material impact on the estimation of the pension liabilities. The discount rate used by the Group to calculate the defined benefit scheme liabilities is based upon a blended market yield at the balance sheet date of high quality bonds with a similar duration to that of the schemes' liabilities and is derived on a basis consistent with prior years. The sensitivity of the scheme liabilities to changes in the principal assumptions used are set out in Note 33.

Long Term Assurance Business

The estimation of the Group's insurance and investment contracts with discretionary participating features (DPF) liabilities and related value of in-force (VIF) assets relies on a number of assumptions in forecasting future experience. The selection of appropriate assumptions requires the application of material judgement and is made with reference to historic trends, taking into account the analysis of actual versus expected experience as well as industry data.

The accounting policy for insurance contracts and investment contracts with DPF and the description of long term assurance business in Note 30 describe the assumptions that are made when calculating the value of these contracts, which also impact on the value of the VIF and the unallocated surplus. The Group applies significant judgement when selecting the rates of persistency to be used in these calculations. The considerations given to lapse and surrender rate assumptions are detailed in Note 30. The sensitivity of the Group's results to changes in certain key variables on long term insurance and investment

Notes to the Financial Statements
continued

contracts with DPF are disclosed in Note 28.

Effective Interest Rate
As described in the accounting policy for effective interest rate, the Group uses statistical and mathematical models to calculate the effective yield for loans and advances. The Group applies judgement when determining the expected life of these loans. The underlying products usually allow the customer to make early repayment before the contractual maturity date. In estimating the expected life of the loan, the Group takes into account a number of relevant considerations when the asset is initially recognised to estimate the cash flows from early redemptions including the type of product, previous experience of customer behaviour, credit scoring of the customer and anticipated future market conditions. The cash flows are adjusted in the light of actual experience, however the effective interest rate is not reassessed. As a consequence of the reduced levels of principal repaid in 2008 and the resulting adjustments to estimated future cash flows a £200m credit (2007 £nil) has been taken to the income statement. If the estimated life of the Retail portfolio were to increase or decrease by one month then the carrying value of the Retail portfolio would increase or decrease by £6m (2007 £18m) respectively.

Impairment Losses on Loans and Advances
The Group regularly reviews its loan portfolios carried at amortised cost to assess for impairment. This review is conducted across all asset types and impairment provisions are established to recognise incurred impairment losses within the loan portfolios. As explained in the Group's accounting policy on loans and advances, impairment loss calculations involve the estimation of future cash flows of loans and advances based on observable data at the balance sheet date, historical loss experience for assets with similar credit risk characteristics and other factors including, inter alia, future prospects of the customers, value of collateral held and reliability of information. These calculations may be undertaken on either a portfolio basis or individually for individually significant exposures. In applying the portfolio basis the Group makes use of various statistical modelling techniques which are specific to different portfolio types.

The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment provisions given the range of asset types, number of customers and current economic conditions. This uncertainty is exacerbated in the current economic climate, where the timing of and value realisable from the collateral held in the form of property is particularly uncertain. Consequently these allowances can be subject to variation.

Goodwill
Goodwill arises on the acquisition of a business. As explained in the accounting policy for goodwill it is subject to a six monthly impairment review. This compares the recoverable amount, being the higher of a cash-generating units' fair value less costs to sell and its value in use, with the carrying value. When this indicates that the carrying value is not recoverable it is written down through the income statement as goodwill impairment.

The recoverable amount of goodwill carried at 31 December 2008 has been based upon value in use. This calculation uses cash flow projections based upon the five year business plan where the main assumptions used for planning purposes relate to the current economic outlook and opinions in respect of economic growth, unemployment, property markets, interest rates and credit quality. Cash flows thereafter are extrapolated using a growth rate of 2.2% p.a., reflecting management's view of the expected future long term trend in growth rate of the respective economies concerned, predominantly being in the UK, and the long term performance of the businesses concerned. The pre-tax discount rate used in discounting the projected cash flows has, in view of current credit conditions, been increased to within a range of 14.4% - 15.3% p.a. (2007: 10.0% - 12.2% p.a.) reflecting, inter alia, the perceived risks within those businesses.

As at 31 December 2008 the carrying value of goodwill held on the balance sheet is £1,556m (2007 £1,940m) as shown in Note 23. Goodwill has been impaired by £158m during the year. The unprecedented levels of market turmoil and current economic conditions have adversely impacted the short-term profitability of the cash generating units. The Group has considered the impact upon the assumptions used and has conducted sensitivity analysis on the impairment tests. For example, an increase in the discount rate to 17% would result in an additional impairment to goodwill of £31m; alternatively if projected cash flows reduced by 20% an additional impairment of £118m would arise.

Notes to the Financial Statements
continued

IFRS and IFRIC Not Yet Applied
The following standards and interpretations are not effective for the year ended 31 December 2008 and have not been applied in preparing the financial statements:

IFRS 8 'Operating Segments' which is effective for periods commencing on or after 1 January 2009. This standard replaces IAS 14 'Segmental Reporting' and aligns the disclosure of operating segments in the financial statements with the internal reporting of segments to senior management. Following the acquisition of the Group by Lloyds TSB plc the Group will adopt the segmental structure and measurement basis for segments of the Lloyds Banking Group. These are currently being determined by the new organisation.

Amendments to IAS 1 'Presentation of Financial Statements: A Revised Presentation' which is effective for periods commencing on or after 1 January 2009. The revised standard will affect the presentation of owner changes in equity and of comprehensive income. Adoption will not change the recognition, measurement or disclosure of specific transactions or events as required by other standards.

Amendment to IAS 23 'Borrowing Costs' which is applicable to borrowing costs related to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009. The application of this revised standard in 2008 would not have had a material impact on the financial statements.

Amendment to IFRS 2 'Share-based Payment: Vesting Conditions and Cancellations' which is effective for periods commencing on or after 1 January 2009. This defines 'non-vesting' conditions and clarifies the accounting. The application of this amendment would not have an impact upon the financial statements as the Group accounting policy accords with the treatment prescribed by the amendment.

Amendments to IAS 32 and IAS 1 'Puttable Financial Instruments and Obligations Arising on Liquidation' which is effective for periods commencing on or after 1 January 2009. This amendment addresses the balance sheet classification of puttable financial instruments and obligations arising only on liquidation. Where these instruments represent a residual interest in the net assets of an entity and meet certain other conditions they should be classified as equity rather than liabilities. The Group has no items currently classified as liabilities that would need to be presented as equity as a result of this amendment because these instruments fail to meet the criteria for such a reclassification.

IFRIC 13 'Customer Loyalty Programmes' which is effective for periods commencing on or after 1 July 2008. The application of this interpretation in 2008 would not have had a material impact on the financial statements.

The following interpretations have not yet been adopted by the European Union but is effective for the year ended 31 December 2008. The Group has implemented the principles of these interpretations in preparing the financial statements:

IFRIC 12 'Service Concession Arrangements' which is effective for periods commencing on or after 1 January 2008. The application of this interpretation would not have affected the financial statements as the Group accounting policy accords with the requirements.

IFRS 1 'First-time adoption of IFRS' which is effective for periods commencing on or after 1 January 2009. As the Group reports under IFRS, the application of this amendment in 2008 would not have any effect upon the financial statements.

Amendments to IAS 27 'Consolidated and Separate Financial Statements' which is effective for periods commencing on or after 1 January 2009. This amendment removes the definition of the cost method which requires dividends from pre-acquisition profits to be set off against the cost of an investment in a subsidiary. Application in 2008 would not have had an effect upon the financial statements.

IFRIC 15 'Agreements for the Construction of Real Estate' which is effective for periods commencing on or after 1 January 2009. The application of this interpretation would not have affected the financial statements as the Group accounting policy accords with the requirements.

IFRIC 16 'Hedges of a Net Investment in a Foreign Operation' which is effective for periods commencing on or after 1 October 2008. The application of this interpretation in 2008 would not have affected the financial statements as the Group accounting policy accords with the requirements.

IFRIC 17 'Distributions of Non Cash Assets to Owners' which is effective for periods commencing on or after 1 July 2009. The application of this interpretation would not have affected the financial statements as the Group accounting policy accords with the requirements.

IFRIC 18 'Transfers of Assets from Customers' which applies to transfers of assets from customers received on or after 1 July 2009. The application of this interpretation in 2008 would not have had a material impact on the financial statements.

Improvements to IFRS 2008 The majority of these improvements are effective for periods commencing on or after 1 January 2009 and their application would not have had a material effect upon the financial statements.

Amendments to IAS 39 'Financial Instruments: Recognition and Measurement: Eligible Hedged Items' which is effective for periods commencing on or after 1 July 2009. This amendment clarifies what can be designated as a hedged item in a hedge accounting relationship and application in 2008 would not have had a material impact upon the financial statements.

Amendments to IAS 39 'Reclassification of Financial Assets': Effective Date and Transition which is effective on or after 1 July 2008. This amendment clarifies the effective date and transition requirements for the change to the standard issued in October 2008 permitting entities to reclassify non derivative financial assets out of the fair value through the income statement category in particular circumstances. The application of this amendment would not have affected the financial statements as the Group accounting policy accords with the requirements.

Revised IFRS 3 'Business Combinations' and amended IAS 27 'Consolidated and Separate Financial Statements' These changes are effective for periods beginning on or after 1 July 2009 with the main effects being that the cost of investment will comprise the consideration paid to the vendors for equity with acquisition costs being expensed immediately; goodwill will be accounted for only upon the acquisition of a subsidiary as subsequent changes in interest will be recognised in equity and only upon the loss of control will any profit or loss be recognised in income. Further, any pre-existing stake held will, where control is subsequently gained, be revalued with any profit or loss arising being booked to income. These changes will affect the manner in which acquisitions and disposals made by the Group are accounted for after the implementation of the revised Business Combinations standard and related revisions to IAS 27.

F-18

Notes to the Financial Statements
continued

1 Net Interest Income

	2008 £m	2007 £m	2006 £m
Interest receivable:			
Loans and advances to customers	29,892	26,354	22,620
Loans and advances to banks	740	2,295	2,062
Investment securities	652	115	64
Lease and hire purchase receivables	299	321	280
Interest receivables on loans and receivables	31,583	29,085	25,026
Available for sale financial assets	2,108	2,278	1,924
Interest receivable on derivatives	3,515	3,374	2,437
Other	205	275	355
Total interest receivable	37,411	35,012	29,742
Interest payable:			
Deposits by banks	3,959	2,568	2,490
Customer accounts	9,538	9,837	8,575
Debt securities in issue	10,191	10,482	7,410
Other borrowed funds	1,450	1,169	1,201
Interest payable on liabilities held at amortised cost	25,138	24,056	19,676
Interest payable on derivatives	3,473	3,399	2,551
Other	629	253	115
Total interest payable	29,240	27,708	22,342
Net interest income	8,171	7,304	7,400

2 Net Trading (Expense)/Income

	2008 £m	2007 £m	2006 £m
Equity and commodity instruments and related non hedging derivatives	952	92	20
Interest bearing securities and related non hedging derivatives	(4,174)	58	164
Foreign exchange and related non hedging derivatives	(16)	72	95
Net gains and losses from trading financial instruments and non hedging derivatives	(3,238)	222	279
Gains/(losses) on fair value hedges:			
On hedging instruments	3,467	1,184	(2,674)
On the hedged items attributable to the hedged risk	(3,110)	(1,227)	2,688
	357	(43)	14
Cash flow hedge ineffectiveness recognised	3	(1)	(1)

Total net trading (expense)/income	(2,878)	178	292

3 Net Operating Income

	2008 £m	2007 £m	2006 £m
Included within net operating income are the following:			
Cash flow hedges:			
Net (losses)/gains released from equity into income (Note 41)	(2,561)	417	(123)
Financial instruments at fair value through the income statement:			
Net (losses)/gains from trading financial instruments and non hedging derivatives (Note 2)	(3,238)	222	324
Net (losses)/gains from designated financial instruments	(9,669)	4,884	5,401
Available for sale financial instruments:			
Dividend income	108	291	25
Net realised gains on sale (Note 41)	24	281	244
Financial instruments designated as loans and receivables:			
Net realised gains on sale	22	3	1

F-19

Notes to the Financial Statements
continued

4 (Loss)/Profit on Sale of Businesses

Non-operating income consists of the following:

	2008 £m	2007 £m	2006 £m
Loss on the sale of Bank of Western Australia Ltd and St. Andrews Australia Pty Ltd	(845)		
Profit on the sale and leaseback of certain branch premises	20	28	22
Profit on the part disposal of Rightmove plc (Note 21)	56	59	17
Distribution from Visa Inc shares listing	26		
Profit on the sale of Insight Investment Management (C.I.) Limited		4	
Profit on the dilution of shareholding in Invista Real Esate Investment Management Holdings plc			22
Profit on the sale of Retail Financial Services Limited			9
Profit on the sale of Drive Financial Services LP			180
	(743)	91	250

On 8 October 2008, the HBOS Group agreed the sale of part of its Australian operations, principally Bank of Western Australia Ltd and St. Andrews Australia Pty Ltd, to Commonwealth Bank of Australia Limited. The sale completed on 19 December 2008 and results in a pre-tax loss on disposal of £845m (including goodwill written-off of £240m) which is included as non-operating income within the (loss)/profit on sale of businesses for the year.

Under the share sale agreement HBOS plc has provided certain warranties to Commonwealth Bank of Australia, that all relevant, material circumstances and facts in relation to the sale have been disclosed and described in agreement. The share sale agreement provided for adjustments to the initial purchase price based on the risk weighted assets of Bank of Western Australia Limited and the net assets of St. Andrews Australia Pty Limited. As a result, the loss on sale of these businesses may be subject to adjustment for the contingent element of the commitment receivable.

Following the sale, HBOS retains a presence in Australia through Bank of Scotland International (Australia) Limited and Capital Finance Australia Limited which are engaged in corporate banking and asset finance activities respectively, together with the Bank of Scotland plc Sydney branch and therefore this sale does not constitute a discontinued activity. As such, the performance of the businesses sold and the loss on disposal remains within the profit arising from continuing operations of the Group. These businesses are reported in International division for segmental reporting purposes.

5 Insurance Premiums and Claims

	2008 £m	2007 £m	2006 £m
Gross written premiums			
Long term insurance	4,542	4,739	4,775

General insurance	887	889	1,046
	5,429	5,628	5,821
Premiums ceded to reinsurers	(178)	(168)	(181)
Net change in provision for unearned premiums	93	156	8
Net earned premiums on insurance contracts	5,344	5,616	5,648

	2008 £m	2007 £m	2006 £m
Claims incurred			
Long term insurance	(3,450)	(2,599)	(2,012)
General insurance	(334)	(420)	(333)
	(3,784)	(3,019)	(2,345)
Claim recoveries from reinsurers	81	67	17
Net claims incurred on insurance contracts	(3,703)	(2,952)	(2,328)

6 Change in Investment Contract Liabilities

	2008 £m	2007 £m	2006 £m
Net change in investment contracts designated at fair value through the income statement	12,863	(2,451)	(3,034)
Net change in investment contracts with a discretionary participating feature	(47)	(87)	124
	12,816	(2,538)	(2,910)

Notes to the Financial Statements
continued

7 Administrative Expenses

	2008 £m	2007 £m	2006 £m
Administrative expenses include:			
Mortgage endowment compensation			95
Regulatory provisions charge (Note 36):			
Financial Services Compensation Scheme (FSCS) management expenses levy	200		
Unauthorised overdraft charges		122	
Colleague costs (Note 8)	2,983	2,911	2,674
Accommodation, repairs and maintenance	493	450	421
Technology	261	273	238
Marketing and communication	432	380	367

8 Colleagues

The Group refers to its employees as colleagues. Most UK based colleagues are contractually employed by the Group.

	2008 Number	2007 Number	2006 Number
The average number of colleagues employed during the year was:			
Full time	58,101	57,129	55,234
Part time	16,575	16,958	16,616
	74,676	74,087	71,850

	2008 £m	2007 £m	2006 £m
The aggregate remuneration payable in respect of Group colleagues is included within administrative expenses and comprises:			
Wages and salaries	2,348	2,340	2,137
Social security costs	207	226	228
Pension costs (Note 33)	268	201	205
Other post retirement benefits (Note 33)	4	5	3
Expense arising from share-based payments (Note 40)	156	139	101
	2,983	2,911	2,674

9 Directors' Remuneration

	2008 £'000	2007 £'000	2006 £'000

Emoluments	8,891	11,834	9,577
Compensation for loss of office(a)		1,475	
	8,891	13,309	9,577
Total potential pre-tax gains on share options exercised	1	715	402
Total potential pre-tax gains on share schemes vested	1,306	4,989	6,681
	10,198	19,013	16,660

(a) This includes non monetary benefits of £nil (2007 £nil, 2006 £nil).

Highest Paid Director

	2008 £'000	2007 £'000	2006 £'000
Emoluments(b)	1,452	2,606	1,570
Total potential pre-tax gains on share options exercised		3	
Total potential pre-tax gains on share schemes vested	603(c)	412	1,650
	2,055	3,021	3,220

(b) This includes the 2007 element of the 2007/2008 biennial cash incentive of £121,000 (2007 £172,000).
(c) As reported previously, a retention reward originally granted in January 2002 matured in 2005. At this time, this was converted into shares and was subsequently placed in the sharekicker scheme maturing in March 2008. The value at maturity was £466,000 and this is included in gains on share schemes vested.

Notes to the Financial Statements
continued

9 Directors' Remuneration continued

The total emoluments including taxable benefits and allowances of Directors in the year are set out in the tables below:

	Salary and fees £'000	Taxable benefits and allowances £'000	Total year ended 2008 £'000	Total year ended 2007 £'000	Total 2008 excluding pension allowance £'000	Total 2007 excluding pension allowance £'000
Chairman						
Dennis Stevenson	795	20	815	821	815	821
Executive Directors						
Peter Cummings	675	193	868	2,434	699	2,276
Jo Dawson	615	164	779	943	625	837
Mike Ellis	650	173	823	292(2)	660	250
Philip Gore-Randall	552	174	726	275(2)	588	235
Andy Hornby	1,025	306	1,331	1,672	1,075	1,437
Colin Matthew	630	179	809	1,055	652	905
Dan Watkins	520	162	682	287(2)	552	247
Non-executive Directors						
Richard Cousins	99		99	70	99	70
Sir Ron Garrick	258		258	235	258	235
Anthony Hobson	230		230	221	230	221
Karen Jones	135		135	100	135	100
John E Mack	117		117	66	117	66
Coline McConville	192		192	151	192	151
Kate Nealon	138		138	151	138	151
Former Directors	244	58	302	3,441	248	3,184
	6,875	1,429	8,304	12,214	7,083	11,186
Biennial cash incentive for 2007/2008 (1)			587	1,095	587	1,095
Total			8,891	13,309	7,670	12,281

(1)The biennial cash incentive 2007/2008 comprises only the element earned in 2007 but deferred and includes Peter Cummings £79,000 (2007 £172,000), Jo Dawson £72,000 (2007 £156,000), Mike Ellis £20,000 (2007 £nil), Philip Gore-Randall £19,000 (2007 £nil), Andy Hornby £121,000 (2007 £254,000), Colin Matthew £73,000 (2007 £160,000), Dan Watkins £54,000 (2007 £42,000), Former Directors £149,000 (2007 £311,000). The Directors waived their rights to any payment in respect of the 2008 element of the scheme.

(2)Part year only.

Notes to the Financial Statements
continued

9 Directors' Remuneration continued

	Salary and fees £'000	Taxable benefits and allowances £'000	Total year ended 2006 £'000	Total 2006 excluding pension allowance £'000
Chairman				
Dennis Stevenson	628		628	628
Executive Directors				
Peter Cummings	547	119	666	561
Jo Dawson	303		303	303
Andy Hornby	787	177	964	811
Colin Matthew	567	126	693	586
Non-executive Directors				
Sir Ron Garrick	213		213	213
Anthony Hobson	250		250	250
Karen Jones	62		62	62
Coline McConville	111		111	111
Kate Nealon	138		138	138
Former Directors	1,955	335	2,290	1,999
	5,561	757	6,318	5,662
Annual cash incentive for 2006 (1)			3,259	3,259
Total			9,577	8,921

(1)The annual cash incentive 2006 includes Peter Cummings £825,000, Jo Dawson £211,000, Andy Hornby £606,000, Colin Matthew £400,000, Former Directors £1,217,000.

Emoluments

No bonuses were paid to any Directors with respect to 2008 following waiver by the Directors of their respective rights to receive these bonus payments. Remuneration in respect of Non-executive Directors consists solely of fees. No short or long term bonuses or benefits were paid to any of the Non-executive Directors in the year.

The Group did not make any payments to Directors' pensions during the year. The table above includes in "taxable benefits and allowances" the non-pensionable cash allowances payable to Executive Directors in lieu of any further service-related pension accrual. The cash allowance was equivalent to 25% of salary, payable monthly. The allowances paid in 2008 were: Peter Cummings £168,833; Jo Dawson £153,833; Mike Ellis £162,500; Philip Gore-Randall £138,000; Andy Hornby £256,000; Colin Matthew £157,416; Dan Watkins £130,000; Phil Hodkinson £53,750.

During the year the non-pensionable cash allowance for Andy Hornby was increased by the Remuneration Committee of the Group to 50% of salary with effect from April 2006. Andy Hornby waived his entitlement to receive this incremental backdated increase of £645,000. His allowance of £256,000 is equivalent to 25% of salary in 2008 as paid to all other Executive Directors.

Comparative year end totals of emoluments excluding the non-pensionable cash allowances are also shown in the table above.

Pension contributions paid, or treated as paid in the year, was nil (2007 £5,000, 2006 £34,000) to defined benefit schemes and nil (2007 nil, 2006 nil) to money purchase schemes and were attributed to nil Directors (2007 one, 2006 four). Nil contributions related to the highest paid Director (2007 nil, 2006 £7,000) resulting an accrued pension of £240,000 at the year end (2007 £344,000, 2006 £184,000). Nil (2007 nil, 2006 nil) was paid to past Directors in respect of retirement benefits in excess of their normal entitlements.

The fees paid to Dennis Stevenson comprise a payment made to him personally in respect of his service as Chairman of the Group of £795,000 (2007 £707,500, 2006 £628,000).

From 1 May 2007 the basic Board membership fee payable to Non-executive Directors was at a rate of £66,000 p.a. and from 1 May 2008 this basic Board membership fee was increased to a rate of £70,000 p.a. The basic Board membership fee covers the full range of duties and responsibilities associated with Non-Executive Directorship, including attending Board meetings and the Group’s Annual General Meeting.

Notes to the Financial Statements
continued

9 Directors' Remuneration continued

The figures shown in the table above also include, in respect of Non-executive Directors, fees for service on Committees of the Board and, where relevant, fees for services as Directors of Subsidiaries and Joint Ventures and for service on other Committees.

The taxable benefits and allowances payment to Dennis Stevenson comprises a Distant Accommodation Allowance of £20,000 p.a.

Taxable benefits and allowances for the Executive Directors comprise, where relevant, the benefit in kind values of company cars, healthcare, life assurance, concessionary rate mortgages and, a contribution towards the cost of providing distant accommodation away from the Executive Director's primary residential area, as well as the non-pensionable cash allowance mentioned earlier.

Resignations and terminations
Phil Hodkinson retired as main board Director on 30 April 2008. He received no termination payment, and his pension benefits, based on service to 5 April 2006 (when further service based accrual ceased) and final pensionable salary at retirement, were reduced for early retirement based on the period between his retirement date and his 55th birthday in line with his contractual entitlements having served 5 years as an Executive Director.

Charles Dunstone stood down as Non-executive Director from the Board immediately following the Group's Annual General Meeting on 29 April 2008. Termination payments are not made to Non-executive Directors and no such payment was made to Charles Dunstone.

On 16 January 2009, on the acquisition of the Group by Lloyds TSB Group plc (now Lloyds Banking Group plc (LBG)) becoming effective, the Chairman and all other Directors of the Group (other than Jo Dawson, Philip Gore-Randall and Dan Watkins) were required to resign from the Board of the Group. Jo Dawson, Philip Gore-Randall and Dan Watkins will resign from the Board of the Group during 2009. For departing Executive Directors, the total payments and pension arrangements put in place at the termination of their respective employments do not, or will not, (as the case may be) go beyond their legal entitlements. No severance payments will be made to Jo Dawson or Dan Watkins on their resignation from the Board of the Group, as they continue to be employed by LBG.

On termination of their contracts by the Group, Messrs Hornby and Stevenson waived their respective entitlements to receive their contractual severance payments under their service agreements. Andy Hornby received a statutory redundancy payment of £2,970.

It was agreed that, on termination of their contracts, the following Executive Directors would receive payments in lieu of notice (equivalent to 12 months' salary) in accordance with their contractual entitlements; for entering into certain post-termination restrictive covenants (approximately £10,000); and, in the case of Peter Cummings and Colin Matthew, statutory redundancy. In total, these payments are as follows: Peter Cummings £702,080; Mike Ellis £670,500; Philip Gore-Randall £568,000; Colin Matthew £656,405. No payments were made with respect to further service based pension accrual, or in lieu of pension. On termination of his contract, Peter Cummings waived his right to receive a contractual bonus entitlement of £1,320,000 which had been earned in 2007 but deferred pursuant to its terms.

Pensions

The pension entitlements of the Executive Directors who were active members of the HBOS Final Salary Pension Scheme (the Scheme) as at 31 December 2008 are set out in the table below:

Executive Directors' pension entitlements

Name	Age at 31/12/08	Accrued pension at 31/12/08 £'000 pa	Increase in accrued pension over year £'000 pa	Increase in accrued pension over year (net of inflation) £'000 pa	Transfer value at 31/12/08 £'000	Increase in transfer value £'000	Transfer value of net increase to accrued pension (less Director's contributions at 31/12/08) £'000
P Cummings	53	369	25	7	7,090	1,120	141
J Dawson	46	100	11	6	1,394	210	85
A Hornby	41	240	20	9	2,813	406	103
C Matthew	58	416	18	(1)	9,089	1,290	(32)
D Watkins	46	218	56	47	2,845	873	619

The accrued pension at 31 December 2008 is the pension which the Director would have been entitled to receive based on his/her completed pensionable service, had he/she left on 31 December 2008 payable from normal retirement age (age 60) and subject to revaluation increases between leaving and retirement.

The transfer values are based on the accrued pensions at 31 December 2008. The transfer value basis was reviewed during 2008 to take account of changes in legislation for the calculation of such values and the change in financial markets. The resulting increase in the transfer values is predominantly as a result of applying the new basis to the accrued pensions at 31 December 2008. The transfer values are the notional lump sums which would have been paid to another pension scheme for the benefit of the Director had he or she left service at the respective dates. It is not possible for a transfer value to be paid directly to the Director personally.

Notes to the Financial Statements
continued

9 Directors' Remuneration continued

The Director's contribution is the personal contribution required, if any, under the terms of the Scheme. Members of the Scheme have the option to pay additional voluntary contributions: neither the additional voluntary contributions nor the resulting benefits are included in the table.

For those Directors whose benefits were above the "Lifetime Allowance" at "A-day", there will be no further service accrual of benefits and no further Directors' contributions*. Those Directors receive the non-pensionable cash allowance referred to previously.

Philip Gore-Randall is not included in the Scheme and simply receives the cash allowance referred to previously. Mike Ellis is in receipt of a pension from his earlier employment with the Group which is unaffected by, and independent of, his current employment. In respect of his current employment he receives the cash allowance referred to previously.

Pension is generally based on retirement from service at normal retirement age (age 60) and is based on final salary. Pension and lump sum life assurance is provided from the Scheme and otherwise from separate arrangements with the Group. On death after retirement or after leaving service, a spouse's or dependant's pension may be payable. Children's benefits may also be payable. Executive Directors who have five years' service as an Executive Director have a contractual right to retire at age 55 or above with a non-reduced pension and at age 50 or above (but below age 55) with a reduced pension.

Pension increases after retirement are a mixture of guaranteed and discretionary. Scheme provisions vary by individual; the maximum extent of the Scheme guarantees is to increase pensions in line with the RPI, subject to a maximum of 5% p.a. and a minimum of 3% p.a. (no minimum for pensionable service after 31st March 2004). There is an established policy of reviewing pensions on a discretionary basis taking account of increases in the RPI. Allowance is made in transfer values on leaving in respect of the guaranteed and discretionary increases outlined above.

Peter Cummings and Colin Matthew retired on termination of their respective employments with the Group on 16 January 2009, as referred to in Resignations and Terminations above. Pension benefits for Colin Matthew were provided without reduction for early payment, based on his service to 5 April 2006 (when further service based accrual ceased) and his final pensionable salary at retirement in line with his contractual right as set out above.

Pension benefits for Peter Cummings were provided in accordance with the Group's standard policy for Directors and senior managers retiring at age 50 and above. In such a case where a Director or senior manager retires by way of redundancy the Group does not reduce the pension payment to reflect retirement after the Director's or senior manager's 55th birthday. The notional additional capital cost of providing benefits for Peter Cummings in accordance with this policy was £0.7m. An actuarial reduction of 4.75% for early retirement based on the period between his retirement date and his 55th birthday was applied to his pension benefits based on service to 5 April 2006 (when further service based accrual ceased) and his final pensionable salary at retirement. As a result, and in waiving his entitlement to receive his contractual bonus of £1,320,000 referred to in 'Resignations and Terminations' above, Peter Cummings received in total less than his legal entitlements.

Potential pre-tax gains on share options exercised

During the year, two Directors exercised 2,045 options (2007 four Directors and 146,814 options, 2006 3 Directors and 52,514 options) under share option schemes. The highest paid Director did not exercise any share options (2007 600 share options, 2006 none).

Shares vested under long term incentive schemes

During the year, one Director (Peter Cummings) had a share grant of 43,350 released (2007 eight Directors had share grants of 530,101 released, 2006 five Directors had share grants of 598,416 released) under long term incentive schemes, in accordance with his contractual entitlement under the rules of the schemes. This relates to the 2003-2006 Long Term Incentive Plan which was granted in January 2003. As explained in previous annual reports, all participants could choose to take any shares released after three years based on a three year performance outcome or could continue to participate in the plan for a further two years and take shares at that point based on the better of the three year and five year performance outcomes. Peter Cummings elected to continue to participate in the plan for the further two years to the end of 2007. HBOS's Total Shareholder Return over the five year performance period exceeded the weighted average of the comparator group by 1.57% consequently 183% of the original share grant was released under the terms of the long term incentive scheme on 27 February 2008. No share grant was released (2007 a share grant of 36,223, 2006 a share grant of 148,641) under long term incentive plans in respect of the highest paid Director.

* Dan Watkins has an element of pre April 2006 pension accrual being released over the period to April 2011.

Notes to the Financial Statements
continued

9 Directors' Remuneration continued

Shares vested under short term incentive schemes
During the year, seven Directors had share grants of 428,938 released (2007 seven Directors had share grants of 121,744 released, 2006 five Directors had share grants of 101,045 released) under short term incentive schemes. As explained in previous annual reports, Executive Directors could elect to take their annual and biennial incentives in HBOS shares. If they elected to do so, and held the shares in trust for three years, additional shares were awarded. The release of these 428,938 shares relates to the shares placed in trust using short term incentive plan awards in 2004 together with the additional shares awarded following the three year holding period. In respect of the highest paid Director, a share grant of 49,191 was released (2007 a share grant of 5,710, 2006 a share grant of 32,908) under short term incentive plans. In addition a special award originally granted in 2002 of 212,739 shares was also released. None of these releases related to performance in 2008.

The value of additional shares is shown net of income tax and National Insurance liability although the value of the additional shares was grossed up to take account of the associated income tax and National Insurance payable by the participant.

Value of shares vested under free shares plan
During the year, 2,674 (2007 nil, 2006 nil) free shares relating to six Directors (2007 no Directors, 2006 no Directors) vested. In the year, seven (2007 six, 2006 none) directors were awarded shares under the free shares plan (see Note 40 for further detail). In respect of the highest paid Director, 333 (2007 nil, 2006 nil) free shares vested in the year.

The net value of assets other than money, shares and options received by the all the Directors was nil.

Change of control
All of the HBOS share plans contained a provision relating to change of control. The acquisition of HBOS by LBG resulted in awards and options vesting and becoming exercisable, in accordance with contractual entitlements under plan rules. Certain awards were exchanged for awards over LBG ordinary shares, but otherwise subject to the same terms as the original award. Certain options will also be exchanged to the extent they have not been exercised within the 6 month exercise period following the change of control.

Where the vesting of awards and options were subject to the satisfaction of performance conditions, in accordance with the plan rules and the terms of such conditions, the Remuneration Committee of the Group determined the extent to which such awards and options vested by taking into account the level of performance. In relation to the Directors, the Remuneration Committee exercised this discretion by reducing vesting to exclude any payments in relation to the 2008 financial year.

The total payments made to Directors of the Group on change of control were Peter Cummings, £129,000 and 2,051 share options; Jo Dawson £139,000 and 3,330 share options; Mike Ellis £83,000; Philip Gore-Randall £73,000; Andy Hornby £251,000 and 7,599 share options; Colin Matthew £151,000; and Dan Watkins £88,000 and 3,330 share options.

10 Auditors' Remuneration

During the year the Group (including its overseas subsidiaries) obtained the following services from the Group's auditor and its associates:

	2008	2007	2006
	£m	£m	£m
Statutory audit of the Group and consolidated accounts	0.3	0.3	0.3
Fees payable for other services:			
Audit of the Group's subsidiaries pursuant to legislation	6.7	7.7	6.5
Other services pursuant to legislation	7.1	1.0	1.4
Total audit fees and audit related services	14.1	9.0	8.2
Tax services	0.5	0.8	0.9
Services relating to information technology		0.1	0.3
Services relating to corporate finance transactions	0.1	0.3	0.7
Other services	1.0	1.2	1.1
Total other services	1.6	2.4	3.0
Total 1	15.7	11.4	11.2

1 Excludes value added taxes

Other services pursuant to legislation includes reporting accountant services in support of the listing rules and includes the review of the half yearly results.

Notes to the Financial Statements
continued

11 Segmental Analysis

Principal activities of the HBOS Group are the provision of banking and other financial services in the UK and overseas.

The Group's activities are organised on a divisional basis which reflect the business sector segments below. Group Items principally comprises the expenses of managing the Group, including technology so far as it is not devolved to divisions, accommodation and other shared services such as cheque clearing and mailing.

Business sector

							2008
	Retail £m	Corporate £m	Insurance & Investment £m	International £m	Treasury & Asset Management £m	Group Items £m	Total £m
Net interest income – internal	(2,393)	300	(66)	(3,723)	5,882		
Net Interest income – external	6,630	1,980	(31)	5,197	(5,605)		8,171
Net fee and commission income – internal	144	62	(490)	38	246		
Net fee and commission income – external	1,002	377	(292)	101	(61)		1,127
Net trading income – external	56	(643)		21	(2,312)		(2,878)
Other operating income – internal	66	3		37	(106)		
Other operating income – external	16	1,594	(4,728)	234	76		(2,808)
Net operating income/(expense)	5,521	3,673	(5,607)	1,905	(1,880)		3,612
Administrative expenses – internal	(635)	(246)	(118)		(233)	1,232	
Administrative expenses – external	(1,339)	(649)	(726)	(786)	(65)	(1,549)	(5,114)
Depreciation and amortisation	(55)	(1,215)	(51)	(67)	(7)	(213)	(1,608)
Goodwill impairment	(69)		(4)	(85)			(158)
Other operating expenses			6,167	25			6,192
Operating expenses	(2,098)	(2,110)	5,268	(913)	(305)	(530)	(688)
	(2,230)	(6,669)		(958)			(9,857)

Impairment losses on loans and advances							
Impairment losses on investment securities		(737)		(35)	(1,421)		(2,193)
Operating (loss)/profit	1,193	(5,843)	(339)	(1)	(3,606)	(530)	(9,126)
Share of (loss)/profit of jointly controlled entities and associates	3	(950)	2	10	(21)		(956)
(Loss)/profit on sale of businesses	102			(845)			(743)
(Loss)/profit before taxation	1,298	(6,793)	(337)	(836)	(3,627)	(530)	(10,825)
Total assets	266,197	127,705	77,588	67,865	147,148	3,414	689,917
Included in total assets:							
Interests in jointly controlled entities and associates	70	952	(38)	166	11		1,161
Loans and advances to customers	255,284	116,388		60,997	2,554		435,223
Total liabilities	192,233	54,470	68,580	24,212	336,244	679	676,418
Included in total liabilities:							
Customer accounts	143,703	38,500	87	6,507	33,454		222,251
Capital expenditure on property and equipment and software	91	1	144	111	12	357	716

F-27

Notes to the Financial Statements
continued

11 Segmental Analysis continued

Business sector

In July 2008 the Group announced a divisional reorganisation under which the Group's Business Banking became part of Corporate division, moving from Retail division. In addition, there was a transfer of Trading Cash Management from Treasury to Corporate division. Accordingly the 2007 comparatives have been reclassified to reflect this new structure and certain other minor reorganisations. There is no impact on the 2007 Consolidated Balance Sheet and Income Statement as previously published.

							2007
	Retail £m	Corporate £m	Insurance & Investment £m	International £m	Treasury & Asset Management £m	Group Items £m	Total £m
Net interest income – internal	(1,024)	393	(70)	(1,269)	1,970		
Net interest income – external	5,020	1,769	(28)	2,357	(1,814)		7,304
Net fee and commission income – internal	184	13	(168)	21	(50)		
Net fee and commission income – external	1,042	448	(521)	45	246		1,260
Net trading income – external	(7)	65	(7)	(3)	130		178
Other operating income – internal	19	15		45	(79)		
Other operating income – external	58	2,043	9,611	652	185		12,549
Net operating income	5,292	4,746	8,817	1,848	588		21,291
Administrative expenses – internal	(641)	(182)	(113)	(6)	(42)	984	
Administrative expenses – external	(1,452)	(773)	(680)	(665)	(283)	(1,126)	(4,979)
Depreciation and amortisation	(70)	(1,018)	(57)	(54)	(4)	(199)	(1,402)
Goodwill impairment			(5)				(5)
Other operating expenses			(7,406)	(278)			(7,684)
Operating expenses	(2,163)	(1,973)	(8,261)	(1,003)	(329)	(341)	(14,070)
Impairment losses on loans and advances	(1,277)	(619)		(116)			(2,012)

Impairment losses on investment securities	(22)	(37)		(1)			(60)
Operating profit/(loss)	1,830	2,117	556	728	259	(341)	5,149
Share of (loss)/profit of jointly controlled entities and associates	(9)	232	(2)	17	(4)		234
Profit on sale of businesses	87				4		91
Profit/(loss) before taxation	1,908	2,349	554	745	259	(341)	5,474
Total assets	259,255	122,642	88,454	76,087	119,806	773	667,017
Included in total assets:							
Interests in jointly controlled entities and associates	83	1,525	(41)	133	24		1,724
Loans and advances to customers	252,595	110,087		67,094	231		430,007
Total liabilities	218,614	59,624	81,905	35,580	245,758	3,302	644,783
Included in total liabilities:							
Customer accounts	154,034	48,334	101	23,585	17,167		243,221
Capital expenditure on property and equipment and software	6	43	11	83	16	397	556

Notes to the Financial Statements
continued

11 Segmental Analysis continued

Business sector

In March 2007 the Group announced a divisional reorganisation under which the Group's European Corporate business became part of Corporate division moving from International division. Accordingly the 2006 comparatives have been reclassified to reflect the new structure.

							2006
	Retail £m	Corporate £m	Insurance & Investment £m	International (b) £m	Treasury & Asset Management £m	Group Items £m	Total £m
Net interest income – internal	(393)	(549)	(70)	(1,149)	2,161		
Net interest income – external	4,503	2,591	(23)	2,285	(1,956)		7,400
Net fee and commission income – internal	185	12	(185)	4	(16)		
Net fee and commission income – external	1,082	377	(480)	25	159		1,163
Net trading income – external	9	30		4	249		292
Other operating income – internal	(1)				1		
Other operating income – external	44	1,374	11,561	859	21		13,859
Net operating income	5,429	3,835	10,803	2,028	619		22,714
Administrative expenses – internal	(658)	(165)	(98)	(2)	(22)	945	
Administrative expenses – external	(1,403)	(704)	(671)	(581)	(270)	(994)	(4,623)
Depreciation and amortisation	(69)	(827)	(51)	(49)	(4)	(192)	(1,192)
Goodwill impairment		(41)	(14)				(55)
Other operating expenses			(9,242)	(459)			(9,701)
Operating expenses	(2,130)	(1,737)	(10,076)	(1,091)	(296)	(241)	(15,571)
Impairment losses on loans and advances	(1,088)	(438)		(216)			(1,742)
Impairment losses on investment securities		(69)		(2)			(71)
Operating profit	2,211	1,591	727	719	323	(241)	5,330
	2	156	(37)	4	1		126

Share of profit of jointly controlled entities and associates							
Non-operating income	48			180	22		250
Profit before taxation	2,261	1,747	690	903	346	(241)	5,706
Total assets (a)	242,326	101,494	82,656	57,900	106,658	779	591,813
Included in total assets:							
Interests in jointly controlled entities and associates	57	536	(43)	51			601
Loans and advances to customers	237,080	90,187		48,684	857		376,808
Total liabilities (a)	235,405	94,415	77,421	57,794	104,828	779	570,642
Included in total liabilities:							
Customer accounts	140,627	43,469		17,509	10,252		211,857
Capital expenditure on property and equipment and software	7	39	18	72	10	351	497

(a) The total assets and total liabilities of Corporate include £1,388m and £909m respectively, being the assets and liabilities of the disposal group.

(b) International division includes the income and expenses of Drive which was disposed of during 2006.

F-29

Notes to the Financial Statements
continued

11 Segmental Analysis continued

Geographical
The table below analyses the Group results and assets by geographical area based on the location of the customer.

			2008			2007
	UK	Rest of world	Total	UK	Rest of world	Total
	£m	£m	£m	£m	£m	£m
Net interest income	6,455	1,716	8,171	6.044	1,260	7,304
Net fees and commission income	950	177	1,127	1,110	150	1,260
Net trading income	(3,104)	226	(2,878)	144	34	178
Other operating income	28	(2,836)	(2,808)	11,135	1,414	12,549
Net operating income	4,329	(717)	3,612	18,433	2,858	21,291
Administrative expenses	(4,290)	(824)	(5,114)	(4,289)	(690)	(4,979)
Depreciation and amortisation	(1,535)	(73)	(1,608)	(1,341)	(61)	(1,402)
Goodwill impairment	(143)	(15)	(158)	(5)		(5)
Other operating expenses	6,690	(498)	6,192	(6,743)	(941)	(7,684)
Operating expenses	722	(1,410)	(688)	(12,378)	(1,692)	(14,070)
Impairment losses on loans and advances	(8,899)	(958)	(9,857)	(1,893)	(119)	(2,012)
Impairment on investment securities	(2,158)	(35)	(2,193)	(59)	(1)	(60)
Operating profit	(6,006)	(3,120)	(9,126)	4,103	1,046	5,149
Share of (loss)/profit of jointly controlled entities and associates	(920)	(36)	(956)	51	183	234
(Loss)/profit on sale of businesses	102	(845)	(743)	91		91
Profit before taxation	(6,824)	(4,001)	(10,825)	4,245	1,229	5,474
Total assets	550,500	139,417	689,917	532,572	134,445	667,017
Included in total assets:						
Interests in jointly controlled entities and associates	756	405	1,161	1,442	282	1,724
Total liabilities	524,991	151,427	676,418	498,417	146,366	644,783
Included in total liabilities:						
Capital expenditure on property and equipment and software	575	141	716	473	83	556

Notes to the Financial Statements
continued

11 Segmental Analysis continued

Geographical
The table below analyses the Group results and assets by geographical area based on the location of the customer.

	UK	Rest of world	2006 Total
	£m	£m	£m
Net interest income	6,393	1,007	7,400
Net fees and commission income	937	226	1,163
Net trading income	284	8	292
Other operating income	12,652	1,207	13,859
Net operating income	20,266	2,448	