31 July 2008

HBOS plc Interim Results 2008

Stock Exchange Announcement
Page1

Contents

This document contains forward-looking statements, including such statements within the meaning of section 27A of the US Securities Act of 1933 and section 21E of the US Securities Exchange Act of 1934.

These statements concern or may affect future matters. These may include HBOS's future strategies, business plans, and results and are based on the current expectations of the directors of HBOS. They are subject to a number of risks and uncertainties that might cause actual results and outcomes to differ materially from expectations outlined in these forward-looking statements. These factors are not limited to regulatory developments but include stock markets, IT developments, and competitive and general operating conditions.

CHIEF EXECUTIVE'S REPORT

HBOS plc 2008 Interim Results

"The first half of 2008 has seen the dislocation in financial markets evolve into a wider economic slowdown. Recognising the importance of strong capital to the HBOS core customer proposition, we have now completed our £4.0bn Rights Issue, rebasing the Group to stronger capital ratios. We are repricing both new and existing business, to deliver margin stability. The Group is now well positioned to operate in the more challenging economic environment."

Andy Hornby, Chief Executive

Group Performance

- Underlying profit before tax ('UPBT') excluding negative fair value adjustments [(1)] ('NFVA') down 14% to £2,546m (H1 2007 £2,962m).
- UPBT including NFVA[(1)] down 51% to £1,451m (H1 2007 £2,962m).
- Profit after tax down 56% to £950m (H1 2007 £2,139m).
- Underlying earnings per share ('EPS') excluding NFVA down 13% to 47.4p (H1 2007 54.6p).
- Underlying EPS including NFVA down 52% to 26.4p (H1 2007 54.6p).
- Basic EPS down 57% to 23.5p (H1 2007 55.0p).

- Proforma Basel II capital ratios at 30 June 2008, adjusted for the proceeds of the Rights Issue:
  - Tier 1 capital ratio 8.6%.
  - Core Tier 1[2] capital ratio 6.5%.
  - Total capital ratio 12.2%.
- A Capitalisation amount totalling £320m, currently equivalent to 6.1p per ordinary share will be allocated in respect of the 2008 interim dividend. It is intended that the final dividend will be paid in cash.
- Group customer lending in H1 has grown by an annualised 12%. Growth is however slowing as planned and we expect full year customer lending growth of mid-single digits.
- Group customer deposits have grown by an annualised 12%. For the full year, we expect the rate of growth of deposits to exceed the rate of growth in lending.
- Group net interest margin 155bps (H2 2007 158bps).
- Group post tax RoE excluding NFVA 16.6% (H1 2007 21.0%).
- Group post tax RoE 10.3% (H1 2007 21.0%).
- Group cost:income ratio (excluding NFVA) 41.2% (H1 2007 39.9%).
- Group cost:income ratio 49.6% (H1 2007 39.9%).
- Group impaired loans as a % of closing advances increases to 2.35% (end 2007 2.03%). Impairment losses as an annualised % of average advances increases to 0.59% (H1 2007 0.50%).

(1) Negative Fair Value Adjustments relating to certain traded debt securities in Treasury taken to the income statement were £1,095m (H1 2007 £nil) – See page 48 for further details.
(2) Core Tier 1 excludes preference shares and preferred securities – See page 67.

CHIEF EXECUTIVE'S REPORT

Group Performance

Profit

The results for the first half of 2008, and the comparison to the first half of 2007, have been significantly affected by £1,095m (H1 2007 nil) of negative fair value adjustments ('NFVA') taken to the income statement in respect of debt securities held in the Treasury Trading Book. In addition, £1,916m of NFVA (H1 2007 nil) on a post tax basis were taken through equity in the Available For Sale ('AFS') reserve, which are not reflected in reported profit or regulatory capital. Looking forward and as previously guided, we expect a stronger second half.

Underlying profit before tax excluding NFVA decreased by 14% to £2,546m (H1 2007 £2,962m). Underlying earnings per share excluding NFVA decreased by 13% to 47.4p (H1 2007 54.6p).

Underlying earnings per share including NFVA decreased by 52% to 26.4p (H1 2007 54.6p). Underlying profit before tax including NFVA decreased by 51% to £1,451m (H1 2007 £2,962m).

Interim dividend

As announced on 29 April 2008, we believe that it is prudent to issue new ordinary shares to shareholders by way of a Capitalisation Issue in respect of the 2008 interim dividend. We have therefore today proposed a Capitalisation amount of £320m, currently equivalent to 6.1p per ordinary share. The Capitalisation Issue price, which will be used to calculate shareholders entitlement to new shares, will be determined as the average of the middle market quotations for ordinary shares over the three dealing days starting on 1 October 2008.

We believe that a payout ratio of around 40% is appropriate for 2008 and over the medium term, reflecting a prudent view of the expected ongoing capital requirements of the Group. We intend to pursue a progressive dividend policy, growing dividends in line with underlying earnings. We intend to pay the final dividend in cash, which together with the Capitalisation Issue results in around 40% of underlying profits attributable to ordinary shareholders being distributed.

Capital

Following the completion of the £4.0bn Rights Issue in late July 2008, the Group's capital ratios have been rebased to a higher level. Strong capital lies at the heart of the HBOS customer proposition and underpins our leading positions in liquid savings, deposits and investments. The Rights Issue is designed to achieve a step change in the ratios through the downturn. At 30 June 2008, the proforma capital ratios (calculated to include the £4.0bn of capital raised from the Rights Issue) were Tier 1 8.6%, Core Tier 1 6.5% and Total Capital 12.2%. These ratios are in the middle of our revised target ranges of 8%-9% for Tier 1 and 6%-7% for Core Tier 1.

Excluding the proceeds of the Rights Issue, the actual Tier 1, Core Tier 1 and Total capital ratios as at 30 June 2008 were 7.3% (end 2007 7.7%), 5.3% (end 2007 5.7%) and 10.9% (end 2007 11.0%), respectively.

Funding

We continue to fund successfully in the wholesale markets. At 30 June 2008 41.4% of our wholesale funding matures in more than one year (end 2007 41.0%). Our asset growth will continue to be selective and, over time, we will grow the relative share of customer deposits in our funding mix.

Margins

The Group net interest margin declined by just 3bps to 1.55% (H2 2007 1.58%). We expect to see relative stability in overall margins in the second half of 2008 with the potential for improving margins in future years.

In Retail, the margin increased by 3bps as asset spreads improved, more than offsetting the increased costs of both customer deposits and wholesale funding.

In Corporate, the margin declined by 5bps, despite wider spreads being achieved on new lending, reflecting slower turnover of the existing book. In International, the margin declined by 7bps primarily as a result of increased funding costs.

Growth

Advances to customers increased by an annualised 12% to £456.0bn (end 2007 £430.0bn). We expect the rate of lending growth to slow in the second half of 2008, particularly in Corporate, and expect growth in the full year for the Group will be mid single digits.

The rate of growth in the first half primarily reflects the pipeline of Corporate lending at the start of the year which, together with slower syndication markets, has seen Corporate lending grow by an annualised 14% to £116.9bn (end 2007 £109.3bn). International's annualised growth of 34% to £78.5bn (end 2007 £67.1bn) partly reflects the impact of foreign exchange translation. In Retail, lending grew by an annualised 2% to £255.8bn (end 2007 £253.4bn) in a smaller mortgage market. We continued our cautious approach to the unsecured personal lending market.

Customer deposits increased by an annualised 12% to £258.1bn (end 2007 £243.2bn). We expect that the rate of deposit growth will exceed the rate of growth in lending in the full year.

General Insurance Gross Written Premiums ('GWP') increased 3% to £892m (H1 2007 £868m) reflecting strong performances in Household (up 7%) and Motor (up 43%) offset by lower Repayment insurance (down 13%). New sales combined with a focus on retention saw overall Household policies increase by 11% to 3.0m (H1 2007 2.7m) and Motor by 30% to 1.3m (H1 2007 1.0m).

Volatile equity markets and changes in government tax policy saw UK investment sales decrease by 5% to £7,201m, Present Value of New Business Premiums ('PVNBP') (H1 2007 £7,574m). However, lower levels of lapses saw net fund flows increase by 33% to £1.2bn.

Insight saw net inflows of £8.7bn (H1 2007 £6.0bn) increasing assets under management by 3% to £112.0bn (end 2007 £109.1bn).

Efficiency

Underlying net operating income (excluding NFVA) was stable at £6,467m (H1 2007 £6,427m). Within this, underlying net interest income increased by 6%, reflecting growth in lending. Underlying non-interest income (excluding NFVA) decreased by 7%, primarily reflecting lower revenues from the Corporate investment portfolio. Underlying operating expenses increased by 4% to £2,667m (H1 2007 £2,563m). The cost:income ratio (excluding NFVA) was higher at 41.2% (H1 2007 39.9%).

Credit Quality

Consistent with a slowing economy, credit experience has seen some deterioration in the first half of 2008. Impaired loans as a % of advances increased to 2.35% (end 2007 2.03%). Impairment losses increased by 36% to £1,310m (H1 2007 £963m, H2 2007 £1,049m) representing 0.59% (annualised) of average advances (H1 2007 0.50%, H2 2007 0.50%).

In Retail, impairment losses increased to 0.57% (annualised) of average advances (H1 2007 0.57%, H2 2007 0.49%). Secured lending impairment losses totalled £213m (H1 2007 £(12)m, H2 2007 £40m) and unsecured lending £509m (H1 2007 £690m, H2 2007 £576m). The decline in house prices in the first half of 2008 has driven an increased secured provisioning requirement. Secured credit quality continues to be underpinned by significant equity in the book where the average LTV is 48%. Consistent with our reduced appetite for unsecured lending for the last 3 years, we saw a decline in unsecured losses in the first half of 2008.

In Corporate, impairment losses increased to 0.83% (annualised) of average advances (H1 2007 0.51%, H2 2007 0.71%) reflecting the weakening economic climate.

In International, impairment losses increased to 0.33% (annualised) of average advances (H1 2007 0.19%, H2 2007 0.21%) primarily reflecting a small number of higher value corporate loans in Australia and North America.

Outlook

The reduced availability of credit and a slowing housing market are now part of a wider economic slowdown. We expect UK GDP growth to remain positive in 2008 but with a risk to the downside in 2009. Consensus forecasts, for the decline in house prices, is now in the range of 15-20% over 2008 and 2009 combined. Despite inflationary pressures in evidence today, we expect that signs of stabilisation will be sufficient for the Monetary Policy Committee to allow interest rates to remain relatively unchanged for the remainder of the year. The slowing economy is likely to see a modest rise in unemployment from its current lows.

We remain cautious on the outlook for global wholesale funding markets and do not expect any significant reopening of securitisation markets in 2008 or the first half of 2009. Asset growth will therefore slow in the second half of 2008 and we expect to deliver lending growth for the Group of mid single digits in 2008. We will also consider selective asset disposals to improve our deposit to loan ratio. Group risk weighted assets are expected to grow at a faster pace than lending growth in the current economic environment. However, we expect to operate comfortably within our target capital ranges.

The net interest margin outlook is more positive than for some time. New lending pricing has increased significantly during the first half and this is increasingly offsetting the higher funding costs. We expect relatively stable margins in the second half of 2008 with the potential for improving margins in 2009.

In light of the deteriorating economic environment, we expect to see upward pressure on impairment losses. Mortgage arrears are on a rising trend from historic lows but are supported by strong employment. In Corporate, we are not currently seeing material signs of tenant default but the deteriorating economic climate is likely to put some further pressure on impairments.

In the Investment markets, whilst short-term volatility and tax policy changes are likely to impact new sales across the industry for the remainder of 2008, this does not change our view of the overall attractiveness of the market and the significant growth potential for our multi-channel Investment business where we also expect to see continued emergence of profits from our in-force book.

In Insurance, we expect H1 trends to continue with the strength of our brands and propositions contributing to good growth in household and motor whilst a more cautious outlook for the unsecured lending markets will see further reductions in repayment sales.

In our International businesses we will be more selective in asset growth as we expand our business with an increasing focus on growing liability products.

In summary, HBOS continues to take a cautious view of the outlook for global financial markets and we are adapting our business model for a tougher economic environment. In particular;

- We are concentrating on the re-pricing of new and existing business to deliver margin stability;

- We have re-based the Group's capital ratios following the Rights Issue;
- We are adjusting the Group's funding mix, over time, to continuously improve the deposit to loan ratio; and
- Cost management will remain extremely tight in light of the economic circumstances.

Post the Rights Issue, and with stable and potentially improving margins underpinning pre-provisioning profitability, we are well placed to compete in tougher markets.

FINANCIAL HIGHLIGHTS

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Divisional underlying profit before tax[1]				
Retail	**992**	1,043	1,006	2,049
Corporate	**753**	1,243	1,077	2,320
Insurance & Investment	**402**	316	328	644
International	**323**	327	430	757
Treasury & Asset Management (excl. NFVA)	**224**	194	308	502
Group Items	**(148)**	(161)	(176)	(337)
Group underlying profit before tax (excl. NFVA)	**2,546**	2,962	2,973	5,935
Negative fair value adjustments	**(1,095)**		(227)	(227)
Group underlying profit before tax	**1,451**	2,962	2,746	5,708
Profit before tax	**848**	2,997	2,477	5,474
Profit attributable to ordinary shareholders	**880**	2,063	1,902	3,965
Balance Sheet				
Loans and advances to customers ('Advances')	**455,950**	395,210	430,007	430,007
Total assets	**681,404**	624,090	666,947	666,947
Customer deposits	**258,130**	227,117	243,221	243,221
Shareholders' equity (excluding minority interests)	**20,100**	21,521	21,849	21,849
Capital Adequacy (Basel II)	**%**[2]	%	%[3]	%[3]
Including the Rights Issue				
Tier 1 capital ratio	**8.6**			
Core Tier 1 ratio	**6.5**			
Total capital ratio	**12.2**			
Excluding the Rights Issue				
Tier 1 capital ratio	**7.3**		7.7	7.7
Core Tier 1 ratio	**5.3**		5.7	5.7
Total capital ratio	**10.9**		11.0	11.0
Performance Ratios	**%**	%	%	%
Post tax return on mean equity (excluding NFVA)[1][4]	**16.6**	21.0	20.0	20.4
Post tax return on mean equity[1][4]	**10.3**	21.0	18.7	19.7
Cost:income ratio (excluding NFVA)[1]	**41.2**	39.9	40.4	40.2
Cost:income ratio[1]	**49.6**	39.9	41.9	40.9

Net interest margin[(1)(4)]	**1.55**	1.68	1.58	1.63
Per Ordinary Share				
Earnings (basic)[(5)]	**23.5p**	55.0p	51.1p	106.1p
Earnings (underlying)[(5)]	**26.4p**	54.6p	51.5p	106.1p
Earnings (underlying excl. NFVA)[(5)]	**47.4p**	54.6p	55.7p	110.3p
Dividends[(6)]	**6.1p**	16.6p	32.3p	48.9p
Proforma net asset value[(7)]	**435p**[(2)]			
Net asset value	**502p**	541p	551p	551p
Share Information				
Closing number of ordinary shares in issue (millions)	**3,749**	3,745	3,733	3,733
Proforma closing number of ordinary shares in issue (millions)[(8)]	**5,249**	3,745	3,733	3,733
Average number of ordinary shares in issue for basic and underlying EPS (millions)	**3,740**	3,749	3,727	3,738

Notes 1 to 10 on page 9.

FINANCIAL HIGHLIGHTS

Notes

(1) References to underlying incorporate the following adjustments:

- Excluding regulatory provisions, the impact of the change in corporation tax rates, goodwill impairment, policyholder tax, the impact of short term fluctuations ('STFs') and changes to economic assumptions for Long Term Assurance Business accounted for on an embedded value basis;
- Netting against income of operating lease depreciation, impairment on investment securities, changes in insurance and investment contract liabilities, change in unallocated surplus and net claims incurred on insurance contracts; and
- Including share of profits of associates and jointly controlled entities within underlying non-interest income.

The following table summarises the movements between underlying profit before tax and profit before tax:

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Underlying profit before tax	**1,451**	2,962	2,746	5,708
Regulatory provisions charge		(79)	(43)	(122)
Impact of the 2008 change in corporation tax rate on the value of leasing assets		(18)	8	(10)
Goodwill impairment	**(2)**	(2)	(3)	(5)
Policyholder tax [(9)]	**(451)**	167	(149)	18
Short term fluctuations [(10)]	**(150)**	(33)	(82)	(115)
Profit before tax	**848**	2,997	2,477	5,474

(2) Includes the £4.0bn net proceeds from the Rights Issue, completed in July 2008.

(3) On 1 January 2008, HBOS implemented the Basel II rules for capital adequacy. The 31 December 2007 comparatives were calculated as at 1 January 2008, on achievement of Advanced status.

(4) On an annualised basis.

(5) Basic earnings per share is based on profit attributable to ordinary shareholders of £880m (H1 2007 £2,063m) and weighted average number of ordinary shares in issue restated of 3,740m (H1 2007 3,749m). Underlying earnings per share is based on underlying profit attributable to ordinary shareholders of £989m (H1 2007 £2,046m). Underlying earnings per share excluding NFVA is based on underlying profit attributable to shareholders of £1,772m (H1 £2,046m). Prior year figures have been restated for the impact of the Rights Issue in accordance with IAS33.

The following table summarises the movements between profit attributable to shareholders and underlying profit attributable to ordinary shareholders:

	Half year ended	Half year ended	Half year ended	Year ended

	30.06.2008 £m	30.06.2007 £m	31.12.2007 £m	31.12.2007 £m
Profit attributable to shareholders	**931**	2,114	1,931	4,045
Preference dividends	**(51)**	(51)	(29)	(80)
Profit attributable to ordinary shareholders	**880**	2,063	1,902	3,965
Regulatory provisions charge		55	30	85
Impact of the 2008 change in corporation tax rate on:				
the value of leasing assets		13	(6)	7
deferred tax net liabilities		(110)	(68)	(178)
Goodwill impairment	**2**	2	3	5
Short term fluctuations [10]	**107**	23	58	81
Underlying profit attributable to ordinary shareholders	**989**	2,046	1,919	3,965
Negative fair value adjustments	**783**		159	159
Underlying profit attributable to ordinary shareholders excluding NFVA	**1,772**	2,046	2,078	4,124

(6) A Capitalisation Issue has been approved in lieu of the 2008 interim dividend at the General Meeting on 26 June 2008. Existing shareholders will receive a number of new shares, the amount of which will be determined on 3 October 2008 and will be based on the average of the middle market quotations for ordinary shares for the three dealing days starting on and including 1 October.

(7) The net asset value is calculated after deducting equity preference shares of £1,267m (end 2007 £1,267m) from shareholders' equity excluding minority interests.

(8) Includes shares allotted, issued but not fully paid with reference to the Rights Issue.

(9) This has no impact on profit after tax. Refer to page 56 in the Financial Review section for additional information.

(10) Short term fluctuations represent the impact of fluctuations in investment returns relative to those based on longer term assumptions and variances in actual policyholder tax payable from an expected charge for the period.

KEY DIVISIONAL STATISTICS

	Half year ended 30.06.2008	Half year ended 30.06.2007	Half year ended 31.12.2007	Year ended 31.12.2007
Retail				
Underlying profit before tax (£m)[1]	**992**	1,043	1,006	2,049
Loans and advances to customers (£bn)	**255.8**	242.1	253.4	253.4
Customer deposits (£bn)	**160.0**	151.3	158.3	158.3
Net mortgage lending market share (estimated) (%)	**7**	8	22	15
Stock of mortgages market share (estimated) (%)	**20**	20	20	20
Share of UK Household Sector Liquid Assets (estimated) (%)	**15.4**	15.8	15.6	15.6
Impairment losses as a % of average advances (%)[2]	**0.57**	0.57	0.49	0.53
Impairment provisions as a % of impaired loans (%)	**31**	32	34	34
Impairment provisions as a % of closing advances (%)	**0.90**	0.86	0.89	0.89
Impaired loans as a % of closing advances (%)	**2.88**	2.67	2.59	2.59
Net interest margin (%)[2]	**1.62**	1.73	1.59	1.66
Cost:income ratio (%)[3]	**38.9**	38.8	40.7	39.7
Corporate				
Underlying profit before tax (£m)[1]	**753**	1,243	1,077	2,320
Loans and advances to customers (£bn)	**116.9**	95.8	109.3	109.3

Customer deposits (£bn)	**44.7**	41.9	44.1	44.1
Impairment losses as a % of average advances (%)[2]	**0.83**	0.51	0.71	0.61
Impairment provisions as a % of impaired loans (%)	**44**	49	53	53
Impairment provisions as a % of closing advances (%)	**0.80**	0.78	0.73	0.73
Impaired loans with loss as a % of closing advances (%)	**1.82**	1.58	1.39	1.39
Net interest margin (%)[2]	**1.96**	2.12	2.01	2.06
Cost:income ratio (%)[3]	**24.8**	22.8	23.7	23.2
Insurance & Investment				
Underlying profit before tax (£m)[1]				
Insurance & Investment	**402**	316	328	644
General Insurance	**176**	107	125	232
Investment Business	**226**	209	203	412
General Insurance sales (GWP) (£m)	**892**	868	893	1,761
Household policies in-force (£m)	**3.0**	2.7	2.8	2.8
Investment sales (PVNBP) (£m)[4][5]	**7,201**	7,574	6,950	14,524
Investment net fund inflow (£bn)	**1.2**	0.9	0.8	1.7

KEY DIVISIONAL STATISTICS

	Half year ended 30.06.2008	Half year ended 30.06.2007	Half year ended 31.12.2007	Year ended 31.12.2007
International				
Underlying profit before tax (£m)[1]	**323**	327	430	757
Loans and advances to customers (£bn)	**78.5**	56.8	67.1	67.1
Customer deposits (£bn)	**25.0**	19.8	23.6	23.6
Impairment losses as a % of average advances (%)[2]	**0.33**	0.19	0.21	0.20
Impairment provisions as a % of impaired loans (%)[6]	**33**	55	50	50
Impairment provisions as a % of closing advances (%)	**0.52**	0.49	0.48	0.48
Impaired loans as a % of closing advances (%)[6]	**1.58**	0.90	0.96	0.96
Net interest margin (%)[2]	**1.84**	1.95	1.91	1.93
Cost:income ratio (%)[3]	**50.1**	47.0	43.4	45.0
Investment sales (PVNBP) (£m)[4]	**300**	342	641	983
Treasury & Asset Management				
Underlying profit before tax (excl. NFVA) (£m)[1]	**224**	194	308	502
Underlying profit before tax (£m)[1]	**(871)**	194	81	275
Customer deposits (£bn)	**28.4**	14.1	17.2	17.2
Cost:income ratio (excl. NFVA) (%)[3]	**41.7**	47.2	35.8	40.7
Asset Management assets under management (£bn)[7]	**120.0**	112.3	117.8	117.8

(1) Refer to Definition of Underlying on page 9.
(2) Annualised.
(3) Calculated on an underlying basis.

(4) Present Value of New Business Premiums ('PVNBP') equals new single premiums plus the expected present value of the new annual premiums.
(5) Excluding Guaranteed Growth Bond sales.
(6) 2007 comparatives have been restated to reflect the change to the methodology used by Bank of Scotland (Ireland) in categorising impaired loans to align more closely to HBOS policy.
(7) Comprising Insight and Invista

SUMMARY RESULTS

Summary Consolidated Income Statement

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Underlying net interest income [1]	**3,861**	3,626	3,688	7,314
Underlying non-interest income [1][2]	**2,606**	2,801	3,015	5,816
Underlying net operating income [1][2]	**6,467**	6,427	6,703	13,130
Underlying operating expenses [1]	**(2,667)**	(2,563)	(2,711)	(5,274)
Underlying operating profit before provisions[2]	**3,800**	3,864	3,992	7,856
Impairment losses on loans and advances	**(1,310)**	(963)	(1,049)	(2,012)
Underlying operating profit [1][2]	**2,490**	2,901	2,943	5,844
Non-operating income	**56**	61	30	91
Underlying profit before taxation excl. NFVA[1]	**2,546**	2,962	2,973	5,935
Negative fair value adjustments	**(1,095)**		(227)	(227)
Underlying profit before taxation [1]	**1,451**	2,962	2,746	5,708
Regulatory provisions		(79)	(43)	(122)
Impact of the 2008 change of corporation tax rate on the value of leasing assets		(18)	8	(10)
Goodwill impairment	**(2)**	(2)	(3)	(5)
Policyholder tax payable	**(451)**	167	(149)	18
Short term fluctuations	**(150)**	(33)	(82)	(115)
Profit before taxation	**848**	2,997	2,477	5,474
Tax on profit	**102**	(858)	(507)	(1,365)
Profit after taxation	**950**	2,139	1,970	4,109
Profit of disposal group classified as held for sale		4		4
Profit for the year	**950**	2,143	1,970	4,113
Attributable to:				
Parent company shareholders	**931**	2,114	1,931	4,045
Minority interests	**19**	29	39	68
	950	2,143	1,970	4,113

Summary Consolidated Balance Sheet

	As at 30.06.2008 £m	As at 30.06.2007 £m	As at 31.12.2007 £m
Assets			
Loans and advances to customers	**455,950**	395,210	430,007
Investment securities	**119,074**	120,864	128,398
Other assets	**106,380**	108,016	108,542
Total Assets	**681,404**	624,090	666,947

Liabilities

Customer accounts	**258,130**	227,117	243,221
Debt securities in issue	**193,475**	181,477	206,520
Other borrowed funds	**26,084**	22,713	24,253
Other liabilities	**182,582**	170,902	170,719
Total Liabilities	**660,271**	602,209	644,713
Shareholders' Equity (excluding minority interests)	**20,100**	21,521	21,849
Minority interests	**1,033**	360	385
Shareholders' Equity	**21,133**	21,881	22,234
Total Liabilities and Shareholders' Equity	**681,404**	624,090	666,947

(1) Refer to Definition of Underlying on page 9.
(2) Excluding NFVA.

RETAIL

Underlying profit before tax in Retail decreased by 5% to £992m (H1 2007 £1,043m), largely reflecting the deterioration in the secured credit risk environment. Underlying operating profit before provisions was broadly in line with H1 2007 and 4% ahead of H2 2007, reflecting an improved net interest margin performance. Total income was broadly unchanged from the level of the previous two half years.

Underlying operating expenses continue to reflect the benefits of cost reduction initiatives and at £1,056m were just £3m higher year on year and £38m (3%) lower than in the second half of 2007.

Impairment losses increased by 6% to £722m (H1 2007 £678m) reflecting an increased charge in respect of secured loan impairments, offset by a reduction in the level of unsecured impairment losses.

Financial Performance

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest income	**2,064**	2,087	2,012	4,099
Underlying non-interest income	**650**	630	674	1,304
Mortgages and Savings	**231**	256	232	488
Banking	**241**	220	251	471
Business Banking	**22**	20	21	41
Personal Loans	**48**	66	57	123
Credit Cards	**135**	116	129	245
Other	**20**	22	28	50
Fees and commission income	**697**	700	718	1,418
Fees and commission expense	**(74)**	(55)	(59)	(114)
Other operating income	**27**	14	17	31
Share of losses of associates and jointly controlled entities		(7)	(2)	(9)
Impairment on investment securities		(22)		(22)
Underlying net operating income	**2,714**	2,717	2,686	5,403
Underlying operating expenses	**(1,056)**	(1,053)	(1,094)	(2,147)

Staff	**(543)**	(524)	(562)	(1,086)
Accommodation, repairs and maintenance	**(4)**	(4)	(5)	(9)
Technology	**(26)**	(25)	(27)	(52)
Marketing and communication	**(93)**	(87)	(87)	(174)
Depreciation:				
Property and equipment and intangible assets	**(32)**	(37)	(33)	(70)
Other	**(19)**	(43)	(41)	(84)
Sub total	**(717)**	(720)	(755)	(1,475)
Recharges:				
Technology	**(120)**	(129)	(128)	(257)
Accommodation	**(145)**	(137)	(137)	(274)
Other shared services	**(74)**	(67)	(74)	(141)
Underlying operating profit before provisions	**1,658**	1,664	1,592	3,256
Impairment losses on loans and advances	**(722)**	(678)	(616)	(1,294)
Underlying operating profit	**936**	986	976	1,962
Non-operating income	**56**	57	30	87
Underlying profit before tax	**992**	1,043	1,006	2,049
Net interest margin	**1.62%**	1.73%	1.59%	1.66%
Impairment losses as an annualised % of average advances	**0.57%**	0.57%	0.49%	0.53%
Cost:income ratio	**38.9%**	38.8%	40.7%	39.7%
Loans and advances to customers	**£255.8bn**	£242.1bn	£253.4bn	£253.4bn
Risk weighted assets (Basel II)	**£71.5bn**		£67.9bn	£67.9bn
Customer deposits	**£160.0bn**	£151.3bn	£158.3bn	£158.3bn

RETAIL

Significant changes in the competitive landscape were evident in the first half of this year. The continued effect of the 2007 financial markets dislocation has contributed directly to a lower supply of mortgage funding (and, therefore, a smaller market) and to increased competition for deposits. In Mortgages our share of new lending was unchanged from the first half of 2007 which, after allowing for the smaller markets and repayments, resulted in a reduced level of net lending. Competition for new retail deposits has been strong. Whilst total balance growth was limited by this in the first quarter, our second quarter performance shows clear evidence of a return to a deposit growth trend. Bank Account and Credit Card sales are broadly in line with those achieved in H1 2007 whilst contraction in the consumer credit market, and our own risk appetite, has seen a commensurate reduction in new business written within our Personal Loan business.

Operating Income and Margin
Total net operating income was broadly unchanged at £2,714m (H1 2007 £2,717m) with net interest income slightly lower at £2,064m (H1 2007 £2,087m) and non-interest income 3% higher at £650m (H1 2007 £630m).

Notwithstanding the increased cost of both wholesale and retail funding, the net interest margin advanced to 1.62%, 3bps higher than the second half of 2007, reflecting the beneficial impact of higher pricing for both mortgage acquisition and retention.

Income from fees and commissions was broadly unchanged at £697m (H1 2007 £700m). Credit Card and Banking fee income both improved on the first half of 2007, the latter being driven by fee generation from our packaged current account product, launched in February 2007. The performance in other product areas was either unchanged or lower compared to the first half of 2007, the natural consequence of more subdued housing and consumer finance market activity.

The net interest margin improved by 3bps compared to the previous six month period with the key movements as follows:

Movement in margin	**Basis points**
Net interest margin for the half year ended 31 December 2007	159
Mortgages and Savings	1
Business Banking	(1)
Unsecured Lending	3
Net interest margin for the half year ended 30 June 2008	**162**

The increased marginal cost of new deposit flows reduced the Savings spread but this was more than offset by an improvement in the Mortgage spread. We increased the pricing on both acquisition and retention business to cover the increased cost of funds and to manage asset growth within our planned range. Approximately one-third of the mortgage portfolio is expected to re-price in 2008 due to new lending and the transfer of existing customers from maturing fixed and introductory rates to new products or to the standard variable rate. The spread on unsecured products increased by 3bps reflecting improved pricing.

Operating Expenses
In the first half of 2008 underlying operating expenses were broadly unchanged at £1,056m (H1 2007 £1,053m) and our cost:income ratio was stable at 38.9% (H1 2007 38.8%).

Credit Quality and Provisions
Against the background of a general deterioration in economic conditions, the credit quality of the Retail balance sheet remains strong. Whilst impaired loans increased to 2.88% (end 2007 2.59%) of closing advances, we continue to benefit from exceptionally strong asset cover, with 92.9% (end 2007 93.0%) of customer loans being secured on residential property.

Impairment losses as an annualised percentage of average advances were unchanged at 0.57% (H1 2007 0.57%). Total impairment losses increased by 6% to £722m (H1 2007 £678m). Secured impairment losses were £213m (H1 2007 (£12)m, H2 2007 £40m) with the charge for unsecured lending at £509m (H1 2007 £690m; H2 2007 £576m). Total provisions coverage of impaired loans decreased to 31% (end 2007 34%), reflecting a higher proportion of secured impaired loans. Provisions as a percentage of closing advances increased slightly to 0.90% (end 2007 0.89%).

Secured Impairments
Total impaired secured loans increased to £5,138m (end 2007 £4,234m), representing 2.16% (end 2007 1.80%) of closing advances. Mortgages in arrears (classified as 3 months or more in arrears) but not in possession increased to 1.95% (end 2007 1.67%) of closing advances.

Collateral within our mortgage portfolio remains strong with the average indexed Loan to Value (LTV) of the portfolio at 48% (end 2007 44%). 12% (end 2007 3.5%) of mortgages have an indexed LTV greater than 90% reflecting the decline in house prices. New lending during the first half of 2008 had an average LTV of 68% (2007 65%). In anticipation of the downturn, our approach in late 2007 and early 2008 was to tighten credit whilst supporting the key segments of the housing market. In the first half of 2008 we reduced the availability of higher LTV products especially in specialist markets. Our Buy to Let lending criteria have also been tightened to require higher rental cover. Business written in recent years has been subject to stringent affordability checks, including the assessment of customers' ability to pay at higher rates of interest.

Arrears	Cases 000s		Total Mortgage Cases %		Value of Debt £m[1]		Total Mortgage Balances %	
	30.06.2008	31.12.2007	**30.06.2008**	31.12.2007	**30.06.2008**	31.12.2007	**30.06.2008**	31.12.2007
Mainstream	**27.0**	26.3	**1.23**	1.16	**2,446**	2,274	**1.44**	1.33
Specialist [2]	**12.3**	9.3	**2.49**	1.97	**2,150**	1,627	**3.27**	2.59
Total	**39.3**	35.6	**1.46**	1.30	**4,596**	3,901	**1.95**	1.67

[1]Value of debt represents total book value of mortgages in arrears but not in possession.
[2]Specialist includes Buy To Let (BTL) where arrears cases, excluding repossessions, were 1.33% of total BTL mortgage cases at the end of June 2008 (Dec 2007 0.94%) and 1.73% of BTL mortgage balances (Dec 2007 1.28%). Self Certified arrears cases, excluding repossessions, were 3.22% of total Self Certified mortgage cases at the end of June 2008 (Dec 2007 2.51%) and 4.12% of value on Self Certified mortgage balances (Dec 2007 3.18%).

Consistent with general economic conditions, overall arrears have increased to a total of 1.95% of balances (end 2007 1.67%), similar to the levels experienced in mid 2006.

Arrears % of total mortgage debt

	30.06.2008	31.12.2007	30.06.2007	31.12.2006	30.06.2006	31.12.2005
	%	%	%	%	%	%
Mainstream	**1.44**	1.33	1.42	1.46	1.60	1.73
Specialist	**3.27**	2.59	2.59	2.40	2.82	3.26
Total	**1.95**	1.67	1.73	1.70	1.91	2.11

We have been operating successfully in the specialist markets for a number of years, targeting products with specific risk adjusted return requirements to meet identified customer needs. We keep our credit criteria and underwriting process under regular review. All applicants are subject to external bureaux checks to establish their previous credit performance and all are subject to assessment through bespoke scorecards. In addition, we assess ability to pay against defined affordability criteria. The level of arrears being experienced is within our risk based pricing assumptions.

The secured impairment charge as a percentage of average advances increased from a very low level to 0.09% (H1 2007 (0.01)%), with secured provisions as a percentage of closing advances also increasing to 0.21% (end 2007 0.14%). Our provisioning methodology recognises changes to impairment and loss trends which has resulted in a strengthening of the provisions coverage of impaired loans to 10% (end 2007 8%) to reflect this. The average LTV of the impaired mortgage portfolio increased to 63% (end 2007 57%) driven by negative house price inflation. The equivalent figures for impaired mainstream and specialist mortgages were 57% (end 2007 52%) and 71% (end 2007 66%) respectively.

Unsecured Impairments

We are not seeing any material stress in our impairment performance but, given the continuing deterioration of the external environment, some deterioration in the second half can be expected. Total impaired unsecured loans reduced to £2,222m (end 2007 £2,322m), representing 12.3% (end 2007 13.0%) of closing advances. Provisions as a percentage of closing advances decreased to 10.1% (end 2007 10.8%), with provisions coverage as a percentage of impaired loans remaining broadly unchanged at 82% (end 2007 83%).

Personal Loans

Impaired personal loans decreased to 14.4% of closing advances (end 2007 16.1%). Provisions as a percentage of closing advances decreased to 10.7% (end 2007 12.9%).

Credit Cards

Impaired loans increased to 15.6% of closing advances (end 2007 15.0%). Provisions as a percentage of closing advances increased to 13.9% (end 2007 13.1%). Stability in credit utilisation and overdrawn limits has been maintained. Roll rates reflect tightening of controls over repayment plans.

	30.06.2008	30.06.2007	31.12.2007
	%	%	%
Credit utilisation[(1)]	**27.0**	27.2	27.6
Overdrawn limits[(2)]	**6.9**	7.0	7.1
Arrears roll rates[(3)]	**66.2**	57.5	63.6

(1) percentage of total available credit lines that are drawn down excluding unutilised expired cards.
(2) percentage of accounts in excess of credit limit.
(3) percentage of credit card balances in arrears that have worsened in the period.

Bank Accounts

Impaired loans have decreased to 4.5% of closing advances (end 2007 5.0%). Provisions as a percentage of closing advances decreased to 3.7% (end 2007 4.1%).

Business Banking

Impaired loans were unchanged at 6.5% of closing advances (end 2007 6.5%) and provisions as a percentage of closing advances decreased to 3.2% (end 2007 3.6%).

Balance Sheet and Asset Quality Information	**As at 30.06.2008**	As at 30.06.2007	As at 31.12.2007
	£bn	£bn	£bn
Loans & advances to customers	**255.8**	242.1	253.4
Impairment provisions on advances	**2.3**	2.1	2.3
Loans & advances to customers before impairment provisions	**258.1**	244.2	255.7
Classification of advances*	**%**	%	%
Residential mortgages	**92.6**	92.4	92.6
Other personal lending:			
Secured Personal Loans	**0.3**	0.5	0.4
Unsecured Personal Loans	**3.6**	3.7	3.7
Credit cards	**2.8**	2.8	2.7
Banking	**0.7**	0.6	0.6
Total	**100.0**	100.0	100.0
Analysis of residential mortgages:	**%**	%	%
Mainstream balances	**72.1**	73.9	73.2
Specialist balances**	**27.9**	26.1	26.8
Total	**100.0**	100.0	100.0

* Before impairment provisions
** Comprising predominantly buy to let and self certificated mortgages

	As at 30.06.2008	As at 30.06.2007	As at 31.12.2007
Loan to value analysis of residential mortgage book	**%**	%	%
Less than 60% (averaging 24%, 30.06.07 28%, 31.12.07 28%)	**37.8**	46.4	46.7
60% to 70%	**14.5**	17.8	18.2
70% to 80%	**17.8**	19.2	18.3
80% to 90%	**17.9**	13.5	13.3
Greater than 90%	**12.0**	3.1	3.5
Total	**100.0**	100.0	100.0
Average loan to value:	**%**	%	%
Stock of residential mortgages	**48**	43	44
New residential lending	**68**	65	65
Impaired mortgages	**63**	55	57

Note: LTV analysis is based on indexed valuation for stock and valuation at inception for new loans.

Impaired loans*	**£m**	£m	£m
Secured	**5,138**	4,183	4,234
Unsecured	**2,222**	2,277	2,322
Total	**7,360**	6,460	6,556
Impaired loans as a % of closing advances	**%**	%	%
Secured	**2.16**	1.86	1.80
Unsecured	**12.28**	12.86	13.04
Total	**2.88**	2.67	2.59
Impairment provisions on advances	**£m**	£m	£m
Secured	**490**	340	330
Unsecured	**1,820**	1,740	1,919
Total	**2,310**	2,080	2,249
Impairment provisions as a % of closing advances	**%**	%	%
Secured	**0.21**	0.15	0.14
Unsecured	**10.06**	9.83	10.78
Total	**0.90**	0.86	0.89
Impairment provisions as a % of impaired loans	**%**	%	%
Secured	**10**	8	8
Unsecured	**82**	76	83
Total	**31**	32	34

* Before impairment provisions

Operational Performance

Lending Growth

In response to the prevailing market conditions and the continuing dislocation in financial markets, we have adopted a very cautious approach to asset growth. Overall, loans and advances grew by an annualised 2% to £255.8bn (end 2007 £253.4bn) with total unsecured product balances remaining relatively unchanged.

Mortgages

Market gross lending in the first half of 2008 is estimated at £151bn (H1 2007 £178bn), 15% lower than the same period last year. The lower gross market reflects the decline in the house purchase market, partially offset by a sustained remortgage market. The reduced market also reflects a lower supply of mortgage finance (especially by previous new entrants in specialist markets). The slowdown in the home mover market has resulted in a contraction in principal repaid to £122bn (H1 2007 £124bn). As a consequence of these factors, the net market has fallen to an estimated £29bn (H1 2007 £54bn).

RETAIL

Our gross lending in the first half of 2008 was £28bn (H1 2007 £34bn), an estimated gross market share of 19% (H1 2007 19%). Within this, we have pursued a strategy of supporting the housing market, attracting a greater proportion of house purchase applications than the market average and consequently reducing the remortgage proportion of our total lending, compared to the market. Our overall market share of principal repaid in H1 2008 is estimated at 22% (H1 2007 24%), consistent with the performance in H2 2007. Net lending in the first half of 2008 was £2bn (H1 2007 £4bn). The net lending share is estimated at 7% (H1 2007 8%) broadly in line with the previous year. Our stock of mortgage assets ended the period at £237bn (end 2007 £235bn), representing an estimated market share of 20% (end 2007 20%).

Unsecured Personal Loans

Gross lending in the Unsecured Personal Loan market has shown an 8% contraction year-on-year. In this environment we have continued the cautious approach adopted in recent years and have selectively tightened risk criteria, focusing on existing customers with known behaviour, credit history and other product relationships. We have progressively improved margins during the first half of 2008 with the margin improvement seen across all acquisition channels. Balances have reduced by 3% to £6.4bn (end 2007 £6.6bn), with the market share remaining at 10%.

Credit Cards

Our appetite for credit card lending remains cautious. In the first half of 2008, we acquired 324,000 new credit cards (396,000 including those acquired through our joint venture partners), representing an estimated market share of 12%. We have continued our focus on acquiring higher quality credit card business, and we are experiencing improved usage and retention from new customers. We have also maintained our policy to tighten credit availability to existing customers, and have further tightened our debt-to-income thresholds in recognition of the harsher economic conditions. Balances outstanding at the end of June were £6.7bn (end 2007 £6.8bn).

Retail Savings

Despite the strong competition throughout the first half of 2008, our market-leading position remains unchanged, with a share of Household Sector Liquid Assets of 15.4% (end 2007 15.6%).

Bank Accounts

The Ultimate Reward Current Account, launched in 2007 offering a package of benefits in return for a monthly fee now accounts for 4% of our full facilities current account stock. In the first half, new bank accounts acquired totalled 478,000 (H1 2007 516,000). Of these, 77% (H1 2007 77%) are full facilities current accounts. Our estimated market share of new current accounts is 21% (H1 2007 24%).

HBOS is one of eight banking groups involved in a test case to resolve legal uncertainties concerning the fairness and lawfulness of unarranged overdraft charges. The first hearing in the test case took place in January and February 2008. The judgement in relation to this hearing found that the banks' current terms and conditions relating to unarranged overdraft charges are not penalties. It did, however, find that they can be assessed for fairness under the Unfair Terms in Consumer Contracts Regulations 1999, although the Judge has given the banks permission to appeal that decision. This appeal is expected to take place in autumn 2008.

A further hearing took place in early July 2008, at which the Court was asked to consider whether terms and conditions previously used by the Test Case banks are capable of being penalties. The judgement is awaited. Depending on the outcome of the appeal and the further hearing that took place in July 2008, another hearing may be required in order for the Court to determine the fairness of the charges.

Business Banking
Business banking continues to attract quality SME Switchers. During the first half of 2008 strong growth has been achieved with 7,350 (H1 2007 7,300) switchers moving to HBOS, whilst growing income by 6% on the first half of 2007.

RETAIL

Prospects

The economic outlook is clearly challenging with rising fuel and utility prices increasing affordability stretch. The reduced supply of mortgage finance and generally less benign prospects for the economy are continuing to contribute to lower levels of housing transactions and falling house prices.

In this environment, we will continue to favour profitable mortgage lending over market share and will maintain our cautious approach to growth in Credit Cards and Unsecured Personal Loans. We expect to grow deposits faster than assets and expect to build on the strong first half performance of our Banking business.

We have adjusted our asset pricing to cover the higher cost of wholesale and retail funding and have delivered a stable net interest margin with the potential for further improvement. Our margin performance, together with tight cost control will continue to underpin pre-provisioning profitability.

CORPORATE

Underlying profit before tax in Corporate decreased to £753m (H1 2007 £1,243m). Net operating income decreased by 15% to £1,626m (H1 2007 £1,914m) reflecting lower revenues from our investment portfolio partially offset by higher net interest income. Impairment losses on loans and advances increased to £469m (H1 2007 £235m).

Loans and advances to customers increased by an annualised 14% to £116.9bn (2007 £109.3bn), as a consequence of the pipeline of business at the end of 2007, lower levels of refinancing and reduced activity in the syndications market. Lending growth is, however, being slowed and we expect to end the year, as a whole, with mid single digit growth in assets.

Financial Performance

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Underlying net interest income	**1,140**	992	1,069	2,061
Underlying non-interest income	**486**	922	824	1,746
Commitment fees	**46**	29	34	63
Guarantee fees	**16**	12	13	25
International fees	**8**	8	8	16
Transaction fees	**30**	30	29	59
Underwriting fees	**24**	87	42	129
Other	**87**	77	63	140
Fees and commission income	**211**	243	189	432
Fees and commission expense	**(13)**	(17)	(15)	(32)

Profit on sale of investment securities	**88**	253	210	463
Operating lease rental income	**659**	646	661	1,307
Other operating income	**225**	187	167	354
Share of (losses)/profits of associates and jointly controlled entities	**(34)**	108	124	232
Operating lease depreciation	**(505)**	(493)	(480)	(973)
Impairment on investment securities	**(145)**	(5)	(32)	(37)
Underlying net operating income	**1,626**	1,914	1,893	3,807
Underlying operating expenses	**(404)**	(436)	(449)	(885)
Staff	**(209)**	(259)	(248)	(507)
Accommodation, repairs and maintenance	**(2)**	(3)	(3)	(6)
Technology	**(9)**	(8)	(8)	(16)
Marketing and communication	**(16)**	(16)	(19)	(35)
Depreciation:				
Property and equipment and intangible assets	**(23)**	(23)	(22)	(45)
Other	**(67)**	(52)	(73)	(125)
Sub total	**(326)**	(361)	(373)	(734)
Recharges:				
Technology	**(25)**	(26)	(25)	(51)
Accommodation	**(30)**	(27)	(26)	(53)
Other shared services	**(23)**	(22)	(25)	(47)
Underlying operating profit before provisions	**1,222**	1,478	1,444	2,922
Impairment losses on loans and advances	**(469)**	(235)	(367)	(602)
Underlying profit before tax	**753**	1,243	1,077	2,320
Net interest margin	**1.96%**	2.12%	2.01%	2.06%
Impairment losses as an annualised % of average advances	**0.83%**	0.51%	0.71%	0.61%
Cost:income ratio	**24.8%**	22.8%	23.7%	23.2%
Loans and advances to customers	**£116.9bn**	£95.8bn	£109.3bn	£109.3bn
Risk weighted assets (Basel II)	**£172.4bn**		£163.4bn	£163.4bn
Customer deposits	**£44.7bn**	£41.9bn	£44.1bn	£44.1bn

CORPORATE

Operating Income and Margins

Underlying net operating income decreased by 15% to £1,626m (H1 2007 £1,914m). Underlying net interest income increased by 15% to £1,140m (H1 2007 £992m) and underlying non-interest income decreased by 47% to £486m (H1 2007 £922m).

New lending pricing has improved as competition in the market has lessened and significant pricing uplift is being achieved on the component of the book (c. 20%) that is available for repricing in any given year. However, slower churn of the back book impacting the timing of fee recognition and higher funding costs have exerted downward pressure on margins.

Movement in margin	**Basis points**
Net interest margin for the half year ended 31 December 2007	201
Lending	8
Fee recognition	(11)
Deposits	(5)
Capital Earnings	3
Net interest margin for half year ended 30 June 2008	**196**

Net fees and commission income decreased by 12% to £198m (H1 2007 £226m) mainly arising from lower underwriting fees. Corporate investment portfolio revenues (i.e. profits on the sale of investment securities, other operating income, share of profits of associates and jointly controlled entities, less impairment on investment securities) decreased to £134m (H1 2007 £543m).

Profits on the sale of investment securities decreased to £88m (H1 2007 £253m), reflecting fewer significant exits under current market conditions, and reduced income from the investment portfolio. Other operating income increased to £225m (H1 2007 £187m), reflecting the fair value uplift on Infrastructure equity investments, offset by lower realisations from our Joint Venture portfolio. Losses from associates and jointly controlled entities were £(34)m (H1 2007 £108m) due to weaker trading performance. Impairment on investment securities increased to £145m (H1 2007 £5m). As at 30 June 2008, the book value of the investment portfolio was £4.9bn (end 2007 £4.2bn) and unrealised gains in the investment portfolio, taken through equity in the Available For Sale ('AFS') reserve, remain broadly unchanged from the end of the year.

Operating Expenses

The cost:income ratio is 24.8% (H1 2007 22.8%). Our continued focus on cost discipline has mitigated the impact of the reduction in net operating income. Underlying operating expenses decreased by 7% to £404m (H1 2007 £436m) reflecting lower levels of performance based remuneration.

Credit Quality and Provisions

Impaired loans as a percentage of advances increased to 1.82% (end 2007 1.39%), reflecting the current economic slowdown. Impairment losses increased to £469m (H1 2007 £235m) and as an annualised percentage of average advances moved to 0.83% (H1 2007 0.51%, H2 2007 0.71%). Impairment provisions as a percentage of impaired loans reduced to 44% (end 2007 53%).

Credit conditions are deteriorating as the economic environment weakens. In terms of commercial property investment, lending to this sector is based primarily on the quality and diversity of tenant covenants and cashflows and we have very limited evidence to date of rising tenant defaults. However, in respect of our traditional commercial lending, we are now seeing some signs of the slowdown impacting our customers, which has led to increased impairment losses.

CORPORATE

Balance Sheet and Asset Quality Information	As at 30.06.2008	As at 30.06.2007	As at 31.12.2007
Loans and advances to customers	**£116.9bn**	£95.8bn	£109.3bn
Impairment provisions on advances	**£0.9bn**	£0.7bn	£0.8bn
Loans and advances to customers before impairment provisions	**£117.8bn**	£96.5bn	£110.1bn
Classification of advances*:	**%**	%	%
Agriculture, forestry and fishing	**1**	1	1
Energy	**2**	2	2
Manufacturing industry	**4**	5	4
Construction and property:			
Property investment	**20**	19	19
Property development	**7**	6	6
Housing associations	**3**	2	3
Housebuilders	**3**	2	3
Other property	**7**	6	6
Hotels, restaurants and wholesale and retail trade	**11**	10	11
Transport, storage and communication	**6**	8	6
Financial	**5**	6	5

Other services	**11**	12	13
Individuals	**2**	3	2
Non-UK residents	**18**	18	19
	100	100	100

Impaired loans*	**£m**	£m	£m
Impaired loans no loss[1]	**1,905**	982	1,648
Impaired loans with loss	**2,131**	1,518	1,517
	4,036	2,500	3,165
Impaired loans with loss as a % of closing advances	**1.82%**	1.58%	1.39%
Impairment provisions	**£941m**	£748m	£802m
Impairment provisions as a % of closing advances	**0.80%**	0.78%	0.73%
Impairment provisions as a % of impaired loans with loss	**44%**	49%	53%

* Before impairment provisions.
(1) Loans categorised as impaired no loss represent loans that have been individually assessed as having impairment characteristics but where we expect, after taking into consideration collateral and other credit enhancements, full recovery of both interest and capital. As we have progressed our Basel II project we have refined the categorisation of assets as reflected in the year on year increase.

Operational Performance

During the first half of 2008, we have set in train a strategy of slower and highly selective growth, continuing to concentrate on markets where we have real expertise and can generate superior returns. Assets continue to be originated on the basis that we are comfortable to hold them on the balance sheet in their entirety, although a proportion of debt or equity positions may be sold down to other market participants if market conditions are supportive.

As a result, however, of a significant pipeline of business at the end of 2007 and limited activity in the syndications market, pre-sell down lending increased by an annualised 17% and post-sell down lending increased by an annualised 14% in the half year. However, asset growth is now being slowed and for the year as a whole is projected to be in mid single digits.

Lending and investment in the housebuilding sector at the end of June 2008 totalled £4.1bn (end 2007 £4.0bn), of which £3.5bn was provided in senior debt, £0.2bn in mezzanine, £0.3bn in loan stock and £0.1bn in equity finance. There are signs of stress in the housebuilding sector, however our housebuilder exposure is mainly to niche sections of the market (including retirement housing, the affluent, urban regeneration and social housing) rather

than volume led operators. At this point in the cycle, whilst housebuilder earnings are projected to fall, thereby impacting interest cover, debt safety is underpinned by collateral, including landbanks.

Customer deposits have increased to £44.7bn (end 2007 £44.1bn) and are expected to increase further during the rest of the year on the back of new initiatives.

Our business is organised according to the following asset classes:

Real Estate

Real Estate accounts for 29% (end 2007 29%) of our advances to customers and operates mainly in the property investment, property development and house building sectors. As UK property values have weakened, we have been selective when considering new business, focusing primarily on long standing proven relationships. Our commercial real estate exposures are underwritten primarily against the quality of the tenant covenant, which include strong underlying cash flows of the businesses to which we have lent, and in addition are typically secured through the senior charge on property. Our business is well spread across the UK, and lending margins continue to improve.

Commercial

Commercial is our traditional lending business and accounts for 23% (end 2007 24%) of our advances to customers. The principal focus is relationship banking with UK businesses whose annual turnover is greater than £1m. During the first half of 2008, we have continued to develop our operating model, which has entailed a much more focused approach to building full banking relationships. Our strategy has been supported by the launch of a series of innovative and competitive banking products which serve as a key differentiator in the market place. The 2007 Entrepreneur Challenge was a huge success and is being repeated in 2008 with over 80% more applicants this year. This competition provides direct access to some of the most exciting and aspirational entrepreneurs across the UK, a market niche in which Bank of Scotland is highly regarded. These innovative approaches to the market will enable us to grow and continue to challenge the incumbent banks in England and Wales.

Specialised Industry Finance ('SIF')

This part of our business accounts for 16% (end 2007 16%) of advances to customers and consists of five discrete asset classes: Housing Finance, Infrastructure Finance, Energy, Telecoms & Media and Transport. Our businesses performed well for the first half of 2008, in a difficult market environment. Critical to this has been our ability to deliver a coherent service offering to customers, through bespoke products and a dedicated team of professionals with the appropriate track record and experience of the industry.

Joint Ventures

Joint Ventures accounts for 14% (end 2007 13%) of our advances to customers. Some 70% of this portfolio relates to transactions with UK based associate and joint venture companies and 30% to Europe. The underlying industry sectors are predominantly property based and include housebuilders and hotels. For the first half of 2008, the trading and credit performance has been impacted by underlying economic conditions. Our property exposures continue to see no notable deterioration in occupancy rates both in the UK and Europe.

Integrated, Structured & Acquisition Finance ('ISAF')

ISAF accounts for 13% (end 2007 12%) of our advances to customers. It includes a portfolio of leveraged buy-out transactions ('LBOs') where a private equity house acquires control of an existing business. The first half of 2008 has been characterised by much reduced deal volumes across the private equity community in the UK and continental Europe. We have continued to support key private equity house customers with strong track records, in selected transactions, with a reduced quantum of underwriting. Our drawn LBO portfolio debt totalled £7.1bn (end 2007 £6.0bn) with undrawn facilities totalling £1.6bn (end 2007 £1.3bn). It is well spread geographically and by industry. 70% of the portfolio arises from transactions based in the UK, with 30% based in continental Europe. Within the portfolio credit quality has been satisfactory, reflecting the quality of the underlying deals. Impairment provisions totalled £52m (end 2007 £34m), 0.73% (end 2007 0.56%) as a percentage of drawn debt. Our integrated finance business, which has also been less active, nevertheless has made three new investments in the first half of 2008. Investment realisations have also been slower although these have been partially offset by dividend income from our investments.

Asset Solutions
Assets Solutions accounts for 5% (end 2007 6%) of our advances to customers. The Asset Solutions businesses operate mainly in the high volume/low value sectors utilising a number of routes to market and a variety of specific products. In the current climate the recent focus has been on increasing margins to generate an improved return on capital.

CORPORATE

Prospects

The dislocation in world wide financial markets is expected to continue to shape our UK and European markets in 2008 and reduce the supply of credit. We have adopted a cautious approach to lending and as a result, asset growth is now being slowed. Better pricing is being achieved for both new lending and the renewal of existing assets.

Our plans anticipate a worsening in the economic environment, resulting in higher impairment charges. In a slower growth environment we have also planned for lower returns from our investment portfolio. The cost base continues to be reviewed in recognition of the difficult business environment.

INSURANCE & INVESTMENT

Underlying profit before tax in Insurance & Investment increased by 27% to £402m (H1 2007 £316m). General Insurance profit increased by 64% to £176m (H1 2007 £107m), in part, reflecting the flood claims in the first half of 2007. Investment profit increased by 8% to £226m (H1 2007 £209m), reflecting benefits of actual versus expected experience.

On the Full Embedded Value ('EV') basis, underlying profit before tax in Insurance & Investment was £518m (H1 2007 £452m), £116m (H1 2007 £136m) higher than reported under IFRS. Full EV balance sheet embedded value, net of tax for the UK Investment Business was £6,845m (end 2007 £6,794m) and was £2,641m (end 2007 £2,724m) higher than reported under IFRS.

In the first half of 2008, the division paid dividends of £365m to Group (Full year 2007 £312m).

General Insurance ('GI') sales increased by 3% to £892m GWP (H1 2007 £868m) with strong growth in Motor (up 43%) and Household (up 7%) offsetting a fall in Repayment insurance sales. Investment sales fell by 5% to £7,201m PVNBP (H1 2007 £7,574m) reflecting the impact of volatile markets on investor confidence. However, net fund flows increased by 33%, to £1.2bn, as a result of reductions in the level of lapses. Underlying operating expenses increased by 11% reflecting significant marketing spend to support growth in our Motor business, excluding which, expenses were in line with the first half of 2007.

Financial Performance

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest expense	**(52)**	(50)	(48)	(98)
Underlying non-interest income	**910**	775	816	1,591
Fees and commission income	**(12)**	30	61	91
Fees and commission expense	**(390)**	(412)	(394)	(806)
Change in value of in-force long term assurance business	**201**	124	(204)	(80)
Net income from long term business	**555**	549	897	1,446
Investment earnings on surplus assets attributable to shareholders using long term assumptions	**68**	54	61	115

Net earned premiums on GI Contracts	**578**	631	616	1,247
Net GI claims incurred and net change in GI contract liabilities	**(147)**	(246)	(263)	(509)
Investment and other operating income in GI	**41**	42	47	89
Share of profits/(losses) of associates and jointly controlled entities	**16**	3	(5)	(2)
Underlying net operating income	**858**	725	768	1,493
Underlying operating expenses	**(456)**	(409)	(440)	(849)
Staff	**(199)**	(179)	(217)	(396)
Accommodation, repairs and maintenance	**(10)**	(10)	(10)	(20)
Technology	**(17)**	(19)	(23)	(42)
Marketing and communication	**(73)**	(23)	(24)	(47)
Depreciation:				
Property and equipment and intangible assets	**(24)**	(29)	(28)	(57)
Other	**(85)**	(95)	(79)	(174)
Sub total	**(408)**	(355)	(381)	(736)
Recharges:				
Technology	**(20)**	(23)	(25)	(48)
Accommodation	**(18)**	(18)	(17)	(35)
Other shared services	**(10)**	(13)	(17)	(30)
Underlying profit before tax	**402**	316	328	644
Underlying profit before tax (IFRS basis)	**402**	316	328	644
Additional contribution from new business	**218**	255	202	457
Lower contribution from existing business	**(102)**	(123)	(94)	(217)
Additional investment earnings on net assets		4	(4)	
Increase in underlying profit before tax	**116**	136	104	240
Underlying profit before tax (Full EV basis)	**518**	452	432	884

INSURANCE & INVESTMENT

General Insurance Business

Financial Performance

General Insurance profit increased by 64% to £176m (H1 2007 £107m) reflecting strong growth in Household Insurance profit driven by higher sales, robust claims management and lower weather related claims offset in part by an additional marketing spend in our Motor business to drive sales momentum. The H1 2007 result includes £60m of claims incurred in respect of the severe flooding in June 2007.

Underlying non-interest income increased by 69% to £283m (H1 2007 £167m), with income in the first half of 2007 reduced by the cost of the June floods. Underlying operating expenses increased by 65% to £117m (H1 2007 £71m) which included the marketing spend in our Motor business. Excluding this marketing spend, underlying operating expenses were broadly in line with the first half of 2007.

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest income	**10**	11	12	23
Underlying non-interest income	**283**	167	191	358

Fees and commission income	**19**	21	20	41
Fees and commission expense	**(224)**	(288)	(230)	(518)
Net earned premiums on GI contracts	**578**	631	616	1,247
Change in value of in-force long term assurance business		4	6	10
Investment and other operating income	**41**	42	47	89
Net claims incurred	**(190)**	(277)	(164)	(441)
Net change in insurance contract liabilities	**43**	31	(99)	(68)
Share of profits/(losses) of associates and jointly controlled entities	**16**	3	(5)	(2)
Underlying net operating income	**293**	178	203	381
Underlying operating expenses	**(117)**	(71)	(78)	(149)
Underlying profit before tax	**176**	107	125	232

Operational Performance

General Insurance sales increased by 3% to £892m (H1 2007 £868m). Both Motor (up 43%) and Household (up 7%) delivered strong performances partly offset by lower sales in Repayment Insurance (down 13%).

Gross Written Premiums (GWP)

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Household	**277**	260	289	549
Repayment:				
1st party	**233**	254	247	501
3rd party	**149**	186	159	345
Motor	**218**	152	183	335
Other	**15**	16	15	31
Total	**892**	868	893	1,761

Household Insurance

Our household business has had a strong first half, and is the main driver of overall profit growth. Growing our household share remains an important strategic priority allowing us to leverage both our strong UK Retail customer base and our market leading mortgage franchise. Notwithstanding competitive market conditions, we have increased GWP by 7% to £277m (H1 2007 £260m), with particularly strong premium growth from our retail network with GWP up 17% to £92m and with business sold through the telephone and internet up 12% to £80m GWP.

We continue to build on the highly successful promotions of 2007 and have recently launched our Thank You Bonus offering – a compelling proposition which gives £50 back to every new customer at inception and on subsequent renewal (subject to no claims). In addition to driving new business volumes these propositions also drive better business retention by incentivising customers to renew. Growth in sales and a focus on retention at renewal has seen our stock of policies increase by 11% to 3.0m (H1 2007 2.7m).

The household insurance loss ratio fell to 46% (H1 2007 52%), excluding the impact of the 2007 floods, reflecting favourable claims experience and an efficient claims management approach. The strength of our claims management and customer service is demonstrated by the fact that, one year on from the severe flooding of June and July 2007, over 95% of the 1,400 Halifax claimants who had to go into alternative accommodation were back in their homes, which we believe to be ahead of the industry average.

Repayment Insurance
Sales of Repayment Insurance fell by 13% to £382m GWP (H1 2007 £440m), with first party sales to Group customers reducing by 8% to £233m (H1 2007 £254m). The uncertainty surrounding the Competition Commission (CC) investigation and negative media commentary continued to impact sales volumes in the first half, as have lower lending volumes reflecting our reduced risk appetite at this stage in the economic cycle.

Following referral from the Office of Fair Trading, the CC has been reviewing the repayment insurance (otherwise known as Payment Protection Insurance – PPI) market. On 5 June 2008, the CC published its provisional findings, which identified adverse effects on competition, and included a menu of potential remedies. We believe many of the remedies could improve customer searching and enable switching, but some, if eventually enacted, could result in lower levels of protection for UK consumers. The findings are provisional and the ultimate remedies and impacts are unknown and may change. The Group will continue to work constructively with the CC to demonstrate the value of PPI products; specifically, to highlight the importance of being able to offer customers appropriate insurance products at a time when they are taking on increased financial commitments and the unintended consequences on the market and customers arising from some of the potential remedies.

Motor Insurance
Sales of Motor Insurance through our esure joint venture increased by 43% to £218m GWP (H1 2007 £152m). This exceptional performance reflects the strength of the brand portfolio, supported by the additional spend which will fund incremental marketing and new business acquisition activity in 2008 and 2009. An increasing proportion of sales across the industry are through the internet, which provides significant opportunities given our strength in this channel.

INSURANCE & INVESTMENT

Investment Business

Financial Performance

Underlying profit before tax in the Investment Business increased by 8% to £226m (H1 2007 £209m), despite very challenging market conditions, reflecting the emergence of in-force profits. On a Full EV basis, profit fell slightly, by 1%, to £342m (H1 2007 £345m) due to lower new business volumes in the first half of 2008 partly offset by a growing contribution from existing business.

Underlying non-interest income increased by 3% to £627m (H1 2007 £608m) whilst underlying operating expenses of £339m (H1 2007 £338m) remained stable.

New business margins, which are disclosed in detail in the Supplementary EV Information section on page 99, decreased to 3.0% (H1 2007 3.5%, H2 2007 3.1%) of Present Value of New Business Premiums ('PVNBP', calculated as new single premiums plus the expected present value of new annual premiums) but remain strong relative to our competitors. This fall was driven by changes in sales mix, principally due to lower sales of single premium bonds.

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m

Net interest expense	**(62)**	(61)	(60)	(121)
Debt financing costs	**(66)**	(64)	(64)	(128)
Other net interest income	**4**	3	4	7
Underlying non-interest income	**627**	608	625	1,233
Fees and commission income	**(31)**	9	41	50
Fees and commission expense	**(166)**	(124)	(164)	(288)
Change in value of in-force long term assurance business	**201**	120	(210)	(90)
Net income from long term business	**555**	549	897	1,446
Investment earnings on surplus assets attributable to shareholders using long term assumptions	**68**	54	61	115
Underlying net operating income	**565**	547	565	1,112
Underlying operating expenses	**(339)**	(338)	(362)	(700)
Core operating expenses	**(289)**	(276)	(318)	(594)
Development expenditure	**(30)**	(38)	(29)	(67)
Overheads associated with development activity	**(20)**	(24)	(15)	(39)
Underlying profit before tax	**226**	209	203	412
Underlying profit before tax (IFRS basis)	**226**	209	203	412
Additional contribution from new business	**218**	255	202	457
Lower contribution from existing business	**(102)**	(123)	(94)	(217)
Additional investment earnings on net assets		4	(4)	
Increase in underlying profit before tax	**116**	136	104	240
Underlying profit before tax (Full EV basis)	**342**	345	307	652

Under IFRS, the main UK banks account for insurance contracts (i.e. investment business which carries significant insurance risk as well as 'with-profit' contracts) on an embedded value ('EV') basis, whereas investment contracts (i.e. investment business which does not carry significant insurance risk) are accounted for under IAS 39. Consequently, on an IFRS basis the Income Statement incorporates two very different profit recognition patterns depending on the nature of the contract. The table overleaf sets out the contribution from each type of contract.

INSURANCE & INVESTMENT

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Contribution from insurance contracts	**322**	306	273	579
Contribution from investment contracts	**20**	29	38	67
Development expenditure	**(30)**	(38)	(29)	(67)
Overheads associated with development activity	**(20)**	(24)	(15)	(39)
Debt financing cost	**(66)**	(64)	(64)	(128)
Underlying profit before tax	**226**	209	203	412

Insurance Contracts (accounted for on an EV basis)
The contribution from insurance contracts increased by 5% to £322m (2007 £306m). Lower sales of bonds through our bancassurance channel is reflected in the lower profit contribution from new insurance contract business offset by a higher than expected contribution from the existing book. Actual vs expected experience was £72m (H1 2007 £34m) including an element of accelerated profit benefit (£63m) arising from enhancements to our intermediary bond proposition, which has resulted in these contracts being transferred from investment contracts to insurance contracts.

Other favourable experience, totalling £60m, from the benefits of actuarial modelling enhancements and positive experience on expenses and mortality, has been offset by adverse persistency experience of £51m (H1 2007 £51m). Although the adverse impact of persistency experience on the contribution from insurance contracts is in line with the first half of 2007, we have seen improvements in overall persistency experience (across insurance and investment contracts), relative to 2007, despite volatile market conditions. The H1 2007 result benefited from the positive impact of changes to non-unit reserving due to the FSA Policy Statement PS06/14 (£40m).

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Contribution from existing business:				
Expected contribution	**79**	76	86	162
Actual vs expected experience	**72**	34	(1)	33
	151	110	85	195
Contribution from new business	**103**	142	127	269
Investment earnings on surplus assets attributable to shareholders using long term assumptions	**68**	54	61	115
Contribution from insurance contracts	**322**	306	273	579

Investment Contracts (accounted for on an IAS 39 basis)
Under IAS 39, profit recognition on investment contracts is deferred to later years with a loss typically recorded in the year of sale, often referred to as "new business strain". The emergence of profit from our in-force book exceeded the new business strain, resulting in a net positive contribution from investment contracts of £20m (2007 £29m). The contribution from existing business fell 5% to £146m (2007 £153m), reflecting lower investment market levels which result in lower annual management charges, and the impact of transferring certain intermediary bond business to insurance contracts.

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Contribution from existing business	**146**	153	135	288
Contribution from new business	**(126)**	(124)	(97)	(221)
Contribution from investment contracts	**20**	29	38	67

INSURANCE & INVESTMENT

Full EV Basis Supplementary Information
To assist in the understanding of the underlying performance and value generation of the Investment Business, supplementary information is set out on pages 96 to 99, providing Income Statement and Balance Sheet information for our UK Investment Business on a consistent EV accounting basis for both insurance and investment contracts. We refer to this basis as the 'Full EV' basis.

Operational Performance
Investment sales measured by PVNBP, on a comparable basis, fell by 5% to £7,201m (H1 2007 £7,574m). H1 2007 reported sales included £707m PVNBP in respect of our Guaranteed Growth Bond ('GGB') product which we no longer sell given its relatively low profitability and as we focus on driving deposits into our banking business. All commentary will focus on sales trends excluding GGB, in order to ensure comparability between reporting periods.

Overall sales performance reflects the benefits of our multi-channel model with Intermediary sales up 13%, Wealth Management up 1% and Bancassurance sales (which are often to "first-time" investors) down 18%. However, net fund flows increased strongly, up 33%, to £1.2bn (H1 2007 £0.9bn), as a result of reduced lapses.

Along with the rest of the industry, we continue to see volatile markets and economic uncertainty leading many investors to defer investments in equity-based products. Nevertheless, we remain confident about the longer term prospects for the Investment sector.

Investment Sales	**Half year ended 30.06.2008**			Half year ended 30.06.2007		
	Single £m	**Annual £m**	**PVNBP* £m**	Single £m	Annual £m	PVNBP* £m
Investment Bonds	**2,654**	**5**	**2,696**	3,394	4	3,437
Individual Pensions	**1,401**	**122**	**1,945**	1,393	115	1,882
Group Pensions	**21**	**55**	**289**	49	52	304
Annuities	**185**		**185**	167		167
Protection	**2**	**26**	**106**	2	23	88
Mutual Funds	**1,284**	**167**	**1,980**	945	144	1,696
Total exc GGB	**5,547**	**375**	**7,201**	5,950	338	7,574
GGB				707		707
Total inc GGB	**5,547**	**375**	**7,201**	6,657	338	8,281
Bancassurance	**2,083**	**220**	**3,070**	2,753	193	3,735
Intermediary	**1,803**	**100**	**2,283**	1,528	99	2,012
Wealth Management	**1,661**	**55**	**1,848**	1,669	46	1,827
Total exc GGB	**5,547**	**375**	**7,201**	5,950	338	7,574
Insurance Contracts**	**2,145**	**32**	**2,280**	2,238	31	2,385
Investment Contracts**	**3,402**	**343**	**4,921**	3,712	307	5,189
Total exc GGB	**5,547**	**375**	**7,201**	5,950	338	7,574

* PVNBP is the present value of new business premiums. It equals new single premiums plus the expected present value of new annual premiums.

** Insurance contracts include £721m PVNBP in respect of business which has been transferred from investment contracts and so was recorded as investment contract sales in 2007 (H1 2007 £570m PVNBP).

Movement in assets under management

The following table analyses the movement in assets under management.

	Half year ended 30.06.2008 £bn	Half year ended 30.06.2007 £bn	Year ended 31.12.2007 £bn
Opening assets under management *	**82.2**	77.4	77.4
Premiums (new and existing business)	**6.1**	6.5	12.9
Maturities & claims	**(0.8)**	(0.9)	(2.1)
Lapses (i.e. surrenders and repurchases)	**(4.1)**	(4.7)	(9.1)
Net inflow of business	**1.2**	0.9	1.7
Investment return (net of charges)	**(6.4)**	2.1	3.1
(Decrease)/increase in assets under management	**(5.2)**	3.0	4.8

Closing assets under management	**77.0**	80.4	82.2
Lapse rate (lapses as % of average assets)	10%	12%	11%

* The table has been restated to exclude the impacts of GGB business.

Assets under management fell by £5.2bn (6%) to £77.0bn reflecting investment market trends in H1 2008. Net inflows were up 33% at £1.2bn (H1 2007 £0.9bn) due to lower lapses in 2008. Premiums fell by 6% to £6.1bn (H1 2007 £6.5bn). Lapse rates improved to 10% as the absolute level of lapses reduced. Market uncertainty has continued to create upward pressure in terms of surrender activity and the overall reduction in lapse levels reflects the success of our retention initiatives.

Bancassurance

Sales through the Bancassurance channel fell by 18% to £3,070m PVNBP (H1 2007 £3,735m). This channel has been most impacted by the difficult market conditions. Despite this, we remain clear market leader.

Bond sales (down 42% to £1,197m) have been particularly affected by market conditions, alongside legislative changes to both capital gains tax and inheritance tax. However, mutual fund sales increased by 8% to £1,224m, reflecting a highly successful ISA season (up 31%) which saw our market share increase from 7% to 11% in the first quarter of the year.

Notwithstanding market conditions, we continue to grow our adviser numbers to position ourselves for future sales growth. Branch-based PFAs (Personal Financial Advisers) increased to 1,041 (end 2007 1,007) whilst BOSIS Client Manager numbers rose from 282 at the end of 2007 to 318.

Bancassurance margins remain very strong at 3.9% of PVNBP (H1 2007 4.1%) reflecting the strength and efficiency of our distribution model. The fall in margins is a result of changes in business mix with lower bond sales and higher ISA sales.

Intermediary

The Intermediary channel has performed strongly in the first half of 2008 and new business sales grew by 13% to £2,283m PVNBP (H1 2007 £2,012m). We have a number of initiatives underway which will improve margins and returns on capital in this channel although these have yet to feed through to new business margins which fell to 0.9% of PVNBP compared to 1.0% at 2007 year end (H1 2007 1.3%). The fall in margin reflects changes in business mix and case size in respect of pensions business.

Sales of offshore bonds were very strong, growing by 67%, in particular due to our cash fund offering which has proved particularly attractive to investors in the current volatile market conditions. Based on first quarter market figures, we increased our share in the single premium/transfer Personal & Stakeholder pension markets as well as the income drawdown market, whilst reducing our share in the lower margin regular premium pension markets.

Wealth Management

Sales at St. James's Place ('SJP') increased by 1% to £1,848m PVNBP (H1 2007 £1,827m). This follows two years of extremely strong growth.

Underlying business trends are encouraging and partner numbers increased by 3% to 1,291 (end 2007 1,251). Assets under management fell to £17.2bn (end 2007 £18.2bn) reflecting falling market values, however SJP continues to generate positive net inflows of business and retention performance remains strong. Despite falling due to changes in business mix, SJP's new business margin remains very strong at 3.9% of PVNBP (H1 2007 4.3%).

External recognition of the strength of the SJP proposition continues. Following the award of the Daily Telegraph's 'Wealth Manager of the Year' in late 2007, in the first half of 2008 the business has been named 'Wealth Manager of the Year', and 'Best Income Fund Manager' in the FT Investors Chronicle Awards.

Prospects

Our objective remains unchanged; to become the UK's leading personal lines insurance and investment group. We intend to grow profitable market share through our multi-channel approach, leveraging the strength of the Group's brands and retail customer base.

In General Insurance, we expect sales trends in the second half of the year to follow a similar pattern to the first half. In the medium term, prospects for our combined personal lines businesses remain strong, subject to a degree of regulatory uncertainty until the CC Inquiry into PPI concludes. We have experienced strong sales growth in both Household and Motor Insurance in the first half of 2008, building on good growth in 2007. We will continue to target sales growth and market share gains in these areas where we see strong opportunities for continued growth. Our Household business, in particular, generates strong returns on capital.

In Investment, stock market volatility is impacting on new business volumes and persistency across the industry and we expect this trend to continue for the remainder of 2008. The 2008 Budget included changes which increase the attractiveness of mutual fund products relative to bonds, potentially impacting the mix of bond and mutual fund sales. We believe that our number one position in mutual funds gives us a competitive advantage in this context, and we have seen strong mutual fund sales in 2008. Whilst these market and tax policy factors are impacting Investment business in the short term, we believe that the strength of our propositions, our brands and our distribution reach, together with our rigorous focus on cost control, leaves us well placed to succeed and to deliver strong profitable growth as market conditions recover. Short term volatility does not change our view of the significant opportunities for our Investment business and demographic trends and increasing wealth point to good long term potential.

INTERNATIONAL

International

Underlying profit before tax in International is broadly in line with H1 2007 at £323m. Underlying operating profit before provisions increased by 17% to £442m (H1 2007 £377m), reflecting the benefits of our expansion activity over the last 12 months. The increase in impairment losses from prior periods reflects current global economic conditions, and is measured against historically low levels. Lending increased by an annualised 34% to £78.5bn (end 2007 £67.1bn), with deposits increasing by an annualised 12% to £25.0bn (end 2007 £23.6bn).

Financial Performance

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest income	**670**	504	584	1,088
Underlying non-interest income	**215**	207	292	499
Fees and commission income	**106**	92	114	206
Fees and commission expense	**(90)**	(79)	(144)	(223)

Change in value of in-force long term assurance business	**(15)**	35	77	112
Net income from long term business	**197**	134	183	317
Investment earnings on surplus assets attributable to shareholders using long term assumptions	**2**	3	3	6
Operating lease rental income	**5**	8	7	15
Other operating income	**15**	19	43	62
Share of (losses)/profits of associates and jointly controlled entities	**(2)**	2	15	17
Operating lease depreciation	**(3)**	(7)	(5)	(12)
Impairment on investment securities			(1)	(1)
Underlying net operating income	**885**	711	876	1,587
Underlying operating expenses	**(443)**	(334)	(380)	(714)
Staff	**(255)**	(183)	(216)	(399)
Accommodation, repairs and maintenance	**(35)**	(23)	(26)	(49)
Technology	**(27)**	(25)	(24)	(49)
Marketing and communication	**(37)**	(24)	(29)	(53)
Depreciation: Property and equipment and intangible assets	**(29)**	(20)	(22)	(42)
Other	**(58)**	(58)	(58)	(116)
Sub total	**(441)**	(333)	(375)	(708)
Recharges:				
Technology	**(2)**	(1)	(4)	(5)
Accommodation			(1)	(1)
Underlying operating profit before provisions	**442**	377	496	873
Impairment losses on loans and advances	**(119)**	(50)	(66)	(116)
Underlying profit before tax	**323**	327	430	757
Net interest margin	**1.84%**	1.95%	1.91%	1.93%
Impairment losses as an annualised % of average advances	**0.33%**	0.19%	0.21%	0.20%
Cost:income ratio	**50.1%**	47.0%	43.4%	45.0%
Loans and advances to customers	**£78.5bn**	£56.8bn	£67.1bn	£67.1bn
Risk weighted assets (Basel II)	**£69.4bn**		£59.7bn	£59.7bn
Customer deposits	**£25.0bn**	£19.8bn	£23.6bn	£23.6bn

INTERNATIONAL

Balance Sheet and Asset Quality Information	**As at 30.06.2008**	As at 30.06.2007	As at 31.12.2007
Loans and advances to customers	**£78.5bn**	£56.8bn	£67.1bn
Impairment provisions on advances	**£0.4bn**	£0.3bn	£0.3bn
Loans and advances to customers before impairment provisions	**£78.9bn**	£57.1bn	£67.4bn
Classification of advances*:	**%**	%	%
Agriculture, forestry and fishing	**2**	2	2
Energy	**2**	2	2
Manufacturing industry	**3**	3	3
Construction and property	**28**	27	27
Hotels, restaurants and wholesale and retail trade	**10**	10	9
Transport, storage and communication	**2**	2	2
Financial	**3**	3	3

Other services	**7**	8	8
Individuals:			
Home mortgages	**39**	39	40
Other personal lending	**4**	4	4
	100	100	100
Impaired loans *[(1)]	**£1,243m**	£509m	£641m
Impaired loans as a % of closing advances[(1)]	**1.58%**	0.90%	0.96%
Impairment provisions	**£407m**	£281m	£322m
Impairment provisions as a % of closing advances	**0.52%**	0.49%	0.48%
Impairment provisions as a % of impaired loans[(1)]	**33%**	55%	50%

* Before impairment provisions.
(1) 2007 comparatives have been restated to reflect the change to the methodology used by Bank of Scotland (Ireland) in categorising impaired loans to align more closely to HBOS policy.

The results of our International businesses are converted to sterling monthly at the average exchange rate for the month. The average exchange rates for the respective reporting periods were:

	Half year ended 30.06.2008	Half year ended 30.06.2007	Half year ended 31.12.2007	Year ended 31.12.2007
£1 : Australian dollar	**2.14**	2.44	2.34	2.39
£1 : Euro	**1.29**	1.48	1.44	1.46
£1 : US dollar	**1.98**	1.97	2.03	2.00
£1 : Canadian dollar	**1.99**	2.24	2.06	2.15

The closing exchange rates used in the conversion of the International balance sheets were:

	As at 30.06.2008	As at 30.06.2007	As at 31.12.2007
£1 : Australian dollar	**2.08**	2.36	2.28
£1 : Euro	**1.26**	1.49	1.36
£1 : US dollar	**1.99**	2.01	2.00
£1 : Canadian dollar	**2.02**	2.14	1.97

Hedging policy
Our policy is to hedge both our exposures to foreign exchange profits generated in the International businesses and our structural currency exposures arising from our investment in overseas subsidiaries. In respect of the profits earned in foreign currencies, our policy is to hedge, at the start of each year, the next year's forecast earnings using forward contracts. The structural currency exposures are largely hedged with foreign currency borrowing.

INTERNATIONAL

Australia

Underlying profit before tax in Australia decreased by 6% to £135m (H1 2007 £144m) reflecting increased costs as a result of our national expansion, combined with higher impairment charges. Net operating income rose by 29% demonstrating the continued success of our long term strategy to become a major financial services provider in Australia. In local currency, underlying profit before tax decreased by 12%.

Lending increased by an annualised 39% to £39.6bn (end 2007 £33.2bn) (annualised local currency growth of 17%), with deposits increasing by an annualised 19% to £17.7bn (end 2007 £16.2bn) (broadly in line with end 2007 in local currency terms). Growth has been driven by our early success in the national expansion programme, which focuses on our retail and commercial businesses.

Financial Performance

Income Statement	**Half Year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest income	**385**	290	330	620
Underlying non-interest income	**89**	78	100	178
Fees and commission income	**83**	71	87	158
Fees and commission expense	**(11)**	(7)	(12)	(19)
Net income from long term business	**8**	7	10	17
Other operating income	**6**	3	13	16
Operating lease rental income	**3**	6	1	7
Operating lease depreciation	**(2)**	(3)	(2)	(5)
Share of profits of associates and jointly controlled entities	**2**	1	3	4
Underlying net operating income	**474**	368	430	798
Underlying operating expenses	**(264)**	(188)	(221)	(409)
Staff	**(158)**	(111)	(131)	(242)
Accommodation, repairs and maintenance	**(19)**	(13)	(15)	(28)
Technology	**(20)**	(18)	(21)	(39)
Marketing and communication	**(23)**	(12)	(15)	(27)
Depreciation: Property and equipment and intangible assets	**(14)**	(10)	(11)	(21)
Other	**(30)**	(24)	(28)	(52)
Underlying operating profit before provisions	**210**	180	209	389
Impairment losses on loans and advances	**(75)**	(36)	(45)	(81)
Underlying profit before tax	**135**	144	164	308

Net interest margin	**2.09%**	2.20%	2.10%	2.15%
Impairment losses as an annualised % of average advances	**0.41%**	0.27%	0.29%	0.28%
Cost:income ratio	**55.7%**	51.1%	51.4%	51.3%
Loans and advances to customers	**£39.6bn**	£29.4bn	£33.2bn	£33.2bn
Risk weighted assets (Basel II)	**£37.0bn**		£31.0bn	£31.0bn
Customer deposits	**£17.7bn**	£13.5bn	£16.2bn	£16.2bn

Operating Income and Margins

Underlying net operating income increased by 29% to £474m (H1 2007 £368m), reflecting strong growth in net interest income. The 33% increase in net interest income to £385m (H1 2007 £290m) was driven by our asset growth with relatively stable margins reflecting our careful management of funding costs.

Operating Expenses

Underlying operating expenses increased by 40% to £264m (H1 2007 £188m), as a direct result of the significant investment in physical distribution (particularly the initial phase of the national retail branch expansion and the continuing rollout of business banking centres), new products, brand recognition, customer facing staff and back office infrastructure, all of which underpin our future growth. As a result of this investment for growth, the cost:income ratio increased to 55.7% (H1 2007 51.1%).

Credit Quality and Provisions

Consistent with a deteriorating credit environment, impaired loans as a percentage of closing advances have increased to 1.40% (H1 2007 0.99%), reflecting an increase in a small number of high value impaired corporate loans. Impairment provisions as a percentage of impaired loans was 34% (H1 2007 46%), and impairment losses as an annualised percentage of average advances was 0.41% (H1 2007 0.27%). The increase in impairments is broadly in line with those across the industry and the underlying credit quality of the portfolio is considered sound, benefiting from strengthened risk management.

Balance Sheet and Asset Quality Information	**As at 30.06.2008**	As at 30.06.2007	As at 31.12.2007
Loans and advances to customers	**£39.6bn**	£29.4bn	£33.2bn
Impairment provisions on advances	**£0.2bn**	£0.1bn	£0.1bn
Loans and advances to customers before impairment provisions	**£39.8bn**	£29.5bn	£33.3bn
Classification of advances*:	**%**	%	%
Agriculture, forestry and fishing	**3**	3	3
Energy	**1**	2	2
Manufacturing industry	**3**	2	3
Construction and property	**27**	26	26
Hotels, restaurants and wholesale and retail trade	**8**	9	8
Transport, storage and communication	**3**	2	3
Financial	**3**	3	2
Other services	**7**	8	8
Individuals:			
Home mortgages	**39**	39	39
Other personal lending	**4**	4	4
Non-Australian residents	**2**	2	2
	100	100	100
Impaired loans*	**£554m**	£292m	£333m
Impaired loans as a % of closing advances	**1.40%**	0.99%	1.00%
Impairment provisions	**£190m**	£135m	£147m
Impairment provisions as a % of closing advances	**0.48%**	0.46%	0.44%
Impairment provisions as a % of impaired loans	**34%**	46%	44%

* Before impairment provisions.

INTERNATIONAL

Operational Performance

Significant investment in the national expansion of our Australian operations continued with a major part of this relating to the Retail expansion programme launched in October 2007. Deposit growth, which has benefited from initiatives implemented two years ago, is slowing as a result of stronger market competition driven by the financial markets dislocation. Customer deposits increased by an annualised 19% to £17.7bn, mainly reflecting the strength of the Australian dollar. In local currency terms, they remain broadly unchanged from December 2007, but have increased by 16% since June 2007.

Retail Business
Strong performance in our Retail business, operating under the BankWest brand, saw sustained growth in credit cards, mortgages and deposits. Lending was up by an annualised 42% to £13.3bn (end 2007 £11.0bn) and deposits up by an annualised 29% to £7.1bn (end 2007 £6.2bn). The indexed loan to value ratio of our mortgage book at the end of June 2008 was 68% (end 2007 68%).

Our continued growth has seen 24 stores open since the national expansion was announced in July 2007, principally in New South Wales and Victoria. We expect a further 19 new stores to be opened by the end of 2008, for which progress is well advanced.

Australia's first genuine tracking mortgage product, Rate Tracker, and our national banking platform, Happy Banking, were both launched during this period with encouraging initial early results.

Commercial Business
Our Commercial business, also operating under the BankWest brand, performed strongly in the first half of 2008. Lending grew by an annualised 43% to £13.1bn (end 2007 £10.8bn). Deposits grew by 12% on an annualised basis to £10.6bn (end 2007 £10.0bn). Our strategy focuses on improved service provision, value for money products, fast and simple processes and the support of highly trained specialist bankers with industry-specific expertise. This has helped drive growth, brand awareness and customer satisfaction. 43 commercial business centres have now been opened on the East Coast as part of our national expansion plans, 15 of which have opened in the last 12 months. This completes our stated rollout of banking business centres.

Corporate Business
Our Corporate business, operating under the BOS International brand recorded a strong performance. Lending grew by an annualised 31% to £7.5bn (end 2007 £6.5bn). We continue to be successful in leading transactions across each of our M&A financing, Project and Property Finance market segments. We are also pleased with the progress of our Hong Kong and New Zealand offices in support of the existing corporate client base.

Asset Finance Business
Our Asset Finance business, operating under the Capital Finance brand, achieved 33% annualised growth in lending to £5.7bn (end 2007 £4.9bn), with strong performance in core property, motor and equipment markets. Given the expected customer impact from a slowing economy, this growth was achieved while maintaining credit quality and securing higher margins for new business. We have also tightened the credit criteria in a number of business sectors which are expected to be most affected by the global financial markets dislocation and oil price volatility.

We continue to reduce costs by automating processes and delivering a streamlined operating model to support customer service and origination. By doing so, our Asset Finance business is well positioned for the longer term without diminishing our ability to compete successfully in the current market.

Insurance & Investment Business

Sales of life insurance products continued to experience good growth levels. Sales of in-force policies have increased by 33% in the year to date, which translates to an increase in gross written premium of c.30% compared to the comparative period last year, driven in particular by the term life product initiatives. Insurance sales through the new East Coast BankWest stores have been encouraging since the first store opened in October 2007. Plans are well underway to accelerate the roll-out of personal financial advisers in BankWest stores nationally.

INTERNATIONAL

Prospects

Australia remains influenced by global market conditions, in particular the financial markets dislocation and oil prices which are adding significantly to the cost of living. We have seen a marked slowing of the economy over the last 6 months particularly in the east coast. Australia, however, still remains relatively well positioned due to continued increasing demand for natural resources and food, where substantial price increases are being experienced. The slowing economy has heightened credit risk across the market as a whole, following a sustained period of benign credit conditions.

BankWest's national expansion programme has continued. Initial indications from the new retail stores and business banking centres are encouraging and another 19 stores are scheduled to open before the end of the year in New South Wales, Queensland, Victoria and Western Australia.

HBOS continues to invest in building a market leading retail, business and corporate bank in Australia. The expansion of our national physical presence, and the continued investment in infrastructure and colleagues will, in the longer term, position HBOS Australia as a significant national financial services provider.

INTERNATIONAL

Ireland

Underlying profit before tax in Ireland increased by 6% to £85m (H1 2007 £80m), reflecting strong growth in net interest income partially offset by higher funding costs, increased operating expenses as we continue to grow the franchise, and an increase in impairment charges from a low base. In local currency, underlying profit before tax increased by 5%.

Lending increased by an annualised 34% (local currency 17%) to £25.6bn (end 2007 £21.9bn) with deposits broadly flat at £7.0bn (end 2007 £7.1bn). In local currency, deposits fell by €0.8bn from December 2007, reflecting the competitive market in Ireland.

Financial Performance

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest income	**196**	151	179	330
Underlying non-interest income		12	19	31
Fees and commission income	**8**	6	10	16
Operating lease rental income	**2**	5	3	8
Other operating income	**(5)**	5	10	15
Share of losses of associates and jointly controlled entities	**(4)**			
Operating lease depreciation	**(1)**	(4)	(3)	(7)

Impairment on investment securities			(1)	(1)
Underlying net operating income	**196**	163	198	361
Underlying operating expenses	**(92)**	(73)	(82)	(155)
Staff	**(50)**	(37)	(46)	(83)
Accommodation, repairs and maintenance	**(9)**	(7)	(7)	(14)
Technology	**(3)**	(3)	(1)	(4)
Marketing and communication	**(9)**	(8)	(9)	(17)
Depreciation: Property and equipment and intangible assets	**(7)**	(4)	(6)	(10)
Other	**(14)**	(14)	(13)	(27)
Underlying operating profit before provisions	**104**	90	116	206
Impairment losses on loans and advances	**(19)**	(10)	(12)	(22)
Underlying profit before tax	**85**	80	104	184
Net interest margin	**1.64%**	1.80%	1.81%	1.81%
Impairment losses as an annualised % of average advances	**0.16%**	0.12%	0.12%	0.12%
Cost:income ratio	**46.9%**	44.8%	41.4%	42.9%
Loans and advances to customers	**£25.6bn**	£17.7bn	£21.9bn	£21.9bn
Risk weighted assets (Basel II)	**£21.8bn**		£18.5bn	£18.5bn
Customer deposits	**£7.0bn**	£6.1bn	£7.1bn	£7.1bn

Operating Income and Margins

Underlying net operating income increased by 20% to £196m (H1 2007 £163m) (local currency growth of 10%). Net interest income increased by 30% to £196m (H1 2007 £151m) (local currency growth of 13%), reflecting strong growth in advances, moderated by a decline in margin due to higher funding costs, slower churn in the back book impacting the timing of fee recognition and a changing asset mix as we grow our Retail business. While significant price increases have been introduced through the first half of the year on new lending activity, these have not yet fully materialised in the margin.

Movement in margin	**Basis points**
Net interest margin for the half year ended 31 December 2007	181
Increased funding costs	(10)
Fee recognition	(3)
Asset mix – growth of Retail & Intermediary	(4)
Net interest margin for the half year ended 30 June 2008	**164**

INTERNATIONAL

Operating Expenses

Underlying operating expenses increased by 26% to £92m (H1 2007 £73m) (local currency growth of 9%). This reflects our continuing investment in both people and infrastructure as we complete the roll out of our offering in the Irish marketplace. In the first half of 2008 we opened 2 Retail branches, bringing the total to 42 (compared with 32 at the end of H1 2007). While the cost:income ratio increased to 46.9%, we remain the lowest cost full service player in the Irish market.

Credit Quality and Provisions

Impairment losses as an annualised percentage of average advances increased to 0.16% (H1 2007 0.12%), reflecting deteriorating economic conditions and a reduction in the level of recovery in the impaired portfolio. Impaired loans as a percentage of closing advances increased to 1.46% (end 2007 1.08%).

While arrears levels in the banking portfolio have increased from historical lows, our customer led approach and prudent risk management should minimise potential losses. We remain satisfied with the quality of the business banking portfolio with exposures underpinned by good cash-flows and security cover. However, we are seeing stress at higher levels than previously experienced, particularly in residential property development which represents 8% of our portfolio. Of our total property development portfolio, 91% is rated better than satisfactory or satisfactory (end 2007 96%), using our internal credit ratings.

Irish residential property prices continue to fall. Arrears levels have increased from historic lows but we remain satisfied with the quality of our residential portfolio. We have temporarily withdrawn from the buy to let market and have restricted new activity to lending where the loan to value ratio is less than 90%. The indexed loan to value ratio of our mortgage book at 30 June 2008 was 53% (end 2007 49%). Overall, our cautious entry into the first time buyers segment and the Irish Retail banking market has allowed us to avoid many of the areas generating impairments.

Balance Sheet and Asset Quality Information	**As at 30.06.2008**	As at 30.06.2007	As at 31.12.2007
Loans and advances to customers	**£25.6bn**	£17.7bn	£21.9bn
Impairment provisions on advances	**£0.1bn**	£0.1bn	£0.1bn
Loans and advances to customers before impairment provisions	**£25.7bn**	£17.8bn	£22.0bn
Classification of advances*:	**%**	%	%
Agriculture, forestry and fishing		1	1
Energy	**1**	1	1
Manufacturing industry	**3**	4	3
Construction and property	**28**	29	28
Hotels, restaurants and wholesale and retail trade	**13**	12	12
Transport, storage and communication	**2**	2	2
Financial	**2**	2	2
Other services	**6**	6	6
Individuals:			
Home mortgages	**28**	27	28
Other personal lending	**6**	6	6
Non-Irish residents	**11**	10	11
	100	100	100
Impaired loans *[(1)]	**£375m**	£169m	£237m
Impaired loans as a % of closing advances[(1)]	**1.46%**	0.95%	1.08%
Impairment provisions	**£161m**	£121m	£141m
Impairment provisions as a % of closing advances	**0.63%**	0.68%	0.64%
Impairment provisions as a % of impaired loans[(1)]	**43%**	72%	59%

* Before impairment provisions.

(1) 2007 comparatives have been restated to reflect the change to the methodology used by Bank of Scotland (Ireland) in categorising impaired loans to align more closely to HBOS policy.

INTERNATIONAL

Operational Performance

The financial markets dislocation has had a significant impact on the margin through higher funding costs, including the Euribor spread over base rate. We have introduced price increases on new lending to seek to recover these higher funding costs but the back book will not reprice until existing loans repay. Customer deposits were broadly flat, at £7.0bn, reflecting the strength of the Euro.

Business Banking

The core divisions of Business, Property and Regional Banking all contributed to a strong performance. Advances grew by 31% on an annualised basis to £17.8bn (end 2007 £15.4bn). Our regional distribution capability has been key to our success and we now have 11 banking centres. The declining economic environment has reduced lending opportunities, particularly in property, and also lowered the churn on the back book. We continue to write new business at higher margins and have also modified our credit appetite to ensure the strong quality of our portfolio is maintained.

Retail and Intermediary

Our Retail and Intermediary businesses (Retail branch network, Intermediary Homeloans and Asset Finance) have generated a strong performance. Retail network expansion is on track with 42 branches now open and a further 4 branches due to be opened by the end of the year.

The Retail network will allow us to grow our retail deposit base in the Irish market. The Halifax Current Account, which has been in operation for just over a year, has generated significant levels of new customers, demonstrating the propensity of the customer to switch to our competitive offering.

Prospects

Economic conditions are unlikely to improve in the near future and we are therefore adopting a selective approach to asset growth. Margins remain under pressure from higher funding costs and changes in asset mix, given the focus on retail banking, including deposits and current accounts. Impairment losses are expected to rise in the declining economic environment and softening property markets, but the longer term prospects for growth in the Irish economy are considered to be favourable and the Group continues to invest in Ireland and sees it as a good opportunity for future growth.

INTERNATIONAL

Europe & North America ('ENA')

Underlying profit before tax in ENA is unchanged at £103m (H1 2007 £103m). Underlying operating profit before provisions increased by 20% to £128m (H1 2007 £107m), reflecting the benefits of our expansion activity in 2007. Higher impairment losses are symptomatic of current economic conditions and compare against a very low base.

While we have now slowed our asset growth, we continue to target investment to broaden our product range and distribution reach to exploit commercial opportunities in each of our markets and in response to changing regulatory environments.

Financial Performance

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest income	**89**	63	75	138

Underlying non-interest income	**126**	117	173	290
Fees and commission income	**15**	15	17	32
Fees and commission expense	**(79)**	(72)	(132)	(204)
Change in value of in-force long term assurance business	**(15)**	35	77	112
Net income from long term business	**189**	127	173	300
Investment earnings on surplus assets attributable to shareholders using long term assumptions	**2**	3	3	6
Other operating income	**14**	8	23	31
Share of profits of associates and jointly controlled entities		1	12	13
Underlying net operating income	**215**	180	248	428
Underlying operating expenses	**(87)**	(73)	(77)	(150)
Staff	**(47)**	(35)	(39)	(74)
Accommodation, repairs and maintenance	**(7)**	(3)	(4)	(7)
Technology	**(4)**	(4)	(2)	(6)
Marketing and communication	**(5)**	(4)	(5)	(9)
Depreciation: Property and equipment and intangible assets	**(8)**	(6)	(5)	(11)
Other	**(14)**	(20)	(17)	(37)
Sub total	**(85)**	(72)	(72)	(144)
Recharges:				
Technology	**(2)**	(1)	(4)	(5)
Accommodation			(1)	(1)
Underlying operating profit before provisions	**128**	107	171	278
Impairment losses on loans and advances	**(25)**	(4)	(9)	(13)
Underlying profit before tax	**103**	103	162	265
Net interest margin	**1.46%**	1.47%	1.47%	1.47%
Impairment losses as an annualised % of average advances	**0.40%**	0.09%	0.16%	0.13%
Cost:income ratio	**40.5%**	40.6%	31.0%	35.0%
Loans and advances to customers	**£13.3bn**	£9.7bn	£12.0bn	£12.0bn
Risk weighted assets (Basel II)	**£10.6bn**		£10.2bn	£10.2bn
Customer deposits	**£0.3bn**	£0.2bn	£0.3bn	£0.3bn

INTERNATIONAL

Operating Income and Margins

Net interest income grew by 41% to £89m (H1 2007 £63m), reflecting growth in advances to customers across our corporate and retail banking businesses.

Movement in margin	**Basis points**
Net interest margin for the half year ended 31 December 2007	147
Pricing increases	1
Business mix	4
Foreign exchange impact	(4)
Change in capital earnings	(2)
Net interest margin for the half year ended 30 June 2008	**146**

The net interest margin was broadly stable at 1.46% (H2 2007 1.47%), mainly reflecting a change in business mix and the strong Euro which results in a relatively high weighting of our European retail assets. Through our selective approach to origination, margins on new business lending are increasing. Underlying non-interest income increased by 8% to £126m (H1 2007 £117m). The majority of this increase was driven by activity in the US, with increased fee and commission income and realisations.

Operating Expenses

Underlying operating expenses increased by 19% to £87m (H1 2007 £73m), and reflects continuing targeted investment to expand our product range and distribution channels, and adapting to legislative changes in key markets such as Germany. Furthermore, our Euro denominated operating expenses increased in Sterling terms as a result of the stronger Euro. Increased costs reflect the establishment in H2 2007 of our new corporate business in Canada, new loan production offices in Miami and Dallas, and an increase in the number of branches in Spain. The investment in our infrastructure is carefully phased and managed and is evidenced by a stable cost:income ratio of 40.5% (H1 2007 40.6%).

Credit Quality and Provisions

Impaired loans as a percentage of closing advances have increased from historically low levels to 2.36% (end 2007 0.59%) and is driven largely by a small number of impaired corporate credit exposures. Impairment losses as an annualised percentage of average advances also show an increase from a low base to 0.40% (H1 2007 0.09%). While overall credit quality remains robust across our corporate US portfolio, we are not immune to current conditions, with a small number of individual credits under intensive management.

While the credit quality in our Dutch mortgage portfolio remains robust, our Spanish portfolio has seen an increase in arrears trends as the residential property market deteriorates and the Spanish economy slows. This is being addressed through increasing resources in our arrears management and collections activity, while adjusting our loan to value ratio criteria and pricing to reflect market conditions.

INTERNATIONAL

Balance Sheet and Asset Quality Information	As at 30.06.2008	As at 30.06.2007	As at 31.12.2007
Loans and advances to customers	**£13.3bn**	£9.7bn	£12.0bn
Impairment provisions on advances	**£0.1bn**		
Loans and advances to customers before impairment provisions	**£13.4bn**	£9.7bn	£12.0bn
Classification of advances*:	**%**	%	%
Energy	**7**	6	7
Manufacturing industry	**2**	3	2
Construction and property	**7**	7	7
Hotels, restaurants and wholesale and retail trade	**2**	2	2
Transport, storage and communication	**1**	1	1
Financial	**6**	6	7
Other services etc.	**12**	10	10
Individuals:			
Home mortgages	**62**	65	64
Other personal lending	**1**		
	100	100	100
Impaired loans*	**£314m**	£48m	£71m
Impaired loans as a % of closing advances	**2.36%**	0.49%	0.59%

Impairment provisions	**£56m**	£25m	£34m
Impairment provisions as a % of closing advances	**0.42%**	0.26%	0.28%
Impairment provisions as a % of impaired loans	**18%**	52%	48%

* Before impairment provisions.

Operational Performance

In the current environment, ENA continues to adopt a highly selective approach to origination activity across the banking businesses. New business and asset levels are managed intensively through active product and pricing strategies. Across our banking businesses, particularly those in North America, we continue to source a flow of new business opportunities at attractive margins.

Lending Growth

Loans and advances grew by an annualised 22% to £13.3bn (end 2007 £12.0bn), (local currency annualised growth of 12%), as we take a more selective approach to origination and deliberately slow our asset growth. The growth in our corporate business enhances the spread of the portfolio both geographically and by business, with 38% (end 2007 36%) of lending in Corporate and 62% (end 2007 64%) in Retail. In Retail, our lending portfolio is almost wholly in the form of residential mortgages, although we will continue to develop our range of Retail businesses and products. Corporate continues to benefit from a diverse portfolio spread across a range of specialist sectors such as oil and gas, gaming and real estate.

Loans and advances to customers	**As at 30.06.2008 £bn**	As at 30.06.2007 £bn	As at 31.12.2007 £bn
Corporate (US and Canada)	**5.0**	3.3	4.3
Retail (BHH and BoSNL)	**8.3**	6.4	7.7
	13.3	9.7	12.0

INTERNATIONAL

USA

Our corporate USA business is now based in 9 major economic centres and in a challenging environment, remains highly selective in focusing on our core specialist sectors and in areas that meet our risk / reward appetite. While US lending grew by an annualised 28% to £4.9bn (end 2007 £4.3bn), growth over the past 6 months has slowed to around 14%, reflecting our measured approach to new business opportunities. The USA business has continued to focus on its chosen specialist sectors.

Canada

Our first office in Canada targets specialist corporate sectors, such as corporate finance, real estate, infrastructure and natural resources, with the aim of creating a diverse portfolio and a platform for sustainable profitable growth. The business has focused on building an extensive network of introducers and relationships, while completing a number of loans in partnership with local banks.

Retail Europe

Retail Europe lending of £8.3bn represents annualised growth of 16% (end 2007 £7.7bn). However, this is largely driven by a strengthening Euro, with underlying growth of only 4% in local currency.

BoSNL, our market leading online residential mortgage sales business, saw lending grow by an annualised 16% to £6.8bn (end 2007 £6.3bn) (an annualised 2% growth in local currency terms). In Spain, in a more difficult and slowing residential property market, BHH lending grew by an annualised 14% to £1.5bn (end 2007 £1.4bn) (an annualised 11% growth in local currency terms). Retail Europe deposits remain in line with end 2007 at £0.3bn.

In a weakening economic and financial environment, particularly in Spain, we have adopted a measured and highly selective approach to mortgage lending and slowed down growth over the last 6 months.

European Financial Services

Underlying profit has reduced by 25% to £42m (H1 2007 £56m). However, excluding changes to the existing business in H1 2007, operating profits and new business contribution are at similar levels to the first half of 2007.

The vast majority of investment business in EFS is accounted for on an EV basis under IFRS.

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Contribution from existing business:				
Expected contribution	**33**	25	28	53
Actual vs expected experience	**(7)**	12	30	42
	26	37	58	95
Contribution from new business	**14**	16	21	37
Investment earnings on net assets using long term assumptions	**2**	3	3	6
Underlying profit before tax	**42**	56	82	138

Sales in our European investment business were impacted by difficult market conditions and substantial changes in German regulation, with total new business sales decreasing by 12% to £300m (H1 2007 £342m) on a PVNBP basis. To ensure compliance with the German VVG legislation from 1 January 2008, EFS made significant investments in products and systems and a new competitive range of products is now available to our partners. The business is now positioned to take advantage of growth opportunities in 2008 and beyond.

INTERNATIONAL

Investment Sales	**Half year ended 30.06.2008**			Half year ended 30.06.2007		
	Single £m	**Annual £m**	**PVNBP* £m**	Single £m	Annual £m	PVNBP* £m
Life:	**49**	**22**	**205**	81	28	302
With Profits	**5**	**3**	**24**	13	5	52
Unit Linked	**44**	**19**	**181**	68	21	234
Protection					2	16
Individual Pensions	**1**	**12**	**95**		5	40
Total	**50**	**34**	**300**	81	33	342

* PVNBP is the present value of new business premiums. It equals new single premiums plus the expected present value of new annual premiums.

Funds under management decreased by an annualised 11% to £5.4bn (end 2007 £5.7bn).

Prospects

Our European and North American businesses are not immune to the global dislocation in Commercial markets and we will remain highly selective in asset growth, notwithstanding improved pricing available in the markets. In line with global economic trends, impairment losses are likely to rise from relatively low levels, but overall performance is expected to be satisfactory.

In EFS, a combination of new product launches and distribution agreements are being implemented to strengthen our market position.

TREASURY & ASSET MANAGEMENT

Underlying profit before tax excluding negative fair value adjustments ('NFVA') in Treasury & Asset Management increased by 15% to £224m (H1 2007 £194m). Including NFVA of £1,095m (H1 2007 £nil) relating to debt securities in the Trading Book, loss before tax was £871m (H1 2007 profit before tax of £194m). Post-tax NFVA totalling £1,916m (H1 2007 £nil) in the Banking Book have been taken through the Available For Sale reserve in equity and do not, therefore, impact on reported profit or capital for regulatory purposes.

Financial Performance

Income Statement	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net interest income	**39**	93	71	164
Underlying non-interest income (excl NFVA)	**345**	267	409	676
Net trading income	**200**	105	252	357
Fees and commission income	**133**	128	139	267
Fees and commission expense	**(30)**	(21)	(28)	(49)
Other operating income	**46**	55	50	105
Share of losses of associates and jointly controlled entities	**(4)**		(4)	(4)
Underlying net operating income	**384**	360	480	840
Underlying operating expenses	**(160)**	(170)	(172)	(342)
Staff	**(91)**	(99)	(106)	(205)
Accommodation, repairs and maintenance	**(1)**	(1)	(2)	(3)
Technology	**(5)**	(5)	(5)	(10)
Marketing and communication	**(3)**	(2)	(4)	(6)
Depreciation: Property and equipment and intangible assets	**(3)**	(2)	(2)	(4)
Other	**(34)**	(40)	(32)	(72)
Subtotal	**(137)**	(149)	(151)	(300)
Recharges:				
Technology	**(4)**	(3)	(4)	(7)
Accommodation	**(7)**	(7)	(7)	(14)
Other shared services	**(12)**	(11)	(10)	(21)
Underlying operating profit	**224**	190	308	498
Non-operating income		4		4
Underlying profit before tax (excl. NFVA)	**224**	194	308	502
Negative fair value adjustments	**(1,095)**		(227)	(227)

Underlying profit before tax	**(871)**	194	81	275
Cost:income ratio (excluding NFVA)	**41.7%**	47.2%	35.8%	40.7%
Insight's assets under management	**£112.0bn**	£102.1bn	£109.1bn	£109.1bn
Invista's assets under management	**£8.0bn**	£10.2bn	£8.7bn	£8.7bn
Risk weighted assets (Basel II)	**£17.6bn**		£17.0bn	£17.0bn

Operating Income and Margins
Underlying net operating income excluding NFVA increased 7% to £384m (H1 2007 £360m) driven by our sales and trading operations. Net interest income decreased to £39m (H1 2007 £93m) as a result of the impact of higher funding costs.

Operating Expenses
Underlying operating expenses decreased by 6% to £160m (H1 2007 £170m). The decrease is as a result of a reduction in performance related staff costs and a number of cost savings initiatives implemented in our Asset Management businesses.

TREASURY & ASSET MANAGEMENT

Treasury

Funding and Liquidity
The Group continues to fund successfully in global money markets. In addition, since the beginning of the year, HBOS has raised some £8.7bn in the (over 1 year) term capital markets, including £5.7bn senior debt, £0.6bn covered bonds, £0.5bn securitisation, £750m innovative Tier 1 securities and £1.1bn lower Tier 2 subordinated debt.

Sales and Trading
Net Sales and Trading income (excluding NFVA) increased by 43% to £249m (H1 2007 £174m) reflecting a strong performance from our UK Sales and Trading operations although this is down from an exceptionally strong second half of 2007.

UK Trading Revenues increased by 62% to £146m (H1 2007 £90m). There have been strong performances by our rates desks, in particular interest rate derivatives and collateral trading. These were partially offset by underperformance in our overseas operations. The Sales business has performed well with revenues increasing by 23% to £103m (H1 2007 £84m) with the majority of the growth in sales to corporate customers.

Treasury Debt Securities
As part of its investment credit activities Treasury holds a portfolio of debt securities which are analysed below. The investment credit business has two functions; firstly it manages part of the Group's prudential liquidity portfolio and secondly it takes investment positions principally through the Grampian conduit.

In line with the fall in values generally the year to date profit outcome is impacted by a £1,095m (full year 2007 £227m) NFVA relating primarily to our holdings of Asset Backed Securities and Floating Rate Notes in the Trading Book.

We have also made a post-tax NFVA of £1,916m (full year 2007 £509m) to the Group's Available For Sale reserves primarily in respect of our holdings of Asset Backed Securities and Floating Rate Notes. These adjustments have no impact on reported profits or regulatory capital strength.

HBOS believes that it has adopted a prudent basis for the valuation of its Treasury assets, including significant adjustments for certain parts of the portfolio reflecting the current illiquidity of the relevant markets.

Treasury's total debt securities portfolio as at 30 June 2008, net of NFVAs, is summarised in the following table:

Asset class	Banking Book Grampian £bn	Banking Book Other £bn	Trading Book £bn	As at 30.06.2008 £bn	As at 31.12.2007 £bn
Asset Backed Securities:					
Direct		9.2	12.0	**21.2**	23.3
Grampian conduit	16.2			**16.2**	18.6
	16.2	9.2	12.0	**37.4**	41.9
Covered Bonds		3.2		**3.2**	3.2
Bank/Financial Institution Floating Rate Notes (FRNs)		11.8	5.5	**17.3**	17.4[1]
Bank Certificates of Deposit (CDs)		1.7	12.1	**13.8**	15.3[1]
Other[2]		2.5	1.4	**3.9**	3.4
Total (net of negative fair value adjustments)	**16.2**	**28.4**	**31.0**	**75.6**	81.2

(1) £1.6bn reclassified between CDs and FRNs.
(2) Principally Governments and Supra-nationals.

The table above is net of cumulative pre-tax NFVA of £4.7bn (end 2007 £0.9bn) incurred as follows:

Asset class	Trading Book Half year Ended 30.06.2008 £bn	Trading Book Year Ended 31.12.2007 £bn	Banking Book Half Year Ended 30.06.2008 £bn	Banking Book Year Ended 31.12.2007 £bn	Cumulative Total 30.06.2008 £bn
Asset Backed Securities	**1.2**	0.1	**2.1**	0.4	**3.8**
FRNs	**0.1**	0.1	**0.3**	0.2	**0.7**
Other	**(0.2)**		**0.3**	0.1	**0.2**
Total NFVA pre tax	**1.1**	0.2	**2.7**	0.7	**4.7**
Tax on Banking Book NFVA			**(0.8)**	(0.2)	
Total NFVA taken to AFS reserve			**1.9**	0.5	

Exposure to Asset Backed Securities ('ABS')
ABS, including those held in our Grampian conduit which is, and always has been, consolidated into our balance sheet, are analysed by asset class as shown below.

	Banking	**Banking**	**Total**	Total

Asset class	Book Grampian £bn	Book Other £bn	Trading Book £bn	**As at 30.06.2008 £bn**	As at 31.12.2007 £bn
Mortgage Backed Securities					
US RMBS[(1)]	4.5	1.2	3.0	**8.7**	9.5
Non-US RMBS	1.3	2.0	4.5	**7.8**	8.0
CMBS[(1)]	3.1		0.2	**3.3**	3.3
	8.9	3.2	7.7	**19.8**	20.8
Collateralised Debt Obligations					
CBO[(1)]	3.2	0.2		**3.4**	3.4
CLO[(1)]	2.7		0.5	**3.2**	3.2
	5.9	0.2	0.5	**6.6**	6.6
Personal Sector					
Auto Loans	0.5		0.9	**1.4**	1.5
Credit Cards	1.6	0.3	1.0	**2.9**	2.8
Personal Loans	0.7		0.2	**0.9**	1.0
	2.8	0.3	2.1	**5.2**	5.3
FFELP Student Loans[(1)]		5.5	0.1	**5.6**	5.7
Other ABS	0.6		0.1	**0.7**	0.7
Total Uncovered ABS	18.2	9.2	10.5	**37.9**	39.1
Negative Basis[(2)]		0.5	2.8	**3.3**	3.3
	18.2	9.7	13.3	**41.2**	42.4
Fair Value Adjustments[(3)]	(2.0)	(0.5)	(1.3)	**(3.8)**	(0.5)
Total[(4)(5)]	**16.2**	**9.2**	**12.0**	**37.4**	41.9

(1) RMBS means Residential Mortgage Backed Securities; CMBS means Commercial Mortgage Backed Securities; CBO means Collateralised Bond Obligations; CLO means Collateralised Loan Obligations; FFELP means Federal Family Education Loan Programme.
(2) Negative basis means bonds held with separate matching credit default swap ('CDS') protection.
(3) This comprises Mortgage Backed Securities £2.0bn, Collateralised Debt Obligations £0.8bn, Personal Sector £0.1bn, FFELP Student Loans £0.2bn, Other ABS £0.1bn and Negative Basis £0.6bn before CDS protection.
(4) The total comprises US securities of £22.1bn, and Non-US securities of £15.3bn.
(5) The reduction in ABS balances since December 2007 includes paydowns of £2.2bn and negative fair value adjustments of £3.3bn offset by FX translation of £1.0bn.

TREASURY & ASSET MANAGEMENT

Exposure to US RMBS
The table below details our direct exposure to US RMBS, before NFVA, by asset class.

Asset class	Banking Book Grampian £m	Banking Book Other £m	Trading Book £m	Total £m
Prime[(1)]	1,029	218	697	**1,944**
Alt-A	3,427	975	2,226	**6,628**
Sub-prime	62	9	19	**90**
Total	**4,518**	**1,202**	**2,942**	**8,662**

(1) Includes £568m of second lien loans to prime borrowers, all of which are monoline wrapped.

We consider our Alt-A portfolio to be of high quality, noting that the current weighted average credit enhancement level is 30%.

We have little direct exposure to the US sub-prime residential real estate sector, as shown above. After taking into account ABS CDOs with exposure to that market Treasury's total exposure to US sub-prime investments is less than 0.1% of the Group balance sheet, at £381m (end 2007 £434m), as shown in the table below.

Asset class	Banking Book Grampian £m	Banking Book Other £m	Trading Book £m	Total £m
ABS CDO with Sub-prime Collateral(1)	163	128		**291**
Sub-prime RMBS(2)	62	9	19	**90**
Total US Sub-prime	**225**	**137**	**19**	**381**

(1) Includes £97m of bonds that are monoline wrapped.
(2) 1997-2005 vintages

Exposure to Collateralised Debt Obligations ('CDO')
Our CDO exposure is quantified in the table below. This is a highly rated portfolio, the majority of which is based on corporate credits. ABS CDOs includes bonds based on residential mortgage backed bonds, as noted above.

Asset class	Banking Book Grampian £m	Banking Book Other £m	Trading Book £m	Total £m
ABS CDO(1)	195	128		**323**
High Yield Corporate CBO	101			**101**
Investment Grade Corporate CBO	2,235			**2,235**
Commercial Real Estate CBO	708	63		**771**
Total CBO	3,239	191		**3,430**
CLO	2,701	43	442	**3,186**
Total	**5,940**	**234**	**442**	**6,616**

(1) ABS CDO includes £291m of US Sub-prime related as shown in the previous table.

Exposures to Monolines
Treasury has credit exposure to monolines both through wrapped bonds and negative basis trades with purchased CDS protection. As at 30 June 2008, the nominal exposures were £2.8bn of negative basis CDS (end 2007 £2.8bn) and £2.2bn of wrapped bonds (end 2007 £2.3bn). The calculated exposure to monolines using our internal methodology at 30 June 2008 was £0.7bn (end 2007 £0.4bn) and can be broken down between negative basis trades and wrapped bonds as follows:

	Negative Basis		Wrapped Bonds	
Monoline	**Notional £bn**	**Exposure(1) £bn**	**Notional £bn**	**Exposure(2) £bn**
Investment grade	2.4	0.4	1.9	0.3
Sub-investment grade(3)	0.4		0.3	
	2.8	0.4	2.2	0.3

(1) The exposure to monolines arising from negative basis trades is calculated as the mark to market of the CDS protection net of NFVA. Previously we included an amount for potential future exposure ('PFE') but have restated December 2007 to exclude PFE.

(2) The exposure to monolines arising from wrapped bonds is our assessment of the difference between the value of the unwrapped bond and the value of the wrapped bond including the monoline cover.
(3) For sub-investment grade monolines we have taken a prudent approach and assumed no benefit from the monoline cover, by taking NFVA against these exposures.

Of the total negative basis trades, 77% of the underlying bonds are AAA rated, 10% AA+ rated and 13% B+ rated (with investment grade monoline protection). The total notional amount of negative basis trades in the table above comprises £1.8bn of CLOs, £0.6bn of ABS CDOs, £0.2bn of other CBOs and £0.2bn of personal loans.

Of the total wrapped bonds, 87% are externally rated A- or better, 9% are rated between BBB- and A- and 4% are rated BB. Again, for sub-investment grade monolines, we have assumed no benefit from the monoline cover. The total notional amount of wrapped bonds includes £0.9bn of US RMBS exposure. The wrapped bond exposures by asset class are included within the previous disclosures on ABS.

Fair Values of Debt Securities
The fair values of debt securities 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.

Of the total debt securities of £75.6bn, the fair values of those determined using models for which the inputs are observable in the market is £51.4bn, the fair values of those determined using quoted market prices is £6.4bn and the fair values of the debt securities calculated using models with inputs that are not observable in the market is £17.8bn.

Debt securities valued using models that include non-observable inputs comprise primarily holdings of US RMBS and CDOs. 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.

At 30 June 2008, the fair values of ABS measured using models with non-market observable inputs comprised £2.4bn (end 2007 £5.3bn) within financial assets held for trading and £15.4bn (end 2007 £12.2bn) within assets classified as Available For Sale. During the period, NFVA of £461m pre-tax have been recognised in the income statement on ABS that were valued using models with non-market observable inputs (H1 2007 £nil). In addition to this, post-tax NFVA of £1,485m (end 2007 £158m) on ABS classified as Available For Sale that were valued using models with non-market observable inputs have been recognised in equity reserves.

For the total ABS portfolio the effect of a one basis point move in credit spreads (which based on our experience is the only key sensitivity) would result in a pre-tax movement of £3.1m for assets classified as held for trading and a post-tax movement of £7.6m on assets classified as Available For Sale.

For the part of the ABS portfolio which is valued using non-market observable inputs, the effect of a one basis point move in credit spreads would result in a pre-tax movement of £1.1m for ABS assets classified as held for trading and a post-tax movement of £5.1m on assets classified as Available For Sale.

The use of non-market observable inputs in the valuation models will diminish as and when activity returns to these markets.

Impairment Review

Treasury's Banking Book debt securities portfolio is held at fair value and reviewed regularly for impairment at the specific investment level, in accordance with IFRS. The Banking Book portfolio is reviewed on an ongoing basis for impairment and as at 30 June 2008 no objective evidence of impairment has been found. Objective evidence of impairment might include non-receipt of due interest or principal repayment or a measurable decrease in the estimated future cashflows from a group of financial assets since the initial recognition of those assets. The disappearance of active markets, declines in fair values and rating downgrades associated with this asset portfolio do not in themselves constitute objective evidence of impairment and unless a default has occurred, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement. Although the fair value of the Banking Book portfolio is significantly below its purchase cost, the Group believes that currently this is due to market dislocations rather than impairments of its assets.

TREASURY & ASSET MANAGEMENT

Credit Ratings

An analysis of external credit ratings of our ABS portfolio by asset class is provided below. These ratings are based on the lowest of Moody's, Standard and Poor's and Fitch.

As at 30.06.08

Asset class	Nominal £bn	AAA %	AA %	A %	BBB %	BB %	B %	Total %
Mortgage Backed Securities								
US RMBS								
Prime	**2.0**	80.1	9.3	5.0	3.4	2.2		**100**
Alt-A	**6.6**	97.4	2.3		0.1	0.2		**100**
Sub Prime	**0.1**	87.9	10.2	0.1	1.8			**100**
	8.7	93.5	3.9	1.1	0.9	0.6		**100**
Non-US RMBS	**7.8**	98.6	0.7	0.7				**100**
CMBS	**3.3**	96.9	1.9	1.2				**100**
	19.8							
Collateralised Debt Obligations								
CBO								
ABS CDO	**0.3**	26.0	23.9	13.4	5.6		31.1	**100**
High Yield Corporate CBO	**0.1**	84.8	15.2					**100**
Investment Grade Corporate CBO	**2.2**	100.0						**100**
Commercial Real Estate CBO	**0.8**	78.5	15.0	6.5				**100**
	3.4	87.8	6.1	2.7	0.5		2.9	**100**
CLO	**3.2**	98.7	0.9	0.4				**100**
	6.6							
Personal Sector								
Auto Loans	**1.4**	68.5	15.5	13.1		2.9		**100**
Credit Cards	**2.9**	100.0						**100**
Personal Loans	**0.9**	92.2	5.8	2.0				**100**
	5.2							

FFELP Student Loans	**5.6**	100.0						**100**
Other ABS	**0.7**	26.5	53.2	3.6	16.7			**100**
Negative Basis(1)								
Monolines(2)	**2.8**	77.1	9.8				13.1	**100**
Banks	**0.5**	97.7	2.3					**100**
	3.3	80.3	8.6				11.1	**100**
Total as at 30 June 2008	**41.2**	**93.0**	**3.9**	**1.3**	**0.5**	**0.2**	**1.1**	**100**
Total as at 31 December 2007	42.4	99.6	0.2	0.2				100

(1) The external credit rating is based on the bond ignoring the benefit of the CDS.
(2) The non AAA bonds in the negative basis book are ABS CDOs with investment grade monoline protection. These are the only ABS CDOs within the negative basis book.

TREASURY & ASSET MANAGEMENT

Asset Management

Insight

In the first half of 2008, Insight saw net inflows of £8.7bn (H1 2007 £6.0bn) as its market leading Liability Driven Investment (''LDI'') capability continued to attract strong levels of new business. Despite the fall in equity markets and a transfer out of £1.5bn as part of an agreed sale of Equitable Life funds, Insight's assets under management increased to £112.0bn (end 2007 £109.1bn). The pipeline of new business is strong and our business model is proving resilient in these challenging conditions.

This growth, against a difficult backdrop for the investment management industry, was confirmed by the recent Financial Times Annual Pension Fund Survey, which highlighted Insight's rapid rise, from eighth last year to now being the third largest manager of pension fund assets in the UK.

Following a mixed 2007, the Fixed Income team has had an encouraging start to the year with UK Government, UK Corporate and European Aggregate funds all ahead of their performance benchmarks. The £8.2bn sterling Insight Liquidity Fund remains ahead over all periods. Following good performance in 2007, UK Equity funds continue to perform well with both active and passive funds ahead of benchmark. Overall, three of the five equity sub categories are ahead of benchmark year to date, including outperformance of 8% by the UK Smaller Companies fund. Absolute Insight continues to beat its cash benchmark, whilst the flagship Diversified Target Return Fund is consistently top of the performance tables in the Cautious Managed sector and continues to attract strong fund flows.

Insight continues to win industry accolades after being awarded LDI Manager and Multi Manager of the year at the Financial Times Pensions and Investment Provider Awards. This is the second year they have won the LDI award, further boosting their reputation as market leader in this field. It is also the first recognition of the multi-asset capability in the institutional market place.

Invista

The first half of 2008 has been a period of continued development for Invista, despite significant challenges from the economy and strong headwinds in terms of current real estate market conditions. The Opportunity Fund, launched last year, has made a good entrance to the market and a number of investments have been made. Invista now also manages a new International

Fund initially targeting Singapore, Hong Kong and Japan. Recent investment performance relative to benchmarks has been good.

Prospects

Treasury

The primary focus of our Treasury operations is to manage the Group's funding and liquidity. The dislocation in financial markets which commenced in the second half of 2007 is expected to continue into 2009. In recent years, prior to the dislocation in financial markets, we lengthened the maturity profile of our wholesale funding and diversified the types and sources of such funding. This has enabled us to operate effectively in difficult financial markets, and as term markets recover, we will continue to ensure that the funding profile is appropriate for our longer term business plans.

Treasury also provides services to the Group and to the Group's customers. We continue to invest in our capabilities to deliver a top quality service and performance. Access to the Group's customers, product innovation and our strong standing in the market underpin our confidence in our business model. Our cautious approach to products and services remains unaltered.

TREASURY & ASSET MANAGEMENT

Asset Management

Insight is better positioned than many of its competitors to withstand the market shocks seen over the past year due to the diverse nature of its product portfolio and has proven it can thrive in this challenging economic environment. Its strategic focus on LDI, Fixed Income and Absolute Return have been the drivers behind the growth. In the year ahead, the business will look to further consolidate its position in these key sectors and continue to further diversify its revenue stream through new markets and products. Europe represents a key distribution opportunity and growth in this area has been encouraging to date.

Invista intends to launch a new specialist global property securities fund and a team has been identified and hired with a strong track record of running a Global REIT fund across America, Europe and Asia. The outlook generally for the investment market for commercial property in the UK remains poor and this will continue to impact negatively on some of Invista’s assets under management. Continental Europe has so far remained robust with flat valuations but some downward movement is expected in some parts of the markets in which Invista's funds invest.

FINANCIAL REVIEW

Income Statement Analysis

Underlying profit before tax for the half year to 30 June 2008 was £1,451m (H1 2007 £2,962m). Excluding NFVA underlying profit before tax was £2,546m (H1 2007 £2,962m). Underlying operating income excluding NFVA was broadly in line with the first half of 2007 with growth in net interest income of 6% being largely offset by lower underlying non-interest income. Underlying operating expenses rose by 4% and impairment losses charge was £1,310m (H1 2007 £963m).

Profit before tax was £848m (H1 2007 £2,997m) after policyholder tax charge of £451m (H1 2007 £167m credit) (which reverses in full in the tax line) and short term fluctuations in investment returns of £150m (H1 2007 £33m).

Underlying earnings per share excluding NFVA decreased to 47.4p (H1 2007 54.6p). Underlying earnings per share fell to 26.4p (H1 2007 54.6p). Basic earnings per share decreased to 23.5p (H1 2007 55.0p).

A Capitalisation Issue is being proposed in lieu of the 2008 interim dividend. Existing shareholders will receive a number of new shares, the amount of which will be determined on 3 October 2008 and will be based on the average of the middle market quotations for ordinary shares for the three dealing days starting on and including 1 October. Shareholders authorised the capitalisation of reserves to allow the Capitalisation Issue Shares to be issued at the General Meeting on 26 June 2008. The intention is to pay the final dividend in cash so that taking into account the capitalisation issue, 40% of underlying profit attributable to ordinary shareholders is distributed.

The table below reconciles underlying profit before tax and profit before tax.

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Underlying profit before tax (excluding NFVA)	**2,546**	2,962	2,973	5,935
Negative fair value adjustments	**(1,095)**		(227)	(227)
Underlying profit before tax	**1,451**	2,962	2,746	5,708
Adjusted for:				
Regulatory provisions charge		(79)	(43)	(122)
Impact of the 2008 change in corporation tax rate on the value of leasing assets		(18)	8	(10)
Goodwill impairment	**(2)**	(2)	(3)	(5)
Policyholder tax	**(451)**	167	(149)	18
Short term fluctuations	**(150)**	(33)	(82)	(115)
Profit before tax	**848**	2,997	2,477	5,474

IFRS requires that profit before tax includes charges or credits made to policyholders for tax, with an associated amount included within tax on profit. The amount of policyholder tax is primarily influenced by investment market performance (such as Equities, Gilts and Property), as this tax is charged or credited based on investment gains or losses. To remove this volatility, policyholder tax effects are excluded from underlying profit to give a more meaningful measure of the Group's performance. Policyholder tax for the six months to 30 June 2008 was a charge of £451m (H1 2007 £167m credit). The movement between the two periods predominantly relates to a reduction in the deferred tax liabilities provided in respect of unrealised gains on investments held for policyholders and taxable under the policyholder tax rules. The H1 2007 position primarily reflects an increase in the deferred tax liability in respect of unrealised gains on investments primarily due to a moderate rise in the FTSE.

Short term fluctuations represent the impact of fluctuations in investment returns relative to those based on longer term assumptions and variances in actual policyholder tax payable from an expected charge for the period. This amount has increased to (£150m) (H1 2007 (£33m)) primarily due to falling equity and fixed income markets.

The goodwill impairment of £2m relates to a partial write-down of the goodwill in respect of fund management business in Insurance & Investment division following the latest semi-annual impairment review.

The table below reconciles underlying profit attributable to ordinary shareholders to profit attributable to ordinary shareholders.

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Underlying profit attributable to ordinary shareholders (excluding NFVA)	**1,772**	2,046	2,078	4,124
Negative fair value adjustments	**(783)**		(159)	(159)
Underlying profit attributable to ordinary shareholders	**989**	2,046	1,919	3,965
Adjusted for:				
Regulatory provisions charge		(55)	(30)	(85)
Impact of the 2008 change in corporation tax rate on:				
the value of leasing assets		(13)	6	(7)
deferred tax net liabilities		110	68	178
Goodwill impairment	**(2)**	(2)	(3)	(5)
Short term fluctuations	**(107)**	(23)	(58)	(81)
Profit attributable to ordinary shareholders	**880**	2,063	1,902	3,965

Divisional financial performance can be summarised as follows:

Half year ended 30 June 2008	**Retail £m**	**Corporate £m**	**Insurance & Investment £m**	**International £m**	**Treasury & Asset Mgmt £m**	**Group Items £m**	**Half year ended 30.06.08 £m**	Half year ended 30.06.07 £m
Underlying net interest income	2,064	1,140	(52)	670	39		**3,861**	3,626
Underlying non-interest income(1)	650	486	910	215	345		**2,606**	2,801
Underlying net operating income(1)	2,714	1,626	858	885	384		**6,467**	6,427
Underlying operating expenses	(1,056)	(404)	(456)	(443)	(160)	(148)	**(2,667)**	(2,563)
Underlying operating profit before provisions(1)	**1,658**	**1,222**	**402**	**442**	**224**	**(148)**	**3,800**	3,864
Impairment losses on loans and advances	(722)	(469)		(119)			**(1,310)**	(963)
Underlying operating profit(1)	936	753	402	323	224	(148)	**2,490**	2,901
Non-operating income	56						**56**	61
Underlying profit before tax (excluding NFVA)	**992**	**753**	**402**	**323**	**224**	**(148)**	**2,546**	2,962
Negative fair value adjustments					(1,095)		**(1,095)**	
Underlying profit before tax	**992**	**753**	**402**	**323**	**(871)**	**(148)**	**1,451**	2,962
Half year ended 30 June 2007								
Underlying profit before tax	1,043	1,243	316	327	194	(161)	**2,962**	
Increase/(decrease) in underlying profit before tax (excluding NFVA)	**(5%)**	**(39%)**	**27%**	**(1%)**	**15%**	**8%**	**(14%)**	

(1) Excluding NFVA in Treasury & Asset Management division

Taxation

The tax credit for the period of £102m (H1 2007 tax charge of £858m) includes a £451m tax credit (H1 2007 £167m tax charge) in respect of the tax attributable to the policyholder earnings in the Group's UK life companies. The H1 2007 tax charge of £858m includes a credit of £110m in respect of the change in the rate of UK corporation tax. Excluding these items results in an effective rate of 27.0% (H1 2007 28.3%). Included within the tax credit of £102m is an overseas tax charge of £148m (H1 2007 £110m).

FINANCIAL REVIEW

Post Tax Return on Mean Equity

Group post tax return on mean equity ('ROE') excluding NFVA is 16.6% (H1 2007 21.0%).

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Underlying profit attributable to ordinary shareholders (excluding NFVA)	**1,772**	2,046	2,078	4,124
Underlying profit attributable to ordinary shareholders	**989**	2,046	1,919	3,965
Mean Equity (excluding NFVA)(1) (2)	**21,423**	19,665	20,606	20,240
Mean Equity(1)	**19,275**	19,665	20,347	20,101
Group post tax return on mean equity (excluding NFVA)	**16.6%**	21.0%	20.0%	20.4%
Group post tax return on mean equity	**10.3%**	21.0%	18.7%	19.7%

(1) Mean Equity is calculated as the monthly average of ordinary shareholders' funds.
(2) Mean Equity excluding NFVA is calculated by adding back NFVA on both the Banking and Trading Books.

Net Interest Income

Underlying net interest income grew by 6% to £3,861m (H1 2007 £3,626m), mainly due to good interest income growth in Corporate and International.

The Group net interest margin reduced slightly by 3bps to 1.55% (H2 2007 1.58%). This reflects a change in business mix across the divisions with reductions of 7bps and 5bps in International and Corporate respectively, more than offsetting an increase of 3bps in Retail. The improvement in the Retail margin was driven by unsecured lending and improving mortgage pricing which more than offset the increased costs of funding. Corporate's margin fell despite the introduction of a number of new repricing initiatives due to the slower turnover of the current lending book. Changes in business mix contributed to the fall in the International margin.

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Interest receivable	**18,456**	15,561	19,461	35,022
Interest payable	**(14,595)**	(11,935)	(15,773)	(27,708)

Underlying net interest income	**3,861**	3,626	3,688	7,314
Average balances				
Interest earning assets:				
Loans and advances	**457,105**	383,723	432,440	408,282
Securities and other liquid assets	**42,984**	50,589	30,169	40,295
	500,089	434,312	462,609	448,577
Group net interest margin	**1.55%**	1.68%	1.58%	1.63%
Divisional net interest margins:				
Retail	**1.62%**	1.73%	1.59%	1.66%
Corporate	**1.96%**	2.12%	2.01%	2.06%
International	**1.84%**	1.95%	1.91%	1.93%

FINANCIAL REVIEW

Non-interest Income

Underlying non-interest income excluding NFVA decreased to £2,606m (H1 2007 £2,801m). Following the financial market dislocation, the half year profit outcome to June 2008 is impacted by a £1,095m (end 2007 £227m) negative fair value adjustment to investments held within Treasury division. These investments primarily relate to floating rate notes and asset backed securities. Including the impact of the NFVA, underlying non-interest income decreased to £1,511m (H1 2007 £2,801m).

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Fees and commission income	**1,149**	1,193	1,185	2,378
Fees and commission expense	**(546)**	(539)	(579)	(1,118)
Net earned premiums on insurance contracts	**2,276**	3,051	2,565	5,616
Net trading income (excluding NFVA)	**185**	141	264	405
Change in value of in-force long term	**36**	159	(143)	16
Other operating income:				
Profit on sale of investment securities	**165**	316	180	496
Operating lease rental income	**665**	655	667	1,322
Net investment income related to insurance	**(3,970)**	3,481	1,229	4,710
Other income	**225**	178	308	486
Non-interest income	**185**	8,635	5,676	14,311
Impairment on investment securities	**(145)**	(27)	(33)	(60)
Operating lease depreciation	**(508)**	(500)	(485)	(985)
Change in investment contract liabilities	**2,734**	(2,423)	(115)	(2,538)
Net claims incurred on insurance contracts	**(1,721)**	(1,433)	(1,519)	(2,952)
Net change in insurance contract liabilities	**1,854**	(1,388)	(856)	(2,244)
Change in unallocated surplus	**231**	(169)	219	50
Share of (losses)/profits of associates and jointly controlled entities	**(24)**	106	128	234

Underlying non-interest income (excluding NFVA)	**2,606**	2,801	3,015	5,816
Negative fair value adjustments	**(1,095)**		(227)	(227)
Underlying non-interest income	**1,511**	2,801	2,788	5,589

Underlying non-interest income analysed by division:

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Retail	**650**	630	674	1,304
Corporate	**486**	922	824	1,746
Insurance & Investment	**910**	775	816	1,591
International	**215**	207	292	499
Treasury & Asset Management	**345**	267	409	676
Underlying non-interest income (excluding NFVA)	**2,606**	2,801	3,015	5,816
Negative fair value adjustments	**(1,095)**		(227)	(227)
Underlying non-interest income	**1,511**	2,801	2,788	5,589

Operating Expenses

Underlying operating expenses increased by 4% to £2,667m (H1 2007 £2,563m).

The increase of £104m over last year includes planned investments in International, additional marketing spend in General Insurance and implementation costs and embedded cost benefits achieved via our cost efficiency programme.

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Staff	**1,455**	1,404	1,507	2,911
Accommodation, repairs and maintenance	**246**	224	226	450
Technology	**132**	134	139	273
Marketing and communication	**256**	187	193	380
Depreciation: Property and equipment and intangible assets	**208**	210	207	417
Other	**370**	404	439	843
Underlying operating expenses	**2,667**	2,563	2,711	5,274
Operating lease depreciation	**508**	500	485	985
Change in investment contract liabilities	**(2,734)**	2,423	115	2,538
Net claims incurred on insurance contracts	**1,721**	1,433	1,519	2,952
Net change in insurance contract liabilities	**(1,854)**	1,388	856	2,244
Change in unallocated surplus	**(231)**	169	(219)	(50)
Total	**77**	8,476	5,467	13,943

Underlying operating expenses analysed by division:

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Retail	**1,056**	1,053	1,094	2,147
Corporate	**404**	436	449	885
Insurance & Investment	**456**	409	440	849
International	**443**	334	380	714
Treasury & Asset Management	**160**	170	172	342
Group Items	**148**	161	176	337
Underlying operating expenses	**2,667**	2,563	2,711	5,274

FINANCIAL REVIEW

Cost:income Ratio

The Group cost:income ratio excluding NFVA is 41.2% (H1 2007 39.9%) reflecting broadly stable underlying net operating income and growth in expenses of 4%. Group cost:income ratio including NFVA increased to 49.6% (H1 2007 39.9%).

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Underlying operating expenses	**2,667**	2,563	2,711	5,274
Underlying net interest income	**3,861**	3,626	3,688	7,314
Underlying non-interest income (excluding NFVA)	**2,606**	2,801	3,015	5,816
Underlying net operating income (excluding NFVA)	**6,467**	6,427	6,703	13,130
Negative fair value adjustments	**(1,095)**		(227)	(227)
Underlying net operating income	**5,372**	6,427	6,476	12,903
	%	%	%	%
Group cost:income ratio (excluding NFVA)	**41.2**	39.9	40.4	40.2
Group cost:income ratio	**49.6**	39.9	41.9	40.9

Divisional cost:income ratios are summarised below:

	Half year ended 30.06.2008 %	Half year ended 30.06.2007 %	Half year ended 31.12.2007 %	Year ended 31.12.2007 %
Retail	**38.9**	38.8	40.7	39.7
Corporate	**24.8**	22.8	23.7	23.2
International	**50.1**	47.0	43.4	45.0
Treasury & Asset Management (excluding NFVA)	**41.7**	47.2	35.8	40.7

Group Items

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, mailing, etc. The costs of technology, accommodation and other shared services (other than those borne directly by Group Functions) are subsequently recharged to divisions according to their usage and are shown under the operating expense analysis for each division. Group Items has decreased by £13m compared to the first half of 2007.

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Staff	**158**	160	158	318
Accommodation, repairs and maintenance	**194**	183	180	363
Technology	**48**	52	52	104
Marketing and communication	**34**	35	30	65
Depreciation: Property and equipment and intangible assets	**97**	99	100	199
Other	**107**	116	156	272
Sub total	**638**	645	676	1,321
Less Recharges:				
Technology	**(171)**	(182)	(186)	(368)
Accommodation	**(200)**	(189)	(188)	(377)
Other shared services	**(119)**	(113)	(126)	(239)
Total	**148**	161	176	337

FINANCIAL REVIEW

Group Embedded Value Information (IFRS Basis)

The sources of profit from all long term assurance business accounted for as insurance contracts on an embedded value ('EV') basis under IFRS 4 are set out below. This table includes that part of our Repayment Insurance business accounted for on an EV basis but excludes investment contracts accounted for under IAS 39.

	Half year ended 30.06.2008				Half year ended 30.06.2007			
	UK Investment £m	**Europe £m**	**UK General Insurance £m**	**Total £m**	UK Investment £m	Europe £m	UK General Insurance £m	Total £m
Expected contribution from existing business	**79**	**33**	**2**	**114**	76	25	2	103
Actual vs expected experience on existing business	**72**	**(7)**	**(26)**	**39**	34	12	24	70
	151	**26**	**(24)**	**153**	110	37	26	173
Contribution from new business	**103**	**14**	**(4)**	**113**	142	16	4	162
Investment earnings on net assets using long term assumptions	**68**	**2**	**5**	**75**	54	3	5	62
Contribution from insurance contracts*	**322**	**42**	**(23)**	**341**	306	56	35	397

	Half year ended 31.12.2007				Year ended 31.12.2007			
	UK Investment £m	Europe £m	UK General Insurance £m	Total £m	UK Investment £m	Europe £m	UK General Insurance £m	Total £m
Expected contribution from existing business	86	28	3	117	162	53	5	220
Actual vs expected experience on								

existing business	(1)	30	22	51	33	42	46	121
	85	58	25	168	195	95	51	341
Contribution from new business	127	21	4	152	269	37	8	314
Investment earnings on net assets using long term assumptions	61	3	6	70	115	6	11	132
Contribution from insurance contracts*	273	82	35	390	579	138	70	787

* On an underlying basis

The embedded value of long term assurance business accounted for under IFRS 4, which excludes investment contract business accounted for under IAS 39, is set out below.

	As at 30.06.2008				As at 31.12.2007			
	UK Investment £m	**Europe £m**	**UK General Insurance £m**	**Total £m**	UK Investment £m	Europe £m	UK General Insurance £m	Total £m
Shareholder funds	**2,709**	**107**	**103**	**2,919**	2,573	100	177	2,850
Value of in-force business (net of tax)	**1,495**	**605**	**48**	**2,148**	1,497	565	48	2,110
Total embedded value (net of tax)	**4,204**	**712**	**151**	**5,067**	4,070	665	225	4,960
Shareholder funds as a % of total EV	**64%**	**15%**	**68%**	**58%**	63%	15%	79%	57%

FINANCIAL REVIEW

	Half year ended 30.06.2008			
	UK Investment £m	**Europe £m**	**UK General Insurance £m**	**Total £m**
Opening embedded value	4,070	665	225	4,960
Contribution from insurance contracts	322	42	(23)	341
Developments costs, associated overheads and financing costs	(116)			(116)
Underlying embedded value profit before tax	206	42	(23)	225
Short term investment fluctuations	(117)	(36)		(153)
Underlying tax charge	105	(5)		100
Dividends paid	(75)		(51)	(126)
Other capital movements	15	46		61
Movement in embedded value in the year	134	47	(74)	107
Closing embedded value	**4,204**	**712**	**151**	**5,067**

The economic assumptions (gross of tax) used in the calculation of the embedded values are unchanged from those used at the end of 2007. These are as follows:

	As at 30.06.2008 %	As at 31.12.2007 %
Risk discount rate*	**8.0**	8.0
Return on fixed income securities	**5.0 - 5.5**	5.0 - 5.5
Return on equities	**7.5**	7.5
Expense inflation rate	**3.0**	3.0

* Included in the risk discount rate is an investment risk component which is chosen so as to avoid capitalising any investment risk premiums over the long term view of the risk free rate of return.

Balance Sheet Analysis

Loans and advances to customers increased to £456.0bn (end 2007 £430.0bn). The annualised increase was 2% in Retail, 14% in Corporate and 34% in International.

Customer deposits increased to £258.1bn (end 2007 £243.2bn).

	Retail	**Corporate**	**International**	**Treasury & Asset Mgmt**	**Total 30.06.08**	Total 31.12.07
	£bn	**£bn**	**£bn**	**£bn**	**£bn**	£bn
Loans and advances to customers	255.8	116.9	78.5	4.8	**456.0**	430.0
Impairment provisions	2.3	0.9	0.4		**3.6**	3.4
Loans and advances to customers (before provisions)	258.1	117.8	78.9	4.8	**459.6**	433.4
Customer deposits	160.0	44.7	25.0	28.4	**258.1**	243.2
Risk weighted assets (Basel II) (1)	71.5	172.4	69.4	17.6	**331.6**	309.2 (2)

(1) Total risk weighted assets includes £0.7.bn (2007 £1.2bn) attributable to Insurance & Investment.

(2) On 1 January 2008 HBOS implemented the Basel II rules for capital adequacy.

Classification of advances

The mix of the Group's gross lending portfolio at the period end is summarised in the following table:

	As at 30.06.2008 %	As at 30.06.2007 %	As at 31.12.2007 %
Energy	**1**		1
Manufacturing industry	**1**	1	1
Construction and property	**9**	10	9
Hotels, restaurants and wholesale and retail trade	**3**	2	3
Transport, storage and communication	**2**	2	2
Financial	**3**	2	1
Other services	**3**	3	4
Individuals:			
Residential Mortgages	**51**	56	54
Other personal lending	**4**	5	4
Non-UK residents	**23**	19	21
Total	**100**	100	100

Credit Quality & Provisions

The total charge for loan impairment losses against Group profits is £1,310m (H1 2007 £963m), which on an annualised basis, represents 0.59% of average advances (H1 2007 0.50%, H2 2007 0.50%).

Impairment Provisions	**Total £m**
At 1 January 2008	3,373
Amounts written off during the period	(1,056)
New impairment provisions less releases	1,374
Exchange movements	29
Discount unwind on impaired advances	(62)
Closing balance at 30 June 2008	**3,658**
New impairment provisions less releases	1,374
Recoveries of amounts previously written off	(64)
Net charge to income statement	**1,310**

Impairment provisions as a % of closing advances are analysed in the following table:

	As at 30.06.2008		As at 30.06.2007		As at 31.12.2007	
	£m	**As % of closing advances**	£m	As % of closing advances	£m	As % of closing advances
Retail	**2,310**	**0.90**	2,080	0.86	2,249	0.89
Corporate	**941**	**0.80**	748	0.78	802	0.73
International	**407**	**0.52**	281	0.49	322	0.48
Total impairment provisions	**3,658**	**0.80**	3,109	0.79	3,373	0.78

Impaired loans as a % of closing advances and impairment provisions as a % of impaired loans are analysed by division in the following table:

		Advances	**Impaired loans***	**Impaired loans* as % of closing advances**	**Impairment provisions**	**Impairment provisions as % of impaired loans***
		£bn	**£m**	**%**	**£m**	**%**
As at 30 June 2008						
Retail:	**Secured**	**237.7**	**5,138**	**2.16**	**490**	**10**
	Unsecured	**18.1**	**2,222**	**12.28**	**1,820**	**82**
	Total	**255.8**	**7,360**	**2.88**	**2,310**	**31**
Corporate		**116.9**	**2,131**	**1.82**	**941**	**44**
International		**78.5**	**1,243**	**1.58**	**407**	**33**
Treasury & Asset Management		**4.8**				
Total		**456.0**	**10,734**	**2.35**	**3,658**	**34**
As at 31 December 2007						
Retail:	Secured	235.6	4,234	1.80	330	8
	Unsecured	17.8	2,322	13.04	1,919	83
	Total	253.4	6,556	2.59	2,249	34
Corporate		109.3	1,517	1.39	802	53
International(1)		67.1	641	0.96	322	50

Treasury & Asset Management	0.2				
Total	430.0	8,714	2.03	3,373	39

* Excludes Corporate impaired loans no loss.
(1) 2007 comparatives have been restated to reflect the change to the methodology used by Bank of Scotland (Ireland) in categorising impaired loans to align more closely to HBOS policy.

FINANCIAL REVIEW

Capital Structure

On 1 January 2008 HBOS implemented the Basel II rules for capital adequacy. This followed a year of parallel running and agreement with the FSA of a timetable for further roll out of credit risk models over the next two years. The capital ratios below are therefore shown on a Basel II basis only.

HBOS completed a rights issue raising a net £4.0bn of capital at the end of July 2008. A new Tier 1 target ratio range was set at 8.0%-9.0% (previously 7.5%-8.5%) and a new target Core Tier 1 ratio range of 6.0%-7.0% was established. The Core Tier 1 ratio comprises Total Tier 1 capital excluding Preference Shares and Preferred Securities. The rights issue was completed in July 2008 and is not therefore included in the reported June capital position. However the impact of the Rights Issue has been disclosed below, as at June 2008, on a proforma basis which includes the proceeds of £4.0bn within capital resources and assumes there is no impact on risk weighted assets ('RWAs').

The Tier 1 capital ratio at 30 June 2008 is 7.3% (1 Jan 2008 7.7%) and the core Tier 1 ratio is 5.3% (1 Jan 2008 5.7%). On a proforma basis including the rights issue, the Tier 1 ratio would be 8.6% with the core Tier 1 ratio at 6.5% at 30 June 2008.

Risk Weighted Assets

	As at 30.06.2008 £m	As at 01.01.2008 £m
Credit Risk	294,136	273,155
Operational Risk	14,911	15,176
Market Risk	6,147	7,144
Other Assets(1)	16,361	13,698
Total Risk Weighted Assets	**331,555**	**309,173**
Divisional analysis of Risk Weighted Assets:		
Retail	71,492	67,852
Corporate	172,354	163,470
International	69,452	59,667
Treasury & Asset Management	17,582	17,005
Insurance & Investment	675	1,179
	331,555	**309,173**

(1) Other Assets comprises various non-financial assets including, Property and Equipment, Investment Properties, Other Assets, and Prepayments and Accrued Income.

RWAs increased by an annualised 15% to £331.6bn (1 Jan 2008 £309.2bn) driven by the following factors:

- Corporate RWAs increased by an annualised 11% and are higher under Basel II than Basel I due to both drawn and undrawn exposures attracting higher risk weightings;
- Retail RWAs increased by an annualised 11% partly due to economic conditions increasing average risk weights. Retail RWAs are significantly lower under Basel II than under Basel I due to the lower risk weightings that are applied to residential mortgages;
- In International RWA annualised growth of 33% reflects lending growth as we expand our overseas activities together with increases arising from currency re-translations.

Capital

The capital position of HBOS Group is summarised in the table below.

Capital Structure Basel II	**As at 30.06.2008 Proforma basis £m**	**As at 30.06.2008 £m**	**As at 01.01.2008 £m**
Risk weighted assets	**331,555**	**331,555**	**309,173**
Capital Resources			
Core Tier 1			
Ordinary share capital	1,338	938	933
Eligible reserves[1]	23,924	20,324	20,421
Minority interests	118	118	123
Perpetual non-cumulative preference shares			
Preference share capital	2,789	2,789	2,781
Innovative Tier 1			
Preferred securities	4,058	3,668	3,247
Deductions from Tier 1			
Goodwill & other intangible assets	(2,949)	(2,949)	(2,862)
Excess expected loss	(778)	(778)	(875)
Other deductions	(66)	(66)	(37)
Total Tier 1 capital	**28,434**	**24,044**	**23,731**
Upper Tier 2			
Available for sale reserve	181	181	187
Undated subordinated debt	5,800	6,190	5,591
Collectively assessed impairment provisions	491	491	463
Lower Tier 2			
Dated subordinated debt	11,392	11,392	9,900
Deductions from Tier 2			
Excess expected loss	(778)	(778)	(875)
Other deductions	(66)	(66)	(37)
Total Tier 2 capital	**17,020**	**17,410**	**15,229**
Supervisory deductions			
Unconsolidated investments – life	(4,648)	(4,648)	(4,596)
Unconsolidated investments – other	(506)	(506)	(506)

Total supervisory deductions	**(5,154)**	**(5,154)**	**(5,102)**
Total Capital Resources	**40,300**	**36,300**	**33,858**
Tier 1 capital ratio (%)	**8.6%**	**7.3%**	**7.7%**
Core Tier 1 ratio	**6.5%**	**5.3%**	**5.7%**
Total capital ratio (%)	**12.2%**	**10.9%**	**11.0%**
Tier 1 gearing (%)	**24.1%**	**26.9%**	**25.4%**

(1) The FSA permits the inclusion of profits in Tier 1 capital to the extent that they have been verified by the external auditors. Tier 1 capital as disclosed includes interim profits which have been verified in accordance with the FSA's General Prudential Sourcebook subsequent to 30 June 2008.

FINANCIAL REVIEW

The movement in Tier 1 capital in the period is shown below:

Movement in Tier 1 capital	**As at 30.06.2008 Proforma basis £m**	**As at 30.06.2008 £m**
As at 1 January 2008	23,731	23,731
Profit attributable to parent company shareholders	931	931
Ordinary dividends paid	(1,205)	(1,205)
Rights issue proceeds, net of expenses	4,000	
Decrease in goodwill and intangible assets	(87)	(87)
Preferences shares and preferred securities issued	750	360
Decrease in minority interests	(5)	(5)
Decrease in Excess EL	97	97
Other, including exchange differences	222	222
As at 30 June 2008	28,434	24,044

In addition to retained earnings, Tier 1 capital was strengthened by the issuance of innovative preferred securities of £750m in March 2008 although at 30 June 2008 there was a regulatory restriction in including the full value of these securities in Tier 1 capital. On a proforma basis however the full benefit of this capital is included. Tier 1 gearing at the half year was 26.9% (1 Jan 2008 25.4%) and on a proforma basis 24.1%.

Tier 2 capital was increased during the period by dated subordinated debt issues of €175m and US$2bn. In sterling equivalent terms at 30 June 2008, this new issuance totalled £1,143m.

Supervisory deductions mainly reflect investments in subsidiary undertakings that are not within the banking group for regulatory purposes together with deductions relating to the securitisation of loans. These unconsolidated investments are primarily Clerical Medical, St James's Place, St. Andrew's Group, and Heidelberger Leben. Total supervisory deductions increased to £5,154m from £5,102m primarily as a result of increases in the embedded value of life policies held.

FINANCIAL REVIEW

Risk

There have been no material changes to the risk management processes as described in the Risk Management Report in the HBOS Annual Report and Accounts for the year ended 31 December 2007.

Risks and Uncertainties

The divisional reviews on pages 13 to 55 include a review of the first six months of 2008. The key risks and uncertainties faced by the Group over the next six months are set out below. These should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. Quantitative and other disclosures are given so as to aid understanding.

Economic conditions and credit

The Group's business is affected by economic conditions in the UK, where the majority of the Group's earnings are generated, as well as in the other geographical areas in which it operates. Business and consumer confidence, employment trends, the state of the economy, (including the state of the UK housing market, the commercial real estate sector, equity markets, inflation, the availability and cost of credit), the liquidity of the global financial markets and market interest rates at the time may impact the Group's earnings.

The key credit risks for Retail include any slowdown in the UK economy leading to higher unemployment, deterioration in household finances due to inflation, higher interest rates or other pressures and a further contraction in the UK housing market. The extent of any economic slowdown and the degree of further falls in house prices in the second half of the year will impact on impairment losses.

In our Corporate businesses we have exposures from loans, joint ventures and other investments to customers in different sectors, including developers of commercial real estate and residential property. Commercial real estate has shown material declines in prices in the first half whilst residential property developers are facing extremely challenging market conditions. Whilst we principally assess counterparties on the strength of their underlying business and cashflows rather than the value of collateral a failure of these borrowers to operate through the economic cycle combined with falls in collateral values would lead to increased impairment losses. Impairment losses in the second half will therefore depend on the performance of those sectors exposed directly to property and how the current economic slowdown spreads to other corporate sectors.

Our International businesses have both retail and corporate exposures to a range of geographies. These geographies are subject to different economic pressures. Ireland and the United States are experiencing significant falls in house prices and slowing economies. Australia is somewhat protected by the commodities boom but has experienced rises in interest rates to curtail inflationary pressures. Impairment losses in International in the second half will depend on how these factors affect asset values, unemployment and corporate profitability in those sectors to which we lend.

Liquidity

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations when they fall due or will have to do so at excessive cost. In order to ensure that the Group continues to meet its funding obligations and maintain or grow its business generally, the Group has developed comprehensive liquidity policies supported by a diversified funding mix comprising both customer deposits and wholesale funding. Details of the composition of the Group's funding is set out on page 71.

The Group's banking operations in the UK comply with the FSA's Sterling Stock Liquidity approach for sterling liquidity management and regulatory reporting. A key element of the FSA's Sterling Stock Liquidity policy is that a bank should hold a stock of high quality liquid assets that can be sold quickly and discreetly in order to replace funding that has been withdrawn due to an actual or perceived problem with the bank. The objective is that this stock should enable the bank to continue business, whilst providing an opportunity to arrange more permanent funding solutions. Limits on the five day Sterling net wholesale outflow and the minimum level of stock liquidity have been agreed with the FSA. In addition, the Group Funding and Liquidity Committee has set a requirement for the stock liquidity ratio of at least 105% (FSA minimum level 100%).

HBOS also adheres to the requirements of other regulatory authorities including the Australian Prudential Regulatory Authority and the Irish Financial Regulator in whose jurisdictions the Group has branches or subsidiaries.

FINANCIAL REVIEW

The internal approach to liquidity management, which has been in place for several years, goes considerably beyond the regulatory requirements (in terms of the depth of analysis conducted and the amount of liquidity held). The funding and liquidity framework includes:

- Funding diversity criteria focusing on retail, other customer and wholesale sources;
- Sight to one week and sight to one month mismatch limits as a percentage of total wholesale funding for all major currencies and for all currencies in aggregate;
- Targets on the appropriate balance of short to medium term wholesale funding including limits for one month and three month borrowings; and
- Criteria and limits on marketable assets, by asset class for Sterling, US Dollars, Euros, other currencies, and for all currencies in aggregate.

In response to the market dislocation since the second half of 2007, the Group Capital Committee has increased the frequency of its meetings and Treasury monitors a range of metrics on a daily basis including market movements, flows and amounts of wholesale funding and mismatch ratios. These measures are tailored to prevailing market conditions with agreed escalation procedures if any key triggers are breached.

At 30 June 2008 the Group's liquidity portfolio of marketable assets, net of repos, was £51.7bn (end 2007 £60.0bn). The assets in the liquidity portfolio are treated in two forms. Firstly, assets which we know to be eligible under normal arrangements with the Bank of England, the European Central Bank and the Federal Reserve, which for internal purposes we describe as primary liquidity. Secondly, a substantial pool of high quality (secondary) liquidity assets that allow us to manage through periods of stress taking into account the likely behaviours of depositors and wholesale markets. The Group routinely uses the repo market as a liquidity management tool and has well established relationships with a wide range of market participants. The Group also has access to the standing facilities at a number of central banks.

In addition on 21 April 2008, the Bank of England launched its Special Liquidity Scheme which allows banks to swap their high quality mortgage-backed and other securities for UK Treasury Bills for a defined period. HBOS has used this facility to provide high quality liquidity assets.

Funding

Our ability to generate profitable growth depends on the pricing and availability of both retail and wholesale funding. Higher funding costs in wholesale markets or customer deposits would increase the Group's cost of funding. The margins in the second half will depend on the balance between any increased cost of funding and our ability to reprice our lending.

Loans and advances to customers grew strongly in the first half of 2008 as a consequence of the pipeline of business coming into the year but this growth has now slowed significantly. This growth has been funded through increased customer deposits and wholesale funding.

	As at 30.06.2008 £bn	As at 31.12.2007 £bn

Loans and advances to customers	**456.0**	430.0
Customer accounts	**258.1**	243.2
Customer lending less customer accounts	**197.9**	186.8
Customer accounts as a % of loans and advances to customers	**56.6%**	56.6%

In the current market conditions, global investor appetite in the medium and long term markets, including securitisations, remains greatly reduced and the cost of wholesale funds remains high by historical comparison. Our plans are based on an expectation that the securitisation markets will remain largely closed for the remainder of 2008 and well into 2009. We have issued £8.7bn of term funding (including £750m of equity capital), largely replacing the £11.5bn term funding that matured in the first half. At 30 June 2008 41.4% (end 2007 41.0%) of our wholesale funding matures in more than one year as shown overleaf.

During the first half of 2008 the Group's wholesale funding sources were well diversified by instrument, currency and by maturity as shown in the tables below. Tables are prepared on the basis that "retail" is defined using the current statutory definition, i.e. administered rate products. Wholesale funding, when issued in a foreign currency

but swapped into sterling, is included at the swap exchanged amount. Wholesale funding is shown excluding any repo activity and funding raised in the names of the conduits.

The Group's retail and wholesale funding sources by type of instrument are analysed below:

	As at 30.06.2008 £bn	**As at 30.06.2008 %**	As at 31.12.2007 £bn	As at 31.12.2007 %
Bank deposits	**27.4**	**5.6**	32.9	6.7
Customer deposits	**31.3**	**6.4**	27.8	5.6
Certificates of deposit	**55.3**	**11.4**	63.1	12.8
Medium term notes	**39.7**	**8.2**	42.8	8.7
Covered bonds	**23.9**	**4.9**	23.7	4.8
Commercial paper	**17.7**	**3.7**	16.9	3.4
Securitisation	**43.5**	**9.0**	45.9	9.3
Subordinated debt	**21.5**	**4.4**	20.0	4.1
Other	**5.7**	**1.2**	4.9	0.9
Total Wholesale	**266.0**	**54.8**	278.0	56.3
Retail	**219.4**	**45.2**	215.4	43.7
Total Group Funding	**485.4**	**100.0**	493.4	100.0

Wholesale funding is analysed by currency as follows:

	As at 30.06.2008 £bn	**As at 30.06.2008 %**	As at 31.12.2007 £bn	As at 31.12.2007 %
US dollar	**89.4**	**33.6**	104.5	37.6
Euro	**88.6**	**33.3**	79.0	28.4
Sterling	**63.1**	**23.7**	69.7	25.1
Other	**24.9**	**9.4**	24.8	8.9
Total Wholesale Funding	**266.0**	**100.0**	278.0	100.0

Wholesale funding is analysed by residual maturity as follows:

	As at	**As at**	As at	As at

	30.06.2008 £bn	**30.06.2008 %**	31.12.2007 £bn	31.12.2007 %
Less than one year	**155.9**	**58.6**	164.1	59.0
One to two years	**23.3**	**8.8**	21.6	7.8
Two to five years	**41.9**	**15.7**	46.3	16.7
More than five years	**44.9**	**16.9**	46.0	16.5
Total Wholesale Funding	**266.0**	**100.0**	278.0	100.0

Conduits
HBOS sponsors two conduits, Grampian and Landale, which are special purpose vehicles that invest in highly rated assets and fund via the Asset Backed Commercial Paper ('ABCP') market. At 30 June 2008, investments held by Grampian totalled £16.2bn (Dec 2007 £18.6bn). Grampian is, and always has been, fully consolidated into our balance sheet. We also consolidated £0.6bn of assets held by Landale (Dec 2007 £0.6bn). Grampian is a long established, high grade credit investment vehicle that invests in diversified Asset Backed Securities. Grampian has a liquidity line in place with HBOS which covers all of the assets and programme wide credit enhancement is also provided by HBOS. Landale holds both assets originated from our own balance sheet and third party transactions. Landale has liquidity lines from HBOS and from third party banks, and therefore the former, but not the latter, are consolidated into our balance sheet.

Due to the disruption in the ABCP market, there have been occasions when Grampian and Landale (in respect of assets backed by HBOS liquidity lines) have declined to issue ABCP given the unattractiveness of the spreads and maturities available. At 30 June 2008, HBOS had provided funding to the Grampian and Landale conduits of £10.4bn (end 2007 £8.1bn).

Market risk
Market risk is defined as the potential loss in value or earnings of the Group arising from changes in external market factors such as interest rates, credit spreads, foreign exchange rates, commodity and equity prices.

Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realised between lending and borrowing costs. Since August 2007, there has been a period of high and volatile inter-bank lending rates. Continued high spreads of inter-bank lending rates against the administered rate will continue to negatively effect our margin unless this can be recovered through higher lending margins on new business.

The Group is also subject to a risk of further negative fair value adjustments arising from Treasury's portfolio of debt securities. This portfolio is exposed to changes in market prices principally driven by movements in credit spreads exacerbated by less liquid and/or more volatile financial markets. This may lead to further NFVA arising from securities in the Trading Book, and reductions to the AFS reserve arising from securities in the Banking Book. Further deterioration in financial markets including defaults by monolines that provide protection on a number of our securities could lead to impairments. Less liquid financial markets could also affect the reliability of model valuations of certain asset backed securities. We review our valuation models regularly and adjust the assumptions to take account of evolving market conditions.

Foreign exchange risk arises from earnings and net assets denominated in foreign currency for our International businesses where there is a risk of devaluation upon conversion to sterling. To mitigate, forward contracts are entered into in order to hedge one year's expected earnings and the net asset investment in overseas operations is hedged through borrowing taken out in the relevant currencies.

Insurance and Investment Risk
The key risks and uncertainties faced by Insurance & Investment include the performance of the investment markets, competitive pressures, retention of our customers, insurance claims related risks and regulatory change.

The performance of the investment markets (equities, property and gilts) has a direct impact on our financial results, most immediately through short term fluctuations for Long Term Business accounted for on an embedded value basis. In addition market volatility and investment performance can affect investor confidence, which in turn can impact both sales and retention. Whilst we seek to mitigate this risk through diversification of our portfolio and offering products which will meet customer needs in these more turbulent market conditions, current market conditions are impacting on customers' risk appetite particularly for equity products.

Adverse persistency and customer retention is a major risk to earnings in both our Investment Business and our General Insurance business. To mitigate, we have created specialist retention teams to focus on this issue. These teams have commenced a programme of initiatives, supported by process and system enhancements, which aim to significantly reduce lapse rates in both businesses.

In General Insurance, adverse weather conditions, particularly flooding and storms, could lead to a significant rise in household insurance claims costs and hence reduced profitability. Similarly a significant adverse change in economic conditions could lead to increased claims for our Repayment Insurance business. A reinsurance programme is in place to limit our potential exposure to major weather events.

Regulation
The Group is subject to laws, regulations, administrative actions and policies in each location in which it operates, all of which are subject to change. The FSA is the main regulator for HBOS, although the Group's principal international businesses in the US, Australia and Ireland are subject to direct scrutiny from the Board of Governors of the Federal Reserve System and the Comptroller of the Currency, the Australian Prudential Regulation Authority and the Irish Financial Regulator respectively.

Regulatory intervention is an ongoing feature of UK banking and changes could affect the profitability of our business. A key risk has arisen from the ongoing investigation into bank charges where HBOS is one of eight banks involved in a test case to resolve legal uncertainties concerning the fairness and lawfulness of unarranged overdraft charges. Full details of the test case process are set out in the Contingent Liabilities and Commitments Note 19 on page 93. A definitive outcome of the test case process is unlikely to be known for at least 12 months.

The most immediate and significant regulatory issue facing our Insurance business at present is the Competition Commission investigation of the Repayment Insurance market which may, ultimately, impact profitability across the industry. We are continually reviewing and enhancing our processes and our proposition to ensure that our Repayment Insurance products remain a valued product for our customers. In our Investment Business, we are actively engaged in consultations around the FSA's ongoing Retail Distribution Review ('RDR') and the implementation of the Government's proposals for Personal Accounts. Changes in tax legislation can also create both risks and opportunities for our Investment business, as demonstrated by capital gains tax changes in the 2008 Budget which could materially impact on the life assurance industry.

People Risk

HBOS's success depends on the ability and experience of its senior management. The loss of the services of certain key employees, particularly to competitors, could have a material adverse effect on the Group's revenue, profit and financial condition.

Competition Risk

There is substantial competition for the types of banking and other products and services that the Group provides in the regions in which it conducts its business. The intensity of this competition is affected by competitor behaviour, consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors. Competitive pressure on margins is a key feature across our UK and International businesses, and in an adverse credit or competitive cycle our ability to maintain appropriate levels of returns to shareholders may be adversely affected.

CONDENSED FINANCIAL STATEMENTS

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE HALF YEAR RESULTS

The Directors, listed below (being all the Directors of HBOS plc), are responsible for preparing the Half Year Results in accordance with applicable law and regulations. The Directors are required to prepare the condensed financial statements in accordance with IAS 34 'Interim Financial Reporting' as adopted by the European Union ('EU') and to disclose in the interim management report a fair review of the information required under sections 4.2.7R and 4.2.8R of the Disclosure and Transparency Rules. These include an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed financial statements; a description of the principal risks and uncertainties for the remaining six months of the financial year; any related party transactions that have taken place in the first six months of the current financial year that have materially affected the financial position or performance during the period; and any changes in the related party transactions described in the last annual financial statements that could do so in the remaining six months.

HBOS plc Board of Directors

Chairman	**Executive Directors**	**Non-executive Directors**
Dennis Stevenson	Andy Hornby	Sir Ron Garrick
	Peter Cummings	Richard Cousins
	Jo Dawson	Anthony Hobson
	Mike Ellis	Karen Jones
	Philip Gore-Randall	John E Mack
	Colin Matthew	Coline McConville
	Dan Watkins	Kate Nealon

CONDENSED FINANCIAL STATEMENTS

Basis of Preparation

The condensed consolidated Half Year financial statements ('condensed financial statements') have been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the EU and the Disclosure & Transparency Rules issued by the Financial Services Authority. These are unaudited and they do not include all of the information required in preparing full annual financial statements. They should be read in conjunction with the financial statements for the Group for the year ended 31 December 2007, copies of which can be found on the Group's website at www.hbosplc.com or are available upon request from Computershare Investor Services PLC, PO Box 1909, The Pavilions, Bridgwater Road, Bristol BS99 7DS. Tel. 0870 702 0102.

Section 240 Statement

The comparative figures for the year ended 31 December 2007 included in these condensed financial statements do not constitute the company's statutory accounts for that financial year within the meaning of section 240 of the Companies Act 1985 but are derived from the 2007 Annual Report & Accounts. Those accounts, which were prepared in accordance with International Financial Reporting Standards ('IFRS') and interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') as adopted by the European Union were approved by the Board of Directors on 26 February 2008 and have been delivered to the Registrar of Companies. Those accounts have been reported on by the company's auditors, their report is unqualified and does not contain statements under Section 237(2) or (3) of the Companies Act 1985.

Accounting Policies
The condensed financial statements have been prepared on the basis of the accounting policies as applied and disclosed in the financial statements for the year ended 31 December 2007.

Critical Accounting Judgements
The preparation of these condensed financial statements necessarily requires the exercise of judgement in the selection and application of accounting policies. These judgements are continually reviewed and evaluated based on historical experience and other factors. During the half year to 30 June 2008 the Group's critical accounting judgements have been reviewed as follows with the conclusion that there are no changes to those that were reported in the accounting policy section of the financial statements for the year ended 31 December 2007. However, owing to continued market dislocations, the disclosure previously given on the judgements made in determining whether debt securities classified as available for sale within the Treasury Division are impaired has been enhanced as shown below.

Debt securities classified as available for sale are measured at fair value and are reviewed regularly for impairment at the specific investment level in accordance with IFRS. The portfolio is continually reviewed for impairment and as at 30 June 2008 no objective evidence of impairment has been found. Objective evidence of impairment might include non-receipt of due interest or principal repayment or a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets. The disappearance of active markets, declines in fair values and rating downgrades associated with this asset portfolio do not in themselves constitute objective evidence of impairment and unless a default has occurred, the determination of whether or not objective evidence of impairment is present at the balance sheet date requires the exercise of management judgement. Although the fair value of the portfolio is significantly below its purchase cost, the Group believes that currently this is due to market dislocations rather than impairments of its assets.

Critical Accounting Estimates
The preparation of these condensed financial statements requires the Group to make estimations where uncertainty exists. These estimates are continually reviewed in the light of changing conditions and other factors. During the half year to 30 June 2008 the Group's principal critical accounting estimates have been reviewed and the disclosure previously given on the valuation of asset backed securities ('ABS') has been updated as follows.

Fair values
The designation of financial instruments for measurement purposes and the valuation methodologies for financial instruments remain as disclosed in the accounting policy section in the financial statements for the year ended 31 December 2007.

Derivatives and financial instruments classified as at fair value through the income statement or available for sale are recognised at fair value. The fair value of debt securities in active markets is 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 value is estimated using quoted market prices for securities with similar credit, maturity and yield characteristics or similar valuation models.

ABS not traded in an active market are valued using valuation models that include non-market observable inputs. These consist primarily of US RMBS and CDOs. 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 liquidity considerations for particular asset classes.

At 30 June 2008, the fair value of ABS measured using models with non-market observable inputs comprised £2.4bn (end 2007 £5.3bn) within financial assets held for trading and £15.4bn (end 2007 £12.2bn) within assets classified as Available For Sale.

During the period, a £461m pre-tax negative fair value adjustment has been recognised in the income statement on ABS that were valued using models with non-market observable inputs (H1 2007 £nil). In addition to this a post-tax negative fair value adjustment of £1,485m (H1 2007 £nil) on ABS classified as available for sale that were valued using models with non-market observable inputs was recognised in equity reserves.

For ABS valuations using non-market observable inputs, the effect of a one basis point move in credit spreads (which based on our experience is the only key sensitivity) would result in a pre-tax movement of £1.1m for ABS assets classified as held for trading and a post-tax movement of £5.1m on assets classified as Available For Sale.

The use of non-market observable inputs in valuation models will diminish as and when activity returns to these markets.

CONDENSED FINANCIAL STATEMENTS

Consolidated Income Statement (unaudited)

	Notes	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Interest income		**18,456**	15,549	19,463	35,012
Interest expense		**(14,595)**	(11,935)	(15,773)	(27,708)
Net interest income		**3,861**	3,614	3,690	7,304
Fees and commission income		**1,149**	1,193	1,185	2,378
Fees and commission expense		**(546)**	(539)	(579)	(1,118)
Net earned premiums on insurance contracts		**2,276**	3,051	2,565	5,616
Net trading income	1	**(910)**	141	37	178
Change in value of in-force long term assurance business		**36**	159	(143)	16
Net investment income related to insurance and investment business		**(4,571)**	3,615	998	4,613
Other operating income		**1,055**	1,143	1,161	2,304
Net operating income	2	**2,350**	12,377	8,914	21,291
Change in investment contract liabilities		**2,734**	(2,423)	(115)	(2,538)
Net claims incurred on insurance contracts		**(1,721)**	(1,433)	(1,519)	(2,952)
Net change in insurance contract liabilities		**1,854**	(1,388)	(856)	(2,244)

Change in unallocated surplus		**231**	(169)	219	50
Administrative expenses	3	**(2,459)**	(2,432)	(2,547)	(4,979)
Depreciation and amortisation:		**(716)**	(710)	(692)	(1,402)
Intangible assets other than goodwill		**(104)**	(94)	(99)	(193)
Property and equipment		**(104)**	(116)	(108)	(224)
Operating lease assets		**(508)**	(500)	(485)	(985)
Goodwill impairment	5	**(2)**	(2)	(3)	(5)
Operating expenses		**(79)**	(8,557)	(5,513)	(14,070)
Impairment losses on loans and advances	6	**(1,310)**	(963)	(1,049)	(2,012)
Impairment losses on investment securities		**(145)**	(27)	(33)	(60)
Operating profit		**816**	2,830	2,319	5,149
Share of profits of jointly controlled entities		**13**	97	137	234
Share of (losses)/profits of associates		**(37)**	9	(9)	
Non-operating income	7	**56**	61	30	91
Profit before taxation	8	**848**	2,997	2,477	5,474
Tax on profit	9	**102**	(858)	(507)	(1,365)
Profit after taxation		**950**	2,139	1,970	4,109
Profit of disposal group			4		4
Profit for the period		**950**	2,143	1,970	4,113
Attributable to:					
Parent company shareholders		**931**	2,114	1,931	4,045
Minority interests		**19**	29	39	68
		950	2,143	1,970	4,113
Basic earnings per share	10	**23.5p**	55.0p	51.1p	106.1p
Diluted earnings per share	10	**23.5p**	54.6p	50.8p	105.4p

CONDENSED FINANCIAL STATEMENTS

Consolidated Balance Sheet (unaudited)

	Notes	**As at 30.06.2008 £m**	As at 30.06.2007 £m	As at 31.12.2007 £m
Assets				
Cash and balances at central banks		**1,973**	1,780	2,572
Items in course of collection		**1,133**	1,074	945
Financial assets held for trading		**46,023**	58,250	54,681
Derivative assets		**18,050**	12,205	14,141
Loans and advances to banks		**13,534**	9,001	8,056
Loans and advances to customers	11	**455,950**	395,210	430,007
Investment securities	12	**119,074**	120,864	128,398
Interests in jointly controlled entities		**923**	652	836
Interests in associates		**190**	141	149
Goodwill and other intangible assets		**2,811**	2,739	2,790
Property and equipment		**1,597**	1,506	1,494
Investment properties		**4,045**	5,324	4,731
Operating lease assets		**4,370**	4,707	4,643
Deferred costs		**1,130**	899	1,101
Current tax asset		**133**		

Value of in-force long term assurance business	13	**3,284**	3,267	3,184
Other assets		**6,224**	5,396	7,468
Prepayments and accrued income		**960**	1,075	1,751
Total Assets		**681,404**	624,090	666,947
Liabilities				
Deposits by banks		**47,005**	37,530	41,513
Customer accounts		**258,130**	227,117	243,221
Financial liabilities held for trading		**28,744**	22,346	22,705
Derivative liabilities		**16,470**	15,061	12,311
Notes in circulation		**923**	859	881
Insurance contract liabilities	14	**25,012**	26,074	26,864
Investment contract liabilities		**50,007**	53,441	52,828
Unallocated surplus		**1,262**	1,712	1,493
Net post retirement benefit liabilities	4	**725**	543	347
Current tax liabilities			389	370
Deferred tax liabilities		**1,601**	2,726	2,530
Other liabilities		**7,666**	7,249	5,072
Accruals and deferred income		**2,993**	2,782	3,630
Provisions		**174**	190	175
Debt securities in issue	15	**193,475**	181,477	206,520
Other borrowed funds	16	**26,084**	22,713	24,253
Total Liabilities		**660,271**	602,209	644,713
Shareholders' Equity	17			
Share capital		**1,136**	1,134	1,131
Share premium		**3,085**	2,925	2,997
Other reserves		**(1,223)**	1,145	154
Retained earnings		**17,102**	16,317	17,567
Shareholders' Equity (excluding minority interests)		**20,100**	21,521	21,849
Minority interests		**1,033**	360	385
Total Shareholders' Equity		**21,133**	21,881	22,234
Total Liabilities and Shareholders' Equity		**681,404**	624,090	666,947

CONDENSED FINANCIAL STATEMENTS

Consolidated Statement of Recognised Income and Expense (unaudited)

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Net actuarial (losses)/gains from defined benefit plans (net of tax)	**(292)**	261	51	312
Foreign exchange translation	**48**	63	(61)	2
Available for sale investments:				
Net change in fair value (net of tax)	**(1,954)**	87	(420)	(333)
Transfer to the income statement (net of tax)	**94**	(129)	(55)	(184)
Cash flow hedges:				
Effective portion of changes in fair value taken to equity (net of tax)	**486**	74	(290)	(216)
Net gains transferred to the				

income statement (net of tax)	**(51)**	(118)	(174)	(292)
Net (expense)/income recognised directly in equity	**(1,669)**	238	(949)	(711)
Profit for the period	**950**	2,143	1,970	4,113
Total recognised income and expense	**(719)**	2,381	1,021	3,402
Attributable to:				
Parent company shareholders	**(738)**	2,352	982	3,334
Minority interests	**19**	29	39	68
	(719)	2,381	1,021	3,402

CONDENSED FINANCIAL STATEMENTS

Consolidated Cash Flow Statement (unaudited)

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Year ended 31.12.2007 £m
Profit before taxation	**848**	2,997	5,474
Adjustments for:			
Impairment losses on loans and advances	**1,310**	963	2,012
Impairment losses on investment securities	**145**	27	60
Depreciation and amortisation	**716**	710	1,402
Goodwill impairment	**2**	2	5
Interest on other borrowed funds	**702**	609	1,229
Pension charge for defined benefit schemes	**74**	72	146
Cash contribution to defined benefit schemes	**(105)**	(75)	(295)
Exchange differences	**867**	295	(769)
Movement in derivatives held for trading	**56**	659	(1,487)
Other non-cash items	**344**	(741)	45
Net change in operating assets	**(13,764)**	(32,715)	(78,923)
Net change in operating liabilities	**12,014**	26,158	68,470
Net cash flows from operating activities before tax	**3,209**	(1,039)	(2,631)
Tax paid	**(631)**	(449)	(895)
Cash flows from operating activities	**2,578**	(1,488)	(3,526)
Cash flows from investing activities	**(442)**	(117)	(289)
Cash flows from financing activities	**42**	1,244	298
Net increase/(decrease) in cash and cash equivalents	**2,178**	(361)	(3,517)
Opening cash and cash equivalents	**4,674**	8,191	8,191
Closing cash and cash equivalents	**6,852**	7,830	4,674

Analysis of Cash and Cash Equivalents	**Half year ended 30.06.2008 £m**	Half year ended 30.06.2007 £m	Year ended 31.12.2007 £m
Cash and balances at central banks repayable on demand	**862**	457	1,061
Loans and advances to banks with an original maturity of less than three months	**5,990**	7,373	3,613
Closing cash and cash equivalents	**6,852**	7,830	4,674

CONDENSED FINANCIAL STATEMENTS

Consolidated Cash Flow Statement (unaudited) (continued)

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Year ended 31.12.2007 £m
Investing Activities			
Sale of other intangible assets	**8**	18	31
Purchase of other intangible assets	**(148)**	(142)	(249)
Sale of property and equipment	**22**	108	182
Purchase of property and equipment	**(287)**	(158)	(307)
Sale of investment properties	**57**	57	58
Investment in subsidiaries			(41)
Disposal of subsidiaries		115	115
Investment in jointly controlled entities and associates	**(189)**	(219)	(396)
Disposal of jointly controlled entities and associates	**92**	55	176
Dividends received from jointly controlled entities	**3**	43	132
Dividends received from associates		6	10
Cash flows from investing activities	**(442)**	(117)	(289)
Financing Activities			
Issue of ordinary shares	**93**	64	146
Issue of equity preference shares	**750**		
Share capital buyback, including costs		(394)	(500)
Purchase of own shares	**(62)**	(28)	(212)
Disposal of own shares	**167**		35
Issue of other borrowed funds	**1,144**	3,944	4,742
Repayments of other borrowed funds		(530)	(928)
Interest on other borrowed funds relating to the servicing of finance	**(673)**	(686)	(1,199)
Repayment of capital to minority interest	**(110)**		
Equity dividend paid	**(1,256)**	(1,101)	(1,747)
Dividends paid to minority shareholders in subsidiaries	**(11)**	(25)	(39)
Cash flows from financing activities	**42**	1,244	298

CONDENSED FINANCIAL STATEMENTS

Notes to the Condensed Financial Statements

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
1. Net Trading Income				
Net trading income comprises:				
Equity and commodity instruments and related derivatives	**(35)**	27	65	92
Interest bearing securities and related derivatives:				
Asset backed securities	**(1,095)**		(227)	(227)
Other	**70**	82	203	285
Foreign exchange and related derivatives	**31**	31	41	72

Fair value hedges:				
Net (losses)/gains from hedging instruments	**(400)**	350	834	1,184
Net gains/(losses) from hedged items	**517**	(349)	(878)	(1,227)
Cash flow hedge ineffectiveness recognised	**2**		(1)	(1)
	(910)	141	37	178

2. Net Operating Income

Included within net operating income are the following:				
Cash flow hedges:				
Net gains released from equity into income	**72**	169	248	417
Financial instruments at fair value through the income statement:				
Net (losses)/gains from trading financial instruments and non hedging derivatives	**(1,029)**	140	82	222
Net (losses)/gains from designated financial instruments	**(5,880)**	3,923	1,306	5,229
Available for sale financial instruments:				
Dividend income	**74**	13	278	291
Net realised gains on sale	**36**	183	80	263
Financial instruments designated as loans and receivables:				
Net realised gains on sale	**3**	2	1	3

3. Administrative Expenses

Administrative expenses include:				
Regulatory provisions charge		79	43	122
Colleague costs:				
Wages and salaries	**1,156**	1,129	1,211	2,340
Social security costs	**106**	101	125	226
Pension costs	**115**	103	98	201
Other post retirement benefits	**2**		5	5
Expense arising from share based payments	**76**	71	68	139
	1,455	1,404	1,507	2,911
Accommodation, repairs and maintenance	**246**	224	226	450
Technology	**132**	134	139	273
Marketing and communication	**256**	187	193	380

4. Post Retirement Benefits

The defined benefit and defined contribution pension schemes, as well as defined benefit post retirement medical and concessionary mortgage plans, have not changed in the current period and remain as described in the Group's 2007 financial statements.

The Group’s IAS19 pension deficit across all defined benefit post employment plans as at 30 June 2008 is £725m (end 2007 deficit of £347m).

The primary reason for the increase in the deficit is the fall in asset values over the period. The valuation of the liabilities is based on a discount rate of 6.25% and inflation rate of 3.90% (end 2007 5.70% and 3.40%, respectively) reflecting significant changes in the markets and the yields available on the relevant bonds. The increase in the discount rate causes the liabilities to decrease in value while the increase in the inflation rate causes the value of the liabilities to increase.

The impact of increasing the discount rate by 0.1% would be to reduce the defined benefit liabilities of £7,761m at 30 June 2008 by around 2.2% and the impact of increasing the inflation rate assumption by 0.1% would be to increase the defined benefit liabilities by around 2.2%.

5. Goodwill Impairment

The goodwill impairment of £2m relates to a partial write-down of the goodwill in respect of fund management business in Insurance & Investment division following the latest semi-annual impairment review. With the exception of the remaining £6m in respect of the fund management business, the aggregate headroom between the value in use and carrying value of goodwill recognised on the balance sheet plus net assets of the businesses is sufficiently large that changes in growth and discount rates, after allowing for current credit conditions, would have no material impact on the goodwill impairment charge.

6. Impairment Losses on Loans and Advances

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Opening	**3,373**	3,089	3,109	3,089
New impairment provisions less releases	**1,374**	1,003	1,108	2,111
Amounts written off	**(1,056)**	(926)	(800)	(1,726)
Discount unwind on impaired loans and advances to customers	**(62)**	(65)	(64)	(129)
Foreign exchange translation	**29**	8	20	28
Closing	**3,658**	3,109	3,373	3,373
New impairment provisions less releases	**1,374**	1,003	1,108	2,111
Recoveries of amounts previously written off	**(64)**	(40)	(59)	(99)
Net charge to income statement	**1,310**	963	1,049	2,012

7. Non-operating Income

Profit on the sale and leaseback of certain branch premises		28		28
Profit on the part disposal of Rightmove plc	**56**	29	30	59
Profit on the sale of Insight Investment Management (C.I.) Limited		4		4
	56	61	30	91

CONDENSED FINANCIAL STATEMENTS

8. Segmental Analysis

							Half year ended 30.06.2008
	Retail £m	**Corporate £m**	**Insurance & Investment £m**	**International £m**	**Treasury & Asset Mgmt £m**	**Group Items £m**	**Total £m**
Net interest income – internal	**(645)**	**(1,020)**	**(39)**	**(896)**	**2,600**		
Net interest income – external	**2,709**	**2,160**	**(13)**	**1,566**	**(2,561)**		**3,861**
Net fee and commission income – internal	**86**	**5**	**(121)**	**18**	**12**		

Net fee and commission income – external	**524**	**193**	**(249)**	**44**	**91**		**603**
Net trading income	**22**	**(14)**		**(37)**	**(881)**		**(910)**
Other operating income – internal	**11**	**(15)**		**3**	**1**		
Other operating income – external	**7**	**1,001**	**(2,251)**	**8**	**31**		**(1,204)**
Net operating income	**2,714**	**2,310**	**(2,673)**	**706**	**(707)**		**2,350**
Administrative expenses – internal	**(242)**	**(87)**	**(100)**	**(2)**	**(68)**	**499**	
Administrative expenses – external	**(782)**	**(294)**	**(332)**	**(412)**	**(89)**	**(550)**	**(2,459)**
Depreciation and amortisation	**(32)**	**(528)**	**(24)**	**(32)**	**(3)**	**(97)**	**(716)**
Goodwill impairment			**(2)**				**(2)**
Other operating expenses			**2,950**	**148**			**3,098**
Operating expenses	**(1,056)**	**(909)**	**2,492**	**(298)**	**(160)**	**(148)**	**(79)**
Impairment losses on loans and advances	**(722)**	**(469)**		**(119)**			**(1,310)**
Impairment losses on investment securities		**(145)**					**(145)**
Operating profit/(loss)	**936**	**787**	**(181)**	**289**	**(867)**	**(148)**	**816**
Share of profits of jointly controlled entities and associates		**(34)**	**16**	**(2)**	**(4)**		**(24)**
Non-operating income	**56**						**56**
Profit/(loss) before taxation	**992**	**753**	**(165)**	**287**	**(871)**	**(148)**	**848**

The IFRS H108 result of the I&I division has been impacted by falls in investment returns due to market movements and transactions with policyholders in relation to policyholder tax, offset by better insurance contract experience and the absence of significant flood claims in H108.

Half year ended 30.06.2007

	Retail £m	Corporate £m	Insurance & Investment £m	International £m	Treasury & Asset Mgmt £m	Group Items £m	Total £m
Net interest income – internal	(549)	(557)	(37)	(565)	1,708		
Net interest income – external	2,636	1,537	(13)	1,069	(1,615)		3,614
Net fee and commission income – internal	95	4	(86)	31	(44)		
Net fee and commission income – external	537	222	(283)	25	153		654
Net trading income	7	35		(6)	105		141
Other operating income – internal							
Other operating income – external	20	1,046	6,462	387	53		7,968
Net operating income	2,746	2,287	6,043	941	360		12,377
Administrative expenses – internal	(263)	(79)	(82)		(60)	484	
Administrative expenses – external	(832)	(335)	(297)	(314)	(108)	(546)	(2,432)
Depreciation and amortisation	(37)	(516)	(29)	(27)	(2)	(99)	(710)
Goodwill impairment			(2)				(2)
Other operating expenses			(5,194)	(219)			(5,413)
Operating expenses	(1,132)	(930)	(5,604)	(560)	(170)	(161)	(8,557)
Impairment losses on loans and advances	(678)	(235)		(50)			(963)
Impairment losses on investment securities	(22)	(5)					(27)
Operating profit/(loss)	914	1,117	439	331	190	(161)	2,830
Share of profits of jointly controlled entities and associates	(7)	108	3	2			106
Non-operating income	57				4		61
Profit/(loss) before taxation	964	1,225	442	333	194	(161)	2,997

8. Segmental Analysis (continued)

Half year ended 31.12. 2007

	Retail £m	Corporate £m	Insurance & Investment £m	International £m	Treasury & Asset Mgmt £m	Group Items £m	Total £m
Net interest income – internal	(501)	(773)	(33)	(704)	2,011		

Net interest income – external	2,513	1,844	(15)	1,288	(1,940)		3,690
Net fee and commission income – internal	95	3	(82)	(10)	(6)		
Net fee and commission income – external	538	171	(238)	20	115		606
Net trading income	(14)	30	(7)	3	25		37
Other operating income – internal	19	15		45	(79)		
Other operating income – external	38	998	3,149	265	131		4,581
Net operating income	2,688	2,288	2,774	907	257		8,914
Administrative expenses – internal	(409)	(72)	(31)	(6)	18	500	
Administrative expenses – external	(691)	(354)	(383)	(351)	(188)	(580)	(2,547)
Depreciation and amortisation	(33)	(502)	(28)	(27)	(2)	(100)	(692)
Goodwill impairment			(3)				(3)
Other operating expenses			(2,212)	(59)			(2,271)
Operating expenses	(1,133)	(928)	(2,657)	(443)	(172)	(180)	(5,513)
Impairment losses on loans and advances	(616)	(367)		(66)			(1,049)
Impairment losses on investment securities		(32)		(1)			(33)
Operating profit/(loss)	939	961	117	397	85	(180)	2,319
Share of profits of jointly controlled entities and associates	(2)	124	(5)	15	(4)		128
Non-operating income	30						30
Profit/(loss) before taxation	967	1,085	112	412	81	(180)	2,477

							Year ended 31.12.2007
	Retail £m	Corporate £m	Insurance & Investment £m	International £m	Treasury & Asset Mgmt £m	Group Items £m	Total £m
Net interest income – internal	(1,050)	(1,330)	(70)	(1,269)	3,719		
Net interest income – external	5,149	3,381	(28)	2,357	(3,555)		7,304
Net fee and commission income – internal	190	7	(168)	21	(50)		
Net fee and commission income – external	1,075	393	(521)	45	268		1,260
Net trading income	(7)	65	(7)	(3)	130		178
Other operating income – internal	19	15		45	(79)		
Other operating income – external	58	2,044	9,611	652	184		12,549
Net operating income	5,434	4,575	8,817	1,848	617		21,291
Administrative expenses – internal	(672)	(151)	(113)	(6)	(42)	984	
Administrative expenses – external	(1,523)	(689)	(680)	(665)	(296)	(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	(2,265)	(1,858)	(8,261)	(1,003)	(342)	(341)	(14,070)
Impairment losses on loans and advances	(1,294)	(602)		(116)			(2,012)
Impairment losses on investment securities	(22)	(37)		(1)			(60)
Operating profit/(loss)	1,853	2,078	556	728	275	(341)	5,149
Share of profits of jointly controlled entities and associates	(9)	232	(2)	17	(4)		234
Non-operating income	87				4		91
Profit/(loss) before taxation	1,931	2,310	554	745	275	(341)	5,474

9. Taxation

The tax credit for the period of £102m (H1 2007 tax charge of £858m) includes a £451m tax credit (H1 2007 £167m tax charge) in respect of the tax attributable to the policyholder earnings in the Group's UK life companies. The H1 2007 tax charge of £858m includes a credit of £110m in respect of the change in the rate of UK corporation tax. Excluding these items results in an effective rate of 27.0% (H1 2007 28.3%). Included within the tax credit of £102m is an overseas tax charge of £148m (H1 2007 £110m).

The main UK corporation tax rate reduced from 30% to 28% in April 2008. The average rate of UK corporation tax for the year to December 2008 is 28.5%. A reconciliation of the actual tax to the average rate of 28.5% (H1 2007 30%) is detailed below:

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Profit before tax	**848**	2,997	2,477	5,474
Expected tax charge at 28.5%/30%	**242**	899	743	1,642
Effects of:				
Change in rates of corporation tax on deferred assets and liabilities		(110)	(68)	(178)
Expenses not deductible/(income not chargeable) for tax purposes	**29**	(22)	(26)	(48)
Net effect of differing tax rates overseas	**20**	(1)	30	29
Tax exempt gains	**(35)**	(35)	(55)	(90)
Policyholder tax for life assurance business	**(322)**	117	(104)	13
Impairment on investment securities	**35**	12	4	16
Adjustments in respect of previous periods	**(83)**	(4)	(10)	(14)
Other	**12**	2	(7)	(5)
Total income tax on profit	**(102)**	858	507	1,365
The tax expense is made up as follows:				
Tax on policyholder returns	**(451)**	167	(149)	18
Tax on shareholder returns	**349**	691	656	1,347
	(102)	858	507	1,365

10. Earnings Per Share

Basic and diluted earnings per ordinary share are based upon Group profit attributable to ordinary shareholders which is calculated as follows:

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Profit attributable to parent company shareholders	**931**	2,114	1,931	4,045
Profit attributable to preference shareholders	**(51)**	(51)	(29)	(80)
Profit attributable to ordinary shareholders for continuing operations	**880**	2,063	1,902	3,965

The closing share price on 26 June 2008 was 275.7p, 0.7p higher than the 275p issue price per new share under the Rights Issue resulting in an adjustment factor of 1.001. Applying the adjustment factor to the average number of ordinary shares in issue restates earnings per share as follows:

	Half year ended 30.06.2007	Year ended 31.12.2007
As published:		
Average number of ordinary shares in issue for basic EPS (millions)	3,746	3,735
Earnings (basic)	55.1p	106.2p
Earnings (diluted)	54.6p	105.5p
Restated:		
Average number of ordinary shares in issue for basic EPS (millions)	3,749	3,738
Earnings (basic)	55.0p	106.1p
Earnings (diluted)	54.6p	105.4p

11. Loans and Advances to Customers

	As at 30.06.2008 £m	As at 31.12.2007 £m
Retail secured lending	**238,151**	235,849
Retail unsecured lending	**19,880**	19,831
Corporate, International and Treasury	**201,577**	177,700
Gross loans and advances to customers	**459,608**	433,380
Impairment losses on loans and advances (Note 6)	**(3,658)**	(3,373)
Net loans and advances to customers	**455,950**	430,007

The mix of the Group's gross lending portfolio is summarised in the following table:

	As at 30.06.2008 £m	As at 31.12.2007 £m
Energy	**2,343**	2,269
Manufacturing industry	**4,456**	4,332
Construction and property	**46,154**	41,099
Hotels, restaurants and wholesale and retail trade	**13,737**	12,620
Transport, storage and communication	**6,987**	6,834
Financial	**12,350**	6,312
Other services	**16,258**	15,396
Individuals:		
Residential mortgages	**235,924**	235,771
Other personal lending	**17,910**	19,229
Non-UK residents	**103,489**	89,518
Total	**459,608**	433,380

Loans and advances to customers include advances that are securitised under the Group's securitisation programmes, the majority of which have been sold by subsidiary companies to bankruptcy remote special purpose entities, funded by the issue of debt on terms whereby some of the risks and rewards of the portfolio are retained by the subsidiary. Accordingly, all these advances are retained on the Group's balance sheet with the debt issued included within debt securities in issue. The Group's principal securitisation programmes and the type of loans and advances securitised are as follows

Programme		As at 30.06.2008 £m	As at 31.12.2007 £m
Permanent	UK residential mortgages	**38,770**	31,577
Mound	UK residential mortgages	**4,545**	4,545
Swan	Australian residential mortgages	**2,592**	2,726
Candide	Dutch residential mortgages	**3,878**	2,491
Prominent	Commercial loans	**1,061**	1,101
Covered Bonds	UK residential mortgages	**44,775**	34,704
Social Housing Covered Bonds	UK residential mortgages	**2,393**	2,362
Pendeford	UK residential mortgages	**2,088**	2,508
Melrose	Commercial loans		750
Other	UK residential mortgages	**103**	104
		100,205	82,868

In addition to the programmes above loans and advances totalling £nil (2007 £14,089m) relating to UK residential mortgages have been securitised using credit default swaps.

12. Investment Securities

As at 30.06.2008

	Policyholder assets at fair value through the income statement £m	At fair value through the income statement £m	Available for sale £m	Loans and receivables £m	Total £m
Listed					
Debt securities	**17,982**	**6,822**	**30,518**		**55,322**
Equity shares	**44,764**	**313**	**206**		**45,283**
Total listed	**62,746**	**7,135**	**30,724**		**100,605**
Unlisted					
Debt securities	**20**	**277**	**13,845**	**1,697**	**15,839**
Equity shares	**89**	**409**	**2,132**		**2,630**
Total unlisted	**109**	**686**	**15,977**	**1,697**	**18,469**
Total	**62,855**	**7,821**	**46,701**	**1,697**	**119,074**
Comprising:					
Debt securities	**18,002**	**7,099**	**44,363**	**1,697**	**71,161**
Equity shares	**44,853**	**722**	**2,338**		**47,913**

As at 31.12.2007

	Policyholder assets at fair value through the income statement £m	At fair value through the income statement £m	Available for sale £m	Loans and receivables £m	Total £m
Listed					
Debt securities	20,712	7,774	31,944		60,430
Equity shares	46,875	393	261		47,529
Total listed	67,587	8,167	32,205		107,959
Unlisted					
Debt securities	2	847	14,833	1,441	17,123

Equity shares	94	274	2,948		3,316
Total unlisted	96	1,121	17,781	1,441	20,439
Total	67,683	9,288	49,986	1,441	128,398
Comprising:					
Debt securities	20,714	8,621	46,777	1,441	77,553
Equity shares	46,969	667	3,209		50,845

In keeping with normal market practice, the Group enters into securities lending transactions and repurchase agreements, whereby cash and securities are temporarily received or transferred as collateral.

Debt securities with a value of £23,806m (end 2007 £14,181m) were subject to agreement to repurchase, where the transferee obtains the right to pledge or sell the asset they receive. Debt securities also include securities pledged as collateral as part of securities lending transactions amounting to £28,549m (end 2007 £11,918m).

Debt securities include asset backed securities of £16,208m (end 2007 £18,563m) which are held in the Group's Grampian conduit. This is a series of bankruptcy remote special purpose entities ('SPEs') that are funded by the issue of commercial paper and banking facilities. As some of the rewards and risks of the portfolio are retained by the Group, including the provision of liquidity facilities by Bank of Scotland plc, to the conduit, the assets and liabilities of the conduit are consolidated as part of the Group.

The Group also has a smaller conduit, Landale, which is partially consolidated. Debt securities of £552m (end 2007 £604m) are included in available for sale investments. Further details are included in Note 20.

Impairments on investment securities of £145m (H1 2007 £27m) have been charged to the income statement and there are no impairment provisions held in respect of the Group's investment securities at the period end.

Securities held as collateral as stock borrowed or under reverse repurchase agreements amounted to £51,248m (end 2007 £39,975m). These are not recognised as assets and are therefore not included above. Of this amount the Group had resold or repledged £49,169m (end 2007 £28,817m) as collateral for its own transactions.

13. Value of In-force Long Term Assurance Business

	30.06.2008 **£m**	31.12.2007 £m
At 1 January	**3,184**	3,104
Unwind of discount rate	**127**	245
Release to income statement	**(225)**	(415)
Effect of experience in the period(1)	**(83)**	(201)
New business	**199**	567
Changes in assumptions(2)	**18**	(180)
Exchange translation	**64**	64
Closing	**3,284**	3,184

(1) Effect of experience in the period
During the period to 30 June 2008 changes have been made to certain investment bonds with additional life cover being added. In accordance with IFRS 4 'Insurance Contracts' this results in these products transferring from being accounted for as investment contracts to insurance contracts. This has resulted in a £143m increase in the value of in-force long term assurance business. This is partly offset by a net £80m, principally arising from a reduction in deferred origination costs, which are charged to fees and

commission expense. The overall impact of this change is an increase in profit before tax of £63m (H1 2007 £nil).

(2) Change in assumptions
The key assumptions used in the measurement of the value of in-force long term assurance business relating to insurance contracts and investment contracts with a discretionary participating feature ('DPF') are determined by the Board of Directors.

The economic assumptions that have the greatest effect on the calculation of the value of in-force long term assurance business are set out in the Group's 2007 financial statements and there were no significant changes in the economic assumptions during the period to 30 June 2008. These assumptions require the application of material judgement and are chosen to represent a long term view of the likely economic environment.

Experience assumptions also have a significant effect on cash flow projections. The selection of these assumptions also 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 experience assumptions applied in the half year to 30 June 2008 are unchanged from those used in 2007, which are set out in the Group's 2007 financial statements.

14. Insurance Contract Liabilities

Assumptions
The only significant changes to the assumptions used to calculate the value of policyholder liabilities at the half year 30 June 2008 and 30 June 2007 from those used at the year end 31 December 2007 were due to the change in valuation rates of interest which were updated to reflect prevailing economic conditions at the balance sheet date. The valuation rate of interest assumptions were broadly matched by changes in the valuation of investment securities.

The valuation rates of interest used are as follows:

	As at 30.06.2008	As at 31.12.2007
Non-profit policies		
Pension annuities	4.5% - 5.9%	4.1% - 5.3%
Term assurances	4.0% - 4.8%	3.5% - 4.4%
Unit-linked policies		
Life assurance	3.7% - 4.5%	3.3% - 4.0%
Pensions	4.2% - 5.6%	4.1% - 4.9%

In isolation an increase in the valuation rate of interest decreases liabilities leading to an increase in profits or vice versa.

15. Debt Securities in Issue

	As at 30.06.2008 £m	As at 31.12.2007 £m
Bonds and medium term notes	**72,430**	73,818
Other debt securities	**121,045**	132,702
	193,475	206,520

At 30 June 2008, debt securities in issue include £7,763m issued by the Grampian conduit (end 2007 £11,954m) and £689m issued by the Landale conduit (end 2007 £137m).

16. Other Borrowed Funds

	As at 30.06.2008 £m	As at 31.12.2007 £m
Preferred securities	**5,069**	4,973
Preference shares	**1,567**	1,571
Subordinated liabilities:		
Dated	**12,494**	10,964
Undated	**6,954**	6,745
	26,084	24,253

CONDENSED FINANCIAL STATEMENTS

17. Reconciliation of Shareholders' Equity

			Other reserves					
	Share capital[i] £m	Share premium £m	Cash flow hedge reserve £m	Available for sale reserve £m	Other reserves £m	Retained earnings £m	Minority interests[ii] £m	Total £m
At 1 January 2008	**1,131**	**2,997**	**(85)**	**(313)**	**552**	**17,567**	**385**	**22,234**
Foreign exchange translation					**48**			**48**
Net actuarial losses from defined benefit plans						**(292)**		**(292)**
Available for sale investments:								
Net change in fair value				**(1,954)**				**(1,954)**
Transfer to the income statement				**94**				**94**
Cash flow hedges:								
Effective portion of changes in fair value taken to equity			**486**					**486**
Net gains transferred to the income statement			**(51)**					**(51)**
Profit for the period						**931**	**19**	**950**
Total recognised income and expense			**435**	**(1,860)**	**48**	**639**	**19**	**(719)**
Dividends paid (Note 18)						**(1,256)**	**(11)**	**(1,267)**
Issue of new shares	**5**	**88**					**750**	**843**
Ordinary share buyback								
Repayment of capital to minority interests							**(110)**	**(110)**
Movement in own shares						**105**		**105**
Movement in share-based compensation reserve						**47**		**47**
At 30 June 2008	**1,136**	**3,085**	**350**	**(2,173)**	**600**	**17,102**	**1,033**	**21,133**

(i) Share capital

On 29 April 2008 HBOS announced that it would make a rights issue of two new ordinary shares for every five ordinary shares held at a price of 275p per share. On 26 June 2008 a General Meeting increased the authorised share capital of HBOS plc by 2,900m ordinary shares to

7,640m ordinary shares and approved the rights issue. Nil paid shares were issued under the rights issue on 27 June 2008 and consequently at the period end 1,500m of nil paid ordinary shares were outstanding. The rights issue was completed in July and raised £4.0bn net of expenses.

(ii) Minority interests

On 19 March 2008 HBOS Capital Funding No.4 L.P. issued £750m Fixed-to-Floating Rate Perpetual Preferred Securities at par. Discretionary distributions at a rate of 9.54% per annum payable semi-annually in arrears until 19 March 2018 at which time the interest rate will become three month LIBOR plus 6.75% per annum payable quarterly in arrears. The Group has the option to redeem these securities on 19 March 2018 and quarterly thereafter.

17. Reconciliation of Shareholders' Equity (continued)

			Other reserves					
	Share capital £m	Share premium £m	Cash flow hedge reserve £m	Available for sale reserve £m	Other reserves £m	Retained earnings £m	Minority interests £m	Total £m
At 1 January 2007	1,139	2,856	423	203	535	15,529	486	21,171
Foreign exchange translation					63			63
Net actuarial losses from defined benefit plans						261		261
Available for sale investments:								
Net change in fair value				87				87
Net gains transferred to the income statement				(129)				(129)
Cash flow hedges:								
Effective portion of changes in fair value taken to equity			74					74
Net gains transferred to the income statement			(118)					(118)
Profit for the period						2,114	29	2,143
Total recognised income and expense			(44)	(42)	63	2,375	29	2,381
Dividends paid (Note 18)						(1,099)	(25)	(1,124)
Issue of new shares	2	69						71
Ordinary share buyback	(7)				7	(394)		(394)
Sale of disposal group							(129)	(129)
Other movements							(1)	(1)
Movement in own shares						(28)		(28)
Movement in share-based compensation reserve						(66)		(66)
At 30 June 2007	1,134	2,925	379	161	605	16,317	360	21,881

			Other reserves					
	Share capital £m	Share premium £m	Cash flow hedge reserve £m	Available for sale reserve £m	Other reserves £m	Retained earnings £m	Minority interests £m	Total £m
At 1 January 2007	1,139	2,856	423	203	535	15,529	486	21,171
Foreign exchange translation				1	1			2
Net actuarial gains from defined benefit plans (net of tax)						312		312
Available for sale investments:								
Net change in fair value				(333)				(333)
Net gains transferred to the income statement				(184)				(184)
Cash flow hedges:								
Effective portion of changes in fair value taken to equity			(216)					(216)
Net gains transferred to the income statement			(292)					(292)
Profit after tax						4,045	68	4,113
Total recognised income and expense			(508)	(516)	1	4,357	68	3,402
Dividends paid (Note 18)						(1,747)	(39)	(1,786)
Issue of new shares	5	141						146
Ordinary share buyback	(13)				13	(500)		(500)
Sale of disposal group							(130)	(130)
Other movements					3	(15)		(12)
Movement in own shares						(177)		(177)
Tax on share-based compensation schemes						(36)		(36)
Movement in share-based compensation reserve						156		156
At 31 December 2007	**1,131**	**2,997**	**(85)**	**(313)**	**552**	**17,567**	**385**	**22,234**

18. Dividends

A Capitalisation Issue has been approved in lieu of the 2008 interim dividend at the General Meeting on 26 June 2008. After the balance sheet date the Directors have proposed a Capitalisation amount currently equivalent to 6.1p per ordinary share. Existing shareholders will receive a number of new shares, the amount of which will be determined on 3 October 2008 and will be based on the average of the middle market quotations for ordinary shares for the three dealing days starting on and including 1 October 2008.

The following dividends have been charged direct to retained earnings:

	Half year ended 30.06.2008 £m	Half year ended 30.06.2007 £m	Half year ended 31.12.2007 £m	Year ended 31.12.2007 £m
Ordinary dividends				
2007 interim dividend of 16.6 pence per ordinary share			619	619
2007 final dividend paid of 32.3 pence per ordinary share (2006 27.9 pence per share)	**1,205**	1,048		1,048
Preference dividends	**51**	51	29	80

1,256	1,099	648	1,747

CONDENSED FINANCIAL STATEMENTS

19. Contingent Liabilities and Commitments

	As at 30.06.2008 £m	As at 31.12.2007 £m
Contingent liabilities		
Acceptances and endorsements	**6**	43
Guarantees and irrevocable letters of credit	**4,890**	6,891
	4,896	6,934
Commitments		
Short term trade related transactions	**152**	115
Undrawn formal standby facilities, credit lines and other commitments to lend with a maturity:		
Up to and including one year	**58,941**	68,253
Over one year	**32,786**	31,416
	91,879	99,784

On 27 July 2007, it was announced that members of the HBOS Group, along with seven other major UK current account providers, had reached agreement with the Office of Fair Trading to commence legal proceedings in the High Court of England and Wales for a declaration (or declarations) to resolve legal uncertainties concerning the fairness and lawfulness of unarranged overdraft charges (the "Test Case"). It was also announced that HBOS and those other providers will seek a stay of all current and potential future court proceedings which are brought against them in the UK concerning these charges and have obtained the consent of the Financial Ombudsman Service not to proceed with consideration of the merits of any complaints concerning these charges that are referred to them prior to the resolution of the Test Case. By virtue of a waiver granted by the Financial Services Authority of its complaints handling rules, HBOS (and other banks, including the banks party to the Test Case) will not be dealing with or resolving customer complaints about unarranged overdraft charges while the waiver is in force. On 21 July 2008, the FSA confirmed that it is extending its waiver regarding unarranged overdraft charges complaints until 26 January 2009.

The first step in the Test Case was a trial of certain ‘preliminary' issues concerning the legal status and enforceability of contractual terms relating to unarranged overdraft charges.

This preliminary trial concluded on 8 February 2008 and the judgement was handed down on 24 April 2008. The judgement held that the contractual terms relating to unarranged overdraft charges currently used by the HBOS Group (i) are not unenforceable as penalties, but (ii) are not exempt from assessment for fairness under the Unfair Terms in Consumer Contract Regulations 1999 ("UTCCRs").

At a court hearing on 22 and 23 May 2008, the Judge granted HBOS and the other Test Case banks permission to appeal his decision that unarranged overdraft charges are assessable for fairness under the UTCCRs. This appeal is likely to take place before the end of 2008. A further hearing took place in early July 2008 at which the Court was asked to consider whether terms and conditions previously used by the Test Case banks are capable of being penalties. The judgement is awaited. Depending on the outcome of the appeal and the further hearing that took place in July 2008, another hearing may be required in order for the Court to determine the fairness of the charges.

A definitive outcome of the Test Case is unlikely to be known for at least twelve months.

Given the early stage of these proceedings and the uncertainty as to their outcome, it is not practicable at this time to estimate any potential financial effect.

The Group is engaged in other litigation in the UK and overseas arising out of its normal business activities. The Group considers that none of these actions is material and has not disclosed any contingent liability in respect of these actions because it is not practical to do so.

CONDENSED FINANCIAL STATEMENTS

20. Special Purpose Entities

The Group sponsors special purpose entities ('SPEs') that are used in its securitisation and funding programmes. The principal securitisation programmes are listed in Note 11. In addition, the Group sponsors two conduit programmes, Grampian and Landale, which invest in asset-backed securities funded by commercial paper or through banking facilities. Details of the assets secured under these conduit programmes are given in Note 12.

Two of the Landale SPEs are not consolidated by the Group. One is the central funding company for the conduit that obtains external funding and lends it to the purchasing companies. The second is a purchasing company that has acquired floating rate notes issued under the Group's mortgage securitisation programmes and which is supported by liquidity lines that are provided by third party banks. These entities are not consolidated as there are insufficient indicators of control, in particular as the credit risk relating to the assets held by the entities and the liquidity risks are not borne by the Group. If these entities were consolidated the financial impact would be minimal.

21. Related Party Transactions

Related party transactions and transactions with key management personnel in the half year to 30 June 2008 are similar in nature to those for the year ended 31 December 2007. Full details of the Group's related party transactions and transactions with key management personnel for the year ended 31 December 2007 can be found in the Group's 2007 financial statements.

22. Post Balance Sheet Events

On 18 July 2008, the Group completed the Rights Issue announced on 29 April 2008, raising £4.0bn after expenses.

A Capitalisation Issue has been approved in lieu of the 2008 interim dividend as explained in Note 18.

FINANCIAL INFORMATION

Independent Review Report to HBOS plc

Introduction

We have been engaged by HBOS plc (the 'Company') to review the Condensed Financial Statements in the half-yearly financial report for the six months ended 30 June 2008 which comprises the Consolidated Income Statement, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement, the Consolidated Statement of Recognised Income and Expense and the related explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the Condensed Financial Statements.

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the Disclosure and Transparency Rules ('DTR') of the UK Financial Services Authority ('FSA'). Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the Directors. The Directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the FSA.

As disclosed in the Section 240 Statement, the annual financial statements of the Group are prepared in accordance with IFRS as adopted by the EU. The Condensed Financial Statements included in this half-yearly financial report has been prepared in accordance with IAS 34 'Interim Financial Reporting' as adopted by the EU.

Our responsibility
Our responsibility is to express to the Company a conclusion on the Condensed Financial Statements in the half-yearly financial report based on our review.

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

Conclusion
Based on our review, nothing has come to our attention that causes us to believe that the Condensed Financial Statements in the half-yearly financial report for the six months ended 30 June 2008 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the FSA.

KPMG Audit Plc, Chartered Accountants, Edinburgh, 30 July 2008

SUPPLEMENTARY EV INFORMATION

Supplementary Embedded Value Information for the UK Investment Business

Introduction
The introduction of IFRS in 2005 resulted in a change to the timing of reported profit recognition in respect of Investment Business. Under IFRS, insurance contracts continue to be accounted for on an Embedded Value ('EV') basis but investment contracts are now all accounted for under IAS 39. This has the effect of delaying the recognition of profit in respect of some investment contracts and, in particular, has resulted in the reporting of losses in the year of their sale.

To assist in the understanding of the underlying performance and value generation of our UK Investment Business, the supplementary information set out below provides the financial results for our UK Investment Business as if both insurance and investment contracts (including mutual funds) were accounted for on an EV basis. We refer to this as the 'Full EV' basis. The Full EV basis uses the same methodology as that which is applied to the calculation of EV on insurance contract business under IFRS. We have not adopted European EV. The economic assumptions used for the Full EV basis are the same as used under the reported IFRS basis set out on page 63.

Applying the Full EV basis results in the earlier recognition of profit on new investment contract business, but subsequently a lower contribution from existing business, when compared to the recognition of profits on investment contracts under IAS 39. Differences between actual and expected experience on existing business often have a greater impact on a Full EV basis, as changes in experience can result in significant adjustments to modelled future cashflows. In contrast, under IAS 39, variations in experience compared to expectations are recognised in the income statement in the year in which they arise.

No additional information has been provided in relation to General Insurance or European Financial Services as the investment business not already accounted for on an EV basis under IFRS on these businesses is immaterial.

Key Financial Highlights

The key highlights of the Full EV basis are as follows:

- Group embedded value on a Full EV basis was £7,708m as at 30 June 2008 (end 2007 £7,684m), £2,641m higher than reported under IFRS.

- Underlying earnings per share on the Full EV basis decreased 13% to 49.6p (H1 2007 57.1p), 2.2p (5%) higher than reported under IFRS.

- Overall, underlying profit before tax for the UK Investment Business declined 1% to £342m (H1 2007 £345m), £116m higher than reported under IFRS.

- Contribution from new business in the UK Investment Business decreased by 29% to £195m (H1 2007 £273m) due to lower new business volumes, as market volatility has impacted on the new business performance across the sector. However this is £218m higher than the new business contribution reported under IFRS.

A comparison of the Group's financial results on a Full EV basis and the IFRS basis is set out below.

	Half year ended 30.06.2008 Full EV Basis	**Half year ended 30.06.2008 IFRS Basis****	Half year ended 30.06.2007 Full EV Basis	Half year ended 30.06.2007 IFRS Basis**
Underlying profit before tax	**£2,662m**	**£2,546m**	£3,098m	£2,962m
Underlying EPS	**49.6p**	**47.4p**	57.1p	54.6p
Post tax return on mean equity	**16.4%**	**16.6%**	20.6%	21.0%

	As at 30.06.2008 Full EV Basis	**As at 30.06.2008 IFRS Basis**	As at 31.12.2007 Full EV Basis	As at 31.12.2007 IFRS Basis
Group embedded value (net of tax)*	**£7,708m**	**£5,067m**	£7,684m	£4,960m
Proforma net asset value per ordinary share	**461p**	**435p**	589p	551p

* Includes Europe of £712m (2007 £665m) and UK General Insurance of £151m (2007 £225m).
****** Excluding NFVA.

SUPPLEMENTARY EV INFORMATION

UK Investment Business

Full EV Information

Underlying profit before tax for our UK Investment Business on the Full EV basis was 1% lower in 2008 at £342m (H1 2007 £345m), due to lower new business volumes in the first half of 2008, partly offset by growth in the contribution from existing business. The table below analyses this result:

	Half year ended 30.06.2008	Half year ended 30.06.2007

	Life & Pensions Insurance Contracts £m	**Life & Pensions Investment Contracts £m**	**Mutual Funds Investment Contracts £m**	**Total £m**	Life & Pensions Insurance Contracts £m	Life & Pensions Investment Contracts £m	Mutual Funds Investment Contracts £m	Total £m
Contribution from existing business								
Expected contribution	**79**	**72**	**32**	**183**	76	64	31	171
Actual vs expected experience	**72**	**(86)**	**22**	**8**	34	(51)	(14)	(31)
	151	**(14)**	**54**	**191**	110	13	17	140
Contribution from new business	**103**	**42**	**50**	**195**	142	71	60	273
Investment earnings on net assets	**68**	**4**		**72**	54	4		58
Contribution from Investment Business	**322**	**32**	**104**	**458**	306	88	77	471
Development expenditure*	**(30)**			**(30)**	(38)			(38)
Overheads associated with development activity*	**(20)**			**(20)**	(24)			(24)
Debt Financing cost*	**(66)**			**(66)**	(64)			(64)
Underlying profit before tax	**206**	**32**	**104**	**342**	180*	88	77	345

* Development costs, overheads and financing costs have been attributed to Life & Pensions Insurance Contracts business for presentational purposes only.

The contribution from new business under the Full EV basis decreased by 29% in 2008 to £195m (H1 2007 £273m) due to lower new business volumes in the first half of 2008. In addition, we have experienced changes in business mix which have further reduced the new business contribution compared to the first half of 2007. Most notably we have seen lower sales of single premium products, particularly bonds, reflecting volatile markets and economic uncertainty which has led many investors to defer investments in equity based products. This has been offset in part by increased sales of mutual fund, ISA and pensions business which, whilst still generating good returns, make a lower contribution to profit compared to bonds.

The contribution from existing business increased by 36% to £191m (H1 2007 £140m). The expected contribution improved by 7% to £183m (H1 2007 £171m) reflecting the growing in-force book of existing business. Our business is at a relatively early stage of development and hence the contribution to profit from in-force business is smaller than that for some of our longer established peers, but it continues to grow. Positive actual vs expected experience in 2008 was £8m (H1 2007 £(31)m). Actual vs expected persistency experience was £63m adverse (H1 2007 £83m) however, this charge has reduced since H1 2007, despite volatile market conditions. This has been offset by other favourable experience including benefits from enhancements to actuarial modelling and positive experience on expenses and mortality.

Actual vs Expected experience for Investment contracts includes a negative adjustment of £63m in respect of the transfer of certain Intermediary bond business to insurance contracts. There is a corresponding positive adjustment within Actual vs Expected experience for Insurance contracts and hence no impact on overall Full EV underlying profit.

SUPPLEMENTARY EV INFORMATION

Reconciliation of IFRS to Full EV

A reconciliation of underlying profit before tax on the Full EV basis with the reported IFRS basis is set out below.

	Half year ended 30.06.2008				Half year ended 30.06.2007			
	Life & Pensions Insurance Contracts £m	Life & Pensions Investment Contracts £m	Mutual Funds Investment Contracts £m	Total £m	Life & Pensions Insurance Contracts £m	Life & Pensions Investment Contracts £m	Mutual Funds Investment Contracts £m	Total £m
Underlying profit before tax (IFRS basis)	**206**	**13**	**7**	**226**	180	34	(5)	209
Additional contribution from new business		**122**	**96**	**218**		128	127	255
Lower contribution from existing business		**(103)**	**1**	**(102)**		(78)	(45)	(123)
Additional investment earnings on net assets						4		4
Increase in underlying profit before tax		**19**	**97**	**116**		54	82	136
Underlying profit before tax (Full EV basis)	**206**	**32**	**104**	**342**	180*	88	77	345

Moving to the Full EV basis results in earlier recognition of profits from sales of new investment contracts, offset in part by the subsequent recognition of lower profits on existing investment contracts. The Full EV basis, unlike the IFRS basis, recognises profits on new business at the point of sale with the contribution from existing business consisting only of the unwind of the discount rate related to the net present value of future cashflows and changes in experience compared to that initially modelled at the point of sale.

The contribution from new investment contracts under the Full EV basis was £218m (H1 2007 £255m) higher than under the reported IFRS result. The difference between new business contributions on an IFRS and Full EV basis is £37m lower than in 2007, reflecting a greater proportion of insurance contract sales relative to investment contracts.

Under the Full EV basis, the contribution from existing business in 2008 was £102m (H1 2007 £123m) lower than under the IFRS basis, the Full EV basis contribution from existing investment contract business being £44m (including £4m investment return on investment contract net assets) compared to £146m under the IFRS basis.

SUPPLEMENTARY EV INFORMATION

New Business Profitability

Long term assurance businesses have historically disclosed new business in terms of APE and have calculated new business margins as a percentage of APE. There is a growing opinion across the industry that APE does not have a close correlation with the underlying profitability of new business and consequently the industry is moving to provide disclosure on the PVNBP basis, including measuring new business profitability with reference to PVNBP. New business profitability for the UK Investment Business (including both Life & Pensions and Mutual Funds) calculated by using the Full EV basis, as a percentage of PVNBP, is set out below.

	Half year ended 30.06.2008			Half year ended 30.06.2007		
	New Business PVNBP* £m	**New Business Contribution £m**	**New Business Profitability %PVNBP**	New Business PVNBP* £m	New Business Contribution £m	New Business Profitability %PVNBP

Bancassurance	**2,880**	**113**	**3.9**	4,279	177	4.1
Intermediary	**1,938**	**18**	**0.9**	1,853	24	1.3
Wealth Management	**1,653**	**64**	**3.9**	1,681	72	4.3
Total	**6,471**	**195**	**3.0**	7,813	273	3.5
Life & Pensions	**4,897**	**145**	**3.0**	6,325	213	3.4
Mutual Funds	**1,574**	**50**	**3.2**	1,488	60	4.0
Total	**6,471**	**195**	**3.0**	7,813	273	3.5

* Excluding business (£730m PVNBP in 2008, £468m in 2007) distributed but not manufactured by the Group.

New business profitability decreased to 3.0% of PVNBP (H1 2007 3.5%, H2 2007 3.1%). This fall was driven by changes in sales mix, principally due to lower sales of single premium bonds. The most significant impact was in Bancassurance where market conditions have had the greatest effect, with many sales in this channel being to first time investors. Despite these reductions, margins remain relatively strong, driven by the profitability of Bancassurance and SJP, and the strength and efficiency of our distribution continues to be an important advantage.

Balance Sheet Information

The total net of tax embedded value of UK Investment Business on the Full EV basis is as follows:

	As at 30.06.2008				As at 31.12.2007			
	Life & Pensions Insurance Contracts £m	**Life & Pensions Investment Contracts £m**	**Mutual Funds Investment Contracts £m**	**Total £m**	Life & Pensions Insurance Contracts £m	Life & Pensions Investment Contracts £m	Mutual Funds Investment Contracts £m	Total £m
Shareholder funds	**2,709**	**502**	**231**	**3,442**	2,573	500	238	3,311
Value of in-force business (net of tax)	**1,495**	**1,284**	**624**	**3,403**	1,497	1,376	610	3,483
Total embedded value (net of tax)*	**4,204**	**1,786**	**855**	**6,845**	4,070	1,876	848	6,794

* Total embedded value excludes subordinated debt liabilities for the UK Investment Business of £1,074m (2006 £1,014m).

The table below analyses the movement in embedded value of our UK Investment Business on the Full EV basis:

	Half year ended 30.06.2008			
	Life & Pensions Insurance Contracts £m	**Life & Pensions Investment Contracts £m**	**Mutual Funds Investment Contracts £m**	**Total £m**
Opening embedded value	4,070	1,876	848	6,794
Contribution from Investment business	322	32	104	458
Development costs, associated overheads and financing costs *	(116)			(116)
Underlying profit before tax	206	32	104	342
Short term investment fluctuations	(117)	(158)	(81)	(356)
Underlying tax charge	105	12	(17)	100
Dividends paid	(75)	(12)		(87)
Other capital movements	15	36	1	52
Movement in embedded value for the year	134	(90)	7	51
Closing embedded value	**4,204**	**1,786**	**855**	**6,845**

* Development costs, overheads and financing costs have been attributed to Life & Pensions Insurance Contracts business for presentational purposes only.

TIMETABLE AND CONTACTS

Expected Timetable

31 July 2008	Interim Results Announcement
6 August 2008	6.475% preference shares quoted ex-dividend
8 August 2008	6.475% preference shares record date
15 September 2008	6.475% preference shares dividend payment
1 October 2008	Ordinary shares Capitalisation Issue ex-date
3 October 2008	Ordinary shares Capitalisation Issue record date
6 October 2008	Ordinary shares Capitalisation Issue shares issued and admitted to trading
8 October 2008	6.0884% preference shares quoted ex-dividend
10 October 2008	6.0884% preference shares record date
5 November 2008	9¼% & 9¾% preference shares quoted ex-dividend
7 November 2008	9¼% & 9¾% preference shares record date
12 November 2008	6.0884% preference shares dividend payment
19 November 2008	Interim Management Statement
1 December 2008	9¼% & 9¾% preference shares dividend payment
25 February 2009	2008 Preliminary Results Announcement

Contacts

Investor Relations

Charles Wycks
Director of Investor Relations
(0131) 243 5509
(020) 7905 9600
charleswycks@hbosplc.com

John Hope
Director, Investor Relations
(0131) 243 5508
(020) 7905 9600
johnhope@hbosplc.com

Press Office

Shane O'Riordain
General Manager, Group Communications
(020) 7905 9600
07770 544585 (mobile)
shaneo'riordain@hbosplc.com