Lloyds Banking Group plc
Form 6-K
July 26, 2012

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934

26 July 2012

LLOYDS BANKING GROUP plc
(Translation of registrant's name into English)

5th Floor
25 Gresham Street
London
EC2V 7HN
United Kingdom

(Address of principal executive offices)

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

Form 20-F..X..   Form 40-F.....

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

Yes .....   No ..X..

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

Index to Exhibits

Item

No. 1 Regulatory News Service Announcement, dated 26 July 2012
re: 2012 Half-Year Results

2012 Half-Year Results
News Release

Lloyds Banking Group plc

26 July 2012

BASIS OF PRESENTATION

This report covers the results of Lloyds Banking Group plc (the Company) together with its subsidiaries (the Group) for the half-year ended 30 June 2012.

Statutory basis

Statutory results are set out on pages 146 to 186. However, a number of factors have had a significant effect on the comparability of the Group's financial position and results. As a result, comparison on a statutory basis of the 2012 results with 2011 is of limited benefit.

Management basis

In order to present a more meaningful view of underlying business performance, the results of the Group and divisions are presented on a management basis. The key principles adopted in the preparation of the management basis of reporting are described below.

· In order to reflect the impact of the acquisition of HBOS, the following adjustments have been made:

– the amortisation of purchased intangible assets has been excluded; and

– the unwind of acquisition-related fair value adjustments is shown on one line in the management basis income statement, other than unwind related to asset sales which is included within the effects of asset sales, volatile items and liability management.

· In order to better present the business performance the effects of liability management, volatile items and asset sales are shown on separate lines in the management basis consolidated income statement and 'underlying profit' is profit before taking into account these items and fair value unwind. Comparatives have been restated accordingly.

· The following items, not related to acquisition accounting, have also been excluded from management profit:

– volatility arising in insurance businesses;
– integration and Simplification costs;
– EC mandated retail business disposal costs;
– payment protection insurance;
– insurance gross up;
– certain past service pensions credits in respect of the Group's defined benefit pension schemes; and
– provision in relation to German insurance business litigation.

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

The Group's core and non-core activities are not managed separately and the preparation of this information requires management to make estimates and assumptions that impact the reported income statements, balance sheet, regulatory capital related and risk amounts analysed as core and as non-core. The Group uses a methodology that categorises income and expenses as non-core only where management expect that the income or expense will cease to be earned or incurred when the associated asset or liability is divested or run-off, and allocates operational costs to the core portfolio unless they are directly related to non-core activities. This results in the reported operating costs for the non-core portfolios being less than would be required to manage these portfolios on a stand-alone basis. Due to the inherent uncertainty in making estimates, a different methodology or a different estimate of the allocation might result in a different proportion of the Group's income or expenses being allocated to the core and non-core portfolios, different assets and liabilities being deemed core or non-core and accordingly a different allocation of the regulatory effects.

Unless otherwise stated income statement commentaries throughout this document compare the half-year to 30 June 2012 to the half-year to 30 June 2011, and the balance sheet analysis compares the Group balance sheet as at 30 June 2012 to the Group balance sheet as at 31 December 2011.

FORWARD LOOKING STATEMENTS

This announcement contains forward looking statements with respect to the business, strategy and plans of the Lloyds Banking Group, its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about the Group or the Group's management's beliefs and expectations, are forward looking statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will or may occur in the future. The Group's actual future business, strategy, plans and/or results may differ materially from those expressed or implied in these forward looking statements as a result of a variety of risks, uncertainties and other factors, including UK domestic and global economic and business conditions; the ability to derive cost savings and other benefits, including as a result of the Group's Simplification programme; the ability to access sufficient funding to meet the Group's liquidity needs; changes to the Group's credit ratings; risks concerning borrower or counterparty credit quality; instability in the global financial markets, including Eurozone instability; changing demographic and market related trends; changes in customer preferences; changes to laws, regulation, accounting standards or taxation, including changes to regulatory capital or liquidity requirements; the policies and actions of governmental or regulatory authorities in the UK, the European Union, or jurisdictions outside the UK, including other European countries and the US; the implementation of the draft EU crisis management framework directive and banking reform following the recommendations made by the Independent Commission on Banking; the ability to attract and retain senior management and other employees; requirements or limitations imposed on the Group as a result of HM Treasury's investment in the Group; the ability to complete satisfactorily the disposal of certain assets as part of the Group's EC state aid obligations; the extent of any future impairment charges or write-downs caused by depressed asset valuations, market disruptions and illiquid markets; the effects of competition and the actions of competitors, including non-bank financial services and lending companies; exposure to regulatory scrutiny, legal proceedings, regulatory investigations or complaints, and other factors. Please refer to the latest Annual Report on Form 20-F filed with the US Securities and Exchange Commission for a discussion of certain factors together with examples of forward looking statements. The forward looking statements contained in this announcement are made as at the date of this announcement, and the Group undertakes no obligation to update any of its forward looking statements.

CONTENTS

LLOYDS BANKING GROUP PLC 2012 HALF-YEAR RESULTS

'These half-year results show a continuation of what we delivered in the first quarter: significant balance sheet reshaping and another resilient performance against a backdrop of economic challenges and a lack of public confidence in our industry. We are on track to deliver our strategic aims and we are making significant progress with our financial targets. We are building a stronger and safer Group: one with a more robust balance sheet, lower exposure to risk and with lower operating costs. This is enabling us to increase our support to UK households, businesses and communities.

To realise our full potential, we must deal with various issues from the past that continue to affect us. The mandated branch divestment, Verde, is a legacy issue and I'm pleased that we have come to an agreement with The Co-operative Group plc that will establish them as an effective competitor in the UK banking market. The deal provides certainty for our shareholders and I also believe that the Co-operative will be a good home for our customers and colleagues. Mis-sold Payment Protection Insurance policies are an industry legacy issue but by redressing those affected quickly we continue to do the right thing for our customers. We will tackle issues from the past in a way that will, in the long run, allow us to earn back customer trust and confidence.

Lloyds Banking Group is a very different organisation to our main competitors. We will continue to demonstrate that in our actions and our words. We believe there is real competitive advantage in moving faster to become a ring fenced UK retail and commercial bank, and this will be another important step toward providing sustainable returns for our shareholders and support to our customers and communities. By doing that we will return the bank to profitability and that will ultimately give taxpayers the opportunity to get their money back.'

António Horta-Osório
Group Chief Executive

KEY HIGHLIGHTS

FURTHER GOOD PROGRESS ON STRATEGIC INITIATIVES AND RISK REDUCTION

- Balance sheet further strengthened: Group loan to deposit ratio reduced to 126 per cent (core: 103 per cent) and core tier 1 ratio increased to 11.3 per cent; funding position further strengthened, with wholesale funding decreasing by £37 billion in the first half; strong primary liquidity portfolio of £105 billion, covering more than twice our money market exposure of less than one year maturity of £44 billion.

- Substantial progress in reshaping the business: non-core assets reduced £23 billion to £118 billion, ahead of expectations, and international presence reduced, having now announced disposal or exit from 10 countries.

- Simplification savings on track: Simplification annual run-rate cost savings increased to £512 million.

- Continued investment in core growth and new products and services: Group customer deposit growth of 6 per cent and SME net lending growth of 4 per cent year-on-year.

- Signed heads of terms with The Co-operative Group on Verde.

- Moody's short-term rating re-affirmed for Lloyds TSB Bank plc at P-1; long-term rating A2.

- Management team further strengthened; appointed George Culmer, Andrew Bester and Cathy Turner.

RESILIENT UNDERLYING PERFORMANCE GIVEN CHALLENGING ENVIRONMENT

- Management profit increased 6 per cent to £1,165 million.

- Group underlying profit increased £715 million to £1,064 million, with fall in income more than offset by cost and impairment charge reductions.

- Core underlying profit of £2,977 million, down £231 million, with benefit of lower costs and impairments mitigating the effect of lower income.

- Group return on risk-weighted assets improved to 0.62 per cent from 0.18 per cent in the first half of 2011; core return on risk-weighted assets broadly stable at 2.48 per cent (from 2.50 per cent in the first half of 2011).

- Group banking net interest margin of 1.93 per cent, down 19 basis points compared to the first half of 2011, mainly reflecting higher wholesale funding costs; resilient core banking net interest margin of 2.32 per cent, down 11 basis points.

- Group total costs down 6 per cent with increased investment and inflation more than offset by Simplification savings.

- Group impairment charge reduced 42 per cent, ahead of expectations, with further asset quality improvements, in spite of the difficult environment.

- Statutory loss before tax of £439 million, including a further provision relating to costs of customer contact and redress on legacy Payment Protection Insurance business of £700 million in the second quarter, following an additional £375 million provision in the first quarter.

OUTLOOK AND GUIDANCE

- On track to meet 2012 financial guidance, including for full year banking net interest margin to fall year-on-year by approximately the same amount in 2012 as in 2011. Assuming current economic trends continue, expect the 2012 impairment charge to be lower than previous guidance.

  - Expect achievement of long-term Group loan to deposit ratio target of 120 per cent by end Q1 2013.

- Now expect non-core assets to reduce to below £70 billion by the end of 2014; non-core reporting to cease at that time.

- Increasing clarity on regulatory framework to provide greater certainty to operating environment and recent changes supportive of economic growth; working to accelerate adoption of ring-fence given aligned business model.

- Believe that we can create competitive advantages through a lower risk premium and best-in-class efficiencies and therefore remain confident that our medium-term financial targets are achievable over time.

SUMMARY OF RESULTS

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Management basis (note 1, page 84)				
Total underlying income, net of insurance claims	9,246	11,103	(17)	9,943
Total costs	(5,025)	(5,332)	6	(5,289)
Impairment	(3,157)	(5,422)	42	(4,365)
Underlying profit	1,064	349		289
Management profit	1,165	1,104	6	1,581
Banking net interest margin1	1.93%	2.12%		2.01%
Average interest-earning banking assets	£553.2bn	£596.5bn	(7)	£574.4bn
Cost:income ratio2	54.3%	48.0%		53.2%
Impairment as a % of average advances3	1.10%	1.77%		1.46%
Return on risk-weighted assets4	0.62%	0.18%		0.16%
Management basis – core				
Total underlying income, net of insurance claims	8,602	9,704	(11)	9,061
Total costs	(4,647)	(4,860)	4	(4,822)
Impairment	(978)	(1,636)	40	(1,251)
Underlying profit	2,977	3,208	(7)	2,988
Management profit	2,715	2,866	(5)	3,483
Banking net interest margin1	2.32%	2.43%		2.40%
Average interest-earning banking assets	£426.5bn	£445.9bn	(4)	£431.6bn
Cost:income ratio2	54.0%	50.1%		53.2%
Impairment as a % of average advances3	0.44%	0.72%		0.56%
Return on risk-weighted assets4	2.48%	2.50%		2.40%
Statutory results				
Statutory loss before tax	(439)	(3,251)		(291)
Statutory loss per share	(1.0)p	(3.4)p		(0.7)p

1 The calculation basis for banking net interest margins is set out in note 2 on page 87.
2 Total costs divided by total underlying income net of insurance claims.
3 Impairment on loans and advances to customers divided by average loans and advances to customers, excluding reverse repurchase transactions, gross of allowance for impairment losses.
4 Underlying profit (annualised on day count basis) divided by average risk-weighted assets.

SUMMARY OF RESULTS (continued)

Capital and balance sheet	As at 30 June 2012	As at 31 Dec 2011	Change since 31 Dec 2011 %
Statutory			
Loans and advances to customers1	£534.4bn	£565.6bn	(6)
Customer deposits2	£423.2bn	£413.9bn	2
Loans and advances excluding reverse repos	£528.6bn	£548.8bn	(4)
Customer deposits excluding repos	£419.1bn	£405.9bn	3
Loan to deposit ratio3	126%	135%	
Funded assets	£555.8bn	£587.7bn	(5)
Wholesale funding	£213.8bn	£251.2bn	(15)
Wholesale funding >1 year maturity	£140.5bn	£137.9bn	2
Wholesale funding <1 year maturity	£73.3bn	£113.3bn	(35)
Primary liquid assets	£105.0bn	£94.8bn	11
Risk-weighted assets	£332.5bn	£352.3bn	(6)
Core tier 1 capital ratio	11.3%	10.8%	
Net tangible assets per share	57.4p	58.6p	
Leverage ratio	18 times	17 times	
Core			
Loans and advances to customers excluding reverse repos	£428.5bn	£437.0bn	(2)
Customer deposits excluding repos	£415.9bn	£401.5bn	4
Loan to deposit ratio3	103%	109%	
Risk-weighted assets	£239.1bn	£243.5bn	(2)
Non-core			
Total non-core assets	£117.5bn	£140.7bn	(16)
Risk-weighted assets	£93.4bn	£108.8bn	(14)

1 Includes reverse repos of £5.8 billion (31 December 2011: £16.8 billion).
2 Includes repos of £4.1 billion (31 December 2011: £8.0 billion).
3 Loans and advances to customers (excluding reverse repos) divided by customer deposits (excluding repos).

GROUP CHIEF EXECUTIVE'S STATEMENT

In the first half of the year, we delivered a resilient underlying performance in a challenging environment, with higher Group underlying profits and returns, and continued to make good progress on our strategy to be the best bank for customers, focused on our strong UK retail and commercial franchises.

We continued to strengthen our balance sheet, while reshaping the business through reducing non-core assets, delivering increased savings from our Simplification programme, and continuing to invest in growing our core business.

We also continued to take action to resolve our legacy issues and during the half year announced that we had agreed non-binding heads of terms for the sale to The Co-operative Group plc of the mandated retail and commercial divestment known as Verde, and further increased our provision in relation to the costs of Payment Protection Insurance (PPI) contact and redress.

We further strengthened the Group's senior management team to deliver our strategic objectives and the next phase of the Group's transformation with three appointments to key roles, welcoming George Culmer as Group Finance Director, Cathy Turner as Chief Administrative Officer, and Andrew Bester as Chief Executive, Wholesale.

Results overview
We made further good progress on strengthening our balance sheet and reducing risk, and delivered a resilient underlying performance in a challenging environment. Group returns improved with Group underlying pre-tax return on risk-weighted assets increasing to 0.62 per cent from 0.18 per cent in the first half of 2011, while core returns were broadly stable at 2.48 per cent (from 2.50 per cent in the same period in 2011).

The continued good progress we made on the balance sheet was reflected in the further improvement in key balance sheet ratios, in a further substantial reduction in non-core assets, and in our strong liquidity and funding position. Our core tier 1 ratio improved to 11.3 per cent from 10.8 per cent at 31 December 2011. The Group loan to deposit ratio reduced to 126 per cent from 135 per cent at 31 December 2011, and in the core business fell to 103 per cent from 109 per cent at 31 December 2011.

We further reduced risk through achieving a substantial £23 billion reduction of non-core assets to £118 billion, maintained a strong liquidity position, including £105 billion of primary liquid assets, and continued to strengthen our funding position, by reducing wholesale funding by £37 billion, completing our 2012 funding programme and by delivering further growth in customer deposits (excluding repos) of 3 per cent in the half year (6 per cent over the last year) through our multi-brand strategy.

The substantial progress we are making in reducing risk and delivering on our strategic initiatives was reflected in the outcome of Moody's Investors Service (Moody's) rating review of Lloyds TSB Bank plc, which was part of a rating review across 114 financial institutions. Moody's confirmed that Lloyds TSB Bank plc's short-term Prime-1 rating remained unchanged, while the longer-term senior debt and deposit ratings were lowered by only one notch to A2 from A1.

Group underlying profit increased by £715 million to £1,064 million, due to the benefits of the actions we have taken to reduce costs and the impairment charge, which offset a reduction in underlying income. When compared to the first half of 2011, Group total costs fell 6 per cent, principally driven by further savings from our Simplification programme, and impairment reduced 42 per cent, from the continued application of our prudent risk appetite and strong risk management controls resulting in improved portfolio and new business quality. Underlying income, net of insurance claims, reduced by 17 per cent compared to the same period in 2011, driven mainly by further non-core asset reductions and subdued demand for new lending, and by a lower banking net interest margin, which declined as expected by 19 basis points to 1.93 per cent mainly as a result of higher wholesale funding costs.

GROUP CHIEF EXECUTIVE'S STATEMENT (continued)

Our core business delivered a resilient underlying performance given the challenging environment, with return on risk-weighted assets broadly stable at 2.48 per cent. Underlying profit was down 7 per cent to £2,977 million, as a result of underlying income falling 11 per cent to £8,602 million, with core margin reducing by 11 basis points to 2.32 per cent, and subdued demand resulting in core loans and advances declining by 2 per cent compared to the first half of 2011. These effects were only partly offset by a substantial reduction of 40 per cent in the impairment charge and a 4 per cent reduction in total costs.

Our statutory results included a further provision for contact and redress in relation to legacy PPI business totalling £1,075 million in the half year as a result of an increase in the volume of complaints being received, and the costs of our Simplification programme and the Verde disposal of £513 million. As a result, the Group reported a loss before tax of £439 million in the half year.

Further good progress on strategic initiatives

In addition to further strengthening our balance sheet, we continued to make further good progress in the first half of 2012 on the execution of the other elements of our strategic plan to be the best bank for our customers.

In reshaping our business portfolio, the rigorous controls we have put in place over the risk profile of all new business have delivered improving credit quality trends across the Group. This helped to achieve a further reduction in the impairment charge across all divisions when compared to the first half of 2011 and therefore a reduction in the Group charge of 42 per cent to £3,157 million.

As well as further reducing our non-core assets, we have made further good progress in reducing our international presence, having now announced the disposal or exit from 10 countries. In addition, during the first half of 2012 we have announced a reduced presence in a further three locations.

The improving quality of our portfolios and their decreasing risk profile, has also been reflected in a 6 per cent decrease in risk-weighted assets when compared to December 2011.

Our Simplification programme is now well under way and is showing strong momentum in streamlining operations and processes, delayering management structures, consolidating supplier relationships and increasing efficiency. As a result we increased the annual run-rate cost savings achieved under the programme by £270 million in the first half, bringing the annual run-rate at the end of June 2012 to £512 million. We remain on track to deliver annual run-rate cost savings of £1.9 billion by the end of 2014.

Our customers are also benefiting from simpler processes and products, and these benefits are in turn helping to improve customer advocacy and customer acquisition and retention. Notable examples include our current account switching service, which has been awarded a 4 star rating by Defaqto, our new digital technologies in Retail and in Wholesale, and the pilot of our new lending process in Commercial which has halved the time to fulfil lending for our SME customers.

We have continued to invest to grow our core customer businesses using a proportion of the savings realised from our Simplification programme. While the overall environment remains subdued, we have continued to strengthen our franchise and deepen our customer relationships through the launch of new products and services.

In Retail, we have capitalised on our multi-brand strategy by further developing our key relationship brands, Halifax, Lloyds TSB and Bank of Scotland, with new products launched, and over 200 Lloyds TSB branches now refurbished. Notable product and service successes have included the Halifax Savers' Prize Draw with over 900,000 customer registrations received, our internet banking service which now has nine million active users, and our mobile banking apps which now have two and a half million active users.

GROUP CHIEF EXECUTIVE'S STATEMENT (continued)

In Wholesale, we have made the strongest improvement of any UK bank in relationship quality with our customers over the last 12 months (as reported by Greenwich Associates), driven by improving coverage and product capabilities, although we started from a low baseline. These product capabilities include our Arena platform, for which over 2,000 customers have now signed up, and our capital markets franchise which has increased its league table positions and enhanced its market shares in Corporate Sterling and Corporate Euro (Investment Grade) debt capital markets.

In Commercial, our commitment to support our SME customers through developing an integrated SME proposition resulted in a year-on-year increase in core loans and advances to customers of 4 per cent (as described in more detail below), and in June we launched the Guardian 'Small Business Network' to encourage start-up businesses, and provide access to expertise on exporting to new markets, improving cash flow management and winning new business.

Insurance is focusing on simplifying service and claims processes and has implemented a new organisational design allowing greater flexibility in responding to the changing market place to ensure it is better placed to serve customer needs ahead of the Retail Distribution Review (RDR) coming into effect from 1 January 2013. Insurance is supporting the Group strategic initiative to build lasting relationships with our bancassurance customers through the introduction of new advice models, enhanced products and access to new direct channels, and has further enhanced its Protection for Life plan through the addition of the new Essential Earnings Cover (EEC) products.

In Wealth, Asset Finance and International, significant investment is being made in developing compelling propositions for affluent and high net worth customers, a key growth opportunity. In the first half, we saw a 3 per cent increase in customer numbers in the affluent proposition in the UK franchise, while we are further improving customer experience by simplifying customer processes.

Further details on the progress we have made against our strategic initiatives in each business are given in each of the divisional reviews.

Supporting our customers and helping the UK prosper

We continue to actively support sustainable growth in the UK economy through the focused range of products and services we provide to our business and personal customers, as well as through partnerships we have built with industry and Government.

In support of the SME sector, the Group is on track to exceed its SME Charter commitment of £12 billion of lending in 2012 through the core Commercial business, and has now increased this commitment by £1 billion given the benefit of the UK Government's Funding for Lending Scheme. This will be supported by at least 200 customer networking events which we expect to be a key platform for recruitment and customer support. Commercial's core net lending balance growth of 4 per cent compares favourably with the continued contraction of SME lending across the industry reported by the Bank of England.

Commercial encourages enterprise by helping people start in business and has supported over 64,000 start-up businesses already in 2012 making a total of over 292,000 towards our three year commitment to help 300,000 businesses. More than 300 members of Lloyds Banking Group's staff are now trained as mentors to businesses from pre-start up to growth, and social enterprises.

For our Retail customers, we are committed to supporting the UK housing market and first-time buyers in particular. Our new mortgage lending continued to be focused on home purchase with over 70 per cent of lending being for house purchase rather than re-mortgaging. Retail remains the UK's largest lender to first-time buyers, helping over 25,000 customers buy their first home in the first half of 2012, supported by a number of propositions including NewBuy, stamp duty and local lend-a-hand schemes.

GROUP CHIEF EXECUTIVE'S STATEMENT (continued)

Further reducing customer complaints

We have committed to reduce banking complaints per 1,000 accounts to 1.3 by the end of 2012, and are making good progress towards our complaint reduction target, having achieved 1.4 complaints per 1,000 accounts in the half year. We achieved an 18 per cent reduction in our FSA reportable complaints (excluding PPI) compared to the first half of 2011, and reduced our banking complaints by 21 per cent in the same period. This has been achieved primarily through implementation of initiatives to remove the causes of complaints, including ensuring that our telephone banking teams now have the ability to see all details of earmarked transactions on a customer's account. We have also made it easier for our customers to complain by launching a new online complaint form for our three major brands. We expect to continue to improve the customer experience in the second half of 2012 and achieve our complaint reduction target of 1.3 banking complaints per 1,000 accounts by the end of the year.

Awards for our products and services

We received a number of external awards in the first half recognising our products and services, and the support we provide to our customers.

We were awarded 'Bank of the Year' for the eighth consecutive year at the FDs' Excellence Awards (in association with the Institute of Chartered Accountants in England and Wales and supported by the CBI), underlining the strength of our relationships with, and the support we give to, our business customers.

The improvements we are making in our products for business customers were also recognised, inter alia, at the Euroweek Bond Awards 2012, where we won the 'Most Improved Corporate Debt Capital Markets Team' award, and at the Business Moneyfacts Awards 2012, where Arena won the 'Best Innovation in the SME Finance Sector' award, while Scottish Widows was awarded 'Best Group Pension Provider' in the Corporate Adviser awards and 'Best Personal Pensions Provider' in the Professional Adviser Awards.

Heads of terms signed on EC mandated retail business disposal (Project Verde)

After the half year end, we announced that we had agreed non-binding heads of terms with The Co-operative Group plc for the mandated retail and commercial divestment known as Verde, providing greater certainty for our customers and for our shareholders, and allowing us to share in the future financial performance of the Co-operative Group's combined banking business which will be an effective challenger in the market with a strong customer focus.

We will continue to work with the Co-operative to agree a sale and purchase agreement, with completion of the divestment expected by the end of November 2013, and, having had constructive discussions on the transaction with the relevant governmental and regulatory bodies, we will now seek formal approval for the terms of the divestment.

Further detail on the Verde business and the heads of terms are given in the Group Finance Director's review on page 25 of this announcement.

GROUP CHIEF EXECUTIVE'S STATEMENT (continued)

Payment Protection Insurance (PPI) provision

During 2012 there has been an increase in the volume of complaints being received in relation to legacy PPI business. As a result, the Group increased its provision by a further £700 million during the second quarter of 2012, following a £375 million increase in the first quarter, to cover the anticipated redress in relation to these increased volumes. This increases the total estimated cost of redress to £4,275 million.

There are still a number of uncertainties as to the eventual costs from any such contact and redress given the inherent difficulties of assessing the impact of the detailed implementation of the Policy Statement for all PPI complaints, uncertainties around the ultimate emergence period for complaints, the availability of supporting evidence and the activities of claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs. Further detail is given in note 21 on page 175.

Equity dividends

We remain committed to recommencing progressive dividend payments, when the financial position of the Group and market conditions permit, and after regulatory capital requirements are defined and prudently met.

Our capital position continues to strengthen, with our core tier 1 capital ratio increased by 0.5 per cent in the first half to 11.3 per cent, and by 0.6 per cent to an indicative 7.7 per cent on a fully loaded Basel 3 basis, while our total capital increased by 1.0 per cent to 16.6 per cent.

Outlook

As outlined at our 2011 full year results, we continue to believe that, while the outlook for the UK economy remains subdued and also vulnerable to developments in the Eurozone, the most likely scenario is for a relatively flat economy in the second half of this year with a progressive recovery in 2013. As a result, our assumptions for UK base rates, inflation and property prices remain broadly unchanged.

Our operating model positions us well to deliver in the new external environment. Our strategy is enabling us to deliver improved Group underlying results and resilient returns in our core business, even in this challenging environment. We have built a solid foundation for growth, with a strengthened balance sheet, reduced risk, improved efficiency and lower costs. This is now providing us with greater commercial flexibility and increases our options for growth. We also expect that recent regulatory changes, such as a growth agenda, and the Funding for Lending scheme, will help us support economic growth and we believe that we are well positioned for the changes expected from the banking reform White Paper, given our capital strength and the alignment of our business model with the White Paper's ring-fencing goals.

In the remainder of 2012, therefore, we expect a continued resilient underlying business performance and remain on track to meet the 2012 financial guidance we set out in our full year 2011 results in February, including for banking net interest margin to fall year-on-year by approximately the same amount in 2012 as in 2011. Moreover, following a better than expected performance in the first half, and assuming current economic trends continue, we now anticipate that our 2012 impairment charge will be lower than our previous guidance in spite of decreasing non-core assets by more than originally anticipated. We are also targeting achievement of a long-term loan to deposit ratio of 120 per cent by end Q1 2013, and now expect our non-core assets to reduce to below £70 billion by the end of 2014, with non-core reporting to cease at that time.

We believe that we can create competitive advantages through attaining a lower risk premium and best-in-class efficiency and therefore we remain confident that our medium-term financial targets are achievable over time, and that we are well positioned to realise the Group's full potential for growth from our strategy of being a simple, customer-focused UK retail and commercial bank.

António Horta-Osório
Group Chief Executive

MANAGEMENT BASIS INFORMATION

The analysis and commentary set out on pages 11 to 89 is presented on a management basis as defined on the inside front cover. Within the management income statement the profit or loss arising from asset sales, volatile items, liability management actions and fair value unwind are each shown on one line. The accelerated unwind of fair value resulting from asset sales is included within the asset sales line. Comparatives have been restated accordingly.

CONSOLIDATED INCOME STATEMENT

	Half-year to 30 June 2012 £ million	Half-year to 30 June 2011 £ million	Half-year to 31 Dec 2011 £ million
Net interest income	5,215	6,355	5,855
Other income	4,264	4,946	4,233
Insurance claims	(233)	(198)	(145)
Total underlying income, net of insurance claims	9,246	11,103	9,943
Total costs	(5,025)	(5,332)	(5,289)
Impairment	(3,157)	(5,422)	(4,365)
Underlying profit	1,064	349	289
Effects of asset sales, volatile items and liability management	(56)	(264)	1,105
Fair value unwind	157	1,019	187
Management profit	1,165	1,104	1,581
Volatility arising in insurance businesses	(24)	(177)	(661)
Simplification, EC mandated retail business disposal costs and Integration	(513)	(689)	(763)
Payment protection insurance provision	(1,075)	(3,200)	–
Past service pensions credit	250	–	–
Amortisation of purchased intangibles	(242)	(289)	(273)
Provision in relation to German insurance business litigation	–	–	(175)
Loss before tax – statutory	(439)	(3,251)	(291)
Taxation	(202)	973	(145)
Loss for the period	(641)	(2,278)	(436)
Loss per share	(1.0)p	(3.4)p	(0.7)p

MANAGEMENT BASIS CONSOLIDATED CORE AND NON-CORE INCOME STATEMENTS

Core	Half-year to 30 June 2012 £ million	Half-year to 30 June 2011 £ million	Half-year to 31 Dec 2011 £ million
Net interest income	4,948	5,536	5,357
Other income	3,887	4,366	3,849
Insurance claims	(233)	(198)	(145)
Total underlying income, net of insurance claims	8,602	9,704	9,061
Total costs	(4,647)	(4,860)	(4,822)
Impairment	(978)	(1,636)	(1,251)
Underlying profit	2,977	3,208	2,988
Effects of asset sales, volatile items and liability management	–	(245)	1,026
Fair value unwind	(262)	(97)	(531)
Management profit	2,715	2,866	3,483
Banking net interest margin	2.32%	2.43%	2.40%
Cost:income ratio	54.0%	50.1%	53.2%
Impairment as a % of average advances	0.44%	0.72%	0.56%
Return on risk-weighted assets	2.48%	2.50%	2.40%

Non-core			
Net interest income	267	819	498
Other income	377	580	384
Insurance claims	–	–	–
Total underlying income, net of insurance claims	644	1,399	882
Total costs	(378)	(472)	(467)
Impairment	(2,179)	(3,786)	(3,114)
Underlying loss	(1,913)	(2,859)	(2,699)
Effects of asset sales, volatile items and liability management	(56)	(19)	79
Fair value unwind	419	1,116	718
Management loss	(1,550)	(1,762)	(1,902)
Banking net interest margin	0.60%	1.20%	0.81%
Impairment as a % of average advances	3.33%	4.87%	4.32%

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

Non-core portfolios consist of non-relationship assets and liabilities together with assets and liabilities which are outside the Group's current risk appetite.

SUMMARY CONSOLIDATED BALANCE SHEET

Assets	As at 30 June 2012 £ million	As at 31 Dec 2011 £ million
Cash and balances at central banks	87,590	60,722
Trading and other financial assets at fair value through profit or loss	145,626	139,510
Derivative financial instruments	58,347	66,013
Loans and receivables:		
Loans and advances to customers	534,445	565,638
Loans and advances to banks	31,779	32,606
Debt securities	6,429	12,470
	572,653	610,714
Available-for-sale financial assets	32,810	37,406
Held-to-maturity investments	10,933	8,098
Other assets	53,412	48,083
Total assets	961,371	970,546

Liabilities		
Deposits from banks	44,895	39,810
Customer deposits	423,238	413,906
Trading and other financial liabilities at fair value through profit or loss	37,424	24,955
Derivative financial instruments	50,153	58,212
Debt securities in issue	150,513	185,059
Liabilities arising from insurance and investment contracts	131,199	128,927
Subordinated liabilities	34,752	35,089
Other liabilities	42,568	37,994
Total liabilities	914,742	923,952
Total equity	46,629	46,594

GROUP FINANCE DIRECTOR'S REVIEW OF FINANCIAL PERFORMANCE

Overview

In the first half of 2012, we made further good progress in strengthening our balance sheet and reducing risk, increased Group underlying profit, and delivered a resilient performance in the core business. Our non-core business performance reflected the substantial asset reductions achieved in the half, while our statutory results were affected by further provisions for contact and redress costs in relation to legacy Payment Protection Insurance (PPI) business.

Balance sheet strengthened and risk further reduced

In line with our strategy, we made further good progress in strengthening our balance sheet and reducing risk by significantly reducing non-core assets by £23.2 billion to £117.5 billion, strengthening our core tier 1 capital ratio by 0.5 per cent to 11.3 per cent and increasing our primary liquidity portfolio to £105.0 billion. The non-core asset reduction and further deposit growth of 3 per cent (excluding repos) in the half year (6 per cent year-on-year) have allowed us to further improve our funding position, with total wholesale funding reduced to £213.8 billion from £251.2 billion at the end of 2011, with funding with a maturity of less than one year representing less than 35 per cent of total wholesale funding, and money market funding with a maturity of less than one year representing 21 per cent. We have also completed our 2012 term funding programme and have improved the maturity profile of our wholesale funding, such that 65.7 per cent of our wholesale funding now has a maturity of more than one year. As part of reducing risk within the business, we have also made further progress towards addressing a number of legacy issues, including the Verde divestiture and PPI.

Improved Group underlying profitability

The Group delivered an underlying profit of £1,064 million, an increase of £715 million when compared to the first half of 2011. This increase was primarily driven by a 6 per cent reduction in costs, mostly from Simplification savings, and substantially lower impairment (down 42 per cent, reflecting further asset quality improvements overall and our strong credit risk management approach and close management of the quality of new business), more than offsetting the 17 per cent fall in underlying income.

Resilient core business performance

The core business delivered a resilient performance. Underlying profit was £2,977 million, with the core return on risk-weighted assets broadly stable at 2.48 per cent. The movement of £231 million in underlying profit was driven mainly by a reduction in core underlying income of 11 per cent, reflecting subdued lending demand and continued customer deleveraging, partially mitigated by a further reduction in costs and the impairment charge. Net interest margin declined by 11 basis points year-on-year, and 8 basis points in the first half of 2012. This was mainly as a result of higher wholesale funding costs, mitigated by an improved funding mix, with the core loan to deposit ratio further reduced to 103 per cent, and the benefits of asset repricing. The 4 per cent reduction in costs was principally as a result of Simplification savings, while the 40 per cent decrease in the impairment charge was driven by continued improvement in the quality of our portfolios.

Non-core results reflect asset reductions

The non-core loss of £1,913 million reflects the substantial reduction in non-core assets of £44.9 billion achieved since June 2011, and the impact of higher wholesale funding costs on net interest margin which fell by 60 basis points to 0.60 per cent given that the non-core portfolio is almost entirely wholesale funded.

Management and statutory results

Management profit, which incorporates the effects of asset sales, volatile items and liability management along with fair value unwind was £1,165 million in the first half of 2012, an increase of £61 million when compared to the first half of 2011. Statutory loss before tax was £439 million in the first half of 2012, reflecting amongst other things, provisions in relation to legacy PPI business totalling £1,075 million and charges totalling £513 million, of which £274 million related to Simplification and £239 million to costs of the EC mandated retail business disposal. Further detail on the reconciliation to management and statutory results is included on page 24.

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

Balance sheet

Improved capital ratios and further progress on balance sheet reduction

Our core tier 1 capital ratio increased to 11.3 per cent at the end of June 2012 (30 June 2011: 10.1 per cent), principally driven by a reduction in risk-weighted assets of £50.8 billion since 30 June 2011. The total capital ratio improved to 16.6 per cent (30 June 2011: 15.0 per cent).

	As at 30 June 2012	As at 30 June 2011	Change %	As at 31 Dec 2011	Change %
Funded assets	£555.8bn	£612.0bn	(9)	£587.7bn	(5)
Risk-weighted assets	£332.5bn	£383.3bn	(13)	£352.3bn	(6)
Non-core assets	£117.5bn	£162.4bn	(28)	£140.7bn	(16)
Non-core risk-weighted assets	£93.4bn	£128.7bn	(27)	£108.8bn	(14)
Core tier 1 capital ratio	11.3%	10.1%		10.8%	
Tier 1 capital ratio	13.0%	11.6%		12.5%	
Total capital ratio	16.6%	15.0%		15.6%	

Risk-weighted assets reduced by 6 per cent to £332.5 billion in the first half of 2012, driven by the reduction in our non-core asset portfolio, subdued demand for new lending, and continued improvements to the overall quality of our portfolios, partially offset by the application of revised regulatory rules relating to the Group's private equity (including venture capital) investments which are now risk-weighted rather than being deducted from total capital. The removal of this deduction from total capital contributes to the improvement in the total capital ratio.

Total Group funded assets decreased to £555.8 billion from £612.0 billion at 30 June 2011, primarily driven by the reduction in our non-core asset portfolio, and continued customer deleveraging resulting from subdued demand in core lending markets.

The fall in non-core risk-weighted assets over the last year is in line with the asset reductions achieved and reflects the substantial decrease in risk we have achieved over this period.

We are pleased with the progress made on our balance sheet reduction plans, given challenging market conditions. In the first half of 2012, we achieved a substantial reduction in the non-core portfolio of £23.2 billion, resulting in the portfolio at 30 June 2012 amounting to £117.5 billion. This included reductions of £10.6 billion in treasury assets, £2.5 billion in UK commercial real estate and £5.2 billion in International assets of which £2.0 billion was in Ireland and £1.3 billion in Australasia.

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

Further strengthening our liquidity and funding position
The Group further enhanced its funding and liquidity position in the first half of 2012. We saw continued growth in customer deposits (excluding repos), which increased by 3 per cent, reflecting good growth in both our Retail and Wealth, Asset Finance and International divisions. Customer deposits (excluding repos) have grown by 6 per cent since 30 June 2011.

The Group has also made excellent progress in the first half of 2012 with respect to our term wholesale funding objectives with £19.5 billion of wholesale term issuance. Adding this to the £1.7 billion of pre-funding in 2011 and the £4.7 billion benefit from 2011 liability management exercises, we have (as communicated in the Group's Q1 IMS) now completed our 2012 wholesale term issuance plan. Looking ahead to 2013 we expect the Group's public term funding requirement to be less than £10 billion.

	As at 30 June 2012	As at 30 June 2011	Change %	As at 31 Dec 2011	Change %
Customer deposits1	£419.1bn	£394.9bn	6	£405.9bn	3
Wholesale funding	£213.8bn	£295.6bn	(28)	£251.2bn	(15)
Wholesale funding <1 year maturity	£73.3bn	£151.7bn	(52)	£113.3bn	(35)
Of which money market funding <1 year maturity	£44.4bn	£92.9bn	(52)	£69.1bn	(36)
Loan to deposit ratio2	126%	144%		135%	
Core business loan to deposit ratio2	103%	114%		109%	
Government facilities	£4.9bn	£37.1bn	(87)	£23.5bn	(79)
Wholesale funding >1 year maturity	66%	49%		55%	
Primary liquid assets	£105.0bn	£100.9bn	4	£94.8bn	11

1 Excluding repos of £4.1 billion (30 June 2011: £5.0 billion, 31 December 2011: £8.0 billion).
2 Excluding repos and reverse repos.

Wholesale funding reduced by 28 per cent since 30 June 2011 to £213.8 billion. The combination of customer deposit growth, the successful Q1 term issuance programme and the reduction in funded assets has allowed us to aggressively reduce the Group's short-term money-market funding and further improve the maturity profile of wholesale funding. At 30 June 2012, 66 per cent of wholesale funding had a maturity date greater than one year, compared to 49 per cent at 30 June 2011.

By the end of the first half, our Group loan to deposit ratio, excluding repos and reverse repos, had improved to 126 per cent. Our core loan to deposit ratio also improved to 103 per cent from 109 per cent at 31 December 2011. We are now targeting a long-term Group loan to deposit ratio of 120 per cent and assuming a continuation of current market conditions we expect to achieve this target by the end of March 2013.

The Group continued to make repayments under the legacy Credit Guarantee Scheme, achieving a reduction of £18.6 billion in the first half and leaving only £4.9 billion outstanding at the end of June. The remaining debt will mature during the second half of 2012.

In the first quarter, the Group drew €13.5 billion (the Sterling equivalent of which at the date of drawdown was £11.2 billion) under the European Central Bank's Long-Term Refinancing Operation for an initial term of three years, to part fund a pool of non-core euro denominated assets.

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

The Group also continues to maintain a strong liquidity position. Our primary liquid assets portfolio at the half year end was £105.0 billion, an increase of £4.1 billion since 30 June 2011. This represents approximately 223 per cent of our money market funding positions at end June 2012 and is approximately 143 per cent of all wholesale funding with a maturity of less than a year, thus providing a substantial buffer in the event of market dislocation.

In addition to primary liquidity holdings, the Group has significant secondary liquidity holdings of more than £100 billion eligible for use in open market operations and liquidity facilities at a number of central banks of which the Group makes use as part of its liquidity management practices. Use of such facilities will be based on prudent liquidity management and economic considerations, having regard for external market conditions.

The Group welcomes the announcements made at the Mansion House in June 2012 aimed at reducing the pressure from liquidity regulation to deleverage the balance sheet. The combination of the Extended Collateral Term Repo facility (ECTR), Funding for Lending and the potential widening of the definition of primary liquidity under FSA rules strengthens the liquidity position of the UK banking sector and provides a framework for an increased supply of credit to the UK economy.

Given the strong liquidity position and the reduced requirement for funding, the Group decided to tender for certain GBP, Euro and USD senior unsecured securities, to manage its overall wholesale funding level and optimise its future interest expense, whilst maintaining a prudent approach to liquidity. The tender offers closed on 9 July 2012 with £1.4 billion accepted in the non-US tender offer and US$4.9 billion accepted in the US tender offer.

From 31 January 2010 the Group was prohibited under the terms of an agreement with the European Commission from paying discretionary coupons and dividends on hybrid capital securities issued by the Company and certain of its subsidiaries. This prohibition ended on 31 January 2012. Future coupons and dividends on hybrid capital securities will be paid subject to, and in accordance with, the terms of those securities.

During the period the Group issued £170 million of new ordinary shares in relation to payment of coupons in 2012 on hybrid capital securities that are non-cumulative. This decision was taken by the Group in the context of recent macro prudential policy discussions.

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

Total income

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	5,215	6,355	(18)	5,855
Other income	4,264	4,946	(14)	4,233
Insurance claims	(233)	(198)	(18)	(145)
Total underlying income	9,246	11,103	(17)	9,943
Banking net interest margin	1.93%	2.12%		2.01%
Banking asset margin	1.10%	1.54%		1.38%
Banking liability margin	1.19%	0.97%		0.98%
Average interest-earning banking assets	£553.2bn	£596.5bn	(7)	£574.4bn

Total underlying income was down 17 per cent, reflecting reductions in net interest income and other income, and increased insurance claims.

Group net interest income decreased by 18 per cent to £5,215 million. This fall reflects the decrease of 7 per cent in average interest-earning banking assets, as a result of subdued economic environment which affected demand for new credit and continued customer deleveraging in the core business, together with non-core asset reductions, and the reduction in net interest margin.

Banking net interest margin decreased 19 basis points to 1.93 per cent, principally reflecting higher wholesale funding costs and competitive deposit markets, which have more than offset the benefits of repricing certain lending portfolios, and the improved funding mix as reflected in the improvement in our loan to deposit ratio from 135 per cent at 31 December 2011 to 126 per cent at 30 June 2012. Banking asset margin declined to 1.10 per cent as a result of higher wholesale funding costs, which were, however, mitigated by asset repricing. The 22 basis point increase in the banking liability margin reflected the increased value of deposits to the Group, partly offset by the effects of competitive deposit markets.

Other income decreased by 14 per cent to £4,264 million compared with the first half of 2011. Income from non-lending activities has fallen as a result of subdued demand and the run-off of non-core assets. In addition the subdued economic environment has affected the level of income from funds management, and returns in the Insurance business. However, Commercial saw an increase in business activity levels, while our Retail business benefited from sales of newly-launched protection products.

Insurance claims increased, principally reflecting adverse property claims in our General Insurance business as a result of weather events.

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

Core underlying income

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	4,948	5,536	(11)	5,357
Other income	3,887	4,366	(11)	3,849
Insurance claims	(233)	(198)	(18)	(145)
Core underlying income, net of insurance claims	8,602	9,704	(11)	9,061
Banking net interest margin	2.32%	2.43%		2.40%
Average interest-earning banking assets	£426.5bn	£445.9bn	(4)	£431.6bn

Core net interest income fell by 11 per cent, principally reflecting subdued new lending demand and continued customer deleveraging, with average interest-earning banking assets decreasing by 4 per cent, and a lower banking net interest margin.

Core net interest margin fell 11 basis points, mainly reflecting higher wholesale funding costs, but was more resilient than at the Group level due to the benefits of asset repricing and improved funding mix.

Core other income fell 11 per cent reflecting, as in the Group as a whole, subdued demand for new lending and the effects of the economic environment, although these were partly offset by strong performances in some areas.

Insurance claims increased, principally reflecting adverse property claims in our General Insurance business as a result of weather events.

Non-core underlying income

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	267	819	(67)	498
Other income	377	580	(35)	384
Non-core underlying income	644	1,399	(54)	882
Banking net interest margin	0.60%	1.20%		0.81%
Average interest-earning banking assets	£126.7bn	£150.6bn	(16)	£142.8bn

The 54 per cent fall in underlying non-core income reflects the significant de-risking achieved from the targeted reduction in non-core portfolios of £44.9 billion since the end of June 2011, the further movement of assets to non-performing status, and a lower net interest margin.

Net interest income fell by 67 per cent as a result of the reduction in average interest earning assets of 16 per cent, and the decrease in net interest margin, primarily as a result of higher wholesale funding costs, with both of these metrics also adversely affected by a reduction in income from assets becoming newly impaired.

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

Total costs

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Core	4,647	4,860	4	4,822
Non-core	378	472	20	467
Total costs	5,025	5,332	6	5,289
Simplification savings annual run-rate	512	–		242

Total costs decreased by 6 per cent compared to the first half of 2011, mainly as a result of the realisation of Simplification-related savings, partly offset by inflationary pressures and investment in our core business. In accordance with accounting requirements no accrual has been made in the first half for the UK bank levy.

Core total costs reduced by 4 per cent driven by the same factors as in the Group, while in the non-core business, the reduction of 20 per cent was mainly a result of the elimination of certain support costs for the non-core portfolios.

As at 30 June 2012, we had realised annual run-rate cost savings of £512 million from our programme to simplify the Group, an increase of £270 million since 31 December 2011 with the programme having contributed in year cost savings of £298 million.

The Simplification programme continues to make good progress and a strong pipeline of early deliverables has seen the successful implementation of a number of initiatives in the first half of 2012 that not only reduce costs, but also enhance customer service. Examples include a fully re-engineered process for setting up and handling customer accounts transferred from other banks, a redesigned General Insurance claims handling process, a streamlined Commercial lending process and improvements to internet banking customer enrolment.

We remain on track to deliver our increased targets of £1.7 billion of savings in 2014 and £1.9 billion of annual run-rate savings by the end of 2014.

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

Impairment

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Core	978	1,636	40	1,251
Non-core	2,179	3,786	42	3,114
Total impairment	3,157	5,422	42	4,365

The Group impairment charge of £3,157 million in the first half of 2012 was 42 per cent lower than in the first half of 2011. This was principally driven by a reduction in the non-core impairment charge, reflecting lower charges in the Group's wholesale Irish and Australasian businesses, with the core charge also reducing as a result of a continued low interest rate environment and the overall improvement in asset quality.

The reduction in the Group charge was ahead of our expectations, and continues to benefit from the application of our prudent risk appetite and strong risk management controls resulting in improved portfolio and new business quality, from continued low interest rates, and broadly stable UK retail property prices. These benefits were partly offset by subdued UK economic growth, high unemployment and a weak commercial real estate market.

Impaired loans decreased by 12 per cent compared to December 2011 to £53 billion, representing 9 per cent of closing advances, mainly driven by reductions in Wholesale and in Wealth, Asset Finance and International. The Group's coverage ratio increased by 2 per cent to 49 per cent.

Core impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Retail	735	1,052	30	744
Wholesale	111	407	73	334
Commercial	116	160	28	136
Wealth, Asset Finance and International	16	17	6	34
Central items	–	–		3
Core impairment	978	1,636	40	1,251

The core impairment charge decreased by £658 million, or 40 per cent, compared to the charge in the first half of 2011. The reduction was principally driven by the decrease in Retail as a result of reductions in the unsecured charge, and in Wholesale and Commercial, which reflected robust and proactive risk management, an appropriately impaired portfolio (against our current economic assumptions), and a low interest rate environment helping to maintain defaults at a lower level.

GROUP FINANCE DIRECTOR’S REVIEW OF FINANCIAL PERFORMANCE (continued)

Non-core impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Retail	23	121	81	53
Wholesale	882	1,035	15	925
Commercial	(7)	–		7
Wealth, Asset Finance and International	1,281	2,630	51	2,129
Non-core impairment	2,179	3,786	42	3,114

The non-core impairment charge reduced by £1,607 million, or 42 per cent compared to the charge in the first half of 2011, principally as a result of a material reduction in Wealth, Asset Finance and International reflecting lower charges in the Group’s wholesale Irish and Australasian businesses.

Non-core loans and advances to customers generated 76 per cent of the Group's impaired loans reflecting their higher risk profile, with a coverage ratio of 51 per cent at 30 June 2012 (30 June 2011: 47 per cent).

GROUP FINANCE DIRECTOR’S REVIEW OF FINANCIAL PERFORMANCE (continued)

Management profit

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Half-year to 31 Dec 2011 £m
Underlying profit	1,064	349	289
Own debt volatility	(357)	(250)	434
Asset and bond sales1	585	88	196
Other volatile items	(452)	(102)	(820)
Liability management	168	–	1,295
Fair value unwind	157	1,019	187
Management profit	1,165	1,104	1,581

1 Net of associated fair value unwind of £603 million (30 June 2011: £649 million).

Own debt volatility includes a £205 million charge relating to the change in fair value of the small proportion of the Group’s wholesale funding which was designated at fair value at inception. This compares to a £203 million gain in the second half of 2011, and a £14 million charge in the first half of 2011. Own debt volatility also includes a £152 million charge relating to the change in fair value of the equity conversion feature of the Enhanced Capital Notes, which principally reflects the ongoing amortisation of the value of the conversion feature over its life.

Asset and bond sales of £585 million comprise the loss on asset disposals, which principally comprised non-core asset reductions, and resulted in net losses on disposal of £73 million including fair value unwind benefits of £603 million, and gains on bond sales as we repositioned the available-for-sale portfolio of Government securities.

Other volatile items includes the change in fair value of interest rate derivatives and foreign exchange hedges in the banking book not mitigated through hedge accounting. A charge of £529 million was included in the first half of 2012 and reflected the volatile market conditions that resulted in substantial changes in interest and foreign exchange rates in the period. Also included was a positive net derivative valuation adjustment of £77 million, reflecting a reduction in the market implied credit risk associated with customer derivative balances.

Liability management gains of £168 million arose on transactions undertaken as part of the Group’s management of capital, largely the exchange of certain debt securities for other debt instruments, comprising £109 million recognised in statutory net interest income and £59 million recognised in statutory other income. There were no such gains in the first half of 2011.

Management profit also includes a gain of £157 million relating to an unwind of acquisition-related fair value adjustments. The unwind of fair value relating to assets disposed in the period is included in the asset sales line.

GROUP FINANCE DIRECTOR’S REVIEW OF FINANCIAL PERFORMANCE (continued)

Statutory profit

	Half-year to 30 June 2012 £ million	Half-year to 30 June 2011 £ million	Half-year to 31 Dec 2011 £ million
Management profit	1,165	1,104	1,581
Volatility arising in insurance businesses	(24)	(177)	(661)
Simplification, EC mandated retail business disposal costs, and integration costs	(513)	(689)	(763)
Payment protection insurance provision	(1,075)	(3,200)	–
Past service pensions credit	250	–	–
Amortisation of purchased intangibles	(242)	(289)	(273)
Provision in relation to German insurance business litigation	–	–	(175)
Loss before tax – statutory	(439)	(3,251)	(291)
Taxation	(202)	973	(145)
Loss for the period	(641)	(2,278)	(436)
Loss per share	(1.0)p	(3.4)p	(0.7)p

Volatility arising in insurance businesses

The Group's statutory result before tax is affected by insurance volatility, caused by movements in financial markets, and policyholder interests volatility, which primarily reflects the gross up of policyholder tax included in the Group tax charge. In the first half of 2012 the Group’s statutory result before tax included negative insurance and policyholder interests volatility totalling £24 million compared to negative volatility of £177 million in the first half of 2011. Further detail is given in note 3 on page 88.

Simplification, EC mandated retail business disposal costs, and integration costs

The costs of the Simplification programme were £274 million in the first half of 2012. These costs related to severance, IT and business costs of implementation. 4,555 FTE role reductions were announced in the first half of 2012 taking the total to 6,653 since the start of the programme. Simplification of our business operations continues through reduction in management layers and increasing spans of control as well as restructuring business units. The latter includes consolidation of back office operations sites, optimisation of our model for delivery of IT and outsourcing of our property facilities and asset management services. Costs relating to the EC mandated business disposal in the first half of 2012 were £239 million and from inception to date total £451 million (costs in the year ended 31 December 2011: £170 million). There were no integration costs in the first half of 2012.

Payment protection insurance (PPI)

The Group provided £3,200 million in 2011 in respect of the anticipated costs of contact and/or redress, including administration expenses, in relation to legacy PPI business. During 2012 there has been an increase in the volume of complaints being received in relation to PPI, although other assumptions continue to be in line with expectations. As a result, the Group has increased its provision by a further £1,075 million during the first half of 2012 (of which £375 million was reflected in the first quarter) to cover the anticipated redress in relation to these increased volumes. This increases the total estimated cost of contact and redress to £4,275 million; redress payments made and expenses incurred to the end of June 2012 amounted to £2,955 million. However, there are still a number of uncertainties as to the eventual costs from any such contact and/or redress given the inherent difficulties of assessing the impact of the detailed implementation of the Policy Statement for all PPI complaints, uncertainties around the ultimate emergence period for complaints, the availability of supporting evidence and the activities of claims management companies, all of which will significantly affect complaints volumes, uphold rates and redress costs. Further detail is given in note 21 on page 175.

Past service pensions credit

Following a review of policy in respect of discretionary pension increases in relation to the Group's defined benefit pension schemes, increases in certain schemes are now linked to the Consumer Price Index rather than the Retail Price Index. The impact of this change is a reduction in the Group's defined benefit obligation of £250 million, the benefit of which is recognised in the Group's income statement in the first half of 2012.

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

Taxation
The tax charge for the first half of 2012 was £202 million. This represents a greater tax burden than the credit implied by the UK statutory rate. This is primarily due to a policyholder tax charge of £338 million, and the £120 million effect of the UK corporation tax rate reduction to 24 per cent on the net deferred tax asset.

EC mandated retail business disposal (Project Verde)
On 19 July 2012, we announced that we had agreed non-binding heads of terms with The Co-operative Group plc (Co-operative) for the mandated retail and commercial divestment known as Verde.

Under the heads of terms, the Co-operative will pay on completion an initial consideration of £350 million, and up to an additional £400 million in present value – equivalent to around £800 million on a nominal basis – based on the performance of the Co-operative's combined banking business from completion up to 2027. The initial consideration will be funded through the sale by Co-operative of perpetual subordinated debt, underwritten by Lloyds Banking Group.

We expect to deliver the Verde business with £1.5 billion of equity capital assuming a standardised capital model. Under an Internal Ratings Based (IRB) capital model and subject to regulatory approval, the equity capital requirement is expected to be in the range of £1.2 billion to £1.4 billion. We intend to apply for an IRB approach to be adopted prior to completion. The Verde business will have approximately £11 billion of risk-weighted assets on a standardised basis.

The completion of the divestment is currently expected to be recognised in our 2013 financial statements. We expect that the loss on disposal will be broadly offset by lower capital requirements from a reduction in our risk-weighted assets. The divestment is not expected to have a material effect on our future profitability.

Further progress made towards addressing legacy issues
We made further progress in the half towards addressing a number of legacy issues that we are committed to resolving. These include PPI and the Verde divestiture, as already described, and we have also agreed with the FSA to carry out a thorough assessment of interest rate hedging product sales to small and medium-sized businesses. On conclusion of this assessment, we have undertaken to provide redress to SME customers where appropriate. However, based on our analysis to date, the total cost of this redress is not expected to be material.

In other areas, we have received a number of claims in the German courts relating to policies issued by Clerical Medical Investment Group Limited, principally during the late 1990s and early 2000s, and recognised a provision of £175 million in respect of this litigation in 2011. Following a decision on 11 July 2012 by the German Federal Court of Justice to remand five cases back to their respective Courts of Appeal, there a risk that the ultimate outcome of this litigation could be more unfavourable than previously assessed.

We continue to co-operate with investigations by several government agencies in the UK, US and overseas into submissions made to the bodies that set various interbank offered rates. In addition the Group has been named in private lawsuits in the US including with regard to the setting of BBA London interbank offered rates. It is currently not possible to predict the scope and ultimate outcome of the various regulatory investigations or private lawsuits, including the timing and scale of the potential impact of any investigations and private lawsuits on the Group.

Further detail on these matters is contained in notes 21 and 22 on pages 175 to 179 of this announcement.

Conclusion

The resilient underlying returns we have delivered in our core business in the first half of the year reflect the strength of the Group's franchise, and the potential we have to capitalise on future opportunities for growth and therefore to deliver strong, stable and sustainable returns for shareholders. In the second half of the year, our focus will remain on further strengthening the balance sheet and reducing costs and risk, while ensuring that we deliver a resilient core business performance and continue to invest behind opportunities for growth within our core business.

George Culmer
Group Finance Director

MANAGEMENT BASIS SEGMENTAL ANALYSIS

Half-year to 30 June 2012	Retail £m	Wholesale £m	Commercial £m	Wealth, Asset Finance and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	3,490	554	587	448	(37)	173	5,215
Other income	766	1,261	210	1,031	1,156	(160)	4,264
Insurance claims	–	–	–	–	(233)	–	(233)
Total underlying income, net of insurance claims	4,256	1,815	797	1,479	886	13	9,246
Total costs	(2,089)	(808)	(433)	(1,177)	(384)	(134)	(5,025)
Impairment	(758)	(993)	(109)	(1,297)	–	–	(3,157)
Underlying profit (loss)	1,409	14	255	(995)	502	(121)	1,064
Asset sales1	–	(42)	–	(31)	–	658	585
Volatile items	–	17	–	–	–	(826)	(809)
Liability management	–	–	–	–	–	168	168
Fair value unwind1	241	410	16	(38)	(21)	(451)	157
Management profit (loss)	1,650	399	271	(1,064)	481	(572)	1,165
Banking net interest margin	2.02%	1.12%	3.98%	1.45%			1.93%
Cost:income ratio	49.1%	44.5%	54.3%	79.6%	43.3%		54.3%
Impairment as a % of average advances	0.43%	1.52%	0.72%	4.31%			1.10%
Return on risk-weighted assets	2.79%	0.02%	2.03%	(3.68)%			0.62%
Key balance sheet items As at 30 June 2012	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	347.0	108.2	29.3	43.9		0.2	528.6
Customer deposits excluding repos	254.7	81.2	33.5	49.7		–	419.1
Total customer balances	601.7	189.4	62.8	93.6		0.2	947.7
Risk-weighted assets	100.2	143.2	24.9	51.5		12.7	332.5

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During the first half of the 2012, the Group has changed the presentation of the fair value unwind to include those amounts related to asset sales within that line item. Comparative figures have been restated accordingly.

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MANAGEMENT BASIS SEGMENTAL ANALYSIS (continued)

Half-year to 30 June 2011	Retail £m	Wholesale £m	Commercial £m	Wealth, Asset Finance and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	3,870	969	634	642	(25)	265	6,355
Other income	846	1,387	208	1,221	1,319	(35)	4,946
Insurance claims	–	–	–	–	(198)	–	(198)
Total underlying income, net of insurance claims	4,716	2,356	842	1,863	1,096	230	11,103
Total costs	(2,221)	(816)	(471)	(1,288)	(415)	(121)	(5,332)
Impairment	(1,173)	(1,442)	(160)	(2,647)	–	–	(5,422)
Underlying profit (loss)	1,322	98	211	(2,072)	681	109	349
Asset sales1	41	(1)	–	(21)	–	69	88
Volatile items	–	61	–	–	–	(413)	(352)
Liability management	–	–	–	–	–	–	–
Fair value unwind1	544	902	26	104	(21)	(536)	1,019
Management profit (loss)	1,907	1,060	237	(1,989)	660	(771)	1,104
Banking net interest margin	2.14%	1.47%	4.27%	1.64%			2.12%
Cost:income ratio	47.1%	34.6%	55.9%	69.1%	37.9%		48.0%
Impairment as a % of average advances	0.65%	1.98%	1.07%	7.21%			1.77%
Return on risk-weighted assets	2.44%	0.11%	1.59%	(6.05)%			0.18%
Key balance sheet items As at 30 June 2011	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	357.8	122.5	28.7	58.6		0.5	568.1
Customer deposits excluding repos	242.3	80.9	32.7	38.9		0.1	394.9
Total customer balances	600.1	203.4	61.4	97.5		0.6	963.0
Risk-weighted assets	109.6	165.8	26.8	67.2		13.9	383.3

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During the first half of the 2012, the Group has changed the presentation of the fair value unwind to include those amounts related to asset sales within that line item. Comparative figures have been restated accordingly.

MANAGEMENT BASIS SEGMENTAL ANALYSIS (continued)

Half-year to 31 Dec 2011	Retail	Wholesale	Commercial	Wealth, Asset Finance and Int'l	Insurance	Group Operations and Central items	Group
	£m	£m	£m	£m	£m	£m	£m
Net interest income	3,627	791	617	542	(42)	320	5,855
Other income	814	899	218	1,103	1,368	(169)	4,233
Insurance claims	–	–	–	–	(145)	–	(145)
Total underlying income, net of insurance claims	4,441	1,690	835	1,645	1,181	151	9,943
Total costs	(2,217)	(718)	(477)	(1,244)	(397)	(236)	(5,289)
Impairment	(797)	(1,259)	(143)	(2,163)	–	(3)	(4,365)
Underlying profit (loss)	1,427	(287)	215	(1,762)	784	(88)	289
Asset sales1	7	62	–	–	–	127	196
Volatile items	–	(797)	–	–	–	411	(386)
Liability management	–	–	–	–	–	1,295	1,295
Fair value unwind1	295	535	27	90	(22)	(738)	187
Management profit (loss)	1,729	(487)	242	(1,672)	762	1,007	1,581
Banking net interest margin	2.04%	1.29%	4.15%	1.52%			2.01%
Cost:income ratio	49.9%	42.5%	57.1%	75.6%	33.6%		53.2%
Impairment as a % of average advances	0.44%	1.87%	1.04%	6.28%			1.46%
Return on risk-weighted assets	2.68%	(0.36)%	1.65%	(5.89)%			0.16%
Key balance sheet items							
As at 31 December 2011	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	352.8	116.9	28.8	50.2		0.1	548.8
Customer deposits excluding repos	247.1	84.3	32.1	42.0		0.4	405.9
Total customer balances	599.9	201.2	60.9	92.2		0.5	954.7

Risk-weighted assets	103.2	154.4	25.4	56.7		12.6	352.3

1 During the first half of the 2012, the Group has changed the presentation of the fair value unwind to include those amounts related to asset sales within that line item. Comparative figures have been restated accordingly.

DIVISIONAL PERFORMANCE

RETAIL

Key highlights

- Underlying profit increased by 7 per cent, to £1,409 million compared to the first half of 2011, and the return on risk-weighted assets remained strong at 2.79 per cent despite the challenging operating environment.

- Total underlying income fell by 10percent, to £4,256 million, driven by reduced demand for lending, increased funding costs and prior de-risking of the balance sheet. Whilst the prior de-risking has suppressed income growth, importantly, it has also supported an offsetting reduction in impairment charges. The net interest margin declined to 2.02 per cent, with its reduction slowing in the first half as the rate of funding cost increases moderated.

- Total costs declined by 6percent, to £2,089 million, as a result of strong cost control and the benefits from the Simplification programme. This was partially offset by ongoing cost inflation and investment in the business for future growth. Organisation structure changes, sourcing efficiencies and process simplification all made a contribution to the reduction in costs.

- The impairment charge reduced by 35percent, to £758 million, as Retail continues to benefit from previous credit management which has more than offset the impact of the subdued economic environment. This has been supported by a continued sustainable approach to risk, effective portfolio management, and a focus on lending to existing customers.

- Loans and advances to customers excluding reverse repos decreased by 2percent, compared with December 2011, driven by reduced customer demand for new credit, existing customers continuing to reduce their personal indebtedness, non-core lending run-off and Retail maintaining a sustainable approach to risk. The reduction in lending to customers was in part due to the repayment of unsecured debt where balances reduced by 5 per cent. Secured balances reduced by £4.7 billion, or 1 per cent, of which £0.7 billion was a reduction in non-core mortgage balances. Risk-weighted assets fell 3 per cent largely driven by lower lending balances.

- Customer deposits excluding repos increased by 3percent, compared with December 2011, against a market that experienced modest growth. The solid performance reflected the compelling multi-brand customer proposition Retail has developed. This strong deposit growth, in addition to the issuance of debt securities backed by Retail assets, provided ongoing support to the Group funding position.

- In delivering its strategic objectives, Retail remains focused on building a strong platform for growth when economic conditions improve, based on delivering deeper customer relationships. This is driven by investment in Simplification, our multi-brand strategy, new products, multiple channels, and in building the skills and capabilities of all colleagues. Retail has particularly focused on delivering new digital technologies, such as the rapidly growing mobile banking channel. The Simplification programme is an important enabler of our investment in growth and Retail has continued to make good headway with simplifying its processes and improving the efficiency of IT systems.

RETAIL (continued)

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	3,490	3,870	(10)	3,627
Other income	766	846	(9)	814
Total underlying income	4,256	4,716	(10)	4,441
Total costs	(2,089)	(2,221)	6	(2,217)
Impairment	(758)	(1,173)	35	(797)
Underlying profit	1,409	1,322	7	1,427
Banking net interest margin	2.02%	2.14%		2.04%
Cost:income ratio	49.1%	47.1%		49.9%
Impairment as a % of average advances	0.43%	0.65%		0.44%
Return on risk-weighted assets	2.79%	2.44%		2.68%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos:			
Secured	324.4	329.1	(1)
Unsecured	22.6	23.7	(5)
	347.0	352.8	(2)
Customer deposits excluding repos:			
Savings	212.8	206.3	3
Current accounts	41.9	40.8	3
	254.7	247.1	3
Total customer balances	601.7	599.9	
Risk-weighted assets	100.2	103.2	(3)

RETAIL (continued)

Core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	3,464	3,688	(6)	3,558
Other income	757	836	(9)	802
Total underlying income	4,221	4,524	(7)	4,360
Total costs	(2,086)	(2,218)	6	(2,214)
Impairment	(735)	(1,052)	30	(744)
Underlying profit	1,400	1,254	12	1,402
Banking net interest margin	2.17%	2.23%		2.18%
Cost:income ratio	49.4%	49.0%		50.8%
Impairment as a % of average advances	0.45%	0.63%		0.45%
Return on risk-weighted assets	3.09%	2.58%		2.93%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	320.1	325.1	(2)
Customer deposits excluding repos	254.7	247.1	3
Total customer balances	574.8	572.2	
Risk-weighted assets	90.4	92.6	(2)

Non-core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	26	182	(86)	69
Other income	9	10	(10)	12
Total underlying income	35	192	(82)	81
Total costs	(3)	(3)		(3)
Impairment	(23)	(121)	81	(53)
Underlying profit	9	68	(87)	25
Banking net interest margin	0.19%	1.19%		0.46%

Impairment as a % of average advances	0.17%	0.81%	0.36%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	26.9	27.7	(3)
Customer deposits excluding repos	–	–	
Total customer balances	26.9	27.7	(3)
Risk-weighted assets	9.8	10.6	(8)

RETAIL (continued)

Strategic focus

Retail's goal is to be the UK's best bank for customers. We will achieve this by building deep and enduring relationships with our customers that will deliver real value to them, and by continuing to support the UK economy. We will increase our engagement with our customers by delivering greater choice and flexibility through our multiple brands and channels. At the same time we will simplify the business to increase our agility and enable us to respond quicker to customers' needs, and so deliver an improved customer experience. By further developing our customer insight and gaining a deeper understanding of our customers, we will better align our products and services to our customers' requirements. This will increase customer advocacy and we are confident it will also lead to lower customer acquisition costs, greater share of wallet and improved customer retention.

Progress against strategic initiatives

Reshaping the business and strengthening our balance sheet

Retail is building a business that is driven by customers' needs. Our current focus is on ensuring our product and service developments are supporting sustainable growth while at the same time maintaining an appropriate risk appetite.

Our drive to build a strong business which effectively supports the UK economy has been helped by recent developments to our mortgage proposition, particularly those supporting first time buyers getting onto the property ladder. We helped those customers affected by the end of the stamp duty exemption by extending our offer to pay 50 per cent of home mover's duty fee. This meant we supported one in four first time buyers with their home purchase in the first half of 2012. As the leading new-build property mortgage lender, we have launched the NewBuy mortgage proposition to support the Government led initiative, aiming to assist customers with limited deposits to buy a 'new build' home.

In order to deliver a solid platform for growth it is critical that we have a strong and stable source of funding. We have been investing in our savings business to ensure we have differentiated products across our brands that appeal to our customers. This range includes the Savers' Prize Draw which we launched in Halifax in October last year. This has proved very popular with both new and existing Halifax customers, and we have received over 900,000 registrations to date. We have paid out upwards of £3.5 million in total to more than 6,000 customers who have maintained the minimum qualifying balance of £5,000. This has helped support both new balance growth, existing customer retention and increased customer advocacy.

Simplifying the Bank

We are taking decisive steps towards becoming a simpler organisation, and Retail is making good progress in this area. We are getting smarter and more efficient by becoming simpler and delivering improvements which enable us to take decisions quicker and provide a more effective service to our customers. Our recent integration programme delivered a single banking platform across the vast majority of our brands and channels. We are investing further in our infrastructure to ensure our systems support the future growth of the business and continue to expand our capabilities. In the Lloyds TSB branch network we have rolled out over 300 Immediate Deposit Machines which have already seen 1.3 million transactions migrate from the counter.

We have received recognition for our innovative products so far this year, notably Halifax and Bank of Scotland were highly commended as best current account provider by Moneyfacts. We continue to develop our current account switching service and have recently been the first bank to be awarded a 4 star rating by Defaqto. The ease and simplicity of our switching service across all brands provides customers with greater choice encouraging multiple product switching. Since 2010 the switching service has been used by more than one million customers.

RETAIL (continued)

Investing in Growth

Alongside the Simplification programme, we are making strategic investments in preparation for growth opportunities. Through our multi-brand and multi-channel strategy we will grow the business by delivering deep and enduring customer relationships. We are building the capabilities and skills of our colleagues, and helping the communities in which we operate, and Britain as a whole, to grow and prosper.

We are making additional investment in digital channels for customers to ensure they continue to be as convenient and accessible as possible. These award-winning developments are appealing to customers and in the past year our internet banking user base has grown by 940,000, which takes us to 9 million active users. Our mobile banking app now has two and half million active users, a remarkable increase since its launch in late 2011, and these users now account for almost 25 per cent of our log-ins. These developments have been supported by other innovative new services for customers including our Halifax homebuyer app that provides customers with a one-stop shop for their house search.

We continue to recognise the importance of the branch for many customers. In February 2012 we made a public commitment to maintain the same number of branches for the next three years, including pledging not to close a branch if it is the last in a community. We have started a significant investment programme across the Lloyds TSB branch network which, we believe, will be transformational. This programme targets a number of areas including: upgrading branch interiors; extending opening hours to ensure they are customer centric; simplifying the advisor role structure and improving the queuing experience. Pilots of the revised branch design and structure delivered strong improvements in customer advocacy and new product sales. By the end of June 2012, 211 branches had already been refitted.

Supporting the UK economy and local communities

We know that our support for households is vital to the strength and prosperity of the UK economy and we continue to make a positive contribution. In 2012, amongst other investments, the Group has provided around £30 million to the Lloyds TSB and Bank of Scotland Foundations to help fund grassroots charities working in disadvantaged areas.

Through our community investment agenda we aim to make a lasting difference to the country, focusing on key themes such as financial capability and inclusion and supporting local communities and charities. Our £4 million Money for Life programme helps people across the UK develop vital money management skills, and on the national day of employee volunteering, over 4,500 colleagues used the day to make a difference in their community. In the year of the Olympic and Paralympic games we were also proud to continue our support for National Schools Sport Week which enabled over 12,000 schools and 4.3 million young people to take part in sporting activity.

Balance sheet progress

Retail continued to maintain its relationships with customers during the first half of 2012 with total customer balances remaining stable at £601.7 billion. The mix of these balances moved towards customer deposits as customers reduced their personal indebtedness and Retail continued to make strong progress in attracting savings balances through its multi-brand and multi-channel strategy. This change in customer balance composition has additionally supported the Group’s funding.

Loans and advances to customers decreased by £5.8 billion, or 2 per cent, to £347.0 billion compared to 31 December 2011. This was driven by reduced customer demand for new credit, existing customers continuing to reduce their personal indebtedness, non-core lending run-off and Retail maintaining a sustainable approach to risk. The reduction in lending to customers was in part due to the repayment of unsecured debt where balances reduced by £1.1 billion, or 5 per cent. Secured balances reduced by £4.7 billion, or 1 per cent, of which £0.7 billion was a reduction in non-core mortgage balances.

Retail's gross mortgage lending was £12.3 billion in the first half of 2012 which was equivalent to an estimated market share of 18 per cent. During the first half of the year, Retail continued to increase its lending to first time buyers, helping over 25,000 customers buy their first home in the first half of 2012, equivalent to one in every four in the UK. In addition, Retail continued to focus its new lending on home purchase with over 70 per cent of lending being for house purchase rather than re-mortgaging.

RETAIL (continued)

Risk-weighted assets decreased by £3.0 billion to £100.2 billion compared to 31 December 2011. This decrease was largely driven by the reduction in lending balances.

Total customer deposits increased by £7.6 billion, or 3 per cent, to £254.7 billion in the first half of 2012. The solid performance reflected the successful multi-brand customer propositions and the agile pricing strategy that Retail has developed. Retail continues to perform well in the savings market despite the high levels of competition, with a strong stable of savings brands providing customers with an award-winning range of products to meet their savings needs.

Retail continues to make a significant contribution to Group funding both through customer deposit growth and the supply of assets supporting £68.9 billion of debt securities in external issue. During the year Retail contributed to £10.7 billion of new issuance. The majority of these securitisations are backed by mortgages and have a fixed term repayment schedule and as such provide a stable source of funding for the Group.

Financial performance

Despite the subdued economic environment Retail delivered an underlying profit in the first half of 2012 of £1,409 million which was £87 million, or 7 per cent, higher than the first half of 2011. Retail continued to deliver a strong return on risk-weighted assets delivering a return of 2.79 per cent in the first half of 2012, compared to 2.44 per cent in the first half of 2011.

Total underlying income fell by 10 per cent, to £4,256 million. This was as a result of the reduced demand for lending, increased funding costs and prior de-risking of the balance sheet. Retail has taken a number of actions to offset the pressure on income including making strategic investments and re-pricing of selected mortgage portfolios to reflect rising funding costs.

Net interest income decreased by 10 per cent in the first half of 2012, with net interest margin reducing by 12 basis points to 2.02 per cent when compared to the first half of 2011. Net interest income was particularly constrained by muted demand for lending, previous de-risking of the lending portfolio and increased funding costs including the impact of continued competition for deposits. Whilst the prior de-risking has suppressed income growth, it also supported an offsetting reduction in impairment charges.

Other operating income decreased by 9 per cent in the first half of 2012 to £766 million, largely as a result of lower Bancassurance income as subdued customer demand reflected the investment market environment. This business was also affected by preparation for Retail Distribution Review including advisor restructuring. To support the business in the second half of 2012, new protection products have been launched which are better aligned to customer needs. The fall in other income was also as a result of reductions in lending product fee income.

Total costs fell by 6 per cent compared to the first half of 2011. Total costs benefited from the Simplification programme with successful delivery of end-to-end process enhancements, migration of customers to self-service channels and further improvements in purchasing arrangements across Retail. These Simplification benefits were also supported by other day-to-day cost management activities and, in combination, effectively offset on-going cost inflation and increased investment spend.

Credit performance across the business continued to be strong considering the subdued economic environment and was supported by our sustainable approach to risk, a continued focus on lending to existing customers and low interest rates. The impairment charge on loans and advances decreased by £415 million, or 35 per cent, to £758 million driven by reductions in the unsecured charge. The unsecured impairment charge reduced to £585 million from £878 million in the first half of 2011, reflecting the impact of our sustainable approach to risk (resulting in improved new business quality), effective portfolio management and a reduction in unsecured balances. The secured impairment charge decreased to £173 million from £295 million in the first half of 2011 largely reflecting a reduction in the rate of customers entering arrears and other underlying improvements in the quality of the secured portfolio. While recent credit performance has been strong Retail remains exposed to the economic environment.

WHOLESALE

Key highlights

- Underlying profit in the first half of 2012 was £14 million, compared to £98 million in the first half of 2011, with a 23 per cent fall in total underlying income broadly offset by a 31 per cent decrease in impairments.

- Total underlying income decreased by 23 per cent, driven by a decline of 52 per cent in non-core total underlying income, primarily as a result of asset reductions, with a reduction in core total income of 16 per cent reflecting subdued demand and client deleveraging, and higher funding costs.

- Net interest income decreased by 43 per cent, mainly as a result of the substantial reduction in non-core assets, which decreased 25 per cent, and a decline in net interest margin. Core net interest income was 27 per cent lower, reflecting subdued demand and client deleveraging. Net interest margin fell by 35 basis points, due to the impact of higher funding costs, with limited opportunities for asset re-pricing, and the impact of the non-core reduction programme. Core margin was more resilient, reflecting a more balanced net customer funding position, declining 17 basis points.

- Other income decreased by 9 per cent, with core other income down by 8 per cent, primarily reflecting a one-off income settlement received in the first half of 2011; excluding this, core other income increased by 3 per cent. Non-core other income fell 14 per cent, primarily reflecting non-core asset reductions.

- Total costs were broadly flat, as the benefits of cost management and Simplification initiatives were offset by ongoing investment in core client facing resource and systems. Core costs rose 2 per cent as a result of this investment, while non-core costs reduced 19 per cent, reflecting the non-core portfolio reduction.

- The impairment charge decreased by 31 per cent, principally driven by a 73 per cent reduction in the core impairment charge, as a result of lower impairments in Leveraged Acquisition Finance, Corporate and Mid Markets portfolios, where there were specific large impairments in 2011 which have not been repeated in this period. The non-core impairment charge reduced 15 per cent, driven by lower charges in non-core Leveraged Acquisition Finance exposures.

- Assets decreased by 19 per cent compared to December 2011, reflecting the targeted reduction in the non-core balance sheet. Non-core assets fell by 25 per cent reflecting the disposal programme and run-off of non-core lending. Net lending to core customers (excluding reverse repos) decreased 5 per cent as a result of subdued demand and continued client deleveraging as credit facilities matured and were not renewed by clients. Risk-weighted assets reduced by 7 per cent.

- Customer deposits excluding repos decreased by 4 per cent, however excluding the Markets business and pooled positions, Core deposits increased by 6 per cent.

- In delivering its strategic objectives, Wholesale continued to deepen its relationships with existing core clients through investment in products and capabilities in support of their wider needs. The Transaction Banking Transformation Programme which was initiated in 2011 continues to improve Wholesale’s cash management, payments and trade offerings, alongside which we are enhancing product capabilities in other areas including Interest Rate Management, Foreign Exchange, Debt Capital Markets and Money Markets.

WHOLESALE (continued)

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	554	969	(43)	791
Other income	1,261	1,387	(9)	899
Total underlying income	1,815	2,356	(23)	1,690
Total costs	(808)	(816)	1	(718)
Impairment	(993)	(1,442)	31	(1,259)
Underlying profit (loss)	14	98	(86)	(287)
Banking net interest margin	1.12%	1.47%		1.29%
Cost:income ratio	44.5%	34.6%		42.5%
Impairment as a % of average advances	1.52%	1.98%		1.87%
Return on risk-weighted assets	0.02%	0.11%		(0.36)%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	108.2	116.9	(7)
Reverse repos	5.8	16.8	(65)
Loans and advances to customers	114.0	133.7	(15)
Loans and advances to banks	7.5	8.4	(11)
Debt securities	6.4	12.5	(49)
Available-for-sale financial assets	7.3	12.6	(42)
	135.2	167.2	(19)
Customer deposits excluding repos	81.2	84.3	(4)
Repos	4.1	7.1	(42)
Customer deposits	85.3	91.4	(7)
Risk-weighted assets	143.2	154.4	(7)

WHOLESALE (continued)

Core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	610	835	(27)	766
Other income	991	1,072	(8)	723
Total underlying income	1,601	1,907	(16)	1,489
Total costs	(718)	(705)	(2)	(622)
Impairment	(111)	(407)	73	(334)
Underlying profit	772	795	(3)	533
Banking net interest margin	1.70%	1.87%		1.91%
Cost:income ratio	44.8%	37.0%		41.8%
Impairment as a % of average advances	0.25%	0.96%		0.82%
Return on risk-weighted assets	1.54%	1.50%		1.04%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	72.7	76.3	(5)
Reverse repos	5.8	16.8	(65)
Loans and advances to customers	78.5	93.1	(16)
Loans and advances to banks	7.2	8.2	(12)
Debt securities	0.2	0.2	
Available-for-sale financial assets	2.2	3.1	(29)
	88.1	104.6	(16)
Customer deposits excluding repos	79.0	81.5	(3)
Repos	4.1	7.1	(42)
Customer deposits	83.1	88.6	(6)
Risk-weighted assets	99.8	101.0	(1)

WHOLESALE (continued)

Non-core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	(56)	134		25
Other income	270	315	(14)	176
Total underlying income	214	449	(52)	201
Total costs	(90)	(111)	19	(96)
Impairment	(882)	(1,035)	15	(925)
Underlying loss	(758)	(697)	(9)	(820)
Banking net interest margin	0.29%	0.92%		0.51%
Impairment as a % of average advances	3.56%	3.49%		3.51%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	35.5	40.6	(13)
Reverse repos	–	–	
Loans and advances to customers	35.5	40.6	(13)
Loans and advances to banks	0.3	0.3	
Debt securities	6.2	12.3	(50)
Available-for-sale financial assets	5.1	9.4	(46)
	47.1	62.6	(25)
Customer deposits excluding repos	2.2	2.8	(21)
Repos	–	–	
Customer deposits	2.2	2.8	(21)
Risk-weighted assets	43.4	53.4	(19)

WHOLESALE (continued)

Strategic focus
Wholesale's strategy is to be the best bank for Mid-Markets, Corporate and selected Financial Institutions clients, by supporting them with a focused set of value-added product capabilities. We will continue to strengthen our core client franchise by retaining and deepening recurring, multi-product relationships. We will build on the deep insight we have into client needs to offer a targeted range of lending, Transaction Banking, Risk Management and Capital-light markets products. At the same time, Wholesale will also actively reduce its exposure to mono-line product-driven businesses with returns below the cost of capital.

Progress against strategic initiatives

Reshaping the Business
In order to focus resource on core businesses, Wholesale has continued to make substantial progress in reducing its exposure to capital-intensive, non-relationship portfolios and thereby both reduce risk and improve its customer funding position.

In the first half of 2012, Wholesale reduced non-core assets by £15.5 billion, reducing the overall loan to deposit ratio to 133 per cent, down from 139 per cent at end 2011. Our core lending business continues to have a loan to deposit ratio of less than 100 per cent.

Simplifying the Bank
We have significantly simplified the Wholesale organisational structure to better align and co-ordinate the delivery of our products to match our clients' needs. We are making good progress in a number of initiatives to simplify our end-to-end processes to improve efficiency and enhance responsiveness to our clients.

We continually assess our product range to eliminate marginal products and reduce exposure to capital-intensive businesses that are not part of our core client proposition or do not deliver returns above the cost of capital.

Investing in Growth and Supporting the UK Economy
As part of our investment in products to support our core clients, we are continuing to invest in our Transaction Banking capabilities to help UK businesses optimise their cash management and finance their trade flows. We have enhanced our on-line platform, Arena, with the addition of new features for Commercial and Mid-Corporate clients, including capabilities to view online balances, receive details of transactions, forecast cash flows and carry out analytics across different currencies. This is bringing clear benefits to our clients and in the first half the number of online clients more than doubled, to over 2,000 accounts.

In the first half of 2012, we supported our UK Corporate clients in raising £7.7 billion of financing in the Debt Capital Markets, enabling them to finance and grow their businesses. In Foreign Exchange, we increased our client volumes by 21 per cent compared to the same period last year by delivering further improvement in the way we connect electronically with clients, make prices and manage our risk. We have also improved our rankings in interest rate products, with stronger market penetration, and higher market share and quality scores.

Wholesale attained top 3 and top 20 positions in Investment Grade Corporate Sterling and Corporate Euro debt issuance, with market share increasing by approximately 50 per cent and 120 per cent respectively, and we won the 'Most Improved Corporate Debt Capital Markets Team' award at the Euroweek Bond Awards. In interest rate products Wholesale was rated as number one in a leading professional firm survey of Corporate and Mid-Corporate clients.

The depth and strength of our client relationships was reflected in the award to Wholesale (jointly with Commercial), for the eighth year in a row, of Bank of the Year at the FDs' Excellence Awards (in association with the Institute of Chartered Accountants in England and Wales, supported by the CBI).

WHOLESALE (continued)

Balance sheet progress

In 2012 Wholesale continued to focus on strengthening and de-risking the balance sheet by reducing non-core assets. Assets (comprising loans and advances to customers and banks, reverse repos, debt securities and available-for-sale financial assets) reduced by £32.0 billion, or 19 per cent, to £135.2 billion. This reflected deleveraging by core clients, lower reverse repos, and continued active de-risking of the non-core asset portfolio. The non-core asset reduction was £15.5 billion, or 25 per cent, driven by a reduction of treasury assets of £10.6 billion.

Loans and advances to core customers excluding reverse repos reduced by £3.6 billion, or 5 per cent, to £72.7 billion as demand for new corporate lending and refinancing of existing facilities was more than offset by the level of maturities, reflecting a continued trend of subdued corporate lending demand and client deleveraging as credit facilities matured and were not renewed by clients.

Reverse repos form part of the Group's on balance sheet primary liquidity assets portfolio. The mix of this portfolio is managed in order to optimise returns; the decrease of £11.0 billion is offset by increases within other primary liquidity asset classes. (See page 98 for the composition of Primary Liquid Assets).

Available-for-sale financial assets balances reduced by £5.3 billion, or 42 per cent, to £7.3 billion and debt securities by £6.1 billion, or 49 per cent, to £6.4 billion. This was largely driven by the reduction in the non-core balance sheet through treasury and other asset sales or not replenishing holdings after amortisations and maturities.

In total, customer deposits excluding repos decreased by 4 per cent to £81.2 billion primarily due to customer deposits on the core book decreasing by 3 per cent to £79.0 billion. Within this, the mix of customer deposits has changed in the half year. Excluding a reduction in deposit flows in our Markets business and 'pooled' positions within Transaction Banking (which show an equal and opposite asset impact), there was an increase of 6 per cent in other core deposit portfolios.

Risk-weighted assets decreased by £11.2 billion, or 7 per cent, to £143.2 billion, primarily reflecting balance sheet reductions including treasury asset sales and run-down in other non-core asset portfolios, as well as the impact of subdued corporate lending. Non-core risk-weighted assets represent £10.0 billion, or 89 per cent, of this reduction.

Financial performance

Underlying profit was £14 million compared to £98 million in the first half of 2011. A reduction of £541 million in total income was broadly offset by a significant decrease in the impairment charge which reduced by £449 million to £993 million.

Core underlying profit was £772 million, £23 million below the first half of 2011, with lower income primarily as a result of client deleveraging being broadly offset by a significant reduction in core impairments. The non-core underlying loss was £758 million, or £61 million more than the prior half year, with cost and impairment reductions only partially offsetting lower income.

Total underlying income decreased by £541 million to £1,815 million, mainly driven by a decrease in net interest income. This reflected the loss of income from the significant reduction in non-core assets, lower lending volumes as a result of subdued client demand and the continuing trend of client deleveraging, and a decrease in margin reflecting higher wholesale funding costs.

WHOLESALE (continued)

Core income was £1,601 million, or £306 million below the first half of 2011, reflecting subdued demand and client deleveraging which resulted in lower lending balances, higher wholesale funding costs and in other income the impact of a non-recurring one-off settlement. This more than offset a strong performance in our Markets business, particularly in the Sales, Credit Trading, Swaps Trading, and Money Markets areas. Transaction Banking income was up 16 per cent driven by increased payments revenues and an improved trade offering, while in Capital Markets income in Debt Capital Markets (DCM) bond syndication increased 38 per cent driven by increased investor activity and growth in market share, though this was offset by overall subdued demand in loan syndication. Non-core income decreased to £214 million, or £235 million lower than in the first half of 2011, given significant asset reductions.

Banking net interest income, which excludes trading activity, decreased by £318 million to £611 million as a result of reduced balances, mainly reflecting the substantial reduction in non-core assets and the decline in net interest margin as a result of higher funding costs. Total net interest income decreased by £415 million, or 43 per cent, to £554 million, and was impacted by income losses on the non-core non-banking book from low interest bearing assets, not capable of covering their funding costs.

Banking net interest margin decreased by 35 basis points to 1.12 per cent, as asset margins decreased as a result of higher wholesale funding costs, the effect of which was partly offset by higher deposit values. The core banking margin was more resilient, reflecting a balanced funding position, decreasing of 17 basis points to 1.70 per cent. The non-core banking margin, which is predominantly asset based, decreased by 63 basis points to 0.29 per cent, largely as a result of higher wholesale funding costs.

Other income decreased by £126 million, or 9 per cent, to £1,261 million, mainly reflecting a non-recurring settlement received in 2011 associated with a sizeable financial services company failure. Excluding this, other core income increased by 3 per cent in a challenging environment, due to a stronger performance in our Markets business. Non-core other income fell 14 per cent, primarily reflecting non-core asset reductions.

Total costs were broadly flat, decreasing by £8 million, or 1 per cent, to £808 million. This reflects a continued focus on cost management including savings attributable to the Simplification programme and the reduction in non-core assets, offset by continued investment in client facing resources. Core costs rose 2 per cent, primarily as a result of this investment, while non-core costs reduced 19 per cent, reflecting the non-core portfolio reduction.

The impairment charge decreased £449 million, or 31 per cent, to £993 million, principally driven by a 73 per cent reduction in the core impairment charge, primarily as a result of lower impairments in leveraged acquisition finance, Corporate and Mid Markets portfolios, where there were specific large impairments in 2011 which have not been repeated in this period. The non-core impairment charge reduced 15 per cent, driven by lower charges in non-core leveraged acquisition finance exposures.

Impairment charges have decreased substantially compared with 2011 due to robust and proactive risk management, an appropriately impaired portfolio (against our current economic assumptions), and a low interest rate environment helping to maintain defaults at lower levels. Impairment charges as an annualised percentage of average loans and advances to customers reduced to 1.52 per cent from 1.98 per cent in the first half of 2011.

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COMMERCIAL

Key highlights

- Underlying profit has increased £44 million or 21 per cent to £255 million, compared to the first half of 2011, with a reduction in total income more than offset by substantial reductions in costs and impairments. The return on risk-weighted assets was 2.03 per cent compared with 1.59 per cent in 2011.

- Total income decreased by 5 per cent to £797 million, with an increase in funding costs more than offsetting the benefit of increased business volumes.

- Net interest income reduced by 7 per cent to £587 million, with income from increased core lending offset by higher wholesale funding costs, and non-core asset reductions. Customer income (excluding wholesale funding costs) increased by 2 per cent largely due to the successful growth in term lending and current account products.

- Other income increased by 1 per cent to £210 million, driven by an overall increase in business activity levels.

- Total costs reduced by 8 per cent, primarily as a result of enhanced cost management, and Simplification savings.

- The impairment charge reduced by 32 per cent to £109 million, reflecting the continued benefits of the low interest rate environment and the ongoing application of our prudent risk appetite. The quality of our new business remains good.

- Core loans and advances to customers excluding reverse repos increased by 4 per cent year-on-year (3 per cent compared to December 2011) against a contracting market, underlining our commitment to supporting Small and Medium-sized Enterprises (SMEs), whilst non-core assets fell by 29 per cent year-on-year to £1.2 billion.

- Customer deposits excluding repos grew by 2 per cent year-on-year (4 per cent compared to December 2011), reflecting our ongoing success in attracting new SME customers and current accounts from existing customers.

- In delivering its strategic objectives, Commercial has focused on strengthening its customer relationships and supporting SMEs through the difficult trading conditions by further developing its understanding and support of individual business requirements. This is demonstrated by the following:

- Gross new lending to SMEs is on track to exceed our £12 billion full year target and we have now increased this commitment by £1 billion given the benefit of the UK Government's Funding for Lending Scheme.

    - SME net lending grew 4 per cent year-on-year against a continued market contraction of 4 per cent.

- We supported over 64,000 start ups in the first half of the year towards commitment to support at least 100,000 in 2012.

- Supporting customers through responsible lending, and creating sustainable returns for shareholders with improving credit quality, balance sheet funding and RWA use.

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Over 10 per cent increase in cross-sales of Wealth Management, Retail, Insurance, Fleet Hire, and Treasury products allowing SME customers to fulfil all their financial needs through collective Group product offerings.

COMMERCIAL (continued)

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	587	634	(7)	617
Other income	210	208	1	218
Total underlying income	797	842	(5)	835
Total costs	(433)	(471)	8	(477)
Impairment	(109)	(160)	32	(143)
Underlying profit	255	211	21	215
Banking net interest margin	3.98%	4.27%		4.15%
Cost:income ratio	54.3%	55.9%		57.1%
Impairment as a % of average advances	0.72%	1.07%		1.04%
Return on risk-weighted assets	2.03%	1.59%		1.65%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	29.3	28.8	2
Customer deposits excluding repos	33.5	32.1	4
Total customer balances	62.8	60.9	3
Risk-weighted assets	24.9	25.4	(2)

COMMERCIAL (continued)

Core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	582	619	(6)	610
Other income	210	207	1	218
Total underlying income	792	826	(4)	828
Total costs	(430)	(468)	8	(474)
Impairment	(116)	(160)	28	(136)
Underlying profit	246	198	24	218
Banking net interest margin	4.13%	4.39%		4.34%
Cost:income ratio	54.3%	56.7%		57.2%
Impairment as a % of average advances	0.80%	1.14%		1.05%
Return on risk-weighted assets	2.08%	1.61%		1.78%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	28.1	27.4	3
Customer deposits excluding repos	33.2	31.8	4
Total customer balances	61.3	59.2	4
Risk-weighted assets	23.7	23.8	

Non-core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	5	15	(67)	7
Other income	–	1		–
Total underlying income	5	16	(69)	7
Total costs	(3)	(3)		(3)
Impairment	7	–		(7)
Underlying profit (loss)	9	13	(31)	(3)
Banking net interest margin	0.77%	2.01%		0.80%
Impairment as a % of average advances	(1.15)%	–		0.92%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	1.2	1.4	(14)
Customer deposits excluding repos	0.3	0.3	
Total customer balances	1.5	1.7	(12)
Risk-weighted assets	1.2	1.6	(25)

COMMERCIAL (continued)

Strategic focus

Commercial's goal is to be the best bank for small and medium sized businesses. Commercial's main strategic focus is to improve the depth of relationship with SMEs through specialist customer propositions in key markets. This is achieved by leveraging strong relationship management skills, focusing on meeting the broader financial services needs of SME customers, and by optimising customer service through efficiencies that also contribute to cost effectiveness targets. Commercial is also improving accessibility and functionality of new digital channels promoted through Group support for a major national initiative, 'Go On UK' to transform the UK into the most digitally capable country in the world. Commercial is actively promoting digital products as well as providing expert guidance to customers on how to use digital to optimise their prospects for growth.

Reshaping the Business and Strengthening the Balance Sheet

The business is focused on improving its offerings to customers, leveraging wider Group capabilities, and supporting SMEs through the cycle to help them prosper and develop. This is being achieved through continued investment in our Relationship Managers, supported by product and system development aligning to customers' wider financial needs. For example in the first half of 2012 we launched a specialist manufacturing proposition with over 100 Relationship Managers trained through a programme designed with the Engineering Employers' Federation and Manufacturing Technologies Association at the University of Warwick, Lloyds TSB also sponsored MACH 2012, the UK's premiere manufacturing technologies event, which saw over 20,000 visitors.

Supporting the full range of customer needs continued to result in deposit and lending growth, strengthening the balance sheet, while driving gross customer income growth. Work with Group partners to leverage their products and expertise to drive value for SMEs has delivered an increase of over 10 per cent in referrals and needs met for customers compared to 2011.

In addition, the benefit of close relationship support through the cycle is evidenced in the improvement in portfolio quality while risk-weighted assets have reduced in the context of increased lending, reflecting the improvement in risk profiles as well as the higher mix of secured lending in the book.

Simplifying the Bank

Commercial has made further progress with Simplification, enabling investments to be applied across brands that share a single banking platform. Simpler organisational structures and processes have been delivered which have additionally resulted in lower back office staffing requirements.

The customer benefits arising from Simplification are important and significant progress has been made in simplifying the lending process. A successful pilot of the new process has halved the time taken to complete lending transactions to customers and we expect to have fully implemented the new process by the end of 2012. Our simple and transparent approach is also attractive to customers, as evidenced by over 65,000 customers who have now signed up to the ground-breaking Monthly Price Plan tariffs that provide certainty and control over bank charges, an increase of over 35,000 since the start of the year.

COMMERCIAL (continued)

Investing in Growth and Supporting the UK Economy

SMEs are a strategic priority reflecting the Group's commitment to the sector, the competitive advantage of the Group's distribution strengths and relationship expertise, and the potential to offer a wide range of products from across the Group.

Commercial's commitments to customers are set out in our SME Charter, which has been refreshed and extended in this half year to encourage enterprise, provide clear and fair pricing, access to finance and support for communities. This will be supported by at least 200 substantial customer networking events which have proved to be a key platform for recruitment and customer support.

In support of the SME sector, the Group has committed to make available £12 billion of gross lending in 2012 through the core Commercial business. We are on track to exceed our £12 billion full year target and we have now increased this commitment by £1 billion given the benefit of the UK Government's Funding for Lending Scheme.Commercial's core net lending balance growth of 4 per cent compared favourably with the 4 per cent contraction of SME lending across the industry reported by the Bank of England.

Through the National Loan Guarantee Scheme, Lloyds TSB Bank plc issued £1.4 billion of senior unsecured debt guaranteed by the UK Government. The scheme enhances the terms of finance raised by Lloyds TSB Bank plc, thereby improving the terms of loans so that SME demand for borrowing is stimulated, providing all eligible customers with a 1 per cent discount on their funding rate for a certain period of time.

Building on its Best for Business campaign, Lloyds TSB Commercial in partnership with the Guardian newspaper, launched the Guardian 'Small Business Network' in June. Commercial customers will benefit from this partnership by enabling them to share best practice tips and innovative thinking, accessing insight and guidance from business experts, taking part in live question and answer discussions, and the chance to be profiled in the Guardian.

The Commercial Finance business, which provides asset backed lending to SMEs, has continued to increase support and funding to UK businesses. Invoice Finance client numbers increased 3 per cent and Equipment Financing (Hire Purchase) increased 5 per cent in the first half of the year.

Commercial encourages enterprise by helping people start in business and has supported over 64,000 start up businesses already in 2012 making a total of over 292,000 towards our three year commitment to help 300,000 businesses. More than 300 members of Lloyds Banking Group's staff are now trained as mentors to businesses from pre-start up to growth and social enterprise.

Awards

In demonstration of our commitment to supporting the community Commercial were awarded Bank of the Year for an unprecedented Eighth year at the FDs' Excellence Awards (joint with Wholesale) and best charity account provider for the second year in succession from Business Moneyfacts. Arena, Lloyds Bank's e-solution, has also won the award for 'Best Innovation in the SME Finance Sector' at the Business Moneyfacts Awards 2012.

COMMERCIAL (continued)

Balance sheet progress

Loans and advances to customers were £29.3 billion, an increase of £0.5 billion compared to 31 December 2011. Core lending grew 4 per cent year-on-year, reflecting our commitment to support SME customers through developing an integrated SME proposition. The reduction in non-core assets was more than offset by the increase in core term lending, backed by significant promotional support which included running over 100 customer events in the first half of 2012.

Commercial's risk-weighted assets decreased by £0.5 billion to £24.9 billion compared to December 2011 and reduced by £1.9 billion since 30 June 2011. Our improvement in risk profiles reflects the decrease in risk-weighted assets compared to an overall increase in lending since year end.

Customer deposits increased 4 per cent to £33.5 billion reflecting our continued achievement in attracting new customers particularly through our current account range.

Financial performance

Underlying profit was £255 million compared to a profit of £211 million, an increase of 21 per cent against the comparable period in 2011 with lower income more than offset by reductions in both costs and impairments.

Total income decreased by 5 per cent to £797 million, with a 2 per cent rise in income relating to increased business volumes being offset by increased funding costs.

Net interest income was 7 per cent lower in the first half of 2012 despite a 2 per cent increase in core lending income as higher funding costs resulted in a 29 bps reduction to banking net interest margin.

Other operating income was 1 per cent or £2 million higher, driven by an overall increase in business activity levels.

Total costs have continued to be well controlled and decreased by £38 million, or 8 per cent, primarily through successful delivery of Simplification initiatives, including back office staffing requirements.

Impairment decreased £51 million, 32 per cent, due to an overall improvement in the credit quality of the portfolio through continued application of a prudent risk appetite with the continued benefits of the low interest rate environment helping to maintain defaults at a lower level. Impairment charges as an annualised percentage of average loans and advances to customers has reduced by 35 basis points to 0.72 per cent compared to the first half of 2011.

WEALTH, ASSET FINANCE AND INTERNATIONAL

Key highlights

- Underlying loss decreased 52 per cent to £995 million, driven by a continued reduction in impairments and costs partly offset by a fall in non-core income as a result of the focus on non-core balance sheet reduction.

- Within the Wealth business, underlying profit increased by 17per cent to £176 million against a background of difficult investment markets, reflecting strong deposit growth and simplification of our business model.

- Total underlying income decreased by 21 per cent to £1,479 million.

- Net interest income was 30 per cent lower, primarily reflecting lower lending volumes in our International and Asset Finance non-core businesses where we have continued to focus on asset and risk reduction and, where appropriate, disposals.

- Banking net interest margin was 19 basis points lower at 1.45 per cent, driven by higher funding costs and asset mix partly offset by higher deposit balances. Average interest earning assets have reduced by 19 per cent to £60.5 billion. In our core business, banking net interest margin increased by 58 basis points driven by the benefit from the continued inflow of deposits since the year-end and good management of asset margins.

- Other income decreased by 16 per cent to £1,031 million, largely as a result of lower operating lease assets in the non-core motor and specialist asset finance portfolios, and lower management fees in the Wealth business due to subdued investment markets.

- Total costs decreased by 9per cent to £1,177 million (10 per cent excluding operating lease depreciation) as we continue to benefit from the simplification of our business model and despite significant investment in our core Wealth businesses.

- The impairment charge reduced by 51per cent to £1,297 million, continuing the trend of slowing rate of impaired loan migration. The coverage ratio increased from 60.6 per cent to 65.5 per cent reflecting further provisions in the year, particularly in our non-core Irish and European wholesale businesses.

- Net loans and advances to customers, excluding reverse repos, decreased by 13 per cent, largely driven by de-risking of the balance sheet through reducing non-core assets. Risk-weighted assets decreased by 9 per cent, reflecting lower asset balances and additional impairment provisions, particularly in International.

- Customer deposits grew by 18 per cent (or 36 per cent on an annualised basis), primarily due to continued strong inflows within both the UK and International Wealth businesses together with further growth in our international on-line deposit business.

- In delivering its strategic objectives, Wealth demonstrated continued strength in client acquisition through the UK franchise with a 3 per cent increase in the number of clients in the affluent proposition. We have made material progress on simplifying our international footprint, having now announced the disposal of or exit from ten countries. In addition during the first half of 2012, we have announced a reduced presence in a further three locations. Corporate lending has been refocused around selected customers aligned to UK product and sector plans and the Group's international risk appetite. International is contributing to a strengthening of the Group’s balance sheet through a significant and managed run-down of non-core assets together with diversification of sources of funding through international deposits. In Asset Finance, we are the number one in vehicle and leasing markets supporting the key SME and Corporate segments and we have completed the disposal of, or closed to new business those parts of the portfolio which are outside of our risk appetite.

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WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	448	642	(30)	542
Other income	1,031	1,221	(16)	1,103
Total underlying income	1,479	1,863	(21)	1,645
Total costs	(1,177)	(1,288)	9	(1,244)
Impairment	(1,297)	(2,647)	51	(2,163)
Underlying loss	(995)	(2,072)	52	(1,762)
Wealth	176	151	17	136
International	(1,342)	(2,393)	44	(2,024)
Asset Finance	171	170	1	126
Underlying loss	(995)	(2,072)	52	(1,762)
Banking net interest margin	1.45%	1.64%		1.52%
Cost:income ratio	79.6%	69.1%		75.6%
Impairment as a % of average advances	4.31%	7.21%		6.28%
Return on risk-weighted assets	(3.68)%	(6.05)%		(5.89)%

Key balance sheet and other items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	43.9	50.2	(13)
Customer deposits excluding repos	49.7	42.0	18
Total customer balances	93.6	92.2	2
Operating lease assets	2.7	2.7	
Funds under management	181.5	182.0	
Risk-weighted assets	51.5	56.7	(9)

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

Core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	160	159	1	150
Other income	963	1,004	(4)	996
Total underlying income	1,123	1,163	(3)	1,146
Total costs	(914)	(953)	4	(954)
Impairment	(16)	(17)	6	(34)
Underlying profit	193	193		158
Banking net interest margin	3.90%	3.32%		3.47%
Cost:income ratio	81.4%	81.9%		83.2%
Impairment as a % of average advances	0.39%	0.41%		0.82%
Return on risk-weighted assets	3.02%	2.83%		2.36%

Key balance sheet and other items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	7.4	8.1	(9)
Customer deposits excluding repos	49.0	40.7	20
Total customer balances	56.4	48.8	16
Operating lease assets	2.6	2.6	
Funds under management	181.1	181.6	
Risk-weighted assets	12.5	13.5	(7)

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

Non-core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	288	483	(40)	392
Other income	68	217	(69)	107
Total underlying income	356	700	(49)	499
Total costs	(263)	(335)	21	(290)
Impairment	(1,281)	(2,630)	51	(2,129)
Underlying loss	(1,188)	(2,265)	48	(1,920)
Banking net interest margin	1.08%	1.41%		1.24%
Impairment as a % of average advances	4.91%	8.11%		7.03%

Key balance sheet and other items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	36.5	42.1	(13)
Customer deposits excluding repos	0.7	1.3	(46)
Total customer balances	37.2	43.4	(14)
Operating lease assets	0.1	0.1	
Funds under management	0.4	0.4	
Risk-weighted assets	39.0	43.2	(10)

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

Strategic focus

Wealth provides strong growth opportunities for the Group and through deepening the relationships with existing Group clients alongside targeted customer acquisition, its goal is to be recognised as the primary Wealth advisor to UK mass affluent, affluent and high net worth customers together with UK expatriates and others with UK connections. We aim to increase our market share in UK and International Wealth primarily through growing the amount of customer deposits and funds under management that we manage on behalf of franchise customers, whilst improving margins and operating efficiency.

In the International businesses, the priority is to maximise value in the medium term. The immediate focus is on close management of the balance sheet. We are contributing to a strengthening of the Group's balance sheet through a significant and managed run-down of non-core assets together with increasing and diversifying our funding through international deposit gathering. At the same time, International is delivering operational efficiencies and rightsizing its cost base to fit its reshaped business models.

In Asset Finance, we have refocused the business into sectors which fit our risk appetite and profitability and are looking to deliver focused, profitable growth while completing the run-down or disposal of the closed to new business portfolios.

Progress against strategic initiatives

Reshaping the Business and Strengthening the Balance Sheet

Focus remains on maximising value and aligning with the Group’s risk appetite through close management of the lending portfolio, continuing disciplined reduction of non-core assets, diversifying sources of funding and rationalisation of our international presence.

We have further reduced non-core loans and advances to customers, excluding reverse repos, by £5.6 billion in the first half of 2012 through a mixture of repayments and selected asset disposals (in addition to foreign exchange and impairment effects as outlined below). This reduction includes the sale of £0.8 billion (gross) of Australian corporate real estate loans, which further de-risks the Australian business and has resulted in a cumulative 92 per cent reduction of the real estate non-performing portfolio. It also includes the impact of a £0.3 billion (gross) asset reduction in Ireland in respect of a successful disposal of a portfolio of Wholesale assets.

Our international on-line deposit business continued to grow strongly with customer balances as at June 2012 of £19.8 billion, an increase of £6.0 billion. Overall, the Wealth, Asset Finance and International businesses have become a significant contributor to the Group's funding with a 20 per cent deposit growth across the UK and International Wealth businesses as well as in International online deposits. The division has also made good progress towards reducing its International presence with a further three closures and disposals announced bringing the total to ten and achieving two thirds of our target to halve our international footprint.

Simplifying the Bank

The Simplification initiative is well underway, the focus of which is on simplifying operations and processes, delayering management structures, consolidating supplier relationships and increasing the efficiency of distribution channels. Wealth, Asset Finance and International is in the process of realising additional efficiencies and cost savings through its initiatives to streamline operating models, create a shared support infrastructure and develop a single customer platform across all International Wealth businesses.

Investing in Growth and Supporting the UK Economy
The division will focus on serving customers both within the UK and also those with UK connections. In International, corporate lending has been refocused around selected customers aligned to UK product and sector plans and the Group's international risk appetite. In Wealth, the focus of propositions will be within the existing UK customer franchise in addition to customers with UK connections in Commonwealth countries, Europe, Middle East, and on the Indian Subcontinent.

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

The division is investing significantly in UK and International Wealth to grow market share in what is viewed as a key growth opportunity for the Group. The investment is geared towards developing compelling propositions for affluent and high net worth customers. Underpinning this, we are consolidating our platforms and simplifying the operating model which together with the creation of compelling products will deliver a better customer experience in a more efficient manner, thereby improving customer onboarding, retention and value capture through cross sales.

Balance sheet progress
Net loans and advances to customers decreased by £6.3 billion to £43.9 billion as we continued to focus management action on de-risking the balance sheet. The reduction of £6.3 billion reflects net repayments (including asset sales) of £5.0 billion, additional impairment provisions mainly within the International businesses, and foreign exchange movements of £1.0 billion.

Risk-weighted assets decreased by £5.2 billion to £51.5 billion, reflecting lower asset balances and increased impairment provisions, particularly in the non-core portfolios, together with improved use of collateral across all businesses.

Customer deposits increased by £7.7 billion to £49.7 billion mainly due to continued strong deposit inflows in the International deposit businesses.

Financial performance
From 2012 we have made a small number of changes to our segmental reporting to reflect changes in management responsibilities and to align more closely to our strategic objectives. The primary changes are to report Asset Finance as part of Wealth, Asset Finance and International rather than Wholesale division and to redefine the Wealth and International segments so that Wealth encompasses only our UK and International Wealth businesses, SWIP and St. James' Place. Prior year segment comparatives have been restated and there is no impact on overall Group results.

Underlying loss before tax reduced by 52 per cent to £995 million primarily due to a £1,350 million reduction in impairments and lower expenses but partially offset by a fall in non-core income as a result of the balance sheet reduction.

Within the core business, underlying profit remained flat at £193 million as lower income, which reduced by 3 per cent largely as a result of lower income from fund management as investment markets remained subdued in the first half of 2012 was offset by a reduction in costs. Core costs reduced by 4 per cent to £914 million largely as a result of the impact of one off regulatory costs in the prior year and strong cost management across all our businesses.

Underlying non-core loss reduced by 48 per cent to £1,188 million driven by a continued reduction in impairments and costs partly offset by a fall in non-core income as a result of the focus on non-core balance sheet reduction.

Net interest income decreased by 30 per cent, or 31 per cent in constant currency terms. This was entirely driven by the non-core business, with higher funding costs and the increased strain of impaired assets, reflected in a 31 per cent reduction in net lending margins together with lower lending volumes due to the managed run-off of selected International and Asset Finance portfolios. This was partially offset by the impact of continued deposit inflows in the core International deposit business together with improving volumes and margins across the core Wealth businesses.

Other income decreased by 16 per cent, mainly due to lower operating lease assets in the non-core motor and specialist asset finance portfolios, and the impact of subdued investment markets on the Wealth businesses.

Total costs decreased by 9 per cent (10 per cent excluding operating lease depreciation). This reflected our continued focus on simplifying our business model and reducing our international footprint. This cost reduction was achieved despite increased demand on the business through an 18 per cent increase in customer deposits. The cost:income ratio (treating operating lease depreciation as negative income) was 73.2 per cent.

The impairment charge reduced by 51 per cent to £1,297 million largely as a result of lower charges in the wholesale Irish and Australian businesses. The rate of increase in newly impaired loans in Ireland has slowed through the second half of 2011 and the first half of 2012.

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

Wealth

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	181	149	21	172
Other income	448	474	(5)	460
Total underlying income	629	623	1	632
Total costs	(445)	(457)	3	(478)
Impairment	(8)	(15)	47	(18)
Underlying profit	176	151	17	136
Cost:income ratio	70.7%	73.4%		75.6%
Impairment as a % of average advances	0.32%	0.60%		0.73%

Key balance sheet and other items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	4.5	4.8	(6)
Customer deposits excluding repos	28.2	26.2	8
Total customer balances	32.7	31.0	5
Funds under management	180.9	180.8	
Risk-weighted assets	5.5	5.7	(4)

In Wealth, our key focus has been to grow our market share in UK and International Wealth primarily through growing the total amount of deposits and funds under management that we manage on behalf of franchise customers, whilst improving margins and operating efficiency. Funds under management increased by £0.1 billion at £180.9 billion, reflecting a shift of customer appetite away from investment products towards deposits.

Underlying profit before tax increased by 17 per cent to £176 million driven by a combination of increased income and better operating efficiency.

Total income increased by 1 per cent to £629 million, reflecting strong deposit growth of £2.0 billion, or 8 per cent in the year (approximately 16 per cent annualised), and margins partially offset by lower income from fund management as investment markets remained subdued in the first half of 2012.

Total costs decreased by 3 per cent to £445 million driven by benefits from cost saving initiatives across the Wealth businesses as part of the Simplification programme and despite significant investment in the Wealth business in the first half of the year.

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

Funds under management

	As at 30 June 2012 £bn	As at 30 June 2011 £bn	As at 31 Dec 2011 £bn
Scottish Widows Investment Partnership (SWIP)			
Internal	117.0	120.7	116.8
External	21.3	26.7	23.1
	138.3	147.4	139.9
Other Wealth:			
St James's Place	30.9	29.1	28.5
Invista Real Estate	0.2	2.5	0.8
Private and International Banking	12.1	14.3	12.8
Closing funds under management	181.5	193.3	182.0

	Half-year to 30 June 2012 £bn	Half-year to 30 June 2011 £bn	Half-year to 31 Dec 2011 £bn
Opening funds under management	182.0	192.0	193.3
Inflows:			
SWIP – internal	0.4	1.0	1.7
– external	0.8	0.7	0.8
Other	3.4	3.8	4.7
	4.6	5.5	7.2
Outflows:			
SWIP – internal	(2.5)	(4.4)	(0.1)
– external	(2.7)	(1.8)	(3.5)
Other	(3.2)	(2.1)	(8.0)
	(8.4)	(8.3)	(11.6)
Investment return, expenses and commission	3.3	4.1	(6.9)
Net operating (decrease) increase in funds	(0.5)	1.3	(11.3)
Closing funds under management	181.5	193.3	182.0

Funds under management reduced by £0.5 billion to £181.5 billion. Net outflows of £3.8 billion reflect expected attrition on insurance funds within SWIP, the market backdrop and a shift in customer investments in our Wealth businesses away from funds towards Wealth and Retail deposits.

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

International

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	114	302	(62)	205
Other income	57	157	(64)	109
Total underlying income	171	459	(63)	314
Total costs	(278)	(335)	17	(278)
Impairment	(1,235)	(2,517)	51	(2,060)
Underlying loss	(1,342)	(2,393)	44	(2,024)
Cost:income ratio	162.6%	73.0%		88.5%
Impairment as a % of average advances	5.07%	8.51%		7.36%

Key balance sheet and other items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	33.8	39.0	(13)
Customer deposits excluding repos	21.5	15.8	36
Total customer balances	55.3	54.8	1
Funds under management	0.6	1.2	
Risk-weighted assets	37.9	41.6	(9)

Balance sheet progress

Within International, our key focus has been to strengthen the balance sheet through material and targeted reductions in non-core assets and diversifying sources of funding through international deposit raising.

Net loans and advances to customers decreased by £5.2 billion or 13 per cent, to £33.8 billion due to net repayments of £4.0 billion across all businesses (including the sale of £0.8 billion (gross) of Australia corporate real estate loans), further impairment provisions and foreign exchange movements of £1.0 billion. The division is focused on de-risking and right-sizing the balance sheet, focusing on key Group relationships, as well as reducing concentrations in Commercial Real Estate.

Risk-weighted assets decreased by £3.7 billion, or 9 per cent, to £37.9 billion reflecting lower asset balances and further impairment provisions, improved use of collateral and foreign exchange rate movements. This is partly offset by an increase in risk-weighted assets to cover further deterioration in the Irish housing market and other credit risk model changes which impact risk-weighted assets.

Customer deposits increased by £5.7 billion, or 36 per cent, to £21.5 billion driven by continued strong performance within our International deposit business.

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

Financial performance

Underlying loss reduced by £1,051 million to £1,342 million as a result of a lower impairment charge, mainly reflecting a reduction of £882 million in Ireland and £383 million in Australia. This improvement was partially offset by a fall in total income which decreased by 63 per cent, but was 53 per cent lower in constant currency terms, reflecting lower interest-earning assets (which have reduced by 16 per cent since December 2011 and by 19 per cent over the last 12 months) and the increased strain of lost earnings on higher impaired assets.

Total costs reduced by 17 per cent, or 18 per cent on constant currency terms, reflecting cost saving initiatives across the International business, partly offset by the continued investment in the International deposit business.

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

	Impairment charges			Loans and advances to customers	
	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Half-year to 31 Dec 2011 £m	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn
Ireland wholesale	832	1,539	1,137	6.9	8.7
Ireland retail	65	240	271	5.6	6.0
Australia	203	586	448	6.9	8.1
Wholesale Europe	111	111	93	4.8	5.9
Latin America/Middle East	–	24	41	0.2	0.4
Netherlands (retail)	6	4	17	5.8	6.2
Spain (retail)	12	11	48	1.5	1.5
Asia (retail)	6	2	5	2.1	2.2
	1,235	2,517	2,060	33.8	39.0

The impairment charge reduced by £1,282 million, or 51 per cent, to £1,235 million due to reduced impairment charges in Ireland and Australia. The rate of increase in newly impaired loans in Ireland has reduced, and a significant portion of the Australian impaired portfolio was disposed of in 2011. Excluding Ireland, the impairment charge reduced by £400 million, or 54 per cent to £338 million.

WEALTH, ASSET FINANCE AND INTERNATIONAL (continued)

Asset Finance

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	153	191	(20)	165
Other income	526	590	(11)	534
Total underlying income	679	781	(13)	699
Total costs	(454)	(496)	8	(488)
Impairment	(54)	(115)	53	(85)
Underlying profit	171	170	1	126
Cost:income ratio	66.9%	63.5%		69.8%
Impairment as a % of average advances	1.65%	2.51%		2.13%

Key balance sheet and other items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change since 31 Dec 2011 %
Loans and advances to customers excluding reverse repos	5.6	6.4	(13)
Operating lease assets	2.7	2.7	
Risk-weighted assets	8.1	9.4	(14)

Within Asset Finance, our key focus has been to complete the run-off of the portfolios, now closed to new business, which are outside of our risk appetite while delivering focused, profitable growth elsewhere.

Loans and advances to customers reduced by 13 per cent to £5.6 billion as we continued to run-off the portfolios that are closed to new business.

Underlying profit increased by 1 per cent to £171 million as a result of improved impairment charges and total costs offset by lower income. Excluding the results of Hill Hire (disposed of in June 2011), from the prior year, underlying profit before tax increased by 2 per cent.

Total income decreased by 13 per cent to £679 million, despite improving margins in the retail business, largely as a result of closed book run-off together with the impact of the Hill Hire disposal. Excluding the Hill Hire income included in the first half of 2011, total income decreased by 10 per cent.

Operating lease depreciation decreased 6 per cent to £329 million, reflecting the reduced fleet size and strong disposal returns in Lex Autolease.

Total costs (excluding operating lease depreciation) decreased by 15 per cent to £125 million, reflecting the lower asset base and simplification of our business model. The cost:income ratio (treating operating lease depreciation as negative income) was 35.6 per cent.

The impairment charge reduced by 53 per cent to £54 million (of which £52 million or 96 per cent related to non-core assets), driven by stronger credit management and improving credit quality. The retail portfolio saw more customers meeting their payment arrangements resulting in a lower proportion of people falling into arrears. The retail impairments also benefited from debt sale activity in the first half of the year.

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INSURANCE

Key highlights

- Underlying profit in the first half of 2012 was £502 million, compared to £681 million in the first half of 2011, primarily due to a £109 million reduction in LP&I UK income predominantly as a result of the reduction in economic returns which drive income generated from policyholder funds. Also, incremental adverse property claims of £65 million as a result of weather events have impacted the first half of the year, with the period from April to June being the wettest on record.

- Total underlying income, net of insurance claims, decreased by £210 million to £886 million. This was mainly due to a reduction in LP&I UK income as referred to above, adverse property claims and the underwriting of pet insurance.

- Total costs improved by 7 per cent due to a continued focus on cost management and delivery of Simplification cost savings combined with the non-recurrence of the 2011 charge in respect of FSCS levy.

- LP&I UK sales (PVNBP) decreased by 2 per cent reflecting the subdued economic climate, evidenced by lower Bancassurance protection and investment volumes, mitigated by continued strong sales of corporate pensions before the implementation of the Retail Distribution Review (RDR).

- LP&I UK margin on an EEV basis decreased to 3.8 per cent in the first half of 2012 from 4.2 per cent in the first half of 2011. While remaining strong, the decrease is a reflection of changes in the business mix. The Internal Rate of Return (IRR) on new business remains in excess of 16 per cent.

- General Insurance profits reduced by 30 per cent to £158 million due to increased weather related claims in 2012, an £18 million cost of underwriting pet insurance for customers whose pets have pre-existing conditions, and the impact of the continued run-off of the PPI book.

- In delivering its strategic objectives, Insurance is focusing on simplifying service and claims processes across the business and has implemented a new organisational design allowing the business greater flexibility in responding to the changing market-place to ensure we are better placed to serve customer needs.

INSURANCE (continued)

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	(37)	(25)	(48)	(42)
Other income	1,156	1,319	(12)	1,368
Insurance claims	(233)	(198)	(18)	(145)
Total underlying income, net of insurance claims	886	1,096	(19)	1,181
Total costs	(384)	(415)	7	(397)
Underlying profit	502	681	(26)	784
Underlying profit by business unit				
Life, Pensions and Investments:				
UK business	338	436	(22)	450
European business	6	19	(68)	63
General Insurance	158	226	(30)	271
Underlying profit	502	681	(26)	784
EEV new business margin	3.6%	4.1%		3.9%
Life, Pensions and Investments sales (PVNBP)	5,627	5,763		4,899

Core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	(41)	(30)	(37)	(47)
Other income	1,126	1,282	(12)	1,279
Insurance claims	(233)	(198)	(18)	(145)
Total underlying income, net of insurance claims	852	1,054	(19)	1,087
Total costs	(365)	(395)	8	(377)
Underlying profit	487	659	(26)	710

Non-core	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	4	5	(20)	5
Other income	30	37	(19)	89

Total underlying income	34	42	(19)	94
Total costs	(19)	(20)	5	(20)
Underlying profit	15	22	(32)	74

INSURANCE (continued)

Strategic focus

Insurance is a relationship business focused on helping our customers to protect themselves today whilst preparing for a secure financial future. Its objective is to be the best Insurance business for customers.

Progress against strategic initiatives

Reshaping the Business and Strengthening the Balance Sheet

Work to reshape Insurance to operate as one business with an increasingly customer-focused corporate and management structure is fundamentally complete with a single Executive committee and Board now in place. We have also continued to develop new and enhanced product propositions and to pursue our strategy of selective participation in the important Intermediary and Direct channels.

Following a participation review we announced the withdrawal from the Offshore Bond market in the first quarter of 2012. At the same time we announced our intention to selectively increase our participation in the risk market where product economics and returns meet our criteria. We plan to launch an enhanced Annuities product and beyond that we are aiming to enter the IFA protection market.

Simplifying the Business

Insurance continues to focus on cost reduction with costs improving by 7 per cent year-on-year. Efficiencies have been achieved without compromising the quality of customer service and customer satisfaction ratings have remained robust across the division.

We have made good progress with the Simplification programme in the first half of 2012. A new organisational design has been implemented allowing the business greater flexibility in responding to the changing market place to ensure we are better placed to serve customer needs. The continuous improvement programme is transforming back office and customer contact centre processes, reducing handling time and improving the overall customer experience.

The Simplification programme will continue to deliver further improvements through the provision of simpler systems and processes.

Investing in Growth and Supporting the UK Economy

In Insurance we are focused on leveraging our multi-brand strategy to deliver sustainable growth in key markets.

Through the Group strategic initiative programme we are investing in building lasting relationships with our bancassurance customers through the introduction of new advice models, enhanced products and access to new direct channels.

Our Protection for Life plan has been further enhanced through the addition of Essential Earnings Cover (EEC). Recognising our customers' needs for income protection, EEC is an affordable product designed to build consumer confidence through guaranteed premiums and simpler application and claim processes. It will provide our customers with significant income protection if they suffer an accident or illness that prevents them from working.

We are also seeing good traction in corporate pensions business through our intermediary channel, following a significant investment in our proposition. Our direct sales force which serves those of our customers who do not have a financial adviser is also performing well following enhanced targeting of those customers.

Within Life, Pensions and Investments we recognise a large opportunity in the corporate pensions market as schemes move towards auto-enrolment and a shift from defined benefit to defined contribution schemes. We also continue to explore opportunities within the annuity market.

INSURANCE (continued)

The Retail Distribution Review (RDR) comes into effect from 1 January 2013 and our preparations are progressing well, both in terms of proposition development and in supporting Independent Financial Advisers (IFAs) as they transition business models to comply with the new regulations. Inevitably, as a result of RDR, some IFAs will choose to exit markets and therefore some customers will no longer receive advice from their IFAs. The business is committed to providing a direct proposition to maintain a high quality of service to these customers.

Scottish Widows was awarded Best Group Pension Provider in the Corporate Adviser awards and Best Personal Pensions Provider in the Professional Adviser awards. More recently, Scottish Widows also received an award for its customer focus at the annual Customer Contact Innovation Awards. These awards celebrate excellence in the industry and recognise initiatives which put customers at the heart of businesses.

In General Insurance, our strategy is focused around protecting and growing our home insurance business whilst seeking to expand its role in other markets, including commercial insurance, through targeted participation and underwriting strategy. In line with this we have witnessed strong growth in motor insurance, a product that we distribute directly. An increased focus by the General Insurance business and Commercial banking to improve the customer experience has resulted in a year-on-year increase in premiums of Essential Business Insurance of 17 per cent.

Many parts of the country have experienced record levels of rainfall, and as a result our home claims operations have experienced a significant uplift in open flood claim volumes since April. We have been working to get our customers' lives back on track by deploying our Rapid Response Vehicle to some of the most affected areas, and ensuring our specialist Personal Claims Consultants are deployed to the worst hit areas.

Life, Pensions and Investments

UK business

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Net interest income	(37)	(24)	(54)	(38)
Other income	631	727	(13)	731
Total underlying income	594	703	(16)	693
Total costs	(256)	(267)	4	(243)
Underlying profit	338	436	(22)	450
Underlying profit by business unit				
New business profit – insurance business1	186	201	(7)	181
– investment business1	(25)	(33)	24	(18)
Total new business profit	161	168	(4)	163
Existing business profit	189	267	(29)	272
Experience and assumption changes	(12)	1		15

Underlying profit	338	436	(22)	450
EEV new business margin (UK)	3.8%	4.2%		4.2%
Life, Pensions and Investments sales (PVNBP)	5,510	5,595	(2)	4,624

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

INSURANCE (continued)

Life, Pensions and Investments (LP&I UK) profit was impacted by lower income due to reduction in economic returns which drive income generated from policyholder funds. For insurance contracts, future cash-flows are discounted to give a current Value of in Force assets. A number of assumptions, including economic indices, are used to model those cash-flows. The subdued economic environment has resulted in the rate of return used in calculating the 2012 results being significantly lower than the comparable rate in the prior year, driving a reduction in existing business profits. Existing business was also impacted by higher interest payments following capital restructuring initiatives completed in 2011.

Total new business profit decreased by £7 million, or 4 per cent, to £161 million. The decrease primarily reflects lower Bancassurance volumes, as the economic environment continues to curb customers' desire to invest, partly offset by a strong corporate pensions performance, up 22 per cent versus prior year, through the intermediary channel.

LP&I UK margin on an EEV basis remains strong despite reducing to 3.8 per cent in the first half of 2012 from 4.2 per cent in the same period in 2011. The decrease reflects changes in the business mix. The Internal Rate of Return (IRR) on new business remains in excess of 16 per cent.

The capital position of the Scottish Widows Group remains robust. The estimated Insurance Groups Directive (IGD) capital surplus for the group was £4.0 billion, which compares to £3.7 billion at 31 December 2011.

European business
Profit decreased by £13 million, or 68 per cent, to £6 million. The reduction was driven largely by an expected reduction in new business due to the strategy of focusing on the relationship with our key distributors and securing value in the existing book of business.

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

Present Value of New Business Premiums (PVNBP)

			Half-year to 30 June 2012			Half-year to 30 June 2011	Change since 30 June 2011	Half-year to 31 Dec 2011
Analysis by product	UK	Europe	Total	UK	Europe	Total		Total
	£m	£m	£m	£m	£m	£m	%	£m
Protection	295	16	311	376	18	394	(21)	367
Payment protection	7	–	7	11	–	11	(36)	10
Savings and investments	331	67	398	633	99	732	(46)	647
Individual pensions	877	34	911	780	51	831	10	793
Corporate and other pensions	2,857	–	2,857	2,350	–	2,350	22	2,073

Retirement income	369	–	369	394	–	394	(6)	353
Managed fund business	77	–	77	58	–	58	33	58
Life and pensions	4,813	117	4,930	4,602	168	4,770	3	4,301
OEICs	697	–	697	993	–	993	(30)	598
Total	5,510	117	5,627	5,595	168	5,763	(2)	4,899
Analysis by channel								
Intermediary	3,773	117	3,890	3,407	168	3,575	9	3,283
Bancassurance	1,389	–	1,389	1,850	–	1,850	(25)	1,366
Direct	348	–	348	338	–	338	3	250
Total	5,510	117	5,627	5,595	168	5,763	(2)	4,899

INSURANCE (continued)

Total sales (PVNBP) have decreased by 2 per cent to £5,627 million primarily reflecting lower savings and investments, OEICs and protection volumes partially offset by strong sales of individual and corporate pensions in LP&I UK.

Sales of protection and investment products through the Bancassurance channel have reduced, partly due to subdued customer demand reflecting the market environment and preparation within the Retail business for the Retail Distribution Review (RDR) including advisor restructuring. Total sales in the Bancassurance channel have increased compared to the second half of 2011.

In the Intermediary channel there has been strong growth, particularly in Corporate Pension sales prior to the introduction of RDR, a reflection of the underlying strength of our proposition and the quality of service provided to customers. Initiatives such as My Money Works and our market leading auto enrolment engine, combined with a continuing focus on our strong relationships, will ensure that the business is well positioned to take advantage of the changing market-place as a result of RDR. Individual pensions have increased by 10 per cent, driven by sales of our flagship Retirement Account product.

The direct channel continues to perform well and is being developed for future growth. This channel will become even more important following the introduction of RDR.

INSURANCE (continued)

Funds under management

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

	Half-year to 30 June 2012 £bn	Half-year to 30 June 2011 £bn	Half-year to 31 Dec 2011 £bn
Opening funds under management	127.6	133.1	133.3
UK business			
Premiums	5.3	5.6	4.5
Claims and surrenders	(7.1)	(7.5)	(7.1)
Net outflow of business	(1.8)	(1.9)	(2.6)
Investment return, expenses and commission	2.7	2.3	(2.5)
Net movement	0.9	0.4	(5.1)
European business			
Net movement	–	0.1	(0.6)
Dividends and capital repatriation	–	(0.3)	–
Closing funds under management	128.5	133.3	127.6
Managed by the Group	102.8	107.6	103.4
Managed by third parties	25.7	25.7	24.2
Closing funds under management	128.5	133.3	127.6

The net outflow of business is primarily a result of the move in sales mix away from savings products which generate large single premiums, caused in part by more difficult economic conditions and the run-off of the in-force book.

The key drivers of investment return are equity and gilt market movements. In the year to date UK equity markets have risen by 3 per cent and European markets have risen by 2 per cent while gilt markets increased by 3 per cent.

Maturity profile of in-force business

The table below shows the profile of the Value of In-Force (VIF) asset recognised on the IFRS balance sheet based on the date when the profit is expected to emerge.

	VIF Total £m	VIF emergence in years (%) 0-5	6-10	11-15	16-20	>20
30 June 2012	5,264	38	24	17	11	10
31 December 2011	5,247	37	24	16	10	13

The increase in VIF is mainly due to increased business partially offset by the expected run-off of business.

The profile of the emergence of VIF in future years shows that almost 40 per cent of the VIF is expected to be released within 5 years, with nearly 80 per cent expected to be released within 15 years.

INSURANCE (continued)

General Insurance

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Home insurance	425	421	1	436
Payment protection insurance	46	71	(35)	54
Other	9	33	(73)	20
Net operating income	480	525	(9)	510
Claims paid on insurance contracts (net of reinsurance)	(233)	(198)	(18)	(145)
Operating income, net of claims	247	327	(24)	365
Total costs	(89)	(101)	12	(94)
Underlying profit	158	226	(30)	271
Combined ratio	80%	73%		66%

Underlying profit decreased by 30 per cent to £158 million, a result that is broadly in line with the prior period when excluding increased weather related claims in 2012, the cost of underwriting pet insurance for pets with pre-existing conditions, and the impact of the continued run-off of the PPI book.

Total income for home insurance was 1 per cent up on last year at £425 million and reflects the maturity and competitiveness of the market.

PPI income continues to reduce as a result of the Group ceasing to write new PPI business in 2010.

Increased claims of £233 million, 18 per cent higher than in 2011, were mainly driven by adverse property claims following the weather events that have impacted the first half of the year, with the period from April to June being the wettest on record. Claims were further impacted by the cost of underwriting pet insurance for pets with pre-existing conditions. The combined impact was partly offset by lower unemployment claims which continue to be positively impacted by the reduction in the size of the PPI book.

Operating expenses decreased by £12 million, or 12 per cent, to £89 million primarily as a result of further delivery of Simplification savings and a continued focus on cost management.

Despite the impact of weather related claims our combined ratio remains strong at 80 per cent.

GROUP OPERATIONS

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011[1] £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011[1] £m
Total underlying income	17	(6)		48
Direct costs:				
Information technology	(591)	(621)	5	(553)
Operations	(349)	(363)	4	(349)
Property	(458)	(467)	2	(442)
Sourcing	(24)	(27)	11	(29)
Support functions	(37)	(42)	12	(41)
	(1,459)	(1,520)	4	(1,414)
Result before recharges to divisions	(1,442)	(1,526)	6	(1,366)
Total net recharges to divisions	1,376	1,464		1,372
Underlying (loss) profit	(66)	(62)		6

[1]2011 comparative figures have been amended to reflect the effect of the continuing consolidation of operations across the Group. To ensure a fair comparison of the 2012 performance, 2011 direct costs have been increased with an equivalent offsetting increase in recharges to divisions.

Strategy

Group Operations' aim is to be a world class operations business whilst ensuring value through cost and process efficiency. This will be achieved by: providing excellent technology and effective processes to support the business; driving simplification, automation and continuous improvement; developing world class operations, leadership and capability; and, maintaining strong controls to protect the Group.

Progress against strategic initiatives

The Simplification programme, part of the Group's Strategic transformational journey, is on track to achieve £1.7 billion of savings in 2014. The programme continues to make good progress and a strong pipeline of early deliverables has seen the successful implementation of a number of initiatives in the first half of 2012 that not only reduce costs, but also enhance customer service. Group Operations is playing a major part in the whole programme but particularly through further improved sourcing, End-to-End process re-engineering, and property consolidation.

Sourcing: We are optimising our demand management, simplifying specifications and further strengthening our supplier relationships. We have reduced the number of suppliers to the Group from just over 18,000 to less than 14,000 in the past 12 months whilst continuing to focus on a core group of lead suppliers.

End-to-End Processes: We are conducting an end-to-end redesign of our core processes, including significant process automation, simplifying processes for our staff, increasing accuracy, and reducing complaints. For example: a fully re-engineered process for setting up and handling customer accounts transferred from other banks and improvements to internet banking customer enrolment. These initiatives are already resulting in more time to serve customers and creating an improved customer experience.

Property: We are continuing our consolidation of the Group’s property, enabling the delivery of process and efficiency savings from the Simplification programme. We have also outsourced our property facilities and asset management services.

Group Operations is also playing a key role in delivering the technical expertise and support for the other Group strategic initiatives.

GROUP OPERATIONS (continued)

Financial performance

Direct costs in the first half of 2012 decreased by £61 million, or 4 per cent, to £1,459 million reflecting the continued focus on cost management and the delivery of Simplification benefits.

Information Technology costs decreased by 5 per cent, with Simplification savings offsetting costs supporting the Group's investment programme.

Operations costs decreased by 4 per cent, through the continuing rationalisation of our major Operations functions. Operations includes Banking Operations, Collections and Recoveries, and Payments and Business Services.

Group Property costs decreased by 2 per cent, with the continuing consolidation of the Group's property portfolio delivering further benefits.

Sourcing includes the cost of running the department and certain centrally-managed contracts. Sourcing continues to play a major part in helping to deliver Group-wide sourcing savings.

Support functions (includes Group Security & Fraud and Group Change Management) have decreased by 12 per cent through the delivery of Simplification benefits.

CENTRAL ITEMS

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Half-year to 31 Dec 2011 £m
Total underlying income	(4)	236	103
Total costs	(51)	(65)	(194)
Trading surplus	(55)	171	(91)
Impairment	–	–	(3)
Underlying (loss) profit	(55)	171	(94)

Central items include income and expenditure not recharged to the divisions, including the costs of certain central and head office functions and corporate one-off costs such as the UK bank levy.

Total underlying income largely reflects the net impact of items not recharged by the Group's Corporate Treasury to the divisions. The reduction in income retained in the centre compared to the first half of 2011 is largely due to the impact of certain capital and risk management actions being retained centrally.

CORE AND NON-CORE BUSINESS

Half-year to 30 June 2012	Underlying income, net of insurance claims £m	Impairment charge £m	Loans and advances to customers1 £bn	Risk-weighted assets £bn	Customer deposits1 £bn
Core portfolios					
Retail	4,221	(735)	320.1	90.4	254.7
Wholesale	1,601	(111)	78.5	99.8	83.1
Commercial	792	(116)	28.1	23.7	33.2
Wealth, Asset Finance and International	1,123	(16)	7.4	12.5	49.0
Insurance	852	–	–	–	–
Group Operations & Central items	13	–	0.2	12.7	–
	8,602	(978)	434.3	239.1	420.0
Non-core portfolios					
Retail	35	(23)	26.9	9.8	–
Wholesale	214	(882)	35.5	43.4	2.2
Commercial	5	7	1.2	1.2	0.3
Wealth, Asset Finance and International	356	(1,281)	36.5	39.0	0.7
Insurance	34	–	–	–	–
	644	(2,179)	100.1	93.4	3.2
Total Group	9,246	(3,157)	534.4	332.5	423.2

	%	%	%	%	%
Core portfolios	93.0	31.0	81.3	71.9	99.2
Non-core portfolios	7.0	69.0	18.7	28.1	0.8

Half-year to 30 June 2011	Underlying income, net of insurance claims £m	Impairment charge £m	Loans and advances to customers1 £bn	Risk-weighted assets £bn	Customer deposits1 £bn
Core portfolios					
Retail	4,524	(1,052)	328.9	98.0	242.3
Wholesale	1,907	(407)	98.3	104.4	83.0
Commercial	826	(160)	27.0	25.0	32.4
Wealth, Asset Finance and International	1,163	(17)	8.3	13.3	37.6
Insurance	1,054	–	–	–	–
Group Operations & Central items	230	–	0.5	13.9	0.1
	9,704	(1,636)	463.0	254.6	395.4
Non-core portfolios					
Retail	192	(121)	28.9	11.6	–
Wholesale	449	(1,035)	43.9	61.4	2.9
Commercial	16	–	1.7	1.8	0.3

Wealth, Asset Finance and International	700	(2,630)	50.3	53.9	1.3
Insurance	42	–	–	–	–
	1,399	(3,786)	124.8	128.7	4.5
Total Group	11,103	(5,422)	587.8	383.3	399.9

	%	%	%	%	%
Core portfolios	87.4	30.2	78.8	66.4	98.9
Non-core portfolios	12.6	69.8	21.2	33.6	1.1

1 Includes reverse repos and repos.

CORE BUSINESS

Core	Half-year to 30 June 2012 £ million	Half-year to 30 June 2011 £ million	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £ million
Net interest income	4,948	5,536	(11)	5,357
Other income	3,887	4,366	(11)	3,849
Insurance claims	(233)	(198)	(18)	(145)
Total underlying income, net of insurance claims	8,602	9,704	(11)	9,061
Total costs	(4,647)	(4,860)	4	(4,822)
Impairment	(978)	(1,636)	40	(1,251)
Underlying profit	2,977	3,208	(7)	2,988
Effects of asset sales, volatile items and liability management	–	(245)		1,026
Fair value unwind	(262)	(97)		(531)
Management profit	2,715	2,866	(5)	3,483
Banking net interest margin	2.32%	2.43%		2.40%
Cost:income ratio	54.0%	50.1%		53.2%
Impairment as a % of average advances	0.44%	0.72%		0.56%
Return on risk-weighted assets	2.48%	2.50%		2.40%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change %
Loans and advances to customers (excluding reverse repos)	428.5	437.0	(2)
Reverse repos with customers	5.8	16.8	(65)
Loans and advances to banks	31.3	32.0	(2)
Debt securities held as loans and receivables	0.3	0.2	50
Available-for-sale financial assets	27.7	27.9	(1)
Other assets:			
Derivative financial instruments	58.3	66.0	(12)
Trading and other financial assets at fair value through profit and loss	145.6	138.8	5

Other	146.4	111.1	32
	350.3	315.9	11
Total core assets	843.9	829.8	2
Risk-weighted assets	239.1	243.5	(2)
Customer deposits (excluding repos)	415.9	401.5	4
Repos with customers	4.1	8.0	(49)

MANAGEMENT BASIS CONSOLIDATED INCOME STATEMENT – CORE

Half-year to 30 June 2012	Retail	Wholesale	Commercial	Wealth, Asset Finance and Int'l	Insurance	Group Operations and Central items	Group
	£m	£m	£m	£m	£m	£m	£m
Net interest income	3,464	610	582	160	(41)	173	4,948
Other income	757	991	210	963	1,126	(160)	3,887
Insurance claims	–	–	–	–	(233)	–	(233)
Total underlying income, net of insurance claims	4,221	1,601	792	1,123	852	13	8,602
Total costs	(2,086)	(718)	(430)	(914)	(365)	(134)	(4,647)
Impairment	(735)	(111)	(116)	(16)	–	–	(978)
Underlying profit	1,400	772	246	193	487	(121)	2,977
Asset sales	–	–	–	(17)	–	658	641
Volatile items	–	17	–	–	–	(826)	(809)
Liability management	–	–	–	–	–	168	168
Fair value unwind	208	3	16	(17)	(21)	(451)	(262)
Management profit	1,608	792	262	159	466	(572)	2,715
Banking net interest margin	2.17%	1.70%	4.13%	3.90%			2.32%
Cost:income ratio	49.4%	44.8%	54.3%	81.4%			54.0%
Impairment as a % of average advances	0.45%	0.25%	0.80%	0.39%			0.44%
Return on risk-weighted assets	3.09%	1.54%	2.08%	3.02%			2.48%
Key balance sheet items	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	320.1	72.7	28.1	7.4		0.2	428.5
Customer deposits excluding repos	254.7	79.0	33.2	49.0		–	415.9
Risk-weighted assets	90.4	99.8	23.7	12.5		12.7	239.1

MANAGEMENT BASIS CONSOLIDATED INCOME STATEMENT – CORE (continued)

Half-year to 30 June 2011	Retail £m	Wholesale £m	Commercial £m	Wealth, Asset Finance and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	3,688	835	619	159	(30)	265	5,536
Other income	836	1,072	207	1,004	1,282	(35)	4,366
Insurance claims	–	–	–	–	(198)	–	(198)
Total underlying income, net of insurance claims	4,524	1,907	826	1,163	1,054	230	9,704
Total costs	(2,218)	(705)	(468)	(953)	(395)	(121)	(4,860)
Impairment	(1,052)	(407)	(160)	(17)	–	–	(1,636)
Underlying profit	1,254	795	198	193	659	109	3,208
Asset sales	41	(3)	–	–	–	69	107
Volatile items	–	61	–	–	–	(413)	(352)
Liability management	–	–	–	–	–	–	–
Fair value unwind	420	10	26	4	(21)	(536)	(97)
Management profit	1,715	863	224	197	638	(771)	2,866
Banking net interest margin	2.23%	1.87%	4.39%	3.32%			2.43%
Cost:income ratio	49.0%	37.0%	56.7%	81.9%			50.1%
Impairment as a % of average advances	0.63%	0.96%	1.14%	0.41%			0.72%
Return on risk-weighted assets	2.58%	1.50%	1.61%	2.83%			2.50%
Key balance sheet items	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	328.9	78.6	27.0	8.3		0.5	443.3
Customer deposits excluding repos	242.3	78.0	32.4	37.6		0.1	390.4
Risk-weighted assets	98.0	104.4	25.0	13.3		13.9	254.6

MANAGEMENT BASIS CONSOLIDATED INCOME STATEMENT – CORE (continued)

Half-year to 31 December 2011	Retail £m	Wholesale £m	Commercial £m	Wealth, Asset Finance and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	3,558	766	610	150	(47)	320	5,357
Other income	802	723	218	996	1,279	(169)	3,849
Insurance claims	–	–	–	–	(145)	–	(145)
Total underlying income, net of insurance claims	4,360	1,489	828	1,146	1,087	151	9,061
Total costs	(2,214)	(622)	(474)	(954)	(377)	(181)	(4,822)
Impairment	(744)	(334)	(136)	(34)	–	(3)	(1,251)
Underlying profit	1,402	533	218	158	710	(33)	2,988
Asset sales	7	(17)	–	–	–	127	117
Volatile items	–	(797)	–	–	–	411	(386)
Liability management	–	–	–	–	–	1,295	1,295
Fair value unwind	237	(39)	27	4	(22)	(738)	(531)
Management profit	1,646	(320)	245	162	688	1,062	3,483
Banking net interest margin	2.18%	1.91%	4.34%	3.47%			2.40%
Cost:income ratio	50.8%	41.8%	57.2%	83.2%			53.2%
Impairment as a % of average advances	0.45%	0.82%	1.05%	0.82%			0.56%
Return on risk-weighted assets	2.93%	1.04%	1.78%	2.36%			2.40%
Key balance sheet items	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	325.1	76.3	27.4	8.1		0.1	437.0
Customer deposits excluding repos	247.1	81.5	31.8	40.7		0.4	401.5
Risk-weighted assets	92.6	101.0	23.8	13.5		12.6	243.5

NON-CORE BUSINESS

Non-core	Half-year to 30 June 2012 £ million	Half-year to 30 June 2011 £ million	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £ million
Net interest income	267	819	(67)	498
Other income	377	580	(35)	384
Insurance claims	–	–		–
Total underlying income, net of insurance claims	644	1,399	(54)	882
Total costs	(378)	(472)	20	(467)
Impairment	(2,179)	(3,786)	42	(3,114)
Underlying loss	(1,913)	(2,859)	(33)	(2,699)
Effects of asset sales, volatile items and liability management	(56)	(19)		79
Fair value unwind	419	1,116	(62)	718
Management loss	(1,550)	(1,762)	(12)	(1,902)
Banking net interest margin	0.60%	1.20%		0.81%
Impairment as a % of average advances	3.33%	4.87%		4.32%

Key balance sheet items	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change %
Loans and advances to customers	100.1	111.8	(10)
Loans and advances to banks	0.5	0.6	(17)
Debt securities held as loans and receivables	6.2	12.3	(50)
Available-for-sale financial assets	5.1	9.5	(46)
Other	5.6	6.5	(14)
Total non-core assets	117.5	140.7	(16)
Risk-weighted assets	93.4	108.8	(14)
Customer deposits excluding repos	3.2	4.4	(27)

MANAGEMENT BASIS CONSOLIDATED INCOME STATEMENT – NON-CORE

Half-year to 30 June 2012	Retail	Wholesale	Commercial	Wealth, Asset Finance and Int'l	Insurance	Group Operations and Central items	Group
	£m	£m	£m	£m	£m	£m	£m
Net interest income	26	(56)	5	288	4	–	267
Other income	9	270	–	68	30	–	377
Insurance claims	–	–	–	–	–	–	–
Total underlying income, net of insurance claims	35	214	5	356	34	–	644
Total costs	(3)	(90)	(3)	(263)	(19)	–	(378)
Impairment	(23)	(882)	7	(1,281)	–	–	(2,179)
Underlying profit (loss)	9	(758)	9	(1,188)	15	–	(1,913)
Asset sales1	–	(42)	–	(14)	–	–	(56)
Volatile items	–	–	–	–	–	–	–
Liability management	–	–	–	–	–	–	–
Fair value unwind1	33	407	–	(21)	–	–	419
Management profit (loss)	42	(393)	9	(1,223)	15	–	(1,550)
Banking net interest margin	0.19%	0.29%	0.77%	1.08%			0.60%
Impairment as a % of average advances	0.17%	3.56%	(1.15)%	4.91%			3.33%
Key balance sheet items	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	26.9	35.5	1.2	36.5			100.1
Customer deposits excluding repos	–	2.2	0.3	0.7			3.2
Total non-core assets	26.9	50.7	1.2	38.1	0.6	–	117.5
Risk-weighted assets	9.8	43.4	1.2	39.0			93.4

1 During the first half of the 2012, the Group has changed the presentation of the fair value unwind to include those amounts related to asset sales within that line item. Comparative figures have been restated accordingly.

MANAGEMENT BASIS CONSOLIDATED INCOME STATEMENT – NON-CORE (continued)

Half-year to 30 June 2011	Retail £m	Wholesale £m	Commercial £m	Wealth, Asset Finance and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	182	134	15	483	5	–	819
Other income	10	315	1	217	37	–	580
Insurance claims	–	–	–	–	–	–	–
Total underlying income, net of insurance claims	192	449	16	700	42	–	1,399
Total costs	(3)	(111)	(3)	(335)	(20)	–	(472)
Impairment	(121)	(1,035)	–	(2,630)	–	–	(3,786)
Underlying profit (loss)	68	(697)	13	(2,265)	22	–	(2,859)
Asset sales1	–	2	–	(21)	–	–	(19)
Volatile items	–	–	–	–	–	–	–
Liability management	–	–	–	–	–	–	–
Fair value unwind1	124	892	–	100	–	–	1,116
Management profit (loss)	192	197	13	(2,186)	22	–	(1,762)
Banking net interest margin	1.19%	0.92%	2.01%	1.41%			1.20%
Impairment as a % of average advances	0.81%	3.49%	0.00%	8.11%			4.87%
Key balance sheet items	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	28.9	43.9	1.7	50.3			124.8
Customer deposits excluding repos	–	2.9	0.3	1.3			4.5
Total non-core assets	28.9	76.6	1.7	52.3	0.8	2.1	162.4
Risk-weighted assets	11.6	61.4	1.8	53.9			128.7

1 During the first half of the 2012, the Group has changed the presentation of the fair value unwind to include those amounts related to asset sales within that line item. Comparative figures have been restated accordingly.

MANAGEMENT BASIS CONSOLIDATED INCOME STATEMENT – NON-CORE (continued)

Half-year to 31 December 2011	Retail £m	Wholesale £m	Commercial £m	Wealth, Asset Finance and Int'l £m	Insurance £m	Group Operations and Central items £m	Group £m
Net interest income	69	25	7	392	5	–	498
Other income	12	176	–	107	89	–	384
Insurance claims	–	–	–	–	–	–	–
Total underlying income, net of insurance claims	81	201	7	499	94	–	882
Total costs	(3)	(96)	(3)	(290)	(20)	(55)	(467)
Impairment	(53)	(925)	(7)	(2,129)	–	–	(3,114)
Underlying profit (loss)	25	(820)	(3)	(1,920)	74	(55)	(2,699)
Asset sales1	–	79	–	–	–	–	79
Volatile items	–	–	–	–	–	–	–
Liability management	–	–	–	–	–	–	–
Fair value unwind1	58	574	–	86	–	–	718
Management profit (loss)	83	(167)	(3)	(1,834)	74	(55)	(1,902)
Banking net interest margin	0.46%	0.51%	0.80%	1.24%			0.81%
Impairment as a % of average advances	0.36%	3.51%	0.92%	7.03%			4.32%
Key balance sheet items	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Loans and advances to customers excluding reverse repos	27.7	40.6	1.4	42.1			111.8
Customer deposits excluding repos	–	2.8	0.3	1.3			4.4
Total non-core assets	27.7	66.8	1.4	44.2	0.6	–	140.7
Risk-weighted assets	10.6	53.4	1.6	43.2			108.8

1 During the first half of the 2012, the Group has changed the presentation of the fair value unwind to include those amounts related to asset sales within that line item. Comparative figures have been restated accordingly.

QUARTERLY MANAGEMENT BASIS INFORMATION – GROUP

Group	Quarter ended 30 June 2012 £ million	Quarter ended 31 March 2012 £ million
Net interest income	2,582	2,633
Other income	2,061	2,203
Insurance claims	(125)	(108)
Total underlying income, net of insurance claims	4,518	4,728
Total costs	(2,461)	(2,564)
Impairment	(1,500)	(1,657)
Underlying profit	557	507
Asset sales	463	122
Volatile items	(610)	(199)
Liability management	–	168
Fair value unwind	127	30
Management profit	537	628
Banking net interest margin	1.91%	1.95%
Cost:income ratio	54.5%	54.2%
Impairment as a % of average advances	1.05%	1.14%
Return on risk-weighted assets	0.66%	0.58%

Group	Quarter ended 31 Dec 2011 £ million	Quarter ended 30 Sept 2011 £ million	Quarter ended 30 June 2011 £ million	Quarter ended 31 March 2011 £ million
Net interest income	2,803	3,052	3,057	3,298
Other income	2,246	1,987	2,554	2,392
Insurance claims	(58)	(87)	(84)	(114)
Total underlying income, net of insurance claims	4,991	4,952	5,527	5,576
Total costs	(2,712)	(2,577)	(2,581)	(2,751)
Impairment	(2,409)	(1,956)	(2,814)	(2,608)
Underlying profit (loss)	(130)	419	132	217
Asset sales	208	(12)	9	79
Volatile items	(528)	142	91	(443)
Liability management	1,295	–	–	–
Fair value unwind	92	95	588	431
Management profit (loss)	937	644	820	284

Banking net interest margin	1.97%	2.05%	2.09%	2.16%
Cost:income ratio	54.3%	52.0%	46.7%	49.3%
Impairment as a % of average advances	1.63%	1.30%	1.84%	1.70%
Return on risk-weighted assets	(0.14)%	0.44%	0.14%	0.22%

QUARTERLY MANAGEMENT BASIS INFORMATION – CORE BUSINESS

Core	Quarter ended 30 June 2012 £ million	Quarter ended 31 March 2012 £ million
Net interest income	2,487	2,461
Other income	1,888	1,999
Insurance claims	(125)	(108)
Total underlying income, net of insurance claims	4,250	4,352
Total costs	(2,304)	(2,343)
Impairment	(566)	(412)
Underlying profit	1,380	1,597
Asset sales	445	196
Volatile items	(610)	(199)
Liability management	–	168
Fair value unwind	(78)	(184)
Management profit	1,137	1,578
Banking net interest margin	2.32%	2.32%
Cost:income ratio	54.2%	53.8%
Impairment as a % of average advances	0.52%	0.36%
Return on risk-weighted assets	2.31%	2.65%

Core	Quarter ended 31 Dec 2011 £ million	Quarter ended 30 Sept 2011 £ million	Quarter ended 30 June 2011 £ million	Quarter ended 31 March 2011 £ million
Net interest income	2,596	2,761	2,682	2,854
Other income	2,000	1,849	2,235	2,131
Insurance claims	(58)	(87)	(84)	(114)
Total underlying income, net of insurance claims	4,538	4,523	4,833	4,871
Total costs	(2,456)	(2,366)	(2,341)	(2,519)
Impairment	(640)	(611)	(907)	(729)
Underlying profit	1,442	1,546	1,585	1,623
Asset sales	111	6	48	59
Volatile items	(528)	142	91	(443)
Liability management	1,295	–	–	–
Fair value unwind	(346)	(185)	(64)	(33)
Management profit	1,974	1,509	1,660	1,206

Banking net interest margin	2.34%	2.47%	2.39%	2.47%
Cost:income ratio	54.1%	52.3%	48.4%	51.7%
Impairment as a % of average advances	0.56%	0.55%	0.80%	0.64%
Return on risk-weighted assets	2.32%	2.43%	2.48%	2.53%

QUARTERLY MANAGEMENT BASIS INFORMATION – NON-CORE BUSINESS

Non-core	Quarter ended 30 June 2012 £ million	Quarter ended 31 March 2012 £ million
Net interest income	95	172
Other income	173	204
Insurance claims	–	–
Total underlying income, net of insurance claims	268	376
Total costs	(157)	(221)
Impairment	(934)	(1,245)
Underlying loss	(823)	(1,090)
Asset sales	18	(74)
Volatile items	–	–
Liability management	–	–
Fair value unwind	205	214
Management loss	(600)	(950)
Banking net interest margin	0.50%	0.70%
Impairment as a % of average advances	2.88%	3.71%

Non-core	Quarter ended 31 Dec 2011 £ million	Quarter ended 30 Sept 2011 £ million	Quarter ended 30 June 2011 £ million	Quarter ended 31 March 2011 £ million
Net interest income	207	291	375	444
Other income	246	138	319	261
Insurance claims	–	–	–	–
Total underlying income, net of insurance claims	453	429	694	705
Total costs	(256)	(211)	(240)	(232)
Impairment	(1,769)	(1,345)	(1,907)	(1,879)
Underlying loss	(1,572)	(1,127)	(1,453)	(1,406)
Asset sales	97	(18)	(39)	20
Volatile items	–	–	–	–
Liability management	–	–	–	–
Fair value unwind	438	280	652	464
Management loss	(1,037)	(865)	(840)	(922)
Banking net interest margin	0.75%	0.87%	1.16%	1.24%
Impairment as a % of average advances	5.01%	3.64%	4.93%	4.82%

ADDITIONAL INFORMATION ON A MANAGEMENT BASIS

1. Basis of preparation of management basis information

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

- In order to reflect the impact of the acquisition of HBOS, the following adjustments have been made:
  - the amortisation of purchased intangible assets has been excluded; and
  - the unwind of acquisition-related fair value adjustments is shown on one line in the management basis income statement, other than unwind related to asset sales which is included within the effects of asset sales, volatile items and liability management.
- In order to better present the business performance the effects of liability management, volatile items and asset sales are shown on separate lines in the management basis consolidated income statement and 'underlying profit' is profit before taking into account these items and fair value unwind. Comparatives have been restated accordingly.
- The following items, not related to acquisition accounting, have also been excluded from management profit:
  - volatility arising in insurance businesses;
  - Integration and Simplification costs;
  - EC mandated retail business disposal costs;
  - the payment protection insurance provision;
  - insurance gross up;
  - certain past service pensions credits in respect of the Group's defined benefit pension schemes; and
  - the provision in relation to German insurance business litigation.

Following an increase in activity in the first half of 2012, sales of centrally held government bonds are now included in asset sales; comparatives have been restated accordingly.

1. Basis of preparation of management basis information (continued)

The tables below set out a reconciliation from the published statutory results to the management basis results:

Half-year to 30 June 2012	Lloyds Banking Group statutory £m	Removal of: Acquisition related and other items1 £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Payment protection insurance provision £m	Fair value unwind £m	Management basis £m
Net interest income	4,658	(80)	(2)	327	–	312	5,215
Other income	11,595	136	26	(7,468)	–	(25)	4,264
Insurance claims	(7,288)	–	–	7,055	–	–	(233)
Total underlying income, net of insurance claims	8,965	56	24	(86)	–	287	9,246
Operating expenses2	(6,676)	505	–	86	1,075	(15)	(5,025)
Impairment	(2,728)	–	–	–	–	(429)	(3,157)
Underlying profit (loss)	(439)	561	24	–	1,075	(157)	1,064
Asset sales		585	–	–	–	–	585
Volatile items		(809)	–	–	–	–	(809)
Liability management		168	–	–	–	–	168
Fair value unwind		–	–	–	–	157	157
(Loss) profit	(439)	505	24	–	1,075	–	1,165

1 Comprises the effects of asset sales (gain of £585 million), volatile items (loss of £809 million), liability management (gain of £168 million), Simplification costs related to severance, IT and business costs of implementation (£274 million), EC mandated retail business disposal costs (£239 million) and the amortisation of purchased intangibles (£242 million) and the past service pensions credit (£250 million).

2 Under the management basis, this is described as total costs.

1. Basis of preparation of management basis information (continued)

Half-year to 30 June 2011	Lloyds Banking Group statutory £m	Removal of: Acquisition related and other items1 £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Payment protection insurance £m	Fair value unwind £m	Management basis £m
Net interest income	5,989	(23)	(10)	102	–	297	6,355
Other income	10,540	287	187	(5,644)	–	(424)	4,946
Insurance claims	(5,661)	–	–	5,463	–	–	(198)
Total underlying income, net of insurance claims	10,868	264	177	(79)	–	(127)	11,103
Operating expenses2	(9,628)	978	–	79	3,200	39	(5,332)
Impairment	(4,491)	–	–	–	–	(931)	(5,422)
Underlying (loss) profit	(3,251)	1,242	177	–	3,200	(1,019)	349
Asset sales		88	–	–	–	–	88
Volatile items		(352)	–	–	–	–	(352)
Liability management		–	–	–	–	–	–
Fair value unwind		–	–	–	–	1,019	1,019
(Loss) profit	(3,251)	978	177	–	3,200	–	1,104

1 Comprises the effects of asset sales (gain of £88 million), volatile items (loss of £352 million), integration and Simplification costs related to severance, IT and business costs of implementation (£642 million), EC mandated retail business disposal costs (£47 million) and the amortisation of purchased intangibles (£289 million).

2 Under the management basis, this is described as total costs.

Half-year to 31 December 2011	Lloyds Banking Group statutory £m	Removal of: Acquisition related and other items1 £m	Volatility arising in insurance businesses £m	Insurance gross up £m	Legal and regulatory provisions2 £m	Fair value unwind £m	Management basis £m
Net interest income	6,709	(820)	(9)	(438)	–	413	5,855
Other income	3,605	(285)	670	114	–	129	4,233
Insurance claims	(380)	–	–	235	–	–	(145)
Total underlying income, net of insurance claims	9,934	(1,105)	661	(89)	–	542	9,943
Operating expenses3	(6,622)	1,036	–	89	175	33	(5,289)
Impairment	(3,603)	–	–	–	–	(762)	(4,365)
Underlying (loss) profit	(291)	(69)	661	–	175	(187)	289
Asset sales		196	–	–	–	–	196
Volatile items		(386)	–	–	–	–	(386)

Liability management		1,295	–	–	–	–	1,295
Fair value unwind		–	–	–	–	187	187
(Loss) profit	(291)	1,036	661	–	175	–	1,581

1 Comprises the effects of asset sales (gain of £196 million), volatile items (loss of £386 million), liability management (gain of £1,295 million), integration and Simplification costs related to severance, IT and business costs of implementation (£640 million), EC mandated retail business disposal costs (£123 million) and the amortisation of purchased intangibles (£273 million).

2 Comprises the provision in relation to German insurance business litigation (£175 million).

3 Under the management basis, this is described as total costs.

2. Banking net interest margin

	Half-year to 30 June 2012	Half-year to 30 June 2011	Half-year to 31 Dec 2011
Banking net interest margin			
Banking net interest income	£5,300m	£6,280m	£5,814m
Average interest-earning banking assets	£553.2bn	£596.5bn	£574.4bn
Average interest-bearing banking liabilities	£383.3bn	£358.8bn	£369.1bn
Banking net interest margin	1.93%	2.12%	2.01%
Banking asset margin	1.10%	1.54%	1.38%
Banking liability margin	1.19%	0.97%	0.98%
Core			
Banking net interest margin	2.32%	2.43%	2.40%
Banking net interest income	£4,921m	£5,383m	£5,229m
Average interest-earning banking assets	£426.5bn	£445.9bn	£431.6bn
Non-core			
Banking net interest margin	0.60%	1.20%	0.81%
Banking net interest income	£379m	£897m	£585m
Average interest-earning banking assets	£126.7bn	£150.6bn	£142.8bn

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

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

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

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Half-year to 31 Dec 2011 £m
Banking net interest income – management basis	5,300	6,280	5,814

Insurance division	(37)	(25)	(42)
Other net interest income (including trading activity)	(48)	100	83
Group net interest income – management basis	5,215	6,355	5,855
Fair value unwind	(312)	(297)	(413)
Banking volatility and liability management gains	80	23	820
Insurance gross up	(327)	(102)	438
Volatility arising in insurance businesses	2	10	9
Group net interest income – statutory	4,658	5,989	6,709

3. Volatility arising in insurance businesses

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

In the first half of 2012 the Group's statutory result before tax included negative insurance and policyholder interests volatility totalling £24 million compared to negative volatility of £177 million in the first half of 2011.

Volatility comprises the following:

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m
Insurance volatility	(6)	(69)
Policyholder interests volatility1	(15)	(106)
Total volatility	(21)	(175)
Insurance hedging arrangements	(3)	(2)
Total	(24)	(177)

1 Includes volatility relating to the Group's interest in St James's Place.

Insurance volatility

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

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

United Kingdom (Sterling)	2012 %	2011 %	2010 %
Gilt yields (gross)	2.48	3.99	4.45
Equity returns (gross)	5.48	6.99	7.45
Dividend yield	3.00	3.00	3.00
Property return (gross)	5.48	6.99	7.45
Corporate bonds in unit-linked and with-profit funds (gross)	3.08	4.59	5.05
Fixed interest investments backing annuity liabilities (gross)	3.89	4.78	5.30

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

The negative insurance volatility during the period ended 30 June 2012 in the Insurance division was £6 million, primarily reflecting lower cash returns compared to long-term expectations. This has been broadly offset by the favourable performance of equity investments in the period.

3. Volatility arising in insurance businesses (continued)

Group hedging arrangements

To protect against further deterioration in equity market conditions, and the consequent negative impact on the value of in-force business on the Group balance sheet, the Group purchased put option contracts in 2011, financed by selling some upside potential from equity market movements. These expired in 2012 and the charge booked in 2012 on these contracts was £3 million. New protection was acquired in 2012 to replace the expired contracts. There was no initial cost associated with these hedging arrangements. On a mark-to-market valuation basis the new contracts were profit neutral in the first half of 2012.

Policyholder interests volatility

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

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

In the first half of 2012, the statutory results before tax included a charge to other income which relates to policyholder interests volatility totalling £15 million (first half of 2011: £106 million).

4. Number of employees (full-time equivalent)

	As at 30 June 2012	As at 31 Dec 2011
Retail	42,671	43,264
Wholesale	3,703	3,713
Commercial	5,216	5,227
Wealth, Asset Finance and International	9,789	10,148
Insurance	6,233	6,475
Group Operations	20,662	22,059
Central items	12,171	12,488
	100,445	103,374
Agency staff (full-time equivalent)	(4,470)	(4,836)
Total number of employees (full-time equivalent)	95,975	98,538

RISK MANAGEMENT

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

RISK MANAGEMENT APPROACH

There have been no material changes to the Group's approach to risk management as described in the risk management report within the Lloyds Banking Group annual report and accounts for the year ended 31 December 2011.

PRINCIPAL RISKS AND UNCERTAINTIES

Economy

Global economic growth deteriorated in the first half of 2012. Emerging markets, having been the mainstay of global growth since the financial crisis broke, slowed as last year's monetary policy tightening designed to tackle rising inflation took effect. In the Eurozone, some countries with particularly high government debt or deficit levels have struggled to achieve the necessary fiscal tightening to bring their public finances onto a sustainable trajectory, and their growth prospects weakened significantly as more tightening was planned and their costs of sovereign borrowing rose. Greece completed a private sector sovereign debt restructuring, but it remains unclear that their government finances are yet on a sustainable trajectory and that the economy can start to recover while further sharp budget reductions are attempted. Fiscal slippage was most significant in Spain, and combined with lack of clarity over how and when required capital injections for the banks can be taken on by the European Stability Mechanism rather than individual governments has caused financial markets to lose confidence in the sustainability of the sovereign debt position as their recession deepens. Given the unwillingness of creditor countries within the Eurozone to enact a quick solution to the crisis in the form of fiscal union, due to political difficulty and concerns that it would reduce pressure for necessary reforms, speculation of Euro break-up in some form increased and in turn reduced business confidence. In the US, public finance concerns are less immediate, but the unsustainable long-term trajectory of debt on current policies has led to political stalemate, raising the risk of sudden fiscal tightening at the start of 2013 as previous loosening measures expire.

Whilst initial GDP estimates are unreliable, current data suggests the UK economy entered a 'double-dip' recession in the first quarter of 2012, on the technical definition of two consecutive quarters of falling GDP. Preliminary data for the second quarter shows a further dip. The underlying declines in GDP across the three quarters are small, however, and generally consistent with a broadly stagnant economy rather than one falling into a deepening contraction. The worsening outlook for the Eurozone is encouraging companies to postpone investment spending and recruitment, and consumers' incomes continue to be squeezed by declining wage growth offsetting the recent improvement in inflation. Unemployment, however, declined slightly from 8.4 per cent in the final quarter of 2011 to 8.1 per cent in the three months to May 2012. Company failures in England and Wales rose further in the first quarter to 4,303 from 4,294 in the fourth quarter of 2011 and a low point of 3,965 in the third quarter of 2010, although the failure rate remained steady at just 0.7 per cent of companies, close to its pre-recession trough. Property prices have been mixed so far this year – house prices on average rose marginally by 1.6 per cent between December 2011 and June 2012, and commercial property prices fell on average by 2 per cent.

The Irish economy appears to have grown in 2011 for the first time since 2007, by 1.4 per cent, and the unemployment rate appears to have stabilised. Strict austerity measures in recent years targeted at improving international competitiveness are beginning to pay off – weak domestic demand is now being more than offset by increasing net exports. Property markets remain very weak, however; house prices fell by over 16 per cent in 2011 and CRE prices by 11 per cent. Despite the large fall in prices already, an overhang of vacant property continues to weigh on market prices. House prices fell by a further 5 per cent in the first five months of 2012, and CRE prices by 1.8 per cent during the first quarter.

Future economic developments in the UK and Ireland are highly contingent on how successful political leaders are at stemming the Eurozone crisis, to what extent the private sector can offset shrinking of the public sector, and how the implementation of new regulation on banks impacts their ability to supply credit whilst meeting tighter capital and liquidity criteria. The recent weakening in the Eurozone economy and the balance of risks make recession there through 2012 the most likely scenario.

PRINCIPAL RISKS AND UNCERTAINTIES (continued)

The current consensus view for 2012 UK GDP growth is 0.1 per cent. The low level of imbalances in the economy relative to the 2008 position suggest that weak growth should not deteriorate into significant recession provided the Eurozone crisis doesn't deteriorate further. The UK Bank Rate is likely to stay at current low levels through the remainder of this year and next. House prices are expected to be broadly stable over 2012-13, and CRE prices to fall by around 5 per cent this year before stabilising in 2013. Unemployment is likely to rise further, however, as significant public sector job cuts remain to be made. The current consensus view for 2012 Irish GDP growth is for another year of very weak but positive growth in 2012, and the unemployment rate there is expected to remain broadly stable through the rest of the year. We expect property prices to fall further through the second half of 2012, but overall by less than in 2011 – indeed recent months suggest that the decline in house prices has already slowed significantly.

However, whilst creditor Eurozone countries continue to inch only slowly towards a definitive solution to the sovereign debt crisis there continues to be a high risk that ongoing uncertainty around the Eurozone economic outlook, the survival of the Euro currency and the availability of credit could result in an even longer period of stagnation in the UK and Ireland, or could cause a significant recession. Either scenario would likely result in higher unemployment and higher corporate failures in the UK. A deeper recession would likely lead to a second leg of falling UK property prices, albeit by less than during the 2008-9 recession, and rising commercial tenant defaults. Irish property prices would also fall by more than currently expected. In turn, these developments would have a negative impact on the Group's income, funding costs and impairment charges.

Liquidity and funding risk

Liquidity and funding continues to remain a key area of focus for the Group and the industry as a whole. Like all major banks, the Group is dependent on maintaining confidence in the short and long-term wholesale funding markets. Should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding, its ability to fund its financial obligations could be impacted.

During the first half of 2012 there has been strong investor demand across a range of term products, notwithstanding fears over the Eurozone and the threat of credit rating downgrades. The Group took advantage of this demand and completed its full year 2012 term funding requirement in the first half. The stock of primary liquid assets increased during the half and the Group continued to meet its regulatory liquidity ratios at all times.

The key dependencies on successfully funding the Group's balance sheet include the continued functioning of the money and capital markets; successful right-sizing of the Group's balance sheet; the repayment of the Government Credit Guarantee Scheme facilities in accordance with the agreed terms; no further deterioration in the Group's credit rating; and no significant or sudden withdrawal of deposits resulting in increased reliance on money markets. Additionally, the Group has entered into a number of EU state aid related obligations to achieve reductions in certain parts of its balance sheet by the end of 2014 (further details are provided on page 144). These are assumed within the Group's funding plan. The requirement to meet this deadline may result in the Group having to provide funding to support these asset reductions and/or disposals and may also result in a lower price being achieved.

The combination of right-sizing the balance sheet and continued development of the retail deposit base has seen the Group's wholesale funding requirement reduced materially in the past three years. The progress the Group has made to date in diversifying its funding sources has further strengthened its funding base with further significant progress during the first half of 2012.

Group funding by type

	As at 30 June 2012 £bn	As at 30 June 2012 %	As at 31 Dec 2011 £bn	As at 31 Dec 2011 %
Deposits from banks1	21.8	3.4	25.4	3.9
Debt securities in issue:1				
Certificates of deposit	16.9	2.7	28.0	4.3
Commercial paper	8.4	1.3	18.0	2.7
Medium-term notes2	53.3	8.4	69.8	10.6
Covered bonds	40.6	6.4	36.6	5.6
Securitisation	37.6	6.0	37.5	5.7
	156.8	24.8	189.9	28.9
Subordinated liabilities1	35.2	5.6	35.9	5.4
Total wholesale funding3	213.8	33.8	251.2	38.2
Customer deposits	419.1	66.2	405.9	61.8
Total Group funding4	632.9	100.0	657.1	100.0

1 A reconciliation to the Group's balance sheet is provided on page 96.
2

Medium-term notes include £4.9 billion of funding from the Credit Guarantee Scheme (31 December 2011: £23.5 billion).

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

4 Excluding repos and total equity.

Total wholesale funding reduced by £37.4 billion to £213.8 billion, the volume with a residual maturity less than one year falling £40.0 billion to £73.3 billion. Term wholesale funding for the year totalled £19.5 billion, in excess of plan. The Group term funding ratio (wholesale funding with a remaining life of over one year as a percentage of total wholesale funding) improved to 65.7 per cent (55 per cent at 31 December 2011) due to good progress in new term issuance and a significant reduction in short-term money market funding.

Liquidity and funding risk (continued)

Total wholesale funding is analysed by residual maturity as follows:

Wholesale funding by residual maturity

	As at 30 June 2012 £bn	As at 30 June 2012 %	As at 31 Dec 2011 £bn	As at 31 Dec 2011 %
Less than one year	73.3	34.3	113.3	45.1
One to two years	25.5	11.9	26.0	10.4
Two to five years	58.4	27.3	60.2	23.9
More than five years	56.6	26.5	51.7	20.6
Total wholesale funding	213.8	100.0	251.2	100.0
Less than one year	73.3	34.3	113.3	45.1
Of which secured	18.5	25.2	24.4	21.5
Of which unsecured	54.8	74.8	88.9	78.5
Greater than one year	140.5	65.7	137.9	54.9
Of which secured	64.3	45.8	63.0	45.7
Of which unsecured	76.2	54.2	74.9	54.3

Wholesale funding less than one year includes money markets funding of £44.4 billion (31 December 2011: £69.1 billion; 30 June 2011: £92.9 billion). The total money markets funding at 30 June 2012 was £47.1 billion.

The table below summarises the Group's term issuance during 2012. The challenge of meeting the Group's 2012 issuance plan in a very volatile market was successfully accomplished by the ability of the Group to access a diverse range of markets and currencies, both in unsecured and secured form.

Analysis of 2012 term issuance

	Sterling £bn	US Dollar £bn	Euro £bn	Other currencies £bn	Total £bn
Securitisation	1.0	1.6	1.2	0.5	4.3
Medium-term notes	1.4	0.9	1.3	0.5	4.1
Covered bonds	2.5	–	1.0	–	3.5
Private placements[1]	3.7	1.0	1.1	1.8	7.6
Total issuance	8.6	3.5	4.6	2.8	19.5

1 Private placements include structured bonds and term repurchase agreements (repos).

The wholesale funding position includes debt issued under the legacy Government Credit Guarantee Scheme, for which the last maturity will occur in October 2012.

The ratio of customer loans to deposits improved to 126 per cent compared with 135 per cent at 31 December 2011. Loans and advances reduced by £20 billion and customer deposits increased by £13 billion, representing growth of 3 per cent in 2012.

Liquidity and funding risk (continued)

Group funding position

	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Change %
Funding requirement			
Loans and advances to customers1	528.6	548.8	(4)
Loans and advances to banks2	9.5	10.3	(8)
Debt securities	6.5	12.5	(48)
Reverse repurchase agreements	0.3	–	
Available-for-sale financial assets – secondary3	7.7	12.0	(36)
Cash balances4	3.2	4.1	(22)
Funded assets	555.8	587.7	(5)
Other assets5	296.1	286.1	3
Total Group assets before primary liquidity assets	851.9	873.8	(3)
On balance sheet primary liquidity assets6			
Reverse repurchase agreements	5.8	17.3	(66)
Balances at central banks – primary4	84.4	56.6	49
Available-for-sale financial assets – primary	25.1	25.4	(1)
Held to maturity	10.9	8.1	35
Trading and fair value through profit and loss	(13.2)	(3.5)	
Repurchase agreements	(3.5)	(7.2)	51
	109.5	96.7	13
Total Group assets	961.4	970.5	(1)
Less: Other liabilities5	(258.2)	(251.6)	(3)
Funding requirement	703.2	718.9	(2)
Funded by			
Customer deposits7	419.1	405.9	3
Wholesale funding	213.8	251.2	(15)
	632.9	657.1	
Repurchase agreements	23.7	15.2	56
Total equity	46.6	46.6	
Total funding	703.2	718.9	(2)

1 Excludes £5.8 billion (31 December 2011: £16.8 billion) of reverse repurchase agreements.

2 Excludes £22.0 billion (31 December 2011: £21.8 billion) of loans and advances to banks within the insurance businesses and £0.3 billion (31 December 2011: £0.5 billion) of reverse repurchase agreements.

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

4 Cash balances and balances at central banks – primary are combined in the Group's balance sheet.

5 Other assets and other liabilities primarily include balances in the Group's insurance businesses and the fair value of derivative assets and liabilities.

6

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

7 Excluding repurchase agreements of £4.1 billion (31 December 2011: £8.0 billion).

Liquidity and funding risk (continued)

Encumbered assets

The Group remains a consistent issuer in a number of secured funding markets, in particular Retail Mortgage Backed Securities (RMBS) and covered bonds.

The Group's level of encumbrance arising from external issuance of securitisation and covered bonds has remained broadly constant, reflecting the maturity and stability of the Group's utilisation of this form of term funding, and the established cycle of redemptions and new issuance. Total notes issued externally from secured programmes (ABS and covered bonds) have increased from £74.1 billion at 31 December 2011 to £78.2 billion, reflecting gross issuance of £7.8 billion in the first half of 2012. The Group is able to access open market operations and apply to access liquidity facilities at a number of central banks and a total of £76.7 billion (2011: £118.5 billion) of notes issued under securitisation and covered bond programmes have been retained internally, the bulk of which are held to provide pools of collateral eligible for use in central banks' liquidity facilities and operations.

Reconciliation of Group funding figure to the balance sheet

As at 30 June 2012	Included in funding analysis (above) £bn	Repos £bn	Fair value and other accounting methods £bn	Balance sheet £bn
Deposits from banks	21.8	23.1	–	44.9
Debt securities in issue	156.8	–	(6.3)	150.5
Subordinated liabilities	35.2	–	(0.4)	34.8
Total wholesale funding	213.8	23.1		
Customer deposits	419.1	4.1	–	423.2
Total	632.9	27.2		

As at 31 December 2011	Included in funding analysis (above) £bn	Repos £bn	Fair value and other accounting methods £bn	Balance sheet £bn
Deposits from banks	25.4	14.4	–	39.8
Debt securities in issue	189.9	–	(4.8)	185.1
Subordinated liabilities	35.9	–	(0.8)	35.1
Total wholesale funding	251.2	14.4		
Customer deposits	405.9	8.0	–	413.9
Total	657.1	22.4		

Liquidity and funding risk (continued)

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

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

The Group's stress testing framework considers these factors, including the impact of a range of economic and liquidity stress scenarios over both short and longer term horizons. Internal stress testing results at 30 June 2012 show that the Group has liquidity resources representing more than 167 per cent of modelled outflows from all wholesale funding sources, corporate deposits and rating dependent contracts under the Group's severe liquidity stress scenario. In the first half of 2012, the Group has maintained its liquidity levels in excess of the ILG regulatory minimum (FSA's Individual Liquidity Adequacy Standards) at all times. Funding projections show the Group will achieve the proposed Basel 3 liquidity and funding requirements in advance of expected implementation dates.

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

Within the Group's stress testing framework, the more severe scenarios assume the Group being able to access open market operations and apply to access liquidity facilities at a number of central banks.

The Group's borrowing costs and issuance in the capital markets are dependent on a number of factors, and increased cost or reduction of capacity could materially adversely affect the Group's results of operations, financial condition and prospects. In particular, reduction in the credit rating of the Group or deterioration in the capital markets' perception of the Group's financial resilience could significantly increase its borrowing costs and limit its issuance capacity in the capital markets. As an indicator over the last 12 months the spread between an index of A rated long-term senior unsecured bank debt and an index of similar BBB rated bank debt, both of which are publicly available, has ranged between 75 and 195 basis points. The applicability to and implications for the Group's funding cost would depend on the type of issuance, and prevailing market conditions. The impact on the Group's funding cost is subject to a number of assumptions and uncertainties and is therefore impossible to quantify precisely.

Downgrades of the Group's long-term debt rating could lead to additional collateral posting and cash outflow. A hypothetical simultaneous one or two notch downgrade of the Group's long-term debt rating from all major rating agencies, triggering a short term ratings downgrade after initial actions within management's control, could result in an outflow of £4 billion of collateral posting related to customer financial contracts and £16 billion of cash and £22 billion of collateral posting associated with secured funding programmes. The Group continues to consider other management and restructuring actions that could materially reduce the amount of required collateral postings under derivative contracts related to its own secured funding programmes.

The downgrades that the Group has experienced since the fourth quarter of 2011, did not significantly change its borrowing costs, reduce its issuance capacity or require significant collateral posting. Even in the case of a simultaneous two notch downgrade from all rating agencies, the Group would remain investment grade.

Liquidity and funding risk (continued)

At 30 June 2012, the Group had £215 billion of highly liquid unencumbered assets in its liquidity portfolio which are available to meet cash and collateral outflows, as illustrated in the table below. This liquidity is available for deployment at immediate notice, subject to complying with regulatory requirements, and is a key component of the Group's liquidity management process.

Liquidity portfolio:

	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn
Primary liquidity	105.0	94.8
Secondary liquidity	109.9	107.4
Total	214.9	202.2

Primary liquidity	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Average 2012 £bn	Average 2011 £bn
Central bank cash deposits	84.4	56.6	76.4	51.4
Government bonds	20.6	38.2	27.2	48.4
Total	105.0	94.8	103.6	99.8

Secondary liquidity	As at 30 June 2012 £bn	As at 31 Dec 2011 £bn	Average 2012 £bn	Average 2011 £bn
High-quality ABS/covered bonds	1.9	1.4	1.9	8.0
Credit institution bonds	3.5	2.1	2.3	3.7
Corporate bonds	0.1	0.3	0.2	0.6
Own securities (retained issuance)	47.1	81.6	55.3	76.8
Other securities	9.2	8.6	8.7	9.2
Other1	48.1	13.4	44.1	6.4
Total	109.9	107.4	112.5	104.7

1 Includes other central bank eligible assets.

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

Primary liquid assets of £105 billion represent approximately 223 per cent (133 per cent at 31 December 2011) of the Group's money market funding positions and are approximately 143 per cent (84 per cent at 31 December 2011) of all wholesale funding with a maturity of less than a year, and thus provides substantial buffer in the event of continued market dislocation.

Many central banks provide open market operations and liquidity facilities such as the European Central Bank's Long-Term Refinancing Operation and the Bank of England's Sterling Monetary Framework Operations. The Group is able to access open market operations and apply to access liquidity facilities at a number of central banks and makes use of this ability as part of its liquidity management practices. Further use of such operations and facilities will be based on prudent liquidity management and economic considerations, having regard for external market conditions.

Liquidity and funding risk (continued)

The Group notes the Basel Committee's Principles of Sound Liquidity Risk Management and Supervision (Sound Principles). The planned introduction of the Liquidity Coverage Ratio (LCR – January 2015) and Net Stable Funding Ratio (NSFR – January 2018) contained within CRD IV are intended to raise the resilience of banks to potential liquidity shocks and provide the basis for a harmonised approach to liquidity risk management. The LCR measure promotes short-term resilience of the liquidity profile by ensuring that banks have sufficient high quality liquid assets to meet potential funding outflows in a stressed environment within a one month period. The NSFR promotes resilience over a longer time horizon by requiring banks to fund their activities with a more stable source of funding on a going concern basis. This has a time horizon of one year and has been developed to ensure a sustainable maturity structure of assets and liabilities.

The guidance issued by the Basel Committee is still subject to final ratification by the EU and the methodology is likely to be refined on the basis of feedback from banks and regulators during the observation period. The actions already announced to right size the balance sheet are expected to ensure compliance with the future minimum standards. These standards are expected to be 100 per cent for both ratios by their respective effective dates.

Credit risk – Group

Overview

- The Group achieved a significant reduction in its impairment charge from £5,422 million in the first half of 2011 to £3,157 million in the first half of 2012, a reduction of 42 per cent. This was due primarily to lower impairments in the non-core Irish and Australasian portfolios, together with strong Retail performance and lower charges on leveraged acquisition finance exposures within Wholesale.

- These lower charges were supported by the continued application of our conservative risk appetite and strong risk management controls resulting in an improved portfolio overall and good new business quality. The portfolio also benefited from continued low interest rates, and broadly stable UK retail property prices, partly offset by subdued UK economic growth, high unemployment and a weak commercial real estate market.

- The Group's overall core impairment charge of £978 million during the first half of 2012 was materially lower compared to £1,636 million in the first half of 2011, primarily driven by better performance in all divisions.

- The Group's non-core impairment charge in the first half of 2012 of £2,179 million was also materially lower compared to £3,786 million during the first half of 2011. This is primarily driven by lower impairment from the non-core Irish and Australasian portfolios.

- Prudent credit policies and procedures are in place throughout the Group, focusing on development of enduring client relationships through the cycle. As a result of this approach, the credit quality of new lending remains strong.

- The Group's more difficult exposures are being managed successfully in the current challenging economic environment by the Wholesale Business Support Units and Retail Collection and Recovery Units. The Group's exposure to Ireland is being closely managed, with a dedicated UK-based business support team in place to manage the winding down of the book.

- The Group continues to proactively manage down sovereign as well as banking and trading book exposure to selected Eurozone countries.

  - Divestment strategy is focused on balance sheet reduction and also on the disposal of higher risk positions.

Impairment charge by division

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Retail	758	1,173	35	797
Wholesale	993	1,442	31	1,259
Commercial	109	160	32	143
Wealth, Asset Finance and International	1,297	2,647	51	2,163
Central items	–	–		3
Total impairment charge	3,157	5,422	42	4,365

Credit risk – Group (continued)

Total impairment charge comprises:

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Total impairment losses on loans and advances to customers	3,082	5,369	43	4,343
Loans and advances to banks	–	–		–
Debt securities classified as loans and receivables	28	17	(65)	32
Available-for-sale financial assets	28	32	13	49
Other credit risk provisions	19	4		(59)
Total impairment charge	3,157	5,422	42	4,365

Impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans[3] %
Retail	350,611	8,367	2.4	2,441	33.5
Wholesale	117,976	22,534	19.1	9,381	41.6
Commercial	30,247	2,891	9.6	881	30.5
Wealth, Asset Finance and International	56,507	19,211	34.0	12,588	65.5
Reverse repos and other items	5,983	–		–	
	561,324	53,003	9.4	25,291	48.7
Impairment provisions	(25,291)				
Fair value adjustments[2]	(1,588)				
Total Group	534,445				
As at 31 December 2011					
Retail	356,907	8,822	2.5	2,718	35.4
Wholesale	128,233	26,539	20.7	10,791	40.7
Commercial	29,681	2,915	9.8	880	30.2
Wealth, Asset Finance and International	63,556	21,993	34.6	13,329	60.6
Reverse repos and other items	17,066	–		–	

	595,443	60,269	10.1	27,718	46.9
Impairment provisions	(27,718)				
Fair value adjustments[2]	(2,087)				
Total Group	565,638				

1 Impairment provisions include collective unimpaired provisions.

2 The fair value adjustments relating to loans and advances were those required to reflect the HBOS assets in the Group's consolidated financial records at their fair value and took into account both the expected future impairment losses and market liquidity at the date of acquisition. The unwind relating to future impairment losses requires significant management judgement to determine its timing which includes an assessment of whether the losses incurred in the current period were expected at the date of the acquisition and assessing whether the remaining losses expected at the date of the acquisition will still be incurred. The element relating to market liquidity unwinds to the income statement over the estimated useful lives of the related assets (until 2014 for wholesale loans and 2018 for retail loans) although if an asset is written off or suffers previously unexpected impairment then this element of the fair value will no longer be considered a timing difference (liquidity) but permanent (impairment). The fair value unwind in respect of impairment losses incurred was £429 million for the period ended 30 June 2012 (30 June 2011: £931 million; 31 December 2011: £762 million). The fair value unwind in respect of loans and advances is expected to continue to decrease in future years as fixed-rate periods on mortgages expire, loans are repaid or written off, and will reduce to zero over time.

3 Provisions as a percentage of impaired loans are calculated excluding Retail unsecured loans in recoveries (30 June 2012: £1,090 million; 31 December 2011: £1,137 million).

Credit risk – Group (continued)

Core impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Retail	735	1,052	30	744
Wholesale	111	407	73	334
Commercial	116	160	28	136
Wealth, Asset Finance and International	16	17	6	34
Central items	–	–		3
Core impairment charge	978	1,636	40	1,251

Core impairments on loans and advances

At 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions £m	Impairment provisions as a % of impaired loans1 %
Retail	323,167	6,732	2.1	2,062	36.0
Wholesale	74,506	2,621	3.5	1,775	67.7
Commercial	29,029	2,879	9.9	866	30.1
Wealth, Asset Finance and International	7,618	386	5.1	170	44.0
Reverse repos and other items	5,983	–		–	
	440,303	12,618	2.9	4,873	42.0
Impairment provisions	(4,873)				
Fair value adjustments	(1,005)				
Total core	434,425				
At 31 December 2011					
Retail	328,524	7,151	2.2	2,310	37.9
Wholesale	78,527	3,809	4.9	2,295	60.3
Commercial	28,289	2,885	10.2	858	29.7
Wealth, Asset Finance and International	8,236	360	4.4	125	34.7
Reverse repos and other items	17,066	–		–	
	460,642	14,205	3.1	5,588	42.5
Impairment provisions	(5,588)				

Fair value adjustments	(1,171)
Total core	453,883

1 Provisions as a percentage of impaired loans are calculated excluding Retail unsecured loans in recoveries (30 June 2012: £1,006 million; 31 December 2011: £1,054 million).

Credit risk – Group (continued)

Non-core impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Retail	23	121	81	53
Wholesale	882	1,035	15	925
Commercial	(7)	–		7
Wealth, Asset Finance and International	1,281	2,630	51	2,129
Non-core impairment charge	2,179	3,786	42	3,114

Non-core impairments on loans and advances

At 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions £m	Impairment provisions as a % of impaired loans1 %
Retail	27,444	1,635	6.0	379	24.4
Wholesale	43,470	19,913	45.8	7,606	38.2
Commercial	1,218	12	1.0	15	
Wealth, Asset Finance and International	48,889	18,825	38.5	12,418	66.0
Reverse repos and other items	–	–		–	
	121,021	40,385	33.4	20,418	50.7
Impairment provisions	(20,418)				
Fair value adjustments	(583)				
Total non-core	100,020				
At 31 December 2011					
Retail	28,383	1,671	5.9	408	25.7
Wholesale	49,706	22,730	45.7	8,496	37.4
Commercial	1,392	30	2.2	22	73.3
Wealth, Asset Finance and International	55,320	21,633	39.1	13,204	61.0
Reverse repos and other items	–	–		–	
	134,801	46,064	34.2	22,130	48.1
Impairment provisions	(22,130)				
Fair value adjustments	(916)				

Total non-core	111,755

1 Provisions as a percentage of impaired loans are calculated excluding Retail unsecured loans in recoveries (30 June 2012: £84 million; 31 December 2011: £83 million).

Credit risk – Group (continued)

Outlook – Group

The UK economy remains fragile, and the short-term economic outlook is generally expected to be weak. Consumer and business confidence remains low, and although inflation is reducing, consumer spending power is under pressure and exports are falling. However, companies continue to de-risk, and our core corporate and commercial portfolios are generally performing well despite the subdued environment. Whilst there is some cautious optimism in certain sectors (including manufacturing), a number of other sectors are seeing some stress (retail and leisure for example).

The possibility of further economic deterioration and financial market instability represent downside risk. Despite a number of actions from authorities, uncertainty over the best way forward for the highly indebted Eurozone persists and poses a serious threat to the global economic recovery. Financial markets are expected to remain dislocated and volatile, with the risk of contagion unlikely to dissipate in the near term, and this continues to place strains on funding markets at a time when many financial institutions have material ongoing funding needs.

In particular, given the subdued environment, our Wholesale leveraged finance portfolios, and our commercial real estate and real estate related property lending portfolios remain vulnerable in terms of refinancing risk and higher impairments on loans and advances and associated derivatives. Greater resilience in yield levels is evident at the prime end of the CRE market, whereas secondary yields are under pressure.

Notwithstanding the above, significant progress has been made to reduce the vulnerable assets in our portfolios and our risk management processes and controls remain strong. We expect impairments in our traditional lending portfolios in Corporate and Commercial to increase in the second half of 2012, reflecting an expected lower level of releases in the second half of 2012 compared to the first half of 2012.

Overall, despite the downside risks, the de-risking of our portfolios, the strong risk management focus and the low interest rate environment are helping to maintain defaults at a lower level. As a result, against our base case economic assumptions, the Group expects the total impairment charge in 2012 to be better than previously guided.

Credit risk – Retail

Overview

- The Retail impairment charge was £758 million in the first half of 2012, a decrease of £415 million, or 35 per cent, against the first half of 2011 and 5 per cent against the second half of 2011.

- The decrease in the Retail impairment charge was driven by both the secured and unsecured portfolio as a result of the continuing benefits of tightened credit policy and ongoing effective portfolio management.

- The Retail impairment charge, as an annualised percentage of average loans and advances to customers, decreased to 0.43 per cent in the first half of 2012 from 0.65 per cent in the first half of 2011.

- The overall value of assets entering arrears in the first half of 2012 was lower for both unsecured and secured lending compared to the second half of 2011.

- Non-core represents 8 per cent of total Retail assets as at 30 June 2012 and is primarily specialist mortgages. This book is closed to new business and has been in run-off since 2009.

Impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Secured	173	295	41	168
Unsecured	585	878	33	629
Total impairment charge	758	1,173	35	797
Core:				
Secured	149	202	26	128
Unsecured	586	850	31	616
	735	1,052	30	744
Non-core:				
Secured	24	93	74	40
Unsecured	(1)	28		13
	23	121	81	53
Total impairment charge	758	1,173	35	797

Impaired loans and provisions

Retail impaired loans decreased by £0.4 billion to £8.4 billion compared with 31 December 2011 and, as a percentage of closing loans and advances to customers, decreased to 2.4 per cent from 2.5 per cent at 31 December 2011. Impairment provisions as a percentage of impaired loans (excluding unsecured loans in recoveries) decreased to 33.5 per cent from 35.4 per cent at 31 December 2011 driven by the reduction in unsecured impaired loans.

Credit risk – Retail (continued)

Impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans3 %
Secured	327,223	6,353	1.9	1,619	25.5
Unsecured					
Collections		924		822	89.0
Recoveries2		1,090		–	
	23,388	2,014	8.6	822	
Total gross lending	350,611	8,367	2.4	2,441	33.5
Impairment provisions1	(2,441)				
Fair value adjustments	(1,146)				
Total	347,024				
As at 31 December 2011					
Secured	332,143	6,452	1.9	1,651	25.6
Unsecured					
Collections		1,233		1,067	86.5
Recoveries2		1,137		–	
	24,764	2,370	9.6	1,067	
Total gross lending	356,907	8,822	2.5	2,718	35.4
Impairment provisions	(2,718)				
Fair value adjustments	(1,377)				
Total	352,812				

1 Impairment provisions include collective unimpaired provisions.
2 Recoveries assets are written down to the present value of future expected cash flows on these assets.
3 Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.

The Retail division's loans and advances to customers are analysed in the following table:

Loans and advances to customers

	As at 30 June 2012 £m	As at 31 Dec 2011 £m
Secured:		
Mainstream	252,056	256,518

Buy to let	48,699	48,276
Specialist	26,468	27,349
	327,223	332,143
Unsecured:		
Credit cards	9,721	10,192
Personal loans	11,156	11,970
Bank accounts	2,511	2,602
	23,388	24,764
Total gross lending	350,611	356,907

Credit risk – Retail (continued)

Core impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans3 %
Secured	300,425	4,823	1.6	1,256	26.0
Unsecured					
Collections		903		806	89.3
Recoveries2		1,006		–	
	22,742	1,909	8.4	806	
Total gross lending	323,167	6,732	2.1	2,062	36.0
Impairment provisions	(2,062)				
Fair value adjustments	(950)				
Total core	320,155				
As at 31 December 2011					
Secured	304,589	4,895	1.6	1,265	25.8
Unsecured					
Collections		1,202		1,045	86.9
Recoveries2		1,054		–	
	23,935	2,256	9.4	1,045	
Total gross lending	328,524	7,151	2.2	2,310	37.9
Impairment provisions	(2,310)				
Fair value adjustments	(1,111)				
Total core	325,103				

1 Impairment provisions include collective unimpaired provisions.
2 Recoveries assets are written down to the present value of future expected cash flows on these assets.
3 Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.

Credit risk – Retail (continued)

Non-core impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans3 %
Secured	26,798	1,530	5.7	363	23.7
Unsecured					
Collections		21		16	76.2
Recoveries2		84		–	
	646	105	16.3	16	
Total gross lending	27,444	1,635	6.0	379	24.4
Impairment provisions	(379)				
Fair value adjustments	(196)				
Total non-core	26,869				
As at 31 December 2011					
Secured	27,554	1,557	5.7	386	24.8
Unsecured					
Collections		31		22	71.0
Recoveries2		83		–	
	829	114	13.8	22	
Total gross lending	28,383	1,671	5.9	408	25.7
Impairment provisions	(408)				
Fair value adjustments	(266)				
Total non-core	27,709				

1 Impairment provisions include collective unimpaired provisions.
2 Recoveries assets are written down to the present value of future expected cash flows on these assets.
3 Impairment provisions as a percentage of impaired loans are calculated excluding unsecured loans in recoveries.

Credit risk – Retail (continued)

Secured

Secured impairment charge
The impairment charge increased by £5 million, to £173 million compared with the second half of 2011, and decreased by £122 million compared with the first half of 2011. The annualised impairment charge, as a percentage of average loans and advances to customers, decreased to 0.11 per cent in the first half of 2012 from 0.18 per cent in the first half of 2011. Provision coverage has remained stable at 25.5 per cent compared to 25.6 per cent at 31 December 2011.

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

Secured impaired loans
Impaired loans decreased by £0.1 billion to £6.4 billion at 30 June 2012 and, as a percentage of closing loans and advances to customers, remained stable at 1.9 per cent compared to 31 December 2011.

Secured arrears
The percentage of mortgage cases greater than three months in arrears (excluding repossessions) was broadly stable at 2.4 per cent at 30 June 2012 compared to 31 December 2011. The number of specialist cases greater than three months in arrears decreased in the first half of 2012, however as the book remains closed to new business and has been in run-off since 2009 there was an increase in the percentage of cases greater than three months in arrears (excluding repossessions) to 7.7 per cent at 30 June 2012 compared to 7.5 per cent at 31 December 2011.

The number of customers entering into arrears was 6 per cent lower in the first half of 2012 in comparison with the second half of 2011.

Mortgages greater than three months in arrears (excluding repossessions)

Greater than three months in arrears (excluding repossessions)	Number of cases		Total mortgage accounts %		Value of debt1		Total mortgage balances %	
	30 June 2012	31 Dec 2011	30 June 2012	31 Dec 2011	30 June 2012	31 Dec 2011	30 June 2012	31 Dec 2011
	Cases	Cases	%	%	£m	£m	%	%
Mainstream	54,441	53,734	2.1	2.0	6,105	5,988	2.4	2.3
Buy to let	7,573	7,805	1.7	1.8	1,085	1,145	2.2	2.4
Specialist	13,654	13,677	7.7	7.5	2,407	2,427	9.1	8.9
Total	75,668	75,216	2.4	2.3	9,597	9,560	2.9	2.9

1 Value of debt represents total book value of mortgages in arrears.

The stock of repossession decreased to 2,955 cases at 30 June 2012 compared to 3,054 cases at 31 December 2011 and 3,176 cases at 30 June 2011.

Credit risk – Retail (continued)

Secured loan-to-value analysis

The average indexed loan-to-value (LTV) on the mortgage portfolio at 30 June 2012 was broadly stable at 55.7 per cent compared with 55.9 per cent at 31 December 2011. The average LTV for new mortgages and further advances written in the first half of 2012 was 62.3 per cent compared with 62.1 per cent for 2011.

The percentage of closing loans and advances with an indexed LTV in excess of 100 per cent decreased to 11.1 per cent (£36.4 billion) as at 30 June 2012, compared with 12.0 per cent (£39.7 billion) at 31 December 2011. The tables below show LTVs across the principal mortgage portfolios.

Actual and average LTVs across the Retail mortgage portfolios

As at 30 June 2012	Mainstream	Buy to let	Specialist1	Total
	%	%	%	%
Less than 60%	32.7	12.9	14.8	28.2
60% to 70%	12.9	13.2	10.0	12.7
70% to 80%	18.0	26.0	17.5	19.2
80% to 90%	16.4	16.3	19.9	16.7
90% to 100%	10.6	16.4	18.5	12.1
Greater than 100%	9.4	15.2	19.3	11.1
Total	100.0	100.0	100.0	100.0
Average loan-to-value:2				
Stock of residential mortgages	52.1	73.5	72.2	55.7
New residential lending	62.0	63.9	n/a	62.3
Impaired mortgages	72.1	99.4	87.3	78.2

As at 31 December 2011	Mainstream	Buy to let	Specialist1	Total
	%	%	%	%
Less than 60%	32.5	12.7	14.6	28.1
60% to 70%	12.7	13.0	10.1	12.5
70% to 80%	17.2	24.1	17.2	18.2
80% to 90%	16.0	17.3	19.3	16.5
90% to 100%	11.2	17.1	19.0	12.7
Greater than 100%	10.4	15.8	19.8	12.0
Total	100.0	100.0	100.0	100.0
Average loan-to-value:2				
Stock of residential mortgages	52.2	74.0	72.6	55.9
New residential lending	61.4	65.8	n/a	62.1
Impaired mortgages	72.0	99.8	88.0	78.4

1 Specialist lending is closed to new business and is in run-off.

2 Average loan-to-value is calculated as total loans and advances as a percentage of the total collateral of these loans and advances.

Credit risk – Retail (continued)

Unsecured
In the first half of 2012 the impairment charge on unsecured loans and advances to customers reduced by £44 million to £585 million compared with the second half of 2011 and reduced by £293 million compared with the first half of 2011. This reflected the continuing benefit of tightened credit policy and ongoing effective account management.

A combination of reduced demand from customers for new unsecured borrowing, existing customers continuing to reduce their personal indebtedness and the Group's sustainable risk appetite contributed to loans and advances to customers reducing by £1.4 billion since 31 December 2011 to £23.4 billion at 30 June 2012.

The annualised impairment charge as a percentage of average loans and advances to customers decreased to 4.80 per cent in the first half of 2012 from 6.48 per cent in the first half of 2011, with the impairment charge reducing at a greater rate than the average reduction in average loans and advances.

Impaired loans decreased by £0.4 billion since 31 December 2011 to £2.0 billion at 30 June 2012 which represented 8.6 per cent of closing loans and advances to customers, compared with 9.6 per cent at 31 December 2011. The reduction in impaired loans is a result of the continued benefits of tightened credit policy across the credit lifecycle and ongoing effective portfolio management. Retail's exposure to revolving credit products has been actively managed to ensure that it is appropriate to customers' changing financial circumstances. The portfolios show a level of early arrears for accounts acquired since 2009 which are at pre-recession levels, highlighting underlying strength in the risk profile of the business.

Impairment provisions decreased by £0.2 billion, compared with 31 December 2011, to £0.8 billion at 30 June 2012. This reduction was driven by fewer assets entering arrears and recoveries assets being written down to the present value of future expected cash flows. The proportion of impaired loans that have been written down to the present value of future expected cash flows on these assets increased to 54.1 per cent at 30 June 2012 from 48.0 per cent at 31 December 2011. Impairment provisions as a percentage of impaired loans in collections increased to 89.0 per cent at 30 June 2012 from 86.5 per cent at 31 December 2011.

Credit risk – Wholesale

Overview

- Impairment losses have fallen significantly over the last twelve months to £993 million in the first half of 2012, from £1,442 million for the first half of 2011. Impairments were also lower compared to £1,259 million in the second half of 2011.

- The decrease in the underlying impairment charge was primarily driven by lower charges on leveraged acquisition finance exposures. There was a significant deterioration in the leveraged market during the first half of 2011 which has not been repeated in the first half of 2012.

- Whilst subdued UK economic conditions and weaker consumer confidence was evident in a number of sectors, the reduction in the impairment charge also reflected continued strong risk management and the low interest rate environment helping to maintain defaults at a lower level.

- Despite an uncertain economic environment, the obligor quality of our Wholesale portfolio book was broadly unchanged.

- The Group has proactively managed down sovereign as well as banking and trading book exposures to selected European countries. Divestment strategy was focused on balance sheet reduction and also disposal of higher risk positions.

- A robust credit risk management and control framework is in place across the combined portfolios and a prudent risk appetite approach continues to be embedded across the division. Significant resources continue to be deployed into the Business Support Units, which focus on key and vulnerable obligors and asset classes.

Impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Core	111	407	73	334
Non-core	882	1,035	15	925
Total impairment charge	993	1,442	31	1,259

The impairment charge decreased £449 million, or 31 per cent, compared to £1,442 million for the first half of 2011. Impairment charges have decreased substantially compared with 2011 due to robust and proactive risk management, an appropriately impaired portfolio (against our current economic assumptions), and a low interest rate environment helping to maintain defaults at a lower level. Impairment charges as an annualised percentage of average loans and advances to customers reduced to 1.52 per cent from 1.98 per cent in 2011.

Core impairment charge

Core impairments in the first half of 2012 were materially lower compared to the first half of 2011 and the second half of 2011. This is primarily attributable to lower impairments in our Leveraged Acquisition Finance, Corporate and Mid Markets portfolios. There were specific large impairments in these portfolios during the first half and second half of 2011, which have not been repeated in the first half of 2012.

Non-core impairment charge

Non-core impairments in the first half of 2012 were lower than the first half of 2011. This was primarily driven by lower charges on non-core Leveraged Acquisition Finance exposures. There was a significant deterioration in the leveraged market during the first half of 2011 which has not been repeated in the first half of 2012.

The non-core impairment charge in the first half of 2012 was slightly lower compared to the second half of 2011, primarily due to lower impairment charges on the Corporate Real Estate BSU portfolio, which reflects the active deleverage programme and lower transfers into Business Support. This is despite the continued weak commercial real estate market.

Credit risk – Wholesale (continued)

Impaired loans and provisions

Wholesale's impaired loans reduced by £4,005 million to £22,534 million compared with 31 December 2011. The reduction is due to the flow of newly impaired assets, mainly in the Corporate Real Estate Business Support Unit, being more than offset by write-offs on irrecoverable assets, the sale of previously impaired assets, net repayments and transfers out of Business Support. Furthermore, the flow of assets into impaired status was lower during the first half of 2012 compared to each of the first half and second half of 2011. Impairment provisions also reduced mainly as a result of write-offs, especially in the corporate real estate and real estate related portfolios. However, impairment provisions as a percentage of impaired loans increased to 41.6 per cent from 40.7 per cent at 31 December 2011. This was due to the low level of provision coverage on previously impaired assets which were sold during the first half of 2012, together with additional provisions being taken on existing impaired assets.

As a percentage of closing loans and advances to customers, impaired loans decreased to 19.1 per cent from 20.7 per cent at 31 December 2011. We continue to monitor our vulnerable portfolios within Wholesale and, where appropriate, remedial risk mitigating actions are being undertaken.

Core impaired loans and provisions

Core impaired loans reduced by £1,188 million to £2,621 million compared with 31 December 2011. This arose from a number of factors, including net repayments on impaired assets. This contributed to an increase in the core coverage ratio to 67.7 per cent from 60.3 per cent at 31 December 2011. As a percentage of closing core advances, core impaired loans reduced to 3.5 per cent compared to 4.9 percent at 31 December 2011.

Non-core impaired loans and provisions

Non-core impaired loans reduced by £2,817 million to £19,913 million compared with 31 December 2011. The reduction reflects the strategy to de-risk the Group through deleverage of the non-core portfolio, with significant disposals achieved mostly in the CRE BSU and Specialised Lending portfolios. Both of these portfolios also continue to be the main driver of newly impaired assets. Non-core impairment provisions as a percentage of non-core impaired loans increased marginally to 38.2 per cent from 37.4 per cent at 31 December 2011. As a percentage of closing non-core advances, impaired loans show a marginal increase to 45.8 per cent from 45.7 per cent at 31 December 2011.

Non-core impairment provisions as a percentage of non-core impaired assets are lower at 38.2 per cent compared to 67.7 per cent for core, mainly a factor of the asset mix, where the non-core portfolios are heavily weighted toward real estate and real estate related portfolios with higher collateral values.

Credit risk – Wholesale (continued)

Impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Corporate (including Mid-markets)	61,945	4,526	7.3	2,424	53.6
Specialised Lending	33,882	4,505	13.3	1,860	41.3
Sales and Trading	2,472	–		–	
Corporate Real Estate BSU[4]	19,577	13,405	68.5	5,009	37.4
Wholesale Equity	100	98	98.0	88	89.8
Total Wholesale	117,976	22,534	19.1	9,381	41.6
Reverse repos	5,799				
Impairment provisions	(9,381)				
Fair value adjustments	(374)				
Total	114,020				
Loans and advances to banks	7,448				
Debt securities[2]	6,421				
Available-for-sale financial assets[3]	7,320				

1 Impairment provisions include collective unimpaired provisions.
2 Of which Specialised Lending is £6,130 million, Wholesale Equity £136 million, Sales and Trading £150 million, and CRE BSU £5 million.
3 Of which Specialised Lending is £3,802 million, Wholesale Equity £1,489 million, Sales and Trading £1,993 million, Corporate £28 million and CRE BSU £8 million.
4 Corporate Real Estate BSU includes direct real estate and other real estate related sectors (such as hotels, care homes and housebuilders).

As at 31 December 2011	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions[1] £m	Impairment provisions as a % of impaired loans %
Corporate (including Mid-markets)	68,772	5,631	8.2	3,051	54.2
Specialised Lending	35,802	5,584	15.6	2,009	36.0
Sales and Trading	2,220	–		–	

Corporate Real Estate					
BSU4	21,326	15,211	71.3	5,631	37.0
Wholesale Equity	113	113		100	88.5
Total Wholesale	128,233	26,539	20.7	10,791	40.7
Reverse repos	16,836				
Impairment provisions	(10,791)				
Fair value adjustments	(617)				
Total	133,661				
Loans and advances to banks	8,443				
Debt securities2	12,482				
Available-for-sale financial assets3	12,554				

1 Impairment provisions include collective unimpaired provisions.
2 Of which Specialised Lending is £12,135 million, Wholesale Equity £195 million, Sales and Trading £150 million, and Corporate £2 million.
3 Of which Specialised Lending is £7,798 million, Wholesale Equity £1,797 million, Sales and Trading £2,922 million, and Corporate £37 million.
4 Corporate Real Estate BSU includes direct real estate and other real estate related sectors (such as hotels, care homes and housebuilders).

Credit risk – Wholesale (continued)

Core impairments on loans and advances

At 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Total Wholesale	74,506	2,621	3.5	1,775	67.7
Reverse repos	5,799				
Impairment provisions	(1,775)				
Fair value adjustments	(21)				
Total core	78,509				
Loans and advances to banks	7,193				
Debt securities	216				
Available-for-sale financial assets	2,205				
At 31 December 2011					
Total Wholesale	78,527	3,809	4.9	2,295	60.3
Reverse repos	16,836				
Impairment provisions	(2,295)				
Fair value adjustments	(9)				
Total core	93,059				
Loans and advances to banks	8,153				
Debt securities	155				
Available-for-sale financial assets	3,110				

1 Impairment provisions include collective unimpaired provisions.

Credit risk – Wholesale (continued)

Non-core impairments on loans and advances

At 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Total Wholesale	43,470	19,913	45.8	7,606	38.2
Reverse repos	–				
Impairment provisions	(7,606)				
Fair value adjustments	(353)				
Total non-core	35,511				
Loans and advances to banks	255				
Debt securities	6,205				
Available-for-sale financial assets	5,115				
At 31 December 2011					
Total Wholesale	49,706	22,730	45.7	8,496	37.4
Reverse repos	–				
Impairment provisions	(8,496)				
Fair value adjustments	(608)				
Total non-core	40,602				
Loans and advances to banks	290				
Debt securities	12,327				
Available-for-sale financial assets	9,444				

1 Impairment provisions include collective unimpaired provisions.

Credit risk – Wholesale (continued)

Corporate (including mid-markets)

The £61.9 billion of loans and advances to customers in the Corporate portfolio is structured across a number of different portfolios and sectors as discussed below:

UK Corporate – Major Corporate balance sheets continue to de-lever with most Corporates preferring to reduce risk, through accumulating cash and cost cutting rather than invest in growth. Surveys indicate that Financial Officers intend to run higher cash balances than before the financial crisis and this can be seen in record levels of cash being held in the Corporate sector. Whilst cautious optimism is being seen in sectors such as Manufacturing and globally focused Corporates we continue to see stress in sectors such as Media, Retail, Leisure and Construction across UK and Continental Europe. Public sector austerity continues to impact on recovery prospects, although the long lead-in times to these cuts have allowed Corporates to adjust their own structures and cost bases. Although the largest impact is being seen in Corporates with exposure to the weaker Eurozone countries where revenues are declining rapidly, the number of customers affected within our franchise is very modest. Mergers and acquisitions are being selectively targeted by Corporates, with conservative structuring approaches being adopted. The core portfolio continues to be predominantly investment grade focused and the overall portfolio asset quality remains strong.

US Corporate – The balance sheets of US Major Corporates predominantly remain strong, with good levels of liquidity. The reduction in the non-core US corporate portfolio has continued as planned through a combination of secondary sales, refinancings and realisation of real estate assets.

Mid-Markets – Customers in this sector are almost entirely UK-based, with performance in the majority of businesses reliant on the domestic economy. As such, the portfolio has experienced very limited direct impact from the current challenges within the Eurozone. However, the subdued UK economy during the first half of 2012 reduced corporate activity and borrowing demand in the mid-corporate sector, while pressures on consumer discretionary expenditure had an ongoing negative influence on sectors such as retail, leisure and hospitality, particularly outside London and the South East. The weak real estate market and reduced public sector expenditure contributed to pressure on segments such as professional services, construction services and care homes, with impairments concentrated in these sectors in the first half of 2012.

Financial Institutions (FI) – Wholesale maintains relationships with many major financial institutions throughout the world. These relationships are either client focused or held to support the Group’s funding, liquidity and general hedging requirements. The Eurozone crisis continued during the first half of 2012 and continues to require very close portfolio scrutiny and oversight. Detailed contingency plans are in place and continuously refined, whilst exposures to FI’s domiciled in peripheral Eurozone countries in particular have been further reduced and are being managed within tight risk parameters. Trading exposures continue to be predominantly short term and/or collateralised with inter bank activity mainly undertaken with strong investment grade counterparties only.

Real Estate – Our Corporate customer base is focused on the larger end of the UK property market with a bias to the quoted Plc and funds sector. Despite the challenging market conditions, credit quality remains acceptable, being underpinned by seasoned management teams with proven asset management skills generating predictable cashflows from their income producing portfolios. Loan demand remains subdued but, with a continuing high level of loan maturities over the next few years, refinancing risks remain a wider market issue. Insurers are looking to increase their participation in the real estate market creating increased diversity of funding options.

Credit risk – Wholesale (continued)

In Mid Markets Real Estate, the challenging backdrop of the UK economy is adding further pressures to the domestic real estate market with both capital and rental values coming under pressure particularly outside the London and South East region. Tenant default is an area of ongoing concern especially when the lending is supported by secondary or tertiary assets. Restraints on consumer expenditure have made retail assets a particular area of ongoing focus. Market demand is muted with many customers preferring to de-gear and conserve liquidity. Credit quality remains stable and the number of non-performing customers continues to moderate. New propositions are structured attractively and in line with our through the cycle credit risk appetite.

Specialised Lending
Loans and advances to customers of £33.9 billion largely comprise balances in the Structured Corporate Finance portfolio, which includes Acquisition Finance (leveraged lending), Project Finance, non-core Real Estate and Asset Based Finance (Ship Finance, Aircraft Finance, Rail Capital and Corporate Asset Finance). Whilst the effect of subdued UK economic conditions continues to be felt in the Acquisition Finance portfolio, that portfolio is now smaller in size and has a generally lower risk profile than in previous reporting periods. These factors combined with the significant deterioration seen in the leveraged market in the first half of 2011 not being repeated led to a materially lower impairment charge in the first half of 2012. However, a number of sectors remain vulnerable, especially retail, leisure and healthcare, and refinancing risk is also an issue, with significant loan maturities due in the next few years. In Ship Finance, the outlook for the container, tanker and dry bulk sectors remains challenging.

Specialised Lending is also responsible for the Treasury Assets portfolio which mainly encompasses a portfolio of Asset-Backed Securities and financial institution Covered Bond positions. Portfolio credit quality remained relatively stable over the year and the portfolio size continues to be actively reduced through asset sales and from bond maturities. Further details of Wholesale division's Asset-Backed Securities portfolio is provided in note 15 on page 171 of the Statutory Information.

Non-core Real Estate – Overall market conditions remain difficult although we continue to make good progress with our plans to reduce the portfolio. Reductions have been achieved through a combination of planned repayments and amortisations, customer instigated property sales, and the refinancing opportunities customers have taken with alternative lenders.

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

The portfolio comprises £5.7 billion of loans and advances to banks, £2.0 billion of Available-for-Sale debt securities and £2.5 billion of loans and advances to customers (excluding reverse repos).

Sales and Trading actively manages the government bond portfolio and the credit quality is now almost solely AAA/AA rated sovereign debt.

The majority of Sales and Trading's funding and risk management activity is transacted with investment grade counterparties including Sovereign central banks and much of it is on a collateralised basis, such as repos facing a Central Counterparty (CCP). Derivative transactions with FI counterparties are typically collateralised under a Credit Support Annex in conjunction with the ISDA Master Agreement. During the first half of 2012 Lloyds Banking Group became a member of Eurex, augmenting the LCH SwapClear membership of 2011, as part of an ongoing move to reduce counterparty risk by clearing standardised derivative contracts through a CCP.

Corporate Real Estate Business Support Unit

The Corporate Real Estate Business Support Unit has continued to execute on its active asset management programme of the complex portfolio of over 1,800 cases it manages. This has resulted in a continuing fall in the impairment charge to £530 million (2011: £629 million), against the same period last year and asset disposals ahead of plan, despite a worsening real estate market.

Credit risk – Wholesale (continued)

Both capital values and investment transactions have trended downwards over the 6 months to June 2012, with the latter expected to be 10 per cent down on the same period last year. The IPD capital growth index has declined by 2.0 per cent over the 6 months to June 2012. Although values in London continue to climb, and are 37 per cent above their 2009 trough in June 2012, non-London asset values are struggling and are now only 8 per cent above their 2009 trough.

The management of the portfolio continues to focus on supporting its long-term customers and at the same time reducing the exposure to real estate through managed disposals, which has resulted in a realisation of £1.9 billion of cash receipts against non-core assets (30 June 2011: £1.8 billion) despite the weaker transactional market. These further disposals increased the total sold over the past 30 months to over £10 billion of property assets resulting in an overall £18 billion reduction of gross loan exposure (which includes write-offs).

We have continued to put in place new asset management initiatives for assets under receivership to complement the existing arrangements such as the Residential Asset Management Platform covering residential buy to let portfolios. Such arrangements demonstrate our desire to find solutions to ensure we maximise the recovery from these loan positions or portfolios through managing for value the underlying real estate and we continue to seek innovative ways to achieve this aim.

Wholesale Equity

The Wholesale Equity balance sheet consists of a mix of core and non-core business areas diversified by both sector and geography. While the general market remains at historically low levels with a challenging economic outlook set to continue, we continue to make progress on asset reduction strategies in the non-core portfolio. Overall, portfolio performance is in line with plan for the half-year with relatively flat values evident.

Credit risk – Commercial

Overview

- Impairment losses have fallen over the past twelve months to £109 million in the first half of 2012, from £160 million for the first half of 2011, and from £143 million in the second half of 2011.

- The decrease reflects the continued benefits of the low interest rate environment, which has helped maintain defaults at a lower level and the continued application of our prudent risk appetite.

- Portfolio metrics including delinquencies and assets under close monitoring have generally remained steady or improved.

- Commercial continue to operate rigorous control and monitoring activities which play a crucial role in identifying customers showing early signs of financial distress and bringing them into our support model.

Impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Core	116	160	28	136
Non-core	(7)	–		7
Total impairment charge	109	160	32	143

Commercial's impairment charge decreased £51 million, or 32 per cent, compared to £160 million in the first half of 2011. This reflects the continued application of a prudent credit risk appetite approach for new business and a low interest rate environment helping to maintain defaults at a lower level. Impairment charges as an annualised percentage of average loans and advances to customers reduced to 0.72 per cent from 1.07 per cent in 2011. The majority of the business is based around full banking relationships. The relatively small non-core portfolio has continued to reduce throughout 2012.

Impaired loans and provisions

Commercial's impaired loans decreased by £24 million to £2,891 million compared to 31 December 2011. Impairment provisions remained flat, with decreased default rates across the book, particularly in the smaller business portfolio being offset by higher individual provisions in our Business Support Unit. As a result impairment provisions as a percentage of impaired loans increased slightly to 30.5 per cent from 30.2 per cent at 31 December 2011. As a percentage of closing loans and advances to customers, impaired loans reduced slightly to 9.6 per cent from 9.8 per cent at 31 December 2011.

Credit risk – Commercial (continued)

Impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Commercial	30,247	2,891	9.6	881	30.5
Impairment provisions	(881)				
Fair value adjustments	(34)				
Total	29,332				
As at 31 December 2011					
Commercial	29,681	2,915	9.8	880	30.2
Impairment provisions	(880)				
Fair value adjustments	(51)				
Total	28,750				

1 Impairment provisions include collective unimpaired provisions.

Core impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Commercial	29,029	2,879	9.9	866	30.1
Impairment provisions	(866)				
Fair value adjustments	(34)				
Total core	28,129				
As at 31 December 2011					
Commercial	28,289	2,885	10.2	858	29.7
Impairment provisions	(858)				
Fair value adjustments	(51)				
Total core	27,380				

1 Impairment provisions include collective unimpaired provisions.

Credit risk – Commercial (continued)

Non-core impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Commercial	1,218	12	1.0	15	
Impairment provisions	(15)				
Fair value adjustments	–				
Total non-core	1,203				
As at 31 December 2011					
Commercial	1,392	30	2.2	22	73.3
Impairment provisions	(22)				
Fair value adjustments	–				
Total non-core	1,370				

1 Impairment provisions include collective unimpaired provisions.

Credit risk – Wealth, Asset Finance and International

Overview

- In Wealth, Asset Finance and International, impairment charges fell significantly compared to the first and second half of 2011. The reduction predominantly reflected lower impairment charges in the Group's wholesale Irish and Australasian businesses. The rate of increase in newly impaired loans in Ireland reduced and a significant portion of the Australasian impaired portfolio was disposed of in 2011 and in the first half of 2012.

- In the Irish Wholesale portfolio, 86 per cent (31 December 2011: 84 per cent) is now impaired with a coverage ratio of 67 per cent (31 December 2011: 61 per cent), primarily reflecting further falls in the commercial real estate market during 2012, and further vulnerability exists.

- In the Irish Retail mortgage portfolio, impairment provisions as a percentage of impaired loans remained stable at 70 per cent as the rate of deterioration of residential house prices and increase in arrears has slowed down.

- The Group has further reduced its non-core exposure to Ireland with a reduction in gross advances of £1.9 billion during the first half of 2012 with disposals in the period being broadly in line with current provisioning levels.

- The Group also significantly reduced its exposure in its Australasian business by £2.0 billion including the successful disposal of a £0.8 billion (gross) portfolio of impaired Australasian real estate loans in the first half of 2012. The disposals during the first half of the year represent 90 per cent of the gross real estate impaired portfolio.

    - The majority of Wealth, Asset Finance and International's assets are non-core and in run-off.

Impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Wealth	8	15	47	18
International:				
Ireland	897	1,779	50	1,408
Australia	203	586	65	448
Wholesale Europe	111	111		93
Spain retail	12	11	(9)	48
Netherlands retail	6	4	(50)	17
Asia retail	6	2		5
Latin America and Middle East	–	24		41
	1,235	2,517	51	2,060
Asset Finance	54	115	53	85
Total impairment charge	1,297	2,647	51	2,163

Core impairment charge

	Half-year	Half-year	Change since	Half-year to 31 Dec

	to 30 June 2012 £m	to 30 June 2011 £m	30 June 2011 %	2011 £m
Wealth	8	15	47	18
International	6	–		18
Asset Finance	2	2		(2)
Core impairment charge	16	17	6	34

Credit risk – Wealth, Asset Finance and International (continued)

Non-core impairment charge

	Half-year to 30 June 2012 £m	Half-year to 30 June 2011 £m	Change since 30 June 2011 %	Half-year to 31 Dec 2011 £m
Wealth	–	–		–
International	1,229	2,517	51	2,042
Asset Finance	52	113	54	87
Non-core impairment charge	1,281	2,630	51	2,129

The impairment charge decreased by £1,350 million to £1,297 million compared with the first half of 2011. Impairment charges as an annualised percentage of average loans and advances to customers decreased to 4.3 per cent from 7.2 per cent in 2011. Wealth, Asset Finance and International's impairment charge almost entirely related to non-core portfolios.

Impaired loans and provisions
Total impaired loans decreased by £2,782 million to £19,211 million compared with £21,993 million at 31 December 2011 and as a percentage of closing loans and advances to customers decreased to 34.0 per cent from 34.6 per cent at 31 December 2011. The decrease in impaired loans predominantly relates to the Irish and Australasian book, driven by write-offs and impaired asset disposals.

Impairment provisions as a percentage of impaired loans increased to 65.5 per cent from 60.6 per cent at 31 December 2011. The increase was driven by the Irish and Australasian portfolios. The coverage ratio in the Group's Irish portfolio has increased further reflecting continuing weakness in real estate markets where further vulnerability exists, although the impact of such vulnerability is reducing as more of the portfolio becomes impaired and provided for. The coverage ratio in the Australasian book was affected by the disposal of real estate loans during the period. The remaining impaired assets are heavily impaired corporate loans with lower collateral values which require higher coverage levels than property secured assets.

Credit risk – Wealth, Asset Finance and International (continued)

Impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Wealth	4,557	273	6.0	61	22.3
International:					
Ireland Retail	6,704	1,476	22.0	1,061	71.9
Ireland Wholesale	16,147	13,809	85.5	9,221	66.8
Australia	7,736	1,090	14.1	873	80.1
Wholesale Europe	5,407	1,178	21.8	571	48.5
Other	9,716	432	4.4	217	50.2
	45,710	17,985	39.3	11,943	66.4
Asset Finance	6,240	953	15.3	584	61.3
	56,507	19,211	34.0	12,588	65.5
Impairment provisions	(12,588)				
Fair value adjustments	(34)				
Total	43,885				
As at 31 December 2011					
Wealth	4,865	231	4.7	74	32.0
International:					
Ireland Retail	7,036	1,415	20.1	1,034	73.1
Ireland Wholesale	17,737	14,945	84.3	9,133	61.1
Australia	9,745	2,780	28.5	1,609	57.9
Wholesale Europe	6,356	978	15.4	475	48.6
Other	10,655	427	4.0	258	60.4
	51,529	20,545	39.9	12,509	60.9
Asset Finance	7,162	1,217	17.0	746	61.3
	63,556	21,993	34.6	13,329	60.6
Impairment provisions	(13,329)				
Fair value adjustments	(42)				
Total	50,185				

1 Impairment provisions include collective unimpaired provisions.

Credit risk – Wealth, Asset Finance and International (continued)

Core impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Wealth	4,557	273	6.0	61	22.3
International	2,851	41	1.4	88	
Asset Finance	210	72	34.3	21	29.2
	7,618	386	5.1	170	44.0
Impairment provisions	(170)				
Fair value adjustments	–				
Total core	7,448				
As at 31 December 2011					
Wealth	4,865	231	4.7	74	32.0
International	3,126	34	1.1	26	76.5
Asset Finance	245	95	38.8	25	26.3
	8,236	360	4.4	125	34.7
Impairment provisions	(125)				
Fair value adjustments	–				
Total core	8,111				

1 Impairment provisions include collective unimpaired provisions.

Non-core impairments on loans and advances

As at 30 June 2012	Loans and advances to customers £m	Impaired loans £m	Impaired loans as a % of closing advances %	Impairment provisions1 £m	Impairment provisions as a % of impaired loans %
Wealth	–	–		–	
International	42,859	17,944	41.9	11,855	66.1
Asset Finance	6,030	881	14.6	563	63.9
	48,889	18,825	38.5	12,418	66.0
Impairment provisions	(12,418)				
Fair value adjustments	(34)				
Total non-core	36,437				

As at 31 December 2011					
Wealth	–	–		–	
International	48,403	20,511	42.4	12,483	60.9
Asset Finance	6,917	1,122	16.2	721	64.3
	55,320	21,633	39.1	13,204	61.0
Impairment provisions	(13,204)				
Fair value adjustments	(42)				
Total non-core	42,074				

1 Impairment provisions include collective unimpaired provisions.

Credit risk – Wealth, Asset Finance and International (continued)

Wealth

Total impaired loans increased by £42 million, or 18 per cent, to £273 million compared with £231 million at 31 December 2011 and as a percentage of closing loans and advances increased to 6.0 per cent from 4.7 per cent at 31 December 2011. The impairment charge for the first half of 2012 was £8 million. The impairment charge for loans and advances to customers, as an annualised percentage of average loans and advances to customers, decreased to 0.3 per cent compared with 0.6 per cent in 2011.

International

Ireland

Total impaired loans decreased by £1,075 million, or 7 per cent to £15,285 million compared with £16,360 million at 31 December 2011. The reduction is due to the flow of newly impaired assets being more than offset by foreign exchange movements, write-offs on irrecoverable assets, the sale of previously impaired assets, and net repayments. Impaired loans as a percentage of closing loans and advances increased to 66.9 per cent from 66.0 per cent at 31 December 2011. Continuing weakness in the Irish real estate markets resulted in a further increase in wholesale coverage in the first half of 2012 to 66.8 per cent from 61.1 per cent.

Impairment charges decreased by £882 million to £897 million compared to the first half of 2011 as the rate of increase in newly impaired loans fell during the first half of 2012. Impairment charges as an annualised percentage of average loans and advances to customers decreased to 7.5 per cent from 13.2 per cent in the first half of 2011.

Impairments on loans and advances – Ireland

	As at 30 June 2012			As at 31 December 2011		
	Loans and advances to customers £m	Impaired loans £m	Provisions £m	Loans and advances to customers £m	Impaired loans £m	Provisions £m
Commercial Real Estate	9,957	9,116	6,181	10,872	9,807	6,194
Corporate	6,190	4,693	3,040	6,865	5,138	2,939
Retail	6,704	1,476	1,061	7,036	1,415	1,034
Total Ireland	22,851	15,285	10,282	24,773	16,360	10,167

The most significant contribution to impairment in Ireland is the Commercial Real Estate portfolio. Impairment provisions provide 67.8 per cent coverage on impaired commercial real estate loans. Mortgage lending at 30 June 2012 comprised 99 per cent of the retail portfolio with impairment coverage on the mortgage portfolio remaining stable at 70 per cent. Impaired loans on the retail portfolio increased by £61 million in the first half of 2012 compared to a £171 million increase in the second half of 2011. The reduction in growth of impaired loans is primarily due to a reduction in new customers entering arrears. In addition, the rate of decrease of residential property prices has slowed down in the first half of 2012 compared to 2011.

£2.4 billion of gross wholesale lending within the Commercial Real Estate and Corporate portfolios relates to sterling loans secured on UK property.

Within the Commercial Real Estate portfolio, 92 per cent of the portfolio is now impaired (compared to 90 per cent at 31 December 2011). The average impairment coverage ratio has increased in the first half of the year to 68 per cent (63 per cent 31 December 2011) reflecting the continued deterioration in the Irish commercial property market.

The Group continued to reduce its non-core exposure to Ireland. Gross loans and advances reduced by £1.9 billion in the period. Disposals and repayments in the first half of 2012 totalled £0.8 billion and were broadly in line with current provisioning levels.

Credit risk – Wealth, Asset Finance and International (continued)

Australia
Total impaired loans decreased by £1,690 million, or 61 per cent to £1,090 million compared with £2,780 million at 31 December 2011. The decrease in impaired loans in the period is a result of impaired asset disposals and write-offs. Total impaired loans as a percentage of closing loans and advances decreased to 14.1 per cent from 28.5 per cent at 31 December 2011, reflecting the higher quality of the residual portfolio.

Impairment charges decreased by £383 million to £203 million compared to the first half of 2011 and decreased by £245 million compared to the second half of 2011. Impairment charges as an annualised percentage of average loans and advances to customers decreased to 4.5 per cent from 8.8 per cent in first half of 2011.

Significant progress has been made in de-risking the portfolio through asset sales and run-off. The successful disposal of an £0.8 billion (gross) portfolio of impaired Australasian real estate loans in the first half of 2012 contributed to an almost total exit of distressed real estate lending, from a peak of £2.2 billion in December 2010. The residual Business Support book is now credit stable with good impairment coverage. Although exposure to real estate has reduced materially, historical experience has shown that downside risks remain in this portfolio.

Wholesale Europe
Total impaired loans increased by £200 million, or 20 per cent to £1,178 million compared with £978 million at 31 December 2011. The increase in impaired loans is largely attributable to a small number of exposures. Total impaired loans as a percentage of closing loans and advances increased to 21.8 per cent from 15.4 per cent at 31 December 2011.

Impairment charges remained flat at £111 million compared to the first half of 2011. Further deterioration in European real estate markets during the first half of 2012, which resulted in additional impairment being taken on already impaired assets, was offset by a higher level of releases in this period compared to the first half of 2011. Due to the reducing balance sheet, impairment charges as an annualised percentage of average loans and advances to customers increased to 4.0 per cent compared to 3.1 per cent in 2011.

Core assets relate to global international customers with a UK linkage, and are generally made up of major corporate (which are predominantly investment grade) and project finance customers. The real estate book is mainly classified non-core and is subject to close monitoring. The Group was successful in reducing its real estate exposure during the first half of 2012, with disposals and repayments of £156 million. Disposal values in the period were broadly in line with current provisioning levels.

Other International
Total impaired loans increased by £5 million to £432 million compared with £427 million at 31 December 2011 and as a percentage of closing loans and advances increased to 4.4 per cent from 4.0 per cent at 31 December 2011. Impaired loans predominantly relate to a limited number of corporate exposures and the Spanish mortgage business. We have maintained a high level of impairment coverage on the retail mortgage portfolios in Spain and the Netherlands, against a backdrop of falling house prices. Impairment charges decreased by £17 million to £24 million compared to the first half of 2011.

Asset Finance
This relates to asset-backed funding to a wide portfolio of UK-based personal, commercial and corporate customers, primarily in relation to motor vehicles. Despite the background of challenging economic conditions, arrears levels

across the portfolio have continued to reduce and first half 2012 impairments are well below the level of 2011. Recent growth in new car sales, and strong used vehicle values, are helping to underpin the sector and the positive performance of Asset Finance, supported by strong credit quality controls in the business.

Exposures to Eurozone countries

The following section summarises the Group's direct exposure to Eurozone countries as at 30 June 2012. The exposures comprise on-balance sheet exposures based on their balance sheet carrying values and off-balance sheet exposures, and are based on the country of domicile of the counterparty unless otherwise indicated.

The Group manages its exposures to individual countries through authorised country limits which take into account economic, financial, political and social factors. In addition, the Group manages its direct risks to the selected countries by establishing and monitoring risk limits for individual banks, financial institutions, corporates and individuals. Indirect risk is taken into account where it is determined that counterparties have material direct exposure to selected countries.

The Group has established a Eurozone Instability Steering Group in order to monitor developments within the Eurozone, carry out stress testing through detailed scenario analysis and complete appropriate due diligence on the Group's exposures. The following table summarises the Group's Eurozone exposures:

At 30 June 2012	Sovereign debt	Financial Institutions Banks	Other	Asset backed securities	Corporate	Personal	Insurance assets	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Ireland	–	204	691	344	7,603	5,410	111	14,363
Spain	31	1,261	–	206	2,545	1,566	22	5,631
Portugal	–	102	–	226	245	10	–	583
Italy	9	225	2	11	115	–	32	394
Greece	–	–	–	–	353	–	–	353
	40	1,792	693	787	10,861	6,986	165	21,324
Other Eurozone exposures (see page 136)	30,924	3,016	1,079	506	12,217	6,184	5,069	58,995
Total Eurozone exposures	30,964	4,808	1,772	1,293	23,078	13,170	5,234	80,319
At 31 December 2011								
Ireland	–	207	272	376	8,894	6,027	68	15,844
Spain	52	1,692	7	375	2,955	1,649	39	6,769
Portugal	–	142	8	341	309	11	–	811
Italy	16	433	17	39	152	–	47	704
Greece	–	–	–	55	431	–	–	486
	68	2,474	304	1,186	12,741	7,687	154	24,614
Other Eurozone exposures (see page 136)	10,755	4,254	874	1,404	15,542	6,522	4,836	44,187
Total Eurozone exposures	10,823	6,728	1,178	2,590	28,283	14,209	4,990	68,801

The Group has included certain amounts on a net basis to better reflect the overall risk to which the Group is exposed. Derivative balances are included within exposures to financial institutions or corporates, as appropriate, at fair value adjusted for master netting agreements at obligor level and net of cash collateral in line with legal agreements. Exposures in respect of reverse repurchase agreements are included on a gross IFRS basis and are disclosed based on the counterparty rather than the collateral (repos and stock lending are excluded); reverse repurchase exposures are not, therefore, reduced as a result of collateral held. Exposures to central clearing counterparties are shown net.

For multi-country asset backed securities exposures, the Group has reported exposures based on the largest country exposure. The country of exposure for asset backed securities is based on the location of the underlying assets not on the domicile of the issuer, which are predominantly residential mortgages.

In the first quarter, the Group drew €13.5 billion (the sterling equivalent of which at the date of drawdown was £11.2 billion) under the European Central Bank's Long-Term Refinancing Operation facility for an initial term of three years, to part fund a pool of non-core euro denominated assets.

Exposures to Eurozone countries (continued)

Exposures to Ireland, Spain, Portugal, Italy and Greece

The Group continues to have minimal exposure, in aggregate, which could be considered to be direct recourse to the sovereign risk of the selected countries. Derivatives with sovereigns and sovereign referenced credit default swaps are insignificant. Included within exposures to banks, and treated as available-for-sale assets, are covered bonds of £1.4 billion (31 December 2011: £1.7 billion). The covered bonds are ultimately secured on a pool of mortgage assets in the countries concerned and benefit from over-collateralisation, with an overall weighted maturity of approximately four years. Exposures to other financial institutions relate primarily to balances held within insurance companies and funds. No impairments are held against these exposures.

At 30 June 2012, the Group's total gross derivative asset exposure to counterparties registered in the above countries was £816 million (31 December 2011: £982 million), offset by derivative liabilities of £314 million (31 December 2011: £338 million) and cash collateral held of £167 million (31 December 2011: £191 million).

Assets held by the Insurance business are shareholder assets and are held outside the with-profits and unit-linked funds. Approximately £96 million (31 December 2011: £127 million) of these exposures relate to direct investments where the issuer is resident in Spain, Italy or Ireland and the credit rating is consistent with the tight credit criteria defined under the appropriate investment mandate. The remaining exposures relate to interests in two funds domiciled in Ireland and administered by Scottish Widows Investment Partnership (the Global Liquidity Fund and the Short-Term Fund) where in line with the investment mandates, cash is invested in the money markets. For these funds, the exposure is analysed on a look through basis to the underlying assets held and the Insurance business's pro rata share of these assets rather than treating all the holding the fund as exposure to Ireland. Within the above exposures there are no sovereign exposures.

The Group continued to reduce its exposure to these countries and exposures have been proactively managed down in line with its risk appetite. The Group's total exposure has reduced 13 per cent from £24,614 million to £21,324 million.

Exposures to Eurozone countries (continued)

Ireland

	As at 30 June 2012 £m	As at 31 Dec 2011 £m
Sovereign debt	–	–
Financial institutions – banks		
Amortised cost	48	46
Net trading assets	8	–
Available-for-sale (gross of AFS reserve: £188 million; 2011: £193 million)	147	136
Derivatives (gross asset exposure of £196 million; 2011: £216 million)	1	25
	204	207
Financial institutions – other		
Amortised cost	686	255
Net trading assets	1	5
Derivatives (gross asset exposure of £5 million; 2011: £12 million)	4	12
	691	272
Asset backed securities		
Amortised cost	212	221
Available-for-sale (gross of AFS reserve: £216 million; 2011: £268 million)	132	155
	344	376
Corporate		
Amortised cost (gross of impairment allowances: £14,515 million; 2011: £15,910 million)	6,725	7,949
Derivatives (gross asset exposure of £39 million; 2011: £32 million)	39	31
Off balance sheet exposures	839	914
	7,603	8,894
Personal		
Amortised cost (gross of impairment allowances: £6,721 million; 2011: £7,061 million)	5,410	6,027
Insurance assets	111	68
Total	14,363	15,844

The Group has exposures to a structured vehicle incorporated in Ireland. In accordance with the reporting protocol outlined above, the exposures classified as Bonds have been reported on the basis of the underlying country of risk, while other exposures have been reported against the country of registration of the structured vehicle.

The movement in the period within exposures to financial institutions is primarily due to reverse repurchase transactions secured primarily on UK gilts.

See page 127 for further details on Irish corporate and personal exposures. The off-balance sheet exposures to corporates are principally undrawn facilities.

Exposures to Eurozone countries (continued)

Spain

	As at 30 June 2012 £m	As at 31 Dec 2011 £m
Sovereign debt		
Direct sovereign exposures	10	17
Central bank balances	21	35
	31	52
Financial institutions – banks		
Amortised cost	36	33
Available-for-sale (gross of AFS reserve: £1,554 million; 2011: £1,848 million)	1,191	1,548
Net trading assets	17	59
Derivatives (gross asset exposure of £196 million; 2011: £175 million)	17	52
	1,261	1,692
Financial institutions – other		
Net trading assets	–	7
Asset backed securities		
Amortised cost	108	211
Available-for-sale (gross of AFS reserve: £123 million; 2011: £213 million)	98	164
	206	375
Corporate		
Amortised cost (gross of impairment allowances: £1,786 million; 2011: £2,192 million)	1,614	2,043
Net trading assets	6	20
Derivatives (gross asset exposure of £186 million; 2011: £174 million)	179	167
Off balance sheet exposures	746	725
	2,545	2,955
Personal		
Amortised cost (gross of impairment allowances: £1,590 million; 2011: £1,685 million)	1,518	1,615
Off balance sheet exposures	48	34
	1,566	1,649
Insurance assets	22	39
Total	5,631	6,769

Included within exposures to banks, and treated as available-for-sale assets are covered bonds of £1.2 billion (31 December 2011: £1.4 billion), which are ultimately secured on a pool of mortgage assets in the countries concerned and benefit from over-collateralisation and have an overall weighted maturity of approximately four years. The Group has credit default swap positions referenced to banking groups domiciled in Spain (net short of

£6 million), which are included in the balances detailed above, and unutilised and uncommitted money market lines and repo facilities of approximately £0.3 billion (31 December 2011: £1.1 billion) in respect of Spanish banks. Bank limits have been closely monitored with amounts and tenors reduced where appropriate.

The corporate exposure in Spain is mainly local lending (84 per cent of the total Spanish exposures) comprising corporate loans and project finance facilities (77 per cent) and commercial real estate portfolio (23 per cent).

Personal exposures within Spain are predominantly secured residential mortgages, where about half of the borrowers are expatriates. Impaired lending represented 7 per cent (31 December 2011: 6 per cent) of the portfolio, with a coverage ratio of 63 per cent (31 December 2011: 49 per cent).

Exposures to Eurozone countries (continued)

Portugal

	As at 30 June 2012 £m	As at 31 Dec 2011 £m
Sovereign debt	–	–
Financial institutions – banks		
Amortised cost	30	17
Available-for-sale (gross of AFS reserve: £95 million; 2011: £198 million)	71	124
Derivatives (gross asset exposure of £7 million; 2011: £7 million)	1	1
	102	142
Financial institutions – other		
Net trading assets	–	8
Asset backed securities		
Amortised cost	122	208
Available-for-sale (gross of AFS reserve: £174 million; 2011: £219 million)	104	133
	226	341
Corporate		
Amortised cost (gross of impairment allowances £114 million; 2011: £125 million)	90	100
Derivatives (gross asset exposure of £12 million; 2011: £2 million)	13	13
Off balance sheet exposures	142	196
	245	309
Personal	10	11
Insurance assets	–	–
Total	583	811

Exposures comprise lending to corporates, including a small amount of commercial real estate exposure.

Exposures to Eurozone countries (continued)

Italy

	As at 30 June 2012 £m	As at 31 Dec 2011 £m
Sovereign debt		
Direct sovereign exposures	9	16
Financial institutions – banks		
Amortised cost	72	41
Available-for-sale (gross of AFS reserve: £61 million; 2011: £196 million)	52	180
Net trading assets	78	188
Derivatives (gross asset exposure of £116 million; 2011: £91 million)	23	24
	225	433
Financial institutions – other		
Net trading assets	2	17
Asset backed securities		
Amortised cost	–	26
Available-for-sale (gross of AFS reserve: £12 million; 2011: £14 million)	11	13
	11	39
Corporate		
Amortised cost (gross of impairment allowances: £52 million; 2011: £69 million)	51	86
Net trading assets	4	17
Derivatives (gross asset exposure of £44 million)	44	36
Off balance sheet exposures	16	13
	115	152
Personal	–	–
Insurance assets	32	47
Total	394	704

In addition to the above balances there are unutilised and uncommitted money market lines and repo facilities of approximately £0.2 billion (31 December 2011: £0.6 billion) predominantly in respect of Italian banks. Bank limits have been closely monitored with amounts and tenors reduced where appropriate.

Exposures comprise lending to corporates, including a small amount of commercial real estate exposure.

Exposures to Eurozone countries (continued)

Greece

	As at 30 June 2012 £m	As at 31 Dec 2011 £m
Sovereign debt	–	–
Financial institutions – banks	–	–
Financial institutions – other	–	–
Asset backed securities		
Amortised cost	–	32
Available-for-sale (gross of AFS reserve: 2011 of £44 million)	–	23
	–	55
Corporate		
Amortised cost (gross of impairment allowances: £356 million; 2011: £407 million)	313	364
Derivatives (gross asset exposure of £15 million; 2011: £19 million)	15	19
Off balance sheet exposures	25	48
	353	431
Personal	–	–
Insurance assets	–	–
Total	353	486

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

Exposures to Eurozone countries (continued)

Exposures to other Eurozone countries

In addition to the exposures detailed above, the Group has the following exposures to sovereign, financial institutions, asset backed securities, corporates and personal customers in the following Eurozone countries:

At 30 June 2012	Sovereign debt £m	Financial institutions Banks £m	Financial institutions Other £m	Asset backed securities £m	Corporate £m	Personal £m	Insurance assets £m	Total £m
Netherlands	28,350	725	179	26	2,835	5,817	1,339	39,271
France	202	1,072	50	104	3,383	348	1,798	6,957
Germany	2,296	599	357	376	2,330	19	1,480	7,457
Luxembourg	1	33	466	–	2,122	–	113	2,735
Belgium	73	410	25	–	1,007	–	49	1,564
Finland	–	81	–	–	31	–	290	402
Malta	–	2	–	–	287	–	–	289
Cyprus	–	2	–	–	151	–	–	153
Austria	2	46	2	–	69	–	–	119
Slovenia	–	46	–	–	–	–	–	46
Estonia	–	–	–	–	2	–	–	2
Slovakia	–	–	–	–	–	–	–	–
	30,924	3,016	1,079	506	12,217	6,184	5,069	58,995

At 31 December 2011