



46/10

30 March 2011

**BANK OF SCOTLAND PLC  
ANNUAL REPORT AND ACCOUNTS FOR THE YEAR ENDING  
31 DECEMBER 2010**

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

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

Copies of the document are also available on the Lloyds Banking Group plc website [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com)

This announcement also contains additional information for the purposes of compliance with the Disclosure and Transparency Rules, including principal risk factors, details of related party transactions and a responsibility statement. This information is extracted, in full unedited text, from the Bank of Scotland plc 2010 Annual Report (the '**Annual Report**'). References to page numbers and notes to the accounts made in the following Appendices, refer to page numbers and notes to the accounts in the Annual Report.

– END –

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## **FORWARD LOOKING STATEMENTS**

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

## Appendix 1 – Risk Factors

The principal risks and uncertainties relating to Bank of Scotland plc are set out on pages 7 to 9 of the Annual Report. The following is extracted in full and unedited form from the Annual Report.

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

### **Credit**

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

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

- Wholesale customers (including those in wealth and international operations): where companies continue to face difficult business conditions, resulting in elevated corporate default levels, illiquid commercial property markets and heightened impairment charges. The Group has high levels of exposure in both the UK and internationally, including Ireland, USA and Australia. There are particular concentrations to financial institutions and commercial real estate including secondary and tertiary locations.
- Retail customers: this portfolio will remain strongly linked to the economic environment, with inter alia house prices falls, unemployment increases, consumer over-indebtedness and rising interest rates all likely to impact both secured and unsecured retail exposures.

The Group follows a through the economic cycle, relationship based, business model with risk management processes, appetites and experienced staff in place.

### **Legal and regulatory**

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

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

At the time of the acquisition of HBOS plc by Lloyds Banking Group the Office of Fair Trading (OFT) identified some competition concerns in the UK personal current accounts and mortgages markets and for SME banking in Scotland. The OFT reiterated that it would keep these under review and consider whether to refer any banking markets to the Competition Commission if it identifies any prevention, restriction or distortion of competition.

The UK Government appointed an Independent Commission on Banking to review possible structural measures to reform the banking system and promote stability and competition. That commission will publish its final report by the end of September 2011. The Treasury Select Committee is conducting an examination of competition in retail banking. It is too early to quantify the potential impact of these developments on the Group.

From April 2011, lead regulation and supervision of the Group's activities will begin transitioning from the FSA to the new Financial Conduct Authority for conduct of business supervision and the Prudential Regulatory Authority (PRA) for capital and liquidity supervision. In addition, from 2011, the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority as new EU Supervisory Authorities are likely to have greater influence on regulatory approaches across the EU. These could lead to changes in how the Group is regulated and supervised on a day-to-day basis.

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

Lloyds Banking Group is currently assessing the impacts of these regulatory developments and will participate in the consultation and calibration processes to be undertaken by the various regulatory bodies during 2011. Lloyds Banking Group continues to work closely with the regulatory authorities and industry associations to ensure that it is able to identify and respond to proposed regulatory changes and mitigate against risks to the Group and its stakeholders.

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

### **Liquidity and funding**

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

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

*Features:* Arising in the banking business of the Group through its retail, wholesale and wealth and international operations reflecting the risk that the Group is unable to attract and retain either retail, wholesale or corporate deposits or issue debt securities. Like all major banks, the Group is dependent on confidence in the short and longer term wholesale funding markets; should the Group, due to exceptional circumstances, be unable to continue to source sustainable funding and provide liquidity when necessary, the Group's ability to fund its financial obligations could be impacted.

The key dependencies for successfully funding the Group's balance sheet include the continued functioning of the money and capital markets; successful right sizing of the Lloyds Banking Group balance sheet; the continuation of HM Treasury and Bank of England facilities to Lloyds Banking Group in accordance with the terms agreed; limited further deterioration in the UK's, Lloyds Banking Group's and the Group's credit rating and no significant or sudden withdrawal of deposits resulting in increased reliance on wholesale funding markets. A return to the extreme market conditions of 2008 would place a strain on the Group's ability to meet its financial commitments.

Additionally, the Lloyds Banking Group has entered into a number of EU state aid related obligations to achieve reductions in certain parts of its balance sheet by the end of 2014. The requirement to meet this deadline may result in the Group having to provide funding to support these asset reductions and/or disposals and may also result in a lower price being achieved.

Liquidity and funding risks are managed within a board approved framework using a range of metrics to monitor the Group's profile against its stated appetite and potential market conditions.

### **Market Risk**

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

*Features:* Market risk is managed within a Board approved framework using a range of metrics to monitor the Group's profile against its stated appetite and potential market conditions.

The principal market risks are as follows:

There is a risk to the Group's banking income arising from the level of interest rates and the margin of interbank rates over central bank rates. A further banking risk arises from competitive pressures on product terms in existing loans and deposits, which sometimes restrict the Group in its ability to change interest rates applying to customers in response to changes in interbank and central bank rates.

Continuing concerns about the scale of deficits in Ireland and southern European countries resulted in increased credit spreads in the areas affected, and fears of contagion affected the Euro and widened spreads between central bank and interbank rates.

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

### **Customer treatment**

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

*Features:* Customer treatment and how the Group manages its customer relationships affects all aspects of the Group's operations and is closely aligned with achievement of the Group's strategic aim – to create deep long lasting relationships with its customers. There is currently a high level of scrutiny regarding the treatment of customers by financial institutions from the press, politicians and regulatory bodies.

The FSA continues to drive focus on conduct of business activities and has established a new approach to supervision of Conduct Risk, replacing the previous 'Treating Customers Fairly' initiative for retail customers. Under this new regime the FSA has indicated that it will seek to place greater emphasis on product governance and contract terms in general, and will seek to intervene much earlier in the product lifecycle to prevent customer detriment. The FSA also continues to carry out thematic reviews on a variety of issues across the industry as a whole, for example complaints handling. Lloyds Banking Group actively engages with the regulatory authorities and other stakeholders on these key customer treatment challenges, which includes for example, PPI (see note 43 of financial statements).

The Group has policies, procedures and governance arrangements in place to facilitate the fair treatment of customers. Since the acquisition of HBOS, the Group has made significant progress in aligning its approach to Treating Customers Fairly across both heritages. In addition the Group has aligned its Treating Customers Fairly governance and

management information arrangements, with customer impact being a key factor in assessing every integration proposition. The Group regularly reviews its product range to ensure that it meets regulatory requirements and is competitive in the market place.

## **People**

*Definition:* The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate colleague actions and behaviour, industrial action, legal action in relation to people, or health and safety issues. Loss can also be incurred through failure to recruit, retain, train, reward and incentivise appropriately skilled staff to achieve business objectives and through failure to take appropriate action as a result of staff underperformance.

*Features:* The Group aims to attract, retain, and develop high calibre talent. Failure to do so presents a significant risk to delivering the Group's overall strategy and is affected by a range of factors including:

- Ongoing regulatory and public interest in remuneration practices
- Delivery of Lloyds Banking Group's integration commitments, and
- Uncertainty about European Union state aid requirements and the Independent Commission on Banking's proposals for banking reform.

The Group's remuneration arrangements encourage compliant and appropriate behaviour from colleagues, in line with group policies, values and short and long term people risk priorities. The Group has continued to work closely with regulators to seek to ensure compliance with our obligations. However, there is recognition that international consensus must be achieved to avoid UK institutions being significantly disadvantaged in attracting and retaining the highest calibre talent.

The Group continues to manage union relationships actively and the majority of colleagues are now on harmonised Terms and Conditions. There is strong ongoing commitment to support and retain colleagues throughout a period of significant integration and organisational change. Active monitoring of the Colleague Engagement Survey allows the Group to understand engagement levels. These continue to increase and are now exceeding industry benchmarking for high performing organisations.

Lloyds Banking Group is closely engaged with the UK Government and regulators on reform proposals, and with the EU on disposal arrangements, to influence and manage colleague uncertainty.

## **Integration**

*Definition:* The risk that the Group fails to realise the business growth opportunities, revenue benefits, cost synergies, operational efficiencies and other benefits anticipated from, or incurs unanticipated costs and losses associated with, the acquisition of HBOS plc by Lloyds Banking Group.

*Features:* The integration of the two heritage organisations continues to be one of the largest integration challenges that has been seen in the UK financial services industry. While there continue to be delivery risks to the programme, not least the risk of new regulatory requirements which may have an effect on resourcing, the Group is now two years into the integration programme and has a fully developed and functioning governance framework to manage these risks. There is a clear understanding of the phased deliverables to ensure effective delivery through to 2012.

## Appendix 2 – Related Party Transactions

The following statements regarding related party transactions of Bank of Scotland plc are set out on pages 53 to 55 of the Annual Report. The following is extracted in full and unedited form from the Annual Report.

### 42 RELATED PARTY TRANSACTIONS

#### Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity. At 31 December 2010 and 2009, the Group's key management personnel are the members of the Lloyds Banking Group plc group executive committee together with its non-executive directors.

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

	2010 £m	2009 £m
<b>Compensation</b>		
Salaries and other short-term benefits	<u>6</u>	<u>6</u>

The aggregate of the emoluments of the directors for qualifying services to the Bank, on an estimated basis, in 2010 was £4.2 million (2009: £4.0 million). The total for the highest paid director (J E Daniels) was £1,029,000 (2009: (G T Tate) £722,000).

As a result of the acquisition of HBOS plc by Lloyds Banking Group plc on 16 January 2009, the Board of the Bank changed in its entirety. Accordingly, the disclosures for 2009 begin with the balances of key management personnel on 16 January 2009.

	2010 million	2009 million
<b>Share options over Lloyds Banking Group plc shares</b>		
At 1 January 2010/16 January 2009	2	2
Granted, including certain adjustments (includes entitlements of appointed directors) <sup>1</sup>	<u>4</u>	<u>–</u>
<b>At 31 December</b>	<u>6</u>	<u>2</u>

<sup>1</sup> Adjustments have been made, using a standard HMRC formula, to negate the dilutionary impact of the Lloyds Banking Group's 2009 capital raising activities.

	2010 million	2009 million
<b>Share plans settled in Lloyds Banking Group plc shares</b>		
At 1 January 2010/16 January 2009	19	7
Granted, including certain adjustments (includes entitlements of appointed directors) <sup>1</sup>	39	17
Exercised/lapsed (includes entitlements of former directors)	<u>(2)</u>	<u>(5)</u>
<b>At 31 December</b>	<u>56</u>	<u>19</u>

<sup>1</sup> Adjustments have been made, using a standard HMRC formula, to negate the dilutionary impact of the Lloyds Banking Group's 2009 capital raising activities.

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

	2010 £m	2009 £m
<b>Loans</b>		
At 1 January 2010/16 January 2009	2	3
Advanced (includes loans of appointed directors)	2	–
Repayments (includes loans of former directors)	<u>(1)</u>	<u>(1)</u>
<b>At 31 December</b>	<u>3</u>	<u>2</u>

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 0.50 per cent and 17.90 per cent in 2010 (2009: 1.28 per cent and 24.90 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2009: £nil).

	<b>2010</b>	2009
	<b>£m</b>	£m
<b>Deposits</b>		
At 1 January 2010/16 January 2009	<b>4</b>	6
Placed (includes deposits of appointed directors)	<b>12</b>	12
Withdrawn (includes deposits of former directors)	<b>(12)</b>	(14)
<b>At 31 December</b>	<b>4</b>	4

Deposits placed by key management personnel attracted interest rates of up to 4.25 per cent (2009: 6.50 per cent).

At 31 December 2010 and 2009, the Group did not provide any guarantees in respect of key management personnel.

At 31 December 2010, transactions, arrangements and agreements entered into by the Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £2 million with six directors and four connected persons (2009: £2 million with seven directors and four connected persons).

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

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

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

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

	<b>2010</b>	2009
	<b>£m</b>	£m
Assets, included within:		
Derivative financial instruments	<b>22</b>	144
Loans and receivables:		
Loans and advances to banks	–	17,193
Loans and advances to customers	<b>39,085</b>	57,730
Other	<b>442</b>	3,095
	<b>39,549</b>	78,162
Liabilities included within:		
Deposits from banks	–	3,402
Customer deposits	<b>36,547</b>	45,346
Derivative financial instruments	<b>109</b>	1,901
Debt securities in issue	<b>14,157</b>	22,037
Subordinated liabilities	<b>66</b>	–
	<b>50,879</b>	72,686

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

Details of contingent liabilities and commitments entered into on behalf of fellow Lloyds Banking Group undertakings are given in note 43.

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

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

	The Group		The Bank	
	2010	2009	2010	2009
	£m	£m	£m	£m
Assets, included within:				
Derivative financial instruments	1,497	664	1,495	664
Loans and receivable:				
Loans and advances to banks	55,053	85,456	55,053	85,456
Loans and advances to customers	34,365	35,721	33,322	34,829
Other	7,194	1,760	4,427	1,760
	<u>98,109</u>	<u>123,601</u>	<u>94,297</u>	<u>122,709</u>
Liabilities included within:				
Deposits from banks	131,138	144,876	131,138	144,876
Customer deposits	40,949	33,395	35,065	33,385
Derivative financial instruments	4,196	853	4,196	853
Subordinated liabilities	11,266	10,994	12,216	10,994
Debt securities in issue	2,498	1,578	186	1,578
Trading liabilities	3,294	5,463	3,294	5,463
Other liabilities	145	–	145	–
	<u>193,486</u>	<u>197,159</u>	<u>186,240</u>	<u>197,149</u>

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2010 the Group earned £1,147 million and the Bank earned £923 million of interest income on the above asset balances (2009: Group and Bank £277 million); the Group incurred £2,565 million and the Bank incurred £2,532 million of interest expense on the above liability balances (2009: Group and Bank £823 million).

#### **HM Treasury**

In January 2009, HM Treasury became a related party of Lloyds Banking Group plc, the Bank's ultimate parent company, following its subscription for ordinary shares issued under a placing and open offer. As at 31 December 2010, HM Treasury held a 41 per cent interest (December 2009: 43 per cent) in Lloyds Banking Group plc's ordinary share capital and consequently HM Treasury remained a related party of the Bank and its subsidiaries throughout 2010.

#### **Capital transactions**

During 2010 there were no further subscriptions by HM Treasury for Lloyds Banking Group plc's ordinary or preference share capital, with the decline in the percentage of ordinary shares held by HM Treasury reflecting the issuance by Lloyds Banking Group plc of ordinary shares.

#### **Lending commitments**

On 23 March 2010, Lloyds Banking Group plc entered into a deed poll in favour of HM Treasury, the Department for Business, Innovation and Skills and the Departments for Communities and Local Government confirming its lending commitments for the 12 month period commencing 1 March 2010. Lloyds Banking Group plc agreed, subject to, amongst other things, sufficient customer demand, to provide gross new lending to UK businesses of £44,000 million and to adjust the undertakings (but not the level of lending agreed in 2009) given in connection with lending to homeowners for the 12 month period. This additional lending is expressed to be subject to the Group's prevailing commercial terms and conditions (including pricing and risk assessment) and, in relation to mortgage lending, the Group's standard credit and other acceptance criteria.

#### **Credit Guarantee Scheme**

HM Treasury launched the Credit Guarantee Scheme in October 2008 as part of a range of measures announced by the UK Government intended to ease the turbulence in the UK banking system. It charges a commercial fee for the guarantee of new short and medium-term debt issuance. The fee payable to HM Treasury on guaranteed issues is based on a per annum rate of 50 basis points plus the median five-year credit default swap spread. At 31 December 2010, the Group had £6,030 million (2009: £8,725 million) of debt issued under the Credit Guarantee Scheme. During 2010, the Group redeemed £2,695 million of bonds. The Group's income statement includes fees of £89 million (2009: £236 million) payable to HM Treasury in respect of guaranteed funding.

There were no other material transactions between the Group and HM Treasury during 2010 that were not made in the ordinary course of business or that were unusual in their nature or conditions.



**Other related party disclosures**

The Group provides both administration and processing services to its principal joint venture Sainsbury's Bank plc. The amounts receivable by the Group during the year were £31 million (2009: £34 million), of which £8 million was outstanding at the year end (2009: £10 million). At 31 December 2010, Sainsbury's Bank plc also had balances with the Group and the Bank that were included in loans and advances to banks of £1,277 million (2009: £1,218 million) and deposits by banks of £1,358 million (2009: £1,405 million).

The Group has a number of associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2010, these companies had total assets of approximately £4,713 million (2009: £11,816 million), total liabilities of approximately £4,199 million (2009: £12,106 million) and for the year ended 31 December 2010 had turnover of approximately £744 million (2009: £8,766 million) and made a net profit of approximately £164 million (2009: net loss of £557 million). In addition, the Group has provided £1,406 million (2009: £5,245 million) of financing to these companies on which it received £19 million (2009: £140 million) of interest income in the year.

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

At 31 December 2010 the Group had loans and advances to customers of £5,660 million (2009: £12,216 million), the Bank had loans and advances to customers of £5,628 million (2009: £12,197 million), and the Group and Bank had outstanding balances within customer accounts of £151 million (2009: £174 million) relating to jointly controlled entities and associated undertakings.

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

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

The following statement is extracted from page 4 of the Annual Report. This statement relates solely to the Annual Report and is not connected to the extracted information set out in this announcement or the 2010 Results Announcement dated 25 February 2011.

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

- the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the European Union, give a true and fair view of the assets, liabilities and financial position of the Bank and Group and the profit or loss of the Group;
- the business review includes a fair review of the development and performance of the business and the position of the Bank and Group; and
- the principal risks and uncertainties faced by the Bank and the Group are set out on pages 7 to 9.