TRADING UPDATE – 12 DECEMBER 2008

The following Trading Update is being provided in anticipation of the launch of the proposed placing and open offer and in advance of the meetings to be held today at the NEC Birmingham, to approve that placing and open offer and acquisition of HBOS plc by Lloyds TSB Group plc.

Group Overview

Since the Interim Management Statement published on 3 November 2008, (the November IMS) the Group has been operating in increasingly difficult market conditions. There has recently been an acceleration in the deterioration in credit quality, and further sharp falls in estimated asset values. In addition, pressure is building on net interest margins due to the significant reductions in UK base rates. Wholesale funding costs, including funds obtained under UK Government guarantee, remain high relative to base rate and by historical standards. Deposit flows have improved with Retail inflow in November.

Divisional Review

Retail

As stated in the November IMS, the Retail net interest margin remains stable relative to that reported for the first half of 2008, but will come under additional pressure due to the impact of recent base rate cuts. There has been a deterioration in the trend in secured lending arrears which, taken together with continued sharp declines in house prices, has resulted in an estimated secured lending impairment charge of £0.7bn for the 11 months to 30 November 2008 (£0.4bn 30 September; £0.2bn 30 June 2008). The estimated impairment charge for unsecured lending arrears is £1.0bn for the 11 months to 30 November 2008 (£0.8bn 30 September 2008; £0.5bn 30 June 2008). In light of the worsening economic climate, trends in Retail impairment charges are likely to come under further pressure.

Corporate

Corporate credit conditions have continued to deteriorate significantly since the November IMS. This has resulted in an estimated impairment charge of £3.3bn for the 11 months to 30 November 2008 (£1.7bn 30 September 2008; £0.5bn 30 June 2008). This charge reflects an increase in the migration of exposures into the higher risk and impaired categories and sharp declines in asset values with a consequent impact on estimated recoveries. These factors are expected to continue to impact results in the short to medium term.

Recent pronounced falls in the estimated valuations of property and other investments have impacted significantly on the value of the HBOS investment portfolio with an estimated loss of £0.8bn for the 11 months to 30 November 2008 (£0.1bn loss 30 September 2008; £0.1bn profit 30 June 2008).

Investment valuations are expected to remain under significant pressure in our private equity and joint venture businesses.

Insurance & Investment

Consistent with the November IMS, our Insurance & Investment division continues to make a good contribution to Group results. From January 2009, we will move to offering our personal loan customers a more flexible regular premium payment protection product to protect against accident, sickness and unemployment; this will defer the timing of Group profit recognition in 2009 and later years.

International

The sale of BankWest and St Andrew's Insurance in Australia received approval from the Australian Competition and Consumer Commission (ACCC) on 10 December 2008 and is expected to complete by the end of December 2008. Credit conditions continue to deteriorate in Australia, Ireland and North America and this has resulted in some increase in impairment charges.

Treasury Portfolio

As at 30 November the estimated losses due to market dislocation totalled £2.2bn (£1.8bn 30 September 2008; £1.1bn 30 June 2008), including impairment losses in the Banking Book of £0.6bn (£0.5bn 30 September 2008; nil 30 June 2008).

In light of increasing illiquidity in the markets for asset backed securities (ABS), HBOS has changed the classification of ABS in the Banking Book from Available for Sale (AFS), where they were carried at fair value of £35.4bn as at 31 October 2008, to Loans and Receivables at the same carrying value. Following this change in classification these securities are no longer subject to measurement at fair value, although they will continue to be subject to regular impairment testing.

For the period to 30 November 2008, estimated negative Fair Value Adjustments (FVAs) in respect of the Banking Book totalled on a post tax basis £4.5bn after the reclassification to Loans and Receivables.

Market dislocation losses reflect deteriorating market conditions and credit downgrades, including downgrades to monoline insurers in November 2008. Exposure to monolines calculated on our own internal methodology totalled £1.2bn at 30 November 2008 (£1.1bn 30 September 2008; £0.7bn 30 June 2008).

At 30 November 2008, 84.4% of our ABS portfolio by nominal value was rated AAA, 5.3% AA and 3.1% A, compared to 88.3%, 6.4% and 2.0% as at 30 September 2008.

Financial Services Compensation Scheme (FSCS)

The Financial Services Authority (FSA) has issued draft guidance regarding the levies to be made by the FSCS to enable it to fulfil its obligations and compensate deposit customers of failing banks. Based on the information currently available, HBOS is likely to accrue a charge of around £200m in 2008 in respect of the FSCS levy.

Outlook

Global market and economic conditions, UK recession and increasing unemployment will continue to present a particularly challenging operating and credit environment. Lower interest rates should ease the debt burden but exert further pressure on net interest income. These factors will impact on HBOS capital ratios. However, through the injection of capital and liquidity facilitated by the UK Government, both currently and going forward, HBOS remains confident in its ability to navigate through this difficult period, as it becomes part of the enlarged Lloyds Banking Group.

Contacts

Investor Relations: Charles Wycks
Director of Investor Relations
+44 (0)131 243 5521
charleswycks@hbosplc.com

John Hope
Director, Investor Relations
+44 (0)131 243 5521
johnhope@hbosplc.com

Press Office: Shane O'Riordain
General Manager, Group Communications
+44 (0)131 243 7195
+44 (0)7770 544585 (mobile)
shaneo'riordain@hbosplc.com

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