

Taking care of tomorrow

THE HBOS CORPORATE RESPONSIBILITY REPORT 2004



Taking care of tomorrow



About HBOS

HBOS, formed after the merger of Halifax and Bank of Scotland in 2001, is the UK's largest mortgage and savings provider as well as being a major player in the provision of new current accounts and credit cards in the UK. We are a leading personal lines insurer and asset manager, and have a significant presence in corporate and business banking. Our determination to offer value for money and transparency makes us, we believe, a powerful force for competition in UK financial services. Over 80% of our pre-tax profits are generated in the UK; we also have offices in Europe, Australia, North America and the Far East.

Key facts

HBOS has over 67,000 colleagues, over 20 million customers, and over 2.5 million shareholders. We have a financial relationship with two out of every five households in the UK.

In 2003, HBOS's profits before tax and exceptional items were £3,885 million (an increase of 27%), with a 17.7% post-tax return on equity. The Group paid £688 million in tax on profits on ordinary activities, and over £52 million in local authority rates.

HBOS Group's main brands are

	Halifax,
	Bank of Scotland,
	Clerical Medical,
	Birmingham Midshires,
	HBOS Treasury Services
	Insight Investment,
	The Mortgage Business
	St. Andrews and
	Intelligent Finance.
	In Australia, we now own BankWest, and we have banking and insurance operations in Ireland.
	St James's Place Capital,
	First Alternative and
	e-sure are businesses in which we have substantial shareholdings.

Front cover photograph:

Poplar HARCA is a charitable company limited by guarantee. It is a Registered Social Landlord, and was formed to accept the partial transfer of housing stock from the London Borough of Tower Hamlets. Poplar HARCA currently manages around 5,000 homes, and Bank of Scotland provides a loan facility 50:50 with Abbey. It has been very much involved in the regeneration of the estates on which it works, including community centres and the nursery featured here (website: www.poplarharca.co.uk/community).

Contents

Chief Executive's introduction	2
Our Commitment to the Way We Do Business	3
Corporate responsibility underlies our strategy	4
Our stakeholders	6
Our colleagues	8
Responsibility in the marketplace	12
Investor responsibility	16
Responsible lending	18
Financial inclusion and financial literacy	21
Responsible resource use	22
Community investment	26
Measuring our performance	28
Verification statement by Casella Stanger	30
Commentary by Jonathon Porritt	31

Report coverage and timeframe

This report covers the period January to December 2003, unless otherwise specified. It describes the operations and performance of the HBOS Group within the UK, which together represent over 80% of pre-tax profits. The report has been externally verified by Casella Stanger (see page 30).

Chief Executive's introduction



*James Crosby
Chief Executive*

Our Corporate Responsibility (CR) programme has come a long way in the last year. But, as this report makes clear, there is a lot more to do. Specifically, the publication in this document of The Way We Do Business, along with 48 accompanying metrics, represents a very significant step forward for the Group. Shareholders and customers expect nothing less.

Our strategy

Our strategy is straightforward: we put both colleagues and value for money at the heart of our CR programmes. We want colleagues to be strong advocates of our strategy, our employment policies and our products. Committed colleagues are motivated colleagues, keen to provide our customers with the best solution to their financial needs.

At HBOS, providing value-for-money products is a key CR objective – the provision of simple, transparent, value-for-money products is not only right for customers; providing them has given HBOS a real competitive edge. That is why we have the most competitive current account on the high street and that is why we are the only bank that does not apply entry or exit fees to customers who buy our bancassurance mutual fund range. But we want to deliver better value for money and even greater transparency. We will, and will also let you know when we do.

The old adage “what gets measured gets done” is clearly just as relevant in CR as it is in business generally. We have added an extensive range of measures to track our performance and are committed to independent

verification. For example, the contents of this report were verified by Casella Stanger, an independent CR agency. So, the same verification process that we apply to “business” communications like our Annual Report now applies to our CR programme.

The governance of our CR activities has been very significantly improved as well and we now have a range of committees – both policy and process orientated – in place. For instance, we have a diversity committee (which I chair) and a CR Forum chaired by Phil Hodgkinson, another of our Executive Directors.

Our future plans

The publication of our The Way We Do Business statement represents an important step forward for HBOS. In this statement, we give all our stakeholders guidance on the standards we aspire to, especially with key groups like colleagues and customers. I should stress however that at present the statement is aspirational in the sense that we don't deliver at the moment on all the commitments it contains. But it is a clear statement of our ambition and we are backing it up with continuous measurement and reporting. As a result, all of the 48 performance indicators are both meaningful and measurable. We will be transparent in our reporting with regular updates, where appropriate, on our website and in next year's CR Report.

HBOS continues to make good progress with our CR agenda. But we need to do more. With The Way We Do Business in place, alongside a robust performance measurement system, we aim to do just that.

HBOS: our commitment to the way we do business

We have over 2.5 million shareholders, over 20 million customers, 67,000 colleagues and many thousands of suppliers. Our commitment to these groups and to society in general is that collectively and individually we aspire to act responsibly and to high standards at all times.

Shareholders

We will promote the interests of our shareholders by seeking to increase the value of their shares and dividends, and through sound corporate governance. We will communicate with shareholders regularly and in doing so will seek to be clear, comprehensive and balanced.

Customers

We will be honest, fair and open in our dealings with our customers and endeavour to help them at all times. We are committed to providing them with value-for-money products, designed and promoted in a simple and transparent way, and made as widely available as possible. When things go wrong, as they sometimes do, we will resolve problems as quickly and fairly as we can.

Colleagues

We will create a safe working environment which encourages openness, honesty and mutual respect, and where colleagues can constructively challenge and ask questions. We will offer equal opportunities for all.

We will provide the opportunity for all colleagues to develop their skills and knowledge, and to enjoy fulfilling careers. We will offer competitive remuneration with total rewards linked to individual and collective performance, and the opportunity for colleagues to participate in the success of HBOS.

Suppliers

We will deal openly, fairly and honestly with all our suppliers and business partners. We will not demand of them standards that we do not apply to ourselves but we will seek to understand their approach before doing business with them.

Society

Our main contribution to society is the value we can add through our success in business. We will seek to be a positive influence on those social and environmental issues which, having listened responsibly to our shareholders, customers, colleagues and suppliers, we think are important, for example, upholding human rights.

We will observe the laws and regulations of all countries in which we operate, not just in the letter but also the spirit. We will not countenance bribery, corruption, insider trading or the concealment of conflicts of interest.

We will contribute to the development of the community by making charitable donations to initiatives relating to financial literacy and money advice, and by providing opportunities for colleagues to support the development of the communities in which they live and work.

Delivering our commitments

We will measure our progress against this commitment and report this regularly to shareholders, customers, colleagues and suppliers. Wherever possible, we will independently benchmark or verify that it continues to meet their expectations.

Corporate responsibility underlies our strategy

HBOS provides financial services which allow millions of people to buy their homes, save for retirement, insure their risks and manage their money. This is an important contribution to society, and it comes with a heavy burden of responsibility. Our most important corporate responsibility is to ensure that our customers get products that are right for them. Meeting this responsibility is at the heart of our strategy as a business.

We aim to create competitive advantage by focusing on transparent, value-for-money products. In our Retail Banking division, this comes to life in the Halifax and Bank of Scotland “customer champion” proposition. Our Insurance & Investment division’s low-cost distribution, efficient manufacturing and simple, transparent products follow the same theme, ensuring our customers get the right products for them.

To achieve our objectives it is vital that we attract the right people to

market and sell our products, and manage relationships with our customers. We have therefore worked hard to ensure that our employment practices are designed to make us an “employer of choice”. Through this approach HBOS aims to win the loyalty and trust of a growing share of customers, and so provide the excellent returns that our shareholders expect. For us, corporate responsibility is not something that we pursue separately from our business goals. It is an integral part of the way we do business.

We are committed to improving our performance through participation in benchmarking indices such as Business in the Community’s Corporate Responsibility Index. In 2003, we were ranked 29th out of the top 100 companies; good, but not yet good enough for us. We are also developing our reporting, in response to feedback from stakeholders. See pages 28 and 29 for our comprehensive set of key performance indicators.

Sound governance

The Board meets regularly (normally 10 times per year) to determine the strategic direction of the Group and review its operating and financial performance. In addition to the Chairman Dennis Stevenson, the Board comprises seven Executive Directors and nine Non-executive Directors. James Crosby is Chief Executive; Ron Garrick is Deputy Chairman and the Senior Independent Director. The roles of the Chairman and Chief Executive are separate.

Apart from the Chairman, all of the Non-executive Directors are considered to be independent of management and free from any business or other relationship that could materially interfere with the exercise of their judgement; their remuneration consists only of fees. Annual reports are presented to the Board on corporate responsibility, environment, community investment, and human resources.

Our support for the new Higgs corporate governance recommendations has been followed by early adoption of the new

Gap analysis:

CR review of the Insurance & Investment division

In 2003 the Corporate Responsibility Forum commissioned external consultants PricewaterhouseCoopers LLP to conduct a six-month corporate responsibility review in the Insurance & Investment division (IID). The main findings were:

- Colleagues said that reward and recognition, work–life balance and customer service were of the highest importance to them, but were also concerned that some of our actions (e.g. our paper recycling) appeared not to be always consistent with CR principles. It was clear that HBOS needed to communicate more effectively about its CR management.
- Improvements could be made to product design, delivery and communication. Better management information about product performance from colleagues, intermediaries and customers was needed to allow HBOS to respond adequately to public concerns about products and services.
- HBOS should evaluate the impact of CR on brand strength, clearly define its position on highly visible issues such as ethics, and enhance the quality and quantity of management information.

The review led to the development of The Way We Do Business statement for the Group, 48 key performance indicators to measure our performance, and will help steer the Group-wide CR programme in future.



Combined Code. We aspire to comply with the Code except in very limited instances where we believe a different approach is in the best interests of shareholders, and in these cases we will provide full explanations, in accordance with the “comply or explain” principle.

The Group Audit Committee monitors compliance with the Corporate Governance Framework, supported by the Group Risk Committees and risk functions.

The Communications Action Group, chaired by James Crosby, is an externally focused body, meeting fortnightly. It regularly reviews a range of corporate responsibility (CR) activities, including product and marketplace issues, community investment, and sponsorship. The Internal Communications Group, also chaired by the Chief Executive, covers the communication of these issues to colleagues, and drives the research programmes covering our internal audience.

Corporate responsibility is a strategic issue for HBOS. Phil Hodgkinson, Chief Executive, Insurance & Investment division, has Board

accountability for our CR programme, and chairs the Corporate Responsibility Forum. The Forum is a Group-wide co-ordinating body comprising senior representatives of the key businesses and functions from across the Group, meeting quarterly.

Other bodies supporting our CR strategy include the Diversity Leadership Group chaired by James Crosby, Chief Executive, and the HBOS Foundation, an independent charitable body chaired by Phil Hodgkinson, which works with charitable and not-for-profit organisations across the UK.

Financial Services Authority

Regulation of financial services is growing not only in the UK, but also in Europe and the USA. Regulation is the means by which society consents to our activities as a financial services company. This is an area where we take our responsibilities seriously, and where we see an opportunity for us to create competitive advantage. We also ensure that we learn from our mistakes, and two regulatory actions concerning historical inadequacies have resulted in fines since the last CR Report. In

Where can we do better?

Throughout this report, we have highlighted in boxes like this one the actions that we intend to take in the coming year, underlining the HBOS commitment to improving our corporate responsibility performance. In the 2003 Report, for example, we highlighted the Saving Gateway as an example of the way in which financial institutions can help low-income communities, the work that we were undertaking to make our branches places where customers with disability can do business, the need to recruit more female managers, our commitment to increase colleague volunteering activity. We have been able to report progress on all of these issues in this 2004 Report.

February 2003, Bank of Scotland was disciplined by the Financial Services Authority for breaches of the FSA principles and IMRO rules in the administration of its Pep and ISA business. A fine of £750,000 was imposed. In January 2004, Bank of Scotland was fined £1,250,000 for breaches of the record-keeping aspects of the FSA's Money Laundering Rules.



Our stakeholders



Colleagues at Intelligent Finance, Edinburgh

We believe that the first step in addressing corporate responsibility at HBOS is to develop a deep understanding of our stakeholders, their attitudes towards us and their interests in the company. Trust and confidence are critical factors in the effective business performance of banks, and the sector has recently come under increasing scrutiny.

Colleagues

We have carried out an annual Colleague Opinion Survey since the formation of HBOS in 2001. Similar surveys were also carried out at Halifax and Bank of Scotland before the merger. The Opinion Survey, conducted by MORI, measures employer, product and business strategy advocacy, and this year we asked our 67,000 colleagues specifically about corporate

responsibility (see pages 24 and 26). The results are made available on the Group's intranet to all colleagues, and acted on at local and Group level.

Customers

Our relationship with our 20 million retail customers and thousands of business and corporate clients, from large companies to sole traders, lies at the heart of our business. We ensure that we are aware of their attitudes towards HBOS and its brands, through monthly tracking surveys, regular contact in person, through mortgage and savings reviews in our retail branches, and regular meetings with intermediaries and business clients. We are the UK's largest mortgage lender, and biggest savings institution, and we have ambitions to grow our market share in the other UK retail markets (including credit cards, personal loans, and banking) to between 15% and 20%.

Shareholders

HBOS has over 2.5 million investors. Approximately 250,000 calls and 100,000 written enquiries are managed by Shareholder Services annually, and in 2003, over £1 billion in dividends was paid out to private and institutional shareholders.

The Investor Relations team engages regularly with our largest shareholders, and representative bodies such as the Association of British Insurers and the

National Association of Pension Funds, on key issues such as corporate governance. Meetings are held with over 350 institutional shareholders every year. In 2003, we invited our 25 largest shareholders to a seminar on corporate governance and corporate responsibility, at which our first CR Report was launched. The response to this event was positive, and we plan to repeat it. Increasingly, we are also discussing our CR targets and performance with the socially responsible investment community.

Communities

As a major employer, and as an organisation with over 1,300 branches, we are active in many local communities. Our annual community expenditure approaches £20 million, including donations made through affinity credit cards. The HBOS Foundation, launched in 2002, has committed to donate £20 million in its



Poplar HARCA, London: crochet class

first five years. Last year for example, the Foundation contributed over £1.3 million to Macmillan Cancer Relief by matching funds raised by HBOS colleagues. The Foundation is also very active in the community through our colleagues' matched funding and volunteering programmes.

Suppliers

HBOS has over 20,000 suppliers, and spends over £2 billion each year on procurement. Their environmental and social impacts are important to us and we recognise our responsibility to encourage them to adopt sound business practices. This year, we have researched a sample of key suppliers about our corporate responsibility programme and details appear on page 15.



George Street, Edinburgh branch

Investments

HBOS's asset management business, Insight Investment, applies its Investor Responsibility Policy to £70 billion of funds under management (as at December 2003). Insight believes that as an investor, it has both a moral responsibility and a compelling long-term financial interest to engage with its investee companies in their efforts to comply with good practice principles. Insight is one of a small number of institutions to publish its voting record at AGMs. Details can be found on www.insightinvestment.com. Insight is also a significant investor in commercial property, and is taking steps to ensure that its assets comply with the HBOS Environmental Policy (see www.hbosplc.com).

Government

HBOS is the largest provider of social banking products – a key Government priority – in the UK. Other governmental programmes in which HBOS is active include joint energy and carbon management projects with the Carbon Trust; in urban regeneration, through a secondment to the Office of the Deputy Prime Minister; and in local government. Phil Hodgkinson, who has Board accountability for CR, served on the DTI's Operating & Financial Review



Sustainable homes: Countryside Properties, Chatham Maritime

working group. We actively monitor our CR progress in the eyes of MPs and MSPs through syndicated research carried out for us by MORI. This covers our employment practices, product quality, corporate responsibility and community involvement.

Regulators

The Financial Services Authority is the UK regulator for the financial services sector. Its aims are "to maintain efficient, orderly and clean financial

markets and help retail consumers achieve a fair deal". HBOS works very closely with the Authority, and our CR aims are closely aligned with the FSA's Treating Customers Fairly initiative: we see our products, customer advice and employee training positioned at the heart of our CR strategy.

Trade unions

HBOS has recognition agreements with the trade unions Accord and UNIFI. Since its creation, the company and the unions have worked constructively on issues like the creation of common terms and conditions of employment for colleagues within HBOS and integrating branches within Scotland.

Non-governmental organisations (NGOs)

As part of a major review of corporate responsibility in the Insurance & Investment division, HBOS held a series of meetings with the Consumers' Association, the New Economics Foundation and the Centre for Tomorrow's Company. In 2003, HBOS joined forces with WWF, a leading global environmental organisation, to work on the WWF's One Million Sustainable Homes campaign, with the objective of encouraging the construction of a million new energy- and resource-efficient homes by 2012, as well as making significant progress in improving the existing UK housing stock.



Our colleagues



St Andrew's Square, Edinburgh

A competent and motivated workforce is essential to delivering our business objectives. HBOS's relationship with its employees, our colleagues, is one of its most significant social impacts. We aim to support their performance and development by:

- Developing individual competencies and advocacy for the Group's strategy and products. This approach is exemplified by HBOS Retail's People Strategy (opposite).
- Fostering equality of opportunity and diversity as set out in the Equality and Diversity Policy (see www.hbosplc.com/community).

There are three specific issues on which we focus our responsibilities as an employer: reward, advocacy and diversity.

Reward

The HBOS Total Reward Package rewards high performance so as to attract, motivate and retain the best people. It gives colleagues choice and flexibility about their own benefits and recognises their performance at an individual, team and Group level.

As a result there are hundreds of different bonus schemes to reward team contribution. Decisions on pay are taken by local managers, who reward

individual performance and behaviour according to local market and business conditions.

The package covers salary and bonus, as well as encouraging genuine interest in the success of HBOS through share schemes: Share Options, Sharekicker and Sharesave. Other benefits include pensions, holidays, cars, discounted products such as house insurance and the "Flex" programme, our flexible benefits package, now available to colleagues at

every level across the Group.

HBOS is one of a very small number of companies making Share Options available to all employees. Share Options give colleagues the right to purchase HBOS shares at a fixed price during a specified future period. Some, or all, of a colleague's bonus can be taken as shares as part of the Sharekicker scheme. If these shares are held for three years, then the colleague will receive a further 50% allocation of free shares.



Coffee lounge, Trinity Road, Halifax

“What Flex means to me”

Morag Black works for HBOS in Edinburgh and has benefited from the “Flex” programme since its inception. This year she’s chosen childcare vouchers, private medical insurance and critical illness cover.

“Flex has been a great thing for me. One of my biggest outlays is nursery fees so I opted for £500 worth of childcare vouchers each month which only costs me £450. This means I save £600 a year ... I’m very pleased with Flex. It’s a clear package of benefits where you can choose options to suit your lifestyle – and make savings at the same time. I can see that taking Sainsbury’s vouchers would save on my monthly supermarket shop and may go for that option in the future ... The flexibility is excellent and it seems the more you select, the more you benefit.”

Advocacy

We measure the major aspects of our colleagues’ advocacy: for HBOS as an employer, for our business strategy, and for our products. Some of the results of the 2004 survey are shown in the chart on page 10. Our objective is to take on the competition, and we can only do this if our colleagues are behind our strategy and our products. A better understanding of our strategy drives up colleagues’ belief in and commitment to it.

Internal communications

One of the ways in which we try to foster advocacy is to create an open, progressive culture in which our colleagues are able to speak up and challenge decisions. HBOS aims to keep all employees fully informed about the business, to foster a sense of community and to ensure all colleagues have a “voice”, through a variety of communication tools:

- The company operates one of Europe’s biggest private television

networks, enabling it to broadcast its own TV programmes by satellite to around 1,300 different sites.

- Programmes range from live question and answer sessions with the Chief Executive to regionally produced magazine-style broadcasts using colleagues as presenters.
- Intranets such as the *GroupNet*, which provides Group-wide daily news, information, quizzes, and competitions. *GroupNet* also hosts online question and answer sessions, in which the Chief Executive and senior managers respond to queries and comments from colleagues on any subject.
- Opinion surveys such as the annual MORI survey (see overleaf), a monthly tracking study, and project follow-up surveys. These also enable us to measure the effectiveness of colleague management policies.

Training and development

Employer advocacy is positively influenced by the opportunities for self-development that we offer our colleagues. In 2003, we invested over £16.5 million in improving the skills of our colleagues through tailored off-site courses, distance learning, on-the-job learning, product knowledge sessions, development for senior managers, and special events for graduate entrants. We also have a secondment programme so that colleagues can sample different working environments. Opportunities for volunteering enable skills learned at work to be applied to help community groups and schools, with worthwhile results for all involved. We are also providing colleagues in our Retail division with outstanding personal and career development opportunities, e.g. our Academy training frameworks, which provide a suite of courses for colleagues.

Raising our Performance

We plan to raise performance levels for all colleagues through objective setting, coaching and performance review. This aims to support colleagues in developing the skills required for their role, and in adjusting to changes demanded by the rapid pace of organisational development and change.

The People Strategy in Retail banking

The People Strategy in the Retail division is about developing the best-performing, friendliest and most motivated banking workforce in the UK, led by the most capable management team. The strategy is designed to achieve two key objectives:

- Productivity – developing the skills of our colleagues to improve HBOS’s performance, and building leadership capacity.
- Employer advocacy¹, which has increased over the past three years from 44% to 60% but we aim for world-class levels of 70% by the end of 2005.

Work–life balance

Colleagues say that we have more to do in the area of work–life balance. Our focus here is on giving our colleagues choice and flexibility about their working patterns. The range of options includes job share, part-time working, home working, term-time working and flexible working patterns such as four-day weeks and nine-day fortnights. Workshops are being run, covering the many ways of working more flexibly and the benefits this brings to both colleagues and the business.

¹ The extent to which colleagues speak highly of HBOS outside the company



Cyber Café, Trinity Road, Halifax

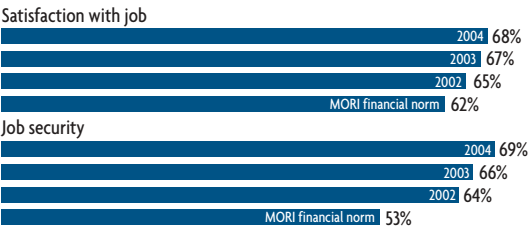


CASE STUDY

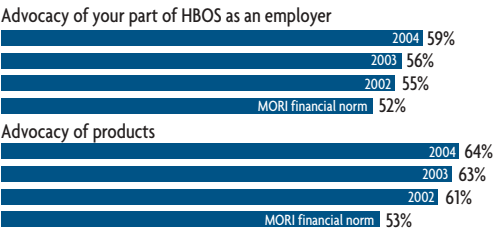
The Institute of Practitioners in Advertising (IPA) has found that advertisers are missing out on a huge potential market by failing to communicate properly with black and Asian people. Their Ethnic Diversity Project praised Halifax for reflecting minority cultures in its advertising, through featuring Howard Brown, one of the bank's colleagues.

MORI Colleague Opinion Survey

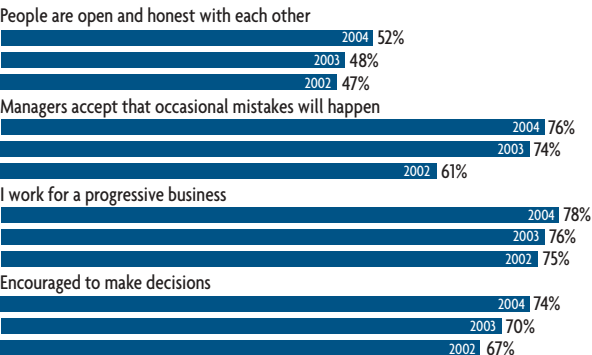
Working life



Advocacy



Culture



Percentage of colleagues rating HBOS performance highly or agreeing with the statement in 2002–2004.

Additional colleague indicators		
	2002	2003
Absence rate	3.7%	3.7%
Voluntary turnover	9.5%	11.3%

Annual MORI Colleague Opinion Survey

This survey asks colleagues for their views on working for the company. By comparing results from year to year we can track change and monitor the effectiveness of our initiatives. Response rates of 85% and over have been achieved for the past three years, indicating a high level of engagement with colleagues at every level, and some of the key results are displayed in the graphs on the left.

Diversity

Led by the Chief Executive, our Equality and Diversity strategy is supported by regular monitoring of workforce composition, and participation in Business in the Community's Opportunity Now and Race for Opportunity (RfO) surveys. These surveys benchmark the performance of HBOS against indicators such as leadership, policy, and employment practices. In 2003 HBOS achieved Gold Standard and an extract from the 2003 RfO report stated:

"Very strong commitment is demonstrated by the personal involvement of your Chairman as well as your senior managers in the six business units. You have also made significant progress in transferring the equality and diversity agenda firmly into the line by making your Diversity Champions personally accountable for engaging their part of the business as well as responsibility for six-monthly feedback to the Chief Executive."

Ethnic diversity

Divisional Diversity Taskforces have carried out a review of their

"Once again, the response rate for HBOS continues to be higher than for any other company we survey. Results show a general increase in satisfaction across the whole workforce and across most questions – with scores for working life, line management, culture, leadership and communications all up on previous years. The vast majority of questions score some way above our MORI financial scores – something HBOS can be very proud of."

Peter Wilde, MORI

recruitment and selection processes as part of their Diversity Action Plans for 2003. As a result, Diversity Awareness workshops, and meetings with recruitment agencies and executive search consultants were held to communicate the Equality and Diversity strategy and review shortlists.

Sensitivity to the needs of colleagues from all ethnic backgrounds is demonstrated by using our flexible working policy to accommodate religious and celebratory festivals, and has been met with positive colleague feedback. The new "Dressed 4 Success" corporate wear includes an ethnic range; and dialogue with catering



Colleagues at Trinity Road, Halifax



Lift for disabled customers, Sowerby Bridge branch

suppliers has raised awareness of cultural and religious needs.

The input and feedback from colleagues is of great value in implementing our strategy, and in designing communications to attract potential customers. One indicator of the benefit to business was demonstrated by the 150% growth in volumes of international payments in the West Midlands in just one quarter of 2003. Sixty per cent of these sales came from Asian customers.

Gender diversity

The proportion of women in management has risen over the past three years from 25% to 27%. In 2003:

- 463 out of 957 (53%) branch managers were female, a significant increase since 2002 (48%).
- 95 out of 662 managers (14%) were

female at senior management level (level 6 and above), and there were 1,616 women (28%) amongst our 5,707 middle managers (levels 4 and 5).

Disability

During the 2003 European Year of Disabled People, a number of key projects were undertaken to move the disability agenda forward. To encourage the recruitment of people with a disability, a booklet entitled *Disability Aware* was developed to help managers overcome their concerns. HBOS websites are also working towards the RNIB's See It Right symbol following an RNIB audit of our websites last year. As a result of such initiatives, HBOS won the Leonard Cheshire Scotland Business Award for promoting inclusion and equality for disabled customers and colleagues.

Workforce data

Gender of overall workforce		
Female	Male	
36%	64%	2003
33%	67%	2002
30%	70%	2001

Gender of managers (level 4 and above)

73%	27%	2003
73%	27%	2002
75%	25%	2001

Ethnicity

Overall workforce		Managers		Unspecified	
White	Ethnic	White	Ethnic		
93.8%	6.2%	98.2%	1.8%	12%	2003
95.0%	5.0%	98.7%	1.3%	15%	2002
94.3%	5.7%	99.2%	0.8%	12%	2001

Colleagues describing themselves as having a disability*

2003	1,001
2002	514
2001	490

* During 2002, the number of colleagues reporting a disability rose from 0.9% to 1.5%, although Opinion Survey data indicates that over 3% of colleagues have a disability.

Where can we do better?

There are some key areas where we need to improve our performance:

- The proportion of women and ethnic minorities at senior levels, including the Board.
- Ethnic minority representation, especially in large corporate sites.
- The number of colleagues with a disability within HBOS.

We believe that it is important to quantify our objectives and targets in this area. Key performance indicators are being developed to help managers focus their activities.



Reception at Intelligent Finance, Edinburgh

Responsibility in the marketplace



Commercial Street, Halifax branch

Our objective is to establish Halifax and Bank of Scotland as the main customer champion brands in UK retail financial services, through value for money, transparency and innovation. Specifically this means:

- No hidden traps or charges.
- The majority of products consistently in the top 25% most competitively priced, compared to similar products from our main competitors.
- A number of “champion” products and services providing the best value in their market segment.

This strategy has proved to be very effective, driving up our market share

across all the main banking products.

Product development

The HBOS product development process reflects stakeholder concerns about consumer indebtedness and prudent lending. It is, for example, very much in our interest to ensure that customers can afford to repay their loans, and adopt sound saving habits. We therefore encourage prudent lending behaviour by offering a lower mortgage rate to customers who put down larger deposits.

The Communications Action Group is chaired by the Chief Executive and attended by the Retail Chief Executive,

with other divisional chief executives and product heads as appropriate. The group meets regularly to consider product design and customer communication issues before and after launch.

Key products

Current account

Halifax launched its high-interest Current Account in January 2001. The account paid 40 times more interest than main competitors, and has continued to pay a high rate. A key feature of the account is a hassle-free switching service, and it is growing rapidly, taking 25% of the “new and switcher” market, double our natural market share.

Banking for smaller businesses

HBOS set out in 2001 to double its UK market share of small and medium-sized enterprises (SMEs), a target that was achieved in 2003, a year ahead of plan. HBOS was the first major high street bank to pay interest on business current accounts, acting before the “Big Four” banks were later compelled to do so following pressure from the Government. HBOS has offered market-leading value in an uncompetitive market; business customers increased by over 28% in 2003 to 350,000 and HBOS’s UK SME market share now stands at 6%.

Savings

HBOS, principally through its Halifax subsidiary, is the largest savings institution in the UK. Research conducted

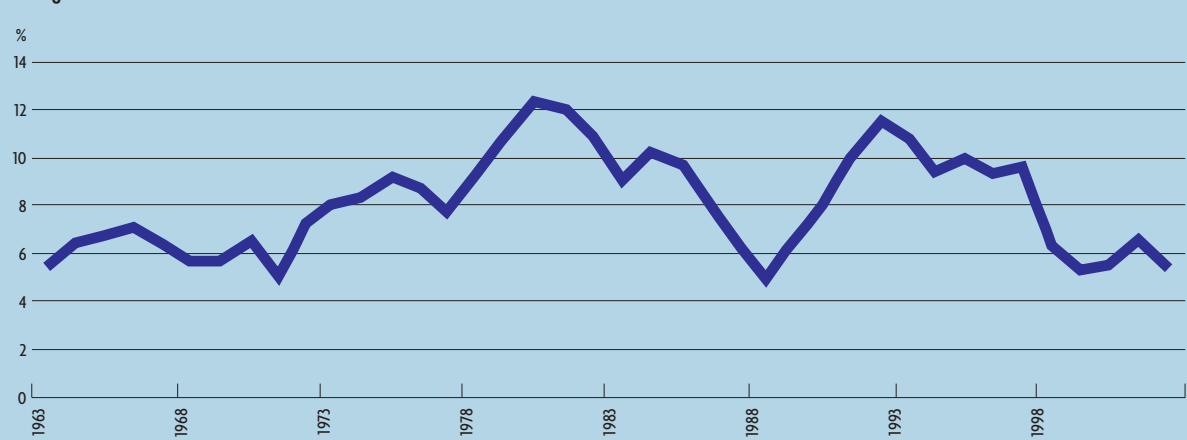
Almost half UK adults (17 million people) have no savings or investments

Men are more likely to save regularly than women (31% compared to 22%)

Of those that do save, only half again save regularly

NOP World, 2004

Savings ratio



for Halifax by NOP World and published in February 2004 showed that the savings habit has significantly deteriorated in the UK. For example, the savings ratio – the proportion of post-tax income saved – is at one of its lowest points in 40 years.

Crucially, the research found that 43% of people (5.5 million) who do not save regularly said they would be encouraged to save on a regular basis, if there was an account which only required a small monthly deposit and that paid a good rate of interest. In response to this demand, Halifax launched the Regular Saver Account in March 2004. It offers a fixed rate of 6% gross (6.05% AER) to customers who save a set amount every month for one year. As a “best buy” it immediately joined 784 other best-buy credits earned by HBOS brands in the national press in 2003, according to Metrica, the media evaluation agency.

Mortgage and savings reviews

Each year mortgage and savings customers are offered a product review to check that their accounts still suit their circumstances and changes are suggested in plain English, without sales pressure. The savings review, for example, has prompted the transfer of £35 billion of balances to better-paying accounts. The mortgage review was the first of its kind offered by a major lender; as a result, over 750,000 Halifax borrowers have moved off the standard variable rate.

Long-term savings

The Sandler Review of Medium and Long-Term Retail Investment in the UK found in 2002 that the British public are failing to save money because savings, investment and pension products are expensive and complicated. In response to the Sandler Review, Halifax was the first high street bank to launch a range of “no load” investment funds with no initial or exit charges. Its products offer value for money, charging a customer investing £100 a month up to 60% less than other high street providers – a total saving of £800 over 10 years.

Endowment mortgages

In keeping with other major banks, a proportion of our mortgage customers



Customers have free access to around 2,700 Halifax and Bank of Scotland ATMs as well as a further 30,000 LINK cash machines around the UK

Responsibility in the marketplace

were sold endowment policies offered by a number of major insurance companies during the 1980s and 90s, and their projected returns and ultimately their ability to repay their mortgages might be affected by recent falls in stock markets.

We have established a dedicated team to deal with any concerns that customers might have either with us or the companies whose endowments they purchased. The team liaises closely with the Financial Ombudsman Service and ensures that if a customer was incorrectly advised they will be appropriately compensated. We have also put in place a range of options for customers in the event that they anticipate not being able to repay their mortgages according to their intended schedule.

Credit cards

Competition in the credit card market presents customers with a great deal of choice, but the multiplicity of products on offer can be confusing for them. We have moved beyond the APACS¹ guidelines by including a summary box on monthly statements with information that our research shows

The Clear Card

The Halifax Clear Card is a flat-rate product with transparent features and pricing. Irrespective of the transaction type, customers pay the same monthly interest rate. Credit limits are not increased unless requested by the customer; there is a summary box too, setting out all the main charges on every monthly statement.

customers want to know. Convenience cheques have been a further cause for concern. HBOS has taken steps to ensure that these are only mailed to customers over 25 years of age.

Customer service

Managing customer service at HBOS

Over 40,000 colleagues work in HBOS Retail Banking, in over 1,300 branches, call centres, and in support of our significant online operations. HBOS is one of the biggest organisations offering telephone and internet banking, and offers better rates for customers using these lower-cost channels, which can also be accessed in over 650 branches. However, the rapid growth of our retail business in the past three years has raised a number of service issues, and the following paragraphs describe how we are tackling them.

Sharpening the focus on customer care

"Customer Experience" research carried out on our service standards in April 2003 revealed that 86% of customers were likely or quite likely to recommend Halifax to others, but that we need to improve areas such as queuing times in branches, and the speed with which we answer telephone calls. In 2004, in a major initiative, we will deploy almost 2,000 additional colleagues to tackle these issues. They will be placed in front-line roles in branches and contact centres.

Handling complaints

Complaints are defined in the Financial Services & Markets Act as "Any expression of dissatisfaction, whether justified or not". Our research reveals that whilst 42% of customers were



Trinity Road, Halifax

satisfied with the way their complaint was handled, an equal number of customers were not, and this has driven a major initiative to improve our service, starting with workshops for customer-facing colleagues that emphasise taking ownership of a complaint at the first point of contact, and including investment in new systems.

Disability

HBOS was awarded a British Diversity Award in 2003 for its work on accessibility in the branch network, largely as a result of Group Property's Project Enable. Working with the National Forum of Wheelchair User Groups and chartered surveyors Faithful and Gould, changes were made to branches that included ramping and lifts, automatic doors, lowering external ATMs and writing shelves, and the introduction of induction loops.

Call centres

"Offshoring" call centres to India and other Asian countries is a high-profile issue with some stakeholders, raising concerns about employment prospects in the UK and a diminution of service levels. HBOS, however, has no plans to move call centres overseas.

Our challenge is to decrease colleague turnover in call centres from just under 30%, the industry norm, to single figures using the People Strategy described on page 9. The aim is "to transform the retail contact centres to become places where colleagues are proud to work, for life". This will also require changing the nature of the job, by introducing more variety, and by training colleagues in a wider set of skills to provide opportunities for career progression. At the same time we plan to change the current mix of our workforce to reflect our customer base, and attract older, experienced people and working mothers.

Responsible procurement

Group Procurement spends £2 billion per year with over 20,000 suppliers, and until last year, the focus had primarily been on environmental issues. We have published a Statement

Supplier dialogue

The SMART Company (www.thesmartcompany.net) undertook a programme of structured dialogue with 14 suppliers to provide an insight into their perception of HBOS. For the most part, HBOS was regarded as an open and fair organisation that seeks to build partnerships with its supply chain. Most suppliers viewed HBOS as commercially focused, with professional and friendly employees. Areas for improvement identified were more indicators relating to supply chain issues, better communication of HBOS CR performance and suggestions on how social and environmental criteria might be introduced into the procurement process.

of Procurement Principles that recognises the importance of suppliers as stakeholders in our business, describes how HBOS will behave towards them, and what our expectations are of them. This is also reflected in The Way We Do Business statement (see page 3).

In 2003, the CR task force on Procurement developed an action plan to measure performance in key areas such as business travel and paper use (see website www.hbosplc.com); and an online environmental survey of a selected number of key suppliers to highlight areas for further dialogue. Action plan objectives that were not met included supplier workshops and researching examples of best practice by other companies. These will be conducted in 2004.

Procurement's revised minimum standards now include corporate responsibility and diversity issues. A risk assessment must be undertaken in advance of entering a contractual relationship for all purchases in accordance with the Supplier Risk Framework. As part of this assessment, issues relating to reputation, including the supplier's corporate responsibility and diversity policies, must also be considered.

Environmental supplier programme

A survey has been conducted with a select number of suppliers to determine their environmental performance. We now aim to collect the required data from all procurement suppliers, and hold supplier forums to share best practice. Some tools are already available to key contractors, such as Group Property's *Environmental Brief for Construction and Renovation Projects*.

Where can we do better?

- Customer service: focusing on queuing times in branches, and the speed with which we answer telephone calls.
- Credit cards: we will be working with the industry to improve data sharing, to tackle "binge borrowing" on cards.
- Procurement: measuring our performance on key indicators like business travel and paper and engaging with suppliers on environmental performance.

¹ Association for Payment Clearing Services

Investor responsibility

Insight Investment, the asset manager of HBOS, manages nearly £70 billion of assets on behalf of around 300 pension funds and several million individuals. The majority of this money is invested in the shares of companies in Britain, making Insight one of the UK's largest institutional investors.

There are growing demands from the Government, individual and pension fund investors, trade unions and other

stakeholders that large institutional shareholders play a more active role in ensuring that the companies they invest in have strong systems of governance and corporate responsibility. Corporate collapses like Enron, controversies over directors' pay and issues like climate change and human rights, have only served to emphasise this need.

Insight has made a strong commitment to acting as a responsible

investor. Insight's Investor Responsibility Policy¹ states that it believes that investors have both an interest and a responsibility to fulfil this role. Insight now has an eight-person Investor Responsibility team that conducts a programme of shareholder activism on behalf of its clients. 2003 was Insight's first full year of implementing its investor responsibility commitments, during which it engaged

Issue	Why is it important	Companies affected
The Baku-Tbilisi-Ceyhan (BTC) pipeline	<p>The oil and gas industry is becoming more dependent on fields in non-OECD countries. Apart from the political risks, the size and complexity of these projects is such that corporate environmental and social performance are increasingly important when negotiating and operating these projects.</p>  <p><i>Baku-Tbilisi-Ceyhan pipeline, Georgia</i></p> <p>One example of the challenges faced by the industry is the controversy surrounding the BTC pipeline, which runs through Turkey, Georgia and Azerbaijan. The pipeline runs through a number of important ecological areas, in a region of political instability and local and regional conflicts. The project has been particularly controversial because of concerns about the potential for the project's legal agreements to undermine national human rights and environmental laws, and the risk of sabotage.</p>	The BTC company is an international consortium of oil companies. BP is the largest shareholder (30.1%) and is managing the project on behalf of the other consortium members: SOCAR, TPAO, Statoil, ENI, Total, INPEX, ConocoPhillips.
Responsible supply chain management	<p>Many UK companies increasingly buy the products they sell to their customers from the developing countries. In many of those countries relatively low standards and weak laws mean that the way that those goods are produced may have detrimental social and environmental impacts. For example, many workers in fields and factories often have to work very long hours in poor conditions. Insight is keen to ensure that the companies in which it invests fully understand the social and environmental impacts of their purchasing policies and practices and take steps to address these effectively. If they do not, they face the prospect of very public criticism that can damage their brands, erode customers' trust and their corporate reputations and ultimately shareholder value.</p>  <p><i>Shelling prawns: fish factory, India</i></p> <p>One example where these problems arise is shrimp farming. Over recent decades, shrimp production has expanded rapidly throughout Asia and Latin America, bringing with it economic development and helping to alleviate the extreme poverty found in those regions. Farmed shrimp currently accounts for 30% of worldwide shrimp production, up from only 5% in the early 1980s. Most farmed shrimp is exported to the UK, continental Europe, Japan and the US to meet growing consumer demand.</p> <p>Although shrimp farming has been good for these countries in many ways, it has also been linked to worrying environmental and human rights problems, such as the destruction of seabeds and mangrove forests; the pollution of drinking water and agricultural land; the depletion of wild fish stocks; conflicts over land rights, illegal appropriation of land for the development of shrimp farms, and associated violence, intimidation, and murder; and the exploitation of workers, including poor working conditions, sexual abuse of female workers, and child and forced labour.</p>	53 companies. See spring 2004 bulletin at www.insightinvestment.com/documents/responsibility/

1 www.insightinvestment.com/responsibility
2 See www.insightinvestment.com/responsibility/project/responsible_supply_chain_management.asp
3 AccountAbility is an international not-for-profit professional institute dedicated to the promotion of organisational accountability for sustainable development

with around 200 UK companies on more than 20 different issues of concern. In addition, it voted on nearly 4,000 resolutions relating to 388 company meetings.

Insight also believes that it has a duty to be transparent and accountable for its engagement. A detailed account of its governance and corporate responsibility activities is therefore available at www.insightinvest

ment.com/responsibility/reporting, which, for 2003, includes four quarterly bulletins and 350 separate company reports. Examples of the way Insight works are presented in the table below.

Insight Investment was named Specialist Manager of the Year at the 2004 UK Pensions Awards. Sponsored by *Professional Pensions*, the award reflects Insight's work in promoting investor activism and corporate responsibility.

Where can we do better?

- Develop a measurement system for assessing the effectiveness of our activism and the extent of the improvements Insight has helped to bring about.
- Explore alternative approaches to company engagement such as engaging with Non-executive Board directors, to maximise our effectiveness.

Nature of engagement

Outcome

Insight's activities have included:

- Organising a meeting between investment institutions and human rights and environmental NGOs to better understand NGO concerns.
- Organising a meeting between BP/BTC and institutional investors, to discuss: project economics and risks, human rights, environmental impacts, legal issues.
- Ongoing discussions with BP and with the Caspian Development Advisory Panel (the independent body established by BP to provide project overview) around the ongoing management of social and environmental issues relating to the project and the monitoring and evaluation of performance.
- Facilitating communication and information sharing between the different parties involved: NGOs, the company, institutional investors.

The BTC project is one of the most important projects in BP's portfolio, and one of the most complex. The project is also a critical test of the company's commitments to corporate social responsibility.

Thus far, the effect of Insight's activity has been threefold: (a) to communicate investors' views to BP, (b) to provide a process for the exchange of views between different parties, and (c) to provide another form of project overview. It is too early to say what the outcomes will be in terms of the project's social and environmental performance. It is likely that such an assessment can only be made at the end of the project's lifetime. Insight intends to maintain an ongoing dialogue with BP and with other stakeholders on this project.

The BTC project raises a series of important questions around large infrastructure projects. Specific aspects are (a) the manner in which legal agreements to protect companies can also enhance social and environmental protection and (b) the emergence of best practice on issues such as stakeholder consultation and human rights. We intend to share these lessons with other companies considering similar projects.

Insight wrote to six UK supermarket and food companies in June 2003 regarding their shrimp-sourcing policies.

Commissioned research:

- To investigate the extent to which companies' own buying activity contributes to poor labour standards.² Results published February 2004, in conjunction with consulting firm Acona.
- To assess how well 35 large UK companies from six business sectors manage supply chain labour standards. Report published in March 2004 in conjunction with AccountAbility.³

Insight showed that companies would benefit from taking a more integrated approach to the challenge of maintaining a competitive, low-cost supply base, while at the same time upholding their commitments to trade ethically.

We demonstrated that, on the basis of their own reporting, most of these companies appear not to be managing supply chain labour standards according to emerging best practice. Marks & Spencer is the clear leader, scoring 84%; only three others – Kingfisher, Sainsbury's, BT Group – scored over 50%. Insight has begun discussions with many of the companies to encourage them to improve their management and reporting on this issue.

All six companies have responded. Marks & Spencer, Tesco, Unilever, Safeway and Sainsbury's have demonstrated that they are aware of these concerns and have sourcing policies and auditing systems to address them. They all stated that they are committed to continuing to work with key NGOs on this issue. Morrison's was not able to provide similar assurances. Insight will continue to engage with the company on this and other supply chain issues.

Responsible lending



HBOS is responsible for 23% of all UK mortgage balances and achieved a 25% share of net new mortgage lending in 2003, covering most segments of the market. Halifax and Intelligent Finance are our primary mainstream lenders, while Birmingham Midshires, Bank of Scotland and The Mortgage Business service the more specialist segments (buy-to-let, self-certification and near-prime).

Asset quality has not been sacrificed to drive sales, with the average loan amount remaining prudent at just over 2.5 times income. The average loan-to-value ratio for the HBOS mortgage book has remained stable at 43%.

Mortgage arrears

Some customers will experience difficulties in meeting their mortgage payments, usually as a result of changed circumstances such as unemployment, reduced earnings and relationship breakdowns. As a responsible lender, we aim to support customers through their difficulties and avoid repossessing the property.

One indicator of the success of this approach is the fact that Halifax accounted for only 9% of total

mortgage lender possessions in 2003, compared to its 19% share of UK mortgages. Halifax led the industry by announcing a few years ago that it will not commence action for recovery of a shortfall debt more than six years after the date of sale. This is now built into the Council of Mortgage Lenders' guidelines on debt recovery.

Specialist lending

Buy-to-let, self-certification and near-prime mortgages meet the needs of specific customer segments, but represent an increased risk to HBOS and its shareholders. These products are therefore priced at a premium and specialised underwriting processes have been developed to mitigate both the credit and fraud risk.

Self-certification mortgages, for example, serve the needs of self-employed customers and others whose income is difficult to certify in the usual way. By requiring a larger deposit and more rigorous underwriting checks, we significantly reduce the fraud and default risk. Our information for customers clearly warns against overstretching their finances, and reminds them of the consequences of providing

false information.

Growing concerns over the incidence of fraud in the self-certification market led the FSA to undertake a review. It concluded that "lenders generally have adequate controls in place to protect themselves from becoming conduits for mortgage application fraud" and "the prudential risks inherent in genuine self-certification lending are not currently significant". HBOS also carried out its own internal review and was satisfied with the overall adequacy of its own controls.

Empty homes

New research by Halifax has revealed that there are around 860,000 empty homes in the UK (approximately 3.4% of the dwelling stock) with the largest concentrations in less affluent areas of the North West, North East and Yorkshire. By tackling this problem we will help to alleviate the current housing shortage, and to regenerate deprived neighbourhoods. A special mortgage product enables borrowers to draw down sums for property improvements as the refurbishment work progresses.

Flooding



Floods in Upton-upon-Severn

Climate change is emerging as a major environmental challenge facing the UK and global economies. It has a number of potential impacts, but perhaps the most immediate is flooding. Halifax, the UK's largest lender, announced in December 2003 that it was extending its unique flood risk guarantee for its 1.8 million homeowner customers for at least a further five years. Halifax is the only major lender offering its customers such a commitment.



Beinn Ghlas Wind Farm, Scotland © National Wind Power, 2004

WWF's campaign for One Million Sustainable Homes by 2012

Residential housing contributes around 27% of the UK's CO₂ emissions associated with energy use. WWF's One Million Sustainable Homes campaign aims to reduce the effect of housing on the environment by providing people with the choice of living in a home that is cheaper, healthier and safer for them and the environment. HBOS is working in partnership with WWF to design market-based incentives for the development of sustainable homes; while Insight Investment and WWF have benchmarked the sustainability performance of house-builders and published their results in a report entitled *Building Towards Sustainability: performance and progress among the UK's leading house-builders* (see www.wwf.org.uk/sustainable_homes/reports.asp).

Corporate lending policy and procedures

In our lending to corporate and business clients, we increasingly look for existing and potential social and environmental risks that could threaten a company's profitability and, possibly, its continued existence.

Our loan assessment process ensures that these issues are considered by lending officials and sanctioners when assessing propositions: the Group Credit Risk Policy makes specific reference to compliance with the Group

Environmental Policy and the HBOS Commitment to the Way We Do Business.

Climate change

We now consider the impact of climate change on the long-term value of companies to which we lend, and in which we invest. Bank of Scotland is one of the leading players in renewable energy projects within the UK, Ireland

and the US (the Bank was one of the lead arrangers underwriting £300 million of funding for RWE Innogy to allow the refinancing and development of 21 wind farms in the UK, hailed as 2003 Deal of the Year by PFI International). By developing relationships in the renewable energy sector, we have gained experience over a range of technologies and fuel sources and share this knowledge

Affordability and customer indebtedness

An affordability model is used to calculate the net income available to service mortgage payments, by making deductions for taxation, household expenditure and outstanding credit commitments. The model then calculates the mortgage payments due on the required loan, and builds in a contingency to protect against rate increases over the medium term. The two results are then compared to confirm the maximum affordable loan amount.



Lenders' Guide to Environmental Risk

This is a reference manual to assist lenders in identifying environmental risks to Bank of Scotland's core business. First introduced in 1995, the Guide was revised in 2001 with the assistance of external environmental consultants. The Guide provides a summary of the environmental risks associated with lending; detailed guidance on environmental risks to customers' businesses; key legislative developments and anticipated regulations; and information on where further sources of help and information can be found. HBOS supports the Equator Principles¹ and is committed to their adoption during 2004.

through membership of bodies such as the British Wind Energy Association, the Aeolus offshore wind consortium, and contacts with Government bodies.

In the second report of the influential Carbon Disclosure Project (www.cdproject.net) HBOS gains coverage for renewables financing, and is named as one of the top 50 global companies assessed as "best in class" for addressing climate change. The assessment was based on key measures such as strategic awareness, management accountability, emissions management and reporting, emissions trading, and programmes in place.

Social housing and urban renewal

The Bank of Scotland Housing Finance team is a leader in social housing, arranging or co-arranging over £1 billion of loans to the RSL (Registered Social Landlords) sector in 2003. The Housing Finance team currently lends £4 billion out of the £28 billion total bank lending to the RSL sector.

The amount of grant available to RSLs from the Housing Corporation is decreasing and it is now concentrated in the hands of fewer associations. This has led the Bank to help RSLs develop innovative funding structures and, as a

result, many are now involved in diversified activities such as student accommodation, key worker housing, housing for sale and housing private finance initiatives. Bank of Scotland also has close links with the social housing sector via its community banking activities.

HBOS plays an active role in supporting both central and local Government in developing housing policy to tackle the regeneration of depressed housing markets. Halifax manager Martin Townsend recently completed an 18-month secondment to the Office of the Deputy Prime Minister (ODPM) as a policy advisor within the Market Renewal Team of the Sustainable Communities Directorate. A key component of the ODPM's Sustainable Communities Plan is the Pathfinders Programme, with Martin's

role being to engage the private sector in developing and implementing housing market renewal solutions for the nine "pathfinder" areas in parts of the North and Midlands.

HBOS's support naturally extends to the provision of mortgage finance to enable customers to benefit from the Government's affordable and sustainable housing initiatives. We are a leading provider of mortgage finance in support of right to buy and shared ownership.

Silvertown Quays

Silvertown Quays is a major mixed-use development planned as part of the London Thames Gateway initiative – Europe's largest regeneration project. The waterfront scheme will create a new heart for London's Royal Victoria Dock and provide a blend of high-quality residential, workspace, retail, leisure and entertainment facilities.

The scheme will also include a world-class aquarium that will be operated by the Zoological Society of London as a centre of excellence for conservation and education. Bank of Scotland, working in conjunction with the project developer, Silvertown Quays Ltd, and the London Development Agency, has provided development funding for the early stages of the project.

¹ A framework to manage environmental and social issues in project financing (see www.equator-principles.com/)

Where can we do better?

- Tackling empty homes.
- Increasing consideration of the social and environmental risks embedded in some lending decisions that can threaten our profitability or reputation.
- Raising the profile of the *Lenders' Guide to Environmental Risk* within the company.



Silvertown Quays, London: future visitor centre and aquarium

Financial inclusion and financial literacy

Financial exclusion is the lack of access to mainstream financial services such as banking, credit and saving facilities, while **financial literacy** involves understanding how to manage money. Almost 8 million people in the UK are unable to access bank or building society credit¹; 3 million are believed to be paying interest on their loans of over 160% APR²; and 1.5 million lack any type of financial product whatsoever.³

Our challenge is to design products that are affordable and accessible to all. We are committed to do so through our products and the HBOS Foundation (see page 26).

Social banking

The Community Banking team in Bank of Scotland provides a range of banking services including business lending to social enterprises, financial services for not-for-profit organisations, and advice on financial literacy.

The triple-award-winning Wester Hailes Community Banking Initiative is an informal agreement between Bank of Scotland and the Wester Hailes Representative Council. Since April 2001 almost 1,000 basic bank accounts have been opened. A "Be Your Own Boss" Enterprise Day was organised to support those thinking of establishing their own businesses. Two financial literacy courses have been successfully completed, and an innovative savings and loans scheme with the local housing association is in operation.

Working with the Government

Newham tax credit take-up scheme

Halifax is working with the UK Government and Community Links (a community organisation) in Newham, East London, in the pilot for the new Child and Working Tax Credit scheme. Tax credits are paid into bank accounts

but 10% of the 6,000 people eligible for the new tax credit in the borough did not have a bank account. Community Links is working with volunteers to run "help clinics" that explain the tax and introduce families to local Halifax branches.

The Saving Gateway

February 2004 marked the second stage of this pilot project, in which five Halifax branches have been working with the Government to encourage saving by those on low incomes. The scheme matches £ for £ the amount invested by those on low incomes up to a limit of £375.

The full evaluation of the project will be published by the Treasury in 2005, however an interim evaluation in December 2003 found that 1,365 accounts were opened between August 2002 and May 2003.

"Overall the Saving Gateway has mainly attracted genuinely new saving."

Interim evaluation, December 2003

"I'm very pleased with the pilot's progress to date, and appreciate the role that Halifax has played."

Ruth Kelly MP, Financial Secretary to the Treasury, January 2004

Initial feedback from participants was also encouraging; with 78% of all participants saying it was important to be able to open a Saving Gateway account through a local organisation; and two-thirds of the account-holders interviewed said they intended to continue saving afterwards.

"It's shocking, because I can't believe that I'm saving that ... I keep looking at my books ... you think wow ... it seems like I've only just opened the account ... It is building up."

"Once you get to a few hundred pounds and you realise that it's a really nice feeling to have something behind you like that, so if something goes wrong you can sort it out ... and that gives you a greater peace of mind."

Halifax is the only financial institution piloting the Saving Gateway.

Financial literacy

Building confidence and competence about finance in communities is a particular priority for the HBOS Foundation, and the following examples illustrate some of the ways we are helping to make these skills accessible for all.

NCH project

The Foundation has pledged £100,000 per year for three years to Money Matters, a new initiative from NCH, the children's charity. Its aims are to promote financial awareness and provide money advice to support underprivileged children and vulnerable young people. A volunteering partnership has also been created through an HBOS Foundation project in which the Retail Marketing team helps NCH create and market the relevant material, as well as work with the local Halifax, Chester and Edinburgh NCH centres to upgrade existing facilities.

Age Concern

According to recent Government figures, over half of the 11 million pensioners in the country are spending their retirement on or below the poverty line because they are unaware of their entitlements, or how to claim, or have difficulty completing the relevant claim forms. It is estimated that up to £1.7 billion per year in additional benefits could be claimed. HBOS Foundation is joining The Community Fund in supporting Age Concern's Income Maximisation Project by donating £70,000 over a period of three years. This will be used in 2004 to develop training packs, specialist benefit calculation software, and 18 training courses for up to 1,000 Age Concern staff.

Where can we do better?

- Adopt a more coherent "joined-up" approach to financial literacy across the Group, in conjunction with the HBOS Foundation.
- Put more effort and commitment into our financial literacy programmes.

1 Datamonitor, January 2003

2 New Economics Foundation, 2001

3 Church Action on Poverty, November 2003

Responsible resource use

HBOS recognises that it has a responsibility to the environment, and we are taking positive steps to address the environmental impacts of our business operations. The HBOS Environmental Policy statement can be found at www.hbosplc.com.

Our environmental impacts are:

- Direct environmental impacts resulting from our operations, related to resource use. These are identified using the FORGE Guidelines, and measured using the Ecopoints system developed by PA Consulting and BRE (The Building Research Establishment Ltd).
- Indirect environmental impacts of the core business issues, including the potential environmental risks associated with lending, insurance and investment. These are covered in the relevant sections of this report.

Management systems and approach

Our primary aim is to minimise adverse environmental impacts through good management, aiming for continuous improvement in our environmental performance.

We believe that it is essential that environmental reporting should be open and transparent, and that the work we do and the lessons learned are shared with the wider community. With this in mind, we are developing a series of detailed case studies that will be published on our website on a rolling basis over the next 12 months.

The company environmental management system is based on ISO 14001. This year external consultants Casella Stanger conducted a review to help us understand the advantages and disadvantages of the requirements for achieving ISO 14001 accreditation. In 2004, we will consider an accreditation pilot in one part of our operations.

Our long-term objectives are reviewed annually, and published on the Group website, www.hbosplc.com, and internally in a range of media. We also measure our progress using key performance targets and external benchmarks. Our performance is reviewed annually by external

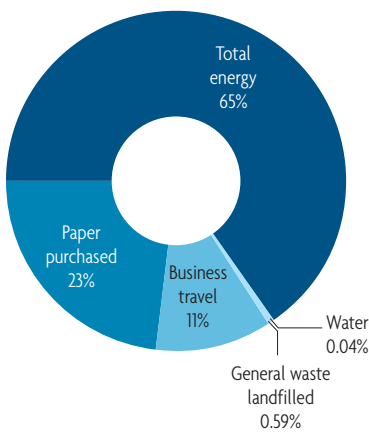
consultants, and reported to the Board. Our overall score in the Business in the Environment Index of Corporate Environmental Engagement improved from 75.9% in 2002 to 90.26% in 2003. Our sector position improved from 9th out of 14 banks to 6th out of 13 in 2003, somewhat better but still not good enough.

For the first time, the HBOS awards in December 2003 recognised colleagues for excellence in the areas of community, equality and diversity, and environment. The environment award went to Roger Hartshorn of Group Property for his work in the Group's energy efficiency programmes.

Impacts of resource use

HBOS's direct environmental impact falls into the five categories shown in the pie chart together with their

HBOS Ecopoints 2003



percentage contribution to the total impact, as measured by Ecopoints. By assigning an Ecopoint to each unit of measurement (energy – kilowatt hours (kWh), water – cubic metres (m³), waste – kg, business travel – miles, paper – kg), we can assess the relative significance of each.

The data¹ showing our performance in 2003 are set against a backdrop of significant growth in our business and a consequent increase in staff numbers

and associated resources. By rationalising the merged property portfolios and making more effective use of available space we were able to accommodate a 10% increase in staff numbers during 2002 and 2003 (see table below).

Energy and water

Highlights:

- On track to exceed our targeted 10% reductions in energy and water consumption and CO₂ emissions per FTE by the end of 2004.
- 90% of 2003 energy data fully verifiable.
- Over 5% of energy sourced from renewables, compared with 3% in 2002.

At around 65%, energy consumption accounts for the largest of HBOS's direct environmental impacts. The Group-wide energy management programme has resulted in improved data management and reduced consumption and costs.

Our revised targets are: to reduce consumption per FTE of electricity and gas by 10%, water by 6% and to reduce CO₂ emissions by 10% between 1st January 2002 and 31st December 2004. We use key performance indicators (KPIs) to assess the impact of initiatives to increase the efficiency of energy and water use and decrease carbon dioxide emissions. The graphs opposite use consumption and emissions per FTE KPIs as means of "normalising" the trends associated with a growing business and increased occupancy.

Business travel

Highlights:

- Verifiable air and rail impact data available.

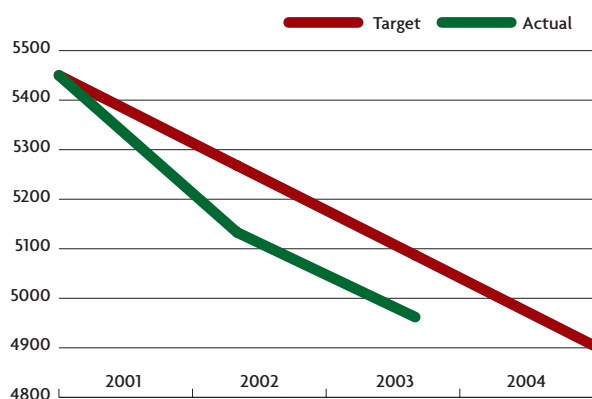
We estimate that business travel accounts for around 11% of HBOS's direct environmental impact. The table shows that the amount of air and rail travel has decreased since 2001, while that of the company car fleet has increased to account for over 70% of

	Unit	2003	2002	2001
Number of occupants (Full-time equivalents)	FTE	56,762	53,602	52,024
Net internal area	m ²	905,283	912,826	936,248
Average (net internal) area per FTE	m ² /FTE	15.95	17.03	18.00

¹ Data relating to joint ventures and non-UK based operations are not included. Data and methodology are analysed as part of an ongoing audit programme and subject to continuous review and enhancement.

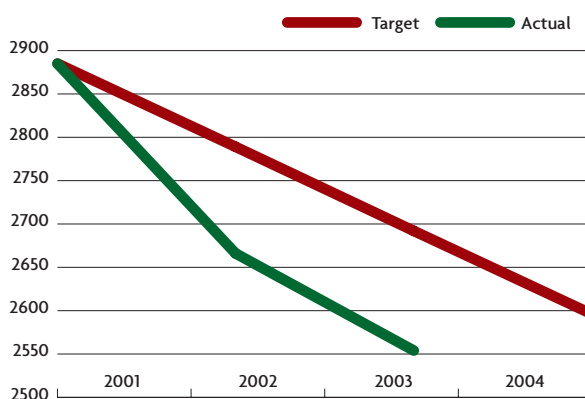
Electricity consumption

Targets based on 10% reduction 1st Jan 02–31st Dec 04
kWh/FTE



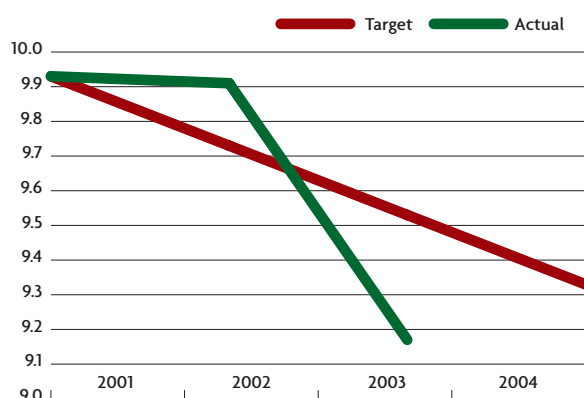
Gas consumption

Targets based on 10% reduction 1st Jan 02–31st Dec 04
kWh/FTE



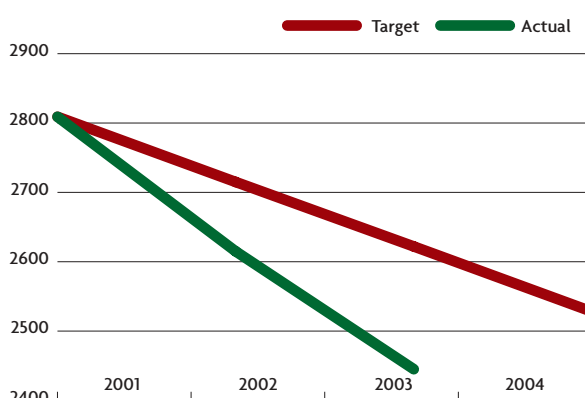
Water consumption

Targets based on 6% reduction 1st Jan 02–31st Dec 04
M³/FTE



CO₂/FTE for electricity and gas

Targets based on 10% reduction 1st Jan 02–31st Dec 04
kg CO₂/FTE



the environmental impact due to business travel.

Following changes to company car tax legislation, we have been unable to collect accurate data, and so estimates are produced from models based on data available prior to April 2002, and changes in the size of the company car fleet. Because a large proportion of business travel data is currently estimated, trend analysis is

not of benefit.

Extensive video-, audio- and web-conferencing facilities are available to all colleagues and the CR team supports the IT teams in encouraging their use – for business, work-life balance and environmental reasons. Car-sharing schemes operate at a number of sites throughout the UK, and discounted travel cards for public transport are available.

Waste

Highlights:

- On track to achieve our target of recycling 50% of our general office waste by the end of 2005.
- Redundant office furniture worth over £0.25 million donated to good causes.
- Pilot carried out to investigate impact of increasing paper-recycling rates in retail network.

General office waste accounts for less than 1% of our direct environmental impact. However, waste recycling is one activity to which all office-based colleagues can contribute. Resources are therefore invested in putting recycling initiatives in place that help to raise colleague awareness of what they can do to help the environment at work and at home.

	Unit	2003	2002	2001
Company car fleet	km	117,927,752	95,103,026	86,654,237
Carbon dioxide emissions	kg	24,182,041	19,501,646	17,769,153
Air (long and short haul)	km	40,490,299	51,932,671	41,012,235
Carbon dioxide emissions	kg	4,556,297	5,811,911	7,380,826
Rail	km	3,151,005	2,878,851	9,030,440
Carbon dioxide emissions	kg	189,060	172,731	541,725

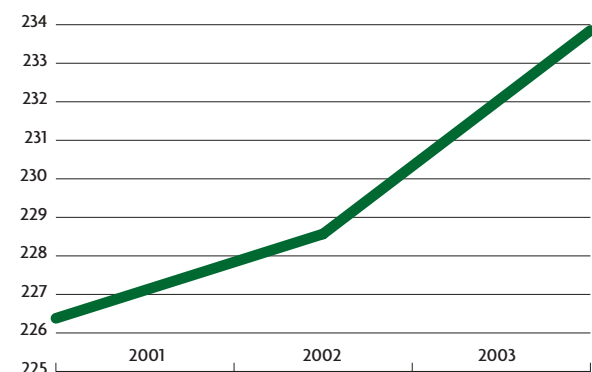
Lighter cells indicate estimates based on historic data; carbon dioxide emissions calculated using the UK Government's Guidelines for Company Reporting on Greenhouse Gas Emissions



Saving cash, time, energy and resources: the 2004 Waste Challenge

In response to colleagues expressing concern about corporate responsibility and the environment, this year will see the continuation of existing recycling schemes which also have social benefits: donating redundant office furniture and reconditioned IT equipment to local community groups and overseas schools plus the introduction of new initiatives, such as recycling toner cartridges and mobile phones, building partnerships with environmental groups, and encouraging increased use of teleconferencing services.

Waste
kg/FTE



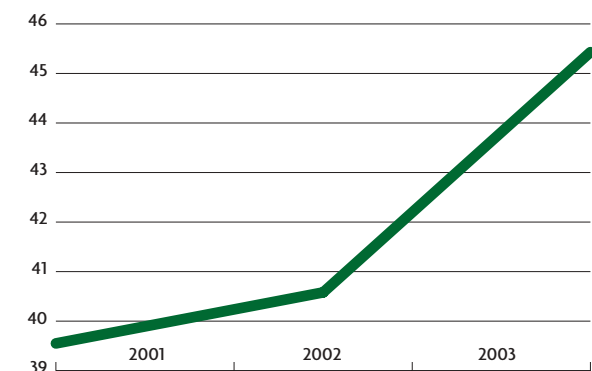
Our target is to increase the recycling of general office waste to 50% by the end of 2005 (2001 baseline). Performance is measured by the amount of waste per FTE and the percentage of general office waste that is recycled.

The diverse nature of our business and the size of our property portfolio mean that general office wastes are managed through a number of contracts and contractors throughout the UK. This makes accurate measurement difficult, so models and the UK Government's Guidelines for Company Reporting on Waste are used to produce estimates. The waste-to-landfill data has been extrapolated, based on a sample of sites throughout HBOS.

Waste management activities in 2003 included a three-month pilot, carried out in 30 branches that looked at ways of increasing recycling in the branch network. The results indicated that the amount of waste recycled could be doubled, but also that roll-out across the branch network would be prohibitive on both cost and environmental grounds.

For the first time in 2004, we asked our colleagues for their views on how we tackle two environmental issues. In response, only 24% would speak highly of the way we manage waste and save energy.

General office recycling rate
% recycled



Paper and print

Highlights:

- Workshop on corporate responsibility and environmental issues held with key paper buyers, key suppliers and The Sustainable Office Forum.
- New template developed to collate better quality data.
- Minimum specification for internal communications publications.



Computers for schools in Africa



Recycled paper production

The paper and print used by the business, and sent to customers, accounts for over 20% of HBOS's direct environmental impacts. Excluding joint ventures, we estimate that 18,490 tonnes of paper and print were consumed in 2003. This is equivalent to 326kg per FTE.

Activities in 2003 included a workshop with a selection of key paper buyers, suppliers and The Sustainable Office Forum to discuss the environmental and corporate responsibility issues associated with the life-cycle of paper used by HBOS. A specification was also developed requiring internal communications publications to contain a minimum level of recycled content.

Property

HBOS Group Services manages the direct environmental impacts arising from the operation and maintenance of HBOS's property portfolio. This comprises over 1,800 properties, including around 20 large sites at key locations throughout the UK.

Project Green is the new building for HBOS Financial Services (main brand Clerical Medical) in Bristol. This will be a

low-energy building that minimises its impact on the environment through such features as low-energy harbour water cooling, chilled beam ceilings, external shading to south elevation, internal shading to atrium glazing, dimmable lighting, daylight and positive infra-red controlled lighting, variable speed pumps, condensing boilers, and hot water solar panels.

Environmental guidelines have been developed for retail branch and major employment sites by our Group Property department, providing a checklist for incorporating environmental specifications in construction and renovation projects. Requirements to consider land use, site ecology, energy and water consumption, material use and disposal, noise and transport issues, as well as to conduct cost analyses, are included in the design briefs for major works. Large construction or renovation projects carried out within the scope of these guidelines are required to meet BREEAM (Building Research Establishment Environmental Assessment Method) for Offices assessment of not less than "Very Good".

Where can we do better?

- Work will continue in 2004 to roll out energy- and water-saving initiatives into the merged HBOS property portfolio and to improve the quality and quantity of verifiable data.
- We will encourage the further development of business travel initiatives, consider ways of measuring usage and agree business travel targets that will be published on www.hbosplc.com. We also plan to start collecting company car and casual mileage data through the business expenses system.
- We will be developing new waste management monitoring systems to replace the pre-merger methodologies. The new systems will standardise reporting and allow improved benchmarking. We will also look at more cost-effective ways of achieving our recycling target in our retail network and at our major sites.
- Targets on paper use will be agreed and published on www.hbosplc.com. A new action plan will be adopted, and a revised reporting template will capture verifiable data from more of the HBOS Group. This will need to be supported with dialogue to encourage its use.
- Colleagues have told us that we need to improve our performance and internal communications in the areas of managing waste and saving energy. We aim to improve our Opinion Survey score from 24% to over 60% within two years.



Project Green, for HBOS Financial Services, Bristol

Community investment

HBOS's support for the community is based on our belief that it is in our long-term interest to foster healthy communities; and because our colleagues tell us that they value programmes that enhance our reputation as a good corporate citizen.

We measure our colleagues' response to the work that we do in the community in the annual Colleague Opinion Survey. In March 2004, 79% of our colleagues told us that they would speak highly of the way HBOS supports charities and local communities, and 50% would speak highly of the way HBOS supports volunteering opportunities for colleagues. A key objective of our Community Investment strategy is to stimulate colleague advocacy; judged by these results, this objective has been achieved in the past 12 months, and the participation of colleagues through fundraising and charitable giving has been outstanding.

An intensive internal communications programme was one of the main drivers behind this high advocacy score and as one of the most important Group-wide initiatives, the Foundation has a major role in helping to shape the HBOS people culture.

The £1 Million Challenge

In 2003 for the first time, HBOS set out to raise £1 million for a charity selected by HBOS colleagues. Macmillan Cancer Relief was chosen, and colleagues were set a £500,000 target, which the Foundation promised to match to fund a £1 million donation to Macmillan. Funds raised exceeded £1 million by the autumn, and the excess was then divided equally between Macmillan, the Alzheimer's Society, Alzheimer's Scotland and Childline, which were the other shortlisted charities of the year. Macmillan used the money they received to fund nine new nursing posts for life at centres around the UK. Over £1.6 million was donated, and in 2004 our colleagues are aiming for £1.8 million for the charity of the year, Help the Hospices. By 2005 we aim to raise £2 million for a charity selected by colleagues.

HBOS Foundation

The trustees of the HBOS Foundation direct activity at three levels:

- A national programme for substantial initiatives aligned to core priorities.
- A regional programme, to consider smaller grants put forward by HBOS colleagues.
- Matched funding: encouraging fundraising by HBOS colleagues.

A total of £20 million over five years has been earmarked by HBOS to support the work of the Foundation, which is focused on two guiding themes: money advice and financial literacy, and developing and improving communities.

National projects

The national programme is managed centrally by the Community Investment team, seeking out projects that will provide UK-wide or significant regional benefits. These focus predominantly on financial literacy initiatives as described on page 21. One example of a national community development project which the Foundation is supporting is Nacro, the National Organisation for the Care and Resettlement of Offenders, a recent recipient of a Foundation grant. This charity is the leading crime reduction charity and wishes to develop a financial literacy programme for people (mainly ex-offenders or those who may be likely to offend) who

MidnightLeague

A soccer initiative aimed at keeping young people off the streets has proved such a success that Bank of Scotland is extending its sponsorship. The Midnight League scheme, an award-winning soccer initiative originally developed by Birmingham Midshires in partnership with Wolverhampton Wanderers Community team, ran as a pilot during 2003. The initiative recognises a community need in tackling crime and social exclusion by encouraging youngsters between the ages of 14 and 16 to play five-a-side football between 10pm and midnight, and is run in partnership with local police. Young people are referred to the scheme by police and local community workers.



MidnightLeague in Dundee

Across the UK over 1,000 youngsters have benefited from the scheme so far, and it is being extended in 2004, in partnership with the Scottish Football Association, to deliver 14 Leagues around Scotland, reaching

a further 1,800 young people.

"The 'Midnight League' has proven to be a marked success, providing young people in Dumfries with a constructive outlet, physical exercise and entertainment. Moreover, as the Dumfries & Galloway Constabulary report a significant reduction in incidents involving young people on the nights when it is running, the 'Midnight League' is clearly of benefit to the whole community. The initiative is making a difference for the town of Dumfries. I wholeheartedly commend Bank of Scotland for its involvement."

Alasdair Morgan, MSP for the South of Scotland

are tenants of Nacro-provided housing.

The Foundation's initial support can often mean that a charity receives additional funding from other national bodies. In identifying projects, the Foundation endeavours to make its funding go further, and help charities more, by "leveraging" other donations from public bodies and other donors. A contribution of £60,000 from the HBOS Foundation to RNIB, for example, enabled the charity to leverage £150,000 from The Football Foundation to help blind or partially sighted people to enjoy live football matches through its Soccer Sight project.

Regional projects

There are 17 regional co-ordinators, enabling us to work more closely with local communities, and this means that approximately 75% of decision-making, activity and expenditure take place at the local level.

The Foundation provides local grants to support a diverse range of projects, from assisting the Gloucestershire Forum for Young Single Homeless in developing an interactive website about youth homelessness, to helping equip a centre in the Grampian region to provide long-term residential care to occupants with neurological diseases. In 2003, 402 regional projects were supported by the HBOS Foundation, through donations ranging from £500 up to £30,000.

Matched funding

The HBOS Foundation's Matched Funding scheme offers to match whatever HBOS colleagues raise for their chosen charity £ for £ up to a maximum of £500 (providing the charity meets HBOS Foundation funding criteria). In 2003, over 1,000 colleagues raised over £676,000 for their chosen charities. The HBOS Foundation matched these funds to a value of £478,000, providing donations of over £1,150,000 to local charities.

Volunteering

HBOS encourages volunteering by matching colleagues' time spent on projects in the "Make A Difference Day" scheme by up to seven hours, to allow further voluntary activity to take place

in office hours. The HBOS Foundation provides grants of up to £250 per project to help volunteers buy materials for their chosen projects. This scheme is in its infancy, and the Foundation's target is to increase the number of colleagues who volunteer for community-based projects from 1,000 in 2003 to 3,000 in 2004.

Sponsorship

As one of the largest supporters of the arts and youth sport, HBOS has a long tradition of sponsorship, particularly through its Bank of Scotland brand. A good example is the Talented Young Athletes Programme in Scotland, which aims to stem the trend of talented athletes leaving sport after school by providing them with support, advice and training. Since its launch in 1999, over 300 athletes have benefited, and over 200 medals have been won by these athletes at international events.

During 2003, 20,000 young people took part in grassroots sporting events made possible by Bank of Scotland. Of these, 60% were from within Social Inclusion Partnership areas. During 2004 we aim to involve 22,000 young people in our youth sports projects, of which 65% will be from within Social Inclusion Partnership areas.

Bank of Scotland has been the principal sponsor of the Children's International Theatre Festival since its inception in 1990, encouraging the development of audiences for quality children's theatre. As one of the largest commercial sponsors of the arts in Scotland, Bank of Scotland prides itself on its long-standing commitment to the Festival, which reaches a combined audience of over 14,500 children, teachers and families through creative and engaging performances. In 2003, Bank of Scotland increased its contribution to support a tour giving many children across Scotland their first opportunity to experience world-class children's theatre. The Festival was also able to extend its outreach programme, taking performances into selected schools unable to visit a theatre. It also staged free performances for schools at the North Edinburgh Arts Centre, located in a Social Inclusion Partnership area.



Curling in Stranraer: Junior Regional Cup competition

Evaluation and impact

We commissioned The Corporate Citizenship Company (TCCC) to assess the impact of current activities, evaluate HBOS's measurement of inputs and outputs, and recommend methods for future performance management. In their evaluation TCCC said:

"The merger of two major companies always poses a major challenge for those involved in delivering the community programme. HBOS has risen to this challenge. The activities that form the core of the programme going forward – the HBOS Foundation, colleague engagement, the well-established arts and sports sponsorships and Visa affinity card schemes – are well targeted, fit closely to the stated policy goals for community and business benefit and have clear success criteria."

Where can we do better?

- We will create a clear picture of the social impact of our community investments, using the London Benchmarking Group's framework.
- We will select four or five geographical areas where we already have a community involvement, and target our resources on these. As a result, we believe that they will benefit from the multiplier effect, creating a real impact.
- The Colleague Opinion Survey indicates that we need to do more to encourage and extend colleague volunteering activities across the Group.

Measuring our performance

The following set of 48 key performance indicators (KPIs) for The Way We Do Business is intended to provide an accurate and balanced picture of how HBOS is progressing against the

principal elements set out in The Way We Do Business statement. Progress against these KPIs will be reported regularly, internally within HBOS and to our external stakeholders. In setting out

Stakeholder	Statement	Key performance indicator	Definition and unit of measurement	Figure reported in CR Report 2004		Reporting period	GRI indicator	
Shareholders	We will promote the interests of our shareholders by seeking to increase the value of their shares and dividends, and through sound corporate governance.	Return on equity	% post-tax return on mean equity	17.70%		Jan–Dec 2003	EC7	
		Performance of shares versus sector (based on total shareholder return)	% by which the Halifax/HBOS total shareholder return (TSR) exceeded the weighted average of the comparator group over the performance period	13.45% pa		Jan 2001–Dec 2003		
	We will communicate with shareholders regularly and in doing so will seek to be clear, comprehensive and balanced.	Total number of contacts with investors, including responsible investment analysts	As identified in the annual audit report for IR prepared by external auditors Makinson Cowell	231		Sept 2002–Sept 2003		
Customers	We will be honest, fair, professional and open in our dealings with our customers and endeavour to help them at all times.	Favourability in independent research (customers and non-customers)						
		Customers agreeing that our employees are polite and helpful when they have a problem	% customers who said “Particularly Good” when interviewed in branch and by telephone, as identified in “Service Tracker” research	Branch: 48%	Phone: 37%	Nov 2003–Jan 2004	PR8	
	We are committed to providing them with value-for-money products and services, designed and promoted in a simple and transparent way, and made as widely available as possible.	Metrica research on best buys	Number of times an HBOS product was featured in best-buy tables	784		Jan–Dec 2003		
		Results of 2004 MORI annual media survey of PFJs	Halifax product quality favourability score	46%		Jan–Dec 2003		
	When things go wrong, as they sometimes do, we will resolve problems as quickly and fairly as we can.	Customers agreeing that they were satisfied with the way in which their complaint was handled	% who were delighted as identified in “Service Tracker” research	12%		Nov 2003–Jan 2004	PR7	
Colleagues	We will create a safe working environment which encourages openness, honesty and mutual respect, and where colleagues can constructively challenge and ask questions.	Colleague Opinion Survey						
		People are open and honest with each other	% HBOS overall that agree	53		2003		
		It is safe to speak up and challenge the way things are done	% HBOS overall that agree	59		2003		
		I feel I am valued as an employee	% HBOS overall that agree	47		2003		
		Employer advocacy e.g. My line manager listens to my ideas	% HBOS overall always/usually applies	76		2003		
		Health & Safety						
	We will offer equal opportunities for all.	Recorded injury-causing accidents (colleagues)	Number	332		Jan–Dec 2003		
		Fines	Number	0		Jan–Dec 2003		
		Workforce profile (split between different levels in HBOS)						
		Gender			Male	Female	Jan–Dec 2003	LA1
			Overall		24,510	42,835		
			%		36.4	63.6		
			Managers (level 4 and above)		4,658	1,711		
			%		73.1	26.9		
		Ethnicity	Part-time as % of workforce)		1,213	15,062	Jan–Dec 2003	
					1.8	22.4		
			Overall		55,646	3,706		
			%		93.8	6.2		
			Level 4 and above		5,776	103		
		Age group	%		98.2	1.8	Jan–Dec 2003	
			Ethnicity not specified by colleagues			7,993 (12%)		
			Overall		46–55	56+		
			%		9,745	2,266		
			Level 4 and above		14.5	3.4		
		Disability	% of “above level 4” population		1,428	95	Jan–Dec 2003	
				22.4	1.5			
	Number of colleagues describing themselves as having a disability				1,001			
% of workforce				1.5				
Colleague Opinion Survey								
We will offer competitive remuneration with rewards linked to individual and collective performance, and the opportunity for colleagues to participate in the success of HBOS.	Satisfied that HBOS makes best use of my skills and abilities	% HBOS overall satisfied	55		2003			
	Satisfied with balance between home/family and work commitments	% HBOS overall satisfied	58		2003			
	Satisfaction with pay	% HBOS overall satisfied	41		2003			
	Satisfaction with total reward and benefits	% HBOS overall that agree	59		2003			
	Good performance is fairly rewarded	% HBOS overall that agree	51		2003			
	Take-up of share schemes (benchmarked market norms)	Number of HBOS colleagues eligible for HBOS Sharesave, number of colleagues who took part, %	Eligible 63,291 – take-up 22,501 – 35%		Sharesave 2003			
	Colleagues who retain shares, rather than convert to cash	Number of colleagues who bought shares via Employee Share Options plan	Share Options 2001 maturity, 9,102 responses at 26/05/04: 6.4% bought shares		Share Options 2001 (Approved)			

these KPIs, we have considered the guidelines produced by the Global Reporting Initiative, the Business in the Community Business Impact Reporting Group, FORGE II and the Association

of British Insurers. Where there is an equivalent GRI indicator, this appears in the right-hand column.

Stakeholder	Statement	Key performance indicator	Definition and unit of measurement	Figure reported in CR Report 2004	Reporting period	GRI indicator
Colleagues	We will provide the opportunity for all colleagues to develop their skills and knowledge, and to enjoy fulfilling careers.	Colleague Opinion Survey				
		Satisfaction with opportunities to learn	% HBOS overall satisfied	53	2003	
		Satisfaction with coaching and development received from line manager	% HBOS overall always/usually applies	61	2003	
		Would speak highly about the way HBOS supports volunteering opportunities for colleagues	% HBOS overall speak highly	50	2003	
Suppliers	We will deal openly, fairly and honestly with all our suppliers and business partners. We will not demand of them standards that we do not apply to ourselves, but we will seek to understand their approach before doing business with them.	Agree that they receive sufficient training to deliver good service to customers	% HBOS overall that agree	57	2003	
		Trade creditors outstanding	The Company's main trading subsidiary undertakings, Halifax plc and Bank of Scotland, had trade creditors outstanding at 31st December 2003 representing 22 days of purchases for each company	22	Jan-Dec 2003	EC4
		Taxation paid	On profit on ordinary activities	£688 million	Jan-Dec 2003	EC8
		Dividends paid	Profit attributable to shareholders: ordinary plus preference dividends	£1,220 million	Jan-Dec 2003	EC6
Society	Our main contribution to society is the value we can add through our success in business.	Total payroll	The remuneration payable to colleagues comprising wages and salaries	£1,755 million	Jan-Dec 2003	EC5
		Environmental performance				
		Energy use	Electricity kWh/m ² Electricity kWh/FTE Gas kWh/m ² Gas kWh/FTE % energy sourced from renewables	311.11 4,962 160.14 2,554 5.39	Jan-Dec 2003	EN3
		Water use	m ³ /m ² m ³ /FTE	0.57 9.17	Jan-Dec 2003	EN5
	We will seek to be a positive influence on those social and environmental issues which, having listened responsibly to our shareholders, customers, colleagues and suppliers, we think are important, for example human rights.	Greenhouse gas emissions	tonnes CO ₂ /m ² tonnes CO ₂ /FTE	153.33 2,445	Jan-Dec 2003	EN8
		Waste	% general office waste recycled Total kg/FTE	45 233.85	Jan-Dec 2003	EN11
		Business miles	tonnes company car CO ₂ /FTE tonnes train CO ₂ /FTE tonnes plane CO ₂ /FTE Total CO ₂ /FTE	426.03 3.33 80.27 509.63	Jan-Dec 2003	
		Colleague Opinion Survey				
	We will observe the laws and regulations of all countries in which we operate, not just in the letter but the spirit. We will not countenance bribery, corruption or the concealment of conflicts of interest.	Would speak highly about the way HBOS manages waste and saves energy	% HBOS overall speak highly	24	2003	
		Prosecutions/reported cases of bribery/corruption		0	Jan-Dec 2003	SO2
		Regulatory fines or reprimands	Number of fines and reprimands	Fines: 2 Reprimands: 1	Feb 2003-Jan 2004	
		Annual Community Spend	HBOS plus HBOS Foundation investment in communities, charities and the sports and arts	£19.59 million	Jan-Dec 2003	EC10
	We will contribute to the development of the community outside of our direct business interests by making charitable donations to initiatives relating to financial literacy and money advice, and by providing opportunities for colleagues to support the development of the communities in which they live and work.	Funds raised by colleagues	Total – including £1m Challenge and matched funding	£2.75 million	Jan-Dec 2003	
		Level of colleague volunteering (hours and value in salary)		Not available for 2003	n/a	
		Colleague Opinion Survey would speak highly about the way HBOS:				
		supports charities and local communities	% HBOS overall speak highly	79	2003	
	We will measure our progress against this statement and report this regularly to shareholders, customers, colleagues and suppliers.	supports volunteering opportunities for colleagues	% HBOS overall that agree	50	2003	
		Presence of HBOS in corporate responsibility indices (eg DJSI and FTSE4Good)	Dow Jones Y/N FTSE4Good Y/N Opportunity Now Y/N Race for Opportunity Y/N	No Yes Yes Yes	Jan-Dec 2003 Jan-Dec 2003 Jan-Dec 2003 Jan-Dec 2003	
		Performance in BitC CR Index	Score, ranking	91.33%, 29th out of top 100 "Companies That Count"	2003	
		Annual independent verification of CR activity, including reports	Annual Environmental Management Review Y/N BitC CR Index Y/N Annual CR Report Y/N	Yes Yes Yes	Jan-Dec 2003 Dec 2003 May 2004	

Verification statement by Casella Stanger

External Verification of the HBOS 2004 Corporate Responsibility Report

Objectives of verification

HBOS Group has commissioned Casella Stanger to conduct an independent verification of the factual data contained in the 2004 Corporate Responsibility Report.

The overall aim of this verification statement is to provide assurance to stakeholders that the information provided by HBOS in their Corporate Responsibility Report is accurate, reliable, objective and has been audited and validated by an independent third party.

Responsibility of the verifier

The verifier's obligation is to stakeholders and readers of this statement. The verifier, Casella Stanger, is responsible exclusively for the contents of the verification statement.

Casella Stanger has not been involved in the preparation of any of the material included in the Corporate Responsibility Report apart from this verification process.

Scope

The scope was limited to the verification of all factual statements and data contained within the 2004 Corporate Responsibility Report. A sample representing 80% of all factual statements contained within the report was verified. In addition, the report was reviewed for clarity, completeness and materiality.

Methodology

Casella Stanger recognises that there are currently no statutory requirements or accepted UK standards with regard to verification. Therefore, the process we have used in this verification exercise is based on current best practice, such as that detailed in the Global Reporting Initiative (GRI), the Institute of Social and Ethical AccountAbility Standard AA1000 and the Association of British Insurers (ABI).

Casella Stanger used interviews, document and data reviews to gather evidence regarding factual statements

contained within the Corporate Responsibility Report. HBOS provided access to head office, records and data required to undertake a comprehensive verification process and the verifier is confident that no material has been withheld.

In addition to this verification statement an audit report was produced for HBOS. This provides further details of the findings of our review and recommendations, summarised in this statement.

Opinion of the verifier

We are satisfied that HBOS's 2004 Corporate Responsibility Report includes factual statements. The data contained and referred to within the report is reliable. We are satisfied that HBOS has provided an accurate, transparent and balanced report of its corporate responsibility performance and has reported on all relevant and material issues. We are satisfied that this whole report is factually correct.

Summary recommendations

The following is a summary of recommendations within the scope of the verification:

- A formalised data collection and reporting process should be developed for all key data sources and report authors. This would help data providers throughout the business to develop a systematic process for gathering evidence throughout the year, rather than reliance on the Corporate Responsibility team to seek data and provide guidance on what is deemed appropriate. It is suggested that a pro forma methodology should be developed.
- The publication of the full range of KPIs for HBOS for the first time is very positive and HBOS is encouraged to use the KPIs as a framework for future reporting.
- HBOS has taken substantial steps forward in producing an ethical policy and the key policy document "Our Commitment to the Way We Do Business" and we would recommend that they continue to communicate with employees on key progress.

Comment

- The CR strategy and reporting has benefited from "Our Commitment to the Way We Do Business" to provide a framework for data gathering and the focus of the report. The further implementation of the policy should assist in development of future strategies.
- Thorough and clear methodologies have been developed to collate resource use data. This enables the verification to examine a wide scope of the data and gives a high level of confidence in the accuracy of figures reported.
- HBOS has shown a high degree of transparency and clarity in its reporting, detailing clearly where data has been collected in full or where modelled or estimated and outlining any challenges encountered.



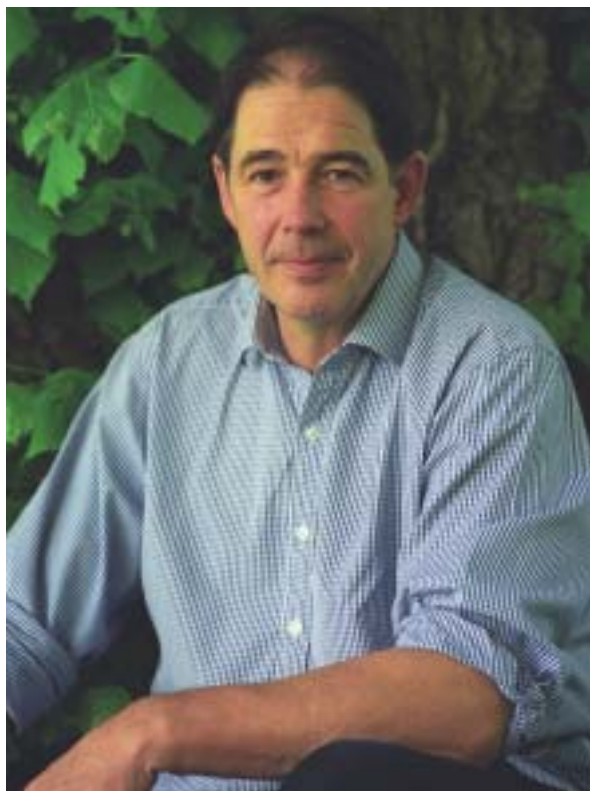
Emma Griffiths
Principal Consultant
Environmental Management,
Sustainability and Risk Group



Reviewed by Ken Smith
Business Director
Environmental Management,
Sustainability and Risk Group

Casella Stanger is a UK-based environmental consultancy which has expertise in a wide range of areas, such as Corporate Social Responsibility, EMS, Risk, Air Quality, Noise, Water Quality and Ecology. The company has experience in the design, development and verification of sustainability reports in a wide range of sectors. Several staff are registered with the Institute of Environmental Management and Assessment (IEMA) as qualified auditors and members of AA1000.

Commentary by Jonathon Porritt



These are challenging times for financial institutions. Repeated financial scandals over the last few years, particularly in relation to pensions and mortgages, executive remuneration, credit card interest rates and irresponsible lending have also featured frequently in the daily press, all contributing to the steady erosion of trust in our financial institutions. Even though we have seen some banks working to improve their lending practices, increase transparency, and contribute more purposefully to financial inclusion projects, the industry still remains very complex, and concerns about the adequacy of governance systems and external regulations rumble on.

All of which keeps a company like HBOS very much in the public eye, needing to address ever higher stakeholder expectations. Last year, HBOS published their Corporate Responsibility Report, combining a published summary report with web-based information. We commended the report for being highly accessible and based on a clear idea of what the information needs of its stakeholders were. However, we also identified areas

where progress could be made.

It is clear that there have been a number of improvements in the last year. The development of the business principles in “Our Commitment to the Way We Do Business” represents a significant commitment to high ethical standards. We are also pleased to see that HBOS has acted on our recommendations, for instance by aligning its key performance indicators to the Global Reporting Initiative guidelines, disclosing which stakeholder groups they have engaged with, and initiating a process to set proper targets against which performance can be measured. We appreciate that HBOS is still at the start of their journey, and we look forward to working with them further on developing their work in corporate responsibility – embracing all areas of impact, embedding it through all their business functions and further refining their reporting practices.

Future challenges for HBOS include widening the scope of its corporate responsibility to start dealing with issues such as third world poverty or lending to companies involved in supporting the arms trade. The development of business principles provides an excellent opportunity to extend its ethical position to cover lending and investments. HBOS is the UK’s largest mortgage lender and residential property insurer, and as such has a golden opportunity to engage with its customers to help accelerate the journey towards a more sustainable society. Green mortgages are already available in the market; other opportunities available to banks include preferential lending terms for sustainable housing, access to credit for excluded groups (already on the HBOS agenda), and the provision of an ethical savings fund for its customers.

In the financial services sector, any company’s “license to operate” depends very largely on the level of trust that it is able to build up. Social, environmental and ethical responsibility form the cornerstones of that trust-building exercise, and it is encouraging to see the way in which HBOS has systemised its approach to these key areas over the last three years.

Forum for the Future is a UK-based charity, with a mission to accelerate the building of a sustainable way of life. Forum for the Future are not auditors or verifiers. As such these comments should not be read as verification of the data or comments contained within this report.

Glossary of terms

Benchmarking survey	Survey that allows participants to compare their activity or performance against specified standards or criteria.
Corporate governance	Boards are accountable to shareholders of companies. Share ownership also gives rise to governance responsibilities. In addition, institutional investors have an overriding fiduciary responsibility to those on whose behalf they are investing. ¹ The FSA has issued Guidance on the Combined Code of Corporate Governance. ²
DTI	Department of Trade and Industry (www.dti.gov.uk)
Near-prime mortgage	Near-prime mortgages are aimed at consumers with an impaired credit record caused, for example, by mortgage arrears, bankruptcy or missed credit card payments. Customers who may be declined by “mainstream” lenders do not necessarily have adverse credit, such as County Court Judgements (CCJs), mortgage arrears, bankruptcy and Individual Voluntary Agreements (IVAs), but might not have a sufficient credit history to obtain a “mainstream” mortgage from a high street lender. ³
RNIB	Royal National Institute for the Blind
Sanctioner	Responsible for approving a decision; seeks compliance with specified agreements or rules of conduct. ⁴
Sandler Review	The Sandler Review of Medium and Long-Term Retail Investment, set up by the Chancellor of the Exchequer in July 2001 and published in July 2002. ⁵
Self-certification mortgage	Any mortgage where a borrower (or their independent financial advisor) certifies their annual income without also having to supply <i>documental</i> proof, such as wage slips or accounts. ⁶
Transparency	Easily understood, frank and open. ⁷

1 www.ivis.co.uk/pages/framegu.html

2 www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf

3 Based on information from Birmingham Midshires website

4 *Oxford Concise English Dictionary*, Ninth Edition

5 www.hm-treasury.gov.uk/newsroom_and_speeches/press/2002/press_67_02.cfm

6 Datamonitor, 2003; *UK Non-Standard and Sub-Prime Lending*, 2004 p191

7 *Oxford Concise English Dictionary*, Ninth Edition

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Photography, design and production by

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Back cover photograph
HBOS colleagues tackle tree-planting in Halifax, West Yorkshire



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