

# The Way We Do Business



# The HBOS difference

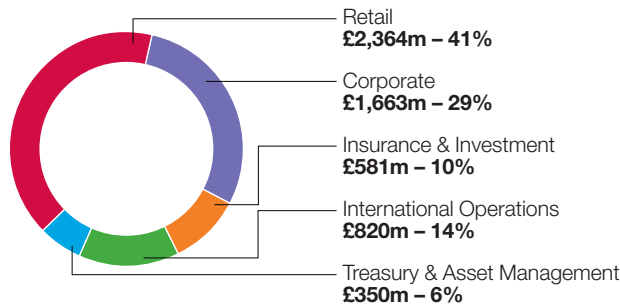
Around 80% of our small shareholders are also our customers. 95% of our colleagues hold HBOS shares. We have the largest small shareholder base in the UK. Their interests are therefore more closely aligned with the Group than any other bank.

HBOS is the UK's largest provider of mortgages, savings and new investment products. We have a relationship with two out of every five households in the UK.

## About HBOS

HBOS has operations across the UK, Australia, Ireland, Europe and North America with 86% of profits generated in the UK. 14% of profits are generated outside the UK, up from 12% in 2005.

HBOS operates a federal structure with the Chief Executive of each of its five divisions reporting to the Group Chief Executive, the Executive Committee and the Board.



## Key facts

Financial	2006	2005
Profit before tax	£5,706m	£4,808m
Underlying earnings per share	100.5p	86.4p
Dividend per share	41.4p	36.1p
Cost:Income ratio	40.9%	42.2%
Return on equity	20.8%	19.6%

Economic	2006	2005
Total income tax on profit	£1,772m	£1,546m
Wages and salaries	£2,137m	£1,940m
Social security costs	£228m	£181m
Pension costs	£205m	£225m

Social impact	2006	2005
Number of small shareholders	99.3%	99.8%
Number of customers (approx.)	23m	22m
Number of employees	74,252	71,985
Total community investment	£44.2m	£43.1m
Number of times HBOS products appeared in best buy tables	3,317	2,671
Percentage of colleagues satisfied with opportunities to learn (sector average 49%)	65%	56%

Environmental	2006	2005
UK CO <sub>2</sub> emissions	56,743	66,811
Energy use per FTE (kWh)	5,097	5,210
Water consumption (m <sup>3</sup> ) per FTE	8.5	8.2
% of waste recycled	47.50	44.17

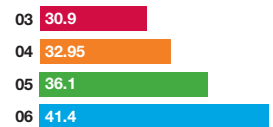
# 56%

increase in share price over three years compared with 27% increase in FT banking index

### Profit before tax (£bn)



### Dividend per share (p)



# 1st

UK's best performing bank stock over past three years

# Largest

small shareholder base in the UK

# 2006 highlights

- **Increased the dividend per share by 15% to 41.4p.**
- **Share price improved 14% to £11.32 by end December.**
- **Achieved more retail best buys than any major bank – over 3,000 appearances in best buy tables.**
- **UK's leading savings provider helping 15 million customers save for the future.**
- **We lend £10bn in mortgages in deprived areas of the UK.**
- **Income multiple of 2.5 across mortgage book, with average loan-to-value of 44%.**
- **Only financial institution to have piloted the Saving Gateway with HM Treasury.**
- **Contributed £1.15bn to our pension fund over two years, including business-as-usual contributions of £350m and extra contributions of £800m.**
- **Invested £44.2m in local communities.**
- **Reduced UK carbon emissions by 65%, or nearly two thirds over two years.**



Included in the FTSE4Good Ethical Index.



Included in the Dow Jones Sustainability Index.



Ranked Platinum in the Business in the Community Corporate Responsibility Index.



Ranked in the Global 100 Most Sustainable Corporations.

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# Our strategy

Our reputation and the health of our brand is one of our strongest assets and integral to the success of our business.

## Outperforming the competition

We aim to deliver a better deal than the other banks, especially the 'big four'. Our integrated approach to Corporate Responsibility (CR), with its emphasis on highly competitive products, helps define our brand.

The interests of our customers, colleagues and shareholders are closely aligned. Around 80% of our small shareholders are also our customers and around 95% of our colleagues hold HBOS shares.

This dynamic is unique among banks and is a key driver of our strategy.

## What are the issues?

We share the benefits of our success across all our stakeholders. Understanding their views and concerns, about how we are growing the business, helps drive our strategy.

- **Shareholders** Creating value; governance; sustainability.
- **Customers** Responsible lending, marketing and advertising; accessibility; value and inclusiveness of products.
- **Colleagues** Remuneration; employment conditions; culture; diversity.
- **Environment** Carbon reduction; paper management; water management.
- **Community** Economic impact; national and local community programmes; dealing fairly with suppliers.

**Our strategy is driven by stakeholder dialogue. The AA1000 Assurance Standard helps us deliver this.**

## Strong governance

HBOS' principles of responsible business growth are set out in our statement, the Way We Do Business, on our website. We have an extensive management framework ensuring these principles apply throughout the business. This framework is set out on pages 43 to 45.

# AAA

**HBOS is one of only two UK banks to receive the highest AAA rating in the Innovest global sustainability review**

## Our Key Performance Indicators

We are the only bank to directly underpin our statement of business principles with a comprehensive suite of Key Performance Indicators.

To give greater prominence to the most challenging issues facing HBOS we have reduced these KPIs from 48 to 28. Those KPIs that have been removed are still measured and covered in this report.

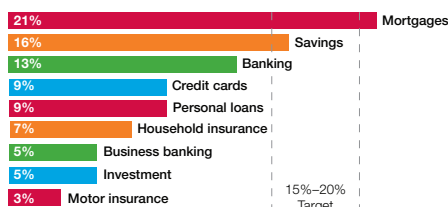
We have also created new indicators, such as a commitment to publishing an annual Financial Inclusion Report, in direct response to stakeholder feedback. We are the first major bank to do so and the first bank to publish a target for new social banking accounts.

The HBOS Board and Executive Committee review our KPIs annually, the last reviews being in July 2006 and July 2007. The biggest challenges are escalated monthly to HBOS's 50 most senior managers in regular reports.

## Where can we do better?

- **In 2007 we will introduce a new comprehensive set of targets for reducing resource use.**

### UK market share



**Our strategy is based around the old adage 'what gets measured gets done'**

# Group Finance Director's report

Taking action where it makes a clear difference helps us take on the competition and achieve sustained success.

This is true of responsible lending, tackling financial inclusion and managing our impact on the climate, three major and continuing drivers of our strategy.

Our core product agenda, providing our customers with better value products than the competition is, as ever, our starting point. I was delighted that HBOS received 3,317 mentions in the best buy tables last year.

Our commitment to publish an in depth Financial Inclusion Report, which we achieved in early 2007, was a major advance in disclosure. We are the only bank to do this, winning support from, amongst others, John McFall MP, Chair of the Treasury Select Committee.

We were also one of the first banks to commit to installing new free ATMs in deprived areas. Our commitment was to add 100 new machines in our heartlands of Scotland and the North of England. I am pleased that over 70 of these are already up and running, more than any other bank.

In large part, we achieved our targets. Page 4 summarises our performance including where we fell short, such as reducing waste. We have reduced our carbon emissions by almost two thirds since 2004, better than any other major UK bank. However, this report would be incomplete without a review of the challenges we face.



First and foremost, the banking industry, as a whole, faces continued pressure with regard to the issue of current account default fees or 'bank charges'. The OFT's review goes beyond just these fees, to look at the total cost of banking in the UK. There is now a court case in the UK legal system.

Our decision last year not to extend European Home Retail's overdraft facility beyond its substantial limit, was controversial for some of our stakeholders, though we believe the right one. We do recognise the frustration and hardship that customers of Farepak experienced. We set out clearly on page 25 how we dealt with this issue and what we have learned.

Finally, how we manage climate change is an increasingly competitive issue for the banks as well as a crucial matter of responsibility. A rigorous and verifiable approach is the only one credible. We want to lead, rather than simply respond to, the developing agenda.

Our priorities for 2007 align with these challenges. First, we want to help bring even more people into banking and savings. An important lesson from Farepak was that we need to help more people on lower incomes save. We hope our new Christmas Savings scheme, launched in May, will go some way toward meeting this need.

Second, we will become a carbon neutral company before the end of 2007. Reduction first has always been our principle. But we do need to offset residual emissions. We are the only major bank to have committed to doing so by purchasing only United Nations regulated credits, albeit at a premium.

We can always do better. However, I believe we have delivered a range of initiatives that positively differentiate HBOS from the competition.

I welcome any comments about our approach to either myself or Liza Vizard, Head of Corporate Responsibility.

**Phil Hodkinson**  
Group Finance Director

# Our commitments

## Performance against 2006 targets.

2005 commitment	Status	Progress
<b>Customers</b>		
We will continue our investment to ensure our service is consistent and reliable.	In progress	We have significantly increased customer service training in 2006. 48% of complaints were being handled at the first point of customer contact by December 2006.
Roll out affordability matrix (which informs direct applications) across branch lending and other channels.	Complete	Mortgage lending is based on affordability, not standard multiples, providing a more accurate picture of ability to pay.
We will campaign for greater data-sharing.	Complete	We are the first bank to publish our data-sharing percentages in this year's CR report and we have campaigned for more data-sharing.
Benny Higgins is now heading a new Financial Inclusion Committee (FIC) and will be supported by a dedicated new financial inclusion unit.	Complete	The FIC is now well established and a new Money Management Unit has been launched to provide support to customers in difficulty.
We will publish an annual data driven FI report, the first of its kind from a UK bank.	Complete	First FI report published to positive reception from MPs.
<b>Colleagues</b>		
HR policies are largely UK-centric. Expand core HR principles internationally.	Complete	A change programme has been established to standardise Group policy internationally. This programme has started to deliver in 2006 and will continue to develop through 2007 and beyond.
Improve change management skills (34% felt change well-managed in 05 – 6% above the sector average).	Complete	Score raised to 45% in 2006.
<b>Environment</b>		
Number of colleagues who speak highly of how we protect the environment remains low.	Complete	Colleague advocacy has increased from 39% to 51%.
Increase recycling to 60% by Dec 07. Improve waste management and reporting.	Not met	Recycling off target at 47.5%. Improved recycling is now in place in major employment sites and will be rolled out across branch network in 2007.
EC Directive on energy performance will improve performance standards for new buildings.	In progress	HBOS' Edinburgh HQ has a renewable energy solution for heating. HBOS' new building in Bristol has many environmentally friendly features but building is not yet complete – until complete the building is using power without being occupied.
We plan to improve reporting on social and environmental issues in corporate lending.	In progress	We include more information on Equator Principles and social and environmental risk than ever before. From next year we will report data on Equator project reviews.
<b>Community</b>		
Double Foundation contribution to £8m.	Complete	Contribution doubled from £4m to £8m.
<b>Suppliers</b>		
Add a CR clause to standard contract templates.	Not met	The new standard contract templates have yet to be launched. This will be an area of focus in 2007.
We are considering holding a supplier CR forum.	Not met	This will be addressed in 2007 as a crucial element of HBOS' climate change strategy.
We will develop an enhanced approach to supplier diversity.	Not met	Supplier diversity will be addressed as part of the work identifying broader CR impacts in the supply chain.

# 2006 at a glance

Our wide-ranging CR programme is detailed throughout this report. Here are some of 2006's biggest initiatives.

## Customers

**High Interest Current Account launched** offering 60x more interest than typically offered by high street banks.

**Ultimate Reward Account launched** one of the best value packaged accounts on the high street.

**Branch expansion programme announced** opening up to 100 new branches in the next five years.

**Dormant account programme launched** the first bank to launch a major campaign to reunite customers with dormant funds.

## Responsible lending

**Increased data-sharing pilot launched** in partnership with credit rating agency CallCredit and the Big Four banks.

**Summary boxes extended** to credit card cheques and payment protection insurance.

**Social and environmental risk guide launched** for corporate lending to support our adoption of the Equator Principles.

## Financial inclusion

**Social banking new business target (15%) published** the only bank to publish such a target.

**Debit card introduced for Easycash customers** making it easier for social banking customers to access their money.

**Financial Inclusion Report launched** the only bank to publish a data-driven standalone report on financial inclusion.

**Saving Gateway** piloted in association with the Government aiming to encourage savings among low-income customers.

## Investor responsibility

**Founding signatory** of the United Nations Principles for Responsible Investment.

**Led the development** of the Investor Statement on Climate Change.

## Colleagues

**25% of senior managers' bonus** now based on performance against our Leadership Commitment.

**HBOS-U launched** to help senior managers understand their responsibilities.

**Human rights policy** updated to incorporate the four Core Conventions of the International Labour Organisation.

**Groupwide Inclusion Audit completed** to ensure our diversity and inclusion policies are consistently applied.

## Environment and climate change

**100% renewable electricity contract signed** for all our 2,200 UK buildings.

**Green Miles piloted** a scheme to encourage colleagues to reduce unnecessary travel by donating part of the savings made to good causes.

**Improved recycling facilities** launched in our major employment sites.

**Emissions reduced by almost two thirds** since 2004.

## Community

**Annual HBOS Foundation donation doubled** from £4m to £8m.

**'Believe and achieve' programme launched** to invite senior business leaders from UK companies see how business can help tackle some of Britain's most pressing social issues.

**Million £ Challenge went from strength to strength** raising £2.5m for ICAN, Leonard Cheshire and Crisis in 2006.

# UK growth

## Delivering value to customers

**Growing our market share** We aim to provide shareholders with a sustainable and profitable return. We seek to do this by growing our market share across all our main products.

**Responsible lending** It is not in our interest or others' to lend to people who cannot afford to take on debt. We have extensive systems in place to manage this.

**Financial inclusion** Commercial opportunity and a recognition it is right to work towards ending financial exclusion are the drivers of our financial inclusion strategy.

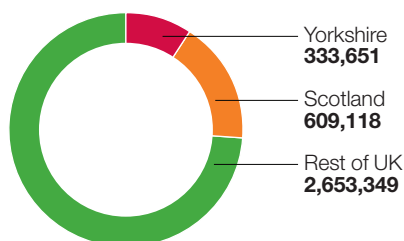
**Risk and regulation** The current regulatory focus is a strong driver for us to create products and services that are transparent and ultimately help consumers make more informed decisions.

**Farepak** When Farepak, a subsidiary of HBOS's customer, European Home Retail Plc, collapsed last year, we were criticised by some with regard to our role.

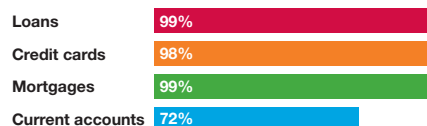
Number of times an HBOS product was featured in Best Buy tables



HBOS social banking in UK deprived areas



Data shared with other providers to improve lending decisions



Account terms and conditions agreed by some pre-2001 customers do not allow us to share data on these accounts



# Growing our market share

Providing excellent value, consistently good service and transparent products are key to our success.

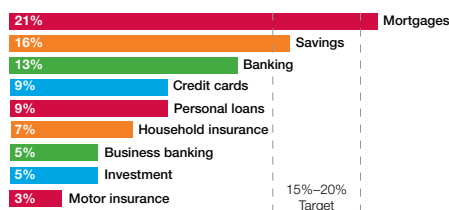
## Our strategy

Competing on each of these will help ensure we remain at the forefront in banking, challenging the traditional high street banks and growing our market share.

## Competing on value

We continue to challenge the Big Four banks by offering excellent value products. In 2006, for the second year running, we had more mentions in 'best buy' tables than any other bank – 3,317. An independent review carried out by Presswatch showed more positive press coverage of HBOS products than any other bank or building society.

### UK market share



## Personal banking

Our market share of new bank accounts, an area traditionally dominated by the Big Four, has continued to increase. This is driven by the value for money accounts we offer:

- We offer a 6% high interest bearing current account – 60 times more interest than the Big Four that typically offer just 0.1%.
- Our Moneyback current account is a European banking first, offering customers 1% money back when using their debit card.
- Our Moneyback current account also offers one of the lowest authorised overdrafts on the market at just 6.9%.
- We offer a new packaged current account (Ultimate Reward Current Account) – one of the best value packaged current accounts on the high street. This features a market leading 6% on credit balances.

## Savings

We are the UK's leading savings provider helping 15 million customers save for the future. In June 2006 we reported that the savings ratio in the UK had reached 6.0% of post-tax household income – a four year high and an increase from 5.6% in 2005. We offer a wide range of accounts including ISAs, regular savings accounts, and children's savings accounts.

### Individual Savings Accounts (ISAs)

ISAs allow customers to save up to £7,000 tax-free per year in 2006/07. We are the biggest provider of cash ISAs, and have a 21% share of new cash ISAs.

### Saving Gateway

Halifax is the only financial institution to have piloted the Saving Gateway for the Government. The pilot aimed to encourage saving by people on low incomes by providing matched funding from the Treasury. More information on the scheme can be found on page 18.

### Child Trust Funds

Child Trust Funds (CTFs) are a way of encouraging tax-free saving from birth. All children born in the UK after 1 September 2002 are entitled to a £250 voucher from the Government to start off a child's account and a further £250 at age seven. The accounts can be topped up by parents, family or friends by up to £1,200 a year, and the accounts do not attract income or capital gains tax. HBOS offers a choice of investments for Child Trust Funds and has opened 10% (270,000) of all 2.6 million accounts opened in the UK.

### Child Trust Fund

Newborn baby Jennifer Chapman from Farnham in Surrey became the 250,000th Halifax Child Trust Fund customer. With an initial lump sum of £250 and £100 a month contributions from her parents the Government's CTF website calculates she could have £34,820 when she turns 18.

## Investments

Halifax is still the only high street bank to offer a range of investment products and funds with no initial or exit charges – just a simple annual management charge. Other high street banks have initial charges as high as 4.5%, with annual charges the same as or slightly higher than Halifax.

# 6%

gross interest on our High Interest Current Account – 60 times that offered by the Big Four banks

The Halifax came top against 31 Association of British Insurers (ABI) members in the 2007 Customer Impact Scheme survey when it came to 'really caring about its customers', 'treating customers fairly' and being 'easy to do business with'.

## Insurance

### Fast response

Customers need an insurer who can respond quickly in an emergency and Halifax Home Insurance is always quick to respond to major events. We have received industry recognition for our handling of the Carlisle floods in 2005, the Buncefield explosion in 2006 and the London tornado at the beginning of 2007.

Halifax set up a dedicated helpline to assist customers affected by the Buncefield explosion, setting up an incident office in the Hemel Hempstead branch. A team of experienced Personal Claims Consultants were on hand to deal with any claims or queries as a result of the blast. After the London tornado we were the only insurer reglazing windows and repairing small roof problems in the 48 hours after the event.

### Value for money

Halifax is the fourth largest household insurer in the UK and with good reason – Halifax home insurance is among the best on the market. Our home insurance offers to insure an unlimited sum, no extra fees for paying by direct debit, and a 25% online discount for new customers.

## Housing

Halifax was awarded Best Overall Lender at the Your Mortgage Awards 2006. We are the UK's number one for mortgages with a 21% market share of UK mortgage balances. This means our mortgage lending now stands at £220bn. We have helped around 250,000 customers own their homes in 2006. We are also the UK's largest single branded estate agent.

### Helping people onto the housing ladder

Rising house prices have made it increasingly difficult for first time buyers (FTBs) to get onto the housing ladder.

HBOS has a range of initiatives to help first time buyers buy their own home. We are one of four lenders working on the Open Market Home Buy scheme – a shared equity scheme for key workers, first time buyers and social tenants. Open Market Home Buy means customers can buy the majority stake in the home, with the Government and HBOS sharing the remainder. This stake may be bought out by the homeowner as they become able to buy more and more of the home.

We also have a dedicated service and product range for first time buyers. The number of first time buyers is decreasing (from 340,000 in 2005 to 315,000 in 2006 according to Halifax research) so it is clear that they need some help.

Customers can pick their rate based on the additional services they need. For help and advice customers can turn to our dedicated website <http://buyingyourfirsthome.co.uk/>

### Specialist mortgages

Birmingham Midshires offers 'specialist' mortgages to customers with CCJs and loan default histories. These customers can find it difficult to get standard mortgages due to an adverse credit history. A slight premium is charged to reflect the additional risk, but the rate is reduced if a borrower repays steadily. Birmingham Midshires will not loan money if it is likely a customer will be unable to afford the borrowing. Meeting regular payments on such a mortgage can help customers 'repair' their credit rating and with time move onto a standard mortgage.

### Flood risk

Halifax was the first and so far only lender and home insurer to stand by its customers and offer our 1.8 million homeowners with Halifax home insurance protection against flooding until 2008. Through the Association of British Insurers we are lobbying Government to increase flood defence spending and to communicate more regularly where flood defence improvements have been carried out.

## Credit cards

Our credit card offering is one of the most competitive on the market and is a best buy. We offer one of the best introductory offers available (0% for 12 months with a One Card) and have one of the lowest APRs around.

### Charity credit cards

In 2006 customers using Halifax and Bank of Scotland credit cards helped raise over £1.5m for charities including Cancer Research UK and The NSPCC. The first time a customer uses a Halifax or Bank of Scotland credit card their chosen charity receives a £20 donation from HBOS. After this, for every £100 the customer spends on the card, HBOS makes a further donation of 25p. Over the past 17 years HBOS has donated over £19.5m through our charity credit cards, entering the Guinness Book of Records in 2000 as the world's most successful charity card provider.

# £19.5m

raised for charities over the past 17 years by customers using Halifax or Bank of Scotland credit cards

**A record 10,500 insurance claims were received in one day following severe storms in the UK in January 2007 compared to an average of 4,000. Overall, we registered 20,000 extra claims over a five day period with an average call answer rate of 2.25 minutes.**

### Sustainable housing

As one of the largest providers of finance to the UK's housing sector, HBOS is playing a leading role in encouraging the growth of sustainable housing. In 2006 HBOS' asset management arm, Insight Investment launched a new initiative in association with WWF and the Housing Corporation to build on the success of its previous detailed sustainable housing benchmarks. The new initiative, NextGeneration brings together investors and non-governmental organisations with the public and private sectors to drive continued improvements. Its first report will be published in 2007.

## Business banking

Business banking also offers substantial opportunities for profitable growth. We aim to attract new customers with innovative and value added products.

Our business current account is a Best Buy, with the highest rate of credit interest on balances up to £50,000 of any high street bank (Business Moneyfacts December 2006).

For business customers switching to HBOS we offer free transactions and no overdraft arrangement fees for the first 12 months.

## Access to finance for SMEs

Most of the UK's SMEs are able to access the finance they require, but we recognise that some new businesses may find it more difficult. To date initiatives have largely been at an industry level with the Small Firms Loan Guarantee Scheme being one of the principal mechanisms used. The Business Banking Code, to which we subscribe, provides the contract that sets out the industry standard. Increasingly, the use of Credit Scorecards and Bureau information has positively contributed to the portability of credit histories and switching behaviour.

## Competing on service

### Expanding our branch network

Unlike some banks we are looking to expand our network, with up to 100 new branches planned for the next five years. By the end of December 2006, nine of these were already open for business. The new branches will be concentrated in the South as we expand our presence outside our heartlands in Scotland and the North. These new branches will also result in the creation

of up to 1,500 new customer-facing jobs and will help us deliver better service for more customers. Around 17 of these branches will be in areas among the 50 most deprived.

### Halifax Ireland

26 of 46 branches planned to open in Ireland are now open for business and we attracted 40,000 customers by the end of 2006. We aim to shake up the banking market by providing better value, simple and appealing products.

### Mobile branches

Bank of Scotland has six mobile branches providing a full banking service to some of the most remote areas in Scotland. Covering a variety of villages as well as schools, retirement homes, community groups and worksites, the vans also visit the homes of disabled customers.

### Branch access

#### Telephones

In 2006 we introduced dedicated customer telephone lines to enable customers in all our 315 branches in Scotland to call their local branch directly. We are expanding these facilities UK-wide in 2007 so all customers across the UK are able to call their branch.

### Parents

Halifax was voted Most Parent Friendly Bank for the fourth year running in the 2007 Tommy's Parent Friendly Awards. The awards credit companies that are taking parents' needs into consideration and helping to make their lives less stressful. In the same awards, Halifax was named Best Children's Savings Account Provider for the second year running.

### Disabled customers

HBOS is committed to providing easy access to our branches, with over 95% of branches being accessible to disabled users with features such as ramps, lifts and modified counters for wheelchair users, and induction loops for customers with hearing impairments. Upgrading the remaining branches is difficult due to planning constraints and building unsuitability – however we will investigate all reasonable steps to meet a customer's access needs. We also offer visually impaired customers the option to receive communications in Braille, audio or large format.

# 1.8m

homeowners protected  
against flooding until 2008

# Over 1,100

We have over 1,100 bank branches  
across the UK with three times as  
many in the 50 most deprived local  
authorities as in the 50 most affluent

## Customer service

### Service leadership

Improving customer service is an important driver for HBOS. In 2006 over 15,000 customer-facing branch colleagues benefited from service training initiatives.

GfK NOP research indicated the proportion of customers who were delighted or completely satisfied with HBOS' service increased from 53% in 2005 to 59% in 2006 – 5% ahead of the average for the Big Four banks – 54%.

We know we can do more and in 2007 we will expand the new customer service training programme to over 4,000 more colleagues across Halifax Estate Agents, the branch network and the regulated sales force.

### Complaints

We treat complaints very seriously and we know that, where possible, customers prefer their complaint to be addressed by their first contact. GfK research shows we have successfully raised the proportion of complaints that are dealt with at the customers first point of contact by 10% – from 38% at the beginning of the year to 48% by December.

### Online banking

We are now the third largest online bank in the UK with over two million customers regularly using the service. To meet the needs of this expanding group of customers we have redesigned our website to make it easier for customers to carry out a range of transactions including setting up an authorised overdraft, making payments and setting up standing orders. We have also improved the navigation of the site to help customers find the answers to their questions more easily.

### ABI Customer Impact Scheme

Along with other members of the Association of British Insurers (ABI) Customer Impact Scheme, we ensure that customer's needs are at the core of the way we do business by:

- Developing and promoting products and services which meet the needs of our customers.
- Providing customers with clear information and good service when they buy our products.
- Maintaining appropriate and effective relationships with our customers and providing them with a good service after they have bought a product.

We deliver these commitments through the Way We Do business. Beyond the main KPIs detailed in this report, further detail of our participation in the ABI scheme can be found at [http://www.hbosplc.com/community/includes/Customer\\_Impact\\_Scheme.pdf](http://www.hbosplc.com/community/includes/Customer_Impact_Scheme.pdf)

## Championing consumer interests

We are the only bank to proactively campaign and produce research on each of the following issues:

### Dormant accounts

In February 2007 HBOS became the first bank to launch a major campaign to reunite customers with their dormant funds. We are the first bank to disclose data on the dormant accounts we hold – approximately £50m is held in 'forgotten' accounts. Almost 75% of these dormant accounts have a balance less than £100.

We have had an excellent response to our campaign. Around 2,000 completed forms were received in the first week. In total we have received almost 4,000 claims.

### Empty homes

We are the only major bank to highlight the issue with an annual survey. In October 2006 there were 290,862 private homes in England that had been empty for more than six months. Average weekly earnings in areas with a high number of empty homes are, on average, 9% below regional averages, and 18% lower than English average earnings.

### Inheritance tax

We are lobbying for an increase in the inheritance tax threshold to account for the rise in house prices over the last 11 years and a commitment to increasing the threshold in line with future house price inflation. In 2006 we published research indicating that the total number of estates paying inheritance tax has increased by 72% over five years to 30,451.

### Stamp duty

We are lobbying to see the threshold for stamp duty rise in line with house prices. Total stamp duty revenue from residential property sales was £4.6bn in 2005/06, up 114% from the £2.1bn raised in 2000/01, with 3.5 million properties now valued above the 3% stamp duty threshold.

**15,000**

colleagues received extra customer service training in 2006

**1st**

bank to disclose data on the dormant accounts we hold

**£50m**

held in dormant accounts HBOS is trying to reunite with owners

### Public sector workers

To highlight the difficulties faced by key workers trying to buy a house Halifax publishes research on affordability for key public sector workers. In 2006 Halifax published research showing that the average house is unaffordable in 65% of towns across Great Britain, up from just 24% in 2001.

### Halifax House Price Index

The Halifax House Price Index is the UK's longest running house price series covering the whole country. As the UK's largest mortgage lender, the data provides a robust and representative sample of the entire UK market.

## Where can we do better?

- We will introduce green products to help customers manage their environmental impacts, including a Green Mortgage in the second half of 2008. Work will start on this during 2007.
- During 2007 facilities will be introduced to allow customers in England, Wales and Northern Ireland to call their local branch to match the facilities now available in Scotland.
- We will provide more help for people in rural communities by launching a new mobile branch service in Aberdeenshire to provide banking services to almost 20 local communities.

## What do our stakeholders think?

**Clerical Medical named Pension Provider of the Year 2006**  
Bankhall Awards.

**Halifax named Best Credit Card Provider**  
2006 Moneyfacts Awards.

**Bank of Scotland named Best Overall Business Bank**  
2006 Moneyfacts Awards.

**Birmingham Midshires Solutions named Best Variable Rate Buy-To-Let Mortgage Provider**  
2006 Moneyfacts Awards.

**“An Excellent Current Account from The Halifax”**  
Halifax Ultimate Reward Current Account – Why we like it, Learnmoney.co.uk, February 2007.

**“It is massively superior to traditional bank accounts from the Big Four”**  
Best Buy Accounts laid bare, Fool.co.uk on the Halifax High Interest Current Account, June 2006.

# Responsible lending

We do not want to lend to people who cannot afford to take on debt and we have extensive systems in place to manage this.

## Our strategy

Ensuring we lend in a responsible way and providing clear information so that our customers make informed decisions about borrowing, is clearly in our interest as well as our customers'.

## Our products

### Mortgages

Most of HBOS's lending is secured lending in the form of mortgages, making up 93% of our total Retail book. Prudence is the name of the game at HBOS. The average loan to value across our mortgage book is 44%. The average income multiple has remained pretty much the same for over 15 years, demonstrating a long history of prudent lending, despite recent high house price growth.

### Affordability

Each application is assessed on an individual basis rather than income multiples alone. This has been the case for many years now. We take into account an applicant's total credit commitments and spending patterns as well as a conservative interest rate assumption.

### Mortgage lending in deprived areas

Lending to customers living in deprived parts of the country can act as a catalyst for economic and social regeneration as well as being a key measure of financial inclusion. 4.7% of HBOS mortgage lending is in the most deprived areas of the UK.

	Total	Yorkshire	Scotland	Rest of UK
Total mortgages (£m)	217,095.78	14,010.16	13,865.99	189,609.63
Mortgages in deprived areas (£m)	10,190.05	463.70	125.89	9,600.46

### Personal loans and credit

Our attitude to unsecured lending (credit cards and personal loans), which makes up only 7% of our total Retail lending, is prudent – typically we turn down 43% of credit card applications and 65% of personal loan applications. 43% of customers pay their credit card bills in full each month.

## Sharing more information

### Current data-sharing

We advocate the fullest possible sharing of data within the banking industry; we believe lenders will make better, more responsible lending decisions with increased data-sharing.

HBOS is leading the way, sharing full data on new products and up to 95% of historical products across its range. In addition, HBOS is ahead of the industry standard on full data-sharing percentages, with an average on Loans 99%, Credit Cards 98%, Mortgages 99%, Current Accounts 72% across our brands. Each month we compare industry data to our own to understand changes to total borrowing.

### Increasing data-sharing

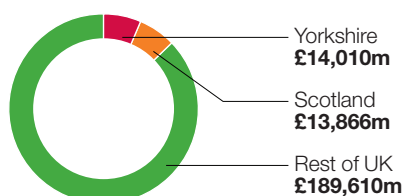
In a bid to both increase the amount of data we share and the data shared with us by other providers we participated in a successful pilot with CallCredit to test the value of sharing a broader data set. We have improved our use of technology to enable us to make better use of this shared data for responsible lending purposes.

We believe that responsible lending decisions could be helped by a fuller sharing of data such as Student Loans, Council Tax arrears, home credit (door-to-door weekly payments), and arrears on utility bills.

### CallCredit

In 2006 HBOS, in partnership with the Big Four banks and credit rating agency CallCredit, piloted a scheme which matched up data on customers' income with information from the five banks on unsecured debt. This information was used to produce a debt to income ratio on customers in the pilot. This debt to income ratio can then be used to evaluate whether or not a customer is likely to be able to manage new borrowing, and provide early warnings on customers likely to find managing their borrowing difficult. The pilot was very successful, and the scheme will be rolled out nationwide in 2007.

### Total mortgage lending



## Giving clear information

### Summary boxes on credit cards, PPI, marketing literature and credit card cheques

HBOS was the first card issuer to provide clear and concise personalised summary boxes on the front of all our credit card statements. In 2006 we became the first issuer to extend personal summary boxes to credit card cheques, providing details about interest rates, cheque fees and legal safeguards. We also became the first bank to introduce summary boxes on Payment Protection Insurance (PPI) literature so customers can easily see what the benefits and exclusions are.

### Credit card cheques

HBOS was the first issuer of credit card cheques not to issue them to under 25s. We also include a reminder in every mailing that customers have the right to opt out of receiving them and we were the first to include the cheque's interest rate on the cheque stub as well as the accompanying literature.

## Financial capability and generic financial advice

We believe it is important for customers to be equipped to make informed choices about their finances. We believe the best way to improve financial literacy is to ensure that customers have clear and balanced information before taking out a product. We have been at the forefront of the move towards summary boxes and we have a wide range of online tools to help customers manage their finances.

In addition, we support the Government's work to increase access to generic advice, which, we believe, can play an important part in helping people make the right borrowing decisions.

We believe that a national generic advice service should capitalise on existing community and voluntary structures that are already regularly used for advice giving services.

Given the breadth of topics and complicated nature of the UK tax and benefits system, a generic advice service should also be introduced gradually, focusing first on consumers who are vulnerable to making wrong decisions and those not currently serviced by the industry.

HBOS already makes a significant contribution to financial capability projects through the FSA levy. Via the HBOS Foundation, we also finance a wide range of Financial Capability and Money Advice projects, set out on pages 16–19.

## Customers who fall into difficulty

As organisations agree to share more data with us, we hold increasingly better information about customers who are likely to struggle with their credit. If customers do have problems we seek to work with them to identify a solution. We will first try to agree a payment plan with them. If unable to do so, we recommend the customer go to a non fee-charging agency for a full financial assessment. We are happy to work with free debt advice agencies, who can represent customers, to agree payment arrangements that might include, for example, freezing interest or stopping charges for an agreed period.

### Money Management Unit

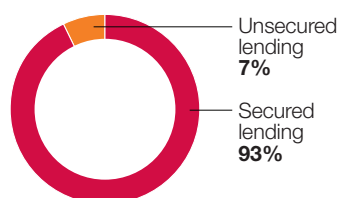
In 2006 HBOS set up a Money Management Unit to work with customers showing signs of financial stress. The unit offers support and advice to customers who request help, helps manage customers out of financial difficulties and, in what we believe to be a first among major banks, proactively looks for signs customers are getting into difficulty up to nine months before the difficulties are likely to escalate. In some cases we can provide advice even before the customer realises they are struggling.

In 2007 we will significantly expand the unit, both in terms of the number of customers we can help, and the range of solutions available. In the first two months of 2007 the unit had reduced 300 credit limits and in the first three months provided 1,500 full affordability reviews.

### Independent debt advice

HBOS contributed £2.25m in 2006 to organisations providing free debt advice (such as the Community Credit Counselling Service and Payplan).

### Retail lending



1st

credit card issuer to extend summary boxes to credit card cheques

£2.25m

contributed to organisations providing free debt advice

## Lending to Small and Medium Enterprises (SMEs)

3.82% of all HBOS business banking accounts are provided within deprived areas and 2.58% of business lending. With the industry average standing at 4.34% and 4.50% respectively, we accept the need to improve our performance in this important area.

We follow the British Bankers' Association Statement of Principles which provides that banks will work together with small and medium sized businesses to establish a good relationship and to help if the business gets into difficulties. In addition, we support Business Debtline, a free confidential and independent helpline, partly funded by HBOS, for people who have cashflow and debt problems.

	All HBOS Dec 06	Deprived areas Dec 06	% support for deprived areas Dec 06	Industry average: % small business accounts in deprived areas June 06
No. of business banking accounts	170,132	6,500	3.82%	4.84%
No. of accounts in credit	146,147	5,386	3.69%	4.85%
No. of accounts with an overdraft limit	35,670	1,332	3.73%	3.68%
No. of business deposit accounts	64,432	2,262	3.51%	4.68%
No. of loans	8,969	208	2.32%	4.16%
Total value of loans and overdrafts	£581.4m	£15m	2.58%	4.50%
Proportion banking online	85%	84%	N/A	N/A

### Lending to registered social landlords

We are one of the largest lenders to social landlords in the country. Our expertise and experience also helps social housing organisations raise additional funds, for example, for community regeneration projects.

### HBOS lending commitments to registered social landlords (December 2006)

	No. of customers	Commitment (£)
England	157	4,048,420,252
Scotland	6	247,650,339
Wales	9	72,026,017
<b>Total</b>	<b>172</b>	<b>4,368,096,608</b>

## Corporate customers

As part of our commitment to building relationships with our clients we continue to work with businesses who are committed to improving their social performance, and in 2006 we further developed our approach to Environmental and Social risk, including detailed procedures to support our adoption of the Equator Principles on Project Finance.

### Environmental and social risk

During 2006 HBOS developed detailed processes to improve its management of environmental and social risks in our corporate lending. We reviewed our entire strategy and governance structures and provided colleagues with new tools with which to assess environmental and social risk, putting in place stronger reporting and monitoring systems. This new framework has been supported by in depth training on the Equator Principles for 40 specialists across our Corporate division. The training will be expanded in 2007.

### Social Risk Banking Guide

Our new Social Risk Banking Guide provides our colleagues with a clear process for assessment, escalation and reporting of social risks. Supported by a Social Risk Assessment Tool, the guide is designed to lead to better assessments and ultimately better management of social risk. Higher risk sectors are subject to greater oversight, and guidelines are available for specific high and medium risk sectors.

### Environmental policy

Our new Corporate environmental policy covers both direct impacts and the indirect impacts arising through our business activity. The policy improves consistency in the way environmental risks are assessed as part of the credit process within the Corporate division.

# £4.4bn

committed to registered social landlords



The policy is supported by an Environmental Procedures Guide and Lenders Guide to Environmental Risk Management. These guides integrate environmental issues into our credit applications and ensure the ongoing management of environmental risks.

#### **Equator Principles**

Project finance is a relatively small part of our Corporate business (representing under a 10th of Corporate lending). We have nonetheless adopted the Equator Principles to demonstrate our commitment to addressing the environmental and social impacts of our business operations.

We go beyond the Equator Principles, applying our new social and environmental risk framework to all the deals we do.

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### **Where can we do better?**

- **Develop and grow the Money Management Unit to increase the number of customers it can help.**
- **Report the number of projects reviewed according to the Equator Principles and expand Equator Principles training to heads of business and European operations.**
- **Increase our provision of clear, easy to understand information on our products and expand our work on financial capability.**

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### **What do our stakeholders think?**

**Halifax named Best Overall Lender**, 2006 Your Mortgage Awards (for fifth year running).

HBOS awarded '**Most Responsible Customer Acquisition Strategy**' at the 2007 Credit Card Awards.

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# 40

**colleagues in specialist roles received in depth training on the Equator Principles**

# Financial inclusion

Commercial opportunity and a recognition that it is right to work towards ending financial exclusion are the drivers of our financial inclusion strategy.

## Our strategy

Our strategy is aligned with the Government's aims to increase access to banking, asset ownership, money advice and credit. We are the first major bank to produce a separate financial inclusion report containing detailed data on our programme.

## Banking

### Social banking

HBOS is the UK's leading provider of social banking accounts. These offer basic money transmission facilities such as direct debits and standing orders but do not provide an overdraft credit facility. We have over three times the number of accounts compared with our nearest competitor.

#### HBOS social banking accounts opened 2003-2006

The table below shows our social banking account openings between April 2003 and December 2006, the period during which Government and banks agreed in 2004, to make "significant progress... towards halving the number of adults in households without a bank account".

Period	Cardcash social bank accounts opened	Easycash social bank accounts opened	Total
2003 Q2-Q4	271,672	10,615	282,287
2004	306,829	54,363	361,192
2005	-	42,630	42,630
2006	-	64,948	64,948
<b>Total</b>	<b>578,501</b>	<b>172,556</b>	<b>751,057</b>

In addition to the Cardcash openings set out above, since 2005, we have opened a net total of 121,510 such accounts for 16 and 17 year olds. Of these young adults, some will still be at school, some will be in their first job and some will be from underprivileged sections of society. Cardcash is a suitable first step on the financial services ladder for these customers.

## Our new business

Our estimated market share of new social banking accounts is 12.2%, compared with our 13% share of the overall bank account market. We aim to increase our share to 15% during 2007. The average time to open an Easycash account is seven days.

### Debit cards for Easycash customers

In 2006 we introduced a debit card for Easycash customers – making it even easier to manage their finances. The Visa Electron can be used to pay for goods in shops and online, and can only be used if there are sufficient funds in the account, so there is no risk of going into overdraft. Not all banks provide this facility.

### Post Office access

Our Easycash accounts are accessible over Post Office counters. The Post Office is a competitor, offering financial services including accounts, loans, savings and insurance. Their charge for access is high and demand for Post Office access from our customers limited. Research amongst our Easycash customers shows that while 91% have used an ATM, only 23% have used a Post Office. Should demand and pricing change we would, of course, review our position.

### Social banking in deprived areas

7.79% of our social banking accounts are held by customers living in the 5% most deprived areas of the UK. As a whole HBOS has 440,000 account holders in deprived areas, of which 280,000 are social banking accounts and 160,000 are current accounts.

December 2006	HBOS		HBOS
	All No. accts	Deprived areas All No. accts	Deprived areas % of all
Current accounts	5,270,394	198,085	3.76%
Social banking accounts	3,612,537	279,568	7.74%
<b>Total bank accounts</b>	<b>8,882,931</b>	<b>477,653</b>	<b>5.38%</b>

### Easycash account openings



We are the first major bank to publish a target (15%) for new social banking account openings.

**Geographical split of social banking in deprived areas**

Scotland and Yorkshire account for 17.4% of the UK's population and 26.2% of our social banking accounts (16.9% of our social banking accounts are held by customers in Scotland and 9.3% in Yorkshire). The table below illustrates the number of our social banking accounts held in deprived areas according to geography and Financial ACORN categorisation.<sup>1</sup>

June 2006	Total	Yorkshire	Scotland	Rest of UK
Total bank accounts	8,597,448	863,321	1,725,062	5,986,222
Social banking accounts	3,596,118	333,651	609,118	2,653,349
Social banking accounts in Financial ACORN groups I, J, K	1,651,717	171,413	322,608	1,157,696
Social banking accounts in deprived areas (BBA definition)	280,162	25,431	12,248	242,483

**Upgrades**

Since 2001, we have upgraded 191,000 social banking customers to full facility accounts: we regularly contact social banking customers to invite them to apply for an upgraded account. We take into consideration factors such as regularly funded accounts, account management and length of relationship. We believe that we move more social banking customers to mainstream accounts than any other bank.

**Introducing self servicing facilities**

Self service facilities are becoming much more widely used by all of our customers. Throughout 2007, as previously announced, we are enabling Cardcash and Easycash customers to share the benefits of this and transact without the need to use our branch counters. These changes are reducing queues in branches for both these card-based customers (the pilot showed reduced queuing times of up to 25%) and those customers with passbooks who can only make use of the counter facilities.

<sup>1</sup>ACORN is a means of classifying areas in order of affluence according to Census characteristics.

Customers, with either Cardcash or Easycash accounts, will always have access to our branch network. We are not changing that. Instead we are introducing a number of additional facilities in the branches to enable these customers to fulfil their transactions without the need to queue to use the counter.

Facilities such as intelligent deposit systems and deposit boxes are being put in branches to supplement the ATM's and Click 'n' Call points.

Any customers, particularly the elderly or disabled who have difficulties using the facilities will be offered help and advice in using the machines. These customers will not be obliged to use this new technology if they have problems doing so.

**Savings and asset ownership**

Regular saving provides individuals with a pool of financial assets for times of financial difficulty, or to enhance long-term independence and opportunity. But there is strong evidence to suggest households on lower incomes are not saving enough for themselves, or their children. We aim to help people on low incomes, where appropriate, to save.

**Saving in deprived areas**

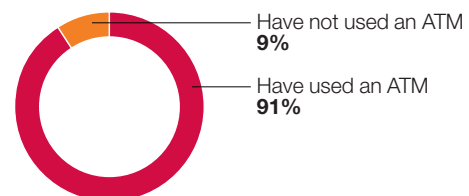
Research we have commissioned of our social banking customers indicates that having a social banking account encourages saving. Our savings account figures support this: the proportion of our social banking account customers in deprived areas also holding savings products stands at 31%.

	Total	Yorkshire	Scotland	Rest of UK
Social banking customers in deprived areas	85,866	8,189	3,474	74,203
Proportion of social banking customers in deprived areas holding a savings account	31%	32%	28%	31%

**191,000**

**social banking customers upgraded to full current accounts**

**Easycash customers using ATMs**



### The Saving Gateway

The Halifax is the only financial institution to have piloted the Saving Gateway for the Government. As the country's biggest savings institution, we are proud to have supported and driven this. The pilot aimed to encourage saving by low-income people through providing matched funding from the Treasury – in effect, a 'buy one, get one free' scheme up to a pre-defined maximum.

The initial pilot aimed to encourage saving by those on low incomes by providing matched funding from the Treasury. Over 23,000 accounts were opened and the pilot finished at the end of 2006. An independent review of this first pilot concluded that the scheme was capable of encouraging people to begin saving on an on-going basis and resulted in a second pilot to test variations in matched funding offers amongst a range of customer groups.

### Promoting savings to Easycash customers

In 2006 we planned two pilots, to be launched in 2007, designed to improve access to savings among social banking customers.

Further updates about both of these pilots have been posted on the HBOS plc financial inclusion website at <http://www.hbosplc.com/community/financialinclusion.asp>

### Credit and microfinance

Our customers include housing associations, social enterprises, Community Development Finance Institutions (CDFIs) and charities. We are therefore uniquely placed to develop sustainable partnerships that can develop long-term solutions to financial exclusion. In particular, our support for the micro-credit sector, including CDFIs, allows consumers access to very small amounts of credit that they would be unable to source otherwise.

### Community Development Finance Institutions

We have lent in excess of £8m to UK CDFIs. We are the largest lender into this sector in the UK. The capital we make available enables these CDFIs to on-lend to social enterprises and small businesses that otherwise would not be able to access credit.

The maturity of many not-for-profit organisations in the UK together with the evolution of the housing association sector offers opportunities to make real inroads into tackling financial exclusion. The infrastructure, IT systems and capital within banks partnered with the hands-on knowledge, network, trust and experience of key people and organisations operating in the sector provides a huge boost to local communities.

### Money advice and financial literacy

A strategic objective for the Group is to actively support, through financial contributions and other means, the delivery of financial literacy and money advice programmes across the UK.

We achieve this not only through HBOS activity but also via the donations strategy of the HBOS Foundation. HBOS plc contributed £2.25m in 2006 to organisations providing free debt advice (such as the Community Credit Counselling Service and Payplan).

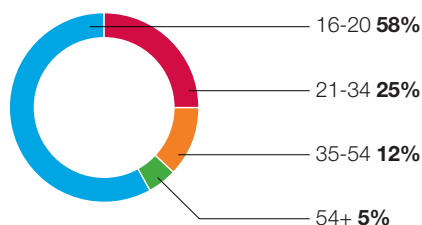
### Websites

Our Halifax and Bank of Scotland websites contain a variety of tools to help customers assess their financial situation at key stages such as buying their first home, including a budget checklist and mortgage calculator, savings selectors and general information for investors such as the difference between investing and saving. We also provide a link to the FSA financial capability website 'Moneymadeclear'.

### HBOS Foundation

The HBOS Foundation, a registered charity, supports a range of projects that address the financial literacy needs of a number of groups across society, for example, deprived communities, young adults, refugees and homeless people. As well as multi-year grants, the Foundation also arranges for HBOS colleagues to volunteer with these charities. In 2006 we doubled our financial support to the HBOS Foundation from £4m to £8m. The Foundation frames its financial literacy work around the FSA's national strategy for financial capability. This was launched in May 2004 and focuses on seven priority areas: schools; young adults (16-25); work; families; borrowing; retirement; and advice.

Age profile of first time bank accounts



FSA priority areas	HBOS Foundation projects
Schools: Laying the foundations	UK Youth
Young adults: New responsibilities	NCH, NACRO
Work: Reaching people through the workplace	Refugee Council, Big Issue Foundation
Families: Being a parent	Refuge, Gingerbread
Retirement: Planning ahead	Age Concern, First Fruit
Borrowing: Making informed decisions	Centrepoint
Advice: The role of generic advice	National Debtline and the CAB

## Support for customers in financial difficulty

HBOS follows the Business Banking Code which sets out standards for banks and building societies to follow in dealing with business customers. We also follow the Statement of Principles which provides that banks will work together with small and medium sized businesses to establish a good relationship, and to help if the business gets into difficulties. In addition, we support Business Debtline, a free confidential and independent helpline, partly funded by HBOS, for people who have cashflow and debt problems.

## Where can we do better?

- We will maintain and build upon our position as the biggest provider of social banking accounts in the UK – aiming to grow our share of new accounts to 15% in 2007.
- We will develop and implement a Group-wide approach to credit unions and the micro-credit sector.
- We will lead on disclosure through our annual financial inclusion report.

## What do our stakeholders think?

**“I look forward to other banks displaying similar innovation to HBOS.”** John McFall MP, Chairman of the Treasury Select Committee in the foreword to HBOS’ 2007 Financial Inclusion report.

**“The Parliament... notes that HBOS provides more than half of all social banking accounts in the United Kingdom and works continuously to reduce the number of ‘unbanked’ people in Scotland.”** Scottish Parliamentary motion tabled by Murdo Fraser MSP.

# Investor responsibility

On behalf of our clients we engage with companies on environmental, social and governance risk to ensure the £98.6bn of clients' funds we manage are invested responsibly.

## Our strategy

Insight Investment, HBOS's asset management business, is firmly established at the leading edge of responsible investment. Our dedicated Investor Responsibility team has a strong track record of engaging with companies to upgrade their governance and management practices. Our investment process, on behalf of our clients, explicitly takes into account issues such as board structure, climate change, human rights, and good governance.

## Our approach

A founding signatory and member of the steering committee of the United Nations Principles for Responsible Investment, Insight delivers on its responsible investment commitments in five ways:

- Integration of responsibility performance into investment analysis.
- Activism on corporate governance.
- Actively encouraging companies to meet high standards of social, ethical and environmental management.
- Offering specialist ethical investment products.
- Promoting corporate governance, corporate responsibility and responsible investment.

## Integration

In 2006, we strengthened the integration of corporate governance and corporate responsibility issues into our investment decisions. This includes research into sector specific issues including nanotechnology, consumer health, water management, alternative energy, and waste management.

## Governance activism, engagement and voting

We engaged with 228 companies in total during 2006.

We engaged with companies 125 times on corporate governance issues such as succession planning, strategy, financing and incentives. We also covered many other governance issues in our wider meetings with companies, and carried out our commitment to vote on all resolutions at Annual General Meetings and Extraordinary General Meetings. During the year, we voted on a total of 7,408 resolutions at 770 company meetings.

## Summary of voting activity 2006

Quarter	Number of company meetings	Votes for	Votes against	Votes abstained	Total resolutions voted
January-March	83	693	7	1	701
April-June	364	3,803	32	12	3,847
July-September	193	1,896	10	2	1,908
Oct-December	130	938	10	4	952
<b>Total</b>	<b>770</b>	<b>7,330</b>	<b>59</b>	<b>19</b>	<b>7,408</b>

We engaged a total of 400 times with companies on 10 different topics relating to corporate responsibility – ranging from climate change to human rights, chemicals and obesity.

## All engagement on corporate responsibility and corporate governance issues, 2006

### Corporate governance

Board policies and codes of ethics	10
Board structure	19
Capital structure	7
Directors' remuneration	42
General governance	45
Non-routine chairman meetings	2
<b>Sub-total</b>	<b>125</b>

### Corporate responsibility

Climate change risks	122
Consumer health and obesity	13
Corporate responsibility, strategy, governance, reporting and management	23
Environmental risk management: general policy and management; biodiversity	26
Health and safety	154
Human rights	9
New and emerging technologies	17
Pension deficits	9
Supply-chain risks: general policy and management; palm oil	15
Sustainable homes	12
<b>Sub-total</b>	<b>400</b>
<b>Total</b>	<b>525</b>

# £98.6bn

funds under management by  
Insight Investment

On behalf of its clients, Insight holds shares in 85% of all the companies in the UK FTSE All Share Index (as at 31 December 2006). Of those, on average, it engaged with 84 companies per quarter, representing 15% of its clients' holdings by number or 57% by value.

When proactive engagement does not generate results we use the formal rights granted to us as shareholders. The most high-profile case in 2006 was SkyePharma, where, we – together with other shareholders – requisitioned an Extraordinary General Meeting. The company agreed to allow Insight to have input into the selection and the appointment of two future non-executive directors.

## Promoting responsible investment

We led the development of the Investor Statement on Climate Change – which is now supported by 16 institutional investors representing over £850bn in assets under management – and continued to play a leading role in major collaborative initiatives, such as the UN Principles for Responsible Investment, the Association of British Insurers, the Institutional Investors Group on Climate Change and the UK Social Investment Forum.

### Consumer health and obesity

During 2005 and 2006, in conjunction with London's City University, Insight analysed how the world's largest food companies are responding to consumer health and obesity.

The research looked at emerging pressures such as the threat of litigation, food labelling and advertising restrictions, along with companies' product portfolios. This work enabled us to identify and evaluate several companies for investment. We made a number of changes to our investment portfolios as a result.

### Taking governance into account in investment decisions

Throughout 2005, the share price of Misys – a UK software and services provider – fell due to high turnover of board members and issues surrounding business disposals. With a low share price, but a sound strategy and structure, Insight became a large shareholder in the company with a view to exerting pressure to make governance changes to improve its performance.

In consultation with shareholders, including Insight, the entire board was refreshed during 2006. The case demonstrates how consideration of corporate governance issues strongly influenced our investment decision, backed up by active engagement with the company to ensure that changes were made at Board level to ensure that good governance was restored.

### European electricity utilities' disclosures

Insight conducted a detailed review of how European electricity utilities are responding to the business risks and opportunities presented by climate change.

One of our key findings was that there are significant gaps and inconsistencies in the greenhouse gas data provided. The weakness of disclosure means that it is difficult for investors to assess the risks and opportunities and understand how each company has structured its business strategy and capital expenditure plans to respond.

In May 2006, we published a report 'The Climate Change Disclosures of European Electricity Utilities' to define Insight's expectations for how electricity utilities should report. We recommended that electricity utilities provide greenhouse gas projections and assessments of the financial impact of climate change according to agreed protocols and verify their climate change-related data in a similar manner as their corporate financial information.

## UN Principles for Responsible Investment

The UN Principles for Responsible Investment (PRI) were launched in April 2006 by Kofi Annan, the then Secretary General of the UN. Insight played an active role in the development of the principles and sponsored their launch. By the end of 2006, the PRI had attracted the support of over 100 institutional investors with responsibility for more than US\$5 trillion (over £2.5 trillion). The Principles set out a broad framework for investor action. We describe below how Insight implements each Principle of the PRI.

### Incorporating Environmental, Social and Governance (ESG) issues into investment analysis and decision-making

In-depth research on ESG issues, which equities and credit analysts build into investment analysis and stock selection.

### Being active owners and incorporating ESG issues into ownership policies and practices

Vote on resolutions on behalf of our clients and engage actively with companies.

### Seeking appropriate disclosure on ESG issues by the entities in which we invest

Engage directly with companies to encourage them to improve their disclosure on ESG issues. Collaborate in industry initiatives designed to enhance corporate accountability, including the Carbon Disclosure Project and the Global Reporting Initiative.

### Promoting acceptance and implementation of the Principles within the investment industry

Meet with brokers, investment consultants and policy makers to encourage increased emphasis on responsible investment.

### Working together to enhance our effectiveness in implementing the Principles

Play an active role with investor groups such as the Association of British Insurers (ABI) and the Institutional Investors Group on Climate Change (IIGCC); we led the development of the IIGCC Investor Statement on Climate Change.

### Reporting on our activities and progress towards implementing the Principles

Provide detailed reports on our investment performance and on our responsible investment activity. In 2006 we published full quarterly engagement and voting reports, 28 briefings and seven publications on corporate governance and responsible investment during the year.

## Vodafone

Vodafone's share price has fallen since the height of the tech boom in Spring 2000. As the share price fell, criticism of management grew and came to a head in late 2005 when the company wrote down the value of some of its assets. In 2006, this criticism was publicly voiced at the AGM. 9% of shareholders voted against both the re-election of Arun Sarin and the Remuneration Report.

Insight has had an ongoing dialogue with the company's board over a number of years. In 2006, Insight met with the Chairman and executive management. We believe the company was initially slow to accept that industry fundamentals had changed. However, in 2006 we believe management changed its strategy and led to a path towards creating long-term shareholder value. Other investors were less sure and argued for the disposal of key assets such as the company's interests in the US. We regarded this as ill-timed and therefore at the AGM on 25 July 2006, Insight voted in favour of all resolutions. We continue to remain supportive of the company and current management.

## Where can we do better?

- Deepen investment research with a particular emphasis on analysing large UK and European companies' management of climate change-related risks.
- Strengthen engagement with a focus on encouraging companies to achieve and maintain high standards of corporate governance and corporate responsibility.
- Promote increased disclosure on environmental, social and governance risk and stronger goals in collaborative initiatives.

**“Insight Investment is the first Principles for Responsible Investment, (PRI) signatory to release a dedicated PRI report, outlining the fund's approach to implementation.”**

**UN Global Compact press release, 29 April 2007**



# Risk and regulation

The current regulatory focus on outcomes is a strong driver for us to create products and services that are transparent and ultimately help consumers make more informed decisions.

## Treating customers fairly

We aim to ensure that our product life cycle, from product conception, through marketing, sales and after sales including complaints handling, captures the essence of principles based regulation.

Our customer contract sets out principles governing how we interact with our customers. Senior managers take responsibility for embedding them in every aspect of our business. The contract also includes an annual review of our products to ensure they still meet the needs of our customers as well as shareholders.

HBOS has been at the forefront of moves to simplify customer communications by providing clear summary boxes on credit card statements and by ensuring marketing literature contains a clear and balanced summary of the features, benefits, risks and commitments of a product. In 2006 we extended summary boxes to estate agent agreements – the first major estate agency in England and Wales to do so. The summary boxes set out plainly and simply the important information such as fees, cancellation terms and agreement type.

### OFT review of fees and charges

In 2006 the OFT began an enquiry into the fees charged by banks and the model of free banking for accounts in credit. We are working closely with the OFT during the review and will continue to do so on future reviews.

The vast majority of banking customers never incur charges and bank for free. Arranging an overdraft, or increasing a limit, in advance can be done 24 hours a day, online or over the phone, and need take no more than five minutes.

Last year we introduced a buffer zone that prevents customers from incurring an unauthorised overdraft charge if it is a charge that takes them over their pre-arranged limit.

## Protecting customers' assets

The banking sector has seen a reduction of 43% in fraud losses for face-to-face transactions in UK retailers during 2006. However, there has been a rising trend in international and internet fraud attacks. We are working hard to tackle this growing problem.

### Card fraud

HBOS reimburses customers who, through no fault of their own, fall victim to card fraud. Chip and PIN has helped to reduce card fraud, but fraudsters are beginning to move to using stolen card data in ATMs in countries which have not yet implemented technology such as Chip and PIN.

We have increased our defences to protect customers, and there are also simple steps customers can take to help reduce the risk – always shield the keypad when entering a PIN, never write down a PIN number, and where possible keep the card in view when paying for goods and services.

### Phishing

Phishing attacks, where fraudsters set up fake websites to trick customers into giving away credit card or bank account details, received a great deal of media attention during 2006. HBOS has a specialist Internet Attack Centre tackling online attacks and we are constantly working to ensure that the security of our online banking service remains at the forefront of the industry.

### Boiler room scams

'Boiler room scams' involve unlicensed brokers targeting investors by cold-calling or mailing them and using high pressure sales techniques to recommend the purchase of shares. These shares commonly turn out to be worthless or are unlisted. While rare, these frauds can be very costly – HBOS has been working with the City of London Police and the FSA to disrupt and prosecute those involved.

# 43%

reduction in face-to-face fraud  
across all UK retailers in 2006

### **Identity theft**

Identity (ID) theft is when a criminal uses another person's personal information to take on that person's identity. They may then buy expensive goods on credit, take out loans, obtain state benefits and even obtain false passports.

We have rigorous credit reference and application processes to help prevent ID theft in the first place, and if a customer does fall victim we have processes to put things right. We are actively involved in exploring an industry wide response.

### **Anti-money laundering (AML)**

We observe high standards of customer identification and verification, in line with Joint Money Laundering Steering Group guidance. The guidance was updated in 2006 to enable a risk based approach and single form of ID for personal accounts.

Our Group AML policy is updated annually to reflect developments in legislation and guidance. We have recently been heavily engaged in the consultation process for the Draft Money Laundering Regulations 2007. This follows an earlier consultation in July 2006 issued by HM Treasury on the implementation of the Third EU Money Laundering Directive. We were the only major bank to put in an independent response to the Treasury.

# Farepak

When Farepak, a subsidiary of HBOS's customer, European Home Retail Plc, collapsed last year, HBOS was criticised by some with regard to our role.

## The issue

HBOS provided a loan facility to European Home Retail (EHR), the parent company of the pre-payment Christmas club, Farepak. We became aware from Spring 2006 that Farepak's parent company, EHR, had run into severe financial difficulties.

### Fulfilling our obligations

HBOS did not own or run Farepak. We provided a loan to Farepak's parent company EHR.

We stood behind our customer as it tried to find a solution to its funding problem. However no durable, solvent solution was found. Both Farepak and EHR were subsequently placed into receivership. Sadly, this meant that many of Farepak's customers who had been paying the company for goods and vouchers for Christmas lost their money.

Banks are often accused of 'cutting and running' when companies get into financial difficulties. HBOS did not do this. HBOS stood behind its customer – EHR – during its period of greatest financial difficulty. Since then, HBOS made the largest single financial contribution (£2m) to the Farepak Rescue fund.

### Stakeholder dialogue

We held around 20 face-to-face meetings with our critics and spoke to many others over the phone, setting out our perspective and the obligations banks have when companies, sadly, collapse. We provided written briefs to over 300 other stakeholders who we felt might have an interest in the issue.

### Lessons from Farepak

The lesson we learned from the collapse of Farepak was that there are clear gaps in the Christmas Saving Market which mainstream providers can help fill. This is an observation which has also been made by Brian Pomeroy, Chair of the Financial Inclusion Taskforce.

In early 2007, as the UK's largest provider of social banking accounts, we announced we would launch a Christmas Savings Account in May, which hopefully begins the process of meeting that need. Customers will be able to take their savings in either cash or high street vouchers, from very well known high street brands. More detail on this can be found in the HBOS 2007 Financial Inclusion report at [http://www.hbosplc.com/community/includes/HBOS\\_FI\\_report.pdf](http://www.hbosplc.com/community/includes/HBOS_FI_report.pdf)

### Halifax Christmas Savings Pilot

In May 2007, Halifax mailed 10,000 of its social banking customers with details of a tailor made Christmas Savings Account. This was the first such product to be offered by a major UK bank. The account could be opened with just £5 and funded with a minimum of £5 per month.

The account has a very competitive rate of interest (5.25%), making it an ideal product for customers saving for the first time. Customers have the peace of mind that the Halifax stands behind this product. Customers' savings balances are also protected under the Financial Services Compensation Scheme. At the end of the savings period, i.e. October, customers will be able to take their savings in the form of either cash or high street vouchers. We are finalising details as to which retailers will supply the vouchers. They will be very well known high street brands.

The account will allow payments up until 31 October 2007. No withdrawals will be allowed before maturity on this date. If customers do wish to withdraw their money, their funds will be returned to the customers' Easycash account.

# People strategy

## Achieving success

**Leadership** Our strategy focuses on developing colleagues who can Lead, Shape, Build and Deliver.

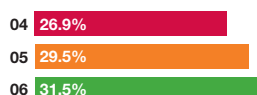
**Diversity** We are determined that our leadership teams act as role models in diversity awareness.

**Health and safety** We are committed to achieving the highest standards of health and safety across all our businesses.

# 85%

of colleagues said they understood the importance of equal opportunities and diversity in their work

### Female managers at Level 4 and above



### Leadership index



Our leadership index is a composite index showing the percentage of colleagues who agreed with 12 statements about good leadership in HBOS in our annual colleague opinion survey, conducted by MORI.

# Our colleagues

Colleague advocacy is not easy to achieve. But it's a big part of HBOS's recipe for success.

## Our strategy

Our senior team help us achieve success by helping to create a positive working environment that reflects colleague diversity and offers the training and personal development colleagues need to deliver high standards to our customers. Our reward system encourages share ownership, amongst other rewards, so that all colleagues benefit from the Group's success.

## Our leadership

To be successful we need to develop colleagues who can Lead, Shape, Build and Deliver. These elements form our Leadership Commitment which drives our approach to hiring, performance management, reward, succession planning and development. The Way We Do Business is also integrated into our Leadership Commitment. From 2006, 25% of senior manager bonus has been based on personal performance against this commitment.

## HBOS-U

In 2006, we launched HBOS-U to help senior managers understand their responsibilities. This offers a full range of development options for our senior leaders. It is an important step for HBOS at a number of levels:

- Creates a 'one stop shop' for all leadership, professional learning and development across the group.
- Reinforces our commitment to leadership capability and the need to excel at both 'what' we do and 'how' we do it.
- Blends a wide variety of learning opportunities – beyond classrooms – to include paired and peer learning and online learning.

By the end of 2006 – only six months after launch – one in three colleagues in the target audience had attended an HBOS-U event and the website had received almost 120,000 hits.

## Colleague numbers

HBOS increased its workforce by around 2.3% last year. In the UK we now employ over 65,700 people. Worldwide we employ over 74,000 people. Explicitly, we are now the largest financial services employer in Yorkshire and one of the largest in Scotland, our heartlands, where we employ 14,100 people and 17,350 people respectively.

## Reward and recognition

### Record colleague payout of £550m to colleagues

Our Total Reward strategy aligns exceptional performance with exceptional rewards and colleagues are encouraged to share in the success of HBOS through share ownership. HBOS's financial performance during 2006 means that £340m in cash bonuses and free shares will be shared this year by colleagues. We believe this may be the largest payout by any company in the UK. In addition, a further £210m will be shared by colleagues after the maturing of our unique Free Share Option and Sharekicker plans.

### Clear communication

Chief Executive Andy Hornby issued all colleagues with their own personalised statement, highlighting the elements of Total Reward such as pensions and childcare options. The communication was printed digitally to limit environmental impact. It has been a key support in helping drive further share ownership and take up of colleague benefits.

### Flexible and every day benefits

Colleagues can access a range of valuable benefits and discounts online. 'Flex' gives colleagues the choice of options to purchase, via their regular salary, benefits such as childcare, health cover and bicycle purchase with the added bonus of these benefits provided at reduced cost. Take up of benefits through Flex increased by over 16% in 2006.

### HBOS car provision for colleagues

In February 2007, HBOS reduced the range of vehicles for our essential car users (4,000 colleagues) by half and we now supply only diesel or hybrid vehicles to help reduce our carbon emissions.

Our wholly owned fleet business, Lex, has partnered with a global vehicle manufacturer to share and learn about best practice. Initiatives include improving how we incentivise and enable colleagues to drive 'smarter' more efficient vehicles, such as attractive purchase options as well as full servicing and business travel enabled insurance so colleagues who are not company car drivers are appropriately covered on business travel.

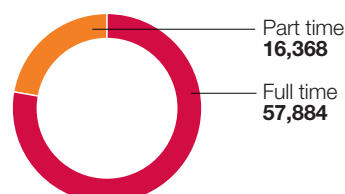
### Fair pay and rewards

HBOS regularly monitors its pay and reward provision across the business to ensure compliance with employment law and regulation and more importantly, ensuring our colleagues get a good deal on reward.

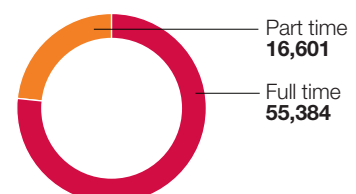
**£550m**

bonuses and free shares to UK colleagues in 2006

Average full/part time colleagues Group 2006



Average full/part time colleagues Group 2005



## Union partnership

We encourage colleagues to seek union membership and estimate that around half of HBOS colleagues in the UK are members of our two recognised unions, Accord and Unite (formerly Amicus). We encourage and foster a collaborative and inclusive approach to working with our union partners, and the way in which they work with the company.

Our Human Rights Policy was updated this year to incorporate the four Core Conventions of the International Labour Organisation. It already endorses the UN declaration of Human Rights. This addition codifies existing HBOS practice.

We work with the unions on strategic, tactical and operational levels, from involvement at an early stage in our strategic direction, determining terms and conditions of employment to discussions on tactical issues such as health and safety and colleague wellbeing. HBOS and the unions will be launching a Partnership Agreement in the spring of 2007 which reinforces and builds on our strong relationship.

The firm foundation for industrial and employee relations in HBOS has evolved through a joint commitment to avoiding compulsory redundancies and to full engagement on issues that impact on colleagues and union members.

## Communicating our CR Agenda

Regular dialogue with colleagues is encouraged through monthly and annual colleague opinion surveys, online 'Ask Andy Hornby' sessions, roadshows and intranet sites.

## Diversity

In January 2006 the HBOS Board agreed a new Diversity Strategy. The key areas agreed in the strategy are Leadership, Awareness, Getting The Basics Right and Disability. We are determined that our leadership teams demonstrate diversity awareness in everything they do and they act as role models. We also aim to ensure that the make-up of our leadership teams increasingly reflects the diversity of our colleagues and customers.

### Leadership

Our Diversity Steering Group is chaired by our Chief Executive, Andy Hornby. Members of the group comprise senior leaders across HBOS. The steering group is there to shape and direct the diversity agenda as well as act as advocates for driving the diversity agenda forward and challenge the business to remove any barriers to progress.

## Getting the basics right

Recording and monitoring the make-up of our workforce helps us understand what impact our strategy is having and where our focus should rest.

### 2006 workforce statistics

- 62.6% of all colleagues were female.
- Almost 60% were aged between 26 and 45.
- 7% of colleagues were from an ethnic minority, compared to 6.6% in 2004 and 6.3% in 2005.
- Approximately 1.4% of our colleagues stated they had some form of disability.

## Age diversity

HBOS recognises the value of age diversity. A result of the implementation of the Equality in Employment (Age) Regulations, as well as ensuring we have age friendly policies, we took the decision in 2006 to remove our contractual retirement age, giving colleagues increased choice over their career plans.

## Education and awareness

A new e-learning tool, 'Diversity at Work', was launched across the Group in late 2006. The purpose of the training is to recognise the benefits that a diverse workforce and customer base bring to HBOS as well as understanding individual roles and responsibilities of colleagues in making HBOS a truly inclusive organisation. To date over 14,000 colleagues have completed the training.

The Diversity and Inclusion intranet site promotes the commitment HBOS has to diversity, sharing information with colleagues about the different projects underway. The leaflet, 'Our Commitment to You', was issued to all colleagues via their salary statement in January 2006. The diversity commitment sets out what our colleagues should expect from working at HBOS such as to be treated with dignity, respect and without prejudice or discrimination.

### Disability

A Group-wide disability strategy was agreed in 2006. The strategy, and subsequent action plan, was endorsed by the Employers Forum on Disability.

# 14,000

colleagues completed diversity training

Disability Confident training was developed during 2006 for group-wide launch in 2007. This e-learning tool not only makes colleagues aware of disability issues, but also gives practical guidance on providing disabled customers with equal access to services, working effectively with disabled colleagues, welcoming disabled colleagues as members of a team and ensuring they are able to achieve their full potential.

### Flexible working

HBOS recognises the importance to colleagues of striking the right balance between the competing demands of both home and work.

Whilst we have one of the most progressive suites of flexible working policies in our sector, we are conducting a major review in 2007 of how we can extend the reach of flexible working opportunities within the business.

Our aim for colleagues at every level is access to opportunities for flexibility of working style, hours, patterns and environments. We believe this will enable them to deliver a high quality service whilst also meeting their home and family commitments.

### HBOS Foundation

The HBOS Awards are held annually to honour colleagues who have demonstrated a determination to go that extra mile in their support for charities, communities, good causes or diversity issues. In 2006, 20 finalists were short-listed from more than 250 nominations, and represented an excellent cross-section of the businesses that make up the HBOS Group.

The award for 'Outstanding Individual Contribution to the Community' was given to Kiran Bali from Group Application Services. Kiran works tirelessly to improve race relations, religious tolerance and cultural awareness. At 28, she is the youngest magistrate on the Huddersfield bench.

The most successful fundraising team, Birmingham Midshires Fundraising Team, was only formed after the 2005 HBOS Awards. By October 2006, they had exceeded their target of £100,000 and went on to raise £183,000. Events taking place throughout the year were a St Patrick's Day fun day, a masquerade ball and a football tournament, with funds raised split between a local charity and the HBOS Foundation Charity of the Year.

### Inclusion audit

In 2006 we conducted a Group-wide Inclusion Audit, to review our policies and identify how they were being implemented across the Group. The survey of 4,600 HBOS managers identified significant consistency in policy application across the group. Policies on colleagues joining and leaving the company were rated highly – as were flexible working and dignity at work. This supports evidence from the 2006 Colleague Opinion Survey (COS) which also showed improvements for colleagues feeling valued and respected.

However, people felt more could be done to raise awareness and evaluate the effectiveness of other people policies. Cross-divisional groups are now working on the recommendations to develop good practice and respond to concerns raised.

### Colleague financial education

In Q2 2007 HBOS will launch a colleague engagement programme around financial education and wellbeing, working alongside our strong partnership with the FSA on financial inclusion within the UK consumer banking market.

The colleague programme will engage on a 1:1 level at all major HBOS employment sites as well as via our UK retail branch network. All colleagues will be actively encouraged to have a free personal financial review and online decision tools and support exist. Key topics include general financial wellbeing and money management, making the most of the HBOS pension proposition and our share plans.

### Eliminating the pension scheme deficit

Around 80,000 HBOS colleagues and former colleagues are members of our final salary pension scheme. It is one of the biggest schemes in the UK. We are well on track to eliminate the deficit in the scheme – one of the few companies in the UK to have announced plans to do so.

- HBOS has contributed £1.15bn to its pension fund over two years. This comprised an extra contribution of £800m and business as usual contributions of £350m. We have always believed that a pension deficit is a debt like any other. It needs to be repaid.

### HBOS workforce aged 56 and above



### Managers from ethnic minorities at Level 4 (senior manager) and above



- The deficit in the scheme now stands at just £0.9bn (pre tax) or £0.6bn (post tax). For a company our size, the deficit is modest.

Alongside this reduction we have increased the average life expectancy assumptions for male and female HBOS pension scheme members. This is a prudent thing to do given that people are living longer.

Our two unions, Unite and Accord have publicly congratulated HBOS for its commitment to eliminating the deficit.

## Health and safety

The health, safety and welfare of colleagues, customers and contractors are key business objectives within HBOS. HBOS is committed to achieving the highest standards of health and safety across all of our businesses.

Our approach is based on the Health and Safety Executive (HSE) best practice allowing the Group to demonstrate a structured and consistent approach. Our approach to health and safety is guided by stakeholder dialogue within HBOS and externally to ensure appropriate consultation and effective implementation.

### Internal dialogue

Positive partnership with our trade unions has seen good results in terms of policy, process and training development. Dialogue with the unions occurs at a number of levels:

- Group Management Health and Safety Joint Working Party (JWP) – quarterly.
- Informal JWPs.
- Divisional Union JWPs.
- Union Rep Meeting at regional and business level.

The unions view on the approach and standards in place in the Group have been described by them as ‘the benchmark for the banking sector’.

### External dialogue

Externally, through the Health and Safety Lead Authority Partnership Scheme and the Lead Fire Authority Partnership Scheme, HBOS has developed arrangements with Calderdale (Health and Safety) and Lothian and Borders FB (Fire). Both authorities act as our point of contact for every other enforcing authority in whose region we may operate. Rigorous Safety Management Reviews were undertaken by the enforcing authorities in relation to ensure that our arrangements met the required standards.

Insight Investment worked with the HSE in developing the Corporate Health and Safety Performance Index Tool (CHaSPI) to encourage large organisations to report publicly their health and safety performance.

## Whistleblowing

We have a policy and a helpline to support colleagues who are concerned about possible unacceptable behaviour or practices at work. By raising concerns, colleagues can help HBOS to protect its reputation and deal with inappropriate behaviours. The policy was updated at the end of 2006 and is supported by the document: Guidance Note on How to Make a Whistleblowing Report. As well as taking account of the Whistleblowing Policy, colleagues are advised to refer to our Grievance and Harassment policies to ensure they report any concerns in the most appropriate way. All cases are treated seriously and sensitively and appropriate follow-up action is taken. Over the past year, some cases have resulted in action being taken against colleagues, as part of the Group’s determination not to allow inappropriate behaviour to pass unaddressed.

### KPI 2006 performance

**Year on year reduction in the number of recorded accidents across the Group**  
**4.2% reduction in Group Incidence rate compared with 2004**

### KPI 2006 performance

**Reduce the number of slip, trip and fall accidents (the most common injury causing accident in HBOS) by 10% from 2004 levels by end of 2009**  
**48% reduction in Group incidence rate following high profile ‘watch your step’ campaign initiated in October 2005**

### KPI 2006 performance

**Reduce the number of RIDDOR (reportable accidents) events across the Group by 6% from 2004 levels by end of 2008**  
**6% reduction in Group Incidence rate**



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## What do our stakeholders think?

### Colleague Opinion Survey

- In 2006 over 58,000 colleagues (90% of UK colleagues) took part – the biggest return for HBOS and Ipsos MORI. Typically, companies in the private sector provide a return of around 56%.
- 85% of colleagues said they understood the importance of equal opportunities and diversity in their work, an increase of 7% from the 2005 survey.
- 74% agree that HBOS is committed to improving equal opportunities and diversity throughout the business, an increase of 9% since the 2005 survey.
- 89% of colleagues felt that meetings and briefings from their line manager were very valuable.
- 73% of colleagues felt that their line manager treated them fairly, with dignity and respect, ahead of the industry norm of 56%.
- 71% of colleagues were satisfied with their job.

### External benchmarking and awards

#### Race for Opportunity

HBOS completed the survey in 2005 and was ranked fifth out of the 70 private sector companies.

#### Opportunity Now

In 2005 HBOS achieved an overall score of 94%, which is gold standard and we plan to take part in the next survey scheduled for 2008.

#### Stonewall Workplace Equality Index

HBOS featured in the top 100 for the third year running, and was named the top Scottish employer.

#### Employers Forum on Disability

The 2005 Employers Forum on Disability (EFD) Standard Benchmark rated HBOS 59%. The disability agenda has been a key focus for HBOS during 2006 and into 2007.

#### Shaw Trust

Our Retail Contact Centres won the Best Large Employer Award for commitment to training and work opportunities for people disadvantaged in the labour market due to disability, ill health or social circumstances.

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## Where can we do better?

- Launch the Disability Confident tool across the HBOS Group in support of our ongoing disability strategy.
- Conduct a major review in 2007 of how we can extend the reach of flexible working opportunities within the business.
- Improve colleague advocacy of HBOS's environmental management strategy.

# Environment

## Protecting our future

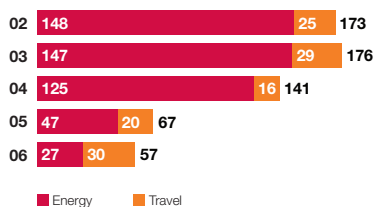
**Emissions** Controlling our energy use and travel.

**Resource use** Controlling water, waste and paper use.

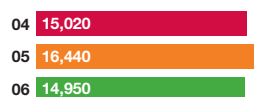
**Market solutions** Innovative products and services.

**Governance** Ensuring strong management.

**HBOS carbon emissions 2002–2006** (thousand tonnes CO<sub>2</sub>)



**Paper use (tonnes)**



# Environment

Protecting and enhancing our business model and doing the right thing drives our strategy.

## Our strategy

HBOS's biggest environmental challenge is responding to climate change. According to the Carbon Disclosure Project, banking has the lowest carbon dioxide (CO<sub>2</sub>) emissions of any sector except insurance. But climate change is a reality affecting all of our main stakeholders as well as impacting on our business model. We are committed to managing the risks posed to HBOS by climate change and grasping the opportunities that it presents.

## Our impact

### Our estate

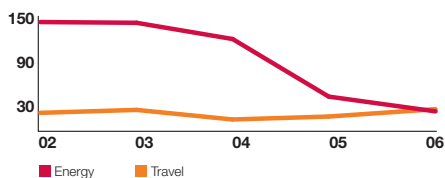
We have a large UK estate with 2,200 buildings (including 1,100 bank branches) occupied by over 65,000 colleagues. As well as investing in environmental efficiencies, to deliver these, we are engaging our colleagues to advocate our strategy.

We assess the environmental impact of operating our buildings using the Building Research Establishment *Ecopoints* system<sup>1</sup>. This shows that energy consumption accounts for around 71% of our direct impact on the environment, followed by paper consumption and business travel. The production of general office waste produced by colleagues while they work, such as food packaging and plastics, together with water consumption, accounts for less than 1% of HBOS's direct impacts.

## Where do our carbon emissions come from?

Our use of energy (electricity and gas) and our business travel are responsible for our carbon emissions. The graph shows that in just two years, HBOS in the UK has reduced its carbon emissions by 65%, or nearly two thirds. HBOS's UK carbon footprint was 163,000 tonnes in 2004 and 57,000 tonnes in 2006. This is a considerable reduction over two years, accounted for largely by our increasing use of renewable electricity.

HBOS carbon emissions 2002–2006 (thousand tonnes CO<sub>2</sub>)



<sup>1</sup>The Ecopoints system forms part of the BRE's Office Toolkit.

## Energy generated CO<sub>2</sub> emissions

The CO<sub>2</sub> impact of our use of energy has dramatically reduced. In October last year, we signed a new contract for 100% renewable electricity, as defined by the DTI and accredited by Ofgem. 100% renewable energy produces no carbon emissions. Remaining energy related emissions arise from use of natural gas in boilers across some of our estate.

## Controlling our use of energy

In 2002, HBOS set itself a stretching target of reducing its consumption of energy by 17.5% per FTE by the end of 2007. By the end of 2006, we achieved a reduction in energy usage of 13% over our 2002 baseline. Although year on year improvements have been delivered, this has been slowed to some extent by the dual running of a number of key sites, for example, during the refurbishment of HBOS's headquarters in Edinburgh and the refit of the Bristol site.

## The HBOS estate

We are required under new building regulations to undertake an energy audit to accompany any new build property or major refurbishment of our buildings. We will, of course, comply with this. Our biggest challenge, however, is managing the existing HBOS estate, where our buildings are older and therefore do not have the benefit of new technology.

We have therefore commenced a detailed energy survey of all our major employment sites. Initial surveys have identified some major opportunities to reduce our energy consumption. Some of these opportunities have already been implemented and are providing real savings.

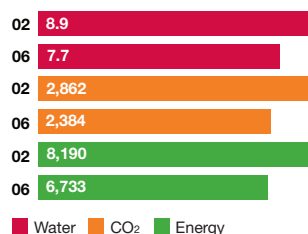
## The Mound

One example is our newly refurbished group headquarters building at The Mound. This building has a renewable energy solution which uses geothermal heat to provide for heating and cooling. Energy is transferred to and from the ground through a network of boreholes drilled into the bedrock. In winter, heat is 'pumped' from the bedrock into the building's climate control system, while in summer the pumps work in reverse and the system is used for cooling. The geothermal system uses considerably less power than conventional building heating/cooling system.

# 65%

reduction in UK CO<sub>2</sub> emissions since 2004

## Our impact per FTE



Other opportunities and energy saving schemes require further work and capital investment but generally most of these are expected to have a return on investment of three years or less. We will continue to survey all of our 100 major buildings during 2007. A capital investment programme will also be developed to make our buildings even more energy efficient.

**Long-life lightbulbs (compact fluorescent lamps)**

Over 75% of light bulbs across HBOS's estate are long-life, low energy bulbs. The remaining light fittings are currently unsuitable for low energy bulbs, but will be upgraded over the next five years as part of our building refurbishment programme.

**Business travel generated emissions**

Prior to the introduction of our renewable energy contract business travel accounted for a small proportion of HBOS CO2 emissions. In 2006, however, travel overtook energy as our biggest contributor. Air travel in particular has grown a great deal in recent years.

Our overall travel has increased considerably over the last two years with a corresponding increase in emissions. Business travel at HBOS generated 30,000 tonnes of carbon dioxide in 2006 compared with 16,000 tonnes in 2004.

**Going for Green Miles**

Last year, HBOS piloted a new initiative, 'Green Miles' with a view to rolling this out across the UK in 2007. The savings generated by the reduction in business travel are shared between HBOS and the Million Pound Challenge. This contribution will in turn be matched by the HBOS Foundation.

The Green Miles Pilot was a great success. Almost £500,000 of savings for HBOS were generated in three months. £50,000 was donated to the Million £ Challenge and matched by the Foundation up to £100k. In April 2007 the initiative was launched to colleagues UK wide. Green Miles is HBOS's first major environmental programme aimed at colleagues.

**A greener car fleet**

We have worked to reduce the environmental impact of our car fleet. Hybrid and LPG cars are available within the car scheme choice lists and the average CO2 profile of the fleet has improved steadily during 2006, from 172.56 grams CO2/km in January to 167.33 in October. We now offer only diesel or hybrid vehicles to 'essential' company car users to help reduce our CO2 emissions.

**Managing waste**

In 2002, HBOS introduced a target to increase waste recycling to 60% by the end of 2007. In 2006, our recycling reached 45%. Meeting our 2007 target is therefore a major challenge. We know we need to do more in this important area, especially in controlling our use of paper, which as you might expect of a major bank, is HBOS's second most significant impact on the environment.

**Paper use**

HBOS directly consumed approximately 14,950 tonnes of paper in 2006. Equivalent figures for 2005 and 2004 were 16,440 and 15,020 tonnes respectively. There are a number of good examples demonstrating how HBOS is managing down its use of paper.

**One million use paper-free banking**

Over one million banking customers are now registered for the Halifax and Bank of Scotland online paper-free service. More than 60% of HBOS online customers use paper-free compared to an average 8% across other UK banks. By registering for the service, customers can:

- Find statements and letters quickly and easily – they are stored securely online for two years.
- Save statements into money management software like Microsoft Money.
- Print statements whenever they need a hard copy.
- Save paper and help the environment.
- Cut out the clutter and reduce paperwork.

**Energy consumption in the UK (million KwH)**



## Recycling

Improved recycling schemes were introduced into over 100 of our major employment sites during 2006. By the first quarter of 2007, these had been expanded to all major employment sites. Five new bins now exist on all floors of HBOS major sites for recycling of paper, printer cartridges, cans and plastic bottles and cups.

The next challenge for 2007 will be to roll out improved recycling facilities to our branch network.

## Water use

Group Property committed to reduce water and resource use by 10% between 2002–2007. By the end of 2006 we achieved a 3.8% reduction against the 2002 baseline. Initiatives during 2006 included reducing water used in washrooms.

## Harbourside move delayed

Plans to help us reach our target include the opening of Clerical Medical's new headquarters building in Bristol – this will be the first building in the HBOS portfolio to achieve a BREEAM 'Excellent' rating. As well as having reduced electrical consumption, the cooling system for this building is supported by water drawn from the adjacent harbour rather than mains water supply. Unfortunately issues with the building construction have delayed the move and we currently have to run both the Harbourside building and our existing buildings.

## Helping our customers

The increasing regulation and emerging fiscal mechanisms designed to tackle climate change are creating opportunities for banks to develop services which will help address climate change and environmental degradation.

### Our Flooding Commitment

Over six years ago, we introduced a market leading flooding policy to help our customers tackle the growing problem of climate change. This remains the only one of its kind in the mortgage and insurance sector, providing cover for our existing mortgage and insurance customers against flood risk until 2008.

## Good deal for green homes

In March, last year, Halifax launched an exclusive mortgage offer for customers buying new homes from the house builders who recently topped the Sustainability Benchmarking survey produced by WWF and Insight Investment.

## Research

New research from the Halifax showed that over the past year nearly a third of people have carried out home improvements that save energy and fuel. The research shows that:

The most popular energy and fuel-saving home improvement was fitting double glazing (45% of respondents), followed by new loft insulation (41%), a new boiler (30%), draught proofing (27%) and new radiators (26%).

The average household now spends around £1,135 a year on energy bills. According to Energywatch, the gas and electricity watchdog, 85% of consumers are worried about energy prices and 99% are trying to save energy around the home.

## Our lending decisions

Lending is one of the key areas where we can have a significant positive impact on managing Climate Change. Towards the end of 2006, our Corporate division introduced its first specific environmental policy.

### The leading provider of renewable energy finance

Bank of Scotland Corporate is a top five lender (in Europe) to renewable energy projects. We have a £250m loan book which is currently focused on wind farms. We continue to explore the commercial opportunities to finance tidal energy and off shore wind projects. Clearly, this commercial UK activity on our part sends an important message to the renewable energy community.

## Our purchasing decisions

Environmental issues continue to be built into our procurement practices and colleagues are actively encouraged to work with suppliers to minimise our environmental impact.

### Travel growth in the UK (thousand tonnes CO<sub>2</sub>)



**“WWF is delighted that HBOS is rewarding the best performing companies, and their customers, with these mortgage products. This is a positive step and should send out a strong message to the house-building industry.”**

**Paul King, director of WWF’s One Million Sustainable Homes campaign**

**Achievements in 2006**

- Branch photocopiers have been upgraded to reduce power consumption.
- SpendWise, our online stationery buying tool, reduces the use of paper in our ordering process. It covers 95% of HBOS's largest business areas. Other goods and services will be added throughout 2007.
- All of our paper comes from sustainably managed sources and our suppliers are ISO 14001 certified.

**Lending to the environmental sector**

Corporate has provided £1.7m of funding to TGM Environmental, enabling the recycling and waste management company to expand into document shredding and multi-material recycling. TGM Environmental is committed to reducing the amount of waste sent to landfill sites.

Graeme Coombs, managing director of TGM Environmental, said: "We had approached our existing bank with the opportunity to keep our business and had also met with other lenders, but Bank of Scotland Corporate presented the most structured deal".

**Leadership in investment**

Institutional investors have a key role to play in tackling climate change. That is why Insight led the process of developing the Investor Statement on Climate Change. Insight itself has analysed how climate change might affect its investments in areas ranging from energy intensive utilities to renewable energy. Its investor responsibility team has played a leading role in engaging with companies and Government on the issue. Douglas Ferrans and Peter Scales took part in a special Financial Times online debate on climate change and institutional investment forum.

Insight has an active approach to investor responsibility including publishing briefings, offering a specific screening service to investors and providing funds such as the Evergreen Fund that has a 20% weighting towards investment in companies that develop environmentally beneficial products.

**Governance**

**The HBOS Environmental Policy**

HBOS has an Environmental Management System based on ISO 14001. This describes how the Environmental Policy is implemented. Based on the advice of independent external consultants, we have decided that external certification to ISO 14001 would currently not add value to our environmental programme; however, we always keep this under review and will be giving it particular attention during 2007.

Corporate Environmental Objectives linked to our significant impacts are published alongside our Environmental Policy Statement on Groupnet (the HBOS intranet) and on our external website. Management and performance targets addressing HBOS's significant operational environmental impacts are set following audits and the management review conducted annually by independent external consultants. Performance against targets is reported in the annual report to the Board on the Environmental Strategy and here, in our Corporate Responsibility Report.

**Training and education**

Internal environmental communications and training are delivered to colleagues via a range of media including, for example, group-wide and divisional intranets and e-magazines, divisional hard copy magazines, presentations, seminars and workshops, to raise our colleagues' awareness of environmental issues and how they can address these at work and at home. We gauge our colleagues' views on the effectiveness of our environmental programme in monthly and annual Colleague Opinion Surveys conducted by MORI.

## What do our stakeholders think?

### Colleague advocacy

In two years, colleague advocacy of our environmental programme has increased from 24% to 46% – a significant improvement, but clearly much remains to be done.

We have raised colleague awareness of the sustainability of their own homes by offering a free online energy saving assessment report (taken up by 3,000 colleagues) and, for 20 participants, a prize of a free energy makeover for their homes.

HBOS is one of the sponsors of environmental charity Global Action Plan's 'Greenscore' website<sup>1</sup>. This allows colleagues and customers to rate their environmental performance at home, learn about the simple things they can do to change their lifestyles and reduce their harmful impact on the environment, and measure the effect this has on their performance.

HBOS also promoted Energy Saving Week, an Energy Saving Trust initiative that raises awareness on climate change and general energy use. Colleagues were encouraged to use alternatives to their normal mode of travel such as audio and video-conferencing facilities, and during European Mobility Week, use free bus travel.

### Stronger external metrics

Most of the external benchmarks concerned with HBOS's environmental performance improved last year. We increased the environmental component of our score in the crucial Dow Jones Sustainability Index from 62% to 67%. We also recorded a number of notable firsts. We are the only UK bank to have featured in the Global 100 Most Sustainable Corporations index every year since its launch at the World Economic Forum in Davos in January 2005. We are the only UK high street bank to be rated AAA in the global Innovest banking review into environmental, social and governance issues. Finally, we are ranked as a climate change leader by the Carbon Disclosure Project.

<sup>1</sup>[www.greenscore.org.uk](http://www.greenscore.org.uk)

## Where can we do better?

- **Offset UK emissions through Certified Emissions Reductions delivered in developing countries.**
- **Roll out Green Miles across the UK.**
- **Be the first bank to rate the energy efficiency of all HBOS buildings on a scale of A-G and display a rating, just like the stickers on new fridges and washing machines.**
- **Launch a Green Mortgage during 2008.**
- **Implement new recycling facilities for all waste paper across our entire branch network, to supplement facilities already in place in our offices and call centres.**

# Community

## Benefiting society

**Economic impact** Our main contribution to society is as a tax payer, employer and generator of wealth. Our economic contribution is large and growing.

**Investment** Our economic contribution is supported by a comprehensive programme of investment in communities, financial inclusion, micro-finance and community giving.



# Community

HBOS is a significant generator of wealth across the UK and, in particular, around our heartlands in Yorkshire and Scotland.

## Our strategy

We are the only major bank to express community contribution in terms of our overall economic impact. Our economic contribution to the community is large and growing. Our community investment strategy centres around two key areas:

- **Our economic contribution** as a tax payer, an employer, and a generator of wealth.
- **Our active investment** in many communities: financial inclusion, micro-finance and community giving.

## Our economic impact

### Tax contributions

We are one of the largest payers of tax in the UK, paying £1.77bn in income tax on profit in 2006. This equates to over £3,350 per minute or the annual salary bill for over 56,650 teachers. According to the PwC 2006 One Hundred Group Survey, HBOS alone accounted for over 10% of all the corporation tax paid in 2005 by the UK's top 100 firms.

### Employment

HBOS directly employs over 65,700 people in the UK and over 74,000 worldwide. We are the single largest private sector employer in Yorkshire and one of the largest private sector employers in Scotland. In the past five years, more than 2,300 new jobs have been created in Yorkshire alone. For 2006 HBOS colleagues shared a bonus and free share payout in the UK of £550m. More about our approach to employment is set out on pages 27 to 31.

### Wealth generation

In 2006, 80% of HBOS's private shareholders were also HBOS customers. With 2.1m private shareholders, the Group had the biggest private shareholder base in the UK as a whole and all benefited in our success. Each received, on average, a payment of £158. Over the past five years, HBOS has paid out dividends totalling £6.2bn to private shareholders and pension funds.

HBOS accounts for £10bn or almost 1% of the UK's GDP according to the annual survey from the DTI. In fact the Group was ranked 11th in the DTI 2006 Value Added scoreboard, a measure of total sales less costs of bought in goods and services. When the earnings and turnover of overseas subsidiaries of UK companies are stripped out, we calculate that HBOS is a top five generator of wealth.

## Purchasing goods and services

HBOS spent £2.92bn on goods and services in 2006. The Procurement Minimum Standards, approved by the Board and the Best Practice Manual identify the process for awarding and evaluating Group-wide contracts with key suppliers, including Corporate Responsibility. The proportion of spend from Scottish suppliers has increased from 9% in 2001 to 26% in 2006.

HBOS	Procurement spend 2006	Procurement spend 2001	2006 v 2001
Total	£2.92bn	£2.2bn	33%
Of which Scotland-based suppliers	£755m	£204m	270%
Yorkshire-based suppliers	£178m	£189m	-6%

## Community investment

In 2006, we contributed £44.2m to communities across the UK. This was an increase of £1.1m on 2005. Our community investment is made up of our support for financial inclusion and micro-finance as well as HBOS community sponsorship and HBOS Foundation projects.

## Financial inclusion

Our substantial investment in reducing financial exclusion is detailed on pages 16 to 19.

## Micro-finance

Concepts like micro-finance and micro-credit tend to be associated with poverty alleviation schemes in developing countries. HBOS concentrates its resources on poverty and income inequality alleviation projects in the UK. Unlike other banks, we have no presence in developing markets. In recent years, there has been a growing interest in the benefits that the micro-finance approach can bring to excluded groups in the UK. HBOS is helping to pioneer UK focused micro-finance projects for financially excluded people.

## Sponsorship

HBOS's award winning sponsorship programme invests £4m in sport and the arts to make a tangible difference to the lives of young people in the communities where we live and work. Last year over 70,000 young people were able to take part in a new sports or arts experience, over 65% of whom were from socially disadvantaged areas.

### Young people involvement 2006

Sport	Young people	Percentage of participants from deprived areas
Premierleague	8,000	n/a
Schools Football	26,800	60%
Midnightleague	3,500	95%
Soccer One	1,400	80%
Halifax Midnightleague	800	100%
Athletics	8,500	60%
Badminton	9,000	65%
<b>Total</b>	<b>58,000</b>	

Arts	Young people	Percentage of participants from deprived areas
Children's Theatre Fest	12,000	65%
Connecting to Music	1,008	75%
Scottish Ballet	800	85%
<b>Total</b>	<b>13,808</b>	

**Total young people** 71,808

### Sport

Bank of Scotland has cemented its commitment to grassroots football with a £1.5m investment over three years which will enable 140,000 schoolchildren to play and develop their skills.

In March 2006, we announced that we would not renew our sponsorship of the Bank of Scotland Premierleague, a contract that will end in May 2007. Instead we are focusing on grass-roots sport.

In Scotland we launched a new schools football initiative, Bank of Scotland Soccer One, creating over 100 new school football teams in its first year. By 2009, over 28,000 first year pupils will take part.

For young people in areas where anti-social behaviour is a problem at night time, we continue to support Bank of Scotland Midnightleagues. By working with police forces, local authorities and football coaches in Scotland, Calderdale and the West Midlands we have helped 4,000 young people take part. In 2007, the programme will expand to reach every corner of Scotland and an expected 10,000 young people.

### Arts

Our Connecting to Music programme, run in partnership with the Edinburgh International Festival, introduces young people to classical music using a series of practical workshops. More than 1,000 children, 70% of whom come from Social Inclusion Partnership areas, took part.

Over 800 young people took part in schools and theatre-based ballet workshops, extending our support for Scottish Ballet to young people across Scotland.

The Children's International Theatre Festival attracts theatre companies from across Europe to perform, entertain and educate more than 13,000 and their families throughout Scotland.

## HBOS Foundation

In 2006 HBOS doubled its annual contribution to the HBOS Foundation from £4m to £8m.

The HBOS Foundation has become one of the largest corporate fundraisers in the UK – almost £5m (including matched funding) was raised by HBOS colleagues and the Foundation in 2006. Since its launch in May 2002, the Foundation has raised, working with HBOS colleagues, £15.5m on behalf of good causes. In addition, over the same time period, £8.7m has been disbursed to charities across the UK.

### National and local projects

£1.1m was donated to National Foundation projects and over £1m to local projects.

The HBOS Foundation focuses investment around two themes:

- Money advice and financial literacy.
- Developing and improving communities.

In particular, the HBOS Foundation supports organisations promoting financial awareness, social inclusion and lifelong learning.

### Local projects

Over 500 good causes were supported by HBOS colleagues in 2006, with volunteering increasing by 40% to over 7,000 colleagues.

### Fund raising

The HBOS Foundation's flagship programme is the Million £ Challenge. This programme raises money for charities voted for by HBOS colleagues. Originally setting a target of raising £1m, the programme has been incredibly successful, raising £2.5m for ICAN, Leonard Cheshire and Crisis last year.

ICAN, the HBOS Foundation's Charity of the Year received £1.5m with Leonard Cheshire and Crisis receiving over half a million pounds each. A wide range of fundraising activities captured the enthusiastic support of HBOS colleagues – for 2007 the Foundation has set a target to raise £3m.

### Matched funding

In 2006 the Foundation matched almost £1.25m worth of colleague support for charities in addition to the Million £ Challenge funding. This scheme is straightforward for colleagues to use and is extended to retired colleagues also. A promotion in HBOS Pensioners magazine resulted in an enthusiastic take up.

### Volunteering

In 2006 HBOS colleagues took up the volunteering challenge, with over 7,300 colleagues registering their volunteering activities with the Foundation. These activities ranged from ongoing regular work by individuals, through to single day 'team challenges' by groups and departments. A number of volunteering initiatives have been launched during 2006, particularly focusing on improving education standards and providing young people and disadvantaged adults with the skills to support them into employment.

### Big Issue Foundation

Financial inclusion has long been implicit in the Big Issue model and the HBOS Foundation is proud to support the Big Issue Foundation with £100,000 over three years. With this grant the Big Issue is developing a Vendor Support Fund to improve financial inclusion and encourage a savings culture.

HBOS plc also offers support through the Grand Central Savings Bank. Set up by the Big Issue with help from Bank of Scotland, the Grand Central Savings Bank caters for homeless and socially disadvantaged people excluded from mainstream banking. Over 1,200 accounts have been opened to date.

### Depaul Trust

The HBOS Foundation is providing the Depaul Trust with £96,200 over two years. The Depaul Trust works with the most disadvantaged young people in the UK. They work particularly in communities where poverty and long-term unemployment have resulted in generations of social exclusion and high rates of homelessness. With this grant the Trust is developing a consolidated training programme for all its UK projects and partners. This programme will develop a financial literacy training tool for staff, a volunteer training curriculum and a web-based learning tool, to capture more detailed information on budget training for the young people it works with.

## HBOS Foundation governance

The HBOS Foundation is a registered charity funded by HBOS plc. All the Foundation's staff, office and administration costs are paid by HBOS, as well as considerable support on marketing and promotion and funding of £8m per year.

The Foundation is governed by the Trustees, the Chairman of which is Phil Hodkinson, HBOS Finance Director. Full details of the HBOS Foundation's activity and governance can be found in the HBOS Foundation Annual Review at [www.hbosfoundation.org/downloads/hbos-foundation-annual-report-2006.pdf](http://www.hbosfoundation.org/downloads/hbos-foundation-annual-report-2006.pdf)

## HBOS Foundation reporting

	2006 Target	2006 Achieved	2007 Target
Fundraising	£4.5m	£4.78m	£5m
Volunteering	7,000 colleagues	7,381	9,000
Community Action Plan	£970,000	£941,283	£1,000,000
Calderdale/Edinburgh	£600,000	£485,426	£600,000
National Investment	£1,430,000	£1,125,649	£1,430,000
Fundraising costs	£850,000	£744,142	£850,000

## Where can we do better?

### University access

- In 2007 the HBOS Foundation and educational charity the Sutton Trust will launch a £1m initiative to help over 350 16–18 year olds from non-privileged backgrounds across Yorkshire to realise their potential and gain a place at a top university.

### Partnership with the Russell Commission

- The Russell Commission launched their new charity, 'V' in May 2006, aiming to transform the volunteering landscape for young people aged 16–25. A £58,000 donation from the Foundation will release matched funding from the Government for a number of volunteering projects, and offer a leading example of best business practice.

### 'Believe and achieve'

- The HBOS Foundation developed a bespoke programme similar to HRH The Prince of Wales Seeing is Believing Programme which invites senior business leaders from companies across the UK to see for themselves how business can play a role tackling some of Britain's most pressing social issues in some of the UK's most deprived areas.

## What do our stakeholders think?

- **Percentage of colleagues who speak highly about the way HBOS supports colleague volunteering – 71% (67% 2005, 50% 2004).**

# Management

## Responsible business

**Managing corporate responsibility** Our programme is supported by a comprehensive governance framework to ensure we manage our responsibilities effectively.

**Stakeholder dialogue** We ensure we respond to the people who are important to us – something we have done for years.

# Managing corporate responsibility

Our continued commercial success is dependent on constantly managing our issues, responsibilities and reputation effectively.

## Our strategy

HBOS has a strong framework of governance supporting decision-making. The governance framework integrating environmental, social and reputational considerations, including the impact on all our stakeholders, into our decision-making. Good governance helps ensure stakeholders have confidence that HBOS has processes in place to ensure the business is properly managed.

## What this means in practice

### Corporate governance

Good corporate governance enhances our ability to perform well. It provides an effective framework for determining how authority and accountability exist throughout the organisation and sets an effective context for our interaction with key stakeholders. Detail of the Group's governance arrangements, including the composition of the Board and internal controls, are set out on pages 90–122 of the Annual Report and Accounts 2006, available at the following link: [http://www.hbosplc.com/investors/includes/HBOSplc\\_ARA\\_2006.pdf](http://www.hbosplc.com/investors/includes/HBOSplc_ARA_2006.pdf)

The remainder of this section sets out how Corporate Responsibility governance fits into our overall governance framework.

## Our CR governance

Ultimate responsibility for Corporate Responsibility lies with the Board. Each member has responsibility for the Way We Do Business and for implementing Group CR policies. Day to day management is carried out on the Board's behalf by a number of specialist committees and by the Group's Corporate Responsibility team, which reports through the Director of Communications, Shane O'Riordain, directly to Chief Executive Andy Hornby.

Once a year, the Board as a whole reviews the Way We Do Business Strategy and KPIs, the HBOS Environment Strategy and the HBOS Community Strategy.

### Specialist CR committees and groups

The Board directs strategy for specific issues and implementation to committees and teams across HBOS.

### Way We Do Business (WWDB) Action Group

Established in 2006 to drive the Corporate Responsibility agenda across the Group, the WWDB Action Group is chaired by Finance Director Phil Hodkinson, and co-ordinates actions and initiatives required to embody the WWDB statement. An executive from each division and key central functions sits on the Group to ensure timely and high quality delivery of the CR agenda.

### Financial Inclusion Committee

Chaired by Benny Higgins, Chief Executive of Retail the Financial Inclusion Committee focuses on products and initiatives designed to increase financial inclusion. Currently focusing especially on our heartlands on Yorkshire and Scotland, the Committee is an important driver of our overall strategy.

### Climate Change Group

Newly established and chaired by Finance Director Phil Hodkinson, the Climate Change Group is comprised of senior leaders from across HBOS's divisions. Formed to develop products and services to meet the growing consumer demand for 'green' products, the Climate Change Group acts as a central coordination point for HBOS's response to Climate Change.

### HBOS Communications Group

Also chaired by Andy Hornby, the HBOS Communications Group is primarily responsible for reviewing strategies to improve the standing of the Group's brands. It sets standards on marketing and product development and addresses communications issues arising from the Group's activities.

### Diversity Leadership Group

The Diversity Leadership Group drives HBOS' Equality and Diversity strategy. Chaired by Andy Hornby, the Leadership Group acts as a central coordination body for HBOS' approach to diversity.

### CR responsibilities and teams

Most of our Corporate Responsibility activity takes place in the business itself – through our lending decisions or the management of our property estate.

A small Corporate Responsibility team co-ordinates the Group's activity, facilitating committees and supporting the Board in the development and implementation of new strategy. The Corporate Responsibility team reports to General Manager, Communications Shane O'Riordain, who reports directly to Andy Hornby, HBOS Chief Executive.

HBOS's Corporate Division has its own CR Director, reporting to Chief Executive of Corporate Peter Cummings. Functional Teams also have CR Managers, for example, Group Services has a functional head of CR and Colleague Engagement.

### **Policies and procedures**

HBOS has a set of detailed policies and procedures supporting the Way We Do Business. Reviewed annually, these Group policies set out our minimum requirements for the integration of Corporate Responsibility principles into our business-as-usual activities. In 2006, we revised our Human Rights Policy so that it now incorporates the International Labour Organisation's Declaration of Principles and Rights at work, as well as the UN declaration of Human Rights.

### **Clear and regular reporting**

Following the introduction of the Companies Act 2006, HBOS has reviewed its annual reporting to bring it in line with the Act. Featuring more detailed narrative reporting than ever before, including on Corporate Responsibility, the Annual Report sets out clearly the strategy of each of our five divisions and provides Key Performance Indicators for each.

Key Performance Indicators supporting the Way We Do Business can be found on page 46.

### **An external verification process**

Reviews are carried out of HBOS's activity and reporting by bodies such as external auditors, diversity specialists, health and safety strategic partners, community investment specialists and HBOS Foundation Trustees. Our Corporate Responsibility programme is reviewed annually by independent consultants and an independent assurance is carried out on this annual CR report. Corporate Responsibility performance is reviewed against peers through a wide range of benchmarking reviews, including Dow Jones Sustainability Index, FTSE4Good and Business in the Community. PricewaterhouseCoopers has conducted a comprehensive review of environmental and social risk management processes to ensure management systems fully support our adoption of the Equator Principles.

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### **Where can we do better?**

- **Expand environmental data capture to include non-UK businesses.**

# Stakeholder dialogue

Stakeholder dialogue is another way of saying that we respond to the people who are important to us – something HBOS has done for years.

## Our strategy

Our approach is aligned with the AA1000 Assurance Standard: completeness, materiality and responsiveness.

## Who do we engage with?

We have identified our stakeholders by assessing who is impacted significantly by the business or who might impact on it. We respond to the feedback. Our main stakeholders include:

### Key stakeholders:

- **Shareholders** Over 2.2m shareholders.
- **Customers** 23 million customers; 80% of our private shareholders are also HBOS customers.
- **Colleagues** 74,000 Group-wide.
- **Suppliers** Around 21,500 suppliers.
- **Society and environment** Consumer groups, NGOs, politicians and regulators.

Since last year, 25% of each colleague's bonus has depended on personal performance, measured against the HBOS leadership framework. This includes stakeholder dialogue.

### Dialogue with shareholders

Our dedicated Shareholder Services and Investor Relations teams are responsible for dialogue with private and institutional shareholders.

In 2006 Investor Relations held 528 meetings with analysts and institutional investors.

The Investor Relations team has primary, day-to-day responsibility for managing communications with institutional shareholders through a combination of briefings to analysts and institutional shareholders (both at the interim and year end results and throughout the year), site visits and individual discussions between institutional shareholders and Board members and key senior executives. Regular dialogue with shareholders helps to ensure that our strategy is understood and that any queries or other issues are addressed in a constructive way.

Having pioneered online voting for shareholders in 2002, HBOS has seen the number of shareholders using this facility grow year on year – to 6,280 in 2006, up from 5,685 in 2005. We will be actively promoting online voting in mailings for our 2007 Annual General Meeting and will donate £1 to the HBOS Foundation for every online vote received.

Last year, HBOS Head of Corporate Responsibility presented our CR strategy to investors attending Citygroup's 2006 Best of British Conference. Small workshops were used to enable detailed dialogue.

### Dialogue with customers

Understanding our customer opinion is one of the most important elements of our dialogue.

We undertake regular (monthly and quarterly) detailed customer research on service and products to ensure high standards are maintained as well as ad hoc research in response to particular business needs or specific customer needs.

In addition to direct customer contact we engage with stakeholder groups representing specific customer groups or specific customer issues. Regular meetings were held in 2006 with consumer groups in the UK and Brussels including Which?, Citizens Advice, National Consumer Council and FIN-USE. The Group's consumer engagement programme culminated in a week of events to promote National Consumer Week (20-25 November).

Our Customer Contract includes an annual product review to ensure we are meeting needs.

### Dialogue with colleagues

Regular dialogue with colleagues is encouraged through monthly and annual colleague opinion surveys, online 'Ask Andy Hornby' sessions, roadshows, and intranet sites.

Our internal communications channels include one-way communications, such as frequent HBOS Today newsletters and intranet communications, central feedback channels coordinated by Group Communications and multi-lateral discussions with business leaders – both in person at roadshows and regular intranet discussions.

## Completeness

Ensuring that we have clearly identified who our stakeholders are and fully understand their views and concerns

## Materiality

Assessing the relative importance of the issues in determining the content of our CR Report

## Responsiveness

How we respond to challenges and concerns



To benchmark ourselves against other high-performing organisations and obtain honest feedback MORI conducts monthly and annual Colleague Opinion Surveys. These surveys allow attitudes and trends to be identified in teams as few as 25 people, but individual responses cannot be identified to help ensure honest feedback. The results are published and plans drawn up for improvement.

We have good relationships with the finance sector trade unions, Unite and ACCORD, and we support colleagues' right to join for all UK colleagues in levels 1-5. We believe around half our UK colleagues are union members. We regularly engage with both unions to ensure they are able to contribute to our strategy and ensure we consult with them when making decisions that might affect large numbers of colleagues, such as pay, reward, pensions and job evaluations.

**Dialogue with consumer groups, government and regulators**

We maintain a regular and open dialogue with the FSA and Financial Ombudsman Service to ensure we are fully aware of, and involved in, the latest consumer and regulatory issues.

Contact with consumer advocates helps to improve the service we provide to our customers. It can give us new perspectives on how we operate, complementing direct feedback from our customers and market research. We frequently engage in dialogue with such groups.

**Assessing the issues**

The assessment process and prioritising our efforts and resources requires judgement. We evaluate issues against the following criteria:

- Key points raised by our stakeholders.
- How directly an issue affects our core business.
- Financial impact.
- Reputational impact.

**Key issues raised by stakeholders during 2006**

- Financial inclusion.
- Dialogue with consumer representatives.
- Collapse of Farepak Food & Drinks Ltd.
- Climate change.

**How do we respond?**

Below are some case studies showing how HBOS responded to issues our stakeholders raised during 2006.

**Financial inclusion**

In 2006, the Treasury Select Committee (TSC) began an investigation into financial inclusion. Its conclusions were published in January 2007.

We submitted written evidence to the Committee and James Crosby, then Chief Executive of HBOS, also gave oral evidence.

The inquiry explored issues ranging from our contribution to reducing the number of un-banked people, free access to cash through ATMs and other outlets and whether our branch practices are consistent with what we claim them to be.

Subsequently, HBOS published its first annual Financial Inclusion Report, which addresses all key elements of the TSC's recommendations. It provides a comprehensive breakdown of data and it sets out a clear agenda for 2007.

**Working with consumer representatives**

If a customer is experiencing financial difficulty, they sometimes prefer to nominate a consumer representative to help resolve the situation. Following dialogue with a large consumer group, we have made our guidance clearer, so that this process works as smoothly as possible.

Our guidance now includes direct contact details for named HBOS colleagues, whom consumer advocates can contact, if they need help in resolving individual cases.

**6,280**

**shareholders made use of online voting in 2006 (5,685 in 2005)**

## Climate change

Climate change is an issue which we have been managing for years, but on which many stakeholders have indicated they would appreciate greater transparency.

Providing clearer information to colleagues about how we are managing our environmental impact almost doubled our colleague opinion score from 24% to 46%. We want to do better.

In early 2007, the HBOS Climate Change Strategy presented to the Board and Executive Committee, set out our 2006 performance, plans for 2007 and a more robust communication strategy than ever before.

Our strategy was publicly launched in March nationally, as well as in our Yorkshire and Scottish heartlands. Stakeholders were written to. For a full week, Groupnet was dedicated to Climate Change and how HBOS is addressing it. Over 400 colleagues responded to the campaign with questions and ideas.

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## What do our stakeholders think?

**“This House...congratulates Halifax Bank of Scotland (HBOS) for pledging to install up to a further 100 new fee-free ATMs in areas without easy access to fee-free ATMs across the North of England and Scotland”**

Early Day Motion tabled by Jim McGovern MP

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## Where can we do better?

- **Launch communications campaign to improve dialogue with colleagues on environmental issues.**
- **Increase engagement with suppliers through supplier workshops.**

## Key performance indicators

Way We Do Business Principle	Key performance indicator	Definition and unit of measurement	2003	2004	2005	2006
<b>Shareholders</b>						
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%	19.60%	19.60%	20.80%
	Performance of shares versus sector (based on total shareholder return)	% by which the HBOS total shareholder return (TSR) exceeded the weighted average of the comparator group over the performance period	13.45%	22.93%	22.80%	14.21%
We will communicate with shareholders regularly and in doing so will seek to be clear, comprehensive and balanced.	Total number of contacts with investors	Number of meetings held by Investor Relations in 2006	231	311	323	528
<b>Customers</b>						
We will be honest, fair, professional and open in our dealings with our customers and endeavour to help them at all times.	Customer satisfaction	Proportion of customers who were 'delighted' or 'completely satisfied' with service from HBOS	53%	53%	53%	59%
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.	Independent research on best buys	Number of times an HBOS product was featured in best buy tables	784	1,666	2,671	3,317
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 satisfied with HBOS as identified in 'Service Tracker' research	N/A for HBOS	39%	40%	40%
<b>Colleagues</b>						
We will create a safe working environment which encourages openness, honesty and mutual respect, and where colleagues can constructively challenge and ask questions.	% colleagues agreeing people are open and honest with each other	% HBOS overall that agree in Colleague Opinion Survey	48%	52%	49%	57%
	% colleagues agreeing it is safe to speak up and challenge the way things are done	% HBOS overall that agree in Colleague Opinion Survey	56%	59%	56%	63%
We will offer equal opportunities for all.	% colleagues satisfied that HBOS is committed to improving equal opportunities and diversity throughout the business		–	–	35%	74%
	% colleagues satisfied that HBOS treats colleagues with dignity and respect		–	–	57%	69%
	Colleague satisfaction with total reward and benefits	% HBOS overall that agree in Colleague Opinion Survey	54%	59%	58%	64%
	% colleagues agreeing good performance is fairly rewarded	% HBOS overall that agree in Colleague Opinion Survey	49%	51%	49%	58%
We will provide the opportunity for all colleagues to develop their skills and knowledge, and to enjoy fulfilling careers.	% colleagues satisfied with opportunities to learn	% HBOS overall satisfied in the Colleague Opinion Survey	51%	53%	56%	65%
	% colleagues satisfied with coaching and development received from line manager	% HBOS overall always/usually applies in the Colleague Opinion Survey	58%	61%	63%	67%
<b>Suppliers</b>						
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.	Trade creditors outstanding	Days of purchases represented by trade creditors by the Company's main trading subsidiary undertakings, Halifax plc and Bank of Scotland plc at the end of the financial year	22	15	13	18

Way We Do Business Principle	Key performance indicator	Definition and unit of measurement	2003	2004	2005	2006
<b>Society</b>						
Our main contribution to Society is the value we can add through our success in business.	Taxation paid	On profit on ordinary activities (£m)	1,091	1,272	1,546	1,772
	Dividends paid	Underlying profit attributable to ordinary shareholders based on IFRS (£m)	–	3,118	3,230	3,879
	Annual community spend	HBOS plus HBOS Foundation investment in communities, charities and the sports and arts, (£m)	£19.59	£36.30	£43.14	£44.16
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.	Total UK greenhouse gas emissions	<ul style="list-style-type: none"> <li>tonnes CO<sub>2</sub> tonnes</li> <li>tonnes CO<sub>2</sub>/m<sup>2</sup></li> <li>tonnes CO<sub>2</sub>/FTE</li> </ul>	167,100 0.185 2.94	162,956 0.179 2.73	66,811 0.077 1.14	56,743 0.065 0.95
	Waste	<ul style="list-style-type: none"> <li>total waste (tonnes)</li> <li>% general office waste recycled</li> <li>waste per FTE (kg/FTE)</li> </ul>	13,274 45.43 234	14,127 48.78 237	13,861 44.17 236	32,325* 47.50 539*
	Business travel	<ul style="list-style-type: none"> <li>car tonnes CO<sub>2</sub>/FTE</li> <li>train tonnes CO<sub>2</sub>/FTE</li> <li>air tonnes CO<sub>2</sub>/FTE</li> <li>all travel tonnes CO<sub>2</sub>/FTE</li> </ul>	0.465 0.004 0.088 0.510	0.177 0.006 0.122 0.267	0.239 0.005 0.101 0.344	0.265 0.11 0.227 0.502
	Number of companies Insight Investment engages with per year on corporate governance and corporate responsibility		–	–	–	228
	Annual Financial Inclusion Report		N/A	N/A	N/A	Planned for 2007
We will observe the laws and regulations of all countries in which we operate, not just in the letter but in the spirit. We will not countenance bribery, corruption or the concealment of conflicts of interest.	Regulatory fines or reprimands	Number of fines and reprimands	Fines: 2 Reprimands: 1	Fines: 4	0	0
<b>Customers</b>						
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 Million £ Challenge and matched funding (£m)	£2.75	£3.50	£3.97	£4.62
	% colleagues who speak highly about the way that HBOS supports volunteering opportunities for colleagues		N/A	50%	67%	71%
We will measure our progress against this statement and report this regularly to shareholders, customers, colleagues and suppliers.	Presence of HBOS in corporate responsibility indices	• Dow Jones	Yes	Yes	Yes	Yes
		• FTSE4Good	Yes	Yes	Yes	Yes
		• BITC CR Index	Yes	Yes	Yes	Yes
Wherever possible, we will independently benchmark or verify that WWDB continues to meet stakeholder expectations.	Annual independent verification of CR activity, including stakeholder review		Yes	Yes	Yes	Yes

\* Increase due to improved data capture.

# Where can we do better?

## Our strategy

- In 2007 we will introduce a new comprehensive set of targets for reducing resource use.

## Growing our market share

- We will introduce green products to help customers manage their environmental impact, including a Green Mortgage in the second half of 2008. Work will start on this during 2007.
- During 2007 facilities will be introduced to allow customers in England, Wales and Northern Ireland to call their local branch to match the facilities now available in Scotland.
- We will provide more help for people in rural communities by launching a new mobile branch service in Aberdeenshire to provide banking services to almost 20 local communities.

## Responsible lending

- Develop and grow the Money Management Unit to increase the number of customers it can help.
- Report the number of projects reviewed according to the Equator Principles and expand Equator Principles training to heads of business and European operations.
- Increase our provision of clear, easy to understand information on our products and expand our work on financial capability.

## Financial inclusion

- We will maintain and build upon our position as the biggest provider of social banking accounts in the UK – aiming to grow our share of new accounts to 15% in 2007.
- We will develop and implement a Group-wide approach to credit unions and the micro-credit sector.
- We will lead on disclosure through our annual financial inclusion report.

## Investor responsibility

- Deepen investment research with a particular emphasis on analysing large UK and European companies' management of climate change-related risks.
- Strengthen engagement with a focus on encouraging companies to achieve and maintain high standards of corporate governance and corporate responsibility.
- Promote increased disclosure on environmental, social and governance risk and stronger goals in collaborative initiatives.

### Our colleagues

- Launch the Disability Confident tool across the HBOS Group in support of our ongoing disability strategy.
- Conduct a major review in 2007 of how we can extend the reach of flexible working opportunities within the business.
- Improve colleague advocacy of HBOS's environmental management strategy.

### Environment

- Offset UK emissions through Certified Emissions Reductions delivered in developing countries.
- Roll out Green Miles across the UK.
- Be the first bank to rate the energy efficiency of all HBOS buildings on a scale of A–G and display a rating, just like the stickers on new fridges and washing machines.
- Launch a Green Mortgage during 2008.
- Implement new recycling facilities for all waste paper across our entire branch network, to supplement facilities already in place in our offices and call centres.

### Community

- *University access*

In 2007 the HBOS Foundation and educational charity the Sutton Trust will launch a £1 million initiative to help over 350 16–18 year olds from non-privileged backgrounds across Yorkshire realise their potential and gain a place at a top university.

- *Partnership with the Russell Commission*

The Russell Commission launched their new charity, 'V' in May 2006, aiming to transform the volunteering landscape for young people aged 16–25. A £58,000 donation from the Foundation will release matched funding from the Government for a number of volunteering projects, and offer a leading example of best business practice.

### Managing corporate responsibility

- Expand environmental data capture to include non-UK businesses.

### Stakeholder dialogue

- Launch communications campaign to improve dialogue with colleagues on environmental issues.
- Increase engagement with suppliers through supplier workshops.

# External assurance

## External assurance statement

We have been asked to conduct independent external assurance and commentary of the HBOS 2006 Corporate Responsibility Report. The aim of this statement is to provide assurance to stakeholders that the information provided by HBOS in their Corporate Responsibility Report is appropriate to the nature and activities of HBOS business operations as well as accurate, reliable, objective and has been validated by an independent third party.

## Responsibility of WSP

WSP's obligation is to stakeholders and readers of this statement. WSP is responsible exclusively for the contents of this statement and providing assurance over the Report. WSP has not been involved in the development of the HBOS Corporate Responsibility strategy or preparation of any of the material included in the Corporate Responsibility Report.

## Scope of our assurance

The scope was determined after discussion with HBOS and is an assessment of whether information reported in the 2006 Report was supported by underlying objective evidence. In addition, WSP undertook a desk based review of the scope and final content of the report for materiality, completeness and responsiveness to stakeholder concerns. HBOS provided access to records and data required to undertake a comprehensive assurance process and WSP is confident that no material information has been withheld.

Excluded from our work are activities outside the reporting period unless stated in the Report, statements of commitment or intention, statements of opinion, belief or aspiration and information on the HBOS Group website which supports this report. In addition to this statement an internal report was produced for HBOS. This provides further details of the findings of our review summarised in this statement.

## Opinion of the verifier – WSP

We are satisfied that HBOS's 2006 Corporate Responsibility Report provides a fair and balanced representation of the corporate responsibility progress that HBOS has made during the period 1 January to 31 December 2006 and that there are processes in place for identifying, managing and understanding corporate responsibility issues.

## Commentary – key highlights

This report, the fifth HBOS Corporate Responsibility Report, demonstrates continuing progress for HBOS. This report identifies that delivering value to customers, responsible lending, financial inclusion and managing their impact on the climate are the key corporate responsibility issues. HBOS continues to recognise the importance of addressing stakeholder concerns and this has been demonstrated through the annual colleague opinion survey and the subsequent availability of the results. The transparent coverage of the collapse of Farepak, the lessons learnt from this matter and the future way forward illustrates an open approach regarding the management of a difficult matter. In addition, the report identifies that HBOS are committed to managing the risks posed by climate change which has been proven by a reduction of carbon emissions produced by the business in 2006 over the last two years.

## Areas for ongoing improvement

Through our work, we offer the following suggestions to HBOS in improving their corporate responsibility performance:

HBOS have reviewed Key Performance Indicators (KPIs) and this process should be repeated to ensure that their KPIs continue to reflect the changing priorities of corporate responsibility issues, stakeholder concerns and business needs.

HBOS make significant resources available to compile their external reporting and to ensure that all relevant issues are addressed. We recommend that HBOS review their approach to identify opportunities to streamline their processes.

Emma Griffiths  
Associate  
July 2007

Reviewed by  
David Symons  
Director



**WSP's global corporate services team supports clients in managing and improving their Corporate Responsibility performance including environmental, social and ethical issues. We work with clients across the industrial, commercial and**

**public sectors, including leading FTSE 100 and Fortune 500 companies as well as innovative small-medium size enterprises. Our global team comprises industry practitioners, consultants and practical specialists working in WSP's offices across the world. Many staff are registered with the Institute of Environmental Management and Assessment (IEMA) as qualified auditors.**



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