Building our business

Annual Report and Accounts 2005

Forward looking statements

This annual report includes certain forward looking statements with respect to the business, strategy and plans of Lloyds TSB Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds TSB Group's or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future.

Examples of such forward looking statements include, but are not limited to, projections or expectations of profit attributable to shareholders, provisions, economic profit, dividends, capital structure or any other financial items or ratios; statements of plans, objectives or goals of Lloyds TSB Group or its management; statements about the future trends in interest rates, stock market levels and demographic trends and any impact on Lloyds TSB Group; statements concerning any future UK or other economic environment or performance including in particular any such statements included in this annual report; statements about strategic goals, competition, regulation, dispositions and consolidation or technological developments in the financial services industry and statements of assumptions underlying such statements.

Factors that could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by Lloyds TSB Group or on Lloyds TSB Group's behalf include, but are not limited to, general economic conditions in the UK and internationally; inflation, interest rate, exchange rate, market and monetary fluctuations; changing demographic developments, adverse weather and similar contingencies outside the Lloyds TSB Group's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; changes in laws, regulations or taxation; changes in competition and pricing environments; the ability to secure new customers and develop more business from existing customers; the ability to achieve value-creating mergers and/or acquisitions at the appropriate time and prices and the success of the Lloyds TSB Group in managing the risks of the foregoing.

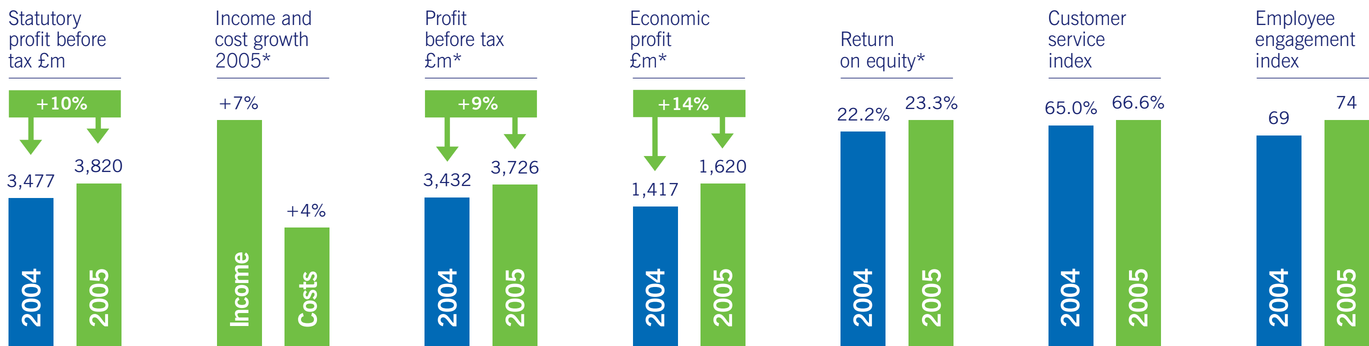
Lloyds TSB Group plc may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the Securities and Exchange Commission ('SEC'), Lloyds TSB Group plc's annual review, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds TSB Group plc to third parties, including financial analysts. The forward looking statements contained in this annual report are made as of the date hereof, and Lloyds TSB Group undertakes no obligation to update any of its forward looking statements.

Contents

Forward looking statements	
2005 highlights	3
Chairman's statement	4
Group chief executive's review	7
Corporate responsibility	10
The businesses of Lloyds TSB	12
Operating and financial review and prospects	14
Five year financial summary	39
The board	40
Directors' report	42
Corporate governance	43
Directors' remuneration report	46
Report of the independent auditors on the consolidated financial statements	58
Primary consolidated financial statements	59
Notes to the group accounts	64
Report of the independent auditors on the parent company financial statements	121
Parent company primary financial statements	122
Notes to the parent company accounts	125
Information for shareholders	129

We are building our business by…

Deepening customer relationships
Improving customer service
Improving processing efficiency
Delivering earnings momentum



* Comparable basis – excluding impact of volatility, other IFRS adjustments applied from 1 January 2005 and discontinued operations. Also excludes provisions for customer redress and the strengthening of reserves for mortality.

2005 highlights

Results – statutory

Profit before tax increased by £343 million, or 10 per cent, to £3,820 million.

Profit attributable to equity shareholders increased by £101 million, or 4 per cent, to £2,493 million.

Earnings per share increased by 4 per cent to 44.6p.

Post-tax return on average shareholders' equity increased to 25.6 per cent, from 22.8 per cent.

Total capital ratio 10.9 per cent, tier 1 capital ratio 7.9 per cent.

Dividend maintained. Final dividend of 23.5p per share, making a total of 34.2p for the year (2004: 34.2p). Dividend cover increased to 1.3 times.

Results – comparable basis

Profit before tax increased by £146 million, or 4 per cent, to £3,466 million.

Excluding customer redress provisions and the strengthening of reserves for mortality

Profit before tax increased by £294 million, or 9 per cent, to £3,726 million.

Income growth of 7 per cent exceeded cost growth of 4 per cent.

Earnings per share increased by 11 per cent to 47.2p.

Economic profit increased by 14 per cent to £1,620 million.

Post-tax return on average shareholders' equity increased to 23.3 per cent, from 22.2 per cent.

Profit before tax

By division

	2005 £ million	2004 £ million
UK Retail Banking		
– Before provisions for customer redress	**1,681**	1,739
– Provisions for customer redress	**(150)**	(100)
	1,531	1,639
Insurance and Investments		
– Before provisions for customer redress and strengthening of reserves for mortality	**908**	790
– Provisions for customer redress	**–**	(12)
– Strengthening of reserves for mortality	**(110)**	–
	798	778
Wholesale and International Banking	**1,504**	1,253
Central group items	**(367)**	(350)
Profit before tax – comparable basis	**3,466**	3,320
Volatility*	**625**	138
Other IFRS adjustments applied from 1 January 2005**		
– Before strengthening of reserves for mortality	**(276)**	–
– Strengthening of reserves for mortality	**(45)**	–
	(321)	–
Profit (loss) on sale and closure of businesses†	**50**	(21)
Trading results of discontinued operations in 2004††	**–**	40
Profit before tax	**3,820**	3,477
Earnings per share	**44.6p**	42.8p

* Volatility relates to Insurance and Investments (2005: £749 million, 2004: £138 million) and Central group items (2005: £(124) million, 2004: nil).

** Other IFRS adjustments applied from 1 January 2005 relate to UK Retail Banking (£(213) million), Insurance and Investments (£(73) million), Wholesale and International Banking (£20 million) and Central group items (£(55) million).

† Profit (loss) on sale and closure of businesses relates to UK Retail Banking (2005: £76 million, 2004: nil), Wholesale and International Banking (2005: £(6) million, 2004: £(21) million) and Central group items (2005: £(20) million, 2004: nil).

†† Trading results of discontinued operations in 2004 relates to Wholesale and International Banking.

Presentation of information

Up to 31 December 2004 the Group prepared its financial statements in accordance with UK Generally Accepted Accounting Principles (UK GAAP). With effect from 1 January 2005 the Group implemented International Financial Reporting Standards (IFRS). In this document the 2004 comparative financial information has been restated to reflect the adoption of those IFRS standards which are required to be applied retrospectively, but does not include the additional impacts arising from first time application of IAS 32 'Financial Instruments: Disclosure and Presentation', IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 4 'Insurance Contracts' (including UK Financial Reporting Standard 27 'Life Assurance'), which have been implemented with effect from 1 January 2005, with the opening balance sheet at that date adjusted accordingly. Further information on the impact of implementing IFRS on comparative information was published in the Group's 'Transition to IFRS' announcement on 27 May 2005.

The impact of IFRS, and in particular the increased use of fair values, has resulted in greater earnings volatility. In order to provide a more comparable representation of business performance this volatility has been separately analysed for the Group's insurance and banking businesses. In addition, other IFRS related adjustments applied with effect from 1 January 2005, for which comparatives are not required to be restated, the profit (loss) on sale and closure of businesses and the impact on the Group's results of businesses sold in 2004 have been separately analysed in the Group's results. A reconciliation of this 'comparable' basis of presentation to the statutory profit before tax is shown on this page.

Chairman's statement

2005 was a successful year for the Lloyds TSB Group, as we continue to build our business and deliver good earnings momentum. Each division has again delivered revenue growth in excess of cost growth, costs have remained firmly under control and overall credit quality has remained satisfactory. Above all the Group has made substantial progress in the execution of its organic growth strategy focused on improving and deepening relationships with our personal and business customers.

Over the last two years the changes that have been introduced by the Group's new management team have addressed the significant external challenges of competition and regulation and have substantially improved the outlook for the Group. There is plenty of scope for organic growth in our chosen markets and our aim is to attract more of the business that our customers have with other financial services companies. We want to be the most successful company in the UK financial services industry.

I am proud of what this Group has achieved in a very short space of time; wherever I go in the business we are making substantial progress.

In Retail Banking we are clearly focused on ensuring that we earn the right to meet 100 per cent of our customers' financial services needs. Customer satisfaction standards continue to improve and are at a higher level than at any time in recent years. This reflects several years of hard work during which all staff have focused their full attention on providing high levels of service to our customers.

In Insurance and Investments we are, after a number of challenging years, starting to make significant progress in distributing bancassurance products through the branch network, as well as building on our existing strength through independent financial advisers. We have achieved higher levels of new business profitability and have improved our market share of new business.

In Wholesale and International Banking we have streamlined our international portfolio of businesses to focus on leveraging our strong customer relationships with business and corporate customers. As a result we have delivered excellent levels of profit growth and made great progress in delivering our strategy to build an integrated wholesale bank.

Whilst we have made considerable progress, we are not resting on our laurels. We know we have to continue to produce good levels of earnings growth and strong results. Going forward, the main thrust of our strategy will be continuing to invest in our businesses to deliver revenue growth through gaining new customers, deepening our relationship with customers, and leveraging the strength of our brands and our multi-channel distribution capability, whilst at the same time continuing to improve the products and services that we offer to our customers. In addition we will further improve our processing efficiency and seek to reduce day-to-day operating costs.

By focusing on this clearly articulated strategy I believe the Group can continue to deliver a strong return on equity together with good levels of economic profit growth. Over the last few years we have substantially improved the quality of the Group's earnings and have re-established satisfactory levels of earnings growth. As a result, during 2005 we delivered a total shareholder return (share price appreciation plus dividends) of 10.9 per cent.

Economic outlook

Whilst the economic outlook for the UK remains dependent on events that unfold in the global economy, we expect economic growth to increase slightly in 2006 to just over 2 per cent. Interest rate changes are expected to remain modest. Consumer spending, which was the major factor behind the economic slowdown in the UK in 2005, is showing some signs of recovery, although we expect only a modest recovery during 2006. The mortgage market should remain reasonably healthy, although personal borrowers are expected to continue to cut back on unsecured borrowing.

The regulatory burden upon the UK financial services industry continues to be a major concern. The adoption of International Financial Reporting Standards, compliance with Sarbanes-Oxley and preparations for the introduction of the Basel capital adequacy regime have all been time consuming and expensive. We welcome signs that notice is at last being taken of the extent of this regulatory burden. We shall, however, wait to see whether de-regulation initiatives, announced by both the UK Government and the European Commission, have any material impact upon the significant burden faced by the industry. The UK financial services industry is one of the great success stories of the last 20 years and great care must be taken to ensure that the conditions remain in place for this success story to continue.

Capital and dividend

During 2005 Lloyds TSB has continued to maintain robust capital ratios and remains one of the very few banks in the world with an 'Aaa' long-term debt rating from Moody's, the credit rating agency. In addition, Scottish Widows remains one of the strongest capitalised life assurance companies in the UK, and the repatriation of £1 billion of surplus capital from Scottish Widows to the Group during 2005 shows the significant improvements that have been made in the capital management of Scottish Widows over the last few years.

The board has decided to maintain the final dividend at 23.5p per share, making a total for the year of 34.2p (2004: 34.2p). This represents a yield of 7.0 per cent calculated using the 31 December 2005 share price of 488.5p.

Community

Lloyds TSB remains one of the UK's largest corporate givers, principally through the excellent work of the Lloyds TSB Foundations who made grants to charities of over £30 million in 2005.

Staff

The Lloyds TSB Group is all about people and in my five and a half years as chairman I have enjoyed meeting so many of them. Throughout our businesses, our employees are the Group's ambassadors – I am extremely proud of them all and am truly grateful for their continuing efforts, without which the Group could not have made such considerable recent progress. We are a service company and I am certain that improved levels of customer service will lead to improved sales performance.

Board changes

Since the 2005 annual general meeting, we have welcomed three directors to the board. Terri Dial was appointed as Group Executive Director, UK Retail Banking in June and Jan du Plessis and Lord Leitch joined us as independent non-executive directors in October.

As previously announced, I shall be retiring as chairman at the annual general meeting in May and I am delighted that Sir Victor Blank will be succeeding me. He will join the board in March as Deputy Chairman. The board carefully considered the provisions of the combined code on corporate governance when nominating Sir Victor as my successor.

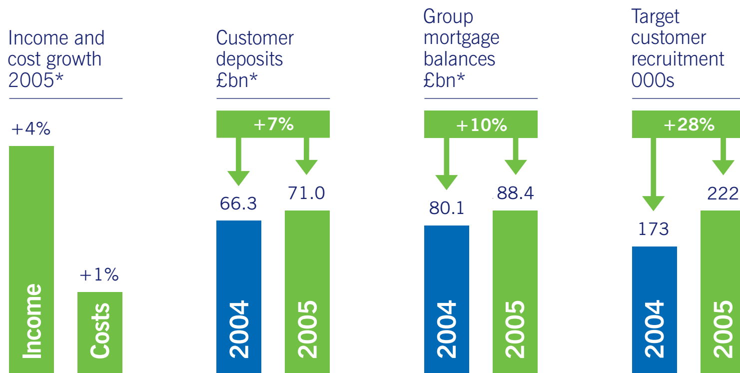
Outlook

We are making good progress in meeting our corporate objectives of achieving sustainable earnings growth, strong cost control, high levels of customer and staff satisfaction, satisfactory asset quality and balance sheet efficiency and strength. As the board looks to the future, the increasing momentum in our businesses, supported by new revenue growth and cost control initiatives, gives us confidence that Lloyds TSB can achieve its objective of being the leading financial services company in the UK.

I have thoroughly enjoyed my time in the banking industry. I know that Lloyds TSB is in great hands and I wish my colleagues all the very best for the future.

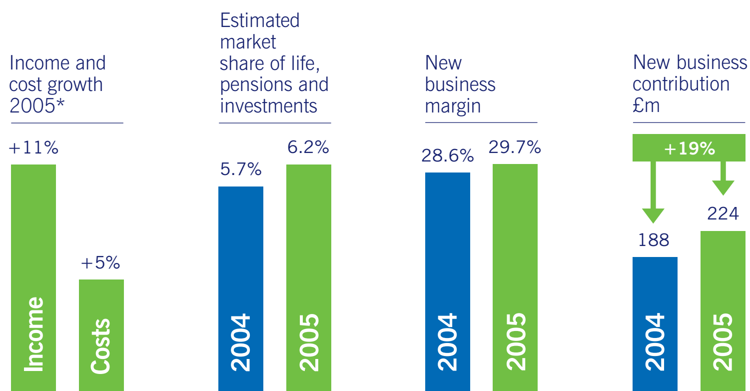
Maarten van den Bergh
Chairman
23 February 2006

In **Retail Banking** we will earn the right to meet 100% of our customers' financial services needs



* Comparable basis – excluding impact of volatility, other IFRS adjustments applied from 1 January 2005 and discontinued operations. Also excludes provisions for customer redress.

In **Insurance and Investments** our focus is on profitability and returns, combined with strong new business sales



* Comparable basis – excluding impact of volatility, other IFRS adjustments applied from 1 January 2005 and discontinued operations. Also excludes provisions for customer redress and the strengthening of reserves for mortality.

Group chief executive's review

2005 was a good year for the Group, both in terms of our financial performance and, as importantly, in making further progress in the development of our organic growth strategy.

On the financial side, we increased our already high return on equity and we delivered a total return of 10.9 per cent to our shareholders. We grew the trading surplus in each division as the rate of growth in income exceeded that of costs and we achieved good overall earnings growth in the face of a slower economic environment.

In terms of delivering the Group strategy, we have established better sales momentum and stronger levels of customer acquisition in our banking businesses and delivered good sales growth in our life assurance business over the course of the year. Our market shares are either stable, or growing, in most of our key product lines. Most importantly, our customer relationship programmes are being effectively implemented and we are delivering higher revenues per customer in our retail and corporate banking businesses.

We have significantly enhanced our productivity, as the quality programmes that we commenced in 2003 continue to show improving results. This is reflected in our cost:income ratio which, on a comparable basis and excluding customer redress provisions and the strengthening of reserves for mortality, improved to 52.7 per cent, from 54.3 per cent in 2004, and I am pleased that we have achieved this whilst continuing to invest substantially in the business. Our customer satisfaction scores hit record highs in 2005, again reflecting the improvement programmes established over the last couple of years, and we will continue to drive further improvements as we seek to differentiate our service performance against that of our competitors.

The risk environment remains satisfactory overall, although we have seen a deterioration in the unsecured consumer lending portfolios as a result of an increase in the number of customers facing repayment difficulties, which has been offset by a strong performance in the Corporate lending portfolios. Over time, we expect the consumer position to stabilise in an improving economy, and the trend in corporate impairments to move away from the unusually benign recent experience.

Our employee engagement scores have also improved significantly during the year, indicating that our people understand and are committed to our strategy, and we have improved our performance management processes in support of the Group strategy. We also strengthened our senior management team, with the addition of key hires in the Retail Bank.

Overall, I am pleased with the progress of the Group during 2005. We delivered on our financial plans and we also used the time to develop the franchise successfully in line with our growth strategy. We have continued to make good progress in each of the divisions, the highlights of which are summarised below.

In the *Retail Bank,* income grew 4 per cent whilst costs rose by just 1 per cent, on a comparable basis and excluding customer redress provisions. This led to 7 per cent growth in the trading surplus which was offset by an increase in the charge for impaired lending, reflecting an increase in customers experiencing repayment difficulties. Profit before tax reduced by 3 per cent. To reflect the general slowdown in the consumer credit markets, a number of actions were taken over the course of the year to tighten credit underwriting.

It is not in the interests of the individual customer or the Group to lend money to a customer who cannot afford to repay. The Group takes its responsibilities in this regard very seriously and has a responsible lending programme, to ensure we help our customers clearly understand the nature of the agreements they are entering into and we confirm affordability before agreeing to any borrowing requests. Where customers do experience repayment difficulties, our staff are trained to offer the necessary advice and support to manage their finances and we have a Customer Support Unit, whose role it is to identify customers who are showing early signs of financial difficulty so that we can provide early advice and support to them.

The Retail Bank is committed to achieving top performance in both effectiveness and efficiency. Effectiveness is the ability to recruit, develop and retain loyal customers who think of us first for their next financial services need. Efficiency is the ability to provide service and sales at a lower cost so that we can give our customers better value. We believe that in order to achieve our goal we must be customer rather than product centric.

We continue to focus our efforts on our existing customers where we have an information advantage that allows us to be more effective and efficient in providing sales and service that meet our customers' financial needs. We have also stepped up our new customer recruitment efforts, which has helped drive good target customer recruitment, particularly in the second half of the year, to give a 28 per cent increase over last year.

We have committed ourselves to earning the right to meet 100 per cent of our customers' financial services needs and helping them succeed financially. In 2005, we recorded our highest ever customer satisfaction scores across all our channels – branch, telephone and internet banking. The improvement in customer satisfaction and the renewed focus on meeting all our customers' financial services needs has helped to drive an improving sales performance during 2005, and has been accompanied by good balance growth in our key product lines with mortgages up 10 per cent, credit cards (excluding Goldfish) up 9 per cent and customer deposits 7 per cent higher. Sales through our internet and telephone channels grew strongly by 28 per cent and 39 per cent respectively.

In *Insurance and Investments*, profits showed significant growth, reflecting further success in delivering our strategies. Profit before tax, on a comparable basis and excluding the 2004 customer redress provision and the strengthening of reserves for mortality, increased by 15 per cent, underpinned by strong growth in both the bancassurance and IFA channels and continued control of costs. Profits grew strongly in both our life assurance and general insurance businesses.

Scottish Widows delivered a significant increase in sales as we focused on more profitable and more capital efficient business lines. This led to a 19 per cent increase in new business contribution. Bancassurance sales grew by 13 per cent despite a slowdown seen in the levels of mortgage related protection business. The sales of OEICs increased by 72 per cent, building on the launch of the simplified product suite that was introduced at the end of 2004.

IFA sales grew strongly with a 30 per cent improvement in weighted sales, underpinned by product and service improvements in pensions and investments. This improved performance led to an estimated market share of 6.8 per cent in 2005, compared to 5.9 per cent last year.

We have also invested in the development of new pensions and life platforms, and continue to develop our distribution capabilities. We remain well placed to benefit from the anticipated growth in savings and investment product sales over the coming years. The new life platform has already supported the launch of the new partnership with Virgin Money.

Scottish Widows remains strongly capitalised. In addition to the payment of a £200 million dividend to the Group in March 2005, Scottish Widows made a further £800 million distribution to the Group in December 2005 as part of our plans to improve capital efficiency. A second annual dividend will be paid in March 2006.

Our General Insurance business continued its successful development, delivering a 22 per cent growth in profits, supported by improvements to both the claims and combined ratios. The results reflect continued successful cross-sales to franchise customers in both retail and business banking as well as continued investment in our service performance, direct channel business and claims processing.

In *Wholesale and International Banking*, our results show excellent progress in our core businesses and the division delivered a 20 per cent improvement in profit before tax, on a comparable basis, at the same time as improving returns. The good results were achieved by the successful implementation of our strategies in Business Banking and Corporate Markets, and these businesses will continue to provide the platform for profitable growth in the division. We again maintained our management discipline of positive jaws, with the rate of growth in income increasing by 10 per cent whilst costs grew by 7 per cent, partly reflecting the increase in investment costs necessary to fund the ongoing development of the division.

In Business Banking, we have again reported strong franchise growth winning increasing numbers of new customers both through attracting profitable 'switchers' from other banks and by cementing our position as the leader in the business start-ups market with a share of 22 per cent. We have continued to build stronger relationships with our customers, as we satisfy more of their needs, and this has been reflected in good balance growth in both customer lending and deposits, as well as fee income.

Corporate Markets has delivered another strong performance with a 31 per cent improvement in profits supported by a 27 per cent growth in income from the cross-sale of products. The results reflect our strategy of managing these businesses in an integrated manner in support of our customers' success. We were pleased to receive external recognition of our efforts as we won a range of awards including the CBI Bank of the Year Award 2005. Across the businesses, our asset quality remains very strong with impairment losses declining year on year. We are continuing to invest within Corporate Markets, in terms of our relationship offers, our product range and our infrastructure, to ensure we can meet even more of our customers' needs in a highly competitive market.

Turning to 2006, our objective across each of the divisions is to continue to improve sales performance and deepen our customer relationships, which will result in market share growth. To support our efficiency and productivity objectives, we will continue to focus on the centralisation and industrialisation of our manufacturing capabilities, take the next steps in our procurement programme and further embed our quality approach throughout the Group.

In support of our customer objectives, we have set stretching customer satisfaction targets and will continue to develop our products, policies and procedures in line with those targets. Our strong risk and control infrastructure remains an important element of our growth strategy and will be further enhanced as we seek to develop risk into a differentiating competency. We will also continue to focus on the development of our staff, whilst aiming for even stronger engagement scores.

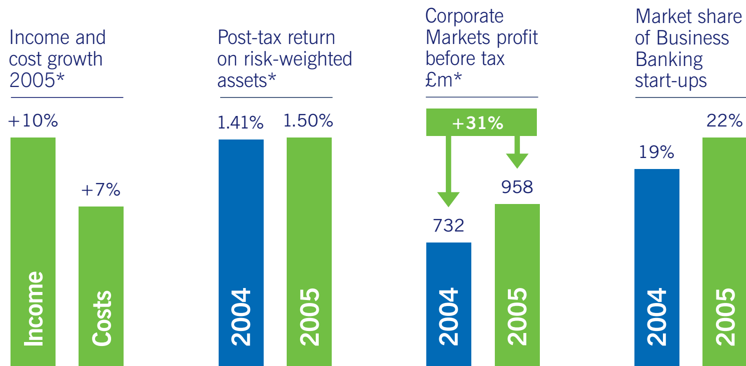
In summary, 2005 was a good year for the Group. We delivered on our short-term financial goals whilst also investing in the long-term health of the business, which is necessary to drive sustainable future earnings growth. This is our last set of results under the chairmanship of Maarten van den Bergh and I would like to take this opportunity to record my appreciation for his major contribution to the Group over the past five and a half years. We are delighted that Sir Victor Blank will succeed him and we look forward to welcoming him to the Group shortly.

Continuing to grow a successful business is the best way for Lloyds TSB to create value for all our stakeholders and to contribute to the wider economy. We maintain one of the largest community investment programmes in the UK, supporting our customers and staff, and making a significant contribution to the local communities in which we operate. Since 1997, the Lloyds TSB Foundations have received over £250 million from the Group's pre-tax profits to distribute to community groups and in 2006 they will receive in excess of £30 million.

Finally, I would like to express my continued thanks to all of the staff who work for the Lloyds TSB Group. They remain committed to serving the needs of our customers and their wonderful efforts are the key element to our continued success.

J Eric Daniels
Group Chief Executive
23 February 2006

In **Wholesale and International Banking** we are growing our earnings by deepening relationships with our customers



* Comparable basis – excluding impact of volatility, other IFRS adjustments applied from 1 January 2005 and discontinued operations.

Corporate responsibility

Our corporate vision is to make Lloyds TSB the best financial services company, firstly in the UK then across borders.

Our corporate responsibility strategy is to help achieve our corporate vision by building a great place for our people to work, a great place for our customers to do business, and generating great returns for our shareholders. In so doing, we believe we create value for all our stakeholders.

We have strong evidence that there is a clear link between employee satisfaction and customer satisfaction, which in turn leads to improved financial performance.

The business case for corporate responsibility is clear. Good management of corporate responsibility risks and opportunities is fundamental to delivering a successful business.

A great place for our people to work

We seek our employees' views on working for Lloyds TSB through our Engagement Index, a quarterly survey of all staff. We know from many years of monitoring staff views of the company that the six main factors influencing employee engagement are:

- providing staff with opportunities for training and development
- giving staff the flexibility and scope to use their abilities and initiative
- inspiring leadership from top management
- the extent to which staff believe Lloyds TSB is highly regarded
- creating a culture where people feel involved and understand how their work contributes to the Group's overall success
- the extent to which the Group is seen as being socially and environmentally responsible and ethical in its operations

Our employee engagement scores have reached record levels this year.

We have developed award-winning programmes in the areas of training and development, career management, work-life balance, diversity and community involvement.

A great place for our customers to do business

We are committed to deepening relationships with our customers by understanding and meeting their needs. We measure our customers' satisfaction with our service and track our progress through our 'CARE Index' which is based on information obtained from over 10,000 interviews with customers each month. The 'CARE Index' reached its highest ever level in 2005.

We also use 'mystery shopping' programmes to test the levels of service in our branches, via the telephone and on the internet. We use the Six Sigma process improvement approach to measure how well we meet our customers' requirements.

We have been at the forefront of developing financial services to help tackle the problems of financial exclusion; these include basic bank accounts, support for community credit unions and other community finance initiatives. We have opened 348,000 basic bank accounts for customers since 2003.

A great return for our shareholders

Through our corporate responsibility management system we identify social, ethical and environmental risks and opportunities. The comprehensive policies and processes for managing risks are described in detail on pages 24 to 34 of this report. We were one of the first UK banks to introduce an environmental risk assessment system for our corporate and business lending. This was described as a 'race leader' in an independent study into European banks' assessment of environmental risks.

Increasingly we are required to demonstrate our commitment to corporate responsibility to win business contracts. In turn, when awarding contracts to key suppliers we take account of their performance in areas of human rights, treatment of employees, treatment of their own customers and suppliers, the environment and the community. In demanding high ethical standards from our suppliers we recognise that our own employees must display the highest ethical standards themselves. We operate to a code of purchasing ethics to ensure fair treatment of suppliers.

By adopting these corporate responsibility policies we aim to provide a better return for our shareholders.

Balanced scorecard

Staff performance is measured using a balanced scorecard that takes account of the needs of customers, employees and shareholders. All staff have objectives which, in addition to financial performance measures, include building the business in the longer term, customer service, risk management and people development. Where relevant, management remuneration and incentives are linked directly to specific areas of corporate responsibility, such as service quality.

Corporate responsibility management

Our corporate responsibility steering group is chaired by the deputy group chief executive and comprises senior executives from all business divisions and relevant group functions. The committee meets quarterly to recommend strategy and provide direction. The board reviews overall corporate responsibility performance annually and individual issues are subject to board discussion throughout the year.

We have been developing a management framework for corporate responsibility that ensures we have:

- a clear and constant purpose, helping us to focus on the delivery of results;
- a focus on customers and how we can create value by better meeting their needs;
- a systematic application of processes and fact-based assessments to manage our business and to make our strategic decisions;
- the ability to identify what we need to do to develop our people and maximise their potential;
- the scope to derive value from meeting our responsibilities to the communities we serve.

We have adopted the European Foundation of Quality Management's Corporate Responsibility Framework. This helps us align corporate responsibility with business strategy, and also with individual balanced scorecard priorities. As part of the process we conduct an annual self-assessment of our performance with independent oversight and assurance. This allows us to identify strengths and areas for improvement and to prioritise actions and objectives. It also provides a benchmark against which we can compare our performance both internally and externally.

The board believes that the systems in place to manage significant social, ethical and environmental (SEE) risks are effective and provide adequate information to identify and assess the short and long-term risks arising from SEE matters. The board is also satisfied that relevant SEE risks have been assessed during 2005 and that they have been managed in compliance with relevant policies and procedures.

Creating value in the community

Continuing to grow a successful business is the best way for Lloyds TSB to create value for all its stakeholders and to contribute to the wider economy. We are a major employer with nearly 70,000 employees. In 2005, salaries, national insurance, pension contributions and other staff costs totalled over £2.8 billion. Over £1.2 billion was paid to governments in tax and £1.9 billion was distributed to shareholders in the form of dividends. When dividends are added to share price appreciation, we delivered a total return to our shareholders of 10.9 per cent in 2005 and 15.1 per cent in 2004.

Corporate responsibility

Through one of the largest community investment programmes in the UK, we are able to make a significant contribution to the local communities in which we operate. The majority of Lloyds TSB's charitable giving is channelled through the four Lloyds TSB Foundations, which cover England and Wales, Scotland, Northern Ireland and the Channel Islands. Their mission is to improve the lives of people in local communities, especially those who are disadvantaged or disabled. During 2005, the Foundations distributed £31 million to community causes across the UK.

Community investment is not just about giving money to good causes. It is also about the substantial time given by our staff in supporting the work of community organisations, whether raising money, providing business expertise or simply providing another willing pair of hands. One of our biggest group wide activities is our Charity of the Year fundraising. In 2005 our staff chose to support Marie Curie Cancer Care, raising £1 million to fund 70 Marie Curie nurses for a year.

More information on all of the above issues is available in the Group's 2005 corporate responsibility report and there are details of how to obtain a copy on page 129.

The businesses of Lloyds TSB

Lloyds TSB Group's activities are organised into three divisions: UK Retail Banking, Insurance and Investments, and Wholesale and International Banking. The main activities of Lloyds TSB Group's three divisions are described below.

UK Retail Banking

UK Retail Banking provides banking, financial services, mortgages and private banking to some 15 million personal customers through our multi-channel distribution capabilities.

Branches. Lloyds TSB Group provides wide-reaching geographic branch coverage in England, Scotland and Wales, with over 2,100 branches of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester as at the end of 2005.

Internet banking. Internet banking provides online banking facilities for personal customers. Some 3.7 million customers have registered to use Lloyds TSB Group's internet banking services. At the end of 2005, these customers were conducting more than 45 million transactions per month online, a 50 per cent increase on 2004.

Telephone banking. Telephone banking continues to grow and Lloyds TSB Group now provides one of the largest telephone banking services in Europe. At the end of 2005, some 4.2 million customers had registered to use the services of PhoneBank and the automated voice response service, PhoneBank Express. Lloyds TSB Group's telephone banking centres handled some 69 million calls during 2005.

Cash machines. Lloyds TSB Group has one of the largest cash machine networks of any leading banking group in the UK and, at 31 December 2005, personal customers of Lloyds TSB Bank and Lloyds TSB Scotland were able to withdraw cash and check balances through some 4,200 ATMs at branches and external locations around the country. In addition, our personal customers have access to a further 54,000 cash machines via LINK in the UK and to cash machines worldwide through the VISA and MasterCard networks.

Current accounts. Lloyds TSB Bank and Lloyds TSB Scotland offer a wide range of current accounts, including interest-bearing current accounts and a range of added value accounts.

Savings accounts. Lloyds TSB Bank and Lloyds TSB Scotland offer a wide range of savings accounts and Cheltenham & Gloucester provide retail investments through their branch networks and a postal investment centre.

Personal loans. Lloyds TSB Bank and Lloyds TSB Scotland offer a range of personal loans through their branch networks and directly to the customer via the internet and telephone.

Credit cards. Lloyds TSB Group provides a range of card-based products and services, including credit and debit cards and card transaction processing services for retailers. Lloyds TSB Group is a member of both the VISA and MasterCard payment systems and has access to the American Express payment system. The Group had a 12.4 per cent share of outstanding card balances at 31 December 2005.

Mortgages. Cheltenham & Gloucester is Lloyds TSB Group's specialist residential mortgage provider, offering a range of mortgage products to personal customers through its own branches and those of Lloyds TSB Bank in England and Wales, as well as through the telephone, internet and postal service, C&G TeleDirect. Lloyds TSB Group also provides mortgages through Lloyds TSB Scotland and Scottish Widows Bank. Lloyds TSB Group is one of the largest residential mortgage lenders in the UK on the basis of outstanding balances, with mortgages outstanding at 31 December 2005 of £88.4 billion, representing a market share of 9.1 per cent.

UK Wealth Management. Private Banking provides a range of tailor-made wealth management services and products to individuals from 28 offices throughout the UK. In addition to asset management, these include tax and estate planning, executor and trustee services, deposit taking, lending and insurance. Shareview Dealing provides retail stockbroking services, personal equity plan and individual savings account (ISA) products.

Insurance and Investments

Insurance and Investments offers life assurance, pensions and investment products, general insurance and fund management services.

Life assurance, pensions and investments. Scottish Widows is Lloyds TSB Group's specialist provider of life assurance, pensions and investment products, which are distributed through Lloyds TSB Bank's branch network, through independent financial advisers and directly via the telephone and the internet. The Scottish Widows brand is the main brand for new sales of Lloyds TSB Group's life, pensions, open ended investment companies and other long-term savings products.

General insurance. Lloyds TSB General Insurance provides general insurance through the retail branches of Lloyds TSB Bank and Cheltenham & Gloucester, and through a direct telephone operation and the internet. Lloyds TSB General Insurance is one of the leading distributors of household insurance in the UK.

Scottish Widows Investment Partnership. Scottish Widows Investment Partnership manages funds for Lloyds TSB Group's retail life, pensions and investment products. Clients also include corporate pension schemes, local authorities and other institutions in the UK and overseas. At 31 December 2005 funds under management amounted to some £95 billion.

Wholesale and International Banking

Wholesale and International Banking provides banking and related services for major UK and multinational corporates and financial institutions, and small and medium-sized UK businesses. It also provides asset finance and share registration services to personal and corporate customers, manages Lloyds TSB Group's activities in financial markets through its treasury function and provides banking and financial services overseas.

Wholesale

Corporate Markets, combining the respective strengths of 2,700 people in Corporate Banking, Structured Finance and Financial Markets, plays an integral role in leveraging and expanding our customer franchise and building deep, long-lasting relationships with around 16,000 corporate customers.

Corporate Banking manages the core customer franchise, providing a relationship-based financial and advisory service to the corporate marketplace through dedicated regional teams throughout the UK and key strategic locations abroad, including New York. Customers have access to our expertise and a broad range of financial solutions. Our relationship managers act as a conduit to partners in Corporate Markets and other parts of the Group.

Structured Finance comprises the structured asset finance, leveraged lending and private equity, and other transactional lending and structuring businesses of Corporate Markets. Structured Finance executes transactions with existing corporate customers as well as introducing new to bank relationships to the franchise.

Financial Markets provides market access to sources of liquidity, hedging tools and investment products on behalf of Lloyds TSB Group and its customers. Financial Markets also provides risk management solutions to corporate customers and structured credit and investment products to the investor community.

Registrars. Lloyds TSB Registrars, part of the Corporate Bank, operates as receiving bank and registrar to some of the UK's leading public limited companies. As market leader, it currently maintains the share register of more than 700 clients, including around 60 per cent of the FTSE 100, managing some 22 million shareholder accounts.

Asset Finance. Lloyds TSB Group's asset finance businesses provide individuals and companies with finance through leasing, hire purchase and contract hire packages. Through its invoice discounting and factoring subsidiary, Lloyds TSB Commercial Finance, Lloyds TSB Group provides working capital finance for its customers. Specialist personal lending, store credit and the Dutton-Forshaw motor dealerships complete this group of businesses. Altogether Asset Finance has over 1.7 million individual customers and relationships with some 40,000 companies and small businesses.

Business Banking. A growing business which has relationships with some 587,000 small businesses managed by business managers based in 500 locations throughout the UK. This has been reinforced by an additional 300 business managers moving back into branches. Lloyds TSB Group has a leading share of the new business start-up market, with some 100,000 new businesses opening an account with Lloyds TSB in 2005. The main activity of the Agricultural Mortgage Corporation is to provide long-term finance to the agricultural sector.

International Banking

The Group has continued to shape its international network to support its UK operations.

Offshore banking. Lloyds TSB Group's offshore banking operations comprise offices in the UK, the Channel Islands, the Isle of Man, Hong Kong, Singapore, Malaysia and overseas representative offices in the Middle East, Africa, Asia and the Americas. The business provides a wide range of retail banking, wealth management and expatriate services to local island residents, UK expatriates, foreign nationals and to other customers requiring offshore financial services.

International private banking. Lloyds TSB Group has international private banking operations for wealthy individuals. The business is conducted through branches of Lloyds TSB Bank located in Switzerland, Luxembourg, Monaco, Gibraltar, Uruguay, Dubai and the US, supported by representative offices in Latin America.

International corporate banking. Serves the corporate and institutional market in Europe, the Middle East and Japan through offices in Belgium, the Netherlands, Spain, Dubai and Japan.

Latin American banking. Lloyds TSB Group continues to have offices in Ecuador and Uruguay which provide mainly corporate banking services. The sale of the business in Paraguay is expected to complete in 2006 after receipt of the required regulatory approval.

Operating and financial review and prospects

Summary of Group results

With effect from 1 January 2005, the Group has been using IFRS for financial reporting. Although IFRS significantly changes the timing of earnings recognition in financial results it has no impact on our business fundamentals and cash flows, the development of our organic growth strategies, or our capital management policies.

Details of the retrospective impact of the Group's implementation of IFRS were published in our 'Transition to IFRS' announcement on 27 May 2005. The increased use in IFRS of fair values has, however, led to greater volatility in the earnings of the Group. In order to provide a more comparable representation of our business performance this earnings volatility, together with other IFRS related adjustments applied with effect from 1 January 2005 and the impact on the Group's results of businesses sold in 2004, have been separately analysed to provide a comparable basis of presentation.

In 2005 statutory profit before tax was £3,820 million, an increase of £343 million, or 10 per cent (2004: £3,477 million). Profit attributable to equity shareholders increased by £101 million, or 4 per cent, to £2,493 million and earnings per share increased by 4 per cent to 44.6p. Economic profit increased by 12 per cent to £1,616 million.

On a comparable basis, profit before tax increased by £146 million, or 4 per cent, to £3,466 million (2004: £3,320 million). Excluding the impact of customer redress provisions and the strengthening of reserves for mortality, profit before tax increased by 9 per cent to £3,726 million. Income increased by 7 per cent whilst costs grew by only 4 per cent. Earnings per share increased by 11 per cent to 47.2p. The post-tax return on shareholders' equity increased to 23.3 per cent (2004: 22.2 per cent) and economic profit rose by 14 per cent to £1,620 million.

Our strategy to deepen customer relationships has led to an increase in customer advances, particularly in mortgages, credit cards and corporate lending, and is reflected in a 9 per cent increase in loans and advances to customers to £175 billion. Customer deposits increased by £5 billion, or 4 per cent, to £131 billion, largely as a result of good growth in customer savings accounts in the retail business.

Group net interest income, on a comparable basis, increased by £423 million, or 8 per cent, compared with last year. Good levels of consumer lending growth increased average personal lending and credit card balances by £1.7 billion and average mortgage balances by £7.8 billion. Customer lending growth in our Business Banking and Corporate Markets franchises increased average interest-earning assets by £4.4 billion. The banking net interest margin decreased by 6 basis points to 2.78 per cent. Much of this margin decline has been caused by the impact of lower earnings on the Group's capital and other interest-free liabilities and, excluding this funding impact, the margin was broadly stable year on year. The banking net interest margin in the second half of 2005 actually increased by 5 basis points to 2.80 per cent, compared with 2.75 per cent in the first half of 2005.

Other income, net of insurance claims, on a comparable basis and excluding the strengthening of reserves for mortality, increased by £260 million, or 6 per cent, to £4,659 million. Fees and commissions receivable increased by 9 per cent to £3,315 million as a result of higher income from strong volume growth in current account fees and an increase in fees from large corporate business and asset based lending, as a result of growing customer transaction volumes.

Operating expenses continued to be tightly controlled and on a comparable basis increased by 5 per cent to £5,506 million. Excluding the impact of customer redress provisions, operating expenses increased by only 4 per cent. Significant improvements continue to be made in processing and operational efficiency and we have continued to expand our programme of offshoring a number of our processing and back office operations to India. Staff numbers reduced by 3,652 to 69,778 during the year, improving group productivity. As a result of this constant focus on day-to-day operating cost control, the cost:income ratio, excluding customer redress provisions and the strengthening of reserves for mortality, improved to 52.7 per cent, from 54.3 per cent in 2004.

Whilst the Group has demonstrated strong cost control during 2005, we have also identified a number of key initiatives which collectively have the potential to significantly improve our cost:income ratio over the next few years whilst also improving operational efficiency and speed of execution. These self-funding initiatives will capture significant group wide synergies and fall broadly into three categories:

- improving our operational efficiency and management accountabilities through organisational redesign and process re-engineering;
- consolidating similar back-office operations and achieving cost reductions through standardising the way we operate and manage back-office processes across the Group; and
- transforming group wide procurement to enhance the way we manage suppliers and achieve the most efficient pricing available.

This programme of efficiency improvement initiatives is expected to deliver gross benefits of £275 million per annum for an initial investment of less than £200 million, of which £40 million was charged in 2005. This will continue to improve the Group's cost:income ratio whilst allowing substantial scope to re-invest in the business. From 2007 onwards we expect the Group's profit before tax to be increased by approximately £100 – £150 million per annum as a result of this programme of cost saving initiatives.

Overall asset quality remains satisfactory. On a comparable basis, impairment losses on loans and advances increased by 21 per cent to £1,090 million. A substantial reduction in impairment losses in the corporate franchise was more than offset by higher retail impairments, resulting from a combination of volume related asset growth in personal loan and credit card lending, the absence of a provision release in the mortgage business which totalled £39 million in 2004 and more customers, with higher levels of indebtedness and therefore lower levels of recovery, experiencing repayment difficulties. As a result of tightening our credit underwriting criteria during 2005, the quality of new business written during 2005 is good. Our impairment charge expressed as a percentage of average lending increased to 0.66 per cent, compared to 0.61 per cent in 2004. On a statutory basis, impaired assets totalled £4,122 million, compared with £3,515 million at 1 January 2005, representing 2.3 per cent of total lending, up from 2.1 per cent at 1 January 2005, but unchanged from 30 June 2005.

We expect a further deterioration in the retail credit environment in the first half of 2006 however, as a result of the improved quality of new business written in the last 12 months, we expect greater stability in the second half of 2006. In Wholesale Markets, impairment levels have remained low throughout 2005 and the outlook for corporate lending remains good, although we expect a return to more normal levels of impairment over time.

Following the publication of revised annuitant mortality tables and consultation on future mortality projections by the actuarial profession's Mortality Committee, the Group has reviewed the annuitant mortality assumptions used in its life assurance businesses. While the actuarial profession is still consulting on the adoption of the new projections, the Group has decided to strengthen its mortality related reserves by £155 million (£110 million on a comparable basis).

Following the introduction of time-barring, and the consequent increase in claims, the Group has also reviewed the estimated cost of redress payments to customers, principally relating to past sales of mortgage endowment policies through the branch network. This has led to an increased provision for customer redress of £150 million.

Our capital position remains robust. At the end of December 2005, the total capital ratio was 10.9 per cent and the tier 1 capital ratio was 7.9 per cent. During the year, risk-weighted assets increased by 10 per cent to £144.9 billion, reflecting good levels of growth in consumer lending and mortgages and strong growth in our Corporate Markets businesses. We continue to plan for risk-weighted asset growth of mid-to-high single digits over the next few years, and expected profit retentions remain sufficient to support this level of risk-weighted asset growth. We are also significantly improving our balance sheet management and capital efficiency, moving from a 'buy and hold' model towards an 'origination and distribution' framework. In this context we are planning to initiate a rolling residential mortgage securitisation programme in the second half of 2006.

Scottish Widows continues to be one of the most strongly capitalised life assurance companies in the UK. The working capital ratio of the Scottish Widows Long-Term Fund remained strong at an estimated 17.8 per cent at the end of December 2005. The required risk capital margin was covered over 11 times. In March 2005, Scottish Widows paid a 2004 dividend of £200 million to Lloyds TSB reflecting the start of an expected regular dividend stream, and in December 2005 a further £800 million of surplus capital was repatriated to the Group. In March 2006, a second annual dividend will be paid to the Group. We are continuing to examine opportunities to improve our capital efficiency and have work in progress that we believe will allow Scottish Widows to repatriate further surplus capital to the Group.

The Group's pension schemes accounting deficit totalled £2,910 million at the end of December 2005 (£2,037 million net of deferred tax). During 2005 the Group made additional voluntary contributions of £220 million to these schemes to be applied in reduction of the schemes' deficit. The Group is currently in the process of finalising its triennial actuarial valuation of the schemes and, as part of this process, is also considering other methods of addressing the schemes' deficit.

The board has decided to maintain the final dividend at 23.5p per share, to make a total for the year of 34.2p. This represents a dividend yield for shareholders of 7 per cent, calculated using the 31 December 2005 share price of 488.5p.

UK Retail Banking

Comparable basis	2005 £m	2004 £m
Net interest income	**3,307**	3,228
Other income	**1,811**	1,696
Total income	**5,118**	4,924
Operating expenses	**(2,532)**	(2,509)
Trading surplus	**2,586**	2,415
Impairment losses on loans and advances	**(905)**	(676)
Profit before tax, before provisions for customer redress	**1,681**	1,739
Provisions for customer redress	**(150)**	(100)
Profit before tax	**1,531**	1,639
Other IFRS adjustments applied from 1 January 2005	**(213)**	–
Profit on sale of businesses	**76**	–
Statutory profit before tax	**1,394**	1,639
Cost:income ratio, before provisions for customer redress	**49.5%**	51.0%
	31 December 2005	1 January 2005
Total assets	**£103.9bn**	£96.5bn
Total risk-weighted assets	**£60.6bn**	£57.2bn

Key achievements

- Satisfactory income growth in a more challenging consumer environment, with good growth in income per customer and a 28 per cent increase in target customer current account recruitment.
- Tight cost control, with a clear focus on improving efficiency. Staff reductions of 2,713 during the year resulted in lower costs in the second half of the year.
- Positive jaws with income growth of 4 per cent exceeding cost growth, excluding customer redress provisions, of 1 per cent.
- Good and broad customer balance growth:

– Group mortgage balances increased by 10 per cent to £88.4 billion.

– Credit card balances, adjusted to exclude the effect of the Goldfish disposal, increased by 9 per cent to £7.2 billion.

– Personal loan balances increased by 3 per cent to £11.0 billion.

– Customer deposit balances increased by 7 per cent to £71.0 billion.

- Customer satisfaction levels reached their highest level in recent years during 2005.
- Higher impairment charge reflecting marketwide deterioration in retail credit quality as a result of more customers, with higher levels of indebtedness, experiencing repayment difficulties.

Profit before tax, on a comparable basis, from UK Retail Banking decreased by £108 million, or 7 per cent, to £1,531 million, reflecting good levels of business growth offset by higher impairment losses and customer redress provisions. Increased income from continued growth in the Group's consumer lending and customer deposit portfolios and improved current account fee income was offset by a higher level of impairment losses in the Group's unsecured lending portfolios. Total income increased by 4 per cent, notwithstanding a decrease in commissions from creditor insurance, whilst cost growth, excluding customer redress provisions, was 1 per cent. Other income increased by 7 per cent, and now represents 35 per cent of total income.

During 2005, good levels of growth were achieved in all key product areas. Gross new mortgage lending for the Group totalled £26.0 billion (2004: £26.3 billion). Net new lending totalled £8.3 billion resulting in a market share of net new lending of 9.1 per cent, and mortgage balances outstanding increased by 10 per cent to £88.4 billion. Personal loan balances outstanding at the year end were £11.0 billion, an increase of 3 per cent and credit card balances totalled £7.2 billion, an increase of 9 per cent, adjusting to exclude the effect of the Goldfish disposal. Credit balances on current accounts and savings and investment accounts increased by 7 per cent. Income per customer continued to improve during the year.

Customers are increasingly choosing to buy through direct channels as well as through our branches. Towards the end of 2005 we saw improved levels of growth in branch based sales, particularly current and savings accounts, whilst continued investment in our direct channel capabilities has supported good levels of business growth. Sales through direct channels represent half of total sales and, during 2005, internet product sales increased by 28 per cent and product sales via the telephone increased by 39 per cent. Our internet bank now has 3.7 million registered users and over 470 million transactions were processed through internet banking, an increase of 40 per cent.

Lloyds TSB remains a leader in the added value current account market, with over 4 million customers. Target customer current account recruitment increased by 28 per cent, compared with 2004.

Operating expenses remained well controlled and, excluding customer redress provisions, increased by only £23 million, or 1 per cent. This included higher levels of restructuring costs as we continue to rationalise back office operations to improve efficiency. Levels of customer service and satisfaction have also continued to improve.

Impairment losses on loans and advances increased by £229 million, or 34 per cent, to £905 million, reflecting a combination of volume related asset growth in personal loan and credit card lending, the absence of a mortgage provision release which in 2004 totalled £39 million, and the impact of more customers, with higher levels of indebtedness, experiencing repayment difficulties. The impairment charge as a percentage of average lending for personal loans and overdrafts increased to 4.76 per cent, from 4.20 per cent in 2004, while the charge in the credit card portfolio increased to 4.01 per cent, from 3.42 per cent in 2004. In the mortgage business the Group continued to experience a low level of losses and, as a result, the mortgage impairment charge was £13 million. Overall, the provisions charge as a percentage of average lending, on a comparable basis, was 0.92 per cent, compared to 0.75 per cent in 2004.

Within personal loans, key initiatives have been the increased use of behavioural and risk-based pricing, and leveraging our customer insight capabilities to enable the Group to deliver more competitive pricing to better quality customers within our existing customer base. Over 99 per cent of new personal loans and 77 per cent of new credit cards sold during 2005 were to existing customers, where the Group has a better understanding of an individual customer’s total financial position. Dynamic delinquency measures remain in line with our expectations given the slowdown in consumer spending.

Cheltenham & Gloucester (C&G) continued to focus on prime lending market segments during 2005. The average indexed loan-to-value ratio on the C&G mortgage portfolio was 43 per cent (31 December 2004: 41 per cent), and the average loan-to-value ratio for C&G new mortgages and further advances written during 2005 was 64 per cent (2004: 62 per cent). At 31 December 2005, 95 per cent of C&G mortgage balances had an indexed loan-to-value ratio of less than 85 per cent (31 December 2004: 94 per cent) and only 0.6 per cent of balances had an indexed loan-to-value ratio in excess of 95 per cent (31 December 2004: 0.3 per cent).

Insurance and Investments

Comparable basis	2005 £m	2004 £m
Net interest income	**411**	283
Other income	**15,820**	10,736
Total income	**16,231**	11,019
Insurance claims	**(14,684)**	(9,622)
Total income, net of insurance claims	**1,547**	1,397
Operating expenses	**(639)**	(610)
Trading surplus	**908**	787
Impairment losses on loans and advances – credit	**–**	3
Profit before tax, excluding customer redress provisions and strengthening of reserves for mortality	**908**	790
Provisions for customer redress	**–**	(12)
Strengthening of reserves for mortality	**(110)**	–
Profit before tax	**798**	778
Volatility	**749**	138
Other IFRS adjustments applied from 1 January 2005	**(73)**	–
Statutory profit before tax	**1,474**	916
Profit before tax analysis		
Life, pensions and OEICs*	**683**	610
General insurance	**209**	172
Scottish Widows Investment Partnership	**16**	8
Profit before tax*	**908**	790

* Excluding customer redress provisions and strengthening of reserves for mortality

Key achievements

- Significantly improved profit performance. Profit before tax, on a comparable basis and excluding customer redress provisions and a significant strengthening of reserves for mortality, increased by 15 per cent to £908 million.
- Strong, and improving, sales performance. 21 per cent increase in Scottish Widows' new business weighted sales, increasing the Group's market share of life, pensions and long-term savings to an estimated 6.2 per cent, from 5.7 per cent.
- Excellent progress in increasing bancassurance sales, particularly in the second half of 2005 when sales grew by 23 per cent, compared with the second half of 2004.
- Improved profitability. New business contribution in Scottish Widows increased by 19 per cent. Life and pensions new business margin increased to 29.7 per cent.
- Good progress with General Insurance's strategy to develop its manufacturing business and increase focus on direct channels. Strong focus on improving underwriting capability, supply chain efficiency and claims management led to profit before tax, on a comparable basis, increasing by 22 per cent.
- Strong capital position maintained. During 2005, Scottish Widows Group repatriated £1 billion surplus capital to the Group.

Profit before tax, on a comparable basis, increased by £20 million, or 3 per cent to £798 million despite a significant strengthening of reserves for mortality which, on a comparable basis, totalled £110 million.

Scottish Widows profit before tax analysis*	2005 £m	2004 £m
Life and pensions		
New business contribution	**224**	188
Existing business	**181**	181
Investment earnings – normalised	**196**	167
Profit before tax	**601**	536
OEICs		
Profit before tax	**82**	74
Profit before tax (life, pensions and OEICs)	**683**	610
New business margin (life and pensions)	**29.7%**	28.6%

* Comparable basis, excluding customer redress provisions and the strengthening of reserves for mortality

Profit before tax, excluding customer redress provisions and the strengthening of reserves for mortality, from the Group's life, pensions and OEICs business increased by 12 per cent to £683 million. The Group's strategy to improve its returns by focusing on more profitable, less capital intensive, business whilst constantly seeking to improve process and distribution efficiency has led to a 19 per cent increase in new business contribution to £224 million. As a result of this improved capital efficiency and strong sales of pensions and single premium investments, the life and pensions new business margin increased to 29.7 per cent (2004: 28.6 per cent).

	2005 £m	2004 £m
Weighted sales (regular + 1/10 single)		
Life and pensions	**754**	657
OEICs	**148**	86
Life, pensions and OEICs	**902**	743
Bancassurance	**274**	242
Independent financial advisers	**562**	432
Direct	**66**	69
Life, pensions and OEICs	**902**	743

Overall, weighted sales in 2005 increased by 21 per cent to £902 million and as a result the Group's life, pensions and investments market share increased significantly to an estimated 6.2 per cent, compared with 5.7 per cent in 2004. During 2005 the Group launched a new group pensions platform which supported the strong growth in sales during the year. Scottish Widows is now also one of the largest UK providers of individual pensions. IFA sales grew 30 per cent to £562 million, supported by significant product and service enhancements in pensions and investments, and our estimated market share of the IFA market improved to 6.8 per cent, from 5.9 per cent in 2004. Bancassurance sales were 13 per cent higher at £274 million. Weighted sales of OEICs were 72 per cent higher, largely through the branch network and to Lloyds TSB private banking clients. Our estimated market share through the bancassurance and direct channels increased to 5.5 per cent, from 5.4 per cent in 2004.

In January 2006, Scottish Widows announced a new partnership with Virgin to market life assurance and a new cancer insurance product under the Virgin Money brand. This supports Scottish Widows' long-term strategy to secure a greater breadth of distribution for its products.

Scottish Widows Investment Partnership

Pre-tax profit, on a comparable basis, from Scottish Widows Investment Partnership (SWIP) increased to £16 million, compared with £8 million in 2004, reflecting improved market performance and increased revenues from new business. SWIP won £4.4 billion of gross new business in 2005, an increase of 110 per cent on 2004, and its assets under management increased by 16 per cent to £95 billion. Overall investment performance during 2005 has continued to improve. Group wide funds under management increased by 12 per cent to £121 billion.

General insurance

Comparable basis	2005 £m	2004 £m
Commission receivable	**681**	672
Commission payable	**(695)**	(750)
Underwriting income (net of reinsurance)	**562**	554
Other income	**18**	64
Net operating income	**566**	540
Claims paid on insurance contracts (net of reinsurance)	**(197)**	(214)
Operating income, net of claims	**369**	326
Operating expenses	**(160)**	(154)
Profit before tax	**209**	172
Claims ratio	**34%**	37%
Combined ratio	**80.8%**	83.2%

Profit before tax, on a comparable basis, from our general insurance operations increased by £37 million, or 22 per cent, to £209 million. Operating income, net of claims, increased by 13 per cent compared with cost growth of 4 per cent. Good progress continues to be made in implementing new platforms for underwriting and claims processes.

Net operating income improved by £26 million, as growth in income from home and motor business was partly offset by reduced broking commission from loan protection insurance, reflecting the slowdown in unsecured consumer lending growth during 2005 and lower health premiums following the transfer of the Group's private medical insurance business to BUPA during 2004. Good progress has also been made in building the Group's corporate partnering capability with a new distribution agreement secured with MORE TH>N during 2005.

Our strategy to increase investment in more cost efficient distribution through direct channels continues to generate earnings momentum with gross written premiums from new policies sold through direct channels increasing by 9 per cent in 2005. This reflected strong growth in levels of new business through the internet, where home insurance sales increased by 39 per cent and motor insurance sales by 12 per cent. New motor insurance sales by telephone increased by 15 per cent. The business has also delivered substantial improvements in business retention reflecting higher levels of customer satisfaction and improvements in operational efficiency.

Claims fell by £17 million to £197 million and the claims ratio improved to 34 per cent (2004: 37 per cent), reflecting good progress in re-engineering the claims process and improvements in the cost effectiveness of the claims supply chain, as well as lower health claims as a result of the transfer of the Group's private medical insurance business to BUPA. As a result, the combined ratio relating to the underwriting business improved to 80.8 per cent in 2005 (2004: 83.2 per cent).

Wholesale and International Banking

Comparable basis	2005 £m	2004 £m
Net interest income	**2,165**	1,986
Other income	**1,710**	1,544
Total income	**3,875**	3,530
Operating expenses	**(2,186)**	(2,047)
Trading surplus	**1,689**	1,483
Impairment losses on loans and advances	**(185)**	(230)
Profit before tax	**1,504**	1,253
Other IFRS adjustments applied from 1 January 2005	**20**	–
Loss on sale of businesses	**(6)**	(21)
Trading results of discontinued operations	**–**	40
Statutory profit before tax	**1,518**	1,272
Cost:income ratio	**56.4%**	58.0%
	31 December 2005	1 January 2005
Total assets	**£124.0bn**	£123.8bn
Total risk-weighted assets	**£80.1bn**	£71.0bn

Profit before tax by business unit	2005 £m	2004 £m
Corporate Markets	**958**	732
Business Banking	**206**	153
Asset Finance	**219**	240
International Banking	**133**	120
Other	**(12)**	8
	1,504	1,253

Key achievements

- Excellent profit growth. Profit before tax, on a comparable basis, increased by 20 per cent to £1,504 million.
- Strong income growth, up 10 per cent as Corporate Markets' strategy begins to deliver results. Income momentum improved during the year.
- Positive jaws. Income growth of 10 per cent exceeded cost growth of 7 per cent. Continued investment in people and systems to support new product capabilities.
- Low levels of impairment as a result of high corporate liquidity and a continued strong level of recoveries. Impairment charge reduced by 20 per cent.
- Good progress in delivering the strategy to build an integrated wholesale bank for corporate markets. 17 per cent increase in Corporate Markets' trading surplus, and 31 per cent increase in profit before tax.
- Good levels of franchise growth in Business Banking. 24 per cent growth in trading surplus, and 35 per cent growth in profit before tax.
- Good new business growth in Asset Finance with trading surplus up 12 per cent. However, higher levels of retail impairment resulted in a fall of 9 per cent in profit before tax.
- Improved post-tax return on risk-weighted assets from 1.41 per cent to 1.50 per cent.

Wholesale and International Banking profit before tax, on a comparable basis, increased by £251 million, or 20 per cent, to £1,504 million. Income growth of 10 per cent exceeded cost growth of 7 per cent, leading to a reduction in the cost:income ratio to 56.4 per cent. Trading surplus increased by £206 million, or 14 per cent, to £1,689 million. There was strong profit growth in Corporate Markets, Business Banking and International Banking while Asset Finance saw strong trading surplus growth before higher impairment losses. Overall growth in profit was ahead of growth in risk-weighted assets and has led to an increase in the post-tax return on average risk-weighted assets to 1.50 per cent, compared to 1.41 per cent in 2004.

Net interest income increased by £179 million, or 9 per cent, reflecting higher income from strong growth in customer lending in Corporate Markets, Business Banking and Asset Finance. Other income increased by £166 million, or 11 per cent. Strong growth in structured finance transactions, increased fee income from relationship business products and higher levels of cross-selling activity led to an increase of 18 per cent in other income from Corporate Markets. In addition, other income benefited from the impact of motor dealership acquisitions in Asset Finance and sustained customer growth in Business Banking. Costs were 7 per cent higher at £2,186 million, reflecting higher staff costs as a result of our increased investment in people, as we continue to build up our Corporate Markets product capability and expertise, and the impact of the motor dealership acquisitions within Asset Finance.

The charge for impairment losses on loans and advances decreased by £45 million, or 20 per cent, to £185 million, as a result of lower provisions and a good level of recoveries from the corporate lending portfolio, partially offset by higher charges in the Asset Finance business.

In Corporate Markets, profit before tax grew by 31 per cent, from £732 million in 2004, to £958 million, driven by a combination of higher income and a reduction in impairment losses. Income increased by 15 per cent, including higher levels of cross-selling income which increased by 27 per cent reflecting our increased customer focus and integration across the business. Income growth was strong in both relationship and transactional business. Customer relationships continue to be deepened, and there has been considerable investment in the business to broaden origination, distribution and portfolio management capabilities. This has included the build up of new credit structuring and loan trading teams and the launch of a variety of new products.

Profit before tax in Business Banking grew by £53 million, or 35 per cent, to £206 million reflecting our strategy to move relationship managers back into branches, and closer to our customers. There was good growth in customer income, tight control of costs, and service and operational improvements. This supported a 4 percentage point reduction in the cost:income ratio for the business. Customer deposits rose by 4 per cent to £10.7 billion and customer lending increased by 11 per cent to £8.0 billion. Business Banking continued to develop and grow its customer franchise, with net customer recruitment of some 13,350 during 2005, reflecting a market leading position in both the overall and start-up markets. Over 18,000 customers transferred their banking arrangements to the Group from other banking providers.

Profit before tax in Asset Finance decreased by 9 per cent to £219 million, largely reflecting higher impairment losses, which offset the continued development of the motor and leisure, and contract hire businesses. Income increased by £71 million, or 8 per cent, leading to a 12 per cent growth in the trading surplus. New business has increased by 7 per cent in the personal and retail finance business. Lloyds TSB Commercial Finance has continued to grow strongly with a 19 per cent market share, measured by client numbers, and the motor and leisure business continues to be the largest independent lender in the UK motor and leisure point of sale market with a market share of 18 per cent.

In International Banking, profit before tax increased by £13 million, or 11 per cent, to £133 million. This reflects a reduction in costs and lower impairment provisions which offset a £12 million, or 3 per cent, reduction in income as a result of lower earnings on retained capital following the repatriation of offshore capital to the Group.

Central group items

Comparable basis	**2005 £m**	2004 £m
Lloyds TSB Foundations	**(34)**	(31)
Funding cost of acquisitions less earnings on capital	**(325)**	(317)
Central costs and other unallocated items	**(8)**	(2)
Loss before tax	**(367)**	(350)
Volatility	**(124)**	–
Other IFRS adjustments applied from 1 January 2005	**(55)**	–
Loss on sale and closure of businesses	**(20)**	–
Statutory loss before tax	**(566)**	(350)

The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly disabled and disadvantaged, to play a fuller role in society. The Foundations receive 1 per cent of the Lloyds TSB Group's pre-tax profit after adjusting for gains and losses on the disposal of businesses and pre-tax minority interests, averaged over three years, instead of a dividend on their shareholdings. In 2005, £34 million was accrued for payment to registered charities.

Volatility

Banking volatility

In accordance with IFRS, it is the Group's policy to recognise all derivatives at fair value. The banking businesses manage their interest rate and other market risks primarily through the use of intra-Group derivatives, with the resulting net positions managed centrally using external derivatives. IFRS does not, however, permit the intra-Group derivatives to be used in a hedge relationship for reporting purposes. Although fair value accounting can have a significant impact on reported earnings, it does not impact on the business fundamentals or cash flows of the businesses. The Group has, therefore, implemented an internal pricing structure that allows divisions to transfer to central group items the volatility associated with marking to market derivatives held for risk management purposes. 'Banking volatility' is principally comprised of the difference between the result that would be recognised on an accrual accounting basis for derivatives held for risk management purposes and their mark to market value. The Group has set up a central hedging function to reduce the impact of this volatility by establishing, where possible, accounting hedge relationships for the external derivatives.

During 2005, profit before tax included negative banking volatility of £124 million.

Insurance volatility

Changes in market variables such as the performance of equity markets and the level of interest rates, which are beyond the control of management, can result in significant volatility in the profitability of the Group's insurance businesses. As in previous years, in order to provide a clearer representation of the underlying performance of the life and pensions and general insurance businesses, the effect of these changes is separately analysed within insurance volatility. Following the implementation of the requirements of IFRS and FRS 27, insurance volatility is principally comprised of the elements described below.

The Group's insurance businesses have substantial holdings of investments which are accounted for at fair value with changes being reflected within the income statement. The difference between the actual return on these investments attributable to shareholders and the expected return based upon economic assumptions made at the beginning of the year is included within insurance volatility. In addition, the calculation of the value of in-force business makes assumptions about future investment returns; to the extent that actual experience is different the effect is also included within insurance volatility.

The main assumptions used in the calculation of the value of in-force business at 31 December 2005 were as follows:

	31 December 2005 %	31 December 2004 %
Risk-adjusted discount rate (net of tax)	**7.02**	7.40
Return on equities (gross of tax)	**6.72**	7.17
Return on fixed interest securities (gross of tax)	**4.12**	4.57
Expenses inflation	**3.79**	3.76

Changes in stock market performance also affect the realistic valuation of the guarantees and options embedded within products written in the Scottish Widows With-Profits Fund, which following the implementation of FRS 27 is now reflected in the Group's balance sheet. Fluctuations in this valuation caused by market-related movements are also included within insurance volatility.

During 2005, profit before tax included positive insurance volatility of £438 million.

Policyholder interests volatility

As a result of the requirement contained in IFRS to consolidate the Group's life and pensions businesses on a line by line basis, the Group's income statement includes amounts attributable to policyholders which affect profit before tax; the most significant of these items is policyholder tax. Under IFRS, tax on policyholder investment returns is included in the Group's tax charge rather than being offset against the related income, either increasing or decreasing profit before tax with a corresponding change in the tax charge. In order to provide a clearer representation of the underlying performance of the Group's life and pensions businesses the impact of these items upon pre-tax profit has been separately identified within volatility.

During 2005, profit before tax included positive policyholder interests volatility of £311 million.

Regulation

In the UK and elsewhere, there is continuing political and regulatory scrutiny on banking and, in particular, retail banking. In the UK, the Office of Fair Trading (OFT) is carrying out several enquiries into certain fees charged to customers in connection with credit cards, and interchange fees charged by some card networks. In addition, the OFT is conducting a market study in relation to payment protection insurance and is reviewing undertakings given by some banks in 2002 regarding the supply of banking services to SMEs. It is not possible to assess whether these enquiries will have any cost or income impact on the Group until the outcome of these enquiries is known.

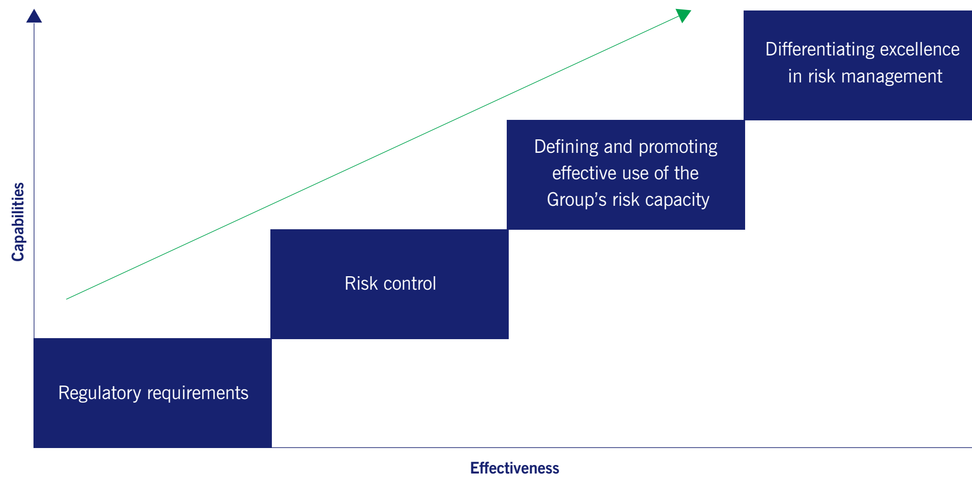
Risk management

Risk as a strategic differentiator

Following the embedding of the risk governance framework and the repositioning of specialist risk functions closer to the business in 2004, the focus for 2005 has been the development of a new risk framework which clearly aligns our risk taking to the objectives and priorities of Lloyds TSB Group and facilitates more effective decision making. The Group's ability to take risks which are well understood, consistent with our strategy and plans and appropriately remunerated, is a key driver of shareholder return.

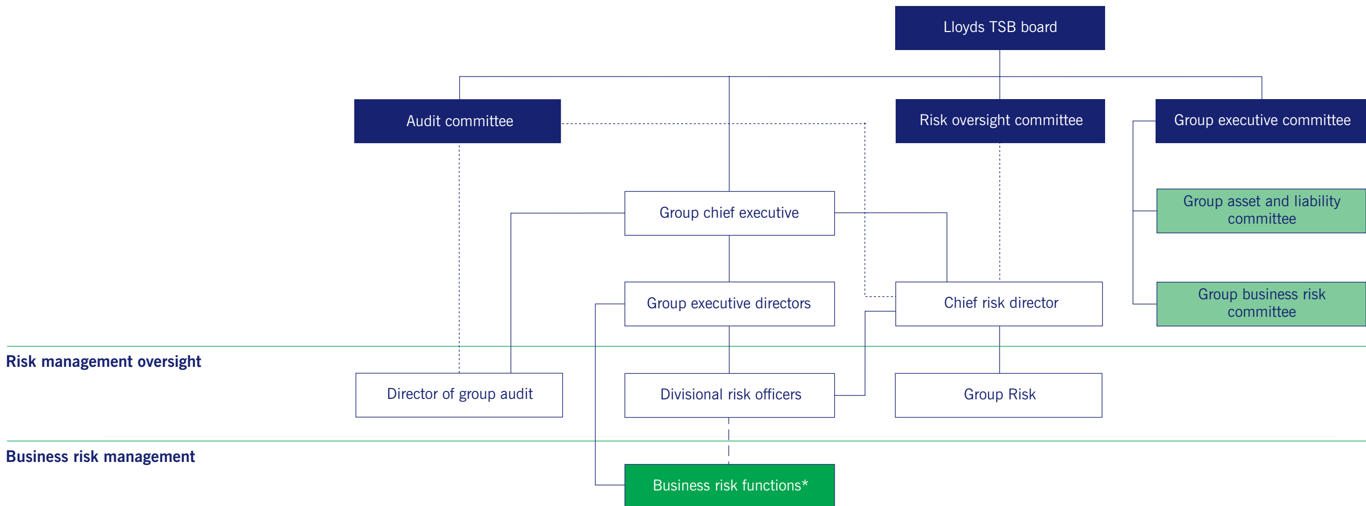
The maintenance of a strong control framework remains a priority and is the foundation for the delivery of effective risk management. Risk analysis and reporting have been further strengthened to identify opportunities as well as risks, to improve the Group's ability to take an aggregate view of the overall risk portfolio and assign clear responsibilities and timescales at group and divisional level for risk mitigation strategies. Risk continues to be a key component of routine management information reporting and is embedded within staff objectives via balanced scorecards.

The objective remains to go beyond risk mitigation and control to developing risk capabilities as a key strategic differentiator for Lloyds TSB.



Risk governance structures

The changing regulatory environment faced by the Group's businesses, and developments in best practice, prompted the Group during 2003 and 2004 to perform an extensive review of its risk governance structures. During 2005 these structures have enabled the Group to strengthen risk evaluation and management.



The board, assisted by its sub-committees, the risk oversight committee, the group executive committee and the audit committee approves the Group's overall risk management framework. The board also reviews the Group's aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board's appetite for risk. The risk oversight responsibilities of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 43 and 44, and further key risk oversight roles are described on the next page.

The group executive committee, assisted by its sub-committees the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and reviews the Group's aggregate risk exposures and concentrations of risk. The group executive committee's duties are described more fully on page 44.

Directors of the Group's businesses have primary responsibility for measuring, monitoring and controlling risks within their areas of accountability and are required to establish control frameworks for their businesses that are consistent with the Group's high level policies and within the parameters set by the board, group executive committee and Group Risk. Compliance with policies and parameters is overseen by the risk oversight committee, the group business risk committee, the group asset and liability committee, Group Risk and the divisional risk officers.

The chief risk director, a member of the group executive committee and reporting directly to the group chief executive, oversees and promotes the development and implementation of a consistent group wide risk management framework. The chief risk director, supported by Group Risk, provides objective challenge to the Group's senior management.

Divisional risk officers provide oversight of risk management activity within each of the Group's operating divisions. Reporting directly to the group executive directors responsible for the divisions and the chief risk director, their day-to-day contact with business management, business operations and risk initiatives seeks to provide an effective risk oversight mechanism.The direct reporting line to the chief risk director enables the Group to maintain a wide ranging and current perspective on material risks facing the Group and provides a mechanism to share best risk management practice.

The director of group audit provides the required independent assurance to the audit committee and the board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group Audit is fully independent of Group Risk, seeking to ensure objective challenge to the effectiveness of the risk governance framework.

Accountability of line management has been further reinforced in relation to the management of risks arising from the Group's business and in developing the risk awareness and risk management capability of the Group's staff. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite. The top management team received regular briefings and guidance from the chief risk director to ensure awareness of the overarching risk model and a clear understanding of their accountabilities for risk and internal control.

During the year a new Control Self Assessment process has increased the focus of management at all levels on risk management and reinforced accountabilities. All business units, divisional risk offices and group functions have completed a Control Self Assessment, reviewing the effectiveness of their internal controls and putting in place enhancements where appropriate. Managing directors and group executive directors have certified the accuracy of their assessment.

Business management forms part of a tiered risk management model, as shown on page 24, with the divisional risk officers providing oversight and challenge, as described above, and the chief risk director and group committees establishing the group wide perspective.

The model seeks to provide the Group with an effective mechanism for developing and embedding risk policies and risk management strategies which are aligned with the risks faced by its businesses. It also facilitates effective communication on these matters across the Group. These arrangements enable the Group to anticipate and pre-empt risks better, and to manage more effectively those risks which crystallise.

Reflecting the importance the Group places on risk management, risk is one of the five principal criteria that it includes in its balanced scorecard on which individual staff performance is judged. Business executives have specified risk management objectives, and incentive schemes take account of performance against these.

Risk management framework

Lloyds TSB Group uses an enterprise-wide framework for the identification, assessment, measurement and management of risk, designed to meet its customers' needs and maximise value for shareholders over time by aligning risk management with the corporate strategy; assessing the impact of emerging risks from new technologies or markets; and developing risk tolerances and mitigating strategies. The framework strengthens the Group's ability to identify and assess risks; aggregate groupwide risks and define the corporate risk appetite; develop solutions for reducing or transferring risk, where appropriate; and exploit risks to gain competitive advantage, thereby seeking to increase shareholder value.

A key focus for 2005 has been the enhancement of this framework. The approach starts with a simple but clear articulation of the Group's strategic vision and the desired outcomes for our key stakeholders (shareholders, customers, staff, debtholders and regulators). The risk implications are expressed in a risk vision and high level risk appetite measures, which are in turn translated into high level risk principles and risk appetite measures and metrics for the primary risk types (credit risk, market risk, insurance risk, operational risk, strategy risk and financial soundness). The degree of sophistication continues to evolve. An overview of each of the primary risk drivers is set out on pages 27 to 34. The more detailed articulation of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses is subsequently agreed by the group chief executive, through consultation with the group executive committee and on the advice of the group business risk committee and the group asset and liability committee.

Risk language

The Group has revised the risk language during the year such that all risks are classified within one of six primary risk drivers. These are further broken down into thirteen enterprise wide risk management (EWRM) risk types to enable more detailed review and facilitate appropriate reporting and analysis of root causes, as set out below.

Primary risk drivers	Strategy	Credit	Market	Insurance	Operational	Financial soundness
EWRM risk types	Strategy	Credit	Market	Insurance	Governance	Financial soundness
	Product and service				Legal and regulatory	
					Customer treatment	
					Process and resource	
					Theft, fraud and other criminal acts	
					People	
					Change	

Governance risk, legal and regulatory risk, customer treatment risk, process and resource risk, theft, fraud and other criminal acts risk, people risk and change-related risk are all categories of operational risk. A more detailed language has been identified for these operational risks.

Risk policy

A key component of the risk management framework is the policy framework. During the year this has been substantially revised to reinforce clarity of accountabilities, efficiency and effectiveness. The process of embedding will continue into 2006.

The main policy levels are identified below:

- Principles – high level policy for the six primary risk drivers (agreed by the board)
- Group policy – policy for the main EWRM risk types aligned to the risk drivers (agreed by the group chief executive)
- Detailed group policy – detailed policy that applies across the Group (agreed by the chief risk director)
- Divisional policy – local policy that specifically applies to a division (agreed by the appropriate group risk director)
- Business unit policy – local policy that specifically applies to a business unit (agreed by the divisional risk officer)

Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy, and the associated accountabilities are clearly outlined. All staff are expected to be aware of the policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all staff within that area.

Group and divisional risk functions have responsibility for overseeing effective implementation of policy. Group Audit provides independent assurance to the board about the effectiveness of the Group's control framework and adherence to policy.

Policies are reviewed regularly to seek to ensure accuracy and appropriateness.

Risk reporting

Divisional risk functions use the standard language when reporting risks centrally, to enable risk aggregation, and when assessing risk levels of new products, change initiatives or business plans. Divisional risk committees monitor their risk levels against their risk appetite seeking to ensure effective mitigating action is being taken where appropriate. Divisional risk reports are reviewed by divisional executive committees to ensure divisional senior management are satisfied with the overall risk profile, risk accountabilities and progress on any necessary mitigating actions.

At group level a consolidated risk report is produced which is reviewed and debated by group business risk committee, group executive committee, risk oversight committee and board to ensure senior management and the board are satisfied with the overall risk profile, risk accountabilities and any necessary mitigating actions. During the year the Group's consolidated risk report was further enhanced to support the identification, control and effective management of risk.

Basel II

The Capital Requirements Directive will come into force for all European banks at the start of 2007, although the final rules to be applied in the UK will only be published in 2006. The rules have been, and will continue to be, subject to further consultation, and Lloyds TSB Group has been playing a full part with the regulatory authorities in attempting to shape them. The Group plans to adopt an Internal Ratings Based approach to credit risk and an Advanced Measurement Approach to operational risk. Accordingly, a considerable investment is being made in order to meet the standards required for these more advanced approaches. As well as meeting the compliance imperative, benefits to the Group will accrue through further enhancement of our risk management and capital allocation capabilities.

Strategy risk

The Group includes product and service risk within the wider definition of strategy risk and the two categories are described in further detail below.

Strategy risk

Definition

Strategy risk is the risk arising from developing a strategy that does not maximise franchise value and/or fails to achieve the initiatives in the agreed strategic plan due to changing or flawed assumptions. In assessing strategic risk consideration is given to both:

- external factors (ie economic, technological, political, social and ethical, environmental, legal and regulatory, market expectations, reputation and competitive behaviour), and
- internal factors (ie resource capability and availability, customer treatment, service level agreements, products and funding and the risk appetite of other risk categories).

Control

An annual strategic planning process is conducted at group and business level which includes a quantitative and qualitative assessment of the risks in the Group's plan. Within the planning round, the Group conducts both scenario analysis and stress tests to assess risks to future earning streams.

The Group's strategy is reviewed and approved by the board. Regular reports are provided to the group executive committee and the board on the progress of the Group's key strategies and plans. Group Risk conducts oversight to seek to ensure the business plans remain consistent with the Group's strategy. Revenue and capital investment decisions require additional formal assessment and approval. Formal risk assessment is conducted as part of the financial approval process. Significant company mergers and acquisitions require specific approval by the board. In addition to the standard due diligence conducted during a merger or acquisition, Group Risk conducts, where appropriate, an independent risk assessment of the target company and its proposed integration into Lloyds TSB Group.

A common approach is applied across the Group to assess the creation of shareholder value. This is measured by economic profit (the profit attributable to shareholders, less a notional charge for the equity invested in the business). The focus on economic profit allows the Group to compare the returns being made on capital employed in each business. The use of risk-based economic capital and regulatory capital is closely monitored at business and group level. The Group's economic capital model covers credit, market, insurance, business and operational risks.

Product and service risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from the inherent characteristics, management or distribution of products or services, or from failure to meet or better customer expectations and competitor offerings.

Control

The Group is strongly committed to the fair treatment of its customers. This is embedded into the processes and risk assessment which takes place to seek to ensure businesses have developed customer centric strategies for product and business development, marketing, selling and after sales service. Businesses maintain a range of products to meet customers' needs and the business strategy and are responsible for managing and controlling product risks and complying with applicable regulations.

Businesses have formal processes for reviewing the range of their product portfolios and subject all product development to rigorous assessment. The assessment includes seeking to ensure that the product meets clearly defined customer needs. Businesses have a defined channel distribution strategy for products, consistent with the Group's distribution strategy. Businesses launching new products are responsible for ensuring compliance with all applicable regulations and that the proposed sales activity is appropriate for the type of customer and their attitude to risk.

The Group defines a new product as a new or amended product that introduces a significantly different risk profile at group or business level. In line with defined policy, businesses provide divisional risk management with details of new products at an early stage of product or service development to seek to ensure compliance with the Group's risk appetite and strategy. Businesses are required to demonstrate that new products meet clearly defined customer needs and that the sales process mitigates the risks of unsuitable sales. Where appropriate, technical advice and approval is sought from specialist functions. Only new products carrying the approval of divisional risk management and the businesses involved in their manufacture and delivery are offered to customers.

Businesses establish and monitor performance standards for all marketed products across a range of indicators, for example sales volumes, customer service and risk profile. Significant deviations from these standards are investigated and appropriate action taken.

Credit risk

Definition

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

Credit risk framework

Credit risk is managed according to baseline credit framework standards, against which all activity is assessed. This framework identifies the following key elements: governance, organisational framework, policies, people, processes and procedures, management information, and systems and technology.

Credit risk can arise from lending or investing or through off balance sheet activities such as guarantees or the undertaking of settlement or delivery risk. The primary off balance sheet instruments used by the Group are guarantees together with standby, documentary and commercial letters of credit.

In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring), although thresholds are set above which an individual credit assessment takes place. Divisional risk departments review scorecard effectiveness and approve changes, with material changes subject to Group Risk approval. Credit risk in non-retail portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers. Control is exercised over those exposures through a suitable combination of formal limits set out in mandates, credit policy parameters and high level committee oversight.

Credit risk also arises from the use of derivatives. Note 17 shows the total notional principal amount of interest rate, exchange rate and equity and other contracts outstanding at 31 December 2005. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

Credit risk may also arise through the existence of contracts for the provision of services or products to Lloyds TSB and this is also considered through individual credit assessments, where the risks of loss are material.

Day-to-day credit management and asset quality within each business is primarily the responsibility of the relevant business director.

Credit quality is supported by specialist units to provide, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business.

Impairment provisions are provided for losses that have been incurred at the balance sheet date. Changes in general economic conditions in the UK or in interest rates could result in losses that are different from those provided for at the balance sheet date.

Control

The following are the principal mechanisms through which the Group operates the credit risk framework set out above:

Credit rating systems. All business units operate appropriate rating system(s) for their portfolio(s). All rating systems, which are authorised by executive management, comply with the Group's standard methodology. The Group uses a 'Master Scale' rating structure with ratings corresponding to a range of probabilities of future default.

Monitoring of rating systems. The Group uses rating systems as an integral part of the credit process deployed within the credit life cycle. Whilst divisional risk teams have responsibility for monitoring rating model performance, Group Risk reviews new models and material changes to existing models, seeking executive management approval as necessary.

Portfolio monitoring and reporting. With Group Risk, businesses and divisions identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by Group Risk. Group Risk in turn produces an aggregated review of credit risk throughout the Group, which is presented to the group business risk committee.

Credit principles and policy. Group Risk sets out the group credit principles according to which credit risk is managed. These form the basis of the group credit policy, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process.

Lending guidelines. These define the responsibilities of lending officers and seek to provide a disciplined and focused benchmark for credit decisions.

Counterparty limits. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. Regular reports on significant credit exposures are provided to the group executive committee and board.

Cross-border and cross-currency exposures. Country limits are authorised and managed by a dedicated unit taking into account economic and political factors.

Concentration risk. Credit risk management sets portfolio controls on certain industries, sectors and product lines that reflect risk appetite, and monitors exposures to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. Amongst these controls is a series of time-referenced sector caps to manage residual value risk exposure, seeking to ensure an acceptable distribution of risk. The Group's large exposures are managed in accordance with regulatory reporting requirements.

Impairment process. The maintenance of adequate impairment allowances is considered a key issue from a credit control perspective. Impairment methodology is set out in credit policy and is subject to a rigorous governance process, including the preparation of a regular Impairment Review paper to executive management, consideration by dedicated business unit and divisional impairment review committees and the reporting to the group executive committee of material individual counterparty impairment charges.

Facilities database. A database is maintained of all non-retail customer relationships to assist in the identification and aggregation of cross-business unit commitments. The Group uses a system known as parent company executives, under which there is a central person responsible for each non-retail customer relationship, to whom other business units wishing to do business with the same customer must apply for credit limits.

Credit portfolio model. The Group models portfolio credit risk based on defaults, using a statistically-based model which calculates the economic equity employed and credit value at risk for each portfolio.

Stress testing and scenario analysis. The credit portfolio model is also used in stress-testing, to simulate a scenario and calculate its impact. Our modelling capabilities are currently subject to further development. Events are modelled both at a group wide level, at divisional and business unit level and by portfolio, for example, for a specific industry sector.

Risk assurance and oversight. Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams and Group Audit are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.

Risk appetite

Credit risk appetite is defined as the quantum and quality of the desired credit portfolio and the direction in which the Group wants to manage it, in order to achieve its short and long-term strategic goals.

Historically, credit risk appetite has been described through a series of policies, sector caps, country limits and the annual and planned bad debt charge. To supplement this, and provide a more forward looking view of credit risk, we have now embarked on the process of introducing more sophisticated metrics to define credit risk appetite, assisted by the introduction of more advanced rating systems across the Group to support Basel II developments. A number of different measures have been developed to describe the Group's credit risk appetite, since no single measure is considered sufficient. These metrics will be used as the basis for setting appetite ranges, at business unit, division and aggregated group level.

These appetite ranges will not replace the existing controls and measures set out above. It is expected that our appetite measures will be improved over time as usage is widened and methodologies developed.

Risk mitigation

Lloyds TSB Group uses a range of approaches to mitigate credit risk. In the case of individual exposures, the Group makes use of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. The Group will also consider the sale of assets, where credit concerns exist. Securitisation is another credit mitigation technique which receives consideration as does the use of credit derivative-based approaches.

Where it is efficient and likely to be effective (generally with counterparties with which it undertakes a significant volume of transactions), the Group enters into master netting arrangements. Although master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis, they do reduce the credit risk to the extent that if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period since it is affected by each transaction subject to the arrangement.

Market risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, arising from unexpected changes in financial prices, including interest rates, exchange rates and bond, commodity and equity prices. It arises in all areas of Lloyds TSB Group's activities and is managed by a variety of different techniques.

Sources

The Group's banking activities expose it to the risk of adverse movements in interest rates or exchange rates, with little or no exposure to equity or commodity risk.

- Most of the Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange and interest rate products. However, some interest rate and exchange rate positions are taken using derivatives and on-balance sheet instruments with the objective of earning a profit from favourable movements in market rates
- Market risk in the Group's retail portfolios and in the Group's capital funds arises from the different repricing characteristics of the Group's banking assets and liabilities. Interest rate risk arises from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets
- Foreign currency risk also arises from the Group's investment in its overseas operations

The Group's insurance activities also expose it to market risk, encompassing interest rate, exchange rate and equity risk.

- The management of with-profits funds leads to assets and liabilities that are mismatched with the aim of generating a higher rate of return to meet policyholders' expectations
- Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of these assets
- For other insurance liabilities the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch
- Surplus assets are held primarily in three portfolios; the surplus in the non-profit fund within the Long-Term Fund of Scottish Widows plc, assets in shareholder funds of life assurance companies and an investment portfolio within the general insurance business

The Group's defined benefit pension schemes are exposed to significant risks from the constituent parts of their assets, primarily equity and interest rate risk, and from the present value of their liabilities.

Control

The group asset and liability committee regularly reviews market risk exposure and makes recommendations to the group chief executive concerning overall market risk appetite and market risk policy.

Banking activity

- Trading is restricted to a number of specialist centres, the most important centre being financial markets division in London. These centres also manage market risk in the wholesale banking books, both in the UK and internationally. The level of exposure is strictly controlled and monitored within approved limits. Active management of the wholesale book is necessary to meet customer requirements and changing market circumstances.
- Market risk in the Group's retail portfolios and in the Group's capital funds is managed within limits set out in the policy for group balance sheet management, which is reviewed annually and approved by the group asset and liability committee. The structural foreign exchange position is managed having regard to the currency composition of the Group's risk-weighted assets and reported to the group asset and liability committee on a monthly basis. The objective is to limit the effect of exchange rate movements on the published risk asset ratio.

Insurance activity

- Market risk exposure from the insurance businesses are controlled via approved investment policies consistent with the Group's overall risk appetite and regularly reviewed by the group asset and liability committee
- With-profits funds are managed in accordance with the relevant fund's Principles and Practices of Financial Management
- The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match the cash flows
- Investment strategy for surplus assets held in excess of liabilities takes account of the regulatory and internal business requirements for capital to be held to support the business now and in the future

The Group liaises with the pension scheme trustees with regard to strategies for the overall mix of pension assets.

Risk appetite

Market risk appetite is defined as the quantum and composition of market risk that exists currently in the Group and the direction in which the Group wishes to manage this.

This statement of the Group's overall appetite for market risk is reviewed and approved annually by the board. The group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

Exposures

The primary market risk measure used within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. The use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. VaR is also not well suited to options positions. The Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity, and include interest rate re-pricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at group level, to simulate extreme conditions to supplement these core measures.

The risk of loss measured by the VaR model is the potential loss in earnings. The total and average trading VaR does not assume any diversification benefit across the three risk types. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole.

Trading

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding three years, the VaR for the years ended 31 December 2005 and 2004 based on the Group's global trading positions was as detailed in the table below (the table also aggregates potential loss measures from options portfolios).

	31 December 2005				31 December 2004			
	Closing £m	**Average £m**	**Maximum £m**	**Minimum £m**	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	**0.9**	**1.8**	**4.5**	**0.5**	0.7	0.9	1.7	0.5
Foreign exchange risk	**0.2**	**0.3**	**0.4**	**0.2**	0.2	0.3	0.6	0.2
Equity risk	**0.0**	**0.0**	**0.0**	**0.0**	0.0	0.0	0.0	0.0
Total VaR (no diversification)	**1.1**	**2.1**	**4.7**	**0.8**	0.9	1.3	2.0	0.8

Non-trading

The Group's banking non-trading exposure is summarised in the form of an interest rate repricing table, as set out in note 51 to the financial statements. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. However, the table does not take into account the effect of interest rate options used by the Group to hedge its exposure.

It is estimated that a hypothetical immediate and sustained 100 basis point increase in interest rates on 1 January 2006 would decrease net interest income by £112.5 million for the 12 months to 31 December 2006, while a hypothetical immediate and sustained 100 basis point decrease in interest rates would increase net interest income by £104.7 million. An analysis by currency is shown below.

	UK £m	**North America £m**	**Asia & Australasia £m**	**Europe & Middle East £m**	**Total 2006 £m**	Total 2005 £m
Change in net interest income from a +100 basis point shift in yield curves	**(76.4)**	**(25.7)**	**0.1**	**(10.5)**	**(112.5)**	(80.7)
Change in net interest income from a –100 basis point shift in yield curves	**68.6**	**25.7**	**(0.1)**	**10.5**	**104.7**	76.3

The analysis above is subject to certain simplifying assumptions including, but not limited to, all rates of all maturities worldwide move simultaneously by the same amount; all positions in the wholesale books run to maturity; and there is no management action in response to movements in interest rates, in particular no changes to product margins.

In practice, positions in both the retail and wholesale books are actively managed and actual impact on net interest income may be different to the model.

The composition, and value, of both the Scottish Widows plc Non-Profit Fund and the General Insurance portfolio are reported to Group Risk on a monthly basis and a VaR is calculated which is presented to the group asset and liability committee. The VaR methodology used is the same in all respects to that used for the traded risk in banking activities, except that in the case of equity risk, the model maps the portfolio composition onto a series of appropriate indices by region and sector. In addition the risks are calculated based on a 99 per cent confidence level and a ten day holding period. The figures quoted below are the sum of the two portfolios with no allowance for diversification between portfolios or asset classes and represents the potential loss in earnings.

The following table shows closing, average, maximum and minimum VaR for the years ended 31 December 2005 and 2004 on a 99 per cent confidence ten day basis.

	31 December 2005				31 December 2004			
	Closing £m	**Average £m**	**Maximum £m**	**Minimum £m**	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	**19.8**	**17.9**	**20.0**	**15.8**	15.5	16.1	17.9	11.2
Foreign exchange risk	**3.3**	**2.8**	**3.5**	**2.3**	2.4	2.7	3.4	2.2
Equity risk	**41.7**	**47.7**	**57.3**	**39.4**	55.2	54.2	56.4	51.6
Total VaR	**64.8**	**68.4**	**77.8**	**59.1**	73.1	73.0	75.9	67.1

The Group's structural foreign exchange position at 31 December 2005 is set out in note 51 to the financial statements. The position implies that at 31 December 2005 a hypothetical increase of 10 per cent in the value of sterling against all other currencies would have led to a £42 million reduction in reserves, and vice versa. On this basis, there would have been no material impact on Lloyds TSB Group's risk asset ratios.

Insurance risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements. This includes fluctuations in profits due to customer behaviour.

Sources

The major sources of insurance risk within the Group are the insurance businesses and the Group's defined benefit pension schemes. The nature of insurance business involves the accepting of insurance risks which relate primarily to mortality, morbidity, persistency, expenses, property damage and unemployment. The prime insurance risk carried by the Group's pension schemes is related to mortality.

Control

Control is exercised primarily through a suitable combination of high level committees/boards. For the life assurance businesses the key control body is the board of Scottish Widows Group Limited with the more significant risks also being subject to approval by the Lloyds TSB group executive committee and/or the Lloyds TSB Group board. For the general insurance businesses the key control body is the Lloyds TSB Insurance executive committee with the more significant risks again being subject to Lloyds TSB group executive committee and/or Lloyds TSB Group board approval. All group pension scheme issues are covered by the group asset and liability committee.

Insurance risks are measured through deterministic studies of the impact of different insurance market scenarios on the future free assets of the business together with relevant stochastic modelling.

New insurance proposals are underwritten to ensure an appropriate premium is charged for the risk or the risk is declined.

Limits are used as a control mechanism for insurance risk at policy level.

Exposures

Some insurance risks are retained while others are reinsured with external underwriters. The retained risk level is carefully controlled and monitored, with close attention being paid to underwriting, claims management, product design, policy wordings, adequacy of reserves, solvency management and regulatory requirements.

General Insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Detailed modelling, including that of the probable maximum loss under various catastrophe scenarios, supports the choice of reinsurance arrangements. Appropriate reinsurance arrangements also apply within the life and pensions businesses with significant mortality risk and morbidity risk being transferred to our chosen reinsurers.

Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present. This occurs as part of the new product approval process (see ‘Product and service risk’ on page 27).

Expenses are monitored by an analysis of the Group’s experience relative to budget. Reasons for any significant divergence from expectation are investigated and remedial action taken.

Persistency rates of life assurance policies, which relate to the rate of policy termination and the rate at which policies cease to pay regular premiums, are regularly assessed by reference to appropriate risk factors.

Operational risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people related or external events.

The Group continues to develop and refine its approach to managing operational risk. A consistent operational risk management framework for the timely identification, measurement, monitoring and control of operational risk has been introduced across the Group. Further development of operational risk metrics is taking place to seek to ensure that current and potential future operational risk exposures are understood in terms of both risk and reward potential.

The Group has seven sub operational risk types: governance risk, legal and regulatory risk, customer treatment risk, process and resource risk, theft, fraud and other criminal acts risk, people risk and change-related risk each of which is described in further detail below.

Governance

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from poor corporate governance at group, divisional and business unit level. Corporate governance in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise.

Control

The Group’s governance arrangements are based upon the following core principles:

- the interests of shareholders and other stakeholders are protected by ensuring that excessive powers are not delegated to individuals;
- decisions taken by management are consistent with the Group’s strategic objectives and risk appetite, which are approved by the board;
- managers are accountable for the management of risk, including internal controls, in their business;
- risk management arrangements and risk exposures (including material transactions, financial positions or portfolios) are subject to independent oversight;
- business is conducted in line with authorities and accountabilities ultimately delegated by the board; these are described within specific policies;
- clear accountabilities are delegated by management to people who have the right level of skills, competencies and experience;
- managers are required to safeguard against conflicts of interest;
- every member of staff is responsible for understanding and managing the risk they take on behalf of the Group and for ensuring that they act within the authorities and accountabilities delegated to them; and
- all staff are required to comply with group policies.

The Group’s policy is to maintain good corporate governance arrangements, as it believes this is consistent with the Group’s objective of maximising shareholder value over time. This includes the means by which risks are effectively managed in order to enable successful implementation of the Group’s strategy. The Group’s high level governance arrangements are described on pages 43 to 45. These arrangements reflect the Group’s policy which is that the board adheres to the principles contained in the Combined Code on corporate governance, issued by the Financial Reporting Council, when determining and reviewing its governance arrangements. The directors review the application of the principles and provisions of the Code annually.

The policy regarding organisational structure is that the Group seeks to optimise performance by allowing divisions, subsidiaries and business units to operate within established capital and risk parameters and the Group’s policy framework. Group policy requires that they must do so in a way which is consistent with realising the Group’s strategy and meets agreed business performance targets.

Group functions (eg Group Human Resources, Group Risk, Group Finance, Group Strategy, Group Audit) are established to provide functional leadership (eg policy, strategy, and standards), challenge and support across the Group and ensure information is consolidated at group level.

Group Audit has unrestricted access to all functions, property, records and staff. It independently reviews adherence to the policies and processes that make up the control environment, disseminating best practices throughout the Group in the course of its monitoring and corrective action activities. The director of group audit reports to and meets regularly with the group chief executive and the audit committee chairman and periodically with the audit committee.

Legal and regulatory risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable.

Control

The Group's business is regulated primarily by the UK Financial Services Authority ('FSA'), the Banking Code Standards Board (BCSB) and the Office of Fair Trading (OFT) and additionally by local regulators in offshore and overseas jurisdictions. Each business has a nominated individual with 'compliance oversight' responsibility under FSA rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

All compliance personnel also have a reporting line to the group compliance director who sets compliance standards across the Group and provides independent reporting and assessment to the board and business directors.

Group Compliance also provides leadership on compliance with money laundering and terrorist financing legislation and regulation across the Group. It sets group policy and standards on the topic and undertakes high level oversight of anti money laundering risks. A specialist team within Group Compliance provides a centre of excellence on the relevant legislation and regulation as well as interfacing with external public and private bodies in order to evolve the Group's approach and seek to ensure greater effectiveness and focus on key risk areas. Its remit also includes compliance with financial sanctions.

Each business unit is responsible for complying with relevant laws and legal principles. Business units have access to legal advice both internal and external. The group chief legal adviser provides policies to assist business units identify areas where legal risk management procedures are necessary. Reports to the group chief legal adviser are required in relation to both significant litigation and also material legal issues.

The group compliance director and the group chief legal adviser have access to the chairman and group chief executive.

Customer treatment risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate or poor customer treatment.

Control

The Group is committed to the fair treatment of its customers. It is an essential part of the way the Group conducts its business and develops deep long lasting relationships with its customers. A range of management information measures is in place across the Group to support the tracking of key customer treatment indicators. Group Risk and Group Audit are required to report regularly on customer treatment risk, management information trends and on compliance with the Group's standards.

Service improvements are monitored by customer satisfaction surveys, as well as internal process evaluations. The results of the research are fed into the Group's CARE Index, which measures ongoing performance against five principal objectives: customer understanding; accessibility; responsibility; expertise; and overall service quality improvement. This is tracked monthly and is a key indicator for the Group.

A framework is in place to guide the consideration and documentation of customer treatment risk when developing policies and procedures. The Group has defined customer treatment principles and benchmark standards in all the key areas and enhanced its processes and procedures for a number of individual initiatives including the governance of responsible lending and complaints handling. The divisions are required to meet or exceed these standards, tailoring customer treatment to the needs of each customer segment.

Trends across all the CARE Index categories are monitored and fed into a programme of continuous customer service improvement. The Group also provides its staff with clear FSA compliant guidelines and processes for dealing with customer complaints.

All advertising and marketing material is required to comply with the Group's governing policy on business conduct. Businesses are required to have procedures in place to seek to ensure that the material is clear, fair and not misleading bearing in mind the knowledge and sophistication of the customer. Any statement of fact should be substantiated through documentary evidence; any comparison should be made in a fair and balanced way; and any reference to past performance should clearly state the basis of measurement.

Process and resource risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems, people-related events, damage to resources (excluding human resources), and deficiencies in the performance of external suppliers/service providers.

Control

Businesses have primary responsibility for identifying and managing their process and resource risks. They employ internal control techniques to reduce their likelihood or impact to tolerable levels within the Group's risk appetite. Where appropriate, risk is mitigated by way of insurance.

The Group has defined high-level process and resource risk policies to seek to ensure a wide-ranging and consistent approach to the identification and management of process and resource risk.

Theft, fraud and other criminal acts risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from frauds carried out against the Group, and/or theft of the Group's assets, and other criminal acts.

Control

The Group has in place appropriate policies, procedures and tools for the management of theft, fraud and other criminal acts risks.

Business units and group functions have primary responsibility for identifying and managing fraud risk at a local level in consultation with the Group Financial Crime Unit. Additionally the group fraud strategy and policy committee is responsible for monitoring fraud risk as well as ensuring that fraud risks are effectively identified and assessed and that strategies for fraud prevention are effectively coordinated.

Group Security has primary responsibility for the security of the people, premises and assets, including identifying and developing countermeasures to minimise the impact of physical threats to the Group. Business unit management seek to ensure that the level of security risk applicable to each site they occupy is assessed, and that the appropriate security countermeasures are determined in order to protect people, premises and assets.

People

Definition

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

Control

The Group's approach to people management is to employ skilled, committed staff, working as a team for the benefit of customers and shareholders, who are given the opportunity to fulfil their potential; employ the highest ethical standards of behaviour and best practice management principles; and recruit on the basis of ability and competence.

Standards of behaviour. The Group has a code of business conduct which applies to all employees. It seeks to ensure that employees act with integrity and endeavour to deliver high levels of customer service. It promotes a working environment free from discrimination, harassment, bullying or victimisation of any kind. Employees are encouraged and expected to alert management to suspected misconduct, fraud or other serious malpractice. We provide mechanisms to facilitate disclosure if an employee is unable to inform their direct line management and will thoroughly investigate any reports made in good faith. The code as amended from time to time is available to the public on the Group's website at www.lloydstsb.com.

Performance and reward management. The Group seeks to ensure that all employees understand their role, the purpose of the role and where it fits into the wider team and organisational context. It manages and measures employees' performance and contribution to collective goals and recognises the contribution of individuals in the context of the pay market and the performance of the business in which they work and rewards appropriately.

Training and development. The Group believes that long-term success depends on the quality and skills of its staff and that it has a joint responsibility with employees for their personal and career development to improve current performance and to enhance future prospects.

Change-related risk

Definition

Change-related risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from change initiatives failing to deliver to requirements, budget or timescale or failing to implement change effectively or realise the desired benefits.

Control

To deliver the Group's strategic aims, change must be managed in an effective, risk-aware and appropriately controlled manner throughout the organisation. The Group's change management standards seek to ensure appropriate control across the project portfolio and the approach is regularly benchmarked against other leading institutions and practices. The Group's change management committee reviews the overall change portfolio monthly, with particular focus on initiatives having a high impact on customers and staff. The committee ensures that the aggregate impact of the implementation of change on customers, staff and systems is understood, managed and controlled.

Financial soundness

Definition

The risk of financial failure arising from lack of liquidity or capital, poor management or poor quality/volatile earnings.

Liquidity risk is defined as the risk of a loss arising from the Group's inability to meet its financial obligations as they fall due. These obligations include the repayment of deposits on demand or at their contractual maturity; the repayment of loan capital and other borrowings as they mature; the payment of insurance policy benefits, claims and surrenders; the payment of lease obligations as they become due; the payment of operating expenses and taxation; the payment of dividends to shareholders; the ability to fund new and existing loan commitments; and the ability to take advantage of new business opportunities.

The international standard for measuring capital adequacy is the risk asset ratio, which relates to on- and off-balance sheet exposures weighted according to broad categories of risk. The Group's capital ratios, calculated in line with the requirements of the FSA, are set out in detail on page 34.

Control

A policy is in place which requires a common methodology to measuring liquidity across the Group. The methodology derives a liquidity ratio calculated by taking the sum of liquid assets, five-day wholesale inflows and back-up lines, and then dividing this by the sum of five-day wholesale outflows and a percentage of retail maturities and contingent claims drawable over the next five days. The Group complies with the FSA's liquidity requirements and with similar liquidity policies in place across all trading centres worldwide. Compliance is monitored by regular liquidity returns to Group Treasury. Work is ongoing to seek to ensure the Group's compliance with the new liquidity framework being proposed by the FSA. The liquidity policy requires all authorised local treasury operations to maintain a liquidity ratio of over 100 per cent, in addition to ensuring compliance with local regulatory requirements. It is the responsibility of local line management to ensure that the liquidity policy is met and the sources and maturities of assets and liabilities are continually managed and appropriately diversified to avoid any undue concentration as market conditions evolve. Compliance is monitored by regular liquidity returns to Group Treasury.

For non-linked funds investments are arranged to minimise the possibility of being a distressed seller whilst at the same time investing to meet policyholder obligations. For unit-linked business, deferral provisions are designed to give time to realise linked assets without being a forced seller.

Lloyds TSB Group and its regulated subsidiary banks have been allocated an Individual Capital Ratio by the FSA, and the board has agreed a formal buffer to be maintained in addition to the Individual Capital Ratio. Actual or prospective breaches of the formal buffer must be notified to the FSA, together with proposed remedial action; no such notifications have been made during 2005. Informally, a further buffer is maintained. In addition, the board has agreed a maximum limit of the proportion of debt instruments in the capital base. Risk-weighted assets are monitored by businesses, while capital is controlled centrally.

Capital ratios are a key factor in the Group's budgeting and planning processes and updates of expected ratios are prepared regularly during the year. Capital raised takes account of expected growth and currency of risk assets and also allows for the sensitivity of the Group's capital to movements in equity markets.

The Group seeks to use appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. Each reporting entity within the Group has a finance function which is responsible for the production of financial, management and regulatory information. It is the responsibility of Group Finance to produce consolidated information for use internally and to meet external regulatory and statutory reporting requirements. Group Finance requires businesses and reporting entities to follow common processes and reporting standards.

Businesses or reporting entities have formal month-end and quarter-end procedures in place for preparation of management and financial accounts respectively, review and approval of management accounts at a determined level of detail, ensuring consistency with financial accounts, and preparation of forecasts and detailed annual budgets that are subject to formal review and approval. They are further required to implement measures to monitor performance at local level to identify significant fluctuations or unusual activity.

Liquidity sources

The principal sources of liquidity for Lloyds TSB Group plc are dividends received from its directly owned subsidiary company, Lloyds TSB Bank, and loans from this and other Lloyds TSB Group companies. The ability of Lloyds TSB Bank to pay dividends, or for Lloyds TSB Bank or other Lloyds TSB Group companies to make loans to Lloyds TSB Group plc, depends on a number of factors, including their own regulatory capital requirements, distributable reserves and financial performance.

Lloyds TSB Group plc is also able to raise funds by issuing loan capital or equity, although in practice Lloyds TSB Group plc has never issued equity for this purpose and the majority of Lloyds TSB Group's loan capital has been issued by Lloyds TSB Bank. As at 31 December 2005, Lloyds TSB Group plc had £1,502 million of subordinated debt in issuance compared with £12,402 million for the consolidated Lloyds TSB Group. The cost and availability of subordinated debt finance are influenced by credit ratings. A reduction in these ratings could increase the cost and could reduce market access. At 31 December 2005, the credit ratings of Lloyds TSB Bank were as follows:

	Senior debt
Moody's	Aaa
Standard & Poor's	AA

The rating outlook from Moody's for Lloyds TSB Bank is stable. The Standard & Poor's rating outlook is negative. These credit ratings are not a recommendation to buy, hold or sell any security; and each rating should be evaluated independently of every other rating.

A significant part of the liquidity of the Group's banking businesses arises from their ability to generate customer deposits. A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally provided a stable source of funding. During 2005, amounts deposited by customers increased by £11,259 million from £119,811 million at 31 December 2004 to £131,070 million at 31 December 2005. These customer deposits are supplemented by the issue of subordinated loan capital and wholesale funding sources in the capital markets, as well as from direct customer contracts. Wholesale funding sources include deposits taken on the inter-bank market, certificates of deposit, sale and repurchase agreements, a Euro Medium-Term Note programme, of which £6,683 million had been utilised for senior funding at 31 December 2005, and a commercial paper programme, under which £3,011 million had been utilised at 31 December 2005.

The ability to sell assets quickly is also an important source of liquidity for the Group's banking businesses. The Group holds sizeable balances of marketable debt securities which could be disposed of to provide additional funding should the need arise.

Group regulatory capital ratios

The international standard for measuring capital adequacy is the risk asset ratio, which relates regulatory capital to balance sheet assets and off-balance sheet exposures weighted according to broad categories of risk.

The Group's regulatory capital is divided into tiers defined by the European Community Banking Consolidation Directive as implemented in the UK by the FSA's Interim Prudential Sourcebook for Banks. Tier 1 comprises mainly shareholders' funds, tier 1 capital instruments and minority interests, after deducting goodwill and other intangible assets. Tier 2 comprises collective impairment provisions, and qualifying subordinated loan capital, with restrictions on the amount of collective impairment provisions and loan capital which may be included. The amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. Total capital is reduced by deducting investments in subsidiaries and associates which are not consolidated for regulatory purposes and investments in the capital of other credit/financial institutions. In the case of Lloyds TSB Group, this means that the net assets of its life assurance and general insurance businesses are deducted from the Group's regulatory capital.

Risk-weighted assets are determined according to a broad categorisation of the nature of each asset or exposure and counterparty and, for the trading book, by taking into account market-related risks.

	31 December 2005 £m	1 January 2005 £m
Capital:		
Tier 1	**11,478**	10,753
Tier 2	**10,447**	8,767
	21,925	19,520
Supervisory deductions	**(6,160)**	(6,219)
Total regulatory capital	**15,765**	13,301
Total risk-weighted assets	**144,921**	131,830
Risk asset ratios:		
Total capital	**10.9%**	10.1%
Tier 1	**7.9%**	8.2%

At 31 December 2005, the risk asset ratios were 10.9 per cent for total capital and 7.9 per cent for tier 1 capital. The 7.9 per cent tier 1 capital ratio appears higher than would perhaps be expected and reflects the higher level of supervisory deductions resulting from the Group's significant investment in its life assurance operations.

The Group's capital management policy is focused on optimising value for shareholders. There is a clear focus on delivering organic growth and expected capital retentions are sufficient to support planned levels of growth. However, management also wishes to maintain the flexibility to make value enhancing 'in market' acquisitions and therefore, at this stage, there are no plans to return capital to shareholders other than by way of dividend payments. Management will keep all options for the utilisation of capital under review.

There are strict limits imposed by the regulatory authorities as to the proportion of the Group's regulatory capital base that can be made up of subordinated debt and preferred securities. The Group's capacity to raise new debt capital for regulatory purposes increases as profits are retained; at 31 December 2005, the Group had capacity to raise approximately £1,000 million of tier 2 debt capital. The unpredictable nature of movements in the value of the investments supporting the long-term assurance funds could cause the amount of qualifying tier 2 capital to be restricted because of falling tier 1 resources. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

Regulatory capital position of the Group's life assurance businesses

Basis of determining regulatory capital of the life assurance business

Available capital resources

Available capital resources represent the excess of assets over liabilities calculated in accordance with detailed regulatory rules issued by the FSA. Different rules apply depending on the nature of the fund, as detailed below.

Statutory basis. Assets are generally valued on a basis consistent with that used for accounting purposes (with the exception that, in certain cases, the value attributed to assets is limited) and which follows a market value approach where possible. With the express permission of the FSA, an intangible asset can be recognised which represents the present value of future releases of prudent margins on business written. The liabilities are calculated using a projection of future cash flows after making prudent assumptions about matters such as investment return, expenses and mortality. Discount rates used to value the liabilities are set with reference to the risk adjusted yields on the underlying assets in accordance with the FSA rules. Other assumptions are based on recent actual experience, supplemented by industry information where appropriate. The assessment of liabilities does not include future bonuses for with-profits policies that are at the discretion of the Company, but does include a value for policyholder options likely to be exercised.

'Realistic' basis. The FSA requires each life assurance company which contains a with-profits fund in excess of £500 million, including Scottish Widows plc ('Scottish Widows'), to carry out a 'realistic' valuation of that fund. The word 'realistic' in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology.

The valuation of with-profits assets in the With-Profits Fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in the With-Profits Fund, it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

The realistic valuation of liabilities is carried out using a stochastic simulation model which values liabilities on a basis consistent with tradable market option contracts (a 'market-consistent' basis). The model takes account of policyholder behaviour on a best-estimate basis and includes an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities. Further details regarding the stochastic simulation model are given below in the section entitled 'Options and guarantees'.

Regulatory capital requirements

Each life assurance company must retain sufficient capital to meet the regulatory capital requirements mandated by the FSA; the basis of calculating the regulatory capital requirement is given below. For Abbey Life Assurance Company Limited ('Abbey Life'), the regulatory capital requirement is a combination of amounts held in respect of actuarial reserves and sums at risk (the Long-Term Insurance Capital Requirement) and amounts required to cover various stress tests. The regulatory capital requirement is deducted from the available capital resources to give 'statutory excess capital'.

For Scottish Widows, a further test is required in respect of the With-Profits Fund which compares the level of 'realistic excess capital' to the 'statutory excess capital' of the With-Profits Fund and, in circumstances where the 'realistic excess capital' position is less, the Company is required to hold additional capital to cover the shortfall. The 'realistic excess capital' is calculated as the difference between realistic assets and realistic liabilities of the With-Profits Fund with a further deduction to cover various stress tests. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component.

The determination of realistic liabilities of the With-Profits Fund in respect of Scottish Widows includes the value of internal transfers expected to be made from the With-Profits Fund to the Non-Profit Fund of Scottish Widows. These internal transfers include charges on policies where the associated costs are borne by the Non-Profit Fund. The value of the transfers exceeds the value of the costs which, in the case of Scottish Widows, results in the somewhat artificial increase in the With-Profits Insurance Capital Component of over £500 million.

Capital statement

The following table provides more detail regarding the sources of capital in the life assurance business and reconciles those amounts to the Group's balance sheet. The figures quoted are based on management's current expectations regarding completion of the annual financial return to the FSA.

	Scottish Widows plc									
	With-Profits Fund £m	Non-Profit Fund £m	Total Long-Term Fund £m	Share-holder's funds £m	Statutory basis £m	Consolidation adjustments £m	Total life business on a Group basis £m	Other sources of capital £m	Consolidation adjustments £m	Group total £m
Assets attributable to the shareholder held outside the long-term funds	–	–	–	1,513	1,513					
Assets attributable to the shareholder held within the long-term funds	–	2,619	2,619	–	2,619					
Total shareholders' funds	–	2,619	2,619	1,513	4,132	1,346	5,478	9,909	(5,192)	10,195
Adjustments onto a regulatory basis:										
Life assurance business										
Unallocated surplus within insurance business	494	–	494	–	494					
Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities	–	(456)	(456)	(767)	(1,223)					
Adjustment to include estimated 'realistic' liabilities payable to the shareholder	(729)	–	(729)	–	(729)					
Adjustment to replace 'realistic' liabilities with statutory liabilities	2,580	–	2,580	–	2,580					
Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With-Profits Fund	(43)	–	(43)	–	(43)					
Recognition of future profits for regulatory capital purposes	–	500	500	–	500					
Banking business										
Collective impairment provisions								1,782		1,782
Goodwill								(2,373)		(2,373)
Pensions deficit adjustment								1,372		1,372
Other								13		13
Qualifying loan capital	–	–	–	561	561	(561)	–	10,936		10,936
Available capital resources – insurance business	2,302	2,663	4,965	1,307	6,272					
Supervisory deductions										
Net investment in life assurance business										(5,478)
Other										(682)
Available capital resources – Group										15,765

The figures shown above for available capital resources within the insurance business relate to Scottish Widows plc only. The amounts relating to the other life assurance subsidiaries within the Group are not significant.

Formal intra-group capital arrangements

Scottish Widows has a formal arrangement with one of its subsidiary undertakings, Scottish Widows Unit Funds Limited, whereby the subsidiary company can draw down capital from Scottish Widows to finance new business which is reinsured from the parent to its subsidiary. Scottish Widows has also provided subordinated loans to its subsidiary Scottish Widows Annuities Limited and its fellow group undertaking Scottish Widows Bank plc.

Constraints over available capital resources

Scottish Widows was created following the demutualisation of Scottish Widows Fund and Life Assurance Society in 2000. The terms of the demutualisation are governed by a Court-approved Scheme of Transfer (the 'Scheme') which, inter alia, created a With-Profits Fund and a Non-Profit Fund and established protected capital support for the with-profits policyholders in existence at the date of demutualisation. Much of that capital support is held in the Non-Profit Fund and, as such, the capital held in that fund is subject to the constraints noted below.

Requirement to maintain a Support Account. The Scheme requires the maintenance of a 'Support Account' within the Non-Profit Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Profit Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account in assessing the realistic value of assets available to the With-Profits Fund. At 31 December 2005, the estimated value of surplus admissible assets in the Non-Profit Fund was £2,163 million (31 December 2004: £2,222 million) and the value of the Support Account was £1,115 million (31 December 2004: £1,265 million).

Further Support Account. The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Profit Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Profit Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2005, the net economic value of the Non-Profit Fund and its subsidiaries for the purposes of this test was £4,140 million (31 December 2004: £4,185 million) and the combined value of the Support Account and Further Support Account was £2,836 million (31 December 2004: £2,704 million).

Other restrictions in the Non-Profit Fund. In addition to the policies which existed at the date of demutualisation, the With-Profits Fund includes policies which have been written since that date. As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2005 is £267 million (31 December 2004: £300 million). There is a further test requiring that no amounts can be transferred from the Non-Profit Fund of Scottish Widows unless there are sufficient assets within the Long-Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

Movements in regulatory capital

The primary reasons for the movement in total available capital resources during the year are as follows:

With-Profits Fund

Available capital in the With-Profits Fund has increased from £1,351 million at 31 December 2004 to an estimated £2,302 million at 31 December 2005 primarily as a result of strong investment market performance.

Non-Profit Fund

Available capital in the Non-Profit Fund has decreased from £2,222 million at 31 December 2004 to an estimated £2,163 million (excluding the recognition of future profits) at 31 December 2005. This is primarily a result of proposed transfers from the Non-Profit Fund to the Shareholder Fund at the year end of £559 million. One of those proposed transfers relates to an investment in Abbey Life which, following a transfer of capital amounting to £560 million from the Shareholder Fund, was acquired by the Non-Profit Fund during the year at market value and then written down to its regulatory value in accordance with FSA asset valuation rules. The effect of these transactions has to a degree been offset by strong investment return and the emergence of surplus.

Shareholder Fund

Available capital in the Shareholder Fund has increased from £770 million at 31 December 2004 to an estimated £1,307 million at 31 December 2005. During the year the Shareholder Fund issued £560 million of subordinated debt and, as noted above, transferred this amount into the Non-Profit Fund. This transaction has had no effect on the available capital of the Shareholder Fund. The reason for the increase in available capital is primarily a result of the proposed transfers from the Non-Profit Fund noted above.

Financial information calculated on a 'realistic' basis

The estimated financial position of the With-Profits Fund of Scottish Widows at 31 December 2005, calculated on a 'realistic' basis, is given in the following table, in the form that the information will be reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the 'realistic' financial position of the Long-Term Fund of Scottish Widows as a whole, which consists of both the With-Profits Fund and the Non-Profit Fund.

	31 December 2005		31 December 2004	
	With-Profits Fund £m	**Long-Term Fund £m**	With-Profits Fund £m	Long-Term Fund £m
Realistic value of assets of fund	**19,018**	**23,242**	17,814	22,012
Support arrangement assets (value of 'Support Account')	**1,115**	**–**	1,265	–
Realistic value of assets available to the fund	**20,133**	**23,242**	19,079	22,012
Realistic value of liabilities of fund	**(19,253)**	**(19,102)**	(18,108)	(17,827)
Working capital for fund	**880**	**4,140**	971	4,185
Working capital ratio for fund	**4.4%**	**17.8%**	5.1%	19.0%

Scottish Widows continues to be well capitalised with the working capital ratios for the With-Profits Fund and the Long-Term Fund being an estimated 4.4 per cent (31 December 2004: 5.1 per cent) and 17.8 per cent (31 December 2004: 19.0 per cent) respectively. The decrease in the Long-Term Fund ratio is a result of the proposed transfers to the Shareholder Fund noted above.

The financial information calculated on a 'realistic' basis reconciles to the Capital Statement as follows:

	31 December 2005	
	With-Profits Fund £m	**Long-Term Fund £m**
Available regulatory capital	**2,302**	**4,965**
Support arrangement assets	**1,115**	**–**
Adjustments to replace statutory liabilities with 'realistic' liabilities	**(2,580)**	**(2,291)**
Adjustments to include the value of future profits recognised in respect of Non-Participating business written in the With-Profits Fund	**43**	**43**
Removal of future profits allowable for regulatory capital purposes	**–**	**(500)**
Recognition of future profits allowable for 'realistic' capital purposes	**–**	**1,923**
	880	**4,140**

Analysis of policyholder liabilities in respect of the Group's life assurance business:

	Scottish Widows plc				
	With-Profits Fund (in accordance with FRS 27) £m	Non-Profit Fund £m	Total long-term fund £m	Other long-term funds £m	Total life business £m
With-Profits Fund liabilities	18,720	–	18,720	133	18,853
Unit-linked business (excluding those accounted for as investment contracts)	–	8,041	8,041	2,738	10,779
Other life assurance business	–	8,671	8,671	1,653	10,324
Insurance and participating investment contract liabilities	18,720	16,712	35,432	4,524	39,956
Non-participating investment contract liabilities	–	14,624	14,624	7,215	21,839
Total policyholder liabilities	18,720	31,336	50,056	11,739	61,795

Capital sensitivities

Shareholders' funds

Shareholders' funds outside the long-term business fund, other than those used to match regulatory requirements, are mainly invested in assets that are less sensitive to market conditions.

With-Profits Fund

The with-profits realistic liabilities and the available capital for the With-Profits Fund are sensitive to both market conditions and changes to a number of non-economic assumptions that affect the valuation of the liabilities of the fund. The available capital resources (and capital requirements) are most sensitive to the level of the stock market, with the position worsening at lower stock market levels as a result of the guarantees to policyholders increasing in value. An increase in the level of equity volatility implied by the market cost of equity put options also increases the market consistent value of the options given to policyholders and worsens the capital position.

The most critical non-economic assumptions are the level of take-up of options inherent in the contracts (higher take up rates are more onerous), mortality rates (lower mortality rates are generally more onerous) and lapses prior to dates at which a guarantee would apply (lower lapse rates are generally more onerous where guarantees are in the money). The sensitivity of the capital position and capital requirements of the With-Profits Fund is partly mitigated by the actions that can be taken by management.

Other long-term funds

Outside the With-Profits Fund, assets backing actuarial reserves in respect of policyholder liabilities are invested so that the values of the assets and liabilities are broadly matched. The most critical non-economic assumptions are mortality rates in respect of annuity business written (lower mortality rates are more onerous). The Group has reduced its exposure to deteriorating mortality rates in respect of life assurance contracts through its reinsurance arrangements. In addition, poor cost control would gradually depreciate the available capital and lead to an increase in the valuation of the liabilities (through an increased allowance for future costs).

Assets held in excess of those backing actuarial reserves are invested across a range of investment categories including fixed interest securities, equities, properties and cash. The mix of investments is determined in line with the policy of Lloyds TSB Group to optimise shareholder risk and return. The value of the investments is sensitive to prevailing conditions in the markets selected.

Options and guarantees

The Group has sold insurance products that contain options and guarantees, both within the With-Profits Fund and in other funds.

Options and guarantees within the With-Profits Fund

The most significant options and guarantees provided from within the With-Profits Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies. For those policies written pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With-Profits Fund of Scottish Widows called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2005 of £1.7 billion (2004: £1.4 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as persistency and mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

As noted above, under the realistic capital regime of the FSA, the liabilities of the With-Profits Fund are valued using a market-consistent stochastic simulation model. This model is used in order to place a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are:

- *Risk-free yield curve*. This is derived from the yield on UK gilts, with an additional 0.1 per cent yield assumed to be risk-free;
- *Investment volatility.* This is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2005, the 10 year equity-implied at-the-money assumption was set at 20.0 per cent (31 December 2004: 18.0 per cent). The long-term at-the-money assumptions for property and fixed interest stocks were 15.0 per cent (31 December 2004: 15.0 per cent) and 13.5 per cent (31 December 2004: 13.0 per cent) respectively.

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take up rates and assumptions regarding persistency (both of which are based on recent actual experience), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

Options and guarantees outside the With-Profits Fund of Scottish Widows

Abbey Life currently has a number of policies in-force which have a guaranteed annuity option. In total it holds traditional regulatory reserves of £332 million to cover this liability at 31 December 2005 (£288 million at 31 December 2004). These reserves have been determined using prudent future interest rate, mortality rate and rate of annuity option take-up assumptions and exceed the value that would be placed on them using a market-consistent stochastic model. It is estimated that a 0.5 per cent reduction in future interest rates would increase the liability by some £54 million.

Under some of Abbey Life's older contracts, the maturity value or the surrender value at the end of the selected period is guaranteed to be not less than total premiums paid or sums assured. The total provision for these options was £5 million at 31 December 2005 (£11 million at 31 December 2004) and was established using stochastic techniques after making prudent assumptions.

In both Abbey Life and Scottish Widows, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £108 million (31 December 2004: £89 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £8 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £19 million.

Five year financial summary

The financial information set out in the table below has been derived from the annual reports and accounts of Lloyds TSB Group plc for each of the past five years. 2005 is the first year in which the annual report and accounts have been prepared under International Financial Reporting Standards (IFRS). 2004 and earlier years have been prepared under UK Generally Accepted Accounting Principles (UK GAAP) and earlier years have been adjusted for subsequent changes in accounting policy and presentation. To bridge the change in framework, 2004 figures have been presented under both IFRS and UK GAAP. Under IFRS, accounting standards dealing with financial instruments (IAS 32 and IAS 39) and insurance (IFRS 4 and FRS 27) have been applied only from 1 January 2005. The comparative IFRS balance sheet data is presented as at 1 January 2005; the 2005 and 2004 IFRS income statement data are not comparable. Details of changes to the Group's 2004 figures arising from transition to IFRS and accounting changes under IFRS that are effective from 1 January 2005 and which do not affect 2004 IFRS comparatives are outlined in note 54 to the 2005 accounts and in the Group's announcement setting out the effects of the implementation of IFRS and FRS 27 published on 27 May 2005. The financial statements for 2001 were audited by PricewaterhouseCoopers, independent accountants; the financial statements for each of the years 2002 to 2005 have been audited by their successor firm PricewaterhouseCoopers LLP, independent accountants.

	IFRS		UK GAAP			
	2005	2004	2004	2003	2002	2001
Income statement data for the year ended 31 December (£m)						
Net interest income	**5,671**	5,110	4,920	5,255	5,171	4,922
Other income	**17,055**	14,173	4,647	4,653	3,716	3,966
Trading surplus	**5,069**	4,364	4,650	4,735	3,974	4,119
Impairment losses on loans and advances	**(1,299)**	(866)	(866)	(950)	(1,029)	(747)
Profit before tax	**3,820**	3,477	3,493	4,348	2,618	3,167
Profit for the year	**2,555**	2,459	2,489	3,323	1,852	2,290
Profit for the year attributable to equity shareholders	**2,493**	2,392	2,421	3,254	1,790	2,233
Total dividend for the year[1]	**1,915**	1,914	1,914	1,911	1,908	1,872
	31 December 2005	1 January 2005	31 December 2004	31 December 2003	31 December 2002	31 December 2001
Balance sheet data (£m)						
Share capital	**1,420**	1,419	1,419	1,418	1,416	1,411
Shareholders' equity	**10,195**	9,489	9,977	9,624	7,943	10,326
Net asset value per ordinary share	**180p**	167p	176p	170p	140p	183p
Customer accounts	**131,070**	126,349	122,062	116,496	116,334	109,116
Undated subordinated loan capital	**7,733**	6,614	5,852	5,959	5,496	4,102
Dated subordinated loan capital	**4,669**	4,597	4,400	4,495	4,672	4,006
Loans and advances to customers	**174,944**	161,162	154,240	135,251	134,474	122,935
Total assets	**309,754**	292,854	279,843	252,012	252,561	235,501
	2005	2004	2004	2003	2002	2001
Share information						
Basic earnings per ordinary share	**44.6p**	42.8p	43.3p	58.3p	32.1p	40.4p
Diluted earnings per ordinary share	**44.2p**	42.5p	43.0p	58.1p	32.0p	40.0p
Total dividend per ordinary share[1]	**34.2p**	34.2p	34.2p	34.2p	34.2p	33.7p
Market price (year-end)	**488.5p**	473p	473p	448p	446p	746p
Number of shareholders (thousands)	**920**	953	953	974	973	981
Number of ordinary shares in issue (millions)[2]	**5,603**	5,596	5,596	5,594	5,583	5,564
	2005	2004	2004	2003	2002	2001
Financial ratios (%)[3]						
Dividend payout ratio	**76.8**	80.0	79.1	58.7	106.6	83.8
Post-tax return on average shareholders' equity	**25.6**	22.8	24.3	38.5	16.8	18.1
Post-tax return on average risk-weighted assets	**1.81**	1.99	2.01	2.63	1.62	2.26
Cost:income ratio[4]	**51.9**	54.8	51.4	52.2	55.3	53.7
	31 December 2005	1 January 2005	31 December 2004	31 December 2003	31 December 2002	31 December 2001
Capital ratios (%)						
Total capital	**10.9**	10.1	10.0	11.3	9.6	8.8
Tier 1 capital	**7.9**	8.2	8.9	9.5	7.7	7.7

[1] Annual dividends comprise both interim and final dividend payments. Under IFRS, the total dividend for the year represents the interim dividend paid during the year and the final dividend which will be paid and accounted for during the following year. Under UK GAAP, final dividends are included in the year to which they relate rather than in the year in which they are paid.

[2] This figure excludes 79 million limited voting ordinary shares.

[3] Averages are calculated on a monthly basis from the consolidated financial data of Lloyds TSB Group.

[4] The cost:income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims for the IFRS numbers in 2004 and 2005).

The board

Non-executive directors

Maarten A van den Bergh◆◆++
Chairman
(retiring at the annual general meeting on 11 May 2006)
Joined the board in 2000 as deputy chairman and was appointed chairman in 2001. Joined the Royal Dutch/Shell Group of companies in 1968 and after a number of senior and general management appointments in that group, became group managing director in 1992. Appointed president of Royal Dutch Petroleum Company and vice chairman of the committee of managing directors of the Royal Dutch/Shell Group in 1998 and continued in these roles until 2000. A non-executive director of Royal Dutch Shell, BT Group and British Airways, and a member of the supervisory board of Akzo Nobel. Aged 63.

Sir Victor Blank
Deputy Chairman
(succeeding Maarten van den Bergh as chairman)
Joins the board on 1 March 2006 as deputy chairman. Will succeed Maarten van den Bergh as chairman following the annual general meeting in May 2006. Former partner in Clifford-Turner (now Clifford Chance) from 1969 to 1981 and chairman and chief executive of Charterhouse until 1997. Director of The Royal Bank of Scotland from 1985 to 1993. Chairman of GUS and Trinity Mirror (until May 2006) and a member of the Financial Reporting Council and of the Council of Oxford University. Chairs two charities, WellBeing of Women and UJS Hillel, as well as the Council of University College School. Aged 63.

Wolfgang C G Berndt✠††
Joined the board in 2003. Joined Procter and Gamble in 1967 and held a number of senior and general management appointments in Europe, South America and North America, before retiring in 2001. A non-executive director of Cadbury Schweppes and GfK AG. Board member of the Institute for the Future. Aged 63.

Ewan Brown CBE FRSE▲◆+**
Chairman of Lloyds TSB Scotland
Joined the board in 1999. A non-executive director of Lloyds TSB Scotland since 1997. Joined Noble Grossart in 1969 and was an executive director of that company until December 2003. Chairman of Transport Initiatives Edinburgh. A non-executive director of John Wood Group, Noble Grossart and Stagecoach Group. Aged 63.

Jan P du Plessis✠*
Joined the board in October 2005. Chairman of British American Tobacco and RHM. Held a number of senior and general management appointments in Rembrandt Group from 1981, before joining Compagnie Financière Richemont as group finance director in 1988, a position he held until 2004. From 1990 to 1995 he was also the group finance director of Rothmans International. Aged 52.

Gavin J N Gemmell CBE✠*
Chairman of Scottish Widows
Joined the board in 2002. A non-executive director of Scottish Widows, having been appointed to the board of that company before it became a member of the Lloyds TSB Group. Retired as senior partner of Baillie Gifford in 2001, after 37 years with that firm. A non-executive director of Archangel Informal Investment. Chairman of the Court of Heriot-Watt University. Aged 64.

Sir Julian Horn-Smith✠†+
Joined the board in January 2005. Joined Vodafone in 1984 and held a number of senior and general management appointments before being appointed to the board of that company in 1996 and deputy chief executive officer in 2005. Previously held positions in Rediffusion from 1972 to 1978, Philips from 1978 to 1982 and Mars GB from 1982 to 1984. A non-executive director of Smiths Group. Aged 57.

DeAnne S Julius CBE✠†◆
Joined the board in 2001. Held a number of senior appointments in the UK and USA with the World Bank, Royal Dutch/Shell Group and British Airways, before membership of the Bank of England Monetary Policy Committee from 1997 to 2001. Chaired HM Treasury's banking services consumer codes review group in 2000/1. Chairman of the Royal Institute of International Affairs. A non-executive director of BP, Serco Group and Roche Holdings SA. Aged 56.

Angela A Knight✠*
Joined the board in 2003. Deputy chairman of Scottish Widows, having been appointed to the board of that company before it became a member of the Lloyds TSB Group. A member of parliament from 1992 to 1997 and Economic Secretary to the Treasury from 1995 to 1997. Chief executive of the Association of Private Client Investment Managers and Stockbrokers. A non-executive director of LogicaCMG and the Port of London Authority. Aged 55.

Lord Leitch✠*
Joined the board in October 2005. Held a number of senior and general management appointments in Allied Dunbar, Eagle Star and Threadneedle Asset Management before the merger of Zurich Group and British American Tobacco's financial services businesses in 1998. Subsequently served as chairman and chief executive officer of Zurich Financial Services (UK & Asia Pacific) until his retirement in 2004. Chairman of HM Treasury's Review of Skills and the National Employment Panel, and deputy chairman of the Commonwealth Education Fund. A non-executive director of United Business Media and BUPA. Aged 58.

* Member of the audit committee
** Chairman of the audit committee
◆ Member of the nomination committee
◆◆ Chairman of the nomination committee
† Member of the remuneration committee
†† Chairman of the remuneration committee
\+ Member of the risk oversight committee
++ Chairman of the risk oversight committee
✠ Independent director
▲ Senior independent director

Executive directors

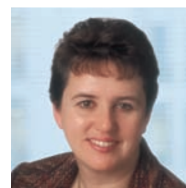
J Eric Daniels
Group Chief Executive
Joined the board in 2001 as group executive director, UK retail banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. Aged 54.

Michael E Fairey
Deputy Group Chief Executive
Joined TSB Group in 1991 and held a number of senior and general management appointments before being appointed to the board in 1997 and deputy group chief executive in 1998. Joined Barclays Bank in 1967 and held a number of senior and general management appointments, including managing director of Barclays Direct Lending Services from 1990 to 1991. President of The British Quality Foundation. Aged 57.

Terri A Dial
Group Executive Director
UK Retail Banking
Joined the board in June 2005. Served with Wells Fargo in the USA from 1973 to 2001 where she held a number of senior and general management appointments before becoming president and chief executive officer of Wells Fargo Bank in 1998. A non-executive director of the LookSmart Corporation and Onyz Software. Aged 56.

Archie G Kane
Group Executive Director
Insurance and Investments
Joined TSB Commercial Holdings in 1986 and held a number of senior and general management appointments in Lloyds TSB Group before being appointed to the board in 2000, as group executive director, IT and operations. Appointed group executive director, insurance and investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. Aged 53.

G Truett Tate
Group Executive Director
Wholesale and International Banking
Joined the Group in 2003 as managing director, corporate banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. Aged 55.



Helen A Weir
Group Finance Director
Joined the board in 2004. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q from 1997, having joined that company in 1995, and held a senior position at McKinsey & Co from 1990 to 1995. Began her career at Unilever in 1983. A non-executive director of Royal Mail Holdings and a member of the Accounting Standards Board. Aged 43.

Company Secretary
Alastair J Michie FCIS FCIBS

Directors' report

Results and dividends

The consolidated income statement on page 59 shows a profit attributable to shareholders for the year ended 31 December 2005 of £2,493 million.

An interim dividend of 10.7p per ordinary share was paid on 5 October 2005 and a final dividend of 23.5p per ordinary share will be paid on 3 May 2006. These dividends will absorb £1,915 million.

Principal activities, business review, future developments and financial risk management objectives and policies

The Company is a holding company and its subsidiaries provide a wide range of banking and financial services through branches and offices in the UK and overseas. A review of the business and an indication of future developments are given on pages 4 to 38. Information regarding the financial risk management objectives and policies of the Company and its subsidiary undertakings, in relation to the use of financial instruments, is given on pages 24 to 34 and in note 51 on pages 107 to 111.

Authority to purchase shares

The authority for the Company to purchase, in the market, up to 567 million of its shares, representing some 10 per cent of the issued ordinary share capital, expires at the annual general meeting. Shareholders will be asked, at the annual general meeting, to give a similar authority.

Directors

Biographical details of directors are shown on pages 40 and 41. Particulars of their emoluments and interests in shares in the Company are given on pages 46 to 57.

Dr Gibson-Smith and Mr Pritchard left the board at the annual general meeting in 2005. Mr Ayliffe left the board on 31 January 2005.

Sir Julian Horn-Smith joined the board on 1 January 2005 and was elected at the annual general meeting on 5 May 2005.

Ms Dial joined the board on 1 June 2005, Mr du Plessis and Lord Leitch joined the board on 1 October 2005 and Sir Victor Blank joins the board on 1 March 2006. In accordance with the articles of association, they offer themselves for election at the annual general meeting.

Also in accordance with the articles of association, Mr Kane retires at the annual general meeting and offers himself for re-election.

Employees

Lloyds TSB Group is committed to employment policies which follow best practice, based on equal opportunities for all employees irrespective of sex, race, national origin, religion, colour, disability, sexual orientation, age or marital status.

In the UK, Lloyds TSB Group supports Opportunity Now and is represented on the board of Race for Opportunity; campaigns to improve opportunities for women and ethnic minorities in the work place. Lloyds TSB Group is a gold card member of the Employers' Forum on Disability, in support of employment of people with disabilities. This recognises the need for ensuring fair employment practices in recruitment and selection, and the retention, training and career development of disabled staff.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Schemes offering share options or the acquisition of shares are available for most staff, to encourage their financial involvement in Lloyds TSB Group.

Directors' indemnities

Directors' service agreements or letters of appointment, which are available for inspection, contain indemnities as provided for in the Companies (Audit, Investigations and Community Enterprise) Act 2004.

Donations

The income statement includes a charge for charitable donations totalling £34,870,000 (2004: £31,571,000), including £34,450,000 (2004: £31,230,000) under deeds of covenant to the four Lloyds TSB Foundations, which will be paid during 2006.

Policy and practice on payment of creditors

The Company follows 'The Better Payment Practice Code' published by the Department of Trade and Industry (DTI), regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the DTI as shown on page 129.

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

As the Company owed no amounts to trade creditors at 31 December 2005, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is nil.

Auditors

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditors and authorising the audit committee to set their remuneration will be proposed at the annual general meeting.

On behalf of the board

A J Michie
Company Secretary
23 February 2006

Corporate governance

Compliance with the combined code

The board considers that good governance is central to achieving the Group's governing objective of maximising shareholder value over time. That has been uppermost in directors' minds when applying the principles contained in the combined code on corporate governance issued by the Financial Reporting Council. The Group has complied with the provisions of the code, and has done so throughout the year regarding the code provisions whose requirements are of a continuing nature.

The board and its committees

The Group is led by a board comprising executive and non-executive directors with wide experience. The appointment of directors is considered by the board and, following the provisions in the articles of association, they must stand for election by the shareholders at the first annual general meeting following their appointment and must retire, and may stand for re-election by the shareholders, at least every three years. Executive directors normally retire at age 60, as required by their service agreements. Independent non-executive directors are appointed for three-year renewable terms, which may be terminated without notice or payment of compensation.

The board meets at least nine times a year. It has a programme designed to enable the directors regularly to review corporate strategy and the operations and results of the businesses and discharge their duties within a framework of prudent and effective controls relating to the assessing and managing of risk.

The roles of the chairman, the group chief executive and the board and its governance arrangements, including the schedule of matters specifically reserved to the board for decision, are reviewed annually. The matters reserved to the board for decision include the approval of the annual report and accounts and any other financial statements; the payment of dividends; the long-term objectives of the Group; the strategies necessary to achieve these objectives; the Group's budgets and plans; significant capital expenditure items; significant investments and disposals; the basis of allocation of capital within the Group; the organisation structure of the Group; the arrangements for ensuring that the Group manages risks effectively; any significant change in accounting policies or practices; the appointment of the Company's main professional advisers; and the appointment of senior executives within the organisation and the related forward planning.

The board has delegated to management the power to make decisions on operational matters, including those relating to credit, liquidity and market risk, within an agreed framework.

All directors have access to the services of the company secretary, and independent professional advice is available to the directors at the Group's expense, where they judge it necessary to discharge their duties as directors.

The board evaluates its performance and that of its committees and individual directors. The process adopted, using an internally produced questionnaire, affords directors the opportunity, through their membership of boards of other companies, in the UK and overseas, to draw on their experience to endeavour to ensure that the Group follows best practice. It also enables directors to suggest how the board's procedures may be improved; to assess strengths and weaknesses; and to address its balance of skills, knowledge and experience. The committees, themselves, assess their respective roles, performance and terms of reference and report accordingly to the board.

The chairman's performance is evaluated by the non-executive directors, taking account of the views of executive directors. This appraisal is discussed at a meeting of the non-executive directors, led by the senior independent director, without the chairman being present.

The remuneration committee reviews the performance of the chairman, the deputy chairman, the group chief executive and the other group executive directors, when considering their remuneration arrangements. The nomination committee reviews the performance of all the directors. Like all board committees, the nomination committee and remuneration committee report to the board on their deliberations, including the results of these performance evaluations.

The chairman has a private discussion at least once a year with every director on a wide range of issues affecting the Group, including any matters which the directors, individually, wish to raise.

There is an induction programme for all new directors, which is tailored to their specific requirements and includes visits to individual businesses and meetings with senior management. Additional training and updates on particular issues are arranged as appropriate.

Meetings with shareholders

In order to develop an understanding of the views of major shareholders, the board receives regular reports from the group finance director and the director of investor relations.

The chairman, the group chief executive and the group finance director also have meetings with representatives of major shareholders and the senior independent director also attends some of these meetings. In addition, all directors are invited to attend investment analysts' and stockbrokers' briefings on the financial results.

All shareholders are encouraged to attend and participate in the Group's annual general meeting.

Each resolution considered at the annual general meeting in 2005 was decided on a poll. Votes representing some 50 per cent of the total number of shares in issue were cast and each resolution was passed by a substantial majority. Details of the poll results are available from the company secretary.

The resolutions to be considered at the annual general meeting in 2006 will also be decided on a poll. Details of the results will be announced on our website, www.lloydstsb.com and will also be available from the company secretary.

Audit committee

The audit committee comprises Mr Brown (chairman), Mr du Plessis, Mr Gemmell, Mrs Knight and Lord Leitch. The committee's terms of reference are available from the company secretary and are displayed on the Company's website www.lloydstsb.com.

During the year, the audit committee received reports from, and held discussions with, management and the auditors. In discharging its duties, the committee has approved the auditors' terms of engagement, including their remuneration and, in discussion with them, has assessed their independence and objectivity (more information about which is given in note 10 to the accounts, in relation to the procedure for approving fees for audit and non-audit work) and recommended their re-appointment at the annual general meeting. The committee also reviewed the financial statements published in the name of the board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; the scope of the work of the Group's internal audit department, reports from that department and the adequacy of its resources; the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations (more information about which is given in the note about internal control on page 45); the results of the external audit and its cost effectiveness; reports from the external auditors on audit planning and their findings on accounting and internal control systems; and the committee's own role and performance. Procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence were established by the committee. The committee also had a meeting with the auditors, without executives present, and a meeting with the head of internal audit alone.

Chairman's committee

The chairman's committee, comprising the chairman, the group chief executive and the deputy group chief executive, meets to assist the chairman in preparing for board meetings.

The committee may have specific powers delegated to it by the board from time to time and following the exercising of these powers, it reports to the board.

Group executive committee

The group executive committee, comprising the group chief executive, the deputy group chief executive, the group executive directors, the chief risk director, the group human resources director and the director of group IT and operations, meets to assist the group chief executive in performing his duties. Specifically, the committee considers the development and implementation of strategy, operational plans, policies and budgets; the monitoring of operating and financial performance; the assessment and control of risk; the prioritisation and allocation of resources; and the monitoring of competitive forces in each area of operation. The committee, assisted by its sub-committees, the group business risk and group asset and liability committees, also supports the group chief executive in endeavouring to ensure the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and in reviewing the Group's aggregate risk exposures and concentrations of risk.

The committee may have specific powers delegated to it by the board from time to time and following the exercising of these powers, it reports to the board. To comply with the Group's articles of association, only committee members who are also directors of the Company participate in the exercising of any powers delegated by the board.

Nomination committee

The nomination committee, comprising Mr van den Bergh (chairman), Mr Brown and Dr Julius, reviews the composition of the board, taking into account the skills, knowledge and experience of directors and considers and makes recommendations to the board on potential candidates for appointment as directors. The committee also makes recommendations to the board concerning the re-appointment of any independent non-executive director by the board at the conclusion of his or her specified term; the re-election of any director by the shareholders under the retirement provisions of the articles of association; any matters relating to the continuation in office of a director; and the appointment of any director to executive or other office, other than the positions of chairman and group chief executive, the recommendation for which would be made at a meeting of the non-executive directors.

During the year, the committee recommended the appointment of one executive director and two non-executive directors. In that regard, detailed role specifications were drawn up, external search consultants were engaged and candidates were interviewed by committee members and the other directors.

In January 2006, it was announced that Mr van den Bergh had decided to retire as chairman of the Group at the annual general meeting in May. Sir Victor Blank will become deputy chairman on 1 March and, subject to shareholder approval of his election as a director at the annual general meeting, will succeed Mr van den Bergh as chairman.

Sir Victor was selected for nomination after a thorough search in which the board was assisted by Egon Zehnder International. The process was led by the senior independent non-executive director, Mr Brown, and the nomination committee for this purpose comprised all the independent non-executive directors. Candidates were interviewed by several directors and the decision was taken by the whole board, on the recommendation of the nomination committee.

It has already been announced that Sir Victor will retire from the board of Trinity Mirror at its annual general meeting in May of this year. As recently announced by GUS plc, he will remain as chairman of GUS until the proposed separation of its businesses, announced last year, but will have no continuing role in these businesses after that.

In deciding to nominate Sir Victor as chairman, the board considered the provision of the combined code on corporate governance, issued by the Financial Reporting Council, that no individual should be appointed to a second chairmanship of a FTSE 100 company. The board concluded that Sir Victor was an outstanding candidate with exceptional skills, knowledge and experience, both as a FTSE 100 company chairman and in the financial services industry, and in consultation with him, both the Lloyds TSB Group board and the GUS board have agreed that he would be able to devote sufficient time to his roles.

Lloyds TSB Group acknowledges Sir Victor's responsibilities as chairman of two FTSE 100 companies for a transitional period but the board feels that his experience will enable him to discharge his duties fully during that time. The senior independent non-executive director, Mr Brown, also recognises the importance of his role in being available to shareholders, especially during this transitional period.

Both the Association of British Insurers and the National Association of Pension Funds were consulted, in line with the principles of the combined code.

The committee's terms of reference are available from the company secretary and are displayed on the Company's website www.lloydstsb.com.

Remuneration committee

Information about the remuneration committee's membership and work is given in the directors' remuneration report on pages 46 to 57 and its terms of reference are available from the company secretary and are displayed on the Company's website www.lloydstsb.com.

Risk oversight committee

The risk oversight committee comprises Mr van den Bergh (chairman), Mr Brown and Sir Julian Horn-Smith. All non-executive directors are also invited to attend meetings if they wish. The risk oversight committee's duties include overseeing the development, implementation and maintenance of the Group's overall risk governance framework, risk appetite, risk strategy and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The committee also oversees the Group's risk exposures; facilitates the involvement of non-executive directors in risk issues and aids their understanding of these issues; oversees adherence to Group risk policies and standards and considers any material amendments to them; and reviews the work of the Group Risk division. The risk oversight committee reports to the board on its deliberations after each meeting.

Attendance at meetings

The attendance of directors at board meetings and at meetings of the audit, nomination, remuneration and risk oversight committees during 2005 was as follows:

	Board	Audit committee	Nomination committee	Remuneration committee	Risk oversight committee
Number of meetings during the year	**9**	**5**	**3**	**7**	**5**
Current directors who served during 2005					
W C G Berndt	9			7	
Ewan Brown[1]	9	5	2		5
J E Daniels	9				
T A Dial[2]	4				
J P du Plessis[3]	2	1			
M E Fairey	9				
G J N Gemmell	9	5		1 (co-opted)	
Sir Julian Horn-Smith[4]	8			6	3
D S Julius	9		3	6	
A G Kane	9				
A A Knight	9	5			
Lord Leitch[3]	2	1			
G T Tate	9				
M A van den Bergh	9		3		4
H A Weir	9				
Former directors who served during 2005					
C S Gibson-Smith[5]	3		2	1	
D P Pritchard[5]	4				2

[1] Appointed to the nomination committee from 3 March 2005
[2] Appointed to the board from 1 June 2005
[3] Appointed to the board and audit committee from 1 October 2005
[4] Appointed to the risk oversight committee from 3 March 2005
[5] Left the board on 5 May 2005

Statement of directors' responsibilities

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Lloyds TSB Group ('the Group') as at the end of the year and of the profit or loss for the year. The directors consider that in preparing the financial statements on pages 59 to 128, the Company and the Group have used appropriate accounting polices, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The directors have responsibility for ensuring that the Company and the Group keep proper accounting records which disclose with reasonable accuracy the financial position of the Company and the Group and which enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and the Group and to prevent and detect fraud and other irregularities.

A copy of the financial statements of the Company is placed on the website of Lloyds TSB Group plc. The directors are responsible for the maintenance and integrity of statutory and audited information on the Company's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Internal control

The board of directors is responsible for the establishment and review of the Lloyds TSB Group's system of internal control, which is designed to ensure effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. It should be noted, however, that such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. In establishing and reviewing the system of internal control the directors have regard to the nature and extent of relevant risks, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The directors and senior management are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of published policies and procedures and regular management briefings. A requirement to comply with internal control and risk policies is a key component of individual staff objectives expressed in the balanced scorecard. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. In addition, there is an annual control self-assessment exercise whereby the key businesses and head office functions review specific controls and attest to the accuracy of their assessments. The assessment covers all EWRM categories and is in accordance with the principles of the Combined Code. As in previous years, this exercise was completed for the year ended 31 December 2005. All returns have been satisfactorily completed and appropriately certified.

The effectiveness of the internal control system is reviewed regularly by the board and the audit committee, which also receives reports of reviews undertaken around the Lloyds TSB Group by its risk management function, including Group Compliance, and Group Audit. The audit committee receives reports from the Company's auditors, PricewaterhouseCoopers LLP, (which include details of significant internal control matters that they have identified) and has a discussion with the auditors at least once a year without executives present, to ensure that there are no unresolved issues of concern.

Going concern

The directors are satisfied that the Company and Lloyds TSB Group have adequate resources to continue to operate for the foreseeable future and are financially sound. For this reason they continue to adopt the going concern basis in preparing the accounts.

Directors' remuneration report

This is a report made by the board of Lloyds TSB Group plc, on the recommendation of the remuneration committee. It covers the current and proposed components of the remuneration policy and details the remuneration for each serving director during 2005.

Statement from Wolfgang Berndt

Recognising that the external reward context is not static and it is good practice to keep our approach under review, we initiated a comprehensive and independent policy review in early 2005. As a result, this has been a particularly busy and challenging year for the remuneration committee. Our focus over the course of seven full meetings has been on leveraging performance and maximising the value of available spend. Ensuring that we have a cost effective and competitive remuneration framework in place plays a critical part in attracting, retaining and motivating a top quality executive team. The timing of this review recognised the expiry of the current executive share option scheme in 2007. Our primary focus has been on reviewing our comparator group, how and from whom we receive independent advice and a review of the remuneration package itself, its components and their balance. A key theme of this work centred on establishing even firmer links between performance and reward and the associated measurements.

As a result of this review, the remuneration committee has decided to:

- Adopt the FTSE 20 as the comparator group used to benchmark the overall competitiveness of our remuneration package, providing a more realistic comparison in terms of company size and a key market for talent. Measured by market capitalisation, the Group is currently positioned around the median of this comparator group.
- Increase executive director expected levels of personal shareholding in the Group.
- Change the mechanism for determining an executive's bonus, providing a stronger and more direct link to individual and Group performance.
- Increase the maximum annual bonus opportunity for the group chief executive to 175 per cent of annual salary for exceptional performance, bringing it closer to comparator group practice.

In addition, we will be recommending to shareholders the adoption of a new long-term incentive plan which will replace the current executive share option scheme.

We believe that these changes, which have the full support of the board, should even more firmly align executive director remuneration with shareholders' interests as well as engaging them in pursuing long-term shareholder value. The remuneration committee unanimously recommends that the long-term incentive plan proposal and the wider remuneration report be approved.

Dr Wolfgang Berndt
Chairman, Remuneration Committee

Content of remuneration report

- Role of remuneration committee
- Remuneration committee membership
- Advisers to the committee
- Directors' remuneration policy
- Dilution limits
- Pensions
- Service agreements
- External appointments
- Performance graph
- Audited information

Role of remuneration committee

The committee reviews the remuneration policy for the top management group, to ensure that members of the executive management are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation. It advises on major changes of employee benefits schemes and it also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, deputy chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount.

All the independent non-executive directors are invited to attend meetings if they wish, and they receive the minutes and have the opportunity to comment and have their views taken into account before the committee's decisions are implemented.

The committee's terms of reference are available from the company secretary and are displayed on the Group's website www.lloydstsb.com.

Remuneration committee membership

The remuneration committee is comprised of the following independent non-executive directors:

- Dr Berndt (chairman)
- Dr Gibson-Smith (until 5 May 2005 when he left the board)
- Sir Julian Horn-Smith
- Dr Julius

Advisers to the committee

Towers Perrin and Kepler Associates were appointed by the committee to advise on matters relating to executive remuneration. Towers Perrin also provides the management of the Group with competitive market data relating to other employees and administrative services for the Group's employee flexible benefits plan.

In addition, in 2005, Alithos Limited provided information for the testing of the total shareholder return (TSR) (calculated by reference to both dividends and growth in share price) performance conditions for the Group's executive share option schemes.

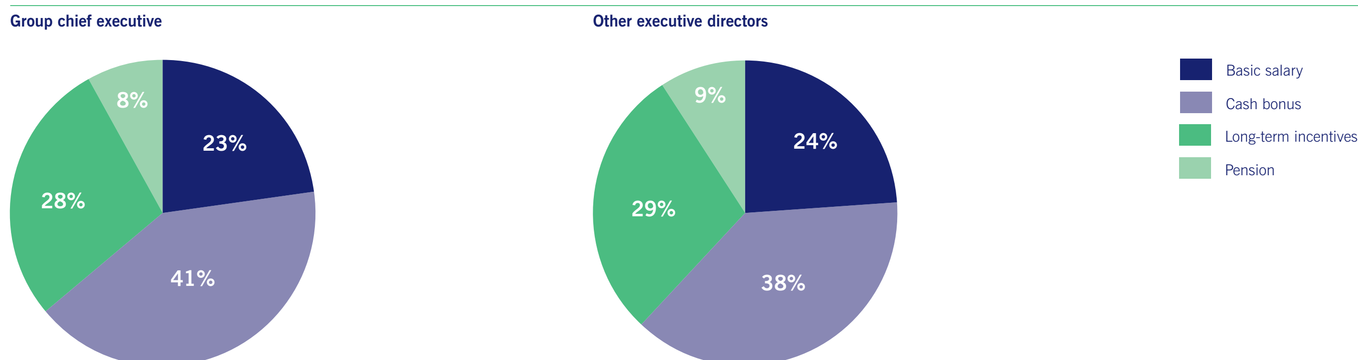
Mr van den Bergh, Mr Daniels, Mr Hijkoop (Group Human Resources Director) and Mr Farley (Group Compensation & Benefits Director) provided guidance to the committee (other than for their own remuneration).

Directors' remuneration policy

The Group's remuneration policy is to ensure that individual rewards are aligned with the Group's performance and the interests of its shareholders, and that cost effective packages are provided which attract and retain executive directors and senior management of the highest calibre and motivate them to perform to the highest standards. The main principles are:

- FTSE 20 as the comparator group used to benchmark overall competitiveness of the remuneration package whilst taking account of practice within the financial services sector.
- The majority of total compensation is linked to the achievement of stretching performance targets.
- The long-term rewards are aligned to shareholder interests, which is achieved by taking account of measures that reflect shareholder interests, and by expecting executive directors to build a shareholding in the Group equivalent to 1 times the director's base pay over a period of four years. This has now increased to 1.5 times (2 times for the group chief executive), with the executives being expected to retain at least 50 per cent of all net vested equity until the guideline is met.
- The overall package reflects market practice and takes account of the terms and conditions applying to other employees of the Group.

As a consequence of the proposed changes in policy, the composition of the remuneration package in 2006 will be as follows:



In 2006, approximately 67 per cent (69 per cent for the group chief executive) of an executive director's potential direct remuneration (salary, annual bonus and long-term incentives) will be performance related. The value of long-term incentives is the expected value calculated by using a 'binomial' model, which is a widely accepted methodology for this purpose.

Chairman's and deputy chairman's remuneration

The chairman's remuneration comprises a salary and benefits which are broadly similar to the executive directors, but he does not participate in the annual bonus and long-term incentive arrangements.

The chairman's salary is reviewed annually, usually in December, taking into account performance and market information (which is provided by Towers Perrin) and then adjusted from 1 January of the following year. His salary from 1 January 2006 is £500,000 and his pension benefits continue to accrue as described on page 52.

Sir Victor Blank has been appointed as deputy chairman from 1 March 2006 and his salary will be £275,000, increasing to £550,000 on his appointment as chairman in May. He will also receive benefits broadly similar to the executive directors, but he will not participate in the annual bonus, long-term incentive arrangements or be entitled to pension benefits.

Independent non-executive directors' fees

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. An increase in the total amount that can be paid is being proposed at the annual general meeting. Directors may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the various responsibilities of a non-executive director's role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees are listed below:

Board	£50,000
Audit committee chairmanship	£40,000
Audit committee membership	£15,000
Nomination committee membership	£5,000
Remuneration committee chairmanship	£20,000
Remuneration committee membership	£15,000
Risk oversight committee membership	£15,000

Independent non-executive directors who serve on the boards of subsidiary companies may also receive fees from the subsidiaries. These are included in the table shown on page 51.

Executive director basic salaries

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by Towers Perrin) and then adjusted from 1 January of the following year. Basic salary increases for other employees across the Group will be generally in the range of 0-10 per cent, and the salary increase awarded to executive directors are consistent with this policy. Salaries payable from 1 January 2006 are as follows:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
Amount	£880,000	£570,000	£570,000	£500,000	£515,000	£500,000

Annual incentive scheme

The annual incentive scheme for executive directors is designed to reflect specific goals linked to the performance of the business.

For executive directors except Mr Daniels, individual bonus awards for 2005 were made from a bonus pool based on group performance with predetermined targets relating to profit before tax and economic profit. The maximum size of the bonus pool applicable to these executives was 100 per cent of the aggregate of their basic salaries, with an amount equal to 75 per cent of their basic salaries payable into the bonus pool on the achievement of a stretching budget; failure to achieve at least 90 per cent of this budget would result in no bonus payment. Executive directors are considered for awards from the bonus pool based on individual targets, contained in a balanced scorecard, which include profitability, franchise growth, risk, service and other specific goals that are relevant to improving overall business performance. These targets are weighted differently for each of the executive directors, reflecting differing strategic priorities. The maximum level of any bonus award distributable from the pool to any individual has been set at 150 per cent of salary for the achievement of exceptional performance targets, to reflect the competitive market position for total earnings opportunity.

From 2006 the current bonus pool arrangement will be discontinued and replaced by an approach based upon individual contribution and overall corporate results. Half of the bonus opportunity will be driven by corporate performance based on the stretching budget and the other half by business unit achievement driven through individual performance based on similar targets to those mentioned above. However, the maximum bonus opportunity will remain 150 per cent for the achievement of exceptional performance targets; an amount equal to 75 per cent of basic salary will continue to be available on the achievement of stretching budget and individual targets. Failure to achieve at least 90 per cent of the stretching budget target would result in no payment under the corporate half of the bonus.

The maximum annual bonus opportunity for 2005 for Mr Daniels was also set at 150 per cent of basic salary for exceptional performance. An amount equal to 112.5 per cent of basic salary is available on the achievement of stretching budget targets relating to profit before tax and economic profit; failure to achieve at least 90 per cent of these performance targets would result in no bonus payment. The actual level of bonus award made takes account of Mr Daniels' individual performance and contribution.

Regarding Mr Daniels' 2006 bonus opportunity, an amount equal to 112.5 per cent of basic salary will continue to be available on the achievement of stretching targets contained in a balanced scorecard. However, his maximum bonus opportunity will be increased to 175 per cent of basic salary for the achievement of exceptional performance targets, bringing Mr Daniels' bonus opportunity closer to comparator group levels. In line with the revised bonus arrangements for the executive directors, half of the bonus will be driven by corporate results and the other half by individual performance. Failure to achieve at least 90 per cent of the stretching budget target would result in no payment under the corporate half of the bonus.

PricewaterhouseCoopers LLP check the calculation of the annual incentive payments for executive directors based on the achievement of performance against targets set. In respect of performance in 2005, the bonus percentages awarded to the directors are shown in the table below.

Performance share plan

If shareholders approve the policy proposal mentioned earlier, further grants under this scheme will not be awarded to directors after 2006. From 2007, therefore, awards under the annual incentive scheme will be in cash only. However, it is envisaged that the loss of the performance share dynamics under the current plan will be compensated for under the proposed new long-term incentive plan.

Under the performance share plan, executive directors have been required to defer 50 per cent of any bonus payable into shares in the Group, known as bonus shares. The bonus shares are held on behalf of the executive for a period of three years before release. The amount of 2005 bonus deferred into bonus shares before the deduction of income tax was:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
Opportunity	150%	150%	150%	150%	150%	150%
% awarded	118.5%	79%	100%	83%	111%	81%
Deferred bonus	£488,812	£215,500	£162,250	£197,000	£262,500	£192,500

Under the performance share plan executives will be eligible for an award of free shares, known as performance shares, to match the bonus shares. The maximum match will be two performance shares for each bonus share, awarded at the end of the three year retention period. The number of performance shares actually awarded will depend on the Group's TSR performance measured over the three year period ending December 2008, compared with the TSR of the other companies in the comparator group listed below. The maximum of two performance shares for each bonus share will be awarded only if the Group's TSR performance places it first in the comparator group; one performance share will be awarded for each bonus share if the Group is placed fifth; and one performance share for every two bonus shares if the Group is placed eighth (median). Between first and fifth positions and fifth and eighth positions sliding scales will apply. If the TSR performance is below median no performance shares will be awarded. There will be no retest. Whilst income tax is deducted from the deferred bonus before the conversion to bonus shares, where a match of performance shares is justified, these shares will be awarded as if income tax had not been deducted. This maintains the original design of the plan prior to the issue of guidance from HM Revenue & Customs in December 2004.

Other companies in the comparator group:

Alliance & Leicester	Aviva	Banco Santander	Barclays
Bradford & Bingley	Friends Provident	HBOS	HSBC Holdings
Legal & General	Northern Rock	Prudential	Royal Bank of Scotland
Royal & Sun Alliance	Standard Chartered		

The remuneration committee believes that the out-performance of the Group's TSR compared with those of the companies in the comparator group will demonstrate the success of the Group's strategy.

Long-term rewards – current executive share option scheme

If the policy proposal mentioned earlier is approved by the shareholders, further options under the current executive option scheme will not be granted to directors in 2006.

In 2005, options were granted to executive directors and senior executives within the scheme limits. These limits relate to the number of shares under option and the price payable on exercise. The maximum limit for the grant of options to an executive director in any one year is equal to 3 times annual basic salary, although in exceptional circumstances, for example on the recruitment of a new executive director, that could be increased to 4 times annual basic salary.

A performance condition was set when the grant of options was made and the options will not normally be exercisable unless the condition is met. The performance condition requires the Group's ranking, based on TSR over the relevant (three year) period, to be at least eighth within the comparator group.

The full award of options for executive directors will only become exercisable if the Group is ranked within the top four places of the comparator group.

The comparator group is the same as that used for the performance share plan.

The following table illustrates the percentage of the grant which would be exercisable depending on the Group's TSR ranking within the comparator group set out above.

Ranking position within comparator group	Per cent of option which may be exercised
1	100
2	100
3	100
4	100
5	82.5
6	65
7	47.5
8	30
9 or below	Nil – options not exercisable

The remuneration committee believes that the out-performance of the Group's TSR compared with those of the companies in the comparator group will demonstrate the success of the Group's strategy. The Group's performance is assessed against the comparator group using data provided by Alithos Limited and PricewaterhouseCoopers LLP checks the results of the testing of the performance conditions.

Long-term rewards – proposed long-term incentive plan

Under the proposed long-term incentive plan, awards of shares may be made, with the receipt of shares and the number of shares received subject to the satisfaction of two distinct pre-determined performance conditions, measuring performance of the Group over a three year period. 50 per cent of the award will be based on a condition measuring the Group's TSR against the comparator group. The comparator group will be the same as that used for the current executive share option scheme and performance share plan. In order for the part of the award subject to the TSR condition to vest in full, it will be necessary for the Group's TSR to exceed the median of the TSR of the comparator group by an average of 7.5 per cent per annum. 8.75 per cent of the award will vest where the Group's TSR is equal to median and vesting will occur on a straight line basis in between these points. Where the Group's TSR is below the median of the comparator group, this part of the award will lapse. The remaining 50 per cent will be based on earnings per share (EPS) growth calculated on a compound annualised basis. In order for the award subject to the EPS condition to vest in full, the EPS growth over the performance period must be at least equivalent to an average of the Retail Price Index (RPI) plus 6 per cent per annum. 8.75 per cent of the award will vest where EPS growth is an average of the RPI plus 3 per cent per annum and vesting will occur on a straight line basis in between these points. Where the EPS growth is less than an average of the RPI plus 3 per cent per annum this part of the award will lapse. Awards in any one financial year will not normally exceed three times basic salary at the time of award. In exceptional circumstances this may be increased to up to four times basic salary. Awards will lapse at the end of the performance period to the extent that the performance conditions have not been satisfied. There will be no retesting. The aim of the plan is to deliver shareholder value through linking the receipt of shares to an improvement in the performance of the Group over a three year period.

Other share plans

The executive directors and the chairman are also eligible to participate in the Group's 'sharesave' scheme and the Group's 'shareplan'. These are 'all-employee' share schemes and performance conditions do not apply.

Dilution limits

The following charts illustrate the shares available for the Group's share schemes.

Pensions

Executive directors are either entitled to participate in the Group's defined benefit pension schemes (based on salary and length of service, with a maximum pension of two thirds of final salary), or the Group's defined contribution scheme (under which their final entitlement will depend on their contributions and the final value of their fund). The defined benefit schemes are closed to new entrants on recruitment.

Service agreements

The Group's policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months' notice from the Group, but would be required to give six months' notice if they wished to leave. The current chairman, Mr van den Bergh, retires at the annual general meeting and the notice period for his successor, Sir Victor Blank, is shown in the table below.

Independent non-executive directors do not have service agreements and, in accordance with the articles of association, their appointment may be terminated at any time without compensation.

It is the Group's policy that where compensation on early termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured, and that bonus payments should relate to the period of actual service, rather than the full notice period and will be determined on the basis of performance.

Any entitlements under the pension scheme or equity plans will be in accordance with the scheme rules on leaving.

	Notice to be given by the Company	Date of service agreement/letter of appointment
Sir Victor Blank	6 months	25 January 2006
J E Daniels	12 months	19 October 2001
M E Fairey	12 months	28 August 1991
T A Dial	12 months	23 May 2005
A G Kane	12 months	9 February 2000
G T Tate	12 months	29 July 2004
H A Weir	12 months	4 March 2004

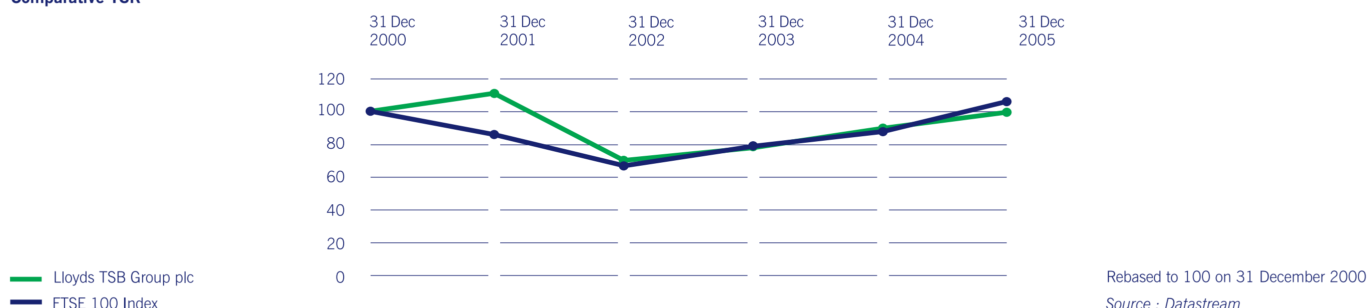
External appointments

The Group recognises that executive directors may be invited to become non-executive directors of other companies and that these appointments may broaden their knowledge and experience, to the benefit of the Group. Fees are normally retained by the individual directors as the post entails personal responsibility. Executive directors are generally allowed to accept one non-executive directorship.

During 2005, Ms Dial and Mrs Weir received fees of $88,775 and £14,375 respectively, which were retained by them, for serving as non-executive directors of other companies.

Performance graph

The graph illustrates the performance of the Group measured by TSR against a 'broad equity market index' over the past five years. As the Group has been a constituent of the FTSE 100 index throughout this five-year period, that index is considered to be the most appropriate benchmark.



Directors' emoluments for 2005

	Salaries/ fees £000	Other benefits Cash £000	Non cash £000	Performance-related payments £000	Compensation for loss of office £000	2005 Total £000	2004 Total £000
Current directors who served during 2005							
Executive directors							
J E Daniels	**825**	**100**	**3**	**1,002**		**1,930**	1,903
M E Fairey	**545**	**462**	**8**	**447**		**1,462**	1,478
T A Dial	**321**	**222**		**334**		**877**	–
A G Kane	**475**	**18**	**18**	**408**		**919**	858
G T Tate	**475**	**52**	**9**	**539**		**1,075**	403
H A Weir	**475**	**73**	**16**	**399**		**963**	654
Non-executive directors							
M A van den Bergh	**475**	**12**				**487**	454
W C G Berndt	**67**					**67**	55
Ewan Brown	**122**					**122**	84
J P du Plessis	**16**					**16**	–
G J N Gemmell	**121**					**121**	110
Sir Julian Horn-Smith	**74**					**74**	–
D S Julius	**66**					**66**	55
A A Knight	**105**					**105**	93
Lord Leitch	**16**					**16**	–
Former directors who served during 2005							
P G Ayliffe	**33**	**2**			**366**	**401**	588
C S Gibson-Smith	**21**					**21**	55
D P Pritchard	**88**	**4**	**5**	**3**		**100**	279
Former directors who served during 2004							
P R Hampton					**4**	**4**	359
Others							1,050
	4,320	**945**	**59**	**3,132**	**370**	**8,826**	8,478

Mr Fairey waived fees payable to him as a director of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £10,000 in 2005 (2004: £nil).

Mr Brown waived fees payable to him as a director and chairman of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £14,000 in 2005 (2004: £nil).

Mr Pritchard left the board on 5 May 2005 but remained a director of Scottish Widows Group and received fees of £26,667 from that company for the period May until December.

The cash column under 'other benefits' includes flexible benefits payments (4 per cent of basic salary), the tax planning allowances for Mr Daniels and Ms Dial, the housing allowance, relocation allowance and pension scheme allowance for Ms Dial, payments to certain directors who elect to take cash rather than a company car under the car scheme, cash balance of pension allowance for Mr Tate and Mrs Weir and an additional payment in respect of the contribution to the separate fund relating to Mr Fairey's pension. The separate fund, which was mentioned in previous annual reports, was established to cover pension obligations of those who joined the Group after 1 June 1989 and who are subject to the Inland Revenue cap relating to pensions, introduced by the Finance Act 1989.

The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance. It also includes the value of any matching shares which are received under the terms of shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.

Performance-related payments relate to cash bonuses based on Group performance and the attainment of pre-determined targets relating to profit before tax and economic profit. These payments also include the value of any award made under shareplan, the first £3,000 of which is made in the form of shares in Lloyds TSB Group plc.

Mr Ayliffe left the board on 31 January 2005. However, he remained with the Company until his employment was terminated on 31 March 2005 and was paid £71,442 for that period. Mr Hampton's employment was terminated on 12 January 2004. Subsequently they both received payments in accordance with their contractual entitlement.

Directors' pensions

The executive directors are members of one of the pension schemes provided by Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined Lloyds TSB Group after 1 June 1989 and are members of a defined benefit scheme, have pensions provided on salary in excess of the earnings cap either through membership of a funded unapproved retirement benefits scheme ('FURBS') or by an unfunded pension promise.

Retirement pensions accrue at rates of between 1/60 and 1/30 of basic salary per annum.

Directors have a normal retirement age of 60. In the event of death in service, a lump sum of four times salary is payable plus, for members of a defined benefit scheme, a spouse's pension of two-thirds of the member's prospective pension. On death in retirement, a spouse's pension of two-thirds of the member's pension is payable. The defined benefit schemes are non-contributory. Members of defined contribution schemes are required to contribute.

Ms Dial elected to become a member of a pension scheme for life cover only. She joined Lloyds TSB Group on 1 June 2005. She receives a salary supplement of 20 per cent of basic pay as an alternative to an employer contribution to a pension scheme.

Defined contribution scheme members

Mr Tate is a member of a defined contribution scheme. During the year to 31 December 2005, the employer has made contributions to the defined contribution scheme in respect of him totalling £62,937.

Mrs Weir is a member of a defined contribution scheme. During the year to 31 December 2005, the employer has made contributions to the defined contribution scheme in respect of her totalling £40,375.

Defined benefit scheme members	**Accrued pension at 31 December 2005 £000 (a)**	Accrued pension at 31 December 2004 £000 (b)	Change in accrued pension £000 (a)-(b)	**Transfer value at 31 December 2005 £000 (c)**	Transfer value at 31 December 2004 £000 (d)	Change in transfer value £000 (c)-(d)	**Additional pension earned to 31 December 2005 £000 (e)**	Transfer value of the increase £000 (f)
P G Ayliffe	**139**	132	7	**2,045**	1,780	265	**3**	46
J E Daniels	**99**	77	22	**1,599**	1,139	460	**19**	309
M E Fairey	**256**	226	30	**5,003**	3,996	1,007	**23**	449
A G Kane	**240**	216	24	**3,700**	3,039	661	**17**	264
In addition, the following unfunded benefits have accrued for Mr van den Bergh instead of a salary increase in 2002:								
M A van den Bergh	**13**	10	3	**190**	136	54	**3**	40

Mr Ayliffe's pension entitlement at 31 December 2005 includes additional service in respect of his notice period in accordance with the terms of his contract.

The disclosures in columns (a) to (d) are as required by the Companies Act 1985 Schedule 7A.

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2005 and 2004, respectively (ignoring the two-year requirement to qualify for a deferred pension).

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2005 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme in accordance with actuarial guidance note GN11. The underlying bases used to arrive at the factors have not changed during the year.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2004 on the assumption that the director left service at that date.

Column (e) is the increase in pension built up during the year, recognising (i) the accrual rate for the additional service based on the pensionable salary in force at the year end, and (ii) where appropriate the effect of pay changes in 'real' (inflation adjusted) terms on the pension already earned at the start of the year.

Column (f) is the capital value of the pension in column (e).

The disclosures in columns (e) and (f) are as required by the UK Listing Authority listing rules. The requirements of the listing rules differ from those of the Companies Act. The listing rules require the additional pension earned over the year to be calculated as the difference between the pension accrued at the end of the financial year and the pension accrued at the start of the financial year less the increase in the pension earned over the year solely due to inflation. The transfer value in column (f) can differ significantly from the change in transfer value as required by the Companies Act because the additional pension accrued over the year calculated in accordance with the listing rules makes allowance for inflation and the change in the transfer value required by the Companies Act will be significantly influenced by changes in the assumptions underlying the transfer value calculation at the beginning and end of the financial year.

Members of Lloyds TSB Group's pension schemes have the option to pay additional voluntary contributions: neither the contributions nor the resulting benefits are included in the above table.

Directors' interests

The interests, all beneficial, of those who were directors at 31 December 2005 in shares in Lloyds TSB Group were:

Shares	At 1 January 2005 (or later date of appointment)	At 31 December 2005	At 23 February 2006†
Executive directors			
J E Daniels	38,136	**160,942**	**160,999**
M E Fairey	77,858	**79,104**	**79,125**
T A Dial	–	**–**	
A G Kane	98,979	**100,101**	**100,158**
G T Tate	701	**1,356**	
H A Weir	1,699	**3,992**	
Non-executive directors			
M A van den Bergh	5,079	**5,098**	
W C G Berndt	46,000	**61,000**	
Ewan Brown	4,027	**4,260**	
J P du Plessis	–	**10,000**	
G J N Gemmell	70,000	**70,000**	
Sir Julian Horn-Smith	5,000	**5,000**	
D S Julius	2,000	**2,000**	
A A Knight	4,940	**4,940**	
Lord Leitch	–	**–**	

† The changes in beneficial interests between 31 December 2005 and 23 February 2006 related to 'partnership' and 'matching' shares acquired under the Lloyds TSB Group shareplan.

Non-beneficial interests

Directors had non-beneficial interests as follows:

Mr Daniels, Mr Fairey, Ms Dial, Mr Kane, Mr Tate, Mr van den Bergh and Mrs Weir, together with some 77,000 other employees, were potential beneficiaries in the 1,364 and 1,237,191 shares held at the end of the year by the Lloyds TSB qualifying employee share ownership trust and the Lloyds TSB Group employee share ownership trust respectively. 1,364 and 1,467,422 shares, respectively, were held by these trusts at the beginning of the year. These holdings were 1,364 and 1,224,846 respectively on 23 February 2006. In addition, the above directors, with the exception of Mr van den Bergh, together with some 77,000 other employees, were potential participants in shareplan and were, therefore, treated as interested in the 582,462 shares held at the end of the year by the trustee of the shareplan. 471,989 shares were held by the trustee at the beginning of the year. This holding was 729,451 on 23 February 2006.

Interests in share options

Current directors who served during 2005	At 1 January 2005 (or later date of appointment)	Granted during the year	Exercised/ lapsed during the year	At 31 December 2005	Exercise price	Exercise periods From	To	Notes
J E Daniels	907,780		**907,780**	**–**	694p	1/11/2004	31/10/2011	d,j
	330,419			**330,419**	715p	6/3/2005	5/3/2012	d,g
	3,327			**3,327**	284p	1/6/2006	30/11/2006	a,h
	599,239			**599,239**	394.25p	21/2/2006	20/2/2013	d,h
	305,232			**305,232**	430p	14/8/2006	13/8/2013	d,h
	939,177			**939,177**	419.25p	18/3/2007	17/3/2014	d,h
		521,876		**521,876**	474.25p	17/3/2008	16/3/2015	e,h
M E Fairey	797			**797**	474p	1/11/2005	30/4/2006	a,f
	54,000			**54,000**	510p	26/3/2000	25/3/2007	b,f
	48,000			**48,000**	859.5p	15/5/2001	14/5/2008	b,f
	57,000			**57,000**	817p	2/8/2002	1/8/2009	b,g
	85,896			**85,896**	549.5p	6/3/2003	5/3/2010	c,g
	10,931			**10,931**	615.5p	8/8/2003	7/8/2010	c,g
	42,884			**42,884**	655p	6/3/2004	5/3/2011	c,g
	148,618		**148,618**	**–**	733p	21/8/2004	20/8/2011	d,j
	345,104			**345,104**	715p	6/3/2005	5/3/2012	d,g
	1,330			**1,330**	284p	1/6/2006	30/11/2006	a,h
	531			**531**	348p	1/11/2006	30/4/2007	a,h
	663,157			**663,157**	394.25p	21/2/2006	20/2/2013	d,h
	555,992			**555,992**	419.25p	18/3/2007	17/3/2014	d,h
		344,754		**344,754**	474.25p	17/3/2008	16/3/2015	e,h
T A Dial	–	**464,134**		**464,134**	474p	11/8/2008	10/8/2015	e,h
A G Kane	25,000			**25,000**	321p	28/3/1999	27/3/2006	b,f
	40,000			**40,000**	510p	26/3/2000	25/3/2007	b,f
	50,000			**50,000**	880p	4/3/2001	3/3/2008	b,f
	27,000			**27,000**	887.5p	4/3/2002	3/3/2009	b,g
	64,786			**64,786**	549.5p	6/3/2003	5/3/2010	c,g
	11,841			**11,841**	615.5p	8/8/2003	7/8/2010	c,g
	34,759			**34,759**	655p	6/3/2004	5/3/2011	c,g
	118,178		**118,178**	**–**	733p	21/8/2004	20/8/2011	d,j
	275,349			**275,349**	715p	6/3/2005	5/3/2012	d,g
	5,783			**5,783**	284p	1/6/2008	30/11/2008	a,h
	529,105			**529,105**	394.25p	21/2/2006	20/2/2013	d,h
	523,255			**523,255**	419.25p	18/3/2007	17/3/2014	d,h
		300,474		**300,474**	474.25p	17/3/2008	16/3/2015	e,h
G T Tate	348,837			**348,837**	430p	14/8/2006	13/8/2013	d,h
	268,336			**268,336**	419.25p	18/3/2007	17/3/2014	d,h
	195,409			**195,409**	403p	12/8/2007	11/8/2014	d,h
		300,474		**300,474**	474.25p	17/3/2008	16/3/2015	e,h
H A Weir	556,208			**556,208**	424.75p	29/4/2007	28/4/2014	d,h
	5,093			**5,093**	321p	1/11/2009	30/4/2010	a,h
		300,474		**300,474**	474.25p	17/3/2008	16/3/2015	e,h
Other share plans:								
J E Daniels	216,763		**216,763**	**–**	(see page 57)			i
T A Dial		**242,825**		**242,825**		1/6/2008	30/11/2008	h

Interests in share options (continued)

Former directors who served during 2005	At 1 January 2005	Granted during the year	Exercised/ lapsed during the year	At 31 December 2005 (or earlier date of leaving the board)	Exercise price	Exercise periods From	To	Notes
P G Ayliffe	3,327			**3,327***	284p	1/6/2006	30/11/2006	a
	13,000			**13,000‡**	321p	28/3/1999	27/3/2006	b,f
	12,000			**12,000**	510p	26/3/2000	25/3/2007	b,f
	20,000			**20,000**	880p	4/3/2001	3/3/2008	b,f
	3,000			**3,000**	887.5p	4/3/2002	3/3/2009	b,g
	23,657			**23,657**	549.5p	6/3/2003	5/3/2010	c,g
	10,560			**10,560**	615.5p	8/8/2003	7/8/2010	c,g
	16,717			**16,717**	655p	6/3/2004	5/3/2011	c,g
	44,562			**44,562**	733p	21/8/2004	20/8/2011	d,k
	104,895			**104,895**	715p	6/3/2005	5/3/2012	d,g
	218,769		**60,770***	**157,999**	394.25p	21/2/2006	20/2/2013	d,h
	177,034		**78,682***	**98,352**	430p	14/8/2006	13/8/2013	d,h
	429,338		**274,300***	**155,038**	419.25p	18/3/2007	17/3/2014	d,h
D P Pritchard	50,000			**50,000**	859.5p	15/5/2001	14/5/2008	b,f
	40,000			**40,000**	817p	2/8/2002	1/8/2009	b,g
	71,519			**71,519**	549.5p	6/3/2003	5/3/2010	c,g
	10,385			**10,385**	615.5p	8/8/2003	7/8/2010	c,g
	36,374			**36,374**	655p	6/3/2004	5/3/2011	c,g
	127,131			**127,131**	733p	21/8/2004	20/8/2011	d,k
	286,363			**286,363**	715p	6/3/2005	5/3/2012	d,g

a) Sharesave.

b) Executive option granted between March 1996 and August 1999.

c) Executive option granted between March 2000 and March 2001.

d) Executive option granted between August 2001 and August 2004.

e) Executive option granted from March 2005.

f) Exercisable.

g) Not exercisable as the performance conditions had not been met.

h) Not exercisable as the option has not been held for the period required by the relevant scheme.

i) Market price on day of exercise was 497p. In that regard Mr Daniels made a gain of £1,077,312. This is the difference between the market price of the shares on the day on which the share option was exercised and the price paid for the shares.

j) These share options lapsed as the performance condition had not been met.

k) These share options lapsed after Mr Ayliffe and Mr Pritchard left the board as the performance condition had not been met.

‡ Mr Ayliffe exercised this share option after he left the board. The date of exercise was 14 December 2005 and the market price of the shares on that day was 480.25p.

* These share options lapsed when Mr Ayliffe left the board.

Lloyds TSB performance share plan

The following bonus and performance shares relating to the bonus award for 2004 are available under the plan. Further information is given on page 48.

	Bonus shares At 1 January 2005	Bonus shares Purchased during the year	Bonus shares At 31 December 2005	Performance shares At 1 January 2005	Performance shares Conditional award during the year (maximum)	Performance shares At 31 December 2005	Award price	Bonus shares release and performance share award date
J E Daniels	–	**57,737**	**57,737**	–	**195,720**	**195,720**	479p	18/3/2008
M E Fairey	–	**31,901**	**31,901**	–	**108,140**	**108,140**	479p	18/3/2008
A G Kane	–	**22,171**	**22,171**	–	**75,156**	**75,156**	479p	18/3/2008
G T Tate	–	**22,710**	**22,710**	–	**76,982**	**76,982**	479p	18/3/2008
H A Weir	–	**16,628**	**16,628**	–	**56,366**	**56,366**	479p	18/3/2008

The market price for a share in the Company at 1 January 2005 and 31 December 2005 was 473p and 488.5p, respectively. The range of prices between 1 January 2005 and 31 December 2005 was 439.5p to 509p.

None of the other directors at 31 December 2005 had options to acquire shares in Lloyds TSB Group plc or its subsidiaries.

The following table contains information on the performance conditions for executive options granted since 1996. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Options granted	Performance conditions
Prior to March 1996	None
March 1996	Growth in earnings per share which is equal to the aggregate percentage change in the retail price index plus two percentage points for each complete year of the relevant period.
March 1997 – August 1999	As for March 1996 plus a further condition that the Company's ranking based on TSR over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the retail price index plus three percentage points for each complete year of the relevant period.
August 2001 – August 2004	That the Company's ranking based on TSR over the relevant period against a comparator group (17 UK and international financial services companies including Lloyds TSB Group) must be at least ninth, when 14 per cent of the option will be exercisable. If the company is ranked first in the group, then 100 per cent of the option will be exercisable and if ranked tenth or below the performance condition is not met. At the end of 2005 Lloyds TSB Group was ranked: 15th after four years of the performance period for options granted in 2002; 17th after three years of the performance period for options granted in 2003; and 8th after two years of the performance period for the options granted in 2004. Options granted in 2001 lapsed as the performance conditions had not been met.
March 2005 – August 2005	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds TSB Group) must be at least eighth, when 30 per cent of the option will be exercisable. If the company is ranked first to fourth position in the group, then 100 per cent of the option will be exercisable and if ranked ninth or below the performance condition is not met. At the end of 2005 Lloyds TSB Group was ranked 10th after one year of the performance period.

Other share plans

Share retention plan

Mr Daniels was the only participant in this plan and held an option, granted to him on 2 November 2001, to acquire 216,763 ordinary shares in Lloyds TSB Group plc for a total price of £1. The option was granted as part of the remuneration package considered necessary to attract him from the USA and was designed to encourage him to remain with Lloyds TSB Group plc. The option was not subject to any performance condition and vested on 31 December 2004. Mr Daniels exercised this option on 4 March 2005. Full details of the plan were set out in the 2002 annual report.

Lloyds TSB Group executive share plan 2005

A further share plan has been established in connection with the recruitment of Ms Dial as an executive director.

The Lloyds TSB Group executive share plan 2005 was adopted in May 2005, specifically to facilitate the recruitment of Ms Dial. Ms Dial is the only participant in the plan and she became eligible to participate in it when she joined Lloyds TSB Group on 1 June 2005. On that same date, an option was granted to her under the plan to acquire 242,825 ordinary shares in Lloyds TSB Group plc (with a value of £1,100,000 at the date of grant) for a total exercise price of £1. No further options may be granted to her under the plan.

The option is designed to encourage Ms Dial to remain with Lloyds TSB Group plc. Accordingly, the option, which is not subject to any performance conditions, will normally become exercisable only if Ms Dial remains as an employee, and has not given notice of resignation, on 31 May 2008. The option will also be exercisable if Ms Dial ceases to be an employee before that date in certain circumstances described in her service agreement, in which case the options will be exercisable for six months and then lapse. These circumstances include her being entitled to terminate her service agreement without notice by reason of the employer's conduct or being removed as a director or employee otherwise than in accordance with that agreement. The options may also become exercisable early on a takeover or reconstruction of Lloyds TSB Group plc, if Ms Dial's service agreement is terminated by Lloyds TSB Group plc due to sickness or injury, or if she dies (in which case her personal representatives would generally have twelve months from the date of death to exercise the option).

The option will lapse if Ms Dial ceases to be an employee, or gives notice of resignation, before the normal exercise date, except in the circumstances described above.

The number and/or nominal amount of shares may be adjusted by the board on certain variations in the share capital of Lloyds TSB Group plc.

The benefit conferred by this option is not pensionable and the option is not transferable.

No new shares will be issued to satisfy the option under this plan.

None of those who were directors at the end of the year had any other interest in the capital of Lloyds TSB Group plc or its subsidiaries.

The register of directors' interests, which is open to inspection, contains full particulars of directors' shareholdings and options to acquire shares in Lloyds TSB Group.

On behalf of the board

A J Michie
Company Secretary
23 February 2006

Report of the independent auditors on the consolidated financial statements

To the members of Lloyds TSB Group plc

We have audited the consolidated financial statements for the year ended 31 December 2005 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of changes in equity and the related notes. These consolidated financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Lloyds TSB Group plc for the year ended 31 December 2005 and on the information in the directors' remuneration report that is described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the consolidated financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the consolidated financial statements give a true and fair view and whether the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the directors' report is not consistent with the consolidated financial statements, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 Financial Reporting Council's Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the annual report and consider whether it is consistent with the audited consolidated financial statements. The other information comprises only the directors' report, the 2005 highlights, the chairman's statement, the Group chief executive's review, the operating and financial review and prospects, the five year financial summary, the unaudited part of the directors' remuneration report and the corporate governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the consolidated financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the consolidated financial statements.

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2005 and of its profit and cash flows for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
23 February 2006

Consolidated income statement

for the year ended 31 December 2005

	Note	**2005 £ million**	2004 £ million
Interest and similar income		**12,589**	10,707
Interest and similar expense		**(6,918)**	(5,597)
Net interest income	4	**5,671**	5,110
Fees and commission income		**2,990**	3,054
Fees and commission expense		**(842)**	(844)
Net fees and commission income	5	**2,148**	2,210
Net trading income	6	**9,298**	5,036
Insurance premium income	7	**4,469**	6,070
Other operating income	8	**1,140**	857
Other income		**17,055**	14,173
Total income		**22,726**	19,283
Insurance claims	9	**(12,186)**	(9,622)
Total income, net of insurance claims		**10,540**	9,661
Operating expenses	10	**(5,471)**	(5,297)
Trading surplus		**5,069**	4,364
Impairment losses on loans and advances	11	**(1,299)**	(866)
Profit (loss) on sale and closure of businesses	12	**50**	(21)
Profit before tax		**3,820**	3,477
Taxation	13	**(1,265)**	(1,018)
Profit for the year		**2,555**	2,459
Profit attributable to minority interests		**62**	67
Profit attributable to equity shareholders		**2,493**	2,392
Profit for the year		**2,555**	2,459
Basic earnings per share	14	**44.6p**	42.8p
Diluted earnings per share	14	**44.2p**	42.5p

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated balance sheet

at 31 December 2005

	Note	**2005 £ million**	2004 £ million
Assets			
Cash and balances at central banks		**1,156**	1,078
Items in the course of collection from banks		**1,310**	1,462
Treasury bills and other eligible bills	15		92
Trading securities and other financial assets at fair value through profit or loss	16	**60,374**	
Derivative financial instruments	17	**5,878**	
Loans and advances to banks	18	**31,655**	31,848
Loans and advances to customers	19	**174,944**	155,318
Debt securities	21		43,485
Equity shares	22		27,310
Available-for-sale financial assets	23	**14,940**	
Investment property	24	**4,260**	3,776
Goodwill	25	**2,373**	2,469
Value of in-force business	26	**2,922**	4,363
Other intangible assets	27	**50**	28
Tangible fixed assets	28	**4,291**	4,180
Other assets	30	**5,601**	9,013
Total assets		**309,754**	284,422

The accompanying notes are an integral part of the consolidated financial statements.

The directors approved the consolidated financial statements on 23 February 2006.

Maarten A van den Bergh
Chairman

J Eric Daniels
Group Chief Executive

Helen A Weir
Group Finance Director

Consolidated balance sheet

at 31 December 2005

Equity and liabilities	Note	**2005 £ million**	2004 £ million
Liabilities			
Deposits from banks	31	**31,527**	39,723
Customer accounts	32	**131,070**	119,811
Items in course of transmission to banks		**658**	631
Derivative financial instruments and other trading liabilities	17	**6,396**	
Debt securities in issue	33	**39,346**	28,770
Liabilities arising from insurance contracts and participating investment contracts	34	**40,550**	52,289
Liabilities arising from non-participating investment contracts	35	**21,839**	
Unallocated surplus within insurance businesses	36	**518**	1,362
Other liabilities	37	**9,843**	14,457
Retirement benefit obligations	38	**2,910**	3,075
Current tax liabilities		**552**	459
Deferred tax liabilities	39	**1,145**	1,704
Other provisions	40	**368**	211
Subordinated liabilities	41	**12,402**	10,252
Total liabilities		**299,124**	272,744
Equity			
Share capital	42	**1,420**	1,419
Share premium account	43	**1,170**	1,145
Other reserves	44	**383**	343
Retained profits	45	**7,222**	8,140
Shareholders' equity		**10,195**	11,047
Minority interests	48	**435**	631
Total equity		**10,630**	11,678
Total equity and liabilities		**309,754**	284,422

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Minority interests £ million	Total £ million
Balance at 1 January 2004 (note 54)	2,554	343	7,646	10,543	782	11,325
Currency translation differences	–	–	(12)	(12)	1	(11)
Profit for the year	–	–	2,392	2,392	67	2,459
Total recognised income for 2004	–	–	2,380	2,380	68	2,448
Dividends	–	–	(1,913)	(1,913)	(68)	(1,981)
Purchase/sale of treasury shares	–	–	8	8	–	8
Employee share option schemes:						
– value of employee services	–	–	19	19	–	19
– proceeds from shares issued	10	–	–	10	–	10
Change in minority interests	–	–	–	–	(151)	(151)
Balance at 31 December 2004 (note 54)	2,564	343	8,140	11,047	631	11,678
Adjustments on transition to IAS 32, IAS 39 and IFRS 4 (note 54)	–	28	(1,586)	(1,558)	(550)	(2,108)
Restated balance at 1 January 2005 (note 54)	**2,564**	**371**	**6,554**	**9,489**	**81**	**9,570**
Movement in available-for-sale financial assets, net of tax	**–**	**8**	**–**	**8**	**–**	**8**
Movement in cash flow hedges, net of tax	**–**	**11**	**–**	**11**	**–**	**11**
Currency translation differences	**–**	**(7)**	**24**	**17**	**–**	**17**
Net income recognised directly in equity	**–**	**12**	**24**	**36**	**–**	**36**
Profit for the year	**–**	**–**	**2,493**	**2,493**	**62**	**2,555**
Total recognised income for 2005	**–**	**12**	**2,517**	**2,529**	**62**	**2,591**
Dividends	**–**	**–**	**(1,914)**	**(1,914)**	**(37)**	**(1,951)**
Purchase/sale of treasury shares	**–**	**–**	**18**	**18**	**–**	**18**
Employee share option schemes:						
– value of employee services	**–**	**–**	**47**	**47**	**–**	**47**
– proceeds from shares issued	**26**	**–**	**–**	**26**	**–**	**26**
Change in minority interests	**–**	**–**	**–**	**–**	**329**	**329**
Balance at 31 December 2005	**2,590**	**383**	**7,222**	**10,195**	**435**	**10,630**

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated cash flow statement

for the year ended 31 December 2005

	Note	**2005 £ million**	2004 £ million
Net cash (used in) provided by operating activities	53a	**(331)**	12,214
Cash flows from investing activities:			
Purchase of fixed asset investments			(10,088)
Proceeds from sale and maturity of fixed asset investments			9,732
Purchase of available-for-sale financial assets		**(10,108)**	
Proceeds from sale and maturity of available-for-sale financial assets		**10,266**	
Purchase of fixed assets		**(1,843)**	(1,565)
Proceeds from sale of fixed assets		**1,073**	698
Acquisition of businesses, net of cash acquired	53e	**(27)**	(16)
Disposal of businesses, net of cash disposed	53f	**(4)**	(25)
Net cash used in investing activities		**(643)**	(1,264)
Cash flows from financing activities:			
Dividends paid to equity shareholders		**(1,914)**	(1,913)
Dividends paid to minority interests	53d	**(37)**	(68)
Proceeds from issue of subordinated liabilities	53d	**1,361**	699
Proceeds from issue of ordinary shares and transactions in own shares held in respect of employee share schemes	53d	**26**	11
Repayment of subordinated liabilities (loan capital)	53d	**(232)**	(764)
Capital element of finance lease rental payments	53d	**(2)**	(1)
Change in minority investment in subsidiaries	53d	**329**	(151)
Net cash used in financing activities		**(469)**	(2,187)
Change in cash and cash equivalents		**(1,443)**	8,763
Cash and cash equivalents at beginning of year		**28,196**	19,433
Cash and cash equivalents at end of year	53b	**26,753**	28,196

Cash and cash equivalents comprise cash and balances at central banks (excluding mandatory deposits) and amounts due from banks with a maturity of less than three months.

The accompanying notes are an integral part of the consolidated financial statements.

Notes to the group accounts

1 Accounting policies

In accordance with the requirements of Regulation (EC) No 1606/2002 of the European Parliament, the Group has applied International Financial Reporting Standards ('IFRS') as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2005. The rules for first time adoption of IFRS are set out in IFRS 1 'First-time Adoption of International Financial Reporting Standards'. On 1 January 2004, the date of transition, the opening IFRS balance sheet position has been determined in accordance with IFRS 1 which requires IFRS accounting policies to be applied on a retrospective basis with certain exceptions and exemptions detailed below.

Mandatory exception	Impact
Estimates	The Group's estimates at the date of transition are consistent with those under UK GAAP.
Assets held for sale and discontinued operations	The Group has no transactions prior to 1 January 2005 that are affected by the transitional requirements of IFRS 5.
Derecognition of financial instruments	Financial instruments derecognised before 1 January 2004 have not been re-recognised by the Group under IFRS.
Hedge accounting	IFRS compliant hedge accounting is applied by the Group from 1 January 2005.
Voluntary exemption	
Business combinations	By electing to apply IFRS 3 on a prospective basis from 1 January 2004, the Group has not restated past acquisitions and mergers. Goodwill previously written off to reserves has not been reinstated and no additional intangible assets have been recognised in this regard.
Retirement benefits	Under UK GAAP, the Group has recognised all cumulative actuarial gains and losses and elects to apply this treatment at the date of transition to IFRS.
Cumulative translation adjustment	The Group has opted to reset the cumulative translation difference on adoption of IFRS to zero.
Comparatives for financial instruments and designation of financial assets	The Group has chosen not to restate comparatives for IAS 32 and IAS 39, but to reflect the impact of these standards through adjustments to shareholders' equity as at 1 January 2005. At this date the Group has designated various financial assets as at fair value through profit or loss or as available-for-sale. The Group has applied UK GAAP to financial instruments and hedging transactions for its 2004 comparatives.
Share-based payments	The Group has elected to apply IFRS 2 to equity instruments that were granted before 7 November 2002.
Insurance contracts	The Group has chosen not to restate its comparatives for IFRS 4 but to reflect the impact of this standard through adjustments to shareholders' equity at 1 January 2005. The Group has applied UK GAAP for its 2004 comparatives.

The Group has also adopted the requirements of Financial Reporting Standard ('FRS') 27 'Life Assurance' issued by the UK Accounting Standards Board. FRS 27 has been applied from 1 January 2005; comparative figures have not been restated.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and other financial assets at fair value through profit or loss and all derivative contracts, on the basis of IFRS as adopted by the EU. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board ('IASB') and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body.

The EU endorsed version of IAS 39 which is operative for years commencing 1 January 2005 relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation.

Further information on the principal differences between IFRS and FRS 27 and the Group's previous accounting policies and the effect of their adoption on the Group's previously published information is given in note 54.

The Group's accounting policies are set out below.

(a) Consolidation

The assets, liabilities and results of Group undertakings (including special purpose entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include all entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Group undertakings are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Open Ended Investment Companies (OEICs) and unit trusts where the Group, through the Group's life funds, has a controlling interest are consolidated; the unit holders' interest is reported in other liabilities. Intra-Group transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

(b) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired entity at the date of acquisition. Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. At the date of disposal of a Group undertaking, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal.

Goodwill arising on acquisitions prior to 1 January 2004, the date of transition to IFRS, has been retained at the balance sheet amount at that date and has been tested for impairment at that date. Goodwill previously written off directly to reserves under UK GAAP has not been reinstated and will not be included in calculating any subsequent profit or loss on disposal.

(c) Revenue recognition

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, including loans and advances, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see i).

1 Accounting policies (continued)

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retains no part of the loan package for itself or retains a part at the same effective interest rate for all interest-bearing financial instruments, including loans and advances, as for the other participants.

The Group receives investment management fees in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the instrument. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group recognises these fees on a straight-line basis over the estimated lives of the contracts.

Revenue recognition policies specific to life assurance and general insurance business, except for investment management fees as noted above, are detailed below (see q).

(d) Trading securities, other financial assets at fair value through profit or loss, and available-for-sale financial assets

Debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value are recognised in the income statement in the period in which they occur.

Other financial assets at fair value through profit or loss are designated as such by management upon initial recognition. Such assets are carried in the balance sheet at their fair value and gains and losses recognised in the income statement in the period in which they occur. Financial assets are only designated as at fair value through profit or loss when doing so results in more relevant information because it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis. No use is currently made of the option to designate financial liabilities at fair value through profit or loss.

The fair value of assets traded in active markets is based on current bid prices. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Debt securities and equity shares, other than those classified as trading securities or at fair value through profit or loss, are classified as available-for-sale and recognised in the balance sheet at their fair value. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest calculated using the effective interest method is recognised in the income statement; dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payment is established.

Purchases and sales of securities and other financial assets are recognised on trade date, being the date that the Group is committed to purchase or sell an asset. Trading securities and other financial assets at fair value through profit or loss are initially recognised at fair value. Available-for-sale financial assets are initially recognised at fair value inclusive of transaction costs. These financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

(e) Loans and advances to banks and customers

Loans and advances to banks and customers are accounted for at amortised cost using the effective interest method, except those which the Group intends to sell in the short term and which are accounted for at fair value, with the gains and losses arising from changes in their fair value reflected in the income statement. Loans and advances are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs. Loans and advances are derecognised when the rights to receive cash flows from them have expired or where the Group has transferred substantially all risks and rewards of ownership.

(f) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in deposits from banks or customer accounts, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability.

(g) Derivative financial instruments and hedge accounting

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

The method of recognising the movements in the fair value of the derivatives depends on whether they are designated as hedging instruments, and if so, the nature of the item being hedged. Derivatives may only be designated as hedges provided certain strict criteria are met. At the inception of a hedge its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship must be tested throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its objective the hedge relationship is terminated.

The Group designates certain derivatives as either: (1) hedges of the fair value of the interest rate risk inherent in recognised assets or liabilities (fair value hedges); or (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges). These are accounted for as follows:

(1) Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged risk are no longer recognised in the income statement; the adjustment that has been made to the carrying amount of a hedged item is amortised to the income statement over the period to maturity.

1 Accounting policies (continued)

(2) Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

(h) Offset

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(i) Impairment

(1) Assets accounted for at amortised cost

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired. Evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the fact that the debt is being restructured to reduce the burden on the borrower.

If there is objective evidence that an impairment loss has been incurred, a provision is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate. For the Group's portfolios of smaller balance homogenous loans, such as the residential mortgage, personal lending and credit card portfolios, provisions are calculated for groups of assets taking into account historical cash flow experience. For the Group's other lending portfolios, provisions are established on a case-by-case basis. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

If there is no objective evidence of individual impairment the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Segmentation takes into account such factors as the type of asset, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the provision is adjusted and the amount of the reversal is recognised in the income statement.

When a loan or advance is uncollectable, it is written off against the related provision once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

(2) Available-for-sale assets

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale asset is impaired. In addition to the factors set out above, a significant or prolonged decline in the fair value of the asset below its cost is considered in determining whether an impairment loss has been incurred. If an impairment loss has been incurred, the cumulative loss measured as the difference between the original cost and the current fair value, less any impairment loss on that asset previously recognised, is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(j) Investment property

Property held for long-term rental yields and capital appreciation within the long-term assurance funds is classified as investment property. Investment property comprises freehold and long leasehold land and buildings and is carried in the balance sheet at fair value. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices on less active markets. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair values are recorded in the income statement.

(k) Tangible fixed assets

Tangible fixed assets are included at cost less depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):

- Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease
- Leasehold improvements: shorter of 10 years or the remaining period of the lease

Equipment:

- Fixtures and furnishings: 10-20 years
- Other equipment and motor vehicles: 3-8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

1 Accounting policies (continued)

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately.

(l) Leases

(1) As lessee

The leases entered into by the Group are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

(2) As lessor

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee; all other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments is recognised as a receivable within loans and advances to banks and customers. Finance lease income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Operating lease assets are included within fixed assets at cost and depreciated over the life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised on a straight line basis over the life of the lease.

(m) Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

(n) Pensions and other post-retirement benefits

The Group operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method adjusted for unrecognised actuarial gains and losses. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. The resulting net surplus or deficit is included in the Group's balance sheet. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The Group's income statement includes the current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities. In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives. Past-service costs are charged immediately to the income statement, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due.

(o) Share-based compensation

The Group operates a number of equity-settled, share-based compensation plans. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement over the remaining vesting period, together with a corresponding adjustment to equity.

(p) Income taxes, including deferred income taxes

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

For the Group's long-term assurance businesses, the tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on equity holders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

1 Accounting policies (continued)

(q) Insurance

The Group undertakes both life assurance and general insurance business. The general insurance business issues insurance contracts only. The life assurance business issues insurance contracts and investment contracts. Insurance contracts are those contracts which transfer significant insurance risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event which are more than the benefits payable if the insured event were not to occur. Investment contracts are those contracts which carry no significant insurance risk.

A number of insurance and investment contracts contain a discretionary participation feature which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses that are likely to be a significant portion of the total contractual benefits and whose amount or timing is contractually at the discretion of the Group and based on the performance of specified assets. Contracts containing a discretionary participation feature are referred to as participating contracts.

IFRS 4 allows entities to continue with existing accounting policies for insurance and participating investment contracts, subject to certain criteria; the Group continues to apply UK GAAP for such contracts. For insurance and participating contracts issued by the life assurance business, this includes continued application of the embedded value basis of accounting although, as described below, the underlying contracts are presented separately from the value of in-force life assurance business in respect of those contracts. Investment contracts that are non-participating are accounted for as financial instruments.

(1) Life assurance business

(i) Accounting for life insurance contracts and participating investment contracts

The majority of the life insurance contracts issued by the Group are long-term life assurance contracts. The Group also issues life insurance contracts to protect customers from the consequences of events (such as death, critical illness or disability) that would affect the ability of the customer or their dependants to maintain their current level of income. Guaranteed claims paid on occurrence of the specified insurance event are either fixed or linked to the extent of the economic loss suffered by the policyholder.

Premiums and claims

Premiums received in respect of life insurance contracts and participating investment contracts are recognised as revenue when due and are shown before deduction of commission.

Claims are recorded as an expense when they are incurred.

Liabilities

– life insurance contracts or participating investment contracts in the Group's With-Profits Fund

Liabilities of the Group's With-Profits Fund, including guarantees and options embedded within products written by that fund, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime.

– life insurance contracts or participating investment contracts which are not unit-linked or in the Group's With-Profits Fund

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

– life insurance contracts or participating investment contracts which are unit-linked

Allocated premiums in respect of unit-linked contracts that are either life insurance contracts or participating investment contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals. The mortality charges deducted in each period from the policyholders as a group are considered adequate to cover the expected total death benefit claims in excess of the contract account balances in each period and hence no additional liability is established for these claims. Revenue consists of fees deducted for mortality, policy administration and surrender charges. Interest or changes in the unit prices credited to the account balances and excess benefit claims in excess of the account balances incurred in the period are charged as expenses in the income statement.

Unallocated surplus

The Group has an obligation to pay policyholders a specified portion of all interest and realised gains and losses arising from the assets backing participating contracts. Any amounts not yet determined as being due to policyholders are recognised as an unallocated surplus which is shown separately from other liabilities.

Value of in-force life assurance business

The Group recognises as an asset the value of in-force life assurance business in respect of life insurance contracts and participating investment contracts. The asset, which represents the present value of future profits expected to arise from these contracts, is determined by projecting the future surpluses and other cash flows arising from life insurance contract and participating investment contract business written by the balance sheet date but excluding any future investment margins, using appropriate economic and actuarial assumptions; the value of future cash flows on with-profits policies has been reduced, where necessary, to allow for the realistic value of options and guarantees. The result is discounted at a rate which removes investment risk margins and reflects the Group's overall risk premium attributable to this business. The asset in the consolidated balance sheet is shown gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

Receivables and payables

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

(ii) Accounting for non-participating investment contracts

All of the Group's non-participating investment contracts are unit-linked. In accordance with industry practice, these contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

The element of premiums and claims in respect of non-participating investment contracts which is invested on behalf of the contract holder is excluded from the income statement, with all movements in the contract holder liability and related assets recorded in the balance sheet. Details of the basis of revenue recognition for the related investment management fees are set out above (see c).

1 Accounting policies (continued)

Directly incremental commissions that vary with and are related to either securing new or renewing existing non-participating investment contracts are deferred; all other costs are recognised as expenses when incurred. This asset is subsequently amortised over the period of the provision of investment management services and is reviewed for impairment in circumstances where its carrying amount may not be recoverable. If the asset is greater than its recoverable amount it is written down immediately.

(2) General insurance business

The Group both underwrites and acts as intermediary in the sale of general insurance products. Underwriting premiums are included, net of refunds, in the period in which insurance cover is provided to the customer; premiums received relating to future periods are deferred and only credited to the income statement when earned. Broking commission is recognised when the underwriter accepts the risk of providing insurance cover to the customer. Where appropriate, provision is made for the effect of future policy terminations based upon past experience.

The underwriting business makes provision for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date.

(3) Liability adequacy test

At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities. In performing these tests current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss by establishing a provision for losses arising from liability adequacy tests.

(4) Reinsurance

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held. Insurance contracts entered into by the Group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

(r) Foreign currency translation

(1) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in sterling, which is the Company's functional and presentation currency.

(2) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

(3) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

(s) Provisions

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

(t) Dividends

Dividends on ordinary shares are recognised in equity in the period in which they are paid.

2 Critical accounting estimates and judgements

The Group makes assumptions and estimates that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, are discussed below.

Impairment on assets accounted for at amortised cost

The Group regularly reviews its loan portfolios to assess for impairment. In determining whether an impairment has occurred the Group considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows and their timings; such observable data includes whether there has been an adverse change in the payment status of borrowers or changes in economic conditions that correlate with defaults on assets in the Group.

The methodology used to calculate the required provision varies according to the type of lending portfolio. For portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances, impairment provisions are calculated collectively using formulae which take into account factors such as the length of time that the customer's account has been delinquent, historical loss rates and the value of any collateral held in order to determine expected future cash flows. The variables used in the formulae are kept under regular review to ensure that as far as possible they reflect the current economic circumstances, although actual experience may differ from that assumed.

For other lending portfolios, provisions are calculated on an individual basis with reference to expected future cash flows including those arising from the realisation of collateral. The determination of these provisions often requires the exercise of considerable judgement by management involving matters such as future economic conditions and the resulting trading performance of the customer and the value of collateral, for which there may not be a readily accessible market. As a result these provisions can be subject to significant variation as time progresses and the circumstances of the customer become clearer.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Pensions

The net liability recognised in the balance sheet in respect of the Group's retirement benefit obligations represents the liabilities of the Group's defined benefit pension schemes after deduction of the fair value of the related assets. The schemes' liabilities are derived by estimating the ultimate cost of benefits payable by the schemes and reflecting the discounted value of the proportion accrued by the year end in the balance sheet. In order to arrive at this estimate a number of key financial and non-financial assumptions are made by management, changes to which could have a material impact upon the net deficit and also the net cost recognised in the income statement.

The principal assumptions relate to the rate of inflation, mortality and the discount rate. The assumed rate of inflation is important because this affects the rate at which salaries grow and therefore the size of the pension that employees receive upon retirement. Over the longer term rates of inflation can vary significantly; at 31 December 2005 it was assumed that the longer term rate of inflation would be 2.7 per cent on average, although if this was increased by 0.2 per cent the net deficit would increase by approximately £600 million and the net cost by approximately £15 million. A reduction of 0.2 per cent would reduce the net deficit by approximately £575 million and the net cost by approximately £20 million.

The overall cost of the benefits payable by the schemes will also depend upon the length of time that members of the schemes live for; the longer they remain alive the higher the cost of the pension benefits to be met by the schemes. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rates of advance in medical science it is uncertain whether these assumptions will prove to be accurate in practice. An increase of one year in the expected lifetime of scheme members would increase the net deficit by approximately £450 million and the net cost by approximately £30 million; a reduction of one year reduces the net deficit and the net cost by similar amounts.

The rate used to discount the resulting cash flows is equivalent to the market yield at the balance sheet date on high quality bonds with a similar duration to the schemes' liabilities. This rate is potentially subject to significant variation. At 31 December 2005 the discount rate used was 4.8 per cent; a reduction of 0.2 per cent would result in an increase in the net deficit of approximately £650 million and in the net cost of approximately £15 million, while an increase of 0.2 per cent would reduce the net deficit by approximately £600 million and the net cost by approximately £15 million.

The net cost recognised in the income statement is also affected by the expected return on the schemes' assets. This is determined on the basis of the asset mix within the schemes at the beginning of the year and market expectations for the return on each asset type. During 2005 the assumed return on equities was 8.2 per cent; a 0.25 per cent increase or decrease in the assumed return on equities increases or decreases the expected return reflected in the income statement by approximately £20 million.

Goodwill

The Group reviews the goodwill arising on the acquisition of subsidiaries for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The impairment review is performed by projecting future cash flows, excluding finance and tax, based upon budgets and plans and making appropriate assumptions about rates of growth and discounting these using a rate that takes into account prevailing market interest rates and the risks inherent in the business. If the present value of the projected cash flows is less than the carrying value of the underlying net assets and related goodwill an impairment charge would be required in the income statement. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or changes in the performance of the subsidiaries affect the amount and timing of future cash flows, goodwill may become impaired in future periods.

Customer remediation provisions

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes are found to have been deficient. The ultimate cost is inherently uncertain and in determining the level of provisions required it is necessary for management to exercise significant judgement. The principal assumptions underlying the provisions relate to the number of cases requiring redress and the estimated average cost of redress per case; these will be affected by external factors beyond the control of management, such as regulatory actions and the performance of the financial markets. Therefore over time it is possible that adjustments will be necessary to the level of provisions held.

Insurance

Life assurance business

Calculation of the value of in-force life assurance business assets and life assurance business policy liabilities are dependent on assumptions made regarding future experience. If actual experience differs from that assumed, this could significantly affect the value attributed to these items. Any profit or loss arising from such changes would be recognised in the income statement in that period. The key assumptions upon which these items are dependent are described in notes 26 and 34, along with the impact on profit before tax which would occur if they were to change.

2 Critical accounting estimates and judgements (continued)

General insurance business

A provision is made for the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date.

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgment. An increase of 10 per cent in the cost of claims would result in the recognition of an additional loss of approximately £14 million. Similarly, an increase of 10 per cent in the ultimate number of such claims would lead to an additional loss of approximately £15 million. There is no relief arising from reinsurance contracts held.

Income taxes

Significant judgement is required in determining the Group's income tax liabilities. There are many transactions and calculations for which the ultimate tax determination is uncertain and where calculations have been based on management's assessment of legal and professional advice, case law and other relevant guidance. In these situations, the various risks are categorised and approximate weightings applied in arriving at the assessment of the expected liability. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax amounts in the period in which such determination is made.

3 Segmental analysis

Lloyds TSB Group is a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

The Group's activities are organised into three segments: UK Retail Banking, Insurance and Investments and Wholesale and International Banking. Services provided by UK Retail Banking encompass the provision of banking and other financial services to personal customers, private banking, stockbroking and mortgages. Insurance and Investments offers life assurance, pensions and savings products, general insurance and asset management services. Wholesale and International Banking provides banking and related services for major UK and multinational companies, banks and financial institutions, and small and medium-sized UK businesses. It also provides asset finance to personal and corporate customers, manages the Group's activities in financial markets through its Treasury function and provides banking and financial services overseas.

Under the Group's transfer pricing arrangements, inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds. In addition, with effect from 1 January 2005, for those derivative contracts entered into by business units for risk management purposes, the difference between the result that would have been recognised on an accruals accounting basis and the actual result calculated using fair values is charged or credited to the central segment where the resulting volatility is managed.

Year ended 31 December 2005	UK Retail Banking £m	General insurance £m	Life, pensions and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Inter-segment eliminations £m	Total £m
Interest and similar income	6,652	27	850	877	6,944	1,091	(2,975)	12,589
Interest and similar expense	(3,131)	(4)	(478)	(482)	(4,679)	(1,601)	2,975	(6,918)
Net interest income	3,521	23	372	395	2,265	(510)	–	5,671
Other income (net of fee and commission expense)	1,605	571	13,288	13,859	1,628	(37)	–	17,055
Total income	5,126	594	13,660	14,254	3,893	(547)	–	22,726
Insurance claims	–	(197)	(11,989)	(12,186)	–	–	–	(12,186)
Total income, net of insurance claims	5,126	397	1,671	2,068	3,893	(547)	–	10,540
Operating expenses	(2,697)	(160)	(434)	(594)	(2,181)	1	–	(5,471)
Trading surplus	2,429	237	1,237	1,474	1,712	(546)	–	5,069
Impairment losses on loans and advances	(1,111)	–	–	–	(188)	–	–	(1,299)
Profit (loss) on sale and closure of businesses	76	–	–	–	(6)	(20)	–	50
Profit (loss) before tax	1,394	237	1,237	1,474	1,518	(566)	–	3,820
External revenue	7,833	1,272	14,127	15,399	7,283	(29)	–	30,486
Inter-segment revenue	744	16	330	346	1,686	1,175	(3,951)	–
Segment revenue	8,577	1,288	14,457	15,745	8,969	1,146	(3,951)	30,486
External assets	103,930	968	79,180	80,148	124,044	1,632	–	309,754
Inter-segment assets	2,146	593	3,893	4,486	81,728	50,855	(139,215)	–
Total assets	106,076	1,561	83,073	84,634	205,772	52,487	(139,215)	309,754
External liabilities	72,335	829	71,894	72,723	141,878	12,188	–	299,124
Inter-segment liabilities	30,492	280	5,133	5,413	59,224	44,086	(139,215)	–
Total liabilities	102,827	1,109	77,027	78,136	201,102	56,274	(139,215)	299,124
Other segment items:								
Capital expenditure	77	13	844	857	702	207	–	1,843
Depreciation	219	11	26	37	383	–	–	639
Customer remediation provision	150	–	–	–	–	–	–	150
Retirement benefit scheme charges	134	4	22	26	84	15	–	259

3 Segmental analysis (continued)

Year ended 31 December 2004	UK Retail Banking £m	General insurance £m	Life, pensions and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Inter-segment eliminations £m	Total £m
Interest and similar income	5,825	56	537	593	5,954	883	(2,548)	10,707
Interest and similar expense	(2,597)	(12)	(298)	(310)	(3,948)	(1,290)	2,548	(5,597)
Net interest income	3,228	44	239	283	2,006	(407)	–	5,110
Other income (net of fee and commission expense)	1,696	504	10,370	10,874	1,558	45	–	14,173
Total income	4,924	548	10,609	11,157	3,564	(362)	–	19,283
Insurance claims	–	(214)	(9,408)	(9,622)	–	–	–	(9,622)
Total income, net of insurance claims	4,924	334	1,201	1,535	3,564	(362)	–	9,661
Operating expenses	(2,609)	(154)	(468)	(622)	(2,078)	12	–	(5,297)
Trading surplus	2,315	180	733	913	1,486	(350)	–	4,364
Impairment losses on loans and advances	(676)	–	3	3	(193)	–	–	(866)
Loss on sale of businesses	–	–	–	–	(21)	–	–	(21)
Profit (loss) before tax	1,639	180	736	916	1,272	(350)	–	3,477
External revenue	7,089	1,288	11,121	12,409	6,135	91	–	25,724
Inter-segment revenue	791	48	19	67	1,716	851	(3,425)	–
Segment revenue	7,880	1,336	11,140	12,476	7,851	942	(3,425)	25,724
External assets	96,763	1,058	70,874	71,932	114,086	1,641	–	284,422
Inter-segment assets	1,340	526	2,644	3,170	70,947	39,503	(114,960)	–
Total assets	98,103	1,584	73,518	75,102	185,033	41,144	(114,960)	284,422
External liabilities	68,149	931	62,305	63,236	130,171	11,188	–	272,744
Inter-segment liabilities	27,035	75	4,105	4,180	50,643	33,102	(114,960)	–
Total liabilities	95,184	1,006	66,410	67,416	180,814	44,290	(114,960)	272,744
Other segment items:								
Capital expenditure	103	–	386	386	907	169	–	1,565
Depreciation	217	11	25	36	385	–	–	638
Customer remediation provision	100	12	–	12	–	–	–	112
Retirement benefit scheme charges	142	3	24	27	90	16	–	275

As the activities of the Group are predominantly carried out in the UK, no geographical analysis is presented.

4 Net interest income

	2005 Average effective interest rate %	2005 £m	2004 £m
Interest receivable:			
Treasury bills and other eligible bills			6
Investment securities			418
Available-for-sale financial assets	3.58	508	
Loans and advances to customers	6.41	10,095	8,440
Loans and advances to banks	3.59	1,199	979
Lease and hire purchase receivables	7.07	787	864
	5.82	12,589	10,707
Interest payable:			
Deposits from banks	3.44	(953)	(558)
Customer accounts	2.84	(3,401)	(3,003)
Debt securities in issue	4.23	(1,307)	(972)
Subordinated liabilities	5.22	(601)	(601)
Liabilities under sale and repurchase agreements	4.53	(394)	(319)
Other	7.24	(262)	(144)
	3.42	(6,918)	(5,597)
Net interest income		5,671	5,110

Included within interest income in 2005 is £209 million in respect of impaired financial assets.

5 Net fees and commission income

	2005 £m	2004 £m
Fees and commission income:		
Current accounts	593	637
Insurance broking	681	672
Credit and debit card services	545	520
Other	1,171	1,225
	2,990	3,054
Fees and commission expense:		
Credit and debit card services	(182)	(176)
Dealer commissions	(247)	(272)
Other	(413)	(396)
	(842)	(844)
Net fees and commission income	2,148	2,210

6 Net trading income

	2005 £m	2004 £m
Foreign exchange translation gains	13	22
Gains on foreign exchange trading transactions	150	152
Total foreign exchange	163	174
Investment property gains	430	329
Securities and other gains	8,705	4,533
	9,298	5,036

7 Insurance premium income

The table below reflects the insurance premiums, substantially all of which relate to business written in the United Kingdom, broken down into life insurance and non-life insurance:

	2005 £m	2004 £m
Life insurance		
Gross premiums	**3,996**	5,581
Ceded reinsurance premiums	**(89)**	(65)
Net premiums earned	**3,907**	5,516
Non-life insurance		
Gross premiums written	**575**	635
Ceded reinsurance premiums	**(22)**	(29)
Net premiums	**553**	606
Change in provision for unearned premiums	**9**	(52)
Net premiums earned	**562**	554
Total net premiums earned	**4,469**	6,070

Life insurance gross written premiums can be further analysed as follows:	2005 £m	2004 £m
Life	**1,286**	2,100
Pensions	**2,136**	2,826
Annuities	**547**	626
Other	**27**	29
Gross premiums	**3,996**	5,581

Non-life insurance gross written premiums can be further analysed as follows:	2005 £m	2004 £m
Credit protection	**173**	224
Home	**390**	396
Health	**12**	15
	575	635

8 Other operating income

	2005 £m	2004 £m
Operating lease rental income	**433**	422
Income from investment property	**272**	158
Other rents receivable	**30**	32
Gains less losses on disposal of available-for-sale financial assets, net of allowances for impairment	**5**	
Gains less losses on disposal of investment securities, net of amounts written off		74
Movement in value of in-force insurance business (note 26)	**162**	16
Other income	**238**	155
	1,140	857

9 Insurance claims

Insurance claims comprise:	2005 £m	2004 £m
Life insurance		
Claims and surrenders:		
– Gross	**4,279**	5,242
– Reinsurers' share	**(56)**	(62)
	4,223	5,180
Changes in life insurance policyholder liabilities:		
– Gross	**7,641**	3,206
– Reinsurers' share	**33**	(1)
	7,674	3,205
Change in unallocated surplus	**92**	1,023
Total life insurance	**11,989**	9,408
Non-life insurance		
Claims and claims paid:		
– Gross	**195**	204
– Reinsurers' share	**(1)**	(1)
	194	203
Changes in non-life insurance policyholder liabilities:		
– Gross	**3**	11
– Reinsurers' share	**–**	–
	3	11
Total non-life insurance	**197**	214
Total insurance claims expense	**12,186**	9,622
Life insurance gross claims can also be analysed as follows:		
Deaths	**298**	354
Maturities	**1,197**	1,617
Surrenders	**2,204**	2,700
Annuities	**528**	528
Other	**52**	43
	4,279	5,242

A non-life insurance claims development table is included in note 34.

10 Operating expenses

	2005 £m	2004 £m
Salaries	**2,068**	1,970
Pensions	**308**	307
Other staff costs	**479**	427
Staff costs	**2,855**	2,704
Other administrative expenses:		
Operating lease rentals	**252**	249
Repairs and maintenance	**136**	129
Communications and data processing	**467**	449
Advertising	**207**	205
Professional fees	**216**	222
Provisions for customer remediation (note 40)	**150**	112
Other	**543**	589
	1,971	1,955
Depreciation	**639**	638
Impairment charges:		
Goodwill (note 25)	**6**	–
Total operating expenses	**5,471**	5,297

10 Operating expenses (continued)

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2005	2004
UK	**77,620**	79,581
Overseas	**1,974**	3,372
	79,594	82,953

During the year the auditors earned the following fees:	2005 £m	2004 £m
Statutory audit	**8.1**	5.5
Other audit related fees:		
– Audit related regulatory reporting	**0.8**	0.9
– Further assurance services	**1.5**	6.4
Total other audit related fees	**2.3**	7.3
Audit and audit related fees	**10.4**	12.8
Tax advisory	**0.6**	0.8
Other non-audit fees		
– Due diligence	**0.3**	0.9
– Other	**0.5**	0.3
Total other non-audit fees	**0.8**	1.2
Total fees	**11.8**	14.8

The auditors' remuneration for the holding company was £57,000 (2004: £51,500).

During the year the auditors also earned fees of £0.3 million (2004: £0.3 million) in respect of the audit of pension schemes and unconsolidated open ended investment companies managed by the Group.

Included in 'Other audited related fees' are the costs of advice provided in relation to the requirements of the Sarbanes-Oxley Act together with the costs of the audit of the Group's Form 20-F filing.

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to the provision of advice on tax issues, assistance in transactions involving the acquisition and disposal of businesses and accounting advice. The auditors are not permitted to provide management consultancy services to the Group.

The Group has procedures that are designed to ensure auditor independence, including that fees for audit and non-audit services are approved in advance. The audit committee has established de minimis fee limits for particular detailed types of service and has approved in advance all non-audit assignments where the fee falls below the relevant limit. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant limit are subject to individual pre-approval by the audit committee. On a quarterly basis, the audit committee receives a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

11 Impairment losses on loans and advances

	2005 £m	2004 £m
Specific bad debt provisions		953
General bad debt provisions		(87)
Impairment losses on loans and advances (note 20)	**1,302**	866
Other credit risk provisions (note 40)	**(3)**	–
	1,299	866

12 Profit (loss) on sale and closure of businesses

	2005 £m	2004 £m
Net profit (loss) on disposal of businesses	**74**	(21)
Adjustment to consideration received in respect of prior period disposals	**(4)**	–
Provision for costs in respect of the closure of businesses	**(20)**	–
	50	(21)

The net profit on the disposal of businesses in 2005 principally relates to the sale of the Goldfish credit card business. During the year ended 31 December 2004 the Group completed the sales of its principal businesses in Colombia and substantially all of the businesses of the branches of Lloyds TSB Bank plc in Argentina, Panama, Guatemala and Honduras.

The businesses sold in 2004 and 2005 were not material to the Group, and consequently they have not been treated as discontinued operations.

13 Taxation

a Analysis of charge for the year

	2005 £m	2004 £m
UK corporation tax:		
Current tax on profits for the year	862	759
Adjustments in respect of prior years	(20)	(69)
	842	690
Double taxation relief	(138)	(57)
	704	633
Foreign tax:		
Current tax on profit for the year	78	118
Adjustments in respect of prior years	(8)	(2)
	70	116
Current tax charge	774	749
Deferred tax (note 39)	491	269
	1,265	1,018

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2004: 30 per cent).

The Group, as a proxy for policyholders in the UK, is required to record taxes on investment income and gains each year. Accordingly, the tax attributable to UK life insurance policyholder earnings is included in income tax expense. The tax expense attributable to policyholder earnings was £298 million (2004: £36 million), including a prior year tax credit of £25 million (2004: £6 million).

b Factors affecting the tax charge for the year

A reconciliation of the charge that would result from applying the standard UK corporation tax rate to profit before tax to the tax charge for the year is given below:

	2005 £m	2004 £m
Profit before tax	3,820	3,477
Tax charge thereon at UK corporation tax rate of 30%	1,146	1,043
Factors affecting charge:		
Disallowed and non-taxable items	(47)	(32)
Overseas tax rate differences	(1)	(14)
Net tax effect of disposals and unrealised gains	(59)	(2)
Tax deductible coupons on non-equity minority interests	–	(12)
Policyholder tax and Open Ended Investment Companies	223	33
Other items	3	2
Tax on profit on ordinary activities	1,265	1,018
Effective rate	33.1%	29.3%

The effective tax rate of the Group excluding the gross policyholder tax charge and Open Ended Investment Company interests from profit before tax and the tax charge was 27.0 per cent (2004: 28.3 per cent).

14 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year, which has been calculated after deducting 5 million (2004: 6 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

	2005	2004
Profit attributable to equity shareholders	£2,493m	£2,392m
Weighted average number of ordinary shares in issue	5,595m	5,590m
Basic earnings per share	44.6p	42.8p

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has dilutive potential ordinary shares in respect of share options granted to employees. The number of shares that could have been acquired at market price (determined as the average annual share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options is determined; the residual bonus shares are added to the weighted average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

	2005	2004
Profit attributable to equity shareholders	£2,493m	£2,392m
Weighted average number of ordinary shares in issue	5,595m	5,590m
Adjustment for share options	44m	35m
Weighted average number of ordinary shares for diluted earnings per share	5,639m	5,625m
Diluted earnings per share	44.2p	42.5p

The weighted average number of anti-dilutive share options excluded from the calculation of diluted earnings per share was 17 million at 31 December 2005 (2004: 39 million).

15 Treasury bills and other eligible bills

Up to 31 December 2004 (prior to the implementation of IAS 32 and IAS 39 on 1 January 2005) treasury bills and other eligible bills were shown separately on the balance sheet. This balance sheet caption comprised both investment securities and other securities. Investment securities were those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. At 31 December 2005, treasury bills and other eligible bills are categorised as either trading securities and other financial assets at fair value through profit or loss (note 16) or available-for-sale financial assets (note 23).

Details of the balance sheet carrying value of the treasury bills and other eligible bills held at 31 December 2004 were as follows:

	£m
Investment securities:	
Treasury bills and similar securities	75
Other eligible bills	13
	88
Other securities:	
Treasury bills and similar securities	4
Balance sheet carrying value – treasury bills and other eligible bills	92
Geographical analysis by issuer:	
Latin America	18
Other	74
	92

16 Trading securities and other financial assets at fair value through profit or loss

From 1 January 2005 (upon the implementation of IAS 32 and IAS 39), the Group is required to disclose its trading securities and other financial assets at fair value through profit or loss separately on the face of the balance sheet.

Details of the balance sheet carrying value of these assets held at 31 December 2005 are:

	£m
Trading securities	**5,442**
Other financial assets at fair value through profit or loss	**54,932**
	60,374

These assets are comprised as follows:

	Trading securities £m	**Other financial assets at fair value through profit or loss £m**
Loans and advances to banks	**5**	**5**
Loans and advances to customers	**161**	**445**
Debt securities:		
Government securities	**535**	**10,638**
Other public sector securities	**35**	**84**
Bank and building society certificates of deposit	**–**	**898**
Corporate debt securities	**4,667**	**4,214**
Mortgage backed securities	**39**	**197**
Other asset backed securities	**–**	**691**
Other debt securities	**–**	**4,255**
	5,276	**20,977**
Equity shares:		
Listed	**–**	**27,497**
Unlisted	**–**	**6,008**
	–	**33,505**
	5,442	**54,932**

See notes 15, 21 and 22 for details of investments held at 31 December 2004.

17 Derivative financial instruments and other trading liabilities

The principal derivatives used by the Group are interest rate and exchange rate contracts; particular attention is paid to the liquidity of the markets and products in which the Group trades to ensure that there are no undue concentrations of activity and risk.

Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual. A currency option gives the buyer, on payment of a premium, the right, but not the obligation, to sell specified amounts of currency at agreed rates of exchange on or before a specified future date.

Equity derivatives are also used by the Group as part of its equity based retail product activity to eliminate the Group's exposure to fluctuations in various international stock exchange indices. Index-linked equity options are purchased which give the Group the right, but not the obligation, to buy or sell a specified amount of equities, or basket of equities in the form of published indices on or before a specified future date.

The principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate.

31 December 2005	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading			
Exchange rate contracts:			
Spot, forwards and futures	145,591	1,515	1,345
Currency swaps	12,306	267	204
Options purchased	3,623	58	–
Options written	3,892	–	45
	165,412	1,840	1,594
Interest rate contracts:			
Interest rate swaps	288,725	2,814	3,860
Forward rate agreements	50,006	16	20
Options purchased	12,679	108	–
Options written	8,812	–	85
Futures	29,358	–	–
	389,580	2,938	3,965
Equity and other contracts	5,349	610	84
Total derivative assets/liabilities held for trading		5,388	5,643
Hedging			
Derivatives designated as fair value hedges:			
Cross currency interest rate swaps	69	12	–
Interest rate swaps (including swap options)	39,499	473	730
	39,568	485	730
Derivatives designated as cash flow hedges:			
Interest rate swaps	648	5	23
Total derivative assets/liabilities held for hedging		490	753
Total recognised derivative assets/liabilities		5,878	6,396

17 Derivative financial instruments and other trading liabilities (continued)

31 December 2004	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
Trading			
Exchange rate contracts:			
Spot, forwards and futures	117,532	4,593	5,237
Currency swaps	11,386	426	588
Options purchased	2,059	44	–
Options written	1,922	–	41
	132,899	5,063	5,866
Interest rate contracts:			
Interest rate swaps	275,547	3,118	3,631
Forward rate agreements	62,797	28	24
Options purchased	9,679	78	–
Options written	7,430	–	163
Futures	48,278	–	–
	403,731	3,224	3,818
Equity and other contracts	4,294	538	215
Effect of netting		(3,956)	(3,956)
Total derivative assets/liabilities held for trading		4,869	5,943

At 31 December 2004, the fair value amounts shown above were included on the balance sheet within other assets and other liabilities (see notes 30 and 37).

The maturity of the notional principal amounts and replacement cost of trading instruments entered into with third parties was:

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Exchange rate contracts				
Notional principal amount	120,794	8,093	4,012	132,899
Replacement cost	4,610	177	276	5,063
Interest rate contracts				
Notional principal amount	203,851	153,422	46,458	403,731
Replacement cost	458	1,353	1,413	3,224
Equity and other contracts				
Notional principal amount	638	3,358	298	4,294
Replacement cost	262	258	18	538
Total				
Notional principal amount	325,283	164,873	50,768	540,924
Replacement cost	5,330	1,788	1,707	8,825

18 Loans and advances to banks

	2005 £m	2004 £m
Lending to banks	**2,510**	2,483
Money market placements with banks	**29,146**	29,366
Total loans and advances to banks	**31,656**	31,849
Allowance for impairment losses (note 20)	**(1)**	(1)
	31,655	31,848

The Group holds collateral with a fair value of £6,381 million, which it is permitted to sell or repledge, of which £5,550 million was repledged or sold to third parties for periods not exceeding three months from the transfer.

19 Loans and advances to customers

	2005 £m	2004 £m
Domestic		
Agriculture, forestry and fishing	**2,299**	2,076
Manufacturing	**5,983**	3,292
Construction	**2,059**	1,877
Transport, distribution and hotels	**7,649**	6,753
Property companies	**8,267**	5,775
Financial, business and other services	**16,272**	13,442
Personal:		
– Mortgages	**88,528**	80,065
– Other	**22,776**	22,830
Lease financing	**5,815**	6,227
Hire purchase	**4,853**	4,828
Other	**7,696**	5,223
	172,197	152,388
International		
Latin America	**173**	125
USA	**1,984**	2,385
Europe	**1,927**	1,587
Rest of the world	**735**	516
Total international	**4,819**	4,613
	177,016	157,001
Allowance for impairment losses (note 20)	**(2,072)**	(1,662)
Interest held in suspense		(21)
	174,944	155,318

The Group holds collateral with a fair value of £1,018 million, which it is permitted to sell or repledge, of which £741 million was repledged or sold to third parties for periods not exceeding three months from the transfer.

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

	2005 £m	2004 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**673**	603
Later than 1 year and not later than 5 years	**2,388**	2,698
Later than 5 years	**6,025**	7,481
	9,086	10,782
Unearned future finance income on finance leases	**(2,954)**	(4,021)
Rentals received in advance	**(200)**	(338)
Commitments for expenditure in respect of equipment to be leased	**(117)**	(196)
Net investment in finance leases	**5,815**	6,227

The net investment in finance leases may be analysed as follows:	2005 £m	2004 £m
Not later than 1 year	**648**	446
Later than 1 year and not later than 5 years	**1,610**	844
Later than 5 years	**3,557**	4,937
	5,815	6,227

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other 'big ticket' items. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £4 million (2004: £10 million).

20 Allowance for impairment losses on loans and advances

	2005 £m	2004 Specific £m	2004 General £m	2004 Total £m
At 1 January	**1,663**	1,313	382	1,695
Adjustment on transition to IAS 39	**256**			
Restated balance at 1 January	**1,919**			
Exchange and other adjustments	**1**	(8)	(3)	(11)
Reclassifications	**43**	–	–	–
Adjustments on acquisitions and disposals	**(27)**	(21)	(12)	(33)
Advances written off	**(1,236)**	(1,028)	–	(1,028)
Recoveries of advances written off in previous years	**158**	174	–	174
Effect of unwinding of discount recognised through interest income	**(87)**			
Charge (release) to the income statement	**1,302**	953	(87)	866
At 31 December	**2,073**	1,383	280	1,663
In respect of:				
Loans and advances to banks (note 18)	**1**			1
Loans and advances to customers (note 19)	**2,072**			1,662
	2,073			1,663

21 Debt securities

As at 31 December 2004 (prior to the implementation of IAS 32 and IAS 39 on 1 January 2005) debt securities were shown separately on the balance sheet. This balance sheet caption comprised both investment securities and other securities. Investment securities were those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. At 31 December 2005, debt securities are categorised as either trading securities and other financial assets at fair value through profit or loss (note 16) or available-for-sale financial assets (note 23).

Details of the balance sheet carrying value of the debt securities held at 31 December 2004 were as follows:

	£m
Investment securities	
Government securities	2,211
Bank and building society certificates of deposit	1,901
Corporate debt securities	2,581
Mortgage backed securities	2,774
Other asset backed securities	3,761
Other debt securities	1,140
	14,368
Other securities	
Government securities	14,018
Other public sector securities	321
Bank and building society certificates of deposit	488
Corporate debt securities	13,445
Mortgage backed securities	533
Other asset backed securities	312
	29,117
Balance sheet carrying value – debt securities	43,485

21 Debt securities (continued)

	£m
Investment securities	
Listed	8,925
Unlisted	5,443
	14,368
Other securities	
Listed	28,400
Unlisted	717
	29,117
Geographical analysis by issuer:	
United Kingdom	21,288
Other European	13,464
North America and Caribbean	5,264
Latin America	76
Asia Pacific	2,866
Other	527
	43,485

22 Equity shares

As at 31 December 2004 (prior to the implementation of IAS 32 and IAS 39 on 1 January 2005) equity shares were shown separately on the balance sheet. This balance sheet caption comprised both investment securities and other securities. Investment securities were those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. At 31 December 2005, equity shares are categorised as either trading securities and other financial assets at fair value through profit or loss (note 16) or available-for-sale financial assets (note 23).

Details of the balance sheet carrying value of the equity shares held at 31 December 2004 were as follows:

	£m
Investment securities	
Listed	5
Unlisted	36
	41
Other securities	
Listed	24,497
Unlisted	2,772
	27,269
Balance sheet carrying value – equity shares	27,310
Geographical analysis by issuer:	
United Kingdom	17,960
Other European	3,921
North America and Caribbean	2,302
Latin America	384
Asia Pacific	1,470
Other	1,273
	27,310

23 Available-for-sale financial assets

From 1 January 2005 (upon the implementation of IAS 32 and IAS 39), the Group is required to disclose its available-for-sale financial assets separately on the face of the balance sheet. Details of the balance sheet carrying value of these assets held at 31 December 2005 are:

	£m
Debt securities:	
Government securities	1,083
Other public sector securities	47
Bank and building society certificates of deposit	1,470
Corporate debt securities	3,036
Mortgage backed securities	4,161
Other asset backed securities	4,981
Other debt securities	29
	14,807
Equity shares:	
Listed	34
Unlisted	12
	46
Treasury bills and other eligible bills:	
Treasury bills and similar securities	70
Other eligible bills	17
	87
	14,940

See notes 15, 21 and 22 for details of investments held at 31 December 2004.

The movement in available-for-sale financial assets is summarised as follows:

	Carrying value before provisions £m	Provisions £m	Balance sheet value £m
At 1 January 2005 (following implementation of IAS 32 and IAS 39)	14,624	(31)	14,593
Exchange and other adjustments	559	–	559
Additions	10,108	–	10,108
Disposals	(10,266)	–	(10,266)
Reclassifications	(31)	31	–
Amortisation of premiums and discounts	(65)	–	(65)
Changes in fair value	11	–	11
At 31 December 2005	14,940	–	14,940

24 Investment property

	2005 £m	2004 £m
At 1 January	3,776	3,551
Fair value movements	430	329
Additions to investment properties	807	351
Disposals of investment properties	(753)	(455)
At 31 December	4,260	3,776

The investment properties are valued at least annually at open-market value, by an independent, professionally qualified valuer, who has recent experience in the location and categories of the investment properties being valued.

In addition, the following amounts have been recognised in the income statement:

	2005 £m	2004 £m
Rental income	272	158
Direct operating expenses arising from investment properties that generate rental income	24	17

Capital expenditure in respect of investment properties:

	2005 £m	2004 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	31	66

25 Goodwill

	2005 £m	2004 £m
At 1 January	**2,469**	2,513
Acquisition adjustment	**–**	(34)
Acquisitions of businesses (note 52)	**3**	–
Adjustments on disposal of businesses	**(93)**	(10)
Impairment charge	**(6)**	–
At 31 December	**2,373**	2,469
Cost*	**2,379**	2,469
Accumulated impairment losses	**(6)**	–
	2,373	2,469

* For acquisitions made prior to 1 January 2004, the date of transition to IFRS, cost is included net of amounts amortised up to 31 December 2003.

An impairment charge of £6 million (2004: nil) was made during 2005 following a strategic review of a business acquired in previous years.

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,373 million (2004: £2,469 milllion), £1,836 million (or 77 per cent of the total) has been allocated to Scottish Widows and £517 million (or 22 per cent of the total) to Asset Finance.

The recoverable amount of Scottish Widows has been based on a value in use calculation. The calculation uses projections of future cash flows based upon budgets and plans approved by management covering a five-year period, and a discount rate of 11 per cent (gross of tax). The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. Cash flows beyond the five-year period have been extrapolated using a steady 3 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 9 per cent. Due to similarities in the risk profile and the funding model management believes that Asset Finance is closely aligned to Lloyds TSB Group; the discount rate represents the Group's cost of equity. The cash flows for each of the businesses of Asset Finance beyond the five-year period are extrapolated using steady growth rates, in each case not exceeding 3 per cent nor the long-term average growth rates for the markets in which the respective businesses of Asset Finance participate. Management also believes that any reasonably possible change in the key assumptions on which the recoverable amount of Asset Finance is based would not cause the carrying amount of Asset Finance to exceed its recoverable amount.

26 Long-term assurance business

Life assurance businesses

The principal subsidiaries involved in the Group's life assurance operations during 2004 and 2005 were Scottish Widows plc ('Scottish Widows', the Group's principal provider of life assurance, pensions and investment products, which holds the only large With-Profits Fund managed by the Lloyds TSB Group), Scottish Widows Annuities Limited (a subsidiary of Scottish Widows that accepts the reinsurance of annuity business from its parent), Scottish Widows Unit Funds Limited (a subsidiary of Scottish Widows that accepts the reinsurance of unit-linked business from its parent), Abbey Life Assurance Company Limited ('Abbey Life') and Lloyds TSB Life Assurance Company Limited ('Lloyds TSB Life'). Since March 2000 both Abbey Life and Lloyds TSB Life have continued to administer existing policies and have undertaken only limited new business. No change in this activity is anticipated in respect of Abbey Life. On 31 December 2004, Lloyds TSB Life ceased trading and transferred most of its assets and insurance business to Scottish Widows.

Further information on the Group's life assurance businesses, including its available capital resources and regulatory capital requirements, the realistic value of its assets and liabilities and its capital sensitivities is given in note 34 and on pages 35 to 38.

Value of in-force business

The Group recognises as an asset the value of in-force life assurance business in respect of life insurance contracts and participating investment contracts. The asset, which represents the present value of future profits expected to arise from these contracts, is determined by projecting future surpluses and other cash flows arising from life insurance contract and participating investment contract business written by the balance sheet date. This asset does not recognise any investment risk margins and is reduced by the value of any with-profits options and guarantees; it is presented gross of attributable tax. The asset in the consolidated balance sheet and movement recognised in the income statement are as follows:

	£m
At 1 January 2004	4,347
Movement in value of in-force business (gross of tax)	16
At 31 December 2004	4,363
Adjustments on the adoption of FRS27	(386)
Adjustments on the adoption of IFRS4 and IAS39	(1,217)
At 1 January 2005	**2,760**
Movement in value of in-force business (gross of tax)	**162**
At 31 December 2005	**2,922**

26 Long-term assurance business (continued)

The principal economic assumptions used in calculating the value of in-force business at 31 December 2005 were as follows:

	2005 %	2004 %
Risk adjusted discount rate (net of tax)	**7.02**	7.40
Return on equities (gross of tax)	**6.72**	7.17
Return on fixed interest securities (gross of tax)	**4.12**	4.57
Expenses inflation	**3.79**	3.76

The process for determining the key assumptions used in the calculations of the value of in-force business is set out below.

• Investment returns

The assumption for future investment returns for fixed (or index linked) investments reflects the actual portfolio. Projected returns from fixed and index linked investments are based on risk-free (gilt-edged) returns and are reduced for the risk of default but not adjusted for liquidity. Where an assumption on future equity or property returns is required, this is based on such returns having an equity or property yield margin over the corresponding risk-free (gilt-edged) return assumed.

• Risk Discount Rate (RDR)

The RDR is set to remove investment risk margins, including those assumed to be generated by equities, whilst retaining a margin for other, non-investment, risks.

• Mortality and morbidity

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this is significant, and relevant industry data otherwise.

• Persistency rates

Persistency rates refer to the rate of policy termination and the rate at which policies cease to pay regular premiums. These rates are based on a combination of historical experience and management's views on future experience.

• Maintenance expenses

Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs. Explicit allowance is made for future expense inflation.

The sensitivity of the value of in-force business to changes in these assumptions is included within the disclosures in note 34.

27 Other intangible assets

These comprise capitalised software enhancements. Amounts are amortised over periods of up to five years, being their estimated useful lives, using the straight-line method. Other intangible assets are reviewed for impairment whenever events or any changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, it is written down immediately.

	2005 £m	2004 £m
Cost:		
At 1 January	**107**	103
Additions	**40**	18
Disposals	**–**	(14)
At 31 December	**147**	107
Accumulated depreciation:		
At 1 January	**79**	62
Charge for the year	**18**	22
Disposals	**–**	(5)
At 31 December	**97**	79
Balance sheet amount at 31 December	**50**	28

28 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m	Total fixed assets £m
Cost:				
At 1 January 2004	1,313	2,378	2,488	6,179
Exchange and other adjustments	2	(1)	(46)	(45)
Adjustments on acquisition and disposal of businesses	(10)	(13)	–	(23)
Additions	73	283	801	1,157
Disposals	(18)	(121)	(476)	(615)
At 31 December 2004	1,360	2,526	2,767	6,653
Exchange and other adjustments	**1**	**(3)**	**63**	**61**
Adjustments on acquisition and disposal of businesses	**8**	**–**	**–**	**8**
Additions	**89**	**280**	**615**	**984**
Disposals	**(37)**	**(136)**	**(484)**	**(657)**
At 31 December 2005	**1,421**	**2,667**	**2,961**	**7,049**
Accumulated depreciation and impairment:				
At 1 January 2004	475	1,439	321	2,235
Exchange and other adjustments	–	2	(3)	(1)
Adjustments on acquisition and disposal of businesses	(4)	(8)	–	(12)
Charge for the year	68	267	281	616
Disposals	(6)	(73)	(286)	(365)
At 31 December 2004	533	1,627	313	2,473
Exchange and other adjustments	**3**	**(1)**	**9**	**11**
Charge for the year	**76**	**267**	**278**	**621**
Disposals	**(11)**	**(97)**	**(239)**	**(347)**
At 31 December 2005	**601**	**1,796**	**361**	**2,758**
Balance sheet amount at 31 December 2005	**820**	**871**	**2,600**	**4,291**
Balance sheet amount at 31 December 2004	827	899	2,454	4,180

At 31 December the future minimum rentals receivable under non-cancellable operating leases were as follows:

	2005 £m	2004 £m
Receivable within 1 year	**393**	326
1 to 5 years	**695**	601
Over 5 years	**165**	258
	1,253	1,185

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2005 and 2004 no contingent rentals in respect of operating leases were recognised in the income statement.

29 Capital commitments

Excluding commitments in respect of investment property (see note 24), capital expenditure contracted but not provided for at 31 December 2005 amounted to £223 million (2004: £150 million). Of this amount, £215 million (2004: £146 million) relates to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

30 Other assets

	2005 £m	2004 £m
Assets arising from reinsurance contracts held	**548**	581
Deferred acquisition costs	**429**	2
Settlement balances	**336**	79
Derivative financial instruments (see note 17)		4,869
Other assets and prepayments	**4,288**	3,482
	5,601	9,013

31 Deposits from banks

The breakdown of deposits from banks between the domestic and international offices of the Group is set out below:

	2005 £m	2004 £m
Domestic:		
Non-interest bearing	105	171
Interest bearing	24,707	33,023
	24,812	33,194
International:		
Non-interest bearing	24	31
Interest bearing	6,691	6,498
	6,715	6,529
	31,527	39,723

32 Customer accounts

	2005 £m	2004 £m
Non-interest bearing current accounts	4,203	3,807
Interest bearing current accounts	40,365	32,157
Savings and investment accounts	62,206	58,773
Other customer deposits	24,296	25,074
	131,070	119,811

The breakdown of customer accounts between the domestic and international offices of the Group is set out below:

	2005 £m	2004 £m
Domestic:		
Non-interest bearing	3,868	3,511
Interest bearing	123,522	113,465
	127,390	116,976
International:		
Non-interest bearing	335	296
Interest bearing	3,345	2,539
	3,680	2,835
	131,070	119,811

33 Debt securities in issue

	2005 £m	2004 £m
Euro medium-term note programme	6,683	5,097
Other bonds and medium-term notes	141	266
Certificates of deposit issued	22,101	15,226
Commercial paper	10,421	8,026
Other marketable paper	–	155
Total debt securities in issue	39,346	28,770

34 Liabilities arising from insurance contracts and participating investment contracts

	2005 £m	2004 £m
Insurance contract liabilities	**26,482**	52,289
Participating investment contract liabilities	**14,068**	
	40,550	52,289

Insurance contract liabilities

Insurance contract liabilities, substantially all of which relate to business written in the United Kingdom, are comprised as follows:

	2005 Gross £m	2005 Reinsurance £m	2005 Net £m	2004 Gross £m	2004 Reinsurance £m	2004 Net £m
Life insurance	**25,888**	**(511)**	**25,377**	51,692	(577)	51,115
Non-life insurance:						
Unearned premiums	**447**	**–**	**447**	456	–	456
Claims outstanding	**147**	**(4)**	**143**	141	(4)	137
	594	**(4)**	**590**	597	(4)	593
	26,482	**(515)**	**25,967**	52,289	(581)	51,708

Life insurance

The movement in gross life insurance contract liabilities over the year can be analysed as follows:

	£m
At 31 December 2004	51,692
Adjustments to reflect the implementation of IAS 32, IAS 39, IFRS 4 and FRS 27	(28,033)
At 1 January 2005	**23,659**
New business	**1,381**
Changes in existing business	**848**
At 31 December 2005	**25,888**

The movement in liabilities arising from participating investment contracts may be analysed as follows:

	£m
At 31 December 2004	
Adjustments to reflect the implementation of IAS 32, IAS 39, IFRS 4 and FRS 27	12,469
At 1 January 2005	**12,469**
New business	**1,181**
Changes in existing business	**418**
At 31 December 2005	**14,068**

Process for determining key assumptions

The process for determining the key assumptions for insurance contracts and participating investment contracts is set out below.

Insurance policy liabilities can be split into With-Profits Fund liabilities, accounted for using the FSA's realistic capital regime (realistic liabilities) and Non-Profit Fund liabilities, accounted for using a traditional prospective actuarial discounted cash flow methodology as described in the accounting policies.

With-Profits Fund Realistic Liabilities

The Group's With-Profits Fund contains life insurance contracts and participating investment contracts. The calculation of With-Profits realistic liabilities uses best estimate assumptions for mortality and morbidity, persistency rates and expenses. These are calculated in a similar manner to those used for the value of the in-force business as discussed in note 26.

Other key assumptions are:

• Investment returns and discount rates

The realistic capital regime dictates that With-Profits Fund liabilities are valued on a market consistent basis. This is achieved by setting assumed investment returns and discount rates equal to a risk-free yield, defined as 0.1 per cent higher than the yield on UK gilts.

• Guaranteed annuity option take up rates

The guaranteed annuity option take up rates are set with regard to the Group's actual experience.

• Investment volatility

Investment volatility is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2005, the 10 year equity-implied at-the-money assumption was set at 20.0 per cent (31 December 2004: 18.0 per cent). The long-term at-the-money assumptions for property and fixed interest stocks were 15.0 per cent (31 December 2004: 15.0 per cent) and 13.5 per cent (31 December 2004: 13.0 per cent) respectively.

34 Liabilities arising from insurance contracts and participating investment contracts (continued)

Non-Profit Fund liabilities

Generally, assumptions used to value Non-Profit Fund liabilities are prudent in nature and therefore contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The key assumptions used in the measurement of Non-Profit Fund liabilities are:

• Interest rates

The rates used are derived in accordance with the FSA Rules. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the FSA Rules, including reductions made to the available yields to allow for default risk based upon the credit rating of each stock.

• Mortality and morbidity

The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation.

• Maintenance expenses

Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviations. Explicit allowance is made for future expense inflation.

Key changes in assumptions

Changes in certain key assumptions were made during 2005 with the following impacts on profit before tax. These amounts include movements in liabilities and value of the in-force business in respect of insurance contracts and participating investment contracts:

	Reduction in profit before tax £m
Annuitant mortality[1]	155
Modelling of options and guarantees in the With-Profits Fund[2]	60
Lapse rates[3]	58

[1] The charge in respect of annuitant mortality reflects the introduction of an assumed minimum annual improvement in mortality.

[2] Changes to the valuation of options and guarantees primarily reflects emerging best practice in this area.

[3] Lapse rates have been set following a detailed review of the Group's current and expected experience.

Sensitivity analysis

The following table demonstrates the effect of changes in key assumptions on profit before tax assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. These amounts include movements in liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts:

	Change in variable	Reduction in profit before tax (Insurance)	Reduction (increase) in profit before tax (Participating Investment)	Total reduction in profit before tax
Mortality[1]	10% adverse	414	11	425
Lapse rates	20% increase	21	32	53
Maintenance expenses	10% increase	40	29	69
Interest rates[2]	1% addition	242	(18)	224
Guaranteed annuity option take up	5% increase	81	–	81
Equity investment volatility	1% addition	12	17	29

[1] Adverse mortality means that mortality rates are either reduced or increased depending on the class of business – ie reduced for annuities and increased for protection business.

[2] The interest rate sensitivity shows the impact of a 1 per cent movement in gilt yields and all of the consequential impacts on key economic assumptions including the RDR, investment returns, valuation rates of interest and values of assets backing the business in question.

Non-life insurance

Non-life insurance contract liabilities are analysed by line of business as follows:	**2005 £m**	2004 £m
Credit protection	**284**	290
Home	**304**	299
Health	**6**	8
	594	597

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. A margin is placed on these best estimate claims reserves to provide confidence in being able to achieve this objective and varies according to product class. A relatively small margin was used for most products where sufficient past experience has been accumulated. An additional margin was used to allow for reserve uncertainty of claims where there is less experience and the introduction of claims re-engineering processes, which will affect how claims are being reported for household and domestic all risks products.

The reserving methodology and associated assumptions are set out below:

The unearned premium reserve is determined on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of each contract.

34 Liabilities arising from insurance contracts and participating investment contracts (continued)

Claims outstanding comprise those claims that have been notified and those that have been incurred but not reported. Claims incurred but not reported are determined based on the historical emergence of claims and their average cost. The notified claims element represents the best estimate of the cost of claims reported using projections and estimates based on historical experience.

The movements in non-life insurance contract liabilities and reinsurance assets over the year have been as follows:

Provisions for unearned premiums	Gross £m	Reinsurance £m	Net £m
At 1 January 2005	456	–	456
Increase in the year	575	–	575
Release in the year	(584)	–	(584)
At 31 December 2005	447	–	447

These provisions represent the liability for short-term insurance contracts for which the Group's obligations are not expired at the year end.

Claims and loss adjustment expenses	Gross £m	Reinsurance £m	Net £m
Notified claims	117	(4)	113
Incurred but not reported	24	–	24
At 1 January 2005	141	(4)	137
Cash paid for claims settled in the year	(221)	–	(221)
Increase in liabilities:			
– arising from current year claims	239	–	239
– arising from prior year claims	(12)	–	(12)
At 31 December 2005	147	(4)	143
Notified claims	120	(4)	116
Incurred but not reported	27	–	27
At 31 December 2005	147	(4)	143

Non-life insurance claims development table

The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Group's estimate of total claims outstanding for each accident year has changed at successive year ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. The accident year basis is considered the most appropriate for the business written by the Group.

Non-life insurance all risks – gross

Accident year	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m	Total £m
Estimate of ultimate claims costs:						
– at end of accident year	195	242	234	227	211	1,109
– one year later	177	230	220	209	–	
– two years later	184	228	223	–	–	
– three years later	181	224	–	–	–	
– four years later	179	–	–	–	–	
Current estimate of cumulative claims	179	224	223	209	211	1,046
Cumulative payments to date	(172)	(221)	(206)	(192)	(123)	(914)
Liability recognised in the balance sheet	7	3	17	17	88	132
Liability in respect of prior years						6
Total liability included in the balance sheet						138

The liability of £138 million shown in the above table excludes £9 million of unallocated claims handling expenses.

35 Liabilities arising from non-participating investment contracts

	2005 £m	2004 £m
Gross unit-linked investment contracts (non-participating)	21,839	
Reinsurance (included in other assets)	(33)	
	21,806	

The movement in liabilities arising from gross non-participating investment contracts may be analysed as follows:	£m
At 31 December 2004	
Adjustments to reflect the implementation of IAS 32, IAS 39 and IFRS 4	16,361
At 1 January 2005	16,361
New business	3,413
Changes in existing business	2,065
At 31 December 2005	21,839

36 Unallocated surplus within insurance businesses

The movement in the unallocated surplus within long-term insurance business over the year can be analysed as follows:	£m
At 31 December 2004	1,362
Adjustments to reflect the implementation of IAS 39 and FRS 27	(936)
At 1 January 2005	**426**
Change in unallocated surplus recognised in the income statement	**92**
At 31 December 2005	**518**

37 Other liabilities

	2005 £m	2004 £m
Settlement balances	**779**	134
Unitholders' interest in OEICs	**3,296**	2,680
Derivative financial instruments (see note 17)		5,943
Other creditors and accruals	**5,768**	5,700
	9,843	14,457

38 Retirement benefit obligations

Amounts recognised in the balance sheet:	**2005 £m**	2004 £m
Pension schemes	**2,809**	2,981
Other post-retirement benefit schemes	**101**	94
	2,910	3,075

Pension schemes

Defined benefit schemes

The Group has established a number of defined benefit pension schemes in the UK and overseas. The majority of the Group's employees are members of the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2. These are funded schemes providing retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes is 50.

The latest full valuations of the schemes were carried out as at 30 June 2005; these have been updated to 31 December 2005 by qualified independent actuaries. The last full valuations of other group schemes were carried out on a number of different dates; these have been updated to 31 December 2005 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The principal financial assumptions used in the scheme valuations were as follows:	**2005 %**	2004 %
Rate of inflation	**2.70**	2.60
Rate of salary increases	**3.98**	4.14
Rate of increase for pensions in payment and deferred pensions	**2.50**	2.60
Discount rate	**4.80**	5.30

The mortality assumptions used in the scheme valuations were based on the experience of the relevant schemes. The mortality assumptions used in the valuations of the Group's principal schemes are illustrated by the following years of life expectancy in retirement:

	31 December 2005 Years	31 December 2004 Years
Life expectancy for member aged 60, on the valuation date		
– Men	**25.6**	24.7
– Women	**27.6**	26.8
Life expectancy for member aged 60, 15 years after the valuation date		
– Men	**26.8**	25.7
– Women	**28.7**	27.8

The amounts recognised in the balance sheet are as follows:	**2005 £m**	2004 £m
Present value of scheme liabilities	**17,320**	14,866
Fair value of scheme assets	**(14,026)**	(11,648)
	3,294	3,218
Unrecognised actuarial losses	**(485)**	(237)
	2,809	2,981

38 Retirement benefit obligations (continued)

The allocation of the assets of the Group's defined benefit schemes was as follows:	2005 £m	2004 £m
Market values of scheme assets:		
Equities	**9,021**	8,032
UK fixed interest gilts	**946**	550
UK index linked gilts	**920**	561
Sterling non-government bonds	**1,415**	938
Property	**1,185**	959
Cash	**539**	608
Total fair value of scheme assets	**14,026**	11,648

The movements in the net amount recognised in the balance sheet are as follows:	2005 £m	2004 £m
At 1 January	**2,981**	3,080
Exchange and other adjustments	**4**	2
Net charge to the income statement	**243**	268
Contributions paid	**(419)**	(369)
At 31 December	**2,809**	2,981

The amounts recognised in the income statement are as follows:	2005 £m	2004 £m
Current service cost	**292**	280
Interest cost	**775**	728
Expected return on scheme assets	**(839)**	(757)
Past service cost	**15**	17
	243	268

The actual return on scheme assets was £2,377 million (2004: £1,119 million).

The expected return on scheme assets has been calculated using the following assumptions:	2005 %	2004 %
Equities	**8.2**	8.1
UK fixed interest gilts	**4.6**	4.8
UK index linked gilts	**4.3**	4.4
Sterling non-government bonds	**5.3**	5.4
Property	**6.9**	7.1
Cash	**3.6**	3.5

The expected return on scheme assets in 2006 will be calculated using the following assumptions:	2006 %
Equities	**8.0**
UK fixed interest gilts	**4.1**
UK index linked gilts	**3.9**
Sterling non-government bonds	**4.8**
Property	**6.4**
Cash	**3.7**

Defined contribution schemes

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally the defined contribution sections of the Lloyds TSB Group Pension Schemes No's 1 and 2.

During the year ended 31 December 2005 the charge to the income statement in respect of these schemes was £49 million (2004: £32 million), representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

The Group operates a number of schemes which provide post-retirement healthcare benefits to certain employees, retired employees and their dependent relatives. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependents) who retired prior to 1 January 1996. The Group has entered into an insurance contract to provide these benefits and a provision has been made for the estimated cost of future insurance premiums payable.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000; this valuation has been updated to 31 December 2005 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.81 per cent (2004: 6.70 per cent).

The movements in the amounts recognised in the balance sheet are as follows:	2005 £m	2004 £m
At 1 January	**94**	92
Exchange and other adjustments	**(3)**	–
Insurance premiums paid	**(6)**	(5)
Charge for the year	**16**	7
	101	94

39 Deferred tax liabilities

The movement in the net deferred tax balance is as follows:	2005 £m	2004 £m
At 1 January	1,704	1,454
Restatement on implementation of IAS 32, IAS 39 and IFRS 4	(779)	
At 1 January – restated	925	
Disposals	(256)	(23)
Exchange and other adjustments	(2)	4
Income statement charge (note 13)	491	269
Amount charged (credited) to equity:		
Available-for-sale financial assets	(2)	
Cash flow hedges	1	
Share based compensation	(16)	–
Amounts transferred to the income statement:		
Available-for-sale financial assets	–	
Cash flow hedges	4	
At 31 December	1,145	1,704

With effect from 1 January 2005 the Group implemented the requirements of IAS 39 'Financial Instruments: Recognition and Measurement'. As a result, certain financial assets and liabilities previously valued at amortised cost are now carried at fair value with a consequential adjustment being made to the deferred tax balance. Comparative figures have not been restated.

The deferred tax charge in the income statement comprises the following temporary differences:	2005 £m	2004 £m
Accelerated capital allowances	59	80
Pensions and other post-retirement benefits	44	37
Investment reserve	–	96
Allowances for impairment losses (provisions for bad and doubtful debts in 2004)	23	48
Unrealised gains	279	40
Tax on value of in-force business	64	(18)
Other temporary differences	22	(14)
	491	269

Deferred tax assets and liabilities are comprised as follows:	2005 £m	2004 £m
Deferred tax assets:		
Pensions and other post-retirement benefits	(873)	(917)
Allowances for impairment losses (provisions for bad and doubtful debts in 2004)	(165)	(84)
Other provisions	(31)	(64)
Derivatives	(164)	–
Tax losses carried forward	(322)	(372)
Other temporary differences	(270)	(187)
	(1,825)	(1,624)

	2005 £m	2004 £m
Deferred tax liabilities:		
Accelerated capital allowances	1,358	1,555
Investment reserve	90	90
Unrealised gains	338	59
Tax on value of in-force business	934	1,450
Other temporary differences	250	174
	2,970	3,328

39 Deferred tax liabilities (continued)

Deferred tax assets

Deferred tax assets are recognised for tax losses and tax credit carry forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable.

Deferred tax assets of £526 million (2004: £527 million) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of Eligible Unrelieved Foreign Tax ('EUFT') and other foreign tax credits carried forward as at 31 December 2005 of £88 million (2004: £32 million), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. EUFT can be carried forward indefinitely.

Deferred tax liabilities

Deferred tax liabilities have not been recognised for tax that may be payable if earnings of certain subsidiaries were remitted to the UK. Such amounts are either permanently reinvested or can be remitted free of tax. Unremitted earnings totalled £609 million (2004: £639 million).

Future transfers from Scottish Widows plc's long-term business funds to its Shareholder Fund will be subject to a shareholder tax charge. Under IAS 12, no provision is required to be made to the extent that the timing of such transfers is under Scottish Widows plc's control. Accordingly, deferred tax liabilities of £110 million (2004: £230 million) have not been recognised.

40 Other provisions

	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
At 31 December 2004	–	121	90	211
Adjustments to reflect the implementation of IAS 32, IAS 39 and IFRS 4	49	–	10	59
At 1 January 2005	**49**	**121**	**100**	**270**
Exchange and other adjustments	**–**	**–**	**24**	**24**
Reclassifications	**(12)**	**–**	**–**	**(12)**
Provisions applied	**(1)**	**(77)**	**(16)**	**(94)**
Charge (credit) for the year	**(3)**	**150**	**33**	**180**
At 31 December 2005	**33**	**194**	**141**	**368**

Provisions for contingent liabilities and commitments

Provisions are held in cases where the Group is irrevocably committed to provide additional funds, but where there is doubt as to the potential borrower's ability to meet its repayment obligations.

Customer remediation provisions

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes are found to be deficient. During 2005 management have reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and as a result an additional charge of £150 million (2004: £112 million) has been made.

At 31 December 2005 the provisions held mainly related to past sales of mortgage endowment policies. Mortgage endowments were sold to customers through the branch network of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester, and underwritten by life assurance companies within the Group and also by third parties. The principal assumptions that have been made in the calculation of the provision relate to the number of cases that are likely to require redress and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the expenditure will be incurred over the next two years.

Vacant leasehold property and other

Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on an annual basis and will normally run off over the period of under-recovery of the leases concerned, currently averaging four years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

The Group also carries provisions in respect of its obligations relating to UIC Insurance Company Limited ('UIC'), which is in liquidation. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a reinsurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate cost of settling the Group's exposure in respect of the insurance business of UIC and the timing remains uncertain. The provision held represents management's current best estimate of the cost after having regard to the financial condition of UIC and actuarial estimates of future claims.

41 Subordinated liabilities

	Note	2005 £m	2004 £m
Undated subordinated loan capital*			
Primary Capital Undated Floating Rate Notes:	a		
Series 1 (US$750 million)		**436**	389
Series 2 (US$500 million)		**291**	259
Series 3 (US$600 million)		**349**	311
$11\frac{3}{4}$% Perpetual Subordinated Bonds (£100 million)		**100**	100
6.625% Perpetual Capital Securities (€750 million) callable 2006	b	**518**	526
6.90% Perpetual Capital Securities callable 2007 (US$1,000 million)	c	**553**	512
$5\frac{5}{8}$% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	g	**892**	877
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a	**103**	105
$6\frac{5}{8}$% Undated Subordinated Step-up Notes callable 2010 (£410 million)	f	**407**	407
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	i,k	**337**	
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	b,g	**371**	350
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million)	d,l	**553**	–
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)	h	**127**	101
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	j,k	**248**	
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		**501**	497
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	b,g,l	**522**	–
$6\frac{1}{2}$% Undated Subordinated Step-up Notes callable 2019 (£270 million)	f	**269**	267
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	f	**202**	199
$6\frac{1}{2}$% Undated Subordinated Step-up Notes callable 2029 (£450 million)	f	**457**	455
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	f	**497**	497
		7,733	5,852
Dated subordinated loan capital			
$8\frac{1}{2}$% Subordinated Bonds 2006 (£250 million)		**250**	250
$7\frac{3}{4}$% Subordinated Bonds 2007 (£300 million)		**300**	299
$5\frac{1}{4}$% Subordinated Notes 2008 (DM 750 million)		**274**	270
$10\frac{5}{8}$% Guaranteed Subordinated Loan Stock 2008 (£100 million)	e	**100**	100
$9\frac{1}{2}$% Subordinated Bonds 2009 (£100 million)		**99**	100
$6\frac{1}{4}$% Subordinated Notes 2010 (€400 million)		**303**	281
Subordinated Floating Rate Notes 2010 (US$400 million)	a	**–**	207
12% Guaranteed Subordinated Bonds 2011 (£100 million)	e	**100**	100
$9\frac{1}{8}$% Subordinated Bonds 2011 (£100 million)		**149**	149
$4\frac{3}{4}$% Subordinated Notes 2011 (€850 million)		**597**	582
$5\frac{7}{8}$% Subordinated Guaranteed Bonds 2014 (€750 million)		**606**	462
$5\frac{7}{8}$% Subordinated Notes 2014 (£150 million)		**148**	148
$6\frac{5}{8}$% Subordinated Notes 2015 (£350 million)		**345**	345
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	a,l	**300**	–
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	a	**343**	353
Subordinated Floating Rate Notes 2020 (€100 million)	a	**68**	70
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		**346**	346
$9\frac{5}{8}$% Subordinated Bonds 2023 (£300 million)		**341**	338
		4,669	4,400
Total subordinated loan capital		**12,402**	10,252

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer.

* In certain circumstances, these notes, bonds and securities would acquire the characteristics of preference share capital. Any repayments of undated loan capital would require the prior consent of the Financial Services Authority. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of certain preference shares.

a) These notes bear interest at rates fixed periodically in advance based on London Interbank rates.

b) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until any deferred payments have been made. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares.

c) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until payments are resumed. Any deferred payments will be made good on redemption of the securities. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 22 November 2007.

d) In certain circumstances the interest payments on these securities can be deferred although in this case Scottish Widows plc cannot declare or pay a dividend until any deferred payments have been made.

e) Issued by a group undertaking under the Company's subordinated guarantee.

f) At the callable date the coupon on these notes will be reset by reference to the applicable five year benchmark gilt rate.

g) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a floating rate.

h) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a fixed margin over the then five year Yen swap rate.

41 Subordinated liabilities (continued)

i) These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 2.33 per cent above EURIBOR, to be set annually. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

j) These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 3.50 per cent above a rate based on the yield of specified UK government stock. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

k) At 31 December 2004, prior to the implementation of the prospective standards IAS 32 and IAS 39 from 1 January 2005, these instruments were classified as minority interests (see note 48).

l) Issued during 2005 primarily to finance the general business of the Group.

42 Share capital

	2005	2004
Authorised:		
Sterling	£m	£m
6,911 million Ordinary shares of 25p each	1,728	1,728
79 million Limited voting ordinary shares of 25p each	20	20
175 million Preference shares of 25p each*		44
	1,748	1,792
US dollars		US$m
160 million Preference shares of US$25 cents each*		40
Euro		€m
160 million Preference shares of €25 cents each*		40
Japanese yen		¥m
50 million Preference shares of ¥25 each*		1,250

* On 1 January 2005, following implementation of IAS 32 and IAS 39, these authorised preference shares were reclassified so that, should any be issued, they would be included within liabilities; no such preference shares were issued in 2005.

	2005 Number of shares	2004 Number of shares	2005 £m	2004 £m
Issued and fully paid:				
Ordinary shares of 25p each				
At 1 January	5,596,397,111	5,593,737,422	1,399	1,398
Issued under employee share schemes	6,216,489	2,659,689	1	1
At 31 December	5,602,613,600	5,596,397,111	1,400	1,399
Limited voting ordinary shares of 25p each				
At 1 January and 31 December	78,947,368	78,947,368	20	20
			1,420	1,419

The limited voting ordinary shares are held by the Lloyds TSB Foundations. These shares carry no rights to dividends but rank pari passu with the ordinary shares in respect of other distributions and in the event of winding up. These shares do not have any right to vote at general meetings other than on resolutions concerning acquisitions or disposals of such importance that they require shareholder consent, or for the winding up of the Company, or for a variation in the class rights of the limited voting ordinary shares. Lloyds TSB Group plc has entered into deeds of covenant with the Lloyds TSB Foundations, under the terms of which the Company makes annual donations to the foundations equal, in total, to 1 per cent of the Group's pre-tax profits (after certain adjustments) averaged over three years. The deeds of covenant can be cancelled by the Company at nine years' notice.

During 2004 the directors approved the allotment at par of 400 6 per cent non-cumulative redeemable preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company. With effect from 1 January 2005, following the implementation of IAS 39, these instruments have been reclassified as debt.

43 Share premium account

	2005 £m	2004 £m
At 1 January	1,145	1,136
Premium arising on issue of shares under share option schemes	25	9
At 31 December	1,170	1,145

44 Other reserves

	2005 £m	2004 £m
Other reserves comprise:		
Merger reserve	**343**	343
Revaluation reserve in respect of available-for-sale financial assets	**29**	
Cash flow hedging reserve	**11**	
	383	343

	2005 £m	2004 £m
Movements in other reserves were as follows:		
Merger reserve		
At 1 January and 31 December	**343**	343

The merger reserve arose on the combination of Lloyds Bank Plc and TSB Group plc in 1995, as permitted by UK GAAP at the time. In accordance with the transitional provisions of IFRS 1, the accounting treatment of this combination was not revisited when the Lloyds TSB Group adopted International Financial Reporting Standards on 1 January 2004.

	2005 £m
Revaluation reserve in respect of available-for-sale financial assets	
At 1 January 2005 (following implementation of IAS 32 and IAS 39)	**28**
Exchange and other adjustments	**(7)**
Change in fair value of available-for-sale financial assets	**11**
Deferred tax thereon	**2**
	13
Transfer to income statement	
Disposal	**(5)**
Deferred tax thereon	**–**
	(5)
At 31 December 2005	**29**

	2005 £m
Cash flow hedging reserve	
At 1 January 2005 (following implementation of IAS 32 and IAS 39)	–
Change in fair value of hedging derivatives	**4**
Deferred tax thereon	**(1)**
	3
Transfer to income statement	**12**
Deferred tax thereon	**(4)**
	8
At 31 December 2005	**11**

45 Retained profits

	2005 £m	2004 £m
At 1 January	**8,140**	7,646
Restatement on implementation of IAS 32, IAS 39 and IFRS 4	**(1,586)**	
At 1 January – restated	**6,554**	
Currency translation differences	**24**	(12)
Profit for the year	**2,493**	2,392
Dividends	**(1,914)**	(1,913)
Purchase/sale of treasury shares	**18**	8
Employee share option schemes – value of employee services	**47**	19
At 31 December	**7,222**	8,140

Retained profits are stated after deducting £73 million (2004: £94 million) repesenting 14 million (2004: 18 million) treasury shares held.

The movements over the year in the cumulative amount of foreign exchange differences taken directly to retained profits are as follows:

	2005 £m
At 1 January 2005	**(12)**
Currency translation differences arising in the year	**24**
At 31 December 2005	**12**

46 Ordinary dividends

	2005 Pence per share	2004 Pence per share	2005 £m	2004 £m
The dividends paid in the year were as follows:				
Final dividend in respect of preceding year	**23.5**	23.5	**1,315**	1,314
Interim dividend	**10.7**	10.7	**599**	599
	34.2	34.2	**1,914**	1,913

The directors have proposed a final dividend of 23.5 pence per share (2004: 23.5 pence per share) representing a total cost of £1,316 million (2004: 1,315 million) which will be paid on 3 May 2006.

47 Share based payments

During the year ended 31 December 2005 the Group operated the following share based payment schemes, all of which are equity settled.

Executive schemes

The Executive share option schemes are long-term incentive schemes and are available to certain senior executives of the Group, with grants usually made annually. Options are granted within limits set by the rules of the schemes. These limits relate to the number of shares under option and the price payable on the exercise of options. In 2005, options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary. Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5. Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied.

Performance conditions for executive options

For options granted up to March 2001

Options granted	Performance conditions
Prior to March 1996	None
March 1996	Growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period.
March 1997 – August 1999	As for March 1996, plus a further condition that Lloyds TSB Group plc's ranking based on shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period.

In respect of options granted between March 1996 and March 2001, the relevant period for the performance conditions begins at the end of the financial year preceding the date of grant and will continue until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions are met. Once the conditions have been satisfied the options will remain exercisable without further conditions. If they are not satisfied by the tenth anniversary of the grant the option will lapse.

For options granted from August 2001 to August 2004

The performance condition is linked to the performance of Lloyds TSB Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds TSB Group plc.

The performance condition is measured over a three year period commencing at the end of the financial year preceding the grant of the option and continuing until the end of the third subsequent year. If the performance condition is not then met, it will be measured at the end of the fourth financial year. If the condition has not then been met, the options will lapse.

To meet the performance conditions, the Group's ranking against the comparator group must be at least ninth. The full grant of options will only become exercisable if the Group is ranked first. A performance multiplier (of between nil and 100 per cent) will be applied below this level to calculate the number of shares in respect of which options granted to executive directors will become exercisable, and will be calculated on a sliding scale. If Lloyds TSB Group plc is ranked below median the options will not be exercisable.

Options granted to senior executives other than executive directors are not so highly leveraged and as a result, different performance multipliers are applied to their options. For the majority of executives, options are granted with the performance condition but no performance multiplier.

For options granted in 2005

The same conditions apply as for grants made up to August 2004, except that:

- the performance condition is linked to the performance of Lloyds TSB Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds TSB Group plc;
- if the performance condition has not been met at the end of the third subsequent year, the options will lapse; and
- the full grant of options becomes exercisable only if the Group is ranked in the top four places of the comparator group. A sliding scale applies between fourth and eighth positions. If Lloyds TSB Group is ranked below the median (ninth or below) the options will not be exercisable and will lapse.

47 Share based payments (continued)

Movements in the number of share options outstanding under the Executive share option schemes during 2005 are set out below:

	2005 Number of options	**2005 Weighted average exercise price (pence)**	2004 Number of options	2004 Weighted average exercise price (pence)
Outstanding at 1 January	**39,289,430**	**515.95**	33,141,522	557.80
Granted	**10,869,357**	**474.23**	12,998,345	418.67
Exercised	**(202,708)**	**273.37**	(474,028)	218.95
Forfeited	**(5,978,668)**	**673.41**	(6,376,409)	557.24
Outstanding at 31 December	**43,977,411**	**485.35**	39,289,430	515.95
Exercisable at 31 December	**1,430,218**	**685.23**	1,949,426	650.12

The weighted average share price at the time that the options were exercised during 2005 was 490.15 pence (2004: 423.80 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 7.4 years (2004: 7.7 years).

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £250 per month and, at the expiry of a fixed term of three or five years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in the Group at a price equal to 80 per cent of the market price at the date the options were granted. Grants in periods up to 31 December 2001 also had options exercising after seven years.

Movements in the number of share options outstanding under the Save-As-You-Earn schemes are set out below:

	2005 Number of options	**2005 Weighted average exercise price (pence)**	2004 Number of options	2004 Weighted average exercise price (pence)
Outstanding at 1 January	**122,115,907**	**321.71**	124,683,429	335.85
Granted	**9,610,466**	**380.00**	16,225,108	322.90
Exercised	**(6,086,150)**	**418.80**	(1,280,773)	354.59
Forfeited	**(4,404,042)**	**315.36**	(2,993,735)	332.84
Cancelled	**(3,722,135)**	**415.76**	(7,640,996)	383.71
Expired	**(3,054,572)**	**488.49**	(6,877,126)	501.03
Outstanding at 31 December	**114,459,474**	**314.17**	122,115,907	321.71
Exercisable at 31 December	**2,153,227**	**497.86**	1,308,580	620.34

The weighted average share price at the time that the options were exercised during 2005 was 465.51 pence (2004: 427.55 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 2.2 years (2004: 2.9 years).

Other share option plans

Lloyds TSB Group plc Share Retention Plan

In 2001, the Group adopted the Lloyds TSB Group plc Share Retention Plan. Options granted under this scheme are not subject to any conditions other than to remain employed by the Group for three years.

	2005 Number of options
Outstanding at 1 January	**216,763**
Exercised	**(216,763)**
Outstanding at 31 December	**–**

The weighted average remaining vesting period as at 31 December 2005 was nil (2004: nil). No options were exercisable at 31 December 2005.

Lloyds TSB Group plc Share Plan 2003

In 2003, the Group adopted the Lloyds TSB Group plc Share Plan 2003. Options granted under this scheme were not subject to any performance conditions. An option was granted in 2003 specifically to facilitate the recruitment of one executive director, this option had a total exercise price of £1, and would have been exercisable in the six month period beginning 31 December 2005; however this option lapsed during 2004 following the executive director's resignation.

	2004 Number of options
Outstanding at 1 January	331,125
Lapsed during the year	(331,125)
Outstanding at 31 December	–

47 Share based payments (continued)

Lloyds TSB Group Executive Share Plan 2003

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees, who may also be directors of Lloyds TSB Group. Options granted to date under this scheme were granted specificially to facilitate recruitment. Options granted under this plan are not subject to any performance condiitions.

	2005 Number of options	**2005 Weighted average exercise price (pence)**	2004 Number of options	2004 Weighted average exercise price (pence)
Outstanding at 1 January	**206,647**	**Nil**	–	–
Granted during the year	**62,271**	**Nil**	206,647	Nil
Outstanding at 31 December	**268,918**	**Nil**	206,647	Nil

The weighted average fair value of options granted in the year was £4.18 (2004: £3.69). No options outstanding at 31December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 1.9 years (2004: 3.0 years).

Lloyds TSB Group executive share plan 2005

This plan was adopted by the Group in 2005, specificially to facilitate the recruitment of Ms Dial. Ms Dial is the only participant in the plan. Options granted under this plan are not subject to any performance conditions and will normally become exercisable only if Ms Dial remains as an employee, and has not given notice of resignation, on 31 May 2008. The option will also be exercisable if Ms Dial ceases to be an employee before that date in certain circumstances described in her service agreement, in which case the options will be exercisable for six months and then lapse.

	2005 Number of options	**2005 Weighted average exercise price (pence)**
Outstanding at 1 January	**–**	**–**
Granted during the year	**242,825**	**Nil**
Outstanding at 31 December	**242,825**	**Nil**

The weighted average fair value of options granted in the year was £3.63. No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 2.4 years.

Performance share plan

Under the performance share plan, introduced during 2005, executive directors will be eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 bonus. The maximum match will be two performance shares for each bonus share, awarded at the end of a three year period. The actual number of shares awarded will depend on the Group's TSR performance measured over a three year period, compared to other companies in the comparator group. The maximum of two performance shares for each bonus share will be awarded only if the Group's TSR performance places it first in the comparator group; one performance share for each bonus share will be granted if the Group is placed fifth; and one performance share for every two bonus shares if the Group is placed eighth (median). Between first and fifth, and fifth and eighth, sliding scales will apply. If the TSR performance is below median, no performance shares will be awarded. There will be no retest. Whilst income tax is deducted from the bonus before deferral into the plan, where a match of performance shares is justified, these shares will be awarded as if income tax had not been deducted.

	2005 Number of shares
Outstanding at 1 January	**–**
Granted during the year	**854,116**
Forfeited	**(27,678)**
Outstanding at 31 December	**826,438**

The fair value of the matching element of the performance shares awarded during 2005 was £1.78.

The ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life and number of options outstanding for the option schemes were as follows:

	Executive schemes			**SAYE schemes**			**Other share option plans**		
31 December 2005	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**	**Weighted average exercise price (pence)**	**Weighted average remaining life (years)**	**Number of options**
Exercise price range									
£0 to £2	**–**	**–**	**–**	**–**	**–**	**–**	**Nil**	**2.2**	**511,743**
£2 to £3	**–**	**–**	**–**	**284.00**	**2.0**	**78,553,860**	**–**	**–**	**–**
£3 to £4	**393.33**	**7.1**	**10,112,857**	**346.71**	**3.1**	**28,535,928**	**–**	**–**	**–**
£4 to £5	**444.04**	**8.6**	**24,177,788**	**469.50**	**1.4**	**3,415,737**	**–**	**–**	**–**
£5 to £6	**542.22**	**3.7**	**2,320,524**	**544.77**	**1.1**	**3,821,055**	**–**	**–**	**–**
£6 to £7	**652.79**	**5.1**	**1,823,756**	**632.00**	**0.2**	**95,572**	**–**	**–**	**–**
£7 to £8	**715.04**	**6.2**	**4,111,758**	**720.20**	**1.0**	**37,322**	**–**	**–**	**–**
£8 to £9	**868.08**	**2.8**	**1,430,728**	**–**	**–**	**–**	**–**	**–**	**–**

47 Share based payments (continued)

31 December 2004	Executive schemes Weighted average exercise price (pence)	Executive schemes Weighted average remaining life (years)	Executive schemes Number of options	SAYE schemes Weighted average exercise price (pence)	SAYE schemes Weighted average remaining life (years)	SAYE schemes Number of options	Other share option plans Weighted average exercise price (pence)	Other share option plans Weighted average remaining life (years)	Other share option plans Number of options
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	2.5	206,647
£2 to £3	245.01	0.2	127,058	284.00	3.0	83,117,427	–	–	–
£3 to £4	392.82	8.0	10,386,979	330.51	3.7	21,992,866	–	–	–
£4 to £5	419.89	9.2	13,813,324	452.21	1.4	10,674,528	–	–	–
£5 to £6	541.65	4.6	2,767,256	554.84	1.6	5,849,754	–	–	–
£6 to £7	665.06	6.3	3,063,872	632.00	1.2	105,995	–	–	–
£7 to £8	717.64	7.1	7,392,741	723.79	0.5	375,337	–	–	–
£8 to £9	873.34	3.7	1,738,200	–	–	–	–	–	–

The weighted average fair value of options granted during the year was £0.67 (2004: £0.47) for executive options and £0.98 (2004: £0.92) for Save-As-You-Earn options. The values for executive options have been determined using a binomial model that uses a stochastic projection model to determine the effect of the market based conditions. The values for the SAYE options have been determined using a standard Black-Scholes model. The fair value calculations are based on the following assumptions:

	Executive	SAYE	Other share option plans
Risk-free interest rate	4.73%	4.61%	4.41%
Expected life	4.8 years	4.1 years	2.8 years
Expected volatility	33%	30%	28%
Expected dividend yield	7.0%	7.4%	7.3%
Weighted average share price	£4.74	£4.76	£4.59
Weighted average exercise price	£4.74	£3.80	Nil
Expected forfeitures	5%	9%	5%

Expected volatility is a measure of the amount by which the Group's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in the Group's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

Share incentive plan

Free shares

An award of shares may be made annually to employees based on a percentage of the employees' salary in the preceding year up to maximum of £3,000. The percentage is normally announced concurrently with the Group's annual results and the price of the shares awarded is announced at the time of grant. The shares awarded are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition: if an employee leaves the Group within this three year period for other than a 'good' reason, a portion of the shares awarded will be forfeited (75 per cent within one year of the award, 50 per cent within two years and 25 per cent within three years).

Matching shares

The Group undertakes to match shares purchased by employees up to the value of £30 per month, these shares are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition; if an employee leaves within this three year period for other than a 'good' reason or the accompanying partnership shares are sold within that time, 100 per cent of the matching shares are forfeited (or the portion relating to the shares sold).

The number of shares awarded relating to free shares in 2005 was 8,748,521 (2004: 8,903,125), with an average fair value of £4.57 (2004: £4.27), based on the market price at the date of award. The number of shares awarded relating to matching shares in 2005 was 2,296,575 (2004: 2,431,305), with an average fair value of £4.73 (2004: £4.28), based on market prices at the date of award.

The charge to the income statement is set out below:	**2005 £m**	2004 £m
Options granted in the year	**4**	3
Options granted in prior years	**27**	27
Shares granted in the year	**24**	19
Shares granted in prior years	**21**	16
	76	65

48 Minority interests

Minority interests comprise:	2005 £m	2004 £m
Euro Step-up Non-voting Non-cumulative Preferred Securities callable 2012 (€430 million)*		302
Sterling Step-up Non-voting Non-cumulative Preferred Securities callable 2015**		248
Capital instruments†		550
Other minority interests (note 53d)	**435**	81
	435	631

* These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 233 basis points above EURIBOR, to be set annually.

** These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 350 basis points above a rate based on the yield of specified UK government stock.

Both of the above issues were made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

† Following the implementation of IAS 32 and IAS 39 on 1 January 2005, these securities are now classified as subordinated loan capital (see note 41).

49 Related party transactions

Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, which for the Group is the group executive committee of Lloyds TSB Group plc together with its non-executive directors.

The table below details, on an aggregated basis, key management personnel compensation:	2005 £m	2004 £m
Compensation		
Salaries and other short-term benefits	**11**	10
Post-employment benefits	**3**	3
Termination benefits	**–**	1
Share based payments	**2**	2
Total	**16**	16

	2005 million	2004 million
Share options		
At 1 January	**12**	10
Granted (including options of appointed directors)	**3**	5
Exercised/lapsed (including options of retired directors)	**(3)**	(3)
At 31 December	**12**	12

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

	2005 £m	2004 £m
Loans		
At 1 January	**3**	3
Advanced	**1**	1
Interest	**–**	–
Repayments	**(1)**	(1)
At 31 December	**3**	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 4.6 per cent and 17.9 per cent in 2005 (2004: 5.4 per cent and 17.9 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2004: nil).

49 Related party transactions (continued)	**2005 £m**	2004 £m
Deposits		
At 1 January	**2**	2
Placed	**22**	5
Interest	**–**	–
Withdrawn	**(19)**	(5)
At 31 December	**5**	2

Deposits placed by key management personnel attracted interest rates of up to 4.5 per cent (2004: 4.8 per cent).

At 31 December 2005, the Group provided guarantees totalling £19,744 in respect of one director (2004: nil).

At 31 December 2005, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £3 million with seven directors and their connected persons (2004: £3 million with four directors and their connected persons).

Subsidiaries

Details of the principal subsidiaries are given in note 7 to the parent company financial statements. In accordance with IAS 27 transactions and balances with subsidiaries that have been eliminated on consolidation are not reported.

Other related party disclosures

At 31 December 2005, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £14 million (2004: £14 million).

The Group manages 86 (2004: 76) Open Ended Investment Companies ('OEICs'), and of these 36 (2004: 47) are consolidated. The Group invested £345 million (2004: £131 million) and redeemed £265 milllion (2004: £164 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £2,074 million (2004: £1,415 million) at 31 December. The Group earned fees of £85 million from the unconsolidated OEICs (2004: £78 million). The company held no investments in OEICs at any time during 2004 or 2005.

The Group has a number of venture capital associates that it accounts for at fair value through profit or loss. At 31 December 2005, these companies had total assets of approximately £1,194 million (2004: £1,095 million), total liabilities of approximately £1,072 million (2004: £968 million) and for the year ended 31 December 2005 had turnover of £1,782 million (2004: £1,551 million) and made a net profit of approximately £36 million (2004: £42 million). In addition, the Group has provided £363 million (2004: £335 million) of financing to these companies on which it received £19 million (2004: £13 million) of interest income in the year.

50 Contingent liabilities and commitments

Legal proceedings

During the ordinary course of business the Group is subject to threatened or actual legal proceedings. All material cases are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the balance sheet date.

In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed to properly assess the merits of the case. No provisions are held against such cases, however the Group does not currently expect the final outcome to have a material effect upon the Group's financial position.

Contingent liabilities and commitments arising from the banking business

Acceptances and endorsements arise where the Lloyds TSB Group agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Guarantees include those given on behalf of a customer to stand behind the current obligations of the customer and to carry out those obligations should the customer fail to do so.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, serving as financial guarantees where the Lloyds TSB Group has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Performance bonds and other transaction related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

Where the guarantees are issued on behalf of customers, Lloyds TSB Group usually holds collateral against the exposure or has a right of recourse to the customer.

Lloyds TSB Group's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held.

50 Contingent liabilities and commitments (continued)

	2005 £m	2004 £m
Contingent liabilities		
Acceptances and endorsements	**35**	71
Guarantees	**9,373**	6,786
Other:		
Other items serving as direct credit substitutes	**550**	345
Performance bonds and other transaction-related contingencies	**1,737**	1,324
	2,287	1,669
	11,695	8,526

The contingent liabilities of the Group, as detailed above, arise in the normal course of its banking business and it is not practicable to quantify their future financial effect.

	2005 £m	2004 £m
Commitments		
Documentary credits and other short-term trade-related transactions	**283**	431
Forward asset purchases and forward deposits placed	**277**	1,654
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year maturity	**55,310**	59,085
1 year or over maturity	**24,123**	20,009
	79,993	81,179

Of the amounts shown above in respect of undrawn formal standby facilities and other commitments to lend £43,094 million (2004: £42,376 million) were irrevocable.

Operating lease commitments

Where a Group company is the lessee the future minimum lease payments under non-cancellable premises operating leases are as follows:

	2005 £m	2004 £m
Not later than 1 year	**216**	211
Later than 1 year and not later than 5 years	**784**	783
Later than 5 years	**1,016**	980
	2,016	1,974

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these are not material. No arrangements have been entered into for contingent rental payments.

Finance lease commitments

Where a Group company is the lessee the future obligations payable under finance leases are as follows:

	2005 £m	2004 £m
Not later than 1 year	**1**	2
Later than 1 year and not later than 5 years	**–**	4
Later than 5 years	**15**	15
	16	21

Finance lease payments relate to leases of certain premises and equipment. No arrangements have been entered into for contingent rental payments. The fair value of these finance lease obligations approximates their carrying amount at 31 December 2005 and 2004.

Capital commitments

Details of capital commitments are given in note 29.

51 Financial risk management

Strategy in using financial instruments

The Group uses financial instruments (including derivatives) to meet the financial needs of its customers, as part of its trading activities and to reduce its own exposure to fluctuations in interest and exchange rates.

The Group accepts deposits from and makes loans to commercial and retail customers at both fixed and floating rates and for various periods. Such exposures to customers involve both on-balance sheet loans and advances and guarantees and other commitments such as letters of credit and irrevocable commitments.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and foreign exchange risk; and liquidity risk. Information about the Group's management of these risks is given on pages 24 to 34, with further disclosure provided below.

Interest rate risk

In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but which bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There are a relatively small volume of deposits whose rate is contractually fixed for periods of up to two years.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However a significant proportion of the Group's lending assets, for example personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The interest rate risk arising from the Group's retail banking activities is managed centrally in part by the use of internal interest rate swaps. For accounting purposes IAS 39 does not permit the use of internal derivatives in hedge relationships and although economically the position is hedged this leads to volatility in the income statement. In response to this the Group has created a function the purpose of which is to establish accounting hedge relationships in order to reduce the volatility arising in the income statement.

The Group establishes two types of hedge accounting relationships; fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio. At 31 December 2005 the aggregate notional principal of interest rate swaps designated as fair value hedges was £39,568 million with a net fair value (liability) of £245 million (see note 17). In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next seven years and will be reported in the income statement as they take place. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2005 was £648 million with a net fair value (liability) of £18 million (see note 17).

The table below summarises the repricing mismatches of the Group's financial assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date.

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
As at 31 December 2005							
Assets							
Trading securities and other financial assets at fair value through profit or loss	**1,734**	**2,418**	**1,035**	**3,796**	**17,886**	**33,505**	**60,374**
Derivative financial instruments*	**–**	**–**	**–**	**–**	**–**	**5,878**	**5,878**
Loans and advances to banks	**25,107**	**2,483**	**2,923**	**370**	**57**	**715**	**31,655**
Loans and advances to customers	**72,912**	**17,048**	**20,327**	**51,044**	**13,594**	**19**	**174,944**
Available-for-sale financial assets	**1,695**	**8,674**	**1,221**	**1,497**	**1,678**	**175**	**14,940**
Other assets	**195**	**50**	**–**	**–**	**–**	**21,718**	**21,963**
Total assets	**101,643**	**30,673**	**25,506**	**56,707**	**33,215**	**62,010**	**309,754**
Liabilities							
Deposits from banks	**23,859**	**4,866**	**1,472**	**131**	**1,070**	**129**	**31,527**
Customer accounts	**112,551**	**4,901**	**3,941**	**4,061**	**1,413**	**4,203**	**131,070**
Derivative financial instruments*	**–**	**–**	**–**	**–**	**–**	**6,396**	**6,396**
Debt securities in issue	**13,167**	**15,640**	**3,905**	**1,709**	**4,925**	**–**	**39,346**
Liabilities arising from insurance and investment contracts	**–**	**–**	**–**	**–**	**–**	**62,907**	**62,907**
Other liabilities	**50**	**23**	**65**	**1**	**3,296**	**12,041**	**15,476**
Subordinated liabilities	**2,046**	**788**	**503**	**2,282**	**6,783**	**–**	**12,402**
Total liabilities	**151,673**	**26,218**	**9,886**	**8,184**	**17,487**	**85,676**	**299,124**
Net repricing gap	**(50,030)**	**4,455**	**15,620**	**48,523**	**15,728**	**(23,666)**	**10,630**

* Derivative financial instruments which are exposed to interest rate risk are carried in the balance sheet at fair value and for the purposes of this analysis have been treated as non-interest bearing.

51 Financial risk management (continued)

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
As at 31 December 2004							
Assets							
Treasury bills and other eligible bills	21	25	41	5	–	–	92
Loans and advances to banks	21,979	5,561	2,984	629	81	614	31,848
Loans and advances to customers	82,251	18,302	13,565	36,681	6,198	(1,679)	155,318
Debt securities and equity shares	1,967	10,788	2,724	6,444	21,643	27,229	70,795
Other assets	234	60	1	3	–	26,071	26,369
Total assets	106,452	34,736	19,315	43,762	27,922	52,235	284,422
Equity and liabilities							
Deposits from banks	31,646	5,142	2,521	122	90	202	39,723
Customer accounts	104,026	5,579	2,034	3,676	689	3,807	119,811
Debt securities in issue	10,624	9,484	3,227	1,436	3,999	–	28,770
Liabilities arising from insurance contracts	–	–	–	–	–	53,651	53,651
Other liabilities	180	–	19	1	2,680	17,657	20,537
Subordinated liabilities	921	776	458	1,884	6,213	–	10,252
Equity	–	–	–	–	–	11,678	11,678
Total equity and liabilities	147,397	20,981	8,259	7,119	13,671	86,995	284,422
Off-balance sheet items	–	(13,253)	6,326	9,467	(2,540)	–	–
Interest rate repricing gap	(40,945)	502	17,382	46,110	11,711	(34,760)	–
Cumulative interest rate repricing gap	(40,945)	(40,443)	(23,061)	23,049	34,760	–	–

Currency risk

Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to Group Treasury. Group Treasury calculates the associated VaR and the closing, average, maximum and minimum for 2004 and 2005 are disclosed on page 30.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the foreign currency exchange equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to retained earnings.

The structural position is managed by Lloyds TSB Group Capital Funds having regard to the currency composition of the Group's risk weighted assets and reported to the group asset and liability committee on a monthly basis. The Group's main overseas operations are in the Americas and Europe. Details of the Group's structural foreign currency exposures are as follows:

	2005 £m	2004 £m
Functional currency of Group operations:		
Euro	**80**	82
US dollar	**102**	114
Swiss franc	**56**	58
Other non-sterling	**183**	189
	421	443

51 Financial risk management (continued)

Credit risk

At 31 December 2005, the maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instruments' balance sheet carrying amount or, for non-derivative off-balance sheet transactions, their contractual nominal amounts.

	2005 £m
Loans and advances to banks	31,656
Loans and advances to customers	177,016
Deposit amounts available for offset[1]	(6,414)
Impairment losses	(2,073)
	200,185
Available for sale debt securities and treasury bills	14,894
Contingent liabilities	11,695
Undrawn irrevocable formal standby facilities, credit lines and other commitments to lend[2]	43,094
Derivative assets, before netting	5,878
Amounts available for offset under master netting arrangements[1]	(3,235)
	2,643
Trading securities and other financial assets at fair value through profit or loss	26,869
	299,380

[1] Deposit amount available for offset and amounts available for offset under master netting arrangements do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

[2] See note 50 – Contingent liabilities and commitments for further information.

Liquidity risk

The Group is exposed to daily calls on its cash resources from current account and other amounts repayable on demand, overnight and other maturing deposits, loan draw-downs and cash-settled derivative instruments.

The Group's policy requires that each business unit meets its financial obligations as they fall due, that the Group complies with the Financial Services Authority Sterling Stock Liquidity Policy in the UK and that all local regulatory requirements are met.

A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally provided a stable source of funding. During 2005, amounts deposited by customers increased by £11,259 million from £119,811 million at 31 December 2004. These customer deposits are supplemented by the issue of subordinated loan capital and wholesale funding sources in the capital markets, including deposits taken on the inter-bank market, certificates of deposit, sale and repurchase agreements, a Euro Medium-Term Note programme and a commercial paper programme.

The ability to sell assets quickly is also an important source of liquidity for the Group's banking businesses. The Group holds sizeable balances of marketable debt securities which could be disposed of to provide additional funding should the need arise.

The table below analyses assets and liabilities of the Group into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

Maturities of assets and liabilities

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2005						
Assets						
Trading securities and other financial assets at fair value through profit or loss	520	818	1,051	6,271	51,714	60,374
Derivative financial instruments	848	617	603	1,906	1,904	5,878
Loans and advances to banks	24,372	1,513	3,955	1,357	458	31,655
Loans and advances to customers	22,999	7,696	10,859	39,132	94,258	174,944
Available-for-sale financial assets	130	1,092	1,839	6,638	5,241	14,940
Other assets	6,284	246	66	154	15,213	21,963
Total assets	55,153	11,982	18,373	55,458	168,788	309,754
Liabilities						
Deposits from banks	23,839	4,778	1,710	141	1,059	31,527
Customer accounts	117,410	5,065	3,317	3,773	1,505	131,070
Derivative financial instruments	690	639	799	1,893	2,375	6,396
Debt securities in issue	20,629	8,395	3,887	1,586	4,849	39,346
Liabilities arising from insurance and investment contracts	1,030	359	1,263	9,502	50,753	62,907
Other liabilities	5,602	340	524	265	8,745	15,476
Subordinated liabilities	–	250	–	1,076	11,076	12,402
Total liabilities	169,200	19,826	11,500	18,236	80,362	299,124
Net liquidity gap	(114,047)	(7,844)	6,873	37,222	88,426	10,630
As at 31 December 2004						
Total assets	53,988	14,668	15,231	51,495	149,040	284,422
Total liabilities	165,187	16,369	9,609	14,192	67,387	272,744
Net liquidity gap	(111,199)	(1,701)	5,622	37,303	81,653	11,678

51 Financial risk management (continued)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. An unmatched position potentially enhances profitability, but also increases the risk of losses.

Fair values of financial assets and liabilities

Financial instruments include financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been estimated using market prices for instruments held by the Group. Where market prices are not available, fair values have been estimated using quoted values for instruments with characteristics either identical or similar to those of the instruments held by the Group. In certain cases, where no ready markets currently exist, various techniques (such as discounted cash flows, or observations of similar recent market transactions) have been developed to estimate what the approximate fair value of such instruments might be. These estimation techniques are necessarily subjective in nature and involve several assumptions.

The fair values presented in the following table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these accounts are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that do not meet the definitions of a financial instrument. These items include intangible assets, such as the value of the Group's branch network, the long-term relationships with depositors and credit card relationships, premises and equipment and shareholders' equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

The valuation technique and fair values for derivative financial instruments are disclosed in note 17; the valuation technique for each other major category of financial instrument is discussed below.

Treasury bills and other eligible bills

Fair value is estimated using market prices, where available.

Trading securities and other financial assets at fair value through profit or loss

Fair value is determined using market prices.

Derivative financial instruments

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cashflow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

Loans and advances to banks and customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans was estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans has been estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period.

Debt securities and equity shares

Listed investment securities are valued at quoted market prices. Unlisted investment securities are valued based on discounted cash flows, market prices of similar securities and other appropriate valuation techniques. Trading securities are valued using market prices.

Available-for-sale financial assets

Listed securities are valued at quoted mid-market prices. Unlisted securities and other financial assets are valued based on discounted cash flows, market prices of similar instruments and other appropriate valuation techniques.

Investment properties

Fair values represent open-market values determined by an independent, professionally qualified valuer.

Deposits from banks and customer accounts

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits and customer accounts is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue and subordinated liabilities

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using quoted market prices.

Liabilities arising from non-participating investment contracts

The value of the Group's non-participating investment contracts, all of which are unit-linked, is contractually linked to the fair values of financial assets within the Group's unitised investment funds and is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

51 Financial risk management (continued)

Financial commitments and contingent liabilities

The Group considers that, given the lack of an established market, the diversity of fee structures and the difficulty of separating the value of the instruments from the value of the overall transaction, it is not meaningful to provide an estimate of the fair value of financial commitments and contingent liabilities. These are therefore excluded from the following table.

	Carrying value 2005 £m	Carrying value 2004 £m	**Fair value 2005 £m**	Fair value 2004 £m
Financial assets				
Treasury bills and other eligible bills – investment securities		88		90
– other securities		4		4
Trading securities and other financial assets at fair value through profit or loss	**60,374**		**60,374**	
Derivative financial instruments	**5,878**		**5,878**	
Loans and advances to banks	**31,655**	31,848	**31,691**	31,800
Loans and advances to customers	**174,944**	155,318	**175,554**	155,829
Debt securities – investment securities		14,368		14,380
– other securities		29,117		29,117
Equity shares – investment securities		41		65
– other securities		27,269		27,269
Available-for-sale financial assets	**14,940**		**14,940**	
Investment properties	**4,260**	3,776	**4,260**	3,776
Financial liabilities				
Deposits from banks	**31,527**	39,723	**31,508**	39,725
Customer accounts	**131,070**	119,811	**131,052**	119,773
Derivative financial instruments and other trading liabilities	**6,396**		**6,396**	
Debt securities in issue	**39,346**	28,770	**39,352**	28,477
Liabilities arising from non-participating investment contracts	**21,839**		**21,839**	
Subordinated liabilities	**12,402**	10,252	**13,262**	11,544

52 Acquisitions

During 2005 the Group, through its subsidiary The Dutton-Forshaw Motor Company Limited, completed the purchases of the assets and trade of three separate motor dealership businesses for a total consideration of £16 million, settled in cash. Goodwill of £3 million arose on these acquisitions; no significant fair value adjustments were made.

53 Consolidated cash flow statement

a Reconciliation of profit before tax to net cash (used in) provided by operating activities

	2005 £m	2004 £m
Profit before tax	**3,820**	3,477
(Profit) loss on disposal of businesses	**(50)**	21
Depreciation of fixed assets	**639**	638
Allowance for loan losses	**1,302**	866
Write-off of allowance for loan losses	**(1,078)**	(854)
Insurance claims	**12,186**	9,622
Insurance claims paid	**(8,269)**	(5,338)
Movement in value of in-force business	**(162)**	(16)
Customer remediation provision	**150**	112
Customer remediation paid	**(77)**	(245)
Net charge in respect of retirement benefit schemes	**259**	275
Contributions to retirement benefit schemes	**(425)**	(374)
Net gain on sale of investment securities	**(5)**	(126)
Revaluation of investment property	**(430)**	(329)
Change in loans and advances to banks	**(1,277)**	(964)
Change in loans and advances to customers	**(14,525)**	(19,681)
Change in deposits from banks	**(8,168)**	16,046
Change in customer accounts	**4,619**	5,676
Change in debt securities in issue	**10,280**	1,876
Change in trading assets	**(103)**	844
Change in trading liabilities	**(3,937)**	–
Change in investment contract liabilities	**6,094**	–
Change in other assets	**(1,049)**	(1,518)
Change in other liabilities	**1,181**	2,830
Tax paid	**(708)**	(763)
Other non-cash movements	**(598)**	139
Total adjustments	**(4,151)**	8,737
Net cash (used in) provided by operating activities	**(331)**	12,214

53 Consolidated cash flow statement (continued)

b Analysis of cash and cash equivalents as shown in the balance sheet

	2005 £m	2004 £m
Cash and balances with central banks (excluding mandatory deposits)	868	833
Loans and advances to banks with a maturity of less than three months	25,885	27,363
	26,753	28,196

Included within cash and cash equivalents at 31 December 2005 is £8,860 million (2004: £7,920 million) held within the Group's life funds, which is not immediately available for use in the business. In addition, mandatory reserve deposits of £288 million (2004: £245 million) are also held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

c Analysis of changes in cash and cash equivalents during the year

	2005 £m	2004 £m
At 1 January	28,196	19,433
Net cash (outflow) inflow before adjustments for the effect of foreign exchange movements	(1,423)	8,777
Effect of foreign exchange movements	(20)	(14)
	(1,443)	8,763
At 31 December	26,753	28,196

d Analysis of changes in financing during the year

	2005 £m	2004 £m
Share capital (including premium and merger reserve):		
At 1 January	2,907	2,897
Issue of share capital	26	10
At 31 December	2,933	2,907

The amounts shown as cash inflows from financing include proceeds in respect of the above issues of share capital together with a net cash inflow in 2004 of £1 million relating to transactions in own shares held in respect of employee share schemes.

	2005 £m	2004 £m
Minority interests:		
At 1 January	631	782
Adjustments on adoption of IAS 32, IAS 39 and IFRS 4	(550)	
At 1 January – restated	81	
Exchange and other adjustments	–	1
Capital invested by minority shareholders	329	–
Repayment of capital to minority shareholders	–	(151)
Minority share of profit after tax	62	67
Payments to minority shareholders	(37)	(68)
At 31 December	435	631

	2005 £m	2004 £m
Subordinated liabilities and finance leases:		
At 1 January	10,273	10,469
Adjustments on adoption of IAS 32, IAS 39 and IFRS 4	959	
At 1 January – restated	11,232	
Exchange and other adjustments	59	(136)
Issue of subordinated liabilities	1,361	699
Repayments of subordinated liabilities	(232)	(764)
Lease financing	–	6
Finance lease capital repayments	(2)	(1)
At 31 December	12,418	10,273

53 Consolidated cash flow statement (continued)

e Acquisition of group undertakings and businesses	**2005 £m**	2004 £m
Net assets acquired:		
Other assets	**8**	–
Tangible fixed assets	**8**	–
Other liabilities	**(3)**	–
	13	–
Goodwill arising on consolidation	**3**	–
Net cash outflow from acquisitions in the year*	**16**	–
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**11**	15
Deferred consideration in respect of acquisition in 2002	**–**	1
Net cash outflow from acquisitions	**27**	16

The consideration of £16 million in respect of these acquisitions was settled in cash in 2005 (see note 52).

f Disposal and closure of group undertakings and businesses	**2005 £m**	2004 £m
Cash and cash equivalents	**–**	46
Loans and advances to banks	**–**	132
Loans and advances to customers	**803**	257
Debt securities and treasury bills	**–**	59
Goodwill	**93**	10
Other intangible assets	**–**	9
Deposits by banks	**–**	(42)
Customer accounts	**–**	(327)
Debt securities in issue	**–**	(111)
Other net assets and liabilities	**(946)**	9
	(50)	42
Profit (loss) on sale and closure of businesses	**50**	(21)
Cash and cash equivalent consideration received	**–**	21
Cash and cash equivalents disposed of	**–**	(46)
Net cash outflow from disposals in the year	**–**	(25)
Adjustment to consideration received in respect of prior period disposals	**(4)**	–
Net cash outflow from disposals	**(4)**	(25)

54 Adoption of International Financial Reporting Standards

IFRS differs in certain respects from the Group's previous accounting policies, which complied with UK Generally Accepted Accounting Principles ('UK GAAP'). Set out below are explanations and reconciliations showing the effect of the adoption of IFRS and FRS 27 upon the Group's previously published financial information.

Accounting changes effective from 1 January 2004 and which impact 2004 comparatives:

Consolidation (IAS 27 and SIC-12)

IFRS requires line-by-line consolidation for all items of income and expenditure; consequently, the Group no longer reports the results and balances of the life assurance business as one line items.

IFRS also requires consolidation of several entities that the Group was not required to consolidate under UK GAAP including companies supporting the Group's securitisation conduits, which facilitate customers' own securitisations, and Open Ended Investment Companies (OEICs) and unit trusts where the Group, through the Group's life funds, has a controlling interest.

Leasing (IAS 17)

IFRS requires income from finance leases to be credited to the income statement to give a constant pre-tax rate of return on the net investment in the lease; UK GAAP required a constant post-tax rate of return. In addition, IFRS requires depreciation on operating lease assets to be charged on the same basis as for other tangible fixed assets, which for the Group is a straight-line basis. Under UK GAAP depreciation was charged so as to give a constant rate of return on the leased asset.

Employee benefits (IFRS 2, IAS 19)

IFRS 2 requires that a cost is recognised in the financial statements for all options granted under executive and employee Save-As-You-Earn ('SAYE') share-option schemes; no costs were recognised under UK GAAP in respect of these schemes.

The Group has elected to apply the corridor approach to determine the treatment of actuarial gains and losses arising during the year as permitted under IAS 19. The effect of this has been to derecognise the actuarial losses charged to reserves in 2004 under UK GAAP in the restated figures.

Capitalisation of software (IAS 38)

Under UK GAAP the Group's accounting policy was to capitalise, within tangible fixed assets, only software costs relating to separable new systems. Under IFRS, both external and directly related internal costs relating to enhancements that lead to additional system functionality are also now capitalised and included in other intangible assets.

Investment management fees (IAS 18)

Under IFRS the Group moved from immediate recognition of up-front fees received for investment management services to recognising them on a straight-line basis over the estimated lives of the investment contracts.

Goodwill (IFRS 3 and IAS 36)

Under UK GAAP the Group's accounting policy was to amortise goodwill arising on acquisitions after 1 January 1998, with the exception of goodwill which arose on the acquisition of Scottish Widows. Under IFRS all goodwill recognised in the UK GAAP balance sheet at 1 January 2004 is carried forward without adjustment in the balance sheet and is now subject to impairment testing annually, or more frequently if events or circumstances indicate that it might be impaired.

Dividends (IAS 10)

Under IFRS equity dividends declared after the balance sheet date may not be included as a liability at the balance sheet date.

Depreciation (IAS 16)

IFRS requires property, plant and equipment to be depreciated from the date of acquisition. Under UK GAAP, long leasehold and freehold properties have been depreciated only since 1 January 2000 and therefore it is necessary to adjust their carrying values to reflect the depreciation that would have been charged from the date of acquisition to 1 January 2000.

Claims equalisation provision (IAS 37)

The claims equalisation provision in respect of the Group's general insurance business, established under law to minimise volatility in incurred claims, is not permitted under IFRS.

Cash flow statement (IAS 7)

Whilst the requirements under IFRS are similar to those under UK GAAP, two principal differences arise between UK GAAP and IFRS with regard to the definition of cash and cash equivalents and the classification of items within the cash flow statement. Cash and cash equivalents comprise cash and balances at central banks and amounts due from banks with a maturity of less than three months (under UK GAAP only amounts due from banks repayable on demand were included in cash and cash equivalents), excluding mandatory deposits. In terms of classification, UK GAAP requires a more detailed classification of cash flows which includes separate classifications of cash flows arising from dividends and taxation.

Accounting changes effective from 1 January 2005 and which do not affect 2004 comparatives:

Fees integral to effective yield (IAS 18, IAS 39)

Fees and commissions that are an integral part of the effective yield on a financial instrument, and direct incremental costs associated with its origination, are included in the calculation of the effective interest rate and recognised over the expected life of the instrument, or a shorter period if appropriate. As a result the recognition of up-front fees and costs that were recognised when received, or incurred, under UK GAAP, for example those related to loan origination, are now deferred and the recognition of fee income typically charged at the end of an agreement, for example early redemption charges on mortgages, brought forward.

Loan impairment (IAS 39)

IFRS adopts an incurred loss model for impairment losses on loans and provides guidance on the measurement of impairment. Any provision required is calculated by comparing the book value of the loans with the net present value of the expected future cash flows from the loans discounted at their effective interest rates or, as a practical expedient for variable rate loans, using observable market prices. The impairment principles under IFRS are similar to those followed by the Group under UK GAAP, with the exception of the requirements to discount the expected cash flows at the original effective interest rate when determining the provisioning requirement.

Netting (IAS 32)

IFRS prohibits financial assets and financial liabilities from being offset unless there is a legal right of set-off and the asset and liability are in practice normally settled, or there is an intention to settle, on a net basis. In the banking business, this has resulted in the grossing-up on the balance sheet of certain assets and liabilities subject to set-off arrangements that were presented net under UK GAAP.

54 Adoption of International Financial Reporting Standards (continued)

Derivative financial instruments and hedging (IAS 39)

The Group enters into derivative contracts for both trading purposes and to hedge exposures arising from within the banking book. Under UK GAAP trading derivatives were carried at fair value but hedging derivatives were accounted for on the same basis as the underlying hedged item, mainly on an accruals basis. IAS 39 requires that all derivative contracts are carried at fair value on the Group's balance sheet and movements in their fair value are reflected in the income statement except where cash flow hedging is applied; this results in a mismatch between the accounting and the underlying economics where the Group has hedged its economic risk resulting from the different treatment of the derivative and the underlying hedged position.

The Group has not changed the way it hedges its economic exposures as a result of the implementation of IFRS, but the Group seeks to mitigate the resulting income statement volatility by the application of hedge accounting. Although the Group intends to mitigate the volatility arising from the requirement to fair value all derivatives as far as possible, this will be a source of increased volatility in the income statement in 2005 and beyond.

Other non-derivative financial assets (IAS 39)

IAS 39 permits financial assets to be designated at the time of initial recognition as being held at fair value, with unrecognised gains or losses reported in the income statement. Certain loans and advances and debt securities previously carried at amortised cost under UK GAAP have been designated as held at fair value through profit or loss on adoption of IAS 39 and have been valued at their fair value at 1 January 2005.

Under UK GAAP debt securities held for continuing use in the business were classified as investment securities and carried in the balance sheet at cost less any provisions for permanent diminution in value. IAS 39 introduces strict requirements to be met before debt securities can be carried at amortised cost and the Group has determined that it does not meet these. Accordingly debt securities previously classified as investment securities have been reclassified as available-for-sale and valued at their fair values at 1 January 2005. Equity investments may not be carried at cost under IAS 39 and these have also been reclassified as available-for-sale.

Insurance (IFRS 4, IAS 39, IAS 18)

IFRS 4 applies to contracts under which the insurer agrees to compensate the policyholder if a specified uncertain future event adversely affects the policyholder as well as to investment contracts which entitle the holder to receive additional discretionary benefits depending on performance. For contracts within the scope of IFRS 4, accounting practices are largely unchanged except for the modifications introduced by FRS 27 which is dealt with separately below.

Investment contracts that are not within the scope of IFRS 4 are accounted for as financial instruments under IAS 39. The principal effects of this change on the accounting for non-participating investment contracts are the removal of that portion of the embedded value which represents the value of in-force business relating to those contracts, the recognition of an asset for deferred acquisition costs, and the deferral of up-front fees received for investment management services; deferred acquisition costs and deferred up-front fees are amortised over the period of the provision of investment management services.

Life assurance (FRS 27)

Following the implementation of FRS 27, the Group excludes from the value of in-force business recognised in the balance sheet any amounts that reflect future investment margins and measures the liabilities of the Scottish Widows With-Profits Fund in accordance with the realistic capital regime of the Financial Services Authority. This basis includes a realistic valuation of guarantees and options embedded within products written by the With-Profits Fund. The principal effect of these new requirements is on the measurement of the in-force business, as the valuation of the With-Profits Fund on a realistic basis reduces the expected income to the shareholder from that fund. Changes in the valuation are reflected in the income statement and because this is market related it is inherently volatile.

Equity to debt reclassification (IAS 32)

The classification of the majority of the Group's capital and subordinated debt instruments continues to follow their UK GAAP treatment. However, the Group's preferred securities, which were treated as non-equity minority interests under UK GAAP, have been reclassified as debt because the coupon payment is not discretionary. Distributions on these securities are shown as interest expense rather than as minority interests.

Derecognition of financial liabilities (IAS 39)

Under IFRS a financial liability may only be removed from the balance sheet after it has been settled, it has expired or alternatively the debtor has been legally released from the liability, either by process of law or by the creditor. Upon adoption of IFRS, certain financial liabilities in respect of which amounts had been released to the income statement under UK GAAP on the basis that the likelihood of their settlement was remote have been remeasured as at 1 January 2005 to reflect the entire legal obligation.

Changes to reconciliations published on 27 May 2005:

Except as noted below, the accounting policies adopted in the preparation of the 2005 results are unchanged from those disclosed in the Group's announcement setting out the effects of the implementation of IFRS and FRS 27 published on 27 May 2005.

The Group recognises as an asset the value of in-force life assurance business in respect of life assurance contracts and participating investment contracts, representing the net present value of future profits expected to accrue to the shareholder from these contracts. In the Group's first IFRS results for the six months ended 30 June 2005, the asset in the consolidated balance sheet and movements in the asset recognised in the income statement were calculated and disclosed on a net of tax basis. Since that time accounting practice has continued to evolve and a consensus has emerged that the value of in-force business should be presented gross of tax. Therefore, in order to facilitate comparisons with the results of other major UK life assurance operations, the Group has changed its accounting policy to present movements in the value of in-force business gross of attributable tax with a consequential adjustment to the tax charge; there is no effect upon the Group's income statement or shareholders' equity. Comparative figures have been restated accordingly.

Comparative figures have also been restated to allow for deferred tax on properties acquired as part of a business combination and for the reclassification of certain balance sheet items following revised interpretations of the requirements of IFRS. This has resulted in a reduction in shareholders' equity although there is no effect upon the Group's income statement.

54 Adoption of International Financial Reporting Standards (continued)

The effect of these changes is set out below.

	As previously reported £m	Value of in-force business £m	Other adjustments £m	Restated £m
For the year ended 31 December 2004				
Profit before tax	3,495	(18)	–	3,477
Taxation	(1,036)	18	–	(1,018)
Profit for the year	2,459	–	–	2,459
At 1 January 2004				
Total assets	253,477	1,468	(64)	254,881
Shareholders' equity	10,644	–	(101)	10,543
At 31 December 2004				
Total assets	282,985	1,450	(13)	284,422
Shareholders' equity	11,150	–	(103)	11,047
At 1 January 2005				
Total assets	291,997	870	(13)	292,854
Shareholders' equity	9,572	–	(83)	9,489

Restated consolidated balance sheet (reconciliation of equity) at 1 January 2004 (excludes effects of IAS 32, IAS 39 and IFRS 4)

		Consolidation									
	UK GAAP £m	Insurance business £m	New entities £m	Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Dividend £m	Other £m	**IFRS £m**
Assets											
Cash and balances at central banks	**1,195**	–	–	–	–	–	–	–	–	–	**1,195**
Items in the course of collection from banks	**1,447**	–	–	–	–	–	–	–	–	–	**1,447**
Treasury bills and other eligible bills	**539**	–	–	–	–	–	–	–	–	–	**539**
Loans and advances to banks	**15,547**	4,948	1,649	–	–	–	–	–	–	(2)	**22,142**
Loans and advances to customers	**135,251**	(137)	1,178	(178)	–	–	–	–	–	(1)	**136,113**
Debt securities	**28,669**	16,896	318	–	–	–	–	–	–	2	**45,885**
Equity shares	**458**	24,972	244	–	–	–	–	–	–	(59)	**25,615**
Investment property	**–**	3,551	–	–	–	–	–	–	–	–	**3,551**
Goodwill	**2,513**	–	–	–	–	–	–	–	–	–	**2,513**
Value of in-force business	**–**	4,347	–	–	–	–	–	–	–	–	**4,347**
Intangible assets	**–**	–	–	–	–	41	–	–	–	–	**41**
Fixed assets	**3,918**	138	–	(85)	–	–	–	–	–	(27)	**3,944**
Other assets	**3,998**	1,203	416	15	–	–	3	–	–	1,914	**7,549**
Prepayments and accrued income	**1,918**	–	–	–	–	–	–	–	–	(1,918)	**–**
Long-term assurance business attributable to the shareholder	**6,481**	(6,481)	–	–	–	–	–	–	–	–	**–**
Long-term assurance assets attributable to the policyholders	**50,078**	(50,078)	–	–	–	–	–	–	–	–	**–**
Total assets	**252,012**	**(641)**	**3,805**	**(248)**	**–**	**41**	**3**	**–**	**–**	**(91)**	**254,881**

		Consolidation									
Equity and liabilities	**UK GAAP £m**	Insurance business £m	New entities £m	Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Dividend £m	Other £m	**IFRS £m**
Liabilities											
Deposits from banks	**23,955**	–	–	–	–	–	–	–	–	(8)	**23,947**
Customer accounts	**116,496**	(1,995)	–	–	–	–	–	–	–	–	**114,501**
Items in course of transmission to banks	**626**	–	–	–	–	–	–	–	–	–	**626**
Debt securities in issue	**25,922**	217	1,319	–	–	–	–	–	–	–	**27,458**
Insurance contract liabilities	**–**	49,079	–	–	–	–	–	–	–	(51)	**49,028**
Unallocated surplus within insurance business	**–**	339	–	–	–	–	–	–	–	–	**339**
Other liabilities	**7,007**	734	2,484	150	–	–	87	–	(1,314)	3,213	**12,361**
Accruals and deferred income	**3,206**	–	–	–	–	–	–	–	–	(3,206)	**–**
Deferred tax liabilities	**1,376**	1,137	–	(155)	(42)	12	(25)	–	–	(849)	**1,454**
Other provisions	**402**	(186)	–	–	–	–	–	–	–	–	**216**
Retirement benefit obligations	**2,139**	–	–	–	117	–	–	–	–	916	**3,172**
Subordinated liabilities	**10,454**	–	–	–	–	–	–	–	–	–	**10,454**
Long-term assurance liabilities to policyholders	**50,078**	(50,078)	–	–	–	–	–	–	–	–	**–**
Total liabilities	**241,661**	**(753)**	**3,803**	**(5)**	**75**	**12**	**62**	**–**	**(1,314)**	**15**	**243,556**
Equity											
Share capital	**1,418**	–	–	–	–	–	–	–	–	–	**1,418**
Share premium account	**1,136**	–	–	–	–	–	–	–	–	–	**1,136**
Other reserves	**343**	–	–	–	–	–	–	–	–	–	**343**
Retained profits	**6,727**	57	–	(241)	(75)	29	(59)	–	1,314	(106)	**7,646**
Shareholders' equity	**9,624**	**57**	**–**	**(241)**	**(75)**	**29**	**(59)**	**–**	**1,314**	**(106)**	**10,543**
Minority interests	**727**	55	2	(2)	–	–	–	–	–	–	**782**
Total equity	**10,351**	112	2	(243)	(75)	29	(59)	–	1,314	(106)	**11,325**
Total equity and liabilities	**252,012**	**(641)**	**3,805**	**(248)**	**–**	**41**	**3**	**–**	**–**	**(91)**	**254,881**

54 Adoption of International Financial Reporting Standards (continued)

Restated consolidated balance sheet (reconciliation of equity) at 31 December 2004 (excludes effects of IAS 32, IAS 39 and IFRS 4)

		Consolidation									
	UK GAAP £m	Insurance business £m	New entities £m	Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Dividend £m	Other £m	**IFRS £m**
Assets											
Cash and balances at central banks	**1,078**	–	–	–	–	–	–	–	–	–	**1,078**
Items in the course of collection from banks	**1,462**	–	–	–	–	–	–	–	–	–	**1,462**
Treasury bills and other eligible bills	**92**	–	–	–	–	–	–	–	–	–	**92**
Loans and advances to banks	**23,565**	5,836	2,447	–	–	–	–	–	–	–	**31,848**
Loans and advances to customers	**154,240**	(99)	1,339	(162)	–	–	–	–	–	–	**155,318**
Debt securities	**25,194**	17,794	498	–	–	–	–	–	–	(1)	**43,485**
Equity shares	**215**	28,072	(914)	–	–	–	–	–	–	(63)	**27,310**
Investment property	**–**	3,160	616	–	–	–	–	–	–	–	**3,776**
Goodwill	**2,425**	–	–	–	–	–	–	44	–	–	**2,469**
Value of in-force business	**–**	4,363	–	–	–	–	–	–	–	–	**4,363**
Intangible assets	**–**	–	–	–	–	28	–	–	–	–	**28**
Fixed assets	**4,181**	133	–	(100)	–	–	–	–	–	(34)	**4,180**
Other assets	**3,273**	2,435	717	14	–	–	3	–	–	2,571	**9,013**
Prepayments and accrued income	**2,573**	–	–	–	–	–	–	–	–	(2,573)	**–**
Long-term assurance business attributable to the shareholder	**6,781**	(6,781)	–	–	–	–	–	–	–	–	**–**
Long-term assurance assets attributable to the policyholders	**54,764**	(54,764)	–	–	–	–	–	–	–	–	**–**
Total assets	**279,843**	**149**	**4,703**	**(248)**	**–**	**28**	**3**	**44**	**–**	**(100)**	**284,422**

		Consolidation									
Equity and liabilities	**UK GAAP £m**	Insurance business £m	New entities £m	Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Dividend £m	Other £m	**IFRS £m**
Liabilities											
Deposits from banks	**39,738**	–	–	–	–	–	–	–	–	(15)	**39,723**
Customer accounts	**122,062**	(2,254)	–	–	–	–	–	–	–	3	**119,811**
Items in course of transmission to banks	**631**	–	–	–	–	–	–	–	–	–	**631**
Debt securities in issue	**27,217**	208	1,345	–	–	–	–	–	–	–	**28,770**
Insurance contract liabilities	**–**	52,350	–	–	–	–	–	–	–	(61)	**52,289**
Unallocated surplus within insurance business	**–**	1,362	–	–	–	–	–	–	–	–	**1,362**
Accruals and deferred income	**3,866**	–	–	–	–	–	–	–	–	(3,866)	**–**
Other liabilities	**6,619**	2,127	3,356	183	–	–	56	–	(1,315)	3,890	**14,916**
Deferred tax liabilities	**1,473**	1,276	–	(159)	17	9	(16)	3	–	(899)	**1,704**
Other provisions	**417**	(206)	–	–	–	–	–	–	–	–	**211**
Retirement benefit obligations	**2,231**	–	–	–	(112)	–	–	–	–	956	**3,075**
Subordinated liabilities	**10,252**	–	–	–	–	–	–	–	–	–	**10,252**
Long-term assurance liabilities to policyholders	**54,764**	(54,764)	–	–	–	–	–	–	–	–	**–**
Total liabilities	**269,270**	**99**	**4,701**	**24**	**(95)**	**9**	**40**	**3**	**(1,315)**	**8**	**272,744**
Equity											
Share capital	**1,419**	–	–	–	–	–	–	–	–	–	**1,419**
Share premium account	**1,145**	–	–	–	–	–	–	–	–	–	**1,145**
Other reserves	**343**	–	–	–	–	–	–	–	–	–	**343**
Retained profits	**7,070**	13	–	(268)	95	19	(37)	41	1,315	(108)	**8,140**
Shareholders' equity	**9,977**	**13**	**–**	**(268)**	**95**	**19**	**(37)**	**41**	**1,315**	**(108)**	**11,047**
Minority interests	**596**	37	2	(4)	–	–	–	–	–	–	**631**
Total equity	**10,573**	50	2	(272)	95	19	(37)	41	1,315	(108)	**11,678**
Total equity and liabilities	**279,843**	**149**	**4,703**	**(248)**	**–**	**28**	**3**	**44**	**–**	**(100)**	**284,422**

54 Adoption of International Financial Reporting Standards (continued)

Restated consolidated income statement (reconciliation of profit) for the year ended 31 December 2004 (excludes effects of IAS 32, IAS 39 and IFRS 4)

	UK GAAP £m	Consolidation Insurance business £m	New entities £m	Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Other £m	IFRS £m
Interest income	**10,395**	170	125	(2)	–	–	–	–	19	**10,707**
Interest expense	**(5,475)**	55	(162)	–	–	–	–	–	(15)	**(5,597)**
Net interest income	**4,920**	**225**	**(37)**	**(2)**	**–**	**–**	**–**	**–**	**4**	**5,110**
Other finance income	**39**	–	–	–	(39)	–	–	–	–	**–**
Insurance premium income	**554**	5,516	–	–	–	–	–	–	–	**6,070**
Fees and commission income	**3,124**	(16)	(52)	(38)	–	–	31	–	5	**3,054**
Fees and commission expense	**(744)**	(95)	(10)	5	–	–	–	–	–	**(844)**
Net fee and commission income	**2,380**	(111)	(62)	(33)	–	–	31	–	5	**2,210**
Dealing profits	**271**	–	–	–	–	–	–	–	(271)	**–**
Net trading income	**–**	4,663	109	–	–	–	–	–	264	**5,036**
Increase in value of long-term assurance business	**715**	(715)	–	–	–	–	–	–	–	**–**
Other operating income	**688**	202	5	16	–	–	–	–	(54)	**857**
Total income	**9,567**	**9,780**	**15**	**(19)**	**(39)**	**–**	**31**	**–**	**(52)**	**19,283**
Insurance claims	**(224)**	(9,408)	–	–	–	–	–	–	10	**(9,622)**
Total income, net of insurance claims	**9,343**	**372**	**15**	**(19)**	**(39)**	**–**	**31**	**–**	**(42)**	**9,661**
Administrative expenses	**(4,284)**	(395)	(2)	2	14	10	–	–	(4)	**(4,659)**
Depreciation of property, plant and equipment	**(589)**	(12)	–	(15)	–	(22)	–	–	–	**(638)**
Amortisation of goodwill	**(44)**	–	–	–	–	–	–	44	–	**–**
Total operating expenses	**(4,917)**	**(407)**	**(2)**	**(13)**	**14**	**(12)**	**–**	**44**	**(4)**	**(5,297)**
Trading surplus	**4,426**	(35)	13	(32)	(25)	(12)	31	44	(46)	**4,364**
Impairment losses on loans and advances	**(866)**	–	–	–	–	–	–	–	–	**(866)**
Amounts written off fixed asset investments	**(52)**	–	–	–	–	–	–	–	52	**–**
Profit and loss on disposal of businesses	**(15)**	–	–	–	–	–	–	–	(6)	**(21)**
Profit before tax	**3,493**	**(35)**	**13**	**(32)**	**(25)**	**(12)**	**31**	**44**	**–**	**3,477**
Taxation	**(1,004)**	(8)	(12)	4	12	4	(9)	(3)	(2)	**(1,018)**
Profit for the year	**2,489**	**(43)**	**1**	**(28)**	**(13)**	**(8)**	**22**	**41**	**(2)**	**2,459**
Profit attributable to minority interests	**68**	–	1	(1)	–	–	–	–	(1)	**67**
Profit attributable to equity shareholders	**2,421**	(43)	–	(27)	(13)	(8)	22	41	(1)	**2,392**
	2,489	**(43)**	**1**	**(28)**	**(13)**	**(8)**	**22**	**41**	**(2)**	**2,459**

54 Adoption of International Financial Reporting Standards (continued)

Restated consolidated balance sheet (reconciliation of equity) at 1 January 2005 (includes effects of IAS 32, IAS 39 and IFRS 4)

	Restated 31 December 2004 £m	Reclassi-fications £m	Effective interest rates £m	Impair-ment £m	Offset £m	Derivatives £m	Available-for-sale £m	Insurance £m	Debt/equity £m	Other £m	1 January 2005 £m
Assets											
Cash and balances at central banks	1,078	–	–	–	–	–	–	–	–	–	1,078
Items in the course of collection from banks	1,462	–	–	–	–	–	–	–	–	–	1,462
Treasury bills and other eligible bills	92	(92)	–	–	–	–	–	–	–	–	
Trading securities and other financial assets at fair value through profit or loss		56,865	–	–	–	25	–	(45)	–	(5)	56,840
Derivative financial instruments		4,869	–	–	3,956	438	–	–	–	–	9,263
Loans and advances to banks	31,848	–	3	–	–	–	–	–	–	–	31,851
Loans and advances to customers	155,318	(337)	108	(314)	6,287	95	–	–	–	5	161,162
Debt securities	43,485	(43,485)	–	–	–	–	–	–	–	–	
Equity shares	27,310	(27,310)	–	–	–	–	–	–	–	–	
Available-for-sale financial assets		14,385	–	–	–	175	33	–	–	–	14,593
Investment property	3,776	–	–	–	–	–	–	–	–	–	3,776
Goodwill	2,469	–	–	–	–	–	–	–	–	–	2,469
Value of in-force business	4,363	–	–	–	–	–	–	(1,603)	–	–	2,760
Intangible assets	28	–	–	–	–	–	–	–	–	–	28
Fixed assets	4,180	–	–	–	–	–	–	–	–	–	4,180
Other assets	9,013	(4,869)	(137)	–	–	(910)	–	291	–	4	3,392
Total assets	**284,422**	**26**	**(26)**	**(314)**	**10,243**	**(177)**	**33**	**(1,357)**	**–**	**4**	**292,854**
Equity and liabilities											
Liabilities											
Deposits from banks	39,723	–	–	–	–	–	–	–	–	–	39,723
Customer accounts	119,811	(36)	(13)	–	6,287	127	–	–	–	173	126,349
Items in course of transmission to banks	631	–	–	–	–	–	–	–	–	–	631
Derivative financial instruments and other trading liabilities		5,943	–	–	3,956	435	–	–	–	–	10,334
Liabilities to customers under investment contracts		16,354	–	–	–	–	–	7	–	–	16,361
Debt securities in issue	28,770	–	–	–	–	(42)	–	–	–	–	28,728
Insurance contract liabilities	52,289	(16,354)	–	–	–	–	–	790	–	–	36,725
Unallocated surplus within insurance business	1,362	–	–	–	–	–	–	(936)	–	–	426
Other liabilities	14,916	(5,940)	(45)	–	–	(784)	–	416	–	(37)	8,526
Deferred tax liabilities	1,704	–	10	(93)	–	(82)	5	(568)	–	(51)	925
Other provisions	211	59	–	–	–	–	–	–	–	–	270
Retirement benefit obligations	3,075	–	–	–	–	–	–	–	–	–	3,075
Subordinated liabilities	10,252	–	–	–	–	361	–	–	550	48	11,211
Total liabilities	**272,744**	**26**	**(48)**	**(93)**	**10,243**	**15**	**5**	**(291)**	**550**	**133**	**283,284**
Equity											
Share capital	1,419	–	–	–	–	–	–	–	–	–	1,419
Share premium account	1,145	–	–	–	–	–	–	–	–	–	1,145
Other reserves	343	–	–	–	–	–	28	–	–	–	371
Retained profits	8,140	–	22	(221)	–	(192)	–	(1,066)	–	(129)	6,554
Shareholders' equity	**11,047**	**–**	**22**	**(221)**	**–**	**(192)**	**28**	**(1,066)**	**–**	**(129)**	**9,489**
Minority interests	631	–	–	–	–	–	–	–	(550)	–	81
Total equity	**11,678**	**–**	**22**	**(221)**	**–**	**(192)**	**28**	**(1,066)**	**(550)**	**(129)**	**9,570**
Total equity and liabilities	**284,422**	**26**	**(26)**	**(314)**	**10,243**	**(177)**	**33**	**(1,357)**	**–**	**4**	**292,854**

55 Future developments

The following pronouncements will be relevant to the Group but were not effective at 31 December 2005 and have not been applied in preparing these financial statements.

Pronouncement	Nature of change	Effective date
*IFRS 7 *Financial Instruments: Disclosures*	Consolidates the current financial instruments disclosures into a single standard and requires more detailed qualitative and quantitative disclosures about exposure to risks arising from financial instruments.	Annual periods beginning on or after 1 January 2007
Amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts – Financial Guarantee Contracts*	Requires issued financial guarantee contracts to be accounted for as financial instruments unless the issuer has previously asserted that the contracts are regarded as insurance contracts and has accounted for them as such.	Annual periods beginning on or after 1 January 2006
Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – The Fair Value Option*	Restricts the fair value option for financial instruments to certain situations, including when doing so results in more relevant information because it eliminates or reduces a measurement or recognition inconsistency or where a group of financial instruments is managed and evaluated on a fair value basis in accordance with a documented strategy.	Annual periods beginning on or after 1 January 2006
Amendment to IAS 19 *Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures*	Permits actuarial gains and losses to be recognised outside profit and loss where those gains and losses are recognised in the period in which they occur, more clearly distinguishes between multi-employer plans and defined benefit plans between entities under common control, and requires additional disclosures about trends in the assets and liabilities in a defined benefit plan and the assumptions underlying the components of the defined benefit cost.	Annual periods beginning on or after 1 January 2006
*Amendment to IAS 1 *Presentation of Financial Statements – Capital Disclosures*	Introduces additional disclosures of the objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, and compliance with capital requirements.	Annual periods beginning on or after 1 January 2007
IFRIC Interpretation 4 *Determining Whether an Arrangement Contains a Lease*	Interpretation provides guidance for determining whether arrangements comprising transactions that do not take the legal form of a lease but convey a right to use an asset contain leases that should be separately accounted for.	Annual periods beginning on or after 1 January 2006

The full impact of these accounting changes is being assessed by the Group; none of these pronouncements are expected to cause any material adjustments to the financial statements. The Group has not yet made a final decision as to whether it will apply in the 2006 financial statements those pronouncements marked (*) in the table above.

56 Approval of the financial statements

The consolidated financial statements were approved by the directors of Lloyds TSB Group plc on 23 February 2006.

Report of the independent auditors on the parent company financial statements

To the members of Lloyds TSB Group plc

We have audited the parent company financial statements of Lloyds TSB Group plc for the year ended 31 December 2005 which comprise the balance sheet, the cash flow statement, the statement of changes in equity and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report on pages 46 to 57 that is described as having been audited.

We have reported separately on the consolidated financial statements of Lloyds TSB Group plc for the year ended 31 December 2005.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the parent company financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the directors' report is not consistent with the parent company financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the directors' report, the chairman's statement, the Group chief executive's review, the operating and financial review and prospects and the unaudited part of the directors' remuneration report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements and the part of the directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements and the part of the directors' remuneration report to be audited.

Opinion

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2005 and cash flows for the year then ended; and
- the parent company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
23 February 2006

Parent company balance sheet

at 31 December 2005

	Note	**2005 £ million**	2004 £ million
Assets			
Non-current assets:			
Investment in subsidiaries	7	**5,589**	5,589
Loans to subsidiaries	7	**1,723**	1,723
Deferred tax assets	2	**21**	15
		7,333	7,327
Current assets:			
Derivative financial instruments		**188**	–
Other assets		**131**	155
Amounts due from subsidiaries	3	**164**	76
Cash and cash equivalents		**107**	208
		590	439
Total assets		**7,923**	7,766
Equity and liabilities			
Capital and reserves:			
Share capital	4	**1,420**	1,419
Share premium account	4	**1,170**	1,145
Retained profits	5	**2,055**	1,996
Total equity		**4,645**	4,560
Non-current liabilities:			
Subordinated liabilities	6	**1,502**	1,358
		1,502	1,358
Current liabilities:			
Current tax liabilities		**5**	7
Amounts owed to subsidiaries		**1,692**	1,741
Other liabilities		**79**	100
		1,776	1,848
Total liabilities		**3,278**	3,206
Total equity and liabilities		**7,923**	7,766

The accompanying notes are an integral part of the parent company financial statements.

The directors approved the parent company accounts on 23 February 2006.

Maarten A van den Bergh
Chairman

J Eric Daniels
Group Chief Executive

Helen A Weir
Group Finance Director

Parent company statement of changes in equity

	Share capital and premium £ million	Retained profit £ million	Total £ million
Balance at 1 January 2004 (note 8)	2,554	1,953	4,507
Profit for the year*	–	1,928	1,928
Dividends	–	(1,913)	(1,913)
Purchase/sale of treasury shares	–	9	9
Employee share option schemes:			
– value of employee services	–	19	19
– proceeds from shares issued	10	–	10
Balance at 31 December 2004 (note 8)	2,564	1,996	4,560
Adjustments on transition to IAS 32 and IAS 39	–	30	30
Restated balance at 1 January 2005 (note 8)	**2,564**	**2,026**	**4,590**
Profit for the year*	**–**	**1,898**	**1,898**
Dividends	**–**	**(1,914)**	**(1,914)**
Purchase/sale of treasury shares	**–**	**(2)**	**(2)**
Employee share option schemes:			
– value of employee services	**–**	**47**	**47**
– proceeds from shares issued	**26**	**–**	**26**
Balance at 31 December 2005	**2,590**	**2,055**	**4,645**

* No income statement has been shown for the parent company, as permitted by section 230 of the Companies Act 1985.

Parent company cash flow statement

for the year ended 31 December 2005

	2005 £ million	2004 £ million
Profit before tax	**1,882**	1,894
Profit on disposal of subsidiary	**–**	(1)
Dividend income	**(1,913)**	(1,913)
Fair value adjustment	**9**	–
Change in other assets	**(72)**	–
Change in other liabilities	**(44)**	(24)
Tax paid	**12**	(122)
Net cash used in operating activities	**(126)**	(166)
Cash flows from investing activities:		
Disposal of businesses, net of cash disposed	**–**	1
Net cash generated by investing activities	**–**	1
Cash flows from financing activities:		
Dividends received from subsidiaries	**1,913**	1,913
Dividends paid to equity shareholders	**(1,914)**	(1,913)
Proceeds from issue of ordinary shares and transactions in own shares held in respect of employee share schemes	**26**	11
Net cash generated by financing activities	**25**	11
Change in cash and cash equivalents	**(101)**	(154)
Cash and cash equivalents at beginning of year	**208**	362
Cash and cash equivalents at end of year	**107**	208

Cash and cash equivalents comprise cash and amounts due from banks with a maturity of less than three months.

The accompanying notes are an integral part of the parent company financial statements.

Notes to the parent company accounts

1 Accounting policies

The parent company has applied International Financial Reporting Standards ('IFRS') as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2005.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of all derivative contracts, on the basis of IFRS adopted by the EU. The parent company has applied IFRS 1 'First-time Adoption of International Financial Reporting Standards' and the opening IFRS balance sheet position at 1 January 2004, the date of transition, has been determined in accordance with that standard; IFRS 1 requires IFRS accounting policies to be applied on a retrospective basis and takes account of any relevant mandatory exceptions and voluntary exemptions applied by the Group as detailed in note 1 to the consolidated accounts.

The accounting policies of the parent company are the same as those of the Group which are set out in note 1 to the consolidated accounts, except that it has no policy in respect of consolidation and investments in subsidiaries are carried at historical cost, less any provisions for impairment.

Further information on the principal differences between IFRS and the parent company's previous accounting policies and the effect of their adoption on the parent company's previously published information is given in note 8.

2 Deferred tax assets

The movement in the net deferred tax asset is as follows:	2005 £m	2004 £m
At 1 January	**15**	6
Restatement on implementation of IAS 32, IAS 39 and IFRS 4	**(12)**	
At 1 January – restated	**3**	6
Income statement credit	**2**	9
Amount credited to equity in respect of employee share schemes	**16**	–
At 31 December	**21**	15

With effect from 1 January 2005 the Company implemented the requirements of IAS 39 'Financial instruments: Recognition and Measurement'. As a result, certain financial assets and liabilities valued at amortised cost are now carried at fair value with a consequential adjustment being made to the deferred tax balance.

The deferred tax assets relate to temporary timing differences.

3 Amounts due from subsidiaries

These comprise short-term lending to subsidiaries, repayable on demand. The fair values of amounts owed by subsidiaries are equal to their carrying amounts. No provisions have been recognised in respect of amounts owed by subsidiaries.

4 Share capital and share premium

Details of the Company's share capital and share premium account are as set out in notes 42 and 43 to the consolidated accounts.

5 Retained profits

	£m
At 1 January 2004	1,953
Profit for the year	1,928
Dividends	(1,913)
Purchase/sale of treasury shares	9
Employee share option schemes: value of employee services	19
At 31 December 2004	1,996
Adjustments on implementation of IAS 32 and IAS 39	30
Restated balance at 1 January 2005	**2,026**
Profit for the year	**1,898**
Dividends	**(1,914)**
Purchase/sale of treasury shares	**(2)**
Employee share option schemes: value of employee services	**47**
At 31 December 2005	**2,055**

6 Subordinated liabilities

	2005 £m	2004 £m
Undated subordinated loan capital*		
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 §	**497**	497
Dated subordinated loan capital		
8 1/2% Subordinated Bonds 2006	**250**	250
9 1/8% Subordinated Bonds 2011	**149**	149
5 7/8% Subordinated Guaranteed Bonds 2014 (€750 million)	**606**	462
	1,005	861
Total subordinated loan capital	**1,502**	1,358

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer.

* In certain circumstances, these notes and bonds would acquire the characteristics of preference share capital. Any repayments of undated loan capital would require the prior consent of the Financial Services Authority. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of certain preference shares.

§ At the callable date the coupon on these bonds will be reset by reference to the applicable five year benchmark gilt rate.

7 Related party transactions

Key management personnel

The key management personnel of the Group and parent company are the same. The relevant disclosures are given in note 49 to the consolidated financial statements.

Investment in subsidiaries	**£m**
At 1 January 2005 and 31 December 2005	**5,589**

The principal subsidiaries, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds TSB Group plc, are:

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds TSB Bank plc	England	100%	Banking and financial services
Cheltenham & Gloucester plc	England	100%†	Mortgage lending and retail investments
Lloyds TSB Commercial Finance Limited	England	100%†	Credit factoring
Lloyds TSB Leasing Limited	England	100%†	Financial leasing
Lloyds TSB Private Banking Limited	England	100%†	Private banking
The Agricultural Mortgage Corporation PLC	England	100%†	Long-term agricultural finance
Lloyds TSB Offshore Limited	Jersey	100%†	Banking and financial services
Lloyds TSB Scotland plc	Scotland	100%†	Banking and financial services
Lloyds TSB General Insurance Limited	England	100%†	General insurance
Scottish Widows Investment Partnership Group Limited	England	100%†	Investment management
Abbey Life Assurance Company Limited	England	100%†	Life assurance
Lloyds TSB Insurance Services Limited	England	100%†	Insurance broking
Lloyds TSB Asset Finance Division Limited	England	100%†	Consumer credit, leasing and related services
Black Horse Limited	England	100%†	Consumer credit, leasing and related services
Scottish Widows plc	Scotland	100%†	Life assurance
Scottish Widows Annuities Limited	Scotland	100%†	Life assurance

† Indirect interest

The country of registration/incorporation is also the principal area of operation for each of the above subsidiaries except as follows:

Lloyds TSB Bank plc operates principally in the UK but also through branches in Belgium, Dubai, Ecuador, Gibraltar, Hong Kong, Japan, Luxembourg, Malaysia, Monaco, Netherlands, Paraguay, Singapore, Spain, Switzerland, Uruguay and the USA.

Amounts owed by subsidiaries:	2005 £m	2004 £m
At 1 January and 31 December	**1,723**	1,723

In addition the parent company carried out all of its banking activities through its subsidiary, Lloyds TSB Bank plc. At 31 December 2005, the parent company held deposits of £107 million with the bank (2004: £208 million). Given the volume of transactions flowing through the account, it is not meaningful to provide gross inflow and outflow information. In addition, at 31 December 2005 the parent company had interest rate and currency swaps with Lloyds TSB Bank plc with an aggregate notional principal amount of £1,379 million and a positive fair value of £188 million, designated as fair value hedges.

Related party information in respect of other related party transactions is given in note 49 to the consolidated financial statements.

8 Adoption of International Financial Reporting Standards

The impact for the parent company in respect of the accounting for dividends, derivatives and hedging instruments is the same as for the Group, as set out in note 54 to the consolidated accounts.

In addition the parent company's investment in subsidiaries, which under UK GAAP was revalued to an amount equal to the net assets of the underlying subsidiaries, is now carried at historical cost (less any provisions for impairment).

Set out below are explanations and reconciliations showing the effect of the adoption of IFRS upon the parent company's previously published financial information.

Restated parent company balance sheet (reconciliation of equity) at 1 January 2004 (excludes the effect of IAS 32 and IAS 39)

	UK GAAP £m	Reclassifi-cations £m	Investment in subsidiaries £m	Dividends £m	Other £m	IFRS £m
Investment in subsidiaries	10,753	–	(5,164)	–	–	5,589
Loans to subsidiaries	1,723	–	–	–	–	1,723
Deferred tax asset	–	–	–	–	6	6
Other assets	88	–	–	–	41	129
Amounts due from subsidiaries	1,387	–	–	(1,314)	–	73
Cash and cash equivalents	362	–	–	–	–	362
Total assets	14,313	–	(5,164)	(1,314)	47	7,882
Share capital	1,418	–	–	–	–	1,418
Share premium account	1,136	–	–	–	–	1,136
Revaluation reserve	4,687	–	(4,687)	–	–	–
Retained profits	2,383	–	(477)	–	47	1,953
Total equity	9,624	–	(5,164)	–	47	4,507
Subordinated liabilities	1,356	–	–	–	–	1,356
Current tax liabilities	–	5	–	–	–	5
Other liabilities	106	(5)	–	–	–	101
Amounts owed to subsidiaries	1,913	–	–	–	–	1,913
Dividend payable	1,314	–	–	(1,314)	–	–
Total liabilities	4,689	–	–	(1,314)	–	3,375
Total equity and liabilities	14,313	–	(5,164)	(1,314)	47	7,882

Restated parent company balance sheet (reconciliation of equity) at 31 December 2004 (excludes the effect of IAS 32 and IAS 39)

	UK GAAP £m	Reclassifi-cations £m	Investment in subsidiaries £m	Dividends £m	Other £m	IFRS £m
Investment in subsidiaries	11,080	–	(5,491)	–	–	5,589
Loans to subsidiaries	1,723	–	–	–	–	1,723
Deferred tax assets	–	9	–	–	6	15
Other assets	97	(9)	–	–	67	155
Amounts due from subsidiaries	1,390	–	–	(1,314)	–	76
Cash and cash equivalents	208	–	–	–	–	208
Total assets	14,498	–	(5,491)	(1,314)	73	7,766
Share capital	1,419	–	–	–	–	1,419
Share premium account	1,145	–	–	–	–	1,145
Revaluation reserve	5,014	–	(5,014)	–	–	–
Retained profits	2,399	–	(477)	1	73	1,996
Total equity	9,977	–	(5,491)	1	73	4,560
Subordinated liabilities	1,358	–	–	–	–	1,358
Current tax liabilities	–	7	–	–	–	7
Other liabilities	107	(7)	–	–	–	100
Amounts owed to subsidiaries	1,741	–	–	–	–	1,741
Dividend payable	1,315	–	–	(1,315)	–	–
Total liabilities	4,521	–	–	(1,315)	–	3,206
Total equity and liabilities	14,498	–	(5,491)	(1,314)	73	7,766

8 Adoption of International Financial Reporting Standards (continued)

Restated parent company balance sheet (reconciliation of equity) at 1 January 2005 (includes the effect of IAS 32 and IAS 39)

	Restated 31 December 2004 £m	Derivatives £m	1 January 2005 £m
Investment in subsidiaries	5,589	–	5,589
Loans to subsidiaries	1,723	–	1,723
Deferred tax assets	15	(12)	3
Derivative financial instruments	–	208	208
Other assets	155	(37)	118
Amounts due from subsidiaries	76	–	76
Cash and cash equivalents	208	–	208
Total assets	7,766	159	7,925
Share capital	1,419	–	1,419
Share premium account	1,145	–	1,145
Retained profits	1,996	30	2,026
Total equity	4,560	30	4,590
Subordinated liabilities	1,358	155	1,513
Current tax liabilities	7	–	7
Other liabilities	100	(26)	74
Amounts owed to subsidiaries	1,741	–	1,741
Total liabilities	3,206	129	3,335
Total equity and liabilities	7,766	159	7,925

9 Approval of the financial statements and other information

The parent company financial statements were approved by the directors of Lloyds TSB Group plc on 23 February 2006.

Lloyds TSB Group plc was incorporated as a public limited company and registered in Scotland under the UK Companies Act 1985 on 21 October 1985 with the registered number 95000. Lloyds TSB Group plc's registered office is Henry Duncan House, 120 George Street, Edinburgh EH2 4LH, Scotland, and its principal executive offices in the UK are located at 25 Gresham Street, London EC2V 7HN.

Information for shareholders

Analysis of shareholders

at 31 December 2005

Size of shareholding	Shareholders		Number of ordinary shares	
	Number	%	Millions	%
1 – 99	74,538	8.10	2.5	0.04
100 – 499	385,662	41.92	128.4	2.29
500 – 999	284,434	30.92	185.9	3.32
1,000 – 4,999	139,327	15.15	269.1	4.81
5,000 – 9,999	19,883	2.16	135.1	2.41
10,000 – 49,999	13,888	1.51	248.9	4.44
50,000 – 99,999	720	0.08	48.5	0.87
100,000 – 999,999	981	0.11	330.5	5.90
1,000,000 and over	504	0.05	4,253.7	75.92
	919,937	100.00	5,602.6*	100.00

* Includes 698 million shares (12.46%) registered in the names of some 812,000 individuals. 227 million shares (4.05%) are held by over 78,000 staff and Group pensioners, or on their behalf by the trustee of the staff shareplan scheme.

Substantial shareholdings

At the date of this report, notifications had been received that Legal & General Investment Management Limited, Barclays PLC and The Capital Group Companies had interests of 3%, 3.30% and 6.04%, respectively, of the nominal value of the issued share capital. No other notification has been received that anyone has an interest of 3% or more of the nominal value of the issued share capital.

Share price information

In addition to listings in the financial pages of the press, the latest price of Lloyds TSB shares on the London Stock Exchange can be obtained by telephoning 0906 877 1515. These telephone calls are charged at 55p per minute, including VAT. Visit www.londonstockexchange.com for details.

Share dealing facilities

A full range of dealing services is available through Lloyds TSB Registrars.

For internet dealing, the current rate of commission for both purchases and sales is 0.5%: minimum £17.50. Visit www.shareview.co.uk/dealing for full details.

For telephone dealing, the current rate for both purchases and sales is 0.5%: minimum £20. For full details, contact Lloyds TSB Registrars on: 0870 850 0852.

For postal dealing, the current rate for both purchases and sales is 0.75%: no minimum. For full details, contact Lloyds TSB Registrars on: 0870 242 4244.

American Depositary Receipts (ADRs)

Lloyds TSB shares are traded in the USA through an NYSE-listed sponsored ADR facility, with The Bank of New York as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4.

For details contact: The Bank of New York, Investor Services, PO Box 11258, Church Street Station, New York, NY 10286-1258. Telephone: 888 BNY ADRS (US toll free), international callers: +1 212 815 3700. Alternatively visit www.adrbny.com or email shareowners@bankofny.com

Individual Savings Accounts (ISAs)

The Company provides a facility for investing in Lloyds TSB shares through an ISA. For details contact Retail Investor Operations, Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6UY. Telephone 0870 242 4244.

Corporate responsibility

A copy of the Group's corporate responsibility report may be obtained by writing to Corporate Responsibility, Lloyds TSB Group plc, 25 Gresham Street, London EC2V 7HN. This information together with the Group's code of business conduct is also available on the Group's website.

The Better Payment Practice Code

A copy of the code and information about it may be obtained from the DTI Publications Orderline 0845 0150010, quoting ref URN 04/606. Alternatively, log on to www.payontime.co.uk for details.

Shareholder enquiries

The Company's share register is maintained by Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. Telephone 0870 600 3990; textphone 0870 600 3950.

Contact them if you have enquiries about your Lloyds TSB shareholding, including those concerning the following matters:

- change of name or address
- loss of share certificate, dividend warrant or tax voucher
- obtaining a form for dividends to be paid directly to your bank or building society account (tax vouchers will still be sent to your registered address unless you request otherwise)
- obtaining details of the dividend reinvestment plan which enables you to use your cash dividends to buy Lloyds TSB shares in the market
- requesting copies of the report and accounts in alternative formats for shareholders with disabilities.

Lloyds TSB Registrars operates a web based enquiry and portfolio management service for shareholders. Visit www.shareview.co.uk for details.

Financial calendar 2006

24 February
Results for 2005 announced

8 March
Ex-dividend date for 2005 final dividend

10 March
Record date for final dividend

5 April
Final date for joining or leaving the dividend reinvestment plan for the final dividend

3 May
Final dividend paid

11 May
Annual general meeting in Glasgow

2 August
Results for half-year to 30 June 2006 announced

9 August
Ex-dividend date for 2006 interim dividend

11 August
Record date for interim dividend

6 September
Final date for joining or leaving the dividend reinvestment plan for the interim dividend

4 October
Interim dividend paid

Head office

25 Gresham Street
London EC2V 7HN
Telephone +44 (0)20 7626 1500

Registered office

Henry Duncan House
120 George Street
Edinburgh EH2 4LH
Registered in Scotland no 95000

Internet

www.lloydstsb.com

Registrar

Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA
Telephone 0870 600 3990
Textphone 0870 600 3950
Overseas +44 (0)121 415 7047

Designed by Starling Design/The Team
Printed in the UK by Royle Corporate Print who are ISO 9001 and ISO 14001 accredited, on paper sourced from sustainable managed forests and made using the elemental chlorine free process at a Mill which is ISO 14001 and Eco-management Audit system accredited.

Lloyds TSB Group