Annual Report and Accounts 2006

Building long-term relationships

Lloyds TSB | for the journey...

Our vision

To be the best financial services organisation in the UK

We will achieve this by:

Building strong customer franchises, that are based on deep customer relationships
- that give value to the customer
- that give sustainable earnings growth to the shareholder

Executing brilliantly
- flawlessly for the customer
- doing what we say we are going to do

Managing our most valuable resource, people

Our strategy

Phase 1 – focus on core markets
- successfully enhanced earnings quality
- exited businesses not regarded as core and/or unnecessarily volatile

Phase 2 – build customer franchises
- extending reach and depth of customer relationships
- enhancing product capabilities to build competitive advantage
- improving processing efficiency
- working capital harder

Phase 3 – expand from strength
- look to leverage our financial strength and enhanced capabilities
- new product, customer and geographical markets

Our business priorities

UK Retail Banking
- grow income from existing customer base
- grow income from new customers
- improve productivity

Insurance and Investments
- maximise bancassurance success
- profitably grow the IFA distribution channel
- continue to improve operational efficiency and cost management
- optimise capital management

Wholesale and International Banking
- grow the Corporate Markets business
- build on the growth momentum in Business Banking

Group key performance indicators

2006 highlights

- Statutory profit before tax increased by 11 per cent to £4,248 million.
- Balanced and continuing trading momentum with income up 6 per cent and trading surplus up 11 per cent.†
- Excellent cost control. Income growth exceeded cost growth of 2 per cent.†
- Productivity improvement programme ahead of schedule.
- Impairment up 20 per cent; overall credit quality remains satisfactory.
- Capital ratios remain robust.
- Post-tax return on average shareholders' equity remained strong at 25.1 per cent.†
- Final dividend of 23.5p per share, making a total of 34.2p for the year (2005: 34.2p).

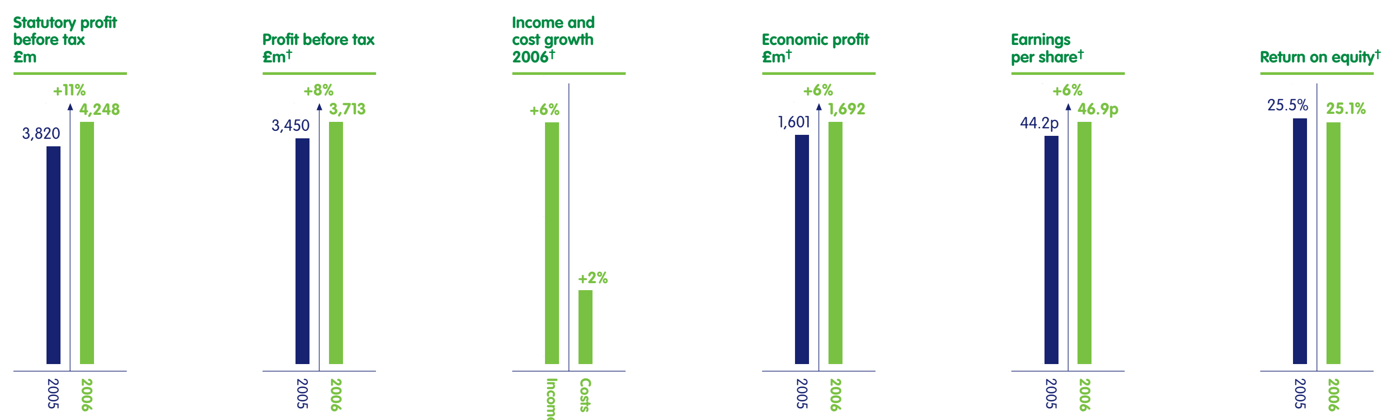
Profit analysis by division

	2006 £ million	2005 £ million
UK Retail Banking		
- Before provisions for customer redress	1,549	1,470
- Provisions for customer redress	–	(150)
	1,549	1,320
Insurance and Investments		
- Before strengthening of reserves for mortality	973	880
- Strengthening of reserves for mortality	–	(155)
	973	725
Wholesale and International Banking	1,640	1,524
Central group items		
- Before pension schemes related credit	(449)	(424)
- Pension schemes related credit	128	–
	(321)	(424)
Profit before tax – excluding volatility and profit on sale and closure of businesses	3,841	3,145
Volatility*		
- Banking	(3)	(124)
- Insurance	84	438
- Policyholder interests	326	311
Profit on sale and closure of businesses**	–	50
Profit before tax	4,248	3,820
Earnings per share	49.9p	44.6p

* Volatility relates to Insurance and Investments (2006: £410 million, 2005: £749 million) and Central group items (2006: £(3) million, 2005: £(124) million).

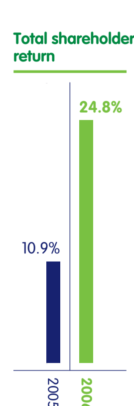
** On a statutory basis, profit on sale and closure of businesses in 2005 relates to UK Retail Banking (profit of £76 million), Wholesale and International Banking (loss of £6 million) and Central group items (loss of £20 million).

Group – financial



Group – non-financial

Total shareholder return



† Excluding volatility, pension schemes related credit and, in 2005, profit on sale and closure of businesses, customer redress provisions and strengthening of reserves for mortality.

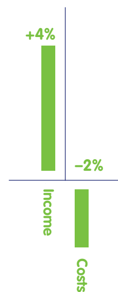
†† See corporate responsibility section (page 27).

Divisional highlights

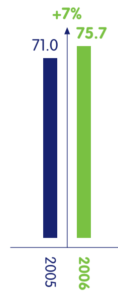
UK Retail Banking

- Good income growth of 4 per cent supported by second half acceleration to 6 per cent.
- Strong sales growth in each key distribution channel; overall product sales up 16 per cent.
- Excellent progress in growing the current account customer franchise, with a 59 per cent increase in target customer current account recruitment.
- Excellent cost control, with a clear focus on improving processing efficiency and service quality.
- Substantial improvements in levels of customer satisfaction.

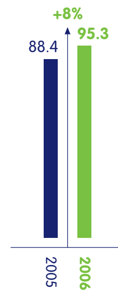
Income and cost growth 2006*



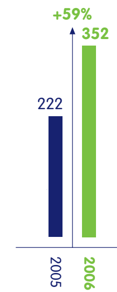
Customer deposits £bn



Group UK mortgage balances £bn



Target customer recruitment 000s

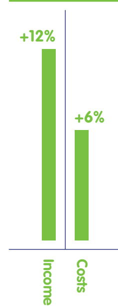


* Excluding 2005 provisions for customer redress.

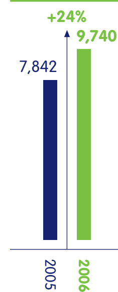
Insurance and Investments

- Significantly improved profit performance. Profit before tax increased by 15 per cent to £950 million.**
- Good income growth. Income, net of insurance claims, increased by 12 per cent, exceeding cost growth of 6 per cent.**
- Excellent sales performance. 24 per cent increase in Scottish Widows' present value of new business premiums.
- Excellent progress in increasing bancassurance sales, up 62 per cent, with OEIC sales more than doubled.
- Good momentum maintained in sales through Independent Financial Advisers. Sales increased by 14 per cent.
- Improved profitability. Life, pensions and OEICs new business profit increased by 36 per cent. Good improvement in new business margin.
- Excellent capital position of Scottish Widows maintained.
- Good progress with General Insurance's strategy to develop its manufacturing business and build distribution capability.

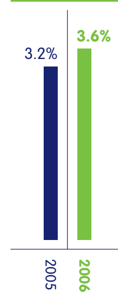
Income and cost growth 2006**



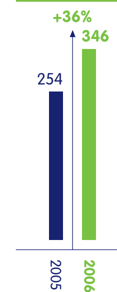
New business sales £m



New business margin



New business profit £m

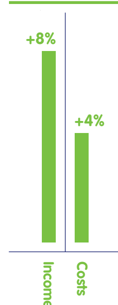


** Excluding volatility and insurance grossing. Also excludes the impact of 2005 capital repatriation and strengthening of reserves for mortality.

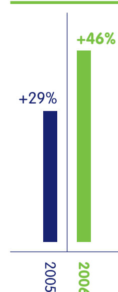
Wholesale and International Banking

- Profit before tax increased by 8 per cent to £1,640 million.
- Strong income growth, up 8 per cent, supported by a 46 per cent increase in cross-selling income.
- Income growth exceeded cost growth of 4 per cent. Continued investment in people and systems to support new product capabilities.
- Continued strong trading momentum. Substantial increase in trading surplus, up 14 per cent, to £1,948 million.
- Corporate asset quality remains strong.
- Further good progress in delivering the strategy to build an integrated wholesale bank for corporate markets, with a 13 per cent increase in Corporate Markets profit before tax.
- Continued strong growth in Business Banking with a 26 per cent growth in profit before tax. Lloyds TSB has retained its leading position as the bank of choice for start-up businesses.

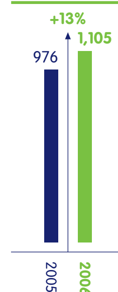
Income and cost growth 2006



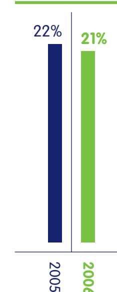
Growth in cross-selling income



Corporate Markets profit before tax £m



Market share of Business Banking start-ups



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Presentation of information

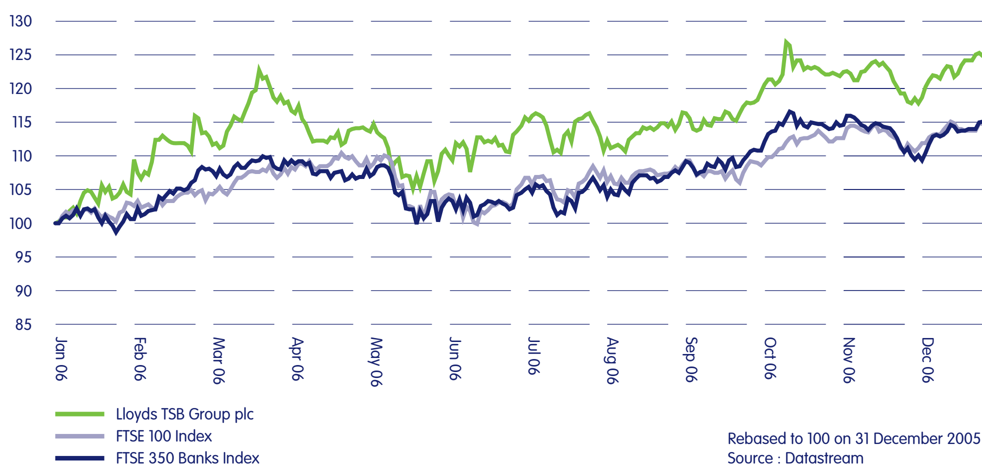
The impact of the implementation of International Financial Reporting Standards ('IFRS') in 2005, and in particular the increased use of fair values, has led to greater earnings volatility than was previously the case under UK GAAP. In order to provide a more comparable representation of underlying business performance, this volatility has been separately analysed for the Group's insurance and banking businesses. In addition, the profit and loss on the sale and closure of businesses in 2005 has been separately analysed in the Group's results. A reconciliation of this basis of presentation to the statutory profit before tax is shown on page i. Certain commentaries separately analyse the impact in 2006 of the one-off pension schemes related credit and, in 2005, of customer redress provisions and the strengthening of reserves for annuitant mortality.

For 2006, the Group has introduced supplementary financial reporting relating to Scottish Widows Group using European Embedded Value ('EEV') Principles as published by the Chief Financial Officers' Forum in 2004. The Group has also aligned the accounting for insurance products which are recognised on an embedded value basis under IFRS to a basis consistent with relevant EEV Principles.

We are building our business by

- deepening customer relationships
- enhancing product capabilities
- improving processing efficiency
- working capital harder

24.8% total return to shareholders



I am delighted to be able to report that the Group has delivered another strong performance – building on the improved earnings momentum that has been achieved over the last few years.

Group overview

The real strength of Lloyds TSB lies in its broadly based, well positioned set of businesses in both the retail and corporate financial services markets. During 2006 we performed strongly throughout the Group but, equally importantly, each division continues to build its franchises for long-term, sustainable growth. In each division we have strong customer relationships, broad distribution strength and well respected brands. We see in each rising levels of customer satisfaction and advocacy, strong sales performances, high levels of new customer recruitment and greater relationship depth. There are, of course, challenges in our market place – slow growth in consumer credit markets, increased levels of impairment and an ongoing regulatory burden. But we are confident in our ability to continue to perform well.

In the Retail Bank, we have a leading market share of current accounts, with 21 per cent of the UK market. We also have a strong position in many other key product areas, such as savings, mortgages and credit cards, and an excellent distribution network, with over 2,000 branches and one of Europe's leading telephone and internet banks. Our Insurance and Investments division benefits from having one of the UK's most recognised life and pensions brands in Scottish Widows, and we also have a very successful general insurance business. In our Wholesale and International Banking division, we have strong customer portfolios in both corporate banking, where Lloyds TSB was once again rated the best corporate bank in the UK by the Confederation of British Industry, and in small business banking, where we have maintained a leading position in the key small business start-up sector, an important feeder market. All of these businesses are focused on better meeting the needs of all our customers, and ensuring that Lloyds TSB is a bank that continues to build life-long customer relationships.

Over the last few years our management team has achieved a great deal against its twin objectives: to improve the financial performance of the Group significantly, and to invest for the future in building strong customer franchises. In this way we will continue to create value for you, our shareholders.

The board has declared a final dividend of 23.5p per share, making a total for the year of 34.2p (2005: 34.2p). This represents a dividend yield of 6 per cent, calculated using the 31 December 2006 share price of 571.5p.

Corporate responsibility

Alongside our twin objectives, the Group looks to benefit the broader community. Lloyds TSB staff continue to support a wide range of community programmes, giving of their time and energy as well as providing financial resource. We are immensely proud of the work that the Lloyds TSB Foundations do throughout the UK, making a significant difference to the lives of so many thousands of people each year. In 2006 we gave £34 million in support of the work of the Lloyds TSB Foundations and this figure will increase to £37 million in 2007. Over the last 10 years, we have given a total of over £300 million to the Foundations, making Lloyds TSB one of the largest charitable donors in the United Kingdom.

We recognise the challenge posed by global climate change and we are committed to making meaningful reductions in our carbon footprint. We have already set a target to reduce property related CO_2 emissions by 30 per cent, and we aim to enhance this plan through the introduction of a carbon management programme and other initiatives. In addition, through Lloyds TSB Corporate Markets, we continue to invest in renewable energy projects.

People

For me, one of the real delights of the last few months has been the opportunity to get to know so many people at all levels in Lloyds TSB. What I have found is a tremendous 'buzz' around the Group created by the enthusiasm, the dedication, the professionalism and the desire to succeed of all the staff I have met. An example, of course, is set from the top by our very high calibre senior management team, a number of whom have recently joined the Group, who are so committed to growing our businesses successfully, and they encourage what is already a high performance culture across the organisation. We operate in a highly complex, ever changing environment and in a challenging and competitive world. It is the continuing and committed endeavours of our staff that enable us to achieve success. On behalf of the whole of the board, I would like to thank the whole of the Lloyds TSB team most sincerely for their continued commitment and hard work.

Board changes

Maarten van den Bergh retired as chairman of Lloyds TSB Group at the end of the last annual general meeting, having served the Group so well over five years. I want to pay tribute to Maarten's tremendous contribution and to thank him on behalf of the board, the staff and the shareholders.

Angela Knight left at the end of October following her appointment as chief executive of the British Bankers' Association. In that role she will provide great leadership to our industry, but we will miss her contribution on the board. We wish her great success in her new role. DeAnne Julius has decided to retire from the board at the annual general meeting, having served as a non-executive director for more than five years. We shall miss her wide experience and wise counsel.

We wish them all well for the future.

Outlook

We continue to invest in the quality of service we give to our customers and in the quality of the people we employ to serve them. As a result, we have seen improvements in our customer satisfaction and customer advocacy scores, in our employee engagement scores and in our sales performance. Taken together with our balance of quality performing businesses, I believe this puts Lloyds TSB in great shape for 2007 and beyond.

Sir Victor Blank
Chairman
22 February 2007

In Retail Banking

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

In Insurance and Investments

our focus is on profitability and returns, combined with strong new business sales and capital management

2006 was another strong year for the Group as we continued to make progress against our strategic plan and delivered both good growth and high returns. We are reporting† a growth in profits of 8 per cent and a 25.1 per cent return on equity, building on the momentum established in recent years. We also achieved a total return for shareholders of 24.8 per cent, which compares very favourably to our peers.

The results reflect a strong performance across each of our three divisions, as we delivered good profitable growth in each, and once again we delivered positive jaws as the rate of growth in income exceeded that of costs.

Our business model is based on building long-lasting relationships with our customers, meeting more of their financial needs and thereby generating sustainable, high quality earnings growth. Our success is reflected in higher customer satisfaction scores, rising levels of customer recruitment and a significant increase in sales. We are continuing to grow strong customer franchises that support our future development.

We have established a strong track record of driving efficiency improvements and I am pleased that in 2006 we improved our cost:income ratio to 50.8 per cent, from 52.8 per cent in 2005. This was achieved by our continued commitment to a range of quality improvement programmes such as lean manufacturing, which enable us to enhance the service we deliver to our customers at a lower cost. We have extended our group wide efficiency programme that is also allowing us to structurally reduce our cost base. As we continue to improve our efficiency and effectiveness, we are creating additional capacity for further investment to support our future growth plans.

As we expected, we have seen signs of stabilisation in the unsecured consumer portfolio, which resulted in a reduction in retail impairments in the second half of the year. This reflects our long established focus on lending to existing customers, where we have better information, and tightening in our credit criteria in previous periods. Our secured consumer portfolios remain in good shape, reflecting our traditional emphasis on the prime mortgage market place. In the Corporate sector, asset quality has remained strong, with the increase in impairments reflecting a reduction in recoveries, compared to last year.

One of the cornerstones of our business model is engaging our staff as we believe this is critical to driving customer satisfaction. I am pleased that we again achieved record employee engagement scores in 2006. These scores match those achieved by other high performing companies, and reflect the focus we place on developing our people in support of our strategy. We have also continued to strengthen the broader management team, which is enhancing our ability to grow the business in a sustainable fashion.

I am pleased with the progress we made during the year. In line with the second phase of our strategic plan, we are building strong customer franchises, improving our product capabilities, enhancing our processing efficiency and working our capital harder. We have made considerable progress across each of the divisions.

The Retail Bank delivered a 5 per cent improvement in profit before tax, as the rate of revenue growth accelerated from 3 per cent in the first half to 6 per cent in the second. The strong growth in the trading surplus, up 10 per cent, was underpinned by positive jaws of 6 percentage points as income growth of 4 per cent was accompanied by productivity improvements that led to costs being reduced by 2 per cent.

The Retail Bank has made considerable progress against its key priorities. By enhancing our customer service, re-engineering processes and developing a series of new and innovative products and services, we are able to offer customers compelling reasons to choose Lloyds TSB.

The success is reflected, for instance, in increased levels of new target current account customer recruitment, which rose 59 per cent year-on-year. In addition, total sales volumes in the Retail Bank grew by 16 per cent, led by a 30 per cent increase in branch sales. Of particular note has been the change in the sales mix and the development of better quality, more annuity-like revenue streams through increased volumes of savings and bancassurance products.

In Insurance and Investments, profit before tax on a like-for-like basis increased by 15 per cent. We have excellent income growth, of 12 per cent, and firm cost control, which resulted in positive jaws of 6 percentage points. Each of the businesses within the division performed strongly and we saw good profitable growth through both the branch network and IFA distribution channels.

Scottish Widows delivered another very good performance, with sales rising 24 per cent on the prior year and we increased our new business profit by 36 per cent. We continue to deliver on our bancassurance performance, with a 62 per cent increase in sales, supported by our simplified product range and new customer offers. In the IFA channel, our emphasis is on growing the business profitably and we saw an increase in sales of 14 per cent.

Scottish Widows remains very well capitalised and in addition to the payment of a £206 million regular dividend to the Group in March 2006, a further £540 million distribution was made in December 2006. We continue to explore a number of opportunities to repatriate further surplus capital from Scottish Widows in 2007.

Our General Insurance business continued to grow successfully, delivering a 16 per cent growth in profits. The results particularly reflect the growth in sales to our franchise customers in retail and Business Banking, as well as continued investment in enhancing our service performance and claims processing capacity.

In Wholesale and International Banking, we made further excellent progress in our core businesses with the division delivering an 8 per cent increase in profit before tax. This has been built on our two key franchises, Corporate Markets and Business Banking, and they again delivered excellent levels of profitable growth. Whilst we are continuing to invest in these franchises to support our growth ambitions, this was achieved within our discipline of positive jaws with income growth of 8 per cent whilst costs grew by 4 per cent. The division also includes the Asset Finance business, which was affected by the market-wide slowdown in consumer lending and increased impairments in its retail portfolios.

Our Corporate Markets business delivered another excellent performance, with a 13 per cent improvement in profits, supported by a 48 per cent increase in cross-selling income. The improvement in profitability reflects the success of our strategy of integrating our product and relationship businesses to meet our customers' needs. We are continuing to receive external recognition for our achievements and we were especially pleased to be awarded the CBI Corporate Bank of the Year Award for the second year running in 2006. We are maintaining our focus on building relationships and this is helping us to sustain strong asset quality performance in this portfolio.

The performance in Business Banking is again underpinned by a very good performance in sales, as we continue to attract a market leading share of business start-ups. We are delivering on our strategy of building deeper customer relationships, with good levels of growth in customer lending and deposits, as well as continuing to raise the level of fee income. This helped to drive growth in profits of 26 per cent.

Outlook

Turning to 2007, we are well positioned to drive further growth as we continue to embed our

In Wholesale and International Banking

we are growing our earnings by deepening relationships with our business and corporate customers

business model. Whilst we are likely to face challenges in terms of the slower rate of growth in the unsecured consumer credit market and the increasing cost of regulation, each of the divisions has now established a strong track record for delivering enhanced customer satisfaction and an improved sales performance, which is resulting in profitable business growth. We will also continue to deliver on our productivity programmes across the business. In addition to improving our efficiency and effectiveness, these also result in better customer satisfaction and enhance our ability to fund increased investment for future growth.

We are a customer focused organisation, and our improved customer satisfaction scores are an important factor in our continued success. In 2007, we will implement a further range of new products and services that meet the needs of our customers, which are underpinned by our 'treating customers fairly' principles and that reinforce our strategy of developing deep, long-lasting customer relationships. Over the past few years, we have developed a strong risk and control infrastructure and this plays an important role in enabling us to drive profitable growth in a controlled and sustainable fashion.

The Group's key market place is the UK, in the retail and corporate banking, and insurance sectors. Retail banking markets have shown strong rates of growth in recent years, notably in unsecured consumer borrowing but the combination of higher interest rates and higher living costs have started to normalise future growth expectations. We forecasted this change last year and have increasingly focused our strategies towards non-lending related product sales and have made good progress in growing current account, bank savings and bancassurance product sales. The markets for mortgage lending, bank savings and life, pensions and investment products are expected to continue to show good rates of growth over the next few years and this will support our growth plans.

Wholesale markets have shown strong growth over the past several years, and cyclically low levels of bad debt. Our opportunities in these markets centre on deepening our customer relationships and cross-selling more fee-based products to our corporate and small business customers. Over the last few years, we have increased cross-selling income substantially, and we believe there is still a great opportunity.

In the competitive financial services market, and with customers able to exercise choice amongst alternative providers, shareholder and customer value creation are closely linked. Shareholder value is created by attracting and retaining customers and winning a greater share of their financial services business. We have a significant opportunity to leverage our customer relationships to build market share in other products. We have significant strengths, in our portfolio of high quality brands, our customer franchises, our multi-channel distribution capability, our high levels of customer satisfaction and our knowledge and understanding of our customers. Our growth will come from leveraging these key strengths.

We believe that successful banks benefit from operating in a vibrant and healthy society. Many thousands of our staff participate in activities that make a significant contribution to the communities in which they live and work. In addition, the four Lloyds TSB Foundations have played a significant role in supporting a broad range of charities, across the United Kingdom, and make a critical difference to many thousands of people.

Summary

In summary, 2006 was another strong year for the Group. We have delivered a good financial performance whilst continuing to build our customer franchises to support future earnings growth. We will continue to extend the reach and depth of our customer relationships whilst improving productivity and efficiency in 2007 and beyond. In doing so, I believe that we can deliver sustained double-digit economic profit growth over time.

Finally, let me again express my continued thanks to all of the staff who work for the Lloyds TSB Group. They deliver great service for our customers and their wonderful efforts drive our growing success. Many thousands of our staff are also shareholders in the Group, and I am delighted that they continue to participate in the success of the Company.

J Eric Daniels
Group Chief Executive
22 February 2007

†To enable meaningful comparisons to be made with 2005, the commentaries in this statement exclude volatility, the 2006 pension schemes related credit and, in 2005, profit on sale and closure of businesses, customer redress provisions and the strengthening of reserves for annuitant mortality.

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Forward looking statements

This annual report includes certain forward looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995 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', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional 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, foreign exchange 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, deflation, interest rate, policies of the Bank of England and other G-7 central banks, exchange rate, market and monetary fluctuations; changing demographic developments including consumer spending, saving and borrowing habits, technological changes, natural and other disasters, 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, taxation, government policies or accounting standards or practices; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; 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 US Securities and Exchange Commission, Lloyds TSB Group plc's annual review, half year announcement, 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.

Summary of Group results

In 2006, statutory profit before tax was £4,248 million, an increase of £428 million, or 11 per cent, compared to £3,820 million in 2005. Profit attributable to equity shareholders increased by £310 million, or 12 per cent, to £2,803 million and earnings per share increased by 12 per cent to 49.9p.

To enable meaningful comparisons to be made with 2005, the income statement commentaries below exclude volatility, the 2006 pension schemes related credit and, in 2005, profit on sale and closure of businesses, customer redress provisions and the strengthening of reserves for annuitant mortality.

Continued earnings momentum

Profit before tax increased by £263 million, or 8 per cent, to £3,713 million, underpinned by continued momentum in all divisions. Revenue growth of 6 per cent exceeded cost growth of 2 per cent, with each division delivering stronger year-on-year revenue growth than cost growth. Our strategy to deepen customer relationships at the same time as improving productivity has led to strong levels of trading surplus growth in each division. Earnings per share increased by 6 per cent to 46.9p and economic profit also increased by 6 per cent to £1,692 million. The post-tax return on average shareholders' equity remains strong at 25.1 per cent.

Balanced income growth

Overall income growth of 6 per cent reflects good progress in delivering our strategies of increasing income from both new and existing customers, with good growth in both assets and liabilities, as well as increased fee income.

Group net interest income, excluding insurance grossing, increased by £192 million, or 4 per cent. Strong levels of customer lending growth in Business Banking and Corporate Markets, and good growth in mortgages, more than offset the expected slowdown in the rate of growth in unsecured personal lending. Total assets increased by 11 per cent to £344 billion, with an 8 per cent increase in loans and advances to customers. Customer deposits increased by 6 per cent to £139 billion, supported by good growth in current account credit balances and savings balances in the retail bank.

The net interest margin from our banking businesses decreased by 11 basis points, from 3.11 per cent in 2005 to 3.00 per cent in 2006. Whilst individual product margins were broadly stable, stronger growth in finer margin mortgage and corporate lending led to a negative mix effect which accounted for 8 basis points of the margin decline.

Other income, net of insurance claims and excluding insurance grossing, increased by £425 million, or 9 per cent, to £5,056 million. This reflected an improvement in fees and commissions receivable as a result of higher income from strong growth in added value current accounts and private banking fees, and an increase in Open Ended Investment Company ('OEIC') sales. In addition, good growth was achieved in cross-selling income from sales and structuring, and debt capital markets activities within Corporate Markets.

Excellent cost control

The Group continues to make significant investment in improving levels of service quality and processing efficiency, the benefits of which are seen in an excellent cost performance. During 2006, operating expenses increased by only 2 per cent to £5,429 million. Over the last 12 months, staff numbers have fallen by 4,167 (6 per cent) to 62,630, largely as a result of greater efficiency in back office processing centres, where the unit costs of transaction processing continue to fall, and the increased automation of administration carried out in the branch network. These improvements in operational effectiveness have resulted in a Group cost:income ratio which is 2 percentage points lower at 50.8 per cent.

The Group's programme of productivity improvement initiatives has exceeded its 2006 target, delivering net benefits of £47 million, largely reflecting earlier than expected procurement benefits. In 2006 we invested £95 million in a number of initiatives, and delivered benefits of £142 million. During 2007, we expect net benefits to total approximately £125 million and, in 2008, the Group expects to increase the net annual benefits of the programme to circa £250 million.

Satisfactory asset quality

Impairment losses on loans and advances increased by 20 per cent to £1,555 million. Our impairment charge expressed as a percentage of average lending was 0.83 per cent, compared to 0.76 per cent in 2005. Impaired assets were 3 per cent lower at £4,006 million, and now represent 2.0 per cent of total lending, down from 2.3 per cent at 31 December 2005.

In UK Retail Banking, impairment losses on loans and advances increased by £173 million, or 16 per cent, to £1,238 million, reflecting more customers with higher levels of indebtedness experiencing repayment difficulties, as well as higher levels of customer insolvency. As a result of tightening our credit criteria the quality of new business written over the last two years has improved. This, as well as improvements in the Group's collection procedures and better than assumed recoveries, has resulted in a reduction in the retail impairment charge in the second half of 2006, compared to the first half.

Towards the end of 2006 we experienced some signs of stabilisation in the rate of our customers filing for bankruptcy and a slowdown in the rate of growth in Individual Voluntary Arrangements (IVAs). In addition, the increased sharing of industry-wide customer data, particularly with regard to credit card use, has improved our customer understanding further and this has led to a reduction in a number of credit limits. Whilst the rate of growth in the number of customers filing for bankruptcy and IVAs remains a key factor in the outlook for retail impairment, we expect that the rate of growth in the unsecured retail lending impairment charge in 2007 will be significantly lower than that experienced in 2006.

As expected, the Wholesale and International Banking charge for impairment losses on loans and advances increased by £120 million to £308 million, reflecting lower levels of releases and recoveries in Corporate Markets than in 2005, and a higher level of consumer finance lending impairment in the Asset Finance business. Overall asset quality remains good and the level of new corporate provisions remained at a low level in 2006, although we expect a return to more normal levels of impairment over time.

Capital position remains robust

At the end of December 2006, the total capital ratio was 10.7 per cent and the tier 1 ratio 8.2 per cent. During the year, risk-weighted assets increased by 8 per cent to £156.0 billion, as strong growth in our mortgage and Corporate Markets businesses was partly offset by the impact of the Group's new securitisation programme. 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 6 per cent, calculated using the 31 December 2006 share price of 571.5p.

Over the last 12 months, we have significantly improved our capital flexibility through the initiation of our securitisation programme and the repatriation of further capital from Scottish Widows to the Group. We have also increased the variety and flexibility of our capital raising programme, with the issuance of both sterling and US dollar preference shares, resulting in a more balanced capital structure. During 2006, we completed two mortgage securitisation transactions totalling over £10 billion as well as a £1 billion synthetic securitisation of commercial banking loans. Over the next few years, we expect to expand our securitisation programme to include a broader range of asset classes.

Scottish Widows remains strongly capitalised and, at the end of December 2006, the working capital ratio of the Scottish Widows Long Term Fund was an estimated 18.9 per cent (page 42) and the risk capital margin was covered over 17 times. In the second half of 2006, an additional capital repatriation of £540 million was made to the Group, bringing the total for the year to approximately £750 million. This is in addition to capital repatriation of £1 billion in 2005. We continue to examine opportunities to improve our capital efficiency and have work under way that we believe will allow Scottish Widows to repatriate further capital to the Group in 2007, whilst maintaining a strong capital position.

The Group is making good progress in its preparations for the introduction of Basel 2. We commenced parallel running at the end of 2006, and our credit risk waiver application was submitted in December 2006. Whilst our work is well advanced, some uncertainty remains with regard to the regulatory treatment of certain issues for capital purposes. The Group expects to maintain satisfactory capital ratios throughout the transition to Basel 2 in 2008, and continues to expect no deduction of investments in insurance subsidiaries from tier 1 capital until at least 2012.

Introduction of EEV reporting

Under IFRS, only insurance policies and discretionary participating investment business are accounted for on an embedded value basis. In 2006, this basis has been revised to be consistent with relevant EEV Principles. Although there is no impact on the 2005 income statement, the impact on the 2006 income statement is to reduce profit before tax, excluding volatility, by £18 million. In line with industry best practice, the Group has introduced supplementary disclosures which show life, pension and OEIC products accounted for on an EEV basis, as we believe that EEV reporting provides for increased clarity, transparency and comparability of financial information.

On an IFRS basis, Scottish Widows' 2006 profit before tax, excluding volatility, totalled £730 million, whilst on an EEV basis 2006 profit before tax, excluding volatility and other non-recurring items, was £852 million. Similarly, the embedded value on an EEV basis at 31 December 2006 was £6,413 million (2005: £6,386 million), compared to the embedded value on an IFRS basis of £5,368 million (2005: £5,478 million).

Improved Group pension schemes position

The Group's defined benefit pension schemes' gross deficit at 31 December 2006 improved by £1,195 million to £2,099 million, comprising net recognised liabilities of £2,362 million partly offset by unrecognised actuarial gains of £263 million. This improvement largely reflects continued strong returns from the schemes' assets, Group contributions to the schemes and an increase in the real discount rate used to value the schemes' liabilities. The decision to stop augmenting the pension entitlement of employees taking early retirement reduced the pension deficit by £129 million.

In 2006, the Group reached agreement with the Trustees of the Group's two principal pension schemes to fund the schemes' actuarial funding deficits of approximately £1.5 billion, as at 30 June 2005, over a period of ten years. The Group also indicated that it expected to continue making additional voluntary contributions to the schemes. Further interim actuarial valuations of the schemes were carried out on behalf of the schemes' Trustees as at 30 June 2006; these valuations showed a significant reduction in the deficits to approximately £0.3 billion.

Delivering strong and balanced trading momentum

During 2006, the Group has delivered strong and balanced trading momentum, with good sales growth, across all of the divisions. Substantial improvements in productivity and operational efficiency have resulted in excellent cost control and widened positive jaws. Asset quality remains satisfactory, our post-tax return on equity remains high, economic profit continues to increase and we have a robust capital position.

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 16 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 2,000 branches of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester as at the end of 2006.

Internet banking. Internet banking provides online banking facilities for personal customers. Some 4.4 million customers have registered to use Lloyds TSB Group's internet banking services. At the end of 2006, these customers were conducting more than 57 million transactions per month online, a 24 per cent increase on 2005.

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 2006, some 5.3 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 62 million calls during 2006.

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 2006, personal customers of Lloyds TSB Bank and Lloyds TSB Scotland were able to withdraw cash and check balances through some 4,100 ATMs at branches and external locations around the country. In addition, our personal customers have access to over 60,000 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.

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 2006.

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, Mortgage Direct. 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 2006 of £95.3 billion, representing a market share of 8.8 per cent.

UK Wealth Management. Wealth Management provides financial planning and advice for Lloyds TSB's affluent customers, providing financial solutions across investments, retirement planning and income, trusts, tax and estate planning as well as share dealing. Expert advice is provided through a large population of Lloyds TSB financial planners who can be accessed via the retail branch network and Private Banking offices nationwide. Customers are also provided with access to relationship banking as part of Lloyds TSB Private Banking, one of the largest private banks in the UK.

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 2006 funds under management amounted to some £102 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 circa 3,000 people in Corporate Banking, Structured Finance and Financial Markets, plays an integral role in leveraging and expanding the customer franchise and building deep, long-lasting relationships with around 18,000 corporate customers.

Corporate Banking manages the core customer franchise, providing a relationship-based financial and advisory service to the corporate market place through dedicated regional teams throughout the UK and key strategic locations abroad, including New York. Customers have access to expert advice and a broad range of financial solutions. Relationship Managers act as a conduit to product and service 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. Through its Debt Capital Markets capability, Financial Markets delivers a range of solutions across a number of markets encompassing debt origination and syndication, securitisation, structured credit, credit derivatives and private placements.

Registrars. Lloyds TSB Registrars is the UK's leading provider of share registration services and employee share plans. It acts for over 650 client companies, including around 60 per cent of the FTSE 100.

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 600,000 small businesses managed by business managers based in 500 locations throughout the UK. 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 2006. 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 Europe, 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, France, 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 now expected to complete in 2007 after receipt of the required regulatory approval.

Summarised segmental analysis

2006	UK Retail Banking £m	Insurance and Investments** £m	Wholesale and International Banking £m	Central group items £m	Group excluding insurance gross up £m	Insurance gross up** £m	Group £m
Net interest income	3,642	56	2,385	(457)	5,626	78	5,704
Other income	1,621	1,740	1,827	68	5,256	8,306	13,562
Total income	5,263	1,796	4,212	(389)	10,882	8,384	19,266
Insurance claims	–	(200)	–	–	(200)	(8,369)	(8,569)
Total income, net of insurance claims	5,263	1,596	4,212	(389)	10,682	15	10,697
Operating expenses	(2,476)	(646)	(2,264)	(51)	(5,437)	8	(5,429)
Trading surplus (deficit)	2,787	950	1,948	(440)	5,245	23	5,268
Impairment losses on loans and advances	(1,238)	–	(308)	(9)	(1,555)	–	(1,555)
Profit (loss) before tax†	1,549	950	1,640	(449)	3,690	23	3,713
Pension schemes related credit	–	–	–	128	128	–	128
Profit (loss) before tax*	1,549	950	1,640	(321)	3,818	23	3,841
Volatility							
– Banking	–	–	–	(3)	(3)	–	(3)
– Insurance	–	84	–	–	84	–	84
– Policyholder interests	–	–	–	–	–	326	326
Profit (loss) before tax	1,549	1,034	1,640	(324)	3,899	349	4,248

2005	UK Retail Banking £m	Insurance and Investments** £m	Wholesale and International Banking £m	Central group items £m	Group excluding insurance gross up £m	Insurance gross up** £m	Group £m
Net interest income	3,483	79	2,265	(393)	5,434	310	5,744
Other income	1,574	1,587	1,628	39	4,828	11,684	16,512
Total income	5,057	1,666	3,893	(354)	10,262	11,994	22,256
Insurance claims	–	(197)	–	–	(197)	(11,989)	(12,186)
Total income, net of insurance claims	5,057	1,469	3,893	(354)	10,065	5	10,070
Operating expenses	(2,522)	(607)	(2,181)	(24)	(5,334)	13	(5,321)
Trading surplus (deficit)	2,535	862	1,712	(378)	4,731	18	4,749
Impairment losses on loans and advances	(1,065)	–	(188)	(46)	(1,299)	–	(1,299)
Profit (loss) before tax†	1,470	862	1,524	(424)	3,432	18	3,450
Customer redress provisions	(150)	–	–	–	(150)	–	(150)
Strengthening of reserves for mortality	–	(155)	–	–	(155)	–	(155)
Profit (loss) before tax*	1,320	707	1,524	(424)	3,127	18	3,145
Volatility							
– Banking	–	–	–	(124)	(124)	–	(124)
– Insurance	–	438	–	–	438	–	438
– Policyholder interests	–	–	–	–	–	311	311
Profit (loss) on sale and closure of businesses	–	–	(6)	56	50	–	50
Profit (loss) before tax	1,320	1,145	1,518	(492)	3,491	329	3,820

* Excluding volatility and profit (loss) on sale and closure of businesses; † also excludes pension schemes related credit and, in 2005, customer redress provisions and the strengthening of reserves for mortality.

** The Group's income statement includes substantial amounts of income and expenditure which are attributable to the policyholders of the Group's long-term assurance funds. These items have no impact upon the profit attributable to equity shareholders and are separately analysed within the segmental analysis in order to provide a clearer representation of the underlying trends within the Insurance and Investments segment.

In the summarised segmental analysis above, and on pages 14 to 23, the results of the Goldfish business, which was sold in December 2005, are included in Central group items.

Divisional results

UK Retail Banking

	2006 £m	2005 £m
Net interest income	3,642	3,483
Other income	1,621	1,574
Total income	5,263	5,057
Operating expenses	(2,476)	(2,522)
Trading surplus	2,787	2,535
Impairment losses on loans and advances	(1,238)	(1,065)
Profit before tax, before provisions for customer redress	1,549	1,470
Provisions for customer redress	–	(150)
Profit before tax*	1,549	1,320
Cost:income ratio, before provisions for customer redress	47.0%	49.9%

* Excluding profit on sale and closure of businesses.

	31 December 2006	31 December 2005
Total assets	£108.4bn	£102.9bn
Risk-weighted assets – post securitisation	£59.1bn	£60.4bn
Risk-weighted assets – pre securitisation	£64.2bn	£60.4bn
Customer deposits	£75.7bn	£71.0bn

Profit before tax from UK Retail Banking, before provisions for customer redress, increased by £79 million, or 5 per cent, to £1,549 million, as strong levels of business growth were partly offset by the impact of higher impairment losses. Increased income from the Group's mortgage lending and customer deposit portfolios more than offset the impact of lower levels of unsecured consumer lending and related insurance products. Total income increased by £206 million, or 4 per cent, notwithstanding a significant decrease in income from creditor insurance, whilst costs fell by 2 per cent. As a result, the trading surplus increased by 10 per cent.

Product net interest banking margins remained broadly stable as lower personal loan margins were offset by improved deposit and credit card margins. The adverse mix effect of finer margin mortgages growing faster than unsecured personal lending led to a slight overall reduction in the divisional margin.

Operating expenses, excluding provisions for customer redress, remained very well controlled, decreasing by 2 per cent. The significant improvements made in the rationalisation of back office operations to improve efficiency have been combined with a substantial improvement in the levels of customer service and satisfaction. We continue to increase the proportion of front office to back office staff in the branch network and have substantially improved our sales productivity.

During 2006, UK Retail Banking has made substantial progress in each of its key strategic priorities: growing income from its existing customer base; expanding its customer franchise; and improving productivity and efficiency. In each of these areas, a key focus has been on improving sales of recurring income products, such as savings and bancassurance products. This has started to generate a better quality, more annuity-like, revenue stream and has supported the accelerating rate of revenue growth in the second half of 2006, compared to that in the first half of the year.

Growing income from the customer base

Overall sales increased by 16 per cent, with strong performance improvements in each key distribution channel and over a broad range of products, particularly current accounts, bank savings and OEICs. This growth has been supported by higher levels of new product innovation during the year with the launch, for example, of enhanced regular savings products. In addition, a number of improved service initiatives, such as the introduction of instant cheque value and the recent 'Save the Change' launch, have been made. These have improved both customer value and our brand perception and will, we believe, create further shareholder value over time.

Over the last 12 months, substantial progress has been made in re-balancing the sales mix towards an increasing focus on non-lending related income streams, with a significant year-on-year increase in the sale of added value current accounts, bank savings products, bancassurance products and in the level of retail bank customer introductions to the Group's wealth management business. Our wider savings product range has led to an improved market share of bank savings and an increase in savings margins. Credit balances on current accounts and savings and investment accounts increased by 7 per cent to £75.7 billion, supported by good growth in Wealth Management and bank savings. Branch network sales rose by 30 per cent and product sales via the internet and telephone increased by 33 per cent as customers increasingly choose to buy through direct channels as well as through our branches. These increases were offset by a 15 per cent reduction in sales from direct mail, following a significant reduction in our direct mailing activity, particularly in the credit card market.

The Group has also continued to deliver good levels of growth in the mortgage business, particularly focusing on better quality, prime mortgage business and seeking to maintain economic returns in what, in 2006, was a competitive market. Gross new mortgage lending for the Group totalled £27.6 billion (2005: £26.0 billion). Mortgage balances outstanding increased by 8 per cent to £95.3 billion and net new lending totalled £6.9 billion, resulting in a market share of net new lending of approximately 10 per cent of the prime mortgage market and 6.3 per cent of the overall mortgage market.

In unsecured consumer lending, tightening of credit criteria over the last two years, together with the slowdown in consumer demand, has led to unsecured consumer credit balances remaining at broadly the same level as last year end. Personal loan balances outstanding at the year end were £11.1 billion, an increase of 1 per cent, and credit card balances totalled £6.9 billion, a decrease of 5 per cent.

Expanding the customer franchise

In addition to growing product sales from existing customers, the Group has made excellent progress in expanding its customer franchise. Target customer current account recruitment increased by 59 per cent, compared with last year. With a renewed focus on the student and graduate market, the Group has also made considerable progress, and this has led to a 133 per cent increase in student account recruitment and a doubling of market share in this market.

Wealth Management continues to make strong progress. The Investment Portfolio Service ('IPS'), launched in 2005, continues to attract both existing and new clients. Approximately two thirds of our existing clients have now moved across to IPS whilst new client recruitment is up 86 per cent and new funds under management have grown by 88 per cent. Wealth protection sales have also seen good growth and banking deposits are up 16 per cent. This trend is expected to continue as we roll out further expansion plans, which include making more Private Bankers accessible to customers in key locations and reducing the complexity and cost of our private banking offers.

Improving productivity and efficiency

During 2006 we have made significant progress in reducing levels of administration and processing work carried out in branches, and increasing the number of branch network staff in customer facing areas and activities. This has resulted in a significant increase in sales and service resource, a higher level of product sales and a reduction of approximately 1,900 branch back-office administration roles. In addition, substantial progress has been made in improving and streamlining sales processes leading to a significant increase in seller effectiveness, with more product sales per customer interview, and significant reductions in the time taken to, for example, open a current account or transfer an account to us from another banking provider.

Impairment growth expected to slow significantly in 2007

Impairment losses on loans and advances increased by £173 million, or 16 per cent, to £1,238 million, reflecting the impact of more customers with higher levels of indebtedness experiencing repayment difficulties, and higher levels of bankruptcies and IVAs. The impairment charge as a percentage of average lending was 1.18 per cent, compared to 1.09 per cent last year. Over 99 per cent of new personal loans and 84 per cent of new credit cards sold during 2006 were to existing customers, where the Group has a better understanding of an individual customer's total financial position. Mortgage credit quality remains good and, as a result, the impairment charge was £5 million lower at £8 million for the year.

The rate of growth in the number of our customers filing for bankruptcy and IVAs remains a key factor in the outlook for retail impairment. Towards the end of 2006 we experienced some signs of stabilisation in the rate of customer bankruptcies and a slowdown in the rate of growth in IVAs. As a result, we believe that the rate of growth in the retail lending impairment charge in 2007 will be significantly lower than that experienced in 2006.

Insurance and Investments

Excluding volatility	2006 £m	2005 £m
Net interest income	56	79
Other income	1,740	1,587
Total income	1,796	1,666
Insurance claims	(200)	(197)
Total income, net of insurance claims	1,596	1,469
Operating expenses	(646)	(607)
Insurance grossing adjustment	23	18
Profit before tax, excluding strengthening of reserves for mortality	973	880
Strengthening of reserves for mortality	–	(155)
Profit before tax	973	725
Profit before tax analysis		
Life, pensions and OEICs*	701	655
General insurance	243	209
Scottish Widows Investment Partnership	29	16
Profit before tax*	973	880
Present Value of New Business Premiums ('PVNBP')	9,740	7,842
PNVBP new business margin (EEV basis)	3.6%	3.2%

* Excluding, in 2005, strengthening of reserves for mortality.

Scottish Widows Life, pensions and OEICs

Profit before tax increased by £46 million, or 7 per cent, to £701 million. In December 2005, Scottish Widows repatriated £800 million of surplus capital to the Group as part of a capital restructuring programme. This capital repatriation has the effect of reducing investment earnings and increasing funding charges by a total of £38 million in 2006. Adjusting 2005 for this impact, profit before tax increased by 14 per cent.

During 2006 Scottish Widows has made strong progress in each of its key business priorities: to maximise bancassurance success; to profitably grow IFA sales; to improve service and operational efficiency and to optimise capital management.

Maximising bancassurance success

In 2006, Scottish Widows' bancassurance sales increased by 62 per cent, building on the success of the simplified product range for distribution through the Lloyds TSB branch network, Business Banking and Wealth Management channels. Sales of OEICs were particularly strong, more than doubling year-on-year through the bancassurance channel. Towards the end of 2006, Scottish Widows launched a new protection product platform 'Protection for Life', which is expected to result in an increase in protection sales during 2007. In addition, in early 2007 a new protected OEIC product was launched in the bancassurance market to support sales of savings and investment products.

Profitably growing IFA sales

Sales through the IFA distribution channel increased by 14 per cent, largely reflecting the introduction of improved product and service offerings for corporate pensions which, together with increased promotional activity, resulted in excellent growth in corporate pension sales via the IFA channel, and good levels of post A-Day growth in retirement income products. Scottish Widows has also developed a new pensions platform for launch in early 2007 to support future pre and post retirement sales, and continues to increase its segmental focus on the IFA market to ensure maximum value is obtained from this market.

Improving service and operational efficiency

Operational efficiencies have continued to improve during 2006, and expense growth has been controlled to significantly below the rate of income growth. Scottish Widows' customer satisfaction levels continued to improve, as did levels of IFA satisfaction. Scottish Widows has again won a significant number of awards for service quality.

Optimising capital management

Scottish Widows' strong capital management has been reinforced by continuing to deliver improving capital efficiency and self-financing growth, a more capital efficient product profile, and improved internal rates of return and new business margins. As a result, the post-tax return on embedded value increased to 9.3 per cent, from 8.0 per cent last year. During 2006, surplus capital generated, excluding volatility and non-recurring items, in excess of the regular annual dividend totalled £227 million. £540 million of capital was repatriated to Lloyds TSB in December 2006, giving a total capital repatriation to the Group of over £1.7 billion over the last two years. We continue to explore a number of opportunities to repatriate surplus capital from Scottish Widows, in order to further improve capital efficiency.

Industry practice has historically been to measure new business sales on a weighted Annual Premium Equivalent ('APE') basis, where APE is calculated as the value of regular premium sales plus 10 per cent of single premium sales. Industry practice is moving towards an alternative basis of calculation – Present Value of New Business Premiums ('PVNBP'). This is calculated as the value of single premiums plus the discounted present value of future expected regular premiums. An analysis of new business sales on a PVNBP basis can be found in the following table.

Present Value of New Business Premiums ('PVNBP')	2006 £m	2005 £m
Life and pensions		
Savings and investments	1,300	1,465
Protection	232	255
Individual pensions	2,219	2,197
Corporate and other pensions	1,961	1,517
Retirement income	960	658
Managed fund business	348	535
Life and pensions	7,020	6,627
OEICs	2,720	1,215
Life, pensions and OEICs	9,740	7,842
Single premium business	7,321	5,636
Regular premium business	2,419	2,206
Life, pensions and OEICs	9,740	7,842
Bancassurance	3,421	2,114
Independent financial advisers	5,358	4,698
Direct	613	495
Managed fund business	348	535
Life, pensions and OEICs	9,740	7,842
New business margin (PVNBP)	3.6%	3.2%

Overall, sales in 2006 increased by 24 per cent reflecting, in particular, strong growth in the sales of OEICs and corporate pension products. Bancassurance sales improved significantly and were 62 per cent higher at £3,421 million, including excellent growth in the sales of OEICs through the branch network and to Lloyds TSB private banking clients. IFA sales grew 14 per cent to £5,358 million, supported by significant product and service enhancements in pensions and retirement income. Sales of savings and investment products declined during the year, following the limiting of investment in the Property Fund in June 2006, but this reduction was more than offset by a significant increase in the sale of OEIC and pension products.

Scottish Widows Investment Partnership

Pre-tax profit from Scottish Widows Investment Partnership ('SWIP') increased to £29 million, compared with £16 million in 2005, reflecting increased revenues from higher funds under management throughout the period. SWIP's assets under management increased by 7 per cent to £102 billion, and group wide funds under management increased by 4 per cent to £126 billion.

Results on a European Embedded Value ('EEV') basis

In May 2004, the Chief Financial Officers' Forum ('CFO Forum') published its EEV Principles and Guidance which set out a series of agreed standards for embedded value reporting. These EEV Principles establish a consistent treatment for the financial information provided for insurance and investment contracts and, in our view, allow a fuller recognition of the economic value being created. Compared with traditional embedded value, EEV Principles also provide a more appropriate valuation of in-force business which explicitly takes into account the cost of financial options and guarantees, and required capital, as well as non-market risks, such as mortality.

Lloyds TSB continues to report under IFRS, however, in line with industry best practice, the Group has introduced supplementary financial reporting relating to Scottish Widows on an EEV basis. The following EEV supplementary results have been prepared in accordance with the CFO Forum's EEV Principles and Guidance.

	2006			2005		
	Life and pensions £m	OEICs £m	Total £m	Life and pensions £m	OEICs £m	Total £m
Life, pensions and OEICs						
New business profit	287	59	346	231	23	254
Existing business						
– Expected return	361	42	403	330	31	361
– Experience variances	35	34	69	5	7	12
– Assumption changes	(129)	(4)	(133)	(147)	–	(147)
	267	72	339	188	38	226
Expected return on shareholders' net assets	160	7	167	202	7	209
Profit before tax, adjusted for capital repatriation*	714	138	852	621	68	689
Impact of £800 million capital repatriation to Group	–	–	–	38	–	38
Profit before tax*	714	138	852	659	68	727
Volatility			176			584
Strengthening of annuitant mortality reserves			–			(162)
Other items**			76			172
Total profit before tax			1,104			1,321
Attributed shareholder tax			(331)			(396)
Total profit after tax			773			925
New business margin (PVNBP)	4.1%	2.2%	3.6%	3.5%	1.9%	3.2%
Post-tax return on embedded value			9.3%			8.0%

* Excluding volatility, other items and, in 2005, the strengthening of reserves for mortality.

** Other items represent amounts not considered attributable to the underlying performance of the business. The figure in 2006 represents the benefits of the FSA's Policy Statement 06/14 and an intra-Group transfer of a portfolio of OEICs. The figure in 2005 represents a similar intra-Group transfer of OEICs, the capitalisation impact of a lower cost of capital following debt issuance, and an increase in the value of deferred tax assets.

Adjusting for the impact of last year's capital repatriation, EEV profit before tax from the Group's life, pensions and OEICs business increased by 24 per cent to £852 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 36 per cent increase in new business profit to £346 million. As a result of improvements in key individual product margins and strong sales of corporate pensions and OEICs the new business margin increased to 3.6 per cent, compared with 3.2 per cent for 2005.

Existing business profit increased by 50 per cent. Expected return has increased by 12 per cent to £403 million reflecting higher earnings on the larger value of in-force business at the start of the year. Positive experience variances were driven by lower than expected take-up rates on guaranteed annuity options in Life and pensions and by favourable lapse experience in OEICs. These were more than offset by negative assumption changes, primarily in respect of lapse assumptions in Life and pensions, and resulted in an overall net charge for experience variances and assumption changes, on an EEV basis, of £64 million. The equivalent net charge on an IFRS basis was £7 million. The expected return on shareholders' net assets has decreased, largely as a result of lower assumed rates of return on free assets.

Overall the post-tax return on embedded value increased to 9.3 per cent from 8.0 per cent.

This section provides further details of the Scottish Widows' EEV financial information.

Composition of EEV balance sheet	2006 £m	2005 £m
Value of in-force business (certainty equivalent)	3,220	3,466
Value of financial options and guarantees	(56)	(193)
Cost of capital	(248)	(262)
Non-market risk	(75)	(70)
Total value of in-force business	2,841	2,941
Shareholders' net assets	3,572	3,445
Total EEV of covered business	6,413	6,386

Reconciliation of opening EEV balance sheet to closing EEV balance sheet on covered business

	Shareholders' net assets £m	Value of in-force business £m	Total £m
As at 1 January 2005	3,880	2,581	6,461
Total profit after tax	565	360	925
Dividends	(1,000)	–	(1,000)
As at 31 December 2005	3,445	2,941	6,386
Total profit after tax	**873**	**(100)**	**773**
Dividends	**(746)**	**–**	**(746)**
As at 31 December 2006	**3,572**	**2,841**	**6,413**

During 2006, Scottish Widows adopted the FSA's Policy Statement 06/14 which amends the reserving requirements for non with-profits business written by life companies. This has increased shareholders' net assets and reduced the value of in-force business by approximately £400 million.

Analysis of shareholders' net assets on an EEV basis on covered business

	Required capital £m	Free surplus £m	Shareholders' net assets £m
As at 1 January 2005	3,058	822	3,880
Total profit after tax	(105)	670	565
Debt issued	(560)	560	–
Dividends	–	(1,000)	(1,000)
As at 31 December 2005	2,393	1,052	3,445
Total profit after tax	**(186)**	**1,059**	**873**
Dividends	**–**	**(746)**	**(746)**
As at 31 December 2006	**2,207**	**1,365**	**3,572**

Economic assumptions

A bottom up approach is used to determine the economic assumptions for valuing the business in order to determine a market consistent valuation.

The risk-free rate assumed in valuing in-force business is 10 basis points over the 15 year gilt yield. In valuing financial options and guarantees the risk-free rate is derived from gilt yields plus 10 basis points, in line with Scottish Widows' FSA realistic balance sheet assumptions. The table below shows the range of resulting yields and other key assumptions.

	31 December 2006 %	31 December 2005 %
Risk-free rate (value of in-force)	**4.72**	4.22
Risk-free rate (financial options and guarantees)	**3.91 to 5.41**	3.9 to 4.3
Retail price inflation	**3.23**	2.89
Expense inflation	**4.13**	3.79

Non-market risk

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the with-profits fund these are asymmetric in the range of potential outcomes for which an explicit allowance is made.

Non-economic assumptions

Future mortality, morbidity, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. These assumptions are intended to represent a best estimate of future experience as at 31 December 2006.

For OEIC business, the lapse assumption is based on experience which has been collected over a 20 month period. To recognise that this is a shorter period than that normally available for life and pensions business, and that this period has coincided with favourable investment conditions, management have used a best estimate of the long-term lapse assumption which is higher than indicated by this 20 month experience. In management's view, the approach and lapse assumption are both reasonable.

Sensitivity analysis

The table below shows the sensitivity of the EEV and the new business profit before tax to movements in some of the key assumptions. The impact of a change in the assumption has only been shown in one direction. The impact can be assumed to be reasonably symmetrical.

	Impact on EEV £m	Impact on new business profit before tax £m
2006 EEV/new business profit before tax	**6,413**	**346**
100 basis points reduction in risk-free rates[1]	237	10
10% reduction in market values of equity and property assets[2]	(228)	n/a
10% reduction in expenses[3]	82	35
10% reduction in lapses[4]	95	21
5% reduction in annuitant mortality[5]	(88)	(5)
5% reduction in mortality and morbidity (excluding annuitants)[6]	28	3
100 basis points increase in equity and property returns[7]	nil	nil

[1] In this sensitivity the impact takes into account the change in the value of in-force business, financial options and guarantee costs, statutory reserves and asset values.

[2] The reduction in market values is assumed to have no corresponding change in dividend or rental yields. The impact on EEV of £(228) million comprises a £177 million reduction in the value of in-force business and a £51 million reduction in the shareholders' net assets.

[3] This sensitivity shows the impact of reducing new business and maintenance expenses to 90 per cent of the expected rate.

[4] This sensitivity shows the impact of reducing lapse and surrender rates to 90 per cent of the expected rate.

[5] This sensitivity shows the impact on our annuity and deferred annuity business of reducing mortality rates to 95 per cent of the expected rate.

[6] This sensitivity shows the impact of reducing mortality rates on non-annuity business to 95 per cent of the expected rate.

[7] Under a market consistent valuation, changes in assumed equity and property returns have no impact on the EEV.

In scenarios (3) to (6) assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and the statutory reserving bases. A change in risk discount rates is not relevant as the risk discount rate is not an input to a market consistent valuation.

General insurance	2006 £m	2005 £m
Commission receivable	629	681
Commission payable	(664)	(695)
Underwriting income (net of reinsurance)	600	562
Other income	35	18
Net operating income	600	566
Claims paid on insurance contracts (net of reinsurance)	(200)	(197)
Operating income, net of claims	400	369
Operating expenses	(157)	(160)
Profit before tax	243	209
Claims ratio	32%	34%
Combined ratio	80%	81%

Profit before tax from our general insurance operations increased by £34 million, or 16 per cent, to £243 million. Operating income, net of claims, increased by 8 per cent whilst costs fell by 2 per cent. Good progress continues to be made in implementing new platforms for underwriting and claims processes.

Net operating income improved by £34 million, or 6 per cent, as 7 per cent growth in underwriting income was offset by a reduction in broking commissions, particularly relating to creditor insurance, and associated profit sharing commissions. The Group's corporate partnering capability was further extended during 2006 with new distribution agreements secured with Argos and Pearl Group.

Excluding the impact of lower creditor insurance business, new sales through the UK Retail Bank have been robust, with a 42 per cent increase in home insurance gross written premiums. Our presence in the small business insurance market continues to improve with an increase of 10 per cent in new business gross written premiums. Internet sales are becoming increasingly important and now represent 33 per cent of direct sales volumes.

Whilst claims increased slightly to £200 million, the claims ratio improved to 32 per cent (2005: 34 per cent), as further progress in re-engineering the claims process and improvements in the cost effectiveness of the claims supply chain offset the impact of higher subsidence related claims. The combined ratio relating to the underwriting business improved to 80 per cent.

Wholesale and International Banking

	2006 £m	2005 £m
Net interest income	**2,385**	2,265
Other income	**1,827**	1,628
Total income	**4,212**	3,893
Operating expenses	**(2,264)**	(2,181)
Trading surplus	**1,948**	1,712
Impairment losses on loans and advances	**(308)**	(188)
Profit before tax*	**1,640**	1,524
Cost:income ratio	**53.8%**	56.0%

	31 December 2006	31 December 2005
Total assets	**£147.8bn**	£124.0bn
Risk-weighted assets – post securitisation	**£91.8bn**	£80.1bn
Risk-weighted assets – pre securitisation	**£92.6bn**	£80.1bn
Customer deposits	**£61.2bn**	£57.9bn

	2006 £m	2005 £m
Profit before tax by business unit*		
Corporate Markets	**1,105**	976
Business Banking	**247**	196
Asset Finance	**190**	219
International Banking and other businesses	**98**	133
	1,640	1,524

* Excluding loss on sale and closure of businesses.

In Wholesale and International Banking, the Group has continued to make significant progress in its strategy to leverage the Group's strong corporate and small business customer franchises and, in doing so, become the best UK mid-market focused wholesale bank. We have continued to develop new product revenue streams, particularly in areas such as securitisation, structured credit and credit loan trading which, coupled with a strong focus on targeted corporate customer segments and Corporate Markets' cross-selling income growth remaining strong, has supported good levels of overall income growth. Revenue growth has continued to exceed cost growth notwithstanding significant investment being made in the enhancement of our product and distribution capabilities, particularly in the Corporate Markets business.

Profit before tax increased by £116 million, or 8 per cent, to £1,640 million. Good trading momentum has continued and has generated strong income growth of 8 per cent, driven by Corporate Markets income growth of 15 per cent. This exceeded cost growth of 4 per cent, leading to a reduction in the cost:income ratio to 53.8 per cent, from 56.0 per cent last year. Trading surplus increased by £236 million, or 14 per cent, to £1,948 million.

Net interest income increased by £120 million, or 5 per cent, reflecting higher income from strong growth in customer lending and customer deposits. The banking net interest margin reduced, largely reflecting the mix effect of slower growth in the wider margin Asset Finance business, and lower Corporate Markets and Business Banking margins reflecting a higher proportion of finer margin secured lending being written. Other income increased by £199 million, or 12 per cent, as a result of good levels of growth in financial markets product sales and credit structuring. In addition, fee and other transactional income throughout the division benefited from volume growth across a broad range of customer activity. Costs were 4 per cent higher at £2,264 million, reflecting higher staff costs resulting from the continuing investment in people, processes and systems, as the Group builds up its Corporate Markets product capability and expertise. This increased investment was mitigated by operational efficiencies achieved in Business Banking and Asset Finance.

As expected, the charge for impairment losses on loans and advances increased by £120 million to £308 million, as a result of the high level of releases and recoveries in Corporate Markets in 2005 which were not repeated in 2006, and a higher level of consumer finance lending impairment in the Asset Finance business. Whilst overall corporate and small business asset quality remains strong and the level of new corporate provisions remained at a low level in 2006, we continue to expect some normalisation in the impairment charge over the next few years.

Corporate Markets	2006 £m	2005 £m
Net interest income	**891**	777
Other income	**923**	807
Total income	**1,814**	1,584
Operating expenses	**(722)**	(665)
Trading surplus	**1,092**	919
Net impairment credit on loans and advances	**13**	57
Profit before tax	**1,105**	976

In Corporate Markets, profit before tax grew by 13 per cent, driven by strong levels of income growth. Income increased by 15 per cent, supported by significantly higher levels of cross-selling income. By building new product revenue streams in areas such as structured products and debt capital markets, and targeting and developing relationships in selected corporate customer segments, Corporate Markets has created a broader, more diversified stream of revenues to underpin future revenue growth. There has also been significant progress in the delivery of our strategy focused on improved origination and distribution capabilities in the mid-sized corporate business. Operating expenses increased by 9 per cent to £722 million, reflecting further investment in people, premises and systems to support ongoing business growth. The trading surplus increased by 19 per cent. The net impairment credit reduced to £13 million, reflecting the lower level of releases and recoveries.

Business Banking	2006 £m	2005 £m
Net interest income	**596**	551
Other income	**255**	248
Total income	**851**	799
Operating expenses	**(517)**	(527)
Trading surplus	**334**	272
Impairment losses on loans and advances	**(87)**	(76)
Profit before tax	**247**	196

Profit before tax in Business Banking grew by £51 million, or 26 per cent, reflecting strong growth in business volumes, further improvements in growing the Business Banking customer franchise and progress in improving operational efficiency. Strong income growth combined with tight cost control led to an improvement of over 5 percentage points in the cost:income ratio. Costs remain tightly controlled and were 2 per cent lower. Business Banking continued to develop and grow its customer franchise strongly, with customer recruitment of some 118,000 during 2006, reflecting a market leading position in the start-up market. Asset quality in the Business Banking portfolios remains strong. The impairment charge increased by £11 million to £87 million, largely reflecting a lower level of releases and recoveries than in 2005.

Asset Finance	2006 £m	2005 £m
Net interest income	**600**	640
Other income	**418**	366
Total income	**1,018**	1,006
Operating expenses	**(583)**	(582)
Trading surplus	**435**	424
Impairment losses on loans and advances	**(245)**	(205)
Profit before tax	**190**	219

Profit before tax in Asset Finance decreased by 13 per cent to £190 million, reflecting higher levels of consumer finance impairment losses. Income increased by £12 million, or 1 per cent, as good fee income growth in the consumer lending business and growth in the asset backed lending and contract hire businesses, was largely offset by the impact of the tightening of lending credit criteria in the consumer lending portfolios. Lloyds TSB Commercial Finance has continued to be a major presence in its market, 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 share of 15 per cent. Costs were held flat, leading to a 3 per cent growth in the trading surplus. The impairment charge increased by £40 million to £245 million, reflecting the ongoing impact of higher levels of retail consumers experiencing repayment difficulties.

Central group items

	2006 £m	2005 £m
Lloyds TSB Foundations	(37)	(34)
Funding cost of acquisitions less earnings on capital	(378)	(378)
Central costs and other unallocated items	(34)	(12)
Pension schemes related credit	128	–
Loss before tax, excluding volatility and profit on sale and closure of businesses	(321)	(424)
Volatility	(3)	(124)
Profit on sale and closure of businesses	–	56
Loss before tax	(324)	(492)

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 2006, £37 million was accrued for payment to registered charities.

Following recent changes in age discrimination legislation, the Group has ceased to augment the pension entitlement of employees taking early retirement. This change has reduced the Group's defined benefit pension liability by £129 million (£1 million of which is unrecognised) and resulted in a one-off credit to the 2006 income statement of £128 million.

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 arrangement whereby divisions transfer to Central group items the volatility associated with marking to market derivatives held for risk management purposes where, as far as possible, the effect is minimised by establishing IAS 39 compliant hedge accounting relationships. The net result is separately disclosed as banking volatility.

During 2006, profit before tax included banking volatility of £(3) million, being a charge of £136 million to net interest income and a credit of £133 million to other income, (2005: £(124) million, being a charge of £79 million to net interest income and a charge of £45 million to other income). The significant reduction in this source of volatility reflects the beneficial effect of rising interest rates which has had the result of changing the way in which the gradual unwind of the Group's fair value hedging relationships has impacted the income statement.

Insurance volatility

The Group's insurance businesses have liability products that are supported by substantial holdings of investments, including equities, property and fixed interest investments, all of which have a volatile fair value. The liabilities and supporting investments do not move exactly in line as the fair value of investments changes, yet IFRS requires that the changes in both the value of the liabilities and investments be reflected within the income statement. As these investments are substantial and movements in their fair value can have a significant impact on the profitability of the Insurance and Investments division, management believes that it is appropriate to disclose the division's results on the basis of an expected return in addition to the actual return. The difference between the actual return on these investments and the expected return based upon economic assumptions made at the beginning of the period is included within insurance volatility.

Changes in market variables also affect the realistic valuation of the guarantees and options embedded within products written in the Scottish Widows With Profit Fund, the value of the in-force business and the value of shareholders' funds. Fluctuations in these values caused by changes in market variables are also included within insurance volatility.

The expected investment returns used to determine the normalised profit of the business, which are based on prevailing market rates and published research into historic investment return differentials, are set out below:

	2007 %	2006 %	2005 %
Gilt yields (gross)	4.62	4.12	4.57
Equity returns (gross)	7.62	6.72	7.17
Dividend yield	3.00	3.00	3.00
Property return (gross)	7.62	6.72	7.17
Corporate bonds (gross)	5.22	4.72	5.17

During 2006, profit before tax included positive insurance volatility of £84 million, being a credit of £2 million to net interest income and a credit of £82 million to other income (2005: £438 million, being a credit of £6 million to net interest income and a credit of £432 million to other income). Returns in 2005 benefited from rising stock markets and rising gilt values. Although equity values continued to rise in 2006, this was less marked than in 2005 and the effect was partly offset by falling gilt values and a charge following the change in the economic assumptions used to calculate the value of in-force business at 31 December 2006.

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 required to be included in the Group's tax charge rather than being offset against the related income, as it is in actual distributions made to policyholders. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge. Other items classified within policyholder interests volatility include the effects of investment vehicles which are only majority owned by the long-term assurance funds. In the case of these vehicles, the Group's profit for the year includes the minorities' share of the profits earned. As these amounts do not accrue to the equity holders, management believes a clearer representation of the underlying performance of the Group's life and pensions businesses is presented by excluding policyholder interests volatility.

During 2006, profit before tax included positive policyholder interests volatility of £326 million, being a charge of £33 million to net interest income and a credit of £359 million to other income (2005: £311 million, being a credit to other income). The increase reflects an improved return from a property partnership majority owned by the policyholders, which more than offset a reduction in the policyholder tax charge as a result of a fall in the capital values of gilts and bonds and a smaller rise in equity markets.

Regulation

In the UK and elsewhere, there is continuing political and regulatory scrutiny of financial services. On 7 February 2007, the Office of Fair Trading ('OFT') published its decision to refer the Payment Protection Insurance market to the Competition Commission, which will report within two years. The OFT is also carrying out a review of undertakings given by some banks in 2002 regarding the supply of banking services to SMEs, a fact find into certain current account charges and an inquiry into interchange fees charged by some card networks. The European Commission is also conducting an inquiry into retail banking services across the EU. It is not presently possible to assess the cost or income impact of these inquiries or any connected matters on the Group until the outcome is known. In addition, a number of EU directives, including the Markets in Financial Instruments Directive ('MiFID') and the Capital Requirements Directive, are currently being implemented in the UK. The EU is also considering regulatory proposals for, inter alia, a Consumer Credit Directive, Payment Services Directive and capital adequacy requirements for insurance companies (Solvency II).

Corporate responsibility

Supporting business strategy

In an increasingly competitive market where customers are able to exercise choice among providers, we believe that shareholder value creation is closely linked to customer value creation. It is only by meeting our customers' needs that we will win the right to a bigger share of their total financial services spend.

We believe that corporate responsibility, built around the creation of employee motivation, customer satisfaction and brand loyalty, has a major part to play in supporting our business strategy. Our commitment to corporate responsibility helps promote trust in the Lloyds TSB brand and reinforces customer loyalty and advocacy. Lloyds TSB is rooted in local communities throughout the UK and we take our responsibilities to those communities very seriously. By investing in the communities where we operate we not only create economic value but also make a positive social contribution. Through the Lloyds TSB Foundations, one per cent of the Group's pre-tax profits, averaged over three years, is distributed to local charities.

Our approach to corporate responsibility focuses on five areas: our people, our customers, our suppliers, our community and the environment.

Our people

Achieving our vision of being the best financial services company in the UK depends on our ability to create a high performance culture. We know that every high performance company needs committed and motivated staff.

Employee engagement

Recent internal research has shown that it is not just employee satisfaction but employee engagement which is critical to high performance and that it is directly related to key business outcomes such as customer satisfaction, improved business performance and lower staff turnover. So, it is essential that we understand not only how engaged employees are but what the business and managers can do to both encourage and support high levels of engagement throughout the organisation.

We track employee engagement using a quarterly engagement index survey, which attracts a consistently high response rate (see page 27).

Equality and diversity

Equality and diversity is not just a legal issue or something which is socially desirable, it is key for competitive advantage. In an ever-tightening employment market, we need to differentiate ourselves as an employer of choice to ensure that we attract and retain the best cross section of talent. We also need to be close to our customers, to understand their needs and provide them with the right products and services. By attracting and retaining a diverse workforce, we will better understand the needs of all our customers and be able to explore the immense opportunities available right across communities.

Over the last few years we have been working to increase the number of women and ethnic minority employees in management and senior management positions across the organisation. At the end of 2006, twenty-one per cent of our senior managers are women, including three female board directors. We are included in the Times top 50 places for women to work and we are the top FTSE 100 company in terms of the number of female executive directors. During the year we won several diversity awards including first in the Race for Opportunity Benchmarking and fourth in the Employers' Forum on Disability Benchmarking.

Training and development

To create a high performance company, we recognise that we need to provide all employees with the opportunity to learn, develop and to fulfil their potential. The University for Lloyds TSB is our centre of excellence for learning, providing an accessible, high quality service structured around the needs of both the business and the individual. In 2006, the University provided over 33,250 training days and over 17,000 delegate places in addition to online learning through a group wide network of 2,029 multimedia personal computers and 20 dedicated cyber-cafés.

Our customers

We want to build a great organisation, which is recognised for operating to high standards and is built on strong customer franchises. Treating our customers fairly is essential to helping us achieve that goal and is one of the ways in which we can develop competitive advantage. We aim to be fair, clear and straightforward in all our dealings with our customers. We have simplified the number and range of products we have and we are continuing our drive to make our terms and conditions simpler to understand and ensure our charges are absolutely clear.

Responsible lending

We are committed to being a responsible lender. It is in our interest to help customers borrow only those amounts they can repay. We have a responsible lending programme with internal management reporting and accountability. Our employees are trained to offer the necessary advice and support to help customers manage their borrowing. Our Customer Support Unit provides help for customers who are in financial difficulties to find an appropriate solution through effective budgeting or rescheduling their borrowing. We also support independent money advice networks including the Money Advice Trust and the Consumer Credit Counselling Service. Payments totalling more than £2.5 million were made in 2006.

Financial inclusion

We continue to develop financial services especially tailored to tackle the problem of financial exclusion. These include basic bank accounts, support for community credit unions and other community finance initiatives and, loan and venture capital funds. Our partnership with the Post Office allows our customers access to the UK network of post offices as well as over 2,000 of our own branches and 4,100 ATMs. At the end of 2006 we had over 400,000 basic bank accounts.

We also believe in the importance of financial education. We have collaborated with the Financial Services Authority to lead the development and delivery of their Financial Capability in the Workplace programme.

Customer satisfaction

We measure our customers' satisfaction with the service they receive via monthly surveys and use the results to calculate our CARE Index which is based on customer understanding, accessibility, responsibility and expertise. We seek to address customer complaints as quickly as prudent whilst ensuring appropriate standards of investigation and communication are maintained (see page 27).

In a poll of Finance Directors across the UK, Lloyds TSB Corporate was voted 'Bank of the Year' for the second year running at the Real Finance/CBI FD's Excellence Awards, in recognition of our quality of service and understanding of our customers' businesses. In 2006 we were also voted 'Adviser of the Year'; in this category we were not only competing against other banks but also leading accountants and lawyers.

Our suppliers

Each year we buy around £2 billion worth of goods and services. Our suppliers are important to us and we want to ensure that we treat them fairly and pay them on time. Our supplier relationships are governed by a strict Code of Purchasing Ethics that defines the way we do business. We also have an established supplier review process that allows us to assess our suppliers' social, ethical and environmental performance as part of the tendering process (see page 27).

Our community

Continuing to grow a successful business is the best way for Lloyds TSB to create value for all its stakeholders and contribute to the wider economy. We are a major employer with some 63,000 employees. In 2006, salaries, national insurance, pension contributions and other staff costs totalled over £2.7 billion. Over £1.3 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 24.8 per cent in 2006 (10.9 per cent in 2005).

In addition to our financial contribution we recognise that it is in our long-term interest to help improve the social and commercial fabric of local communities where we operate. That is why we have one of the largest community investment programmes in the UK.

Lloyds TSB Foundations

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.

Through their shares in the Lloyds TSB Group, the Lloyds TSB Foundations together receive one per cent of the Group's pre-tax profits, averaged over three years, in lieu of their shareholder dividend. Over the last 10 years, we have given a total of over £300 million to the Foundations, making Lloyds TSB one of the largest corporate charitable donors in the United Kingdom.

The Foundations recognise that their success as community and local funders depends on maintaining a presence in and actively engaging with communities. The England and Wales Foundation, for example, remains one of the few grant-makers with a significant regional presence and its regional structure enables the Foundation to respond directly and effectively to local needs.

Foundation funding supports charities working to meet social and community needs. The main grants programmes are designed to address essential community needs and, in particular, to support small 'under funded' charities. 38 per cent of the charities supported by the England and Wales Foundation in 2006 had a total income of £100,000 or less and 70 per cent had an income of £500,000 or less.

Employee volunteering and fundraising

In addition to the Foundations' support for local community causes, thousands of our employees volunteer to help in their communities, raise funds for the Group's Charity of the Year or make direct donations to charity using the UK's Give As You Earn system. In 2006, the Foundations provided matched funding for over 40,000 hours of time volunteered by Lloyds TSB employees in the community.

The Charity of the Year is chosen in an open ballot of staff. A team of Charity Champions across all parts of the Group leads the fundraising, inspiring and motivating their colleagues to organise and take part in events, sell pin badges and find new and innovative ways of raising money. In 2006 our staff raised over £1.8 million for Breast Cancer Care, the third year in a row that over £1 million has been raised for our chosen charity. Our staff have chosen Barnardo's as the charity of the year for 2007.

The environment

Lloyds TSB first introduced a formal environmental policy in 1996 and was also one of the first UK banks to develop an environmental risk assessment system for all of our business lending.

Climate change

The UK Government has stated its belief that climate change is the greatest long-term challenge facing the world today. Measures to tackle climate change will have potential implications for regulation, taxation and public policy and will carry both risks and opportunities for companies and the public.

In respect of our own direct environmental impacts our immediate priority is to reduce our carbon emissions. We have introduced a five-year carbon management programme which, through a series of energy saving projects and other initiatives, will not only reduce our carbon footprint but also deliver cost savings. In 2005 we set a target to reduce property related emissions by 30 per cent from 2004 levels by 2010. We are exploring other opportunities in relation to waste reduction and business travel (see page 27).

While our direct carbon intensity is relatively low compared to other industry sectors, we still need to fully understand the potential financial impact of climate change on others that we may lend to or invest in, so that we can manage the risks and identify business opportunities.

We are in the process of establishing a group wide Climate Forum, led by the deputy group chief executive, to develop a holistic approach to managing climate related risks and opportunities.

Corporate responsibility management

The board reviews overall corporate responsibility performance annually and individual issues are subject to board discussion throughout the year. 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 steering group meets quarterly to recommend strategy and provide direction.

We have adopted the European Foundation of Quality Management's Corporate Responsibility Framework to help us align corporate responsibility with business strategy and also with individual balanced scorecard priorities. As part of the process we have a network of almost 40 representatives across all business divisions, through whom 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 is satisfied that the systems in place to manage corporate responsibility risks are effective and that the relevant risks have been assessed during 2006 and managed in compliance with relevant policies and procedures.

More information on all of the above issues is available in the Group's Corporate Responsibility Report and there are details of how to obtain a copy on page 128.

Corporate responsibility key performance indicators

Our people

			2005	2006
Employee engagement index*			73.0%	**74.5%**

	2003	2004	2005	2006
Women in management positions	36%	37%	38%	**38%**
Women in senior management positions	17%	19%	20%	**21%**

	2003	2004	2005	2006
Ethnic minority managers	2.9%	3.5%	4.1%	**4.3%**
Ethnic minority senior managers	1.1%	1.2%	1.8%	**1.9%**

Our customers

	2005	2006
Customer service index**	68.0%	**69.7%**
Complaints resolved within 8 weeks	86.0%	**94.8%**
Service quality index†	4.02	**4.30**

Our suppliers

	2004	2005	2006
Payment of suppliers			
Number of supplier payments	360,257	379,613	**344,422**
Value	£2.20 billion	£2.16 billion	**£2.29 billion**
Average time to pay	28.02 days	27.01 days	**29.72 days**
Number/amount of compensation payments for late settlement	1 payment totalling £25	None	**None**

The environment

	Tonnes CO_2			
	2003	2004	2005	2006
Greenhouse gas emissions††				
Property	195,175	188,624	177,047	**181,086**
Property renewable	(730)	(4,438)	(14,606)	**(18,944)**
Travel	26,998	29,499	29,540	**27,231**
Total	221,443	213,685	191,981	**189,373**

* The employee engagement index is based on the results of a survey conducted quarterly, asking Lloyds TSB employees a series of questions which reflect both the drivers and outcomes of engagement. The data captures the percentage of total responses received which were favourable for each question, combined into a simple average overall score.

** The customer service index is computed based on the results of a customer satisfaction survey performed monthly for Lloyds TSB by an external agency. Customers in each of six business units are asked to rate the service they receive on fives bases – overall satisfaction, understanding of the customer's needs, accessibility of the service, and the responsiveness and expertise of the service provider. These scores are weighted to produce a Group score based on the proportion of total Group income each business unit represents.

† The service quality index is based on SIGMA, deriving its provenance from the manufacturing world, where it measures Defects per Million Opportunities ('DPMO'). For the Group's purposes, a 'defect' is registered whenever there is a failure to deliver a process or product within a certain time period or to the required standard. The Lloyds TSB DPMO score is measured for over 150 end-to-end processes across eight business units, covering in excess of eighty per cent of transactions by volume.

†† We have reported our greenhouse gas emissions arising from our operations since 1999 using the DEFRA Guideline for Reporting Greenhouse Gas Emissions. The key activities which contribute to our Global Warming Impact are energy used in managing our buildings – lighting, building controls and IT; and in business travel – road, rail and air.

Risk management

Risk as a strategic differentiator

Lloyds TSB Group continues with the development of the risk framework through close alignment of risk capabilities to objectives. Substantial progress has been made in 2006 in embedding our approach across the business. This has included a focus on enhancing our capabilities in providing both qualitative and quantitative data to the board on risks associated with strategic objectives and facilitating more informed and 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 capabilities continue to evolve 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.

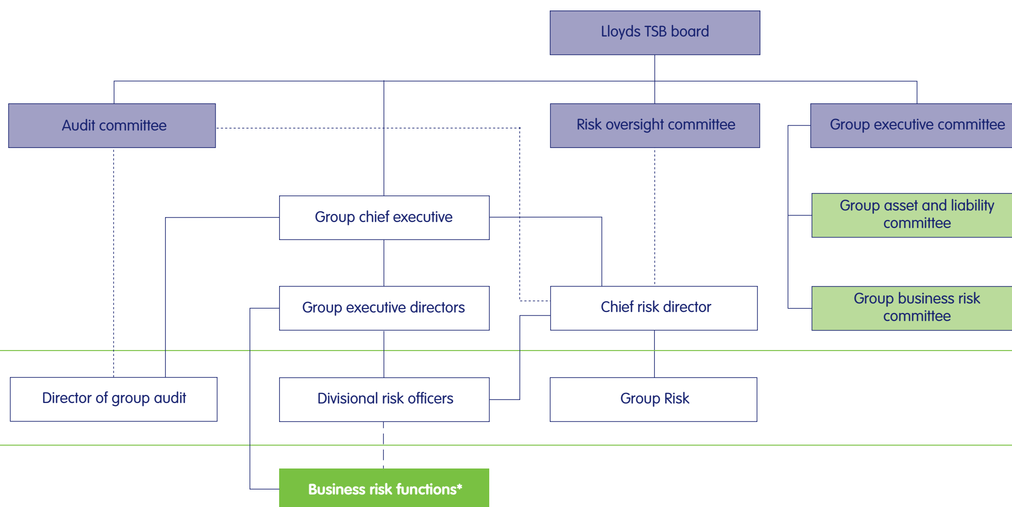
Risk governance structures

Lloyds TSB Group maintains a risk governance structure that strengthens risk evaluation and management, whilst also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

Board and committees

Risk management oversight

Business risk management



Board and board committees — Direct reporting line

Management committees — Functional reporting line to support committees

Personnel — Functional reporting line

Functions — * Business risk functions report to their respective managing director, who in turn reports to the group executive directors

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 49 and 50, 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 50.

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 senior executive team and Board 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 an enhanced 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 28, 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 group wide 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.

Principal risks

The Group's risk language is designed to capture the Group's principal risks referred to as the 'primary risk drivers'. A description of each risk, including definition, appetite, control and exposures is included in the detail to this report. These are further broken down into 13 more granular risk types to enable more detailed review and facilitate appropriate reporting and analysis of root causes, as set out below.

Through Lloyds TSB's risk management processes these risks are assessed on an ongoing basis to ensure optimisation of risk and reward and that, where required, appropriate mitigation is in place. Both quantitative and qualitative factors are considered in assessing Lloyds TSB's current and potential future risks. At present the two most significant risks for the Group are:

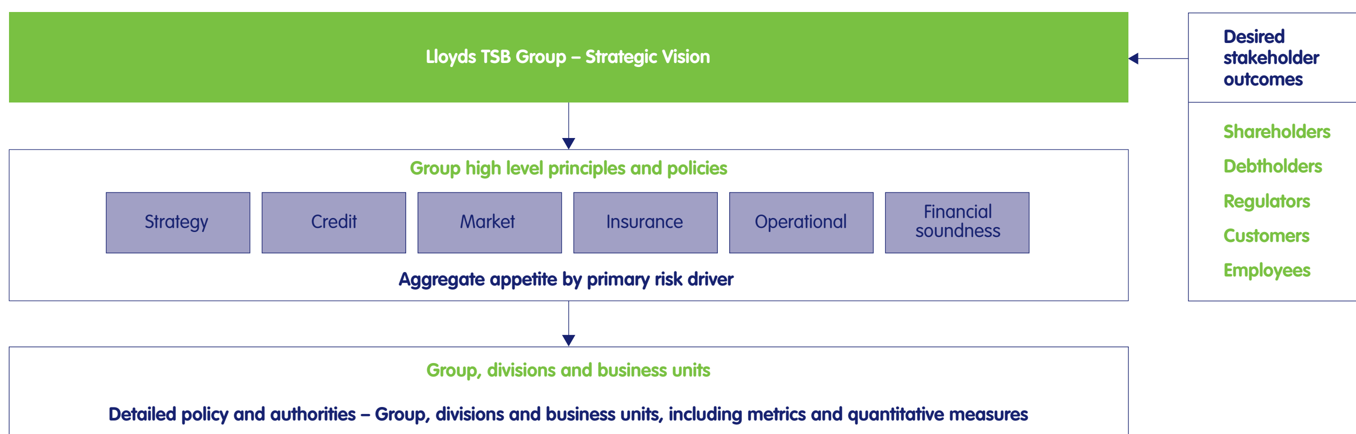
- Legal and regulatory risk, reflecting the volume and pace of change from within the UK and Europe. This impacts Lloyds TSB both operationally in terms of cost of compliance and uncertainty about regulatory expectations, and strategically through pressure on key earnings streams. The latter could potentially result in major changes to business and pricing models, particularly in the UK retail market. Our business planning processes continue to reflect change to the regulatory environment. Major current regulatory reviews are described on page 24.
- Credit risk, reflecting the risk inherent in our lending businesses. Whilst credit quality remains satisfactory this will always be a significant risk for Lloyds TSB. The current focus is on unsecured retail credit, where lending criteria and limits have been tightened over the last two years and collections and recoveries processes enhanced.

Primary risk drivers	**Strategy**	**Credit**	**Market**	**Insurance**	**Operational**	**Financial soundness**
Detailed 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	

Risk appetite

In enhancing our risk framework in 2005, we articulated the Group's strategic vision and the desired outcomes for our key stakeholders. The risk implications are expressed in high level risk principles and risk appetite measures and metrics for the primary risk types. These are then translated into more detailed policies and measures which are applied to the businesses. A key focus in 2006 has been the enhancement of policy and development of risk appetite across our business and this work will continue throughout 2007.

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.



Policy

A key component of the risk management framework is the policy framework. The Group has continued to embed this further during 2006.

The main policy levels are identified below:

- Principles – high level principles for the six primary risk drivers
- High level group policy – policy for the main risk types aligned to the risk drivers
- Detailed group policy – detailed policy that applies across the Group
- Divisional policy – local policy that specifically applies to a division
- Business unit policy – local policy that specifically applies to a business unit

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 annually to seek to ensure they remain fit for purpose.

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. Divisions 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.

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.

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

Risk appetite

Strategy risk is encapsulated as the budget and medium-term plan sanctioned by the board on an annual basis. Divisions and business units subsequently align their plans to the Group's overall strategic risk appetite.

Exposures

The market for UK financial services and the other markets within which the Group operates are highly competitive, and management expects such competition to intensify to response to consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors, which could result in a reduction in profit margins. The Group's ability to generate an appropriate return for its shareholders depends significantly upon the competitive environment and management's response to it.

The Group seeks to achieve further organic growth by securing new customers and developing more business from existing customers. Lloyds TSB is currently expending significant resources and effort to bring about this growth, particularly with respect to its UK retail financial services business. If these expenditures and efforts did not meet with success, its operating results would grow more slowly or decline.

As well as the Group's organic growth plans, management and planning resources are also devoted to identifying possible acquisitions which would provide further opportunities for growth. If these strategic plans do not meet with success, the Group's earnings could grow more slowly or decline.

The Group's businesses are conducted in a market place that is consolidating and significant cross-border mergers and acquisitions may happen in the coming years. Lloyds TSB's ability to generate an appropriate return for its shareholders over the long term may depend upon whether management is able to achieve value creating acquisitions and/or mergers at the appropriate times and prices. Lloyds TSB cannot be sure that it will ultimately be able to make such mergers or acquisitions or that, if it does, such mergers or acquisitions will be integrated successfully or realise anticipated benefits.

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 loss, both financial and reputational, from the inherent design, management or distribution of products, or from the failure to meet or exceed customer expectations, competitor offerings or regulatory requirements

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.

A product is defined as a solution that can be offered to a customer or counterparty that might satisfy a want or a need in order to generate revenue streams or gains (not necessarily financial) for the Group. 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.

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).

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.

Credit risk appetite is described and reported through a suite of metrics derived from a combination of accounting and economic equity model parameters which in turn uses the various credit risk rating systems as inputs. These metrics are supplemented by a variety of policies, sector caps and limits to manage concentration risk at an acceptable level.

Exposures

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. The credit risk exposures of the Group are set out in note 47 to the financial statements.

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.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers.

Credit risk also arises from the use of derivatives. Note 16 to the financial statements shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2006. 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.

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.

Control

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.

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.

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.

The following are the principal control mechanisms through which the Group manages credit risk:

- 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. 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. Business unit policy includes lending guidelines which 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 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.

Lloyds TSB Group also 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 also undertakes asset sales, securitisations and credit derivative-based approaches as appropriate for the nature of the assets and market conditions.

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.

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 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, property 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 those 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.

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 2006 and 2005 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 2006				31 December 2005			
	Closing £m	Average £m	Maximum £m	Minimum £m	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	3.3	2.3	4.6	0.6	0.9	1.8	4.5	0.5
Foreign exchange risk	0.3	0.3	0.7	0.0	0.2	0.3	0.4	0.2
Equity risk	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total VaR (no diversification)	3.6	2.6	5.0	0.9	1.1	2.1	4.7	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 47 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 2007 would decrease net interest income by £237.8 million for the 12 months to 31 December 2007, while a hypothetical immediate and sustained 100 basis point decrease in interest rates would increase net interest income by £237.4 million. An analysis by currency is shown below.

	UK £m	North America £m	Asia & Australasia £m	Europe & Middle East £m	Total 2007 £m	Total 2006 £m
Change in net interest income from a +100 basis point shift in yield curves	(207.6)	(12.8)	0.3	(17.7)	(237.8)	(112.5)
Change in net interest income from a –100 basis point shift in yield curves	207.2	12.8	(0.3)	17.7	237.4	104.7

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.

For the insurance businesses, the composition and value of surplus assets held in excess of liabilities are reported to Group Risk on a monthly basis. 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 table below shows closing, average, maximum and minimum VaR for surplus assets held in excess of liabilities in the Group's insurance businesses for the years ended 31 December 2006 and 2005 on a 99 per cent confidence ten day basis.

	31 December 2006				31 December 2005			
	Closing £m	Average £m	Maximum £m	Minimum £m	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	17.9	19.1	20.5	16.9	19.8	17.9	20.0	15.8
Foreign exchange risk	2.6	3.2	3.5	2.6	3.3	2.8	3.5	2.3
Equity risk	43.1	40.9	43.1	39.4	41.7	47.7	57.3	39.4
Total VaR	63.6	63.2	65.9	59.7	64.8	68.4	77.8	59.1

The Group's structural foreign exchange position at 31 December 2006 is set out in note 47 to the financial statements. The position implies that at 31 December 2006 a hypothetical increase of 10 per cent in the value of sterling against all other currencies would have led to a £43 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.

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 defined in the detailed group policy for interest rate risk in the banking book, which is reviewed annually 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. The objective is to limit the effect of exchange rate movements on the published risk asset ratio

Insurance activity:

- Market risk exposures from the insurance businesses are controlled via approved investment policies set with reference to 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 discusses strategies for the overall mix of pension assets with the pension scheme trustees.

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.

Risk appetite

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

Exposures

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.

Insurance risks are measured using a variety of techniques including stress and scenario testing; and, where appropriate, stochastic modelling.

Control

A key element of the control framework is the consideration of insurance risk by 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.

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.

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.

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

Definition

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.

Risk appetite

Operational risk appetite is defined as the quantum and composition of operational risk that exists in the Group and the direction in which the Group wishes to manage it.

The Group has developed an impact on earnings approach to operational risk appetite. This involves looking at how much the Group could lose due to operational risk losses at various levels of severity. In setting operational risk appetite, the Group looks at both impact on solvency and the Group's reputation, including customer service requirements.

Exposures

The main sources of operational risk within Lloyds TSB Group relate to uncertainties created by the changing business environment in which we operate and how this is managed across the Group. Throughout 2006 there has been ongoing development of operational risk metrics to ensure both current and potential future operational risk exposures are understood in terms of both risk and reward potential.

Control

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 strong 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 49 to 51. 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 (e.g. Group Human Resources, Group Risk, Group Finance, Group Strategy, Group Audit) are established to provide functional leadership (e.g. 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.

The Group's whistleblowing arrangements, reviewed and supported by the independent charity Public Concern at Work, encourage staff to speak up if they have concerns about any possible wrongdoing.

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. The revised detailed group product governance policy also requires customer treatment standards to be tailored.

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. These include policies covering physical and information security, business continuity, outsourcing, procurement and incident management when policy implementation and oversight is lead by specialist teams with a group wide remit.

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, which fall under the remit of the Chief Security Office.

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. This includes external scanning of the threat environment across all service delivery channels and translation mechanisms with particular focus on card payment and internet transactions.

The Chief Security Office establishes policy 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 risk

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 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 that the Group will be unable 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 39.

Risk appetite

Financial soundness risk appetite is set and reported through various metrics that enable the Group to manage liquidity and capital constraints and shareholder expectations.

Exposures

The principal financial soundness risk uncertainties relate to liquidity and capital adequacy and each of these sources of risk is described in more detail below.

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 the majority of Lloyds TSB Group's loan capital has been issued by Lloyds TSB Bank. As at 31 December 2006, Lloyds TSB Group plc had £2,297 million of subordinated debt in issuance compared with £12,072 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 2006, the credit ratings of Lloyds TSB Bank were as follows:

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

The ratings outlook from Moody's, Standard & Poor's and Fitch for Lloyds TSB Bank is stable. 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 Lloyds TSB 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 2006, amounts deposited by customers increased by £8,272 million from £131,070 million at 31 December 2005 to £139,342 million at 31 December 2006. 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 £6,806 million had been utilised for senior funding at 31 December 2006, and commercial paper programmes, under which £2,343 million had been utilised at 31 December 2006. The Group has also raised wholesale funding via the issuance of Residential Mortgage Backed Securities; £10,048 million was outstanding at 31 December 2006.

The ability to sell assets quickly is also an important source of liquidity for the Lloyds TSB Group's banking businesses. The Lloyds TSB 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' equity, 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 its 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 2006 £m	31 December 2005 £m
Capital:		
Tier 1	**12,828**	11,478
Tier 2	**9,965**	10,447
	22,793	21,925
Supervisory deductions	**(6,158)**	(6,160)
Total regulatory capital	**16,635**	15,765
Total risk-weighted assets	**156,043**	144,921
Risk asset ratios:		
Total capital	**10.7%**	10.9%
Tier 1	**8.2%**	7.9%

At 31 December 2006, the risk asset ratios were 10.7 per cent for total capital and 8.2 per cent for tier 1 capital.

The Lloyds TSB 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.

The Group is making good progress in its preparations for the introduction of Basel 2, and our credit risk waiver application was submitted in December 2006. Whilst our work is well advanced, some uncertainty remains with regard to the regulatory treatment of certain issues for capital purposes. The Group expects to maintain satisfactory capital ratios throughout the transition to Basel 2 in 2008, and continues to expect no deduction of investments in insurance subsidiaries from tier 1 capital until at least 2012.

There are strict limits imposed by the regulatory authorities as to the proportion of the Lloyds TSB Group's regulatory capital base that can be made up of subordinated debt and preferred securities. 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 Lloyds TSB Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

Control (Audited information)

In addition to the complying with the FSA's regulatory reporting framework, and similar regulatory/statutory requirements in other jurisdictions, the Group uses a number of internal tools to measure and control liquidity risk, detailed in the liquidity policy. These range from shorter term tactical measures (which include net cash flow profiles and various liquidity ratios) to longer term, more strategic analyses of the overall liquidity of the balance sheet. The reporting framework ensures that the relevant risk control functions have appropriate oversight, and the group asset and liability committee provides strategic direction for liquidity risk management.

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. Any breaches of the formal buffer must be notified to the FSA, together with proposed remedial action. No such notifications have been made during 2006.

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.

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.

Life assurance businesses

Basis of determining regulatory capital of the life assurance businesses

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. 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 a with-profits fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in a with-profits fund (a relatively small amount of business in the case of Scottish Widows), 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, sums at risk and maintenance expenses (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, no amount is required to cover the impact of stress tests on the actuarial reserves. However, a further test is required in respect of the With Profit Fund which compares the level of 'realistic excess capital' to the 'statutory excess capital' of the With Profit Fund. In circumstances where the 'realistic excess capital' position is less than 'statutory excess capital', the Company is required to hold additional capital to cover the shortfall but only to the extent it exceeds the value, calculated in a prescribed way, of internal transfers from the With Profit Fund. Any additional capital requirement under this test is referred to as the With Profit Insurance Capital Component. The 'realistic excess capital' is calculated as the difference between realistic assets and realistic liabilities of the With Profit Fund with a further deduction to cover various stress tests.

The determination of realistic liabilities of the With Profit Fund in respect of Scottish Widows includes the value of internal transfers expected to be made from the With Profit Fund to the Non-Participating Fund of Scottish Widows. These internal transfers include charges on policies where the associated costs are borne by the Non-Participating Fund. The With Profit Insurance Capital Component is reduced by the value, calculated in the stress test scenario, of these internal transfers, but only to the extent that credit has not been taken for the value of these charges in deriving actuarial reserves for the Non-Participating Fund.

Capital statement

The following table provides more detail regarding the sources of capital in the life assurance business. The figures quoted are based on management's current expectations pending completion of the annual financial return to the FSA. The figures allow for the proposed transfer of £750 million from the Long Term Fund to the Shareholder Fund as at 31 December 2006.

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2006					
Assets attributable to the shareholder held outside the long-term funds	–	–	–	1,947	1,947
Assets attributable to the shareholder held within the long-term funds	–	2,317	2,317	–	2,317
Total shareholders' funds	–	2,317	2,317	1,947	4,264
Adjustments onto a regulatory basis:					
Life assurance business					
Unallocated surplus within insurance business	631	–	631	–	631
Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities	–	(109)	(109)	(855)	(964)
Adjustment to include estimated 'realistic' liabilities payable to the shareholder	(693)	–	(693)	–	(693)
Adjustment to replace 'realistic' liabilities with statutory liabilities	3,721	–	3,721	–	3,721
Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With Profit Fund	(32)	–	(32)	–	(32)
Recognition of future profits for regulatory capital purposes	–	–	–	–	–
Qualifying loan capital	–	–	–	525	525
Available capital resources	3,627	2,208	5,835	1,617	7,452

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.

The comparative position as at 31 December 2005 was as follows (again, relating to Scottish Widows plc only):

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2005					
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
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 Profit Fund	(43)	–	(43)	–	(43)
Recognition of future profits for regulatory capital purposes	–	500	500	–	500
Qualifying loan capital	–	–	–	561	561
Available capital resources	2,302	2,663	4,965	1,307	6,272

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 Profit Fund and a Non-Participating 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-Participating 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-Participating 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-Participating 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 Profit Fund. At 31 December 2006, the estimated value of surplus admissible assets in the Non-Participating Fund was £2,208 million (31 December 2005: £2,163 million) and the estimated value of the Support Account was £964 million (31 December 2005: £1,115 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-Participating 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-Participating 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 2006, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £4,219 million (31 December 2005: £4,140 million) and the estimated combined value of the Support Account and Further Support Account was £2,869 million (31 December 2005: £2,836 million).

Other restrictions in the Non-Participating Fund:

In addition to the policies which existed at the date of demutualisation, the With Profit 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 2006 is £210 million (31 December 2005: £267 million). Scottish Widows has obtained from the FSA permission to include the value of this support in assessing the realistic value of assets available to the With Profit Fund. There is a further test requiring that no amounts can be transferred from the Non-Participating 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 movements in Scottish Widows plc's available capital resources can be analysed as follows:

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2005	2,302	2,663	4,965	1,307	6,272
Changes in assumptions used to measure life assurance liabilities	**208**	**(29)**	**179**	**–**	**179**
Dividends and capital transfers	**–**	**(750)**	**(750)**	**499**	**(251)**
Changes in regulatory requirements	**–**	**155**	**155**	**26**	**181**
New business and other factors	**1,117**	**169**	**1,286**	**(215)**	**1,071**
As at 31 December 2006	**3,627**	**2,208**	**5,835**	**1,617**	**7,452**

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

With Profit Fund:

Available capital in the With Profit Fund has increased from £2,302 million at 31 December 2005 to an estimated £3,627 million at 31 December 2006 primarily as a result of strong investment market performance.

Non-Participating Fund:

Available capital in the Non-Participating Fund has decreased from £2,663 million at 31 December 2005 to an estimated £2,208 million at 31 December 2006. This is primarily a result of a proposed transfer from the Non-Participating Fund to the Shareholder Fund at the year end of £750 million, offset by regulatory changes which reduced liabilities and by the return generated from the business.

Shareholder Fund:

Available capital in the Shareholder Fund has increased from £1,307 million at 31 December 2005 to an estimated £1,617 million at 31 December 2006. During the year Scottish Widows Unit Trust Managers Limited was purchased at its market value of £380 million, and was written down to £47 million as required by the regulations. The resultant reduction in capital, together with dividends paid of £251 million, is offset by the proposed transfer from the Non-Participating Fund noted above and by net investment returns.

Financial information calculated on a 'realistic' basis

The estimated financial position of the With Profit Fund of Scottish Widows at 31 December 2006, calculated on a 'realistic' basis, is given in the following table, in the form reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the estimated 'realistic' financial position of the Long Term Fund of Scottish Widows as a whole, which consists of both the With Profit Fund and the Non-Participating Fund.

	31 December 2006		31 December 2005[1]	
	With Profit Fund £m	Long Term Fund £m	With Profit Fund £m	Long Term Fund £m
Realistic value of assets of fund	18,121	22,330	19,018	23,242
Support arrangement assets	1,174	–	1,115	–
Realistic value of assets available to the fund	19,295	22,330	20,133	23,242
Realistic value of liabilities of fund	(18,183)	(18,111)	(19,253)	(19,102)
Working capital for fund	1,112	4,219	880	4,140
Working capital ratio for fund	5.8%	18.9%	4.4%	17.8%

[1] Subsequent to publication of the 2005 results, Scottish Widows obtained from the FSA permission to include the value of additional support assets in respect of policies written since demutualisation in assessing the realistic value of assets available to the With Profit Fund. The actual year end working capital ratios for the With Profit Fund and the Long Term Fund based on information from the final FSA returns were 5.5 per cent and 17.7 per cent respectively.

Scottish Widows continues to be well capitalised with the working capital ratios for the With Profit Fund and the Long Term Fund being an estimated 5.8 per cent (31 December 2005: 5.5 per cent in the final FSA returns) and 18.9 per cent (31 December 2005: 17.7 per cent in the final FSA returns) respectively.

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

	31 December 2006		31 December 2005	
	With Profit Fund £m	Long Term Fund £m	With Profit Fund £m	Long Term Fund £m
Available regulatory capital	3,627	5,835	2,302	4,965
Support arrangement assets	1,174	–	1,115	–
Adjustments to replace statutory liabilities with 'realistic' liabilities	(3,721)	(3,544)	(2,580)	(2,291)
Adjustments to include the value of future profits recognised in respect of Non-Participating business written in the With Profit Fund	32	32	43	43
Removal of future profits allowable for regulatory capital purposes	–	–	–	(500)
Recognition of future profits allowable for 'realistic' capital purposes	–	1,896	–	1,923
	1,112	4,219	880	4,140

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

	Scottish Widows plc With Profit Fund (in accordance with FRS 27) £m	Other long-term funds £m	Total life business £m
As at 31 December 2006			
With Profit Fund liabilities	**17,827**	**116**	**17,943**
Unit-linked business (excluding that accounted for as investment contracts)	**–**	**12,734**	**12,734**
Other life assurance business	**–**	**10,181**	**10,181**
Insurance and participating investment contract liabilities	**17,827**	**23,031**	**40,858**
Non-participating investment contract liabilities	**–**	**24,370**	**24,370**
Total policyholder liabilities	**17,827**	**47,401**	**65,228**

	Scottish Widows plc With Profit Fund (in accordance with FRS 27) £m	Other long-term funds £m	Total life business £m
As at 31 December 2005			
With Profit Fund liabilities	18,720	133	18,853
Unit-linked business (excluding that accounted for as investment contracts)	–	10,779	10,779
Other life assurance business	–	10,324	10,324
Insurance and participating investment contract liabilities	18,720	21,236	39,956
Non-participating investment contract liabilities	–	21,839	21,839
Total policyholder liabilities	18,720	43,075	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 Profit Fund

The with-profits realistic liabilities and the available capital for the With Profit 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 sensitive to the level of the stock market, with the position worsening at low stock market levels as a result of the guarantees to policyholders increasing in value. However, the exposure to guaranteed annuity options increases under rising stock market levels. 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 Profit Fund is partly mitigated by the actions that can be taken by management.

Other long-term funds

Outside the With Profit 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). Reinsurance arrangements are in place to reduce the Group's exposure to deteriorating mortality rates in respect of life assurance contracts. 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 Profit Fund and in other funds.

Options and guarantees within the With Profit Fund

The most significant options and guarantees provided from within the With Profit 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 Profit 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 2006 of £1.8 billion (2005: £1.7 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 Profit 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. The risk-free yield is defined as 0.1 per cent higher than spot yields derived from the UK gilt yield curve
- 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 2006, the 10 year equity-implied at-the-money assumption was set at 20 per cent (31 December 2005: 20 per cent). The long-term at-the-money assumption for property was 15 per cent (31 December 2005: 15 per cent). The equivalent assumption for fixed interest stocks was 13 per cent (31 December 2005: 13.5 per cent)

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 include an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

Options and guarantees outside the With Profit Fund of Scottish Widows

Abbey Life currently has a number of policies in force which have a guaranteed annuity option. It holds traditional regulatory reserves of £257 million to cover this liability at 31 December 2006 (£332 million at 31 December 2005). 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 £27 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 £4 million at 31 December 2006 (£5 million at 31 December 2005) 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 £98 million (31 December 2005: £108 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 £6 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £17 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 was the first year in which the annual report and accounts were prepared under International Financial Reporting Standards (IFRS). 2004 and earlier years had been prepared under UK Generally Accepted Accounting Principles (UK GAAP) and earlier years had 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) were applied only from 1 January 2005. To aid comparison, IFRS balance sheet data is presented as at 1 January 2005 rather than 31 December 2004; the 2004 IFRS income statement data is not comparable to the data for 2005 and 2006. The financial statements for each of the years presented have been audited by PricewaterhouseCoopers LLP, independent accountants.

	IFRS			UK GAAP		
	2006	2005	2004	2004	2003	2002
Income statement data for the year ended 31 December (£m)						
Total income, net of insurance claims	**11,104**	10,540	9,661	9,343	9,672	8,658
Operating expenses	**(5,301)**	(5,471)	(5,297)	(4,917)	(5,173)	(4,913)
Trading surplus	**5,803**	5,069	4,364	4,426	4,499	3,745
Impairment losses on loans and advances	**(1,555)**	(1,299)	(866)	(866)	(950)	(1,029)
Profit before tax	**4,248**	3,820	3,477	3,493	4,348	2,618
Profit for the year	**2,907**	2,555	2,459	2,489	3,323	1,852
Profit for the year attributable to equity shareholders	**2,803**	2,493	2,392	2,421	3,254	1,790
Total dividend for the year[1]	**1,927**	1,915	1,914	1,914	1,911	1,908
	31 December 2006	31 December 2005	1 January 2005	31 December 2004	31 December 2003	31 December 2002
Balance sheet data (£m)						
Share capital	**1,429**	1,420	1,419	1,419	1,418	1,416
Shareholders' equity	**11,155**	10,195	9,489	9,977	9,624	7,943
Net asset value per ordinary share	**195p**	180p	167p	176p	170p	140p
Customer accounts	**139,342**	131,070	126,349	122,062	116,496	116,334
Subordinated liabilities	**12,072**	12,402	11,211	10,252	10,454	10,168
Loans and advances to customers	**188,285**	174,944	161,162	154,240	135,251	134,474
Total assets	**343,598**	309,754	292,854	279,843	252,012	252,561
	2006	2005	2004	2004	2003	2002
Share information						
Basic earnings per ordinary share	**49.9p**	44.6p	42.8p	43.3p	58.3p	32.1p
Diluted earnings per ordinary share	**49.5p**	44.2p	42.5p	43.0p	58.1p	32.0p
Total dividend per ordinary share[1]	**34.2p**	34.2p	34.2p	34.2p	34.2p	34.2p
Market price (year-end)	**571.5p**	488.5p	473p	473p	448p	446p
Number of shareholders (thousands)	**870**	920	953	953	974	973
Number of ordinary shares in issue (millions)[2]	**5,638**	5,603	5,596	5,596	5,594	5,583
	2006	2005	2004	2004	2003	2002
Financial ratios (%)[3]						
Dividend payout ratio	**68.7**	76.8	80.0	79.1	58.7	106.6
Post-tax return on average shareholders' equity	**26.6**	25.6	22.8	24.3	38.5	16.8
Post-tax return on average risk-weighted assets	**1.89**	1.81	1.99	2.01	2.63	1.62
Cost:income ratio[4]	**47.7**	51.9	54.8	51.4	52.2	55.3
	31 December 2006	31 December 2005	1 January 2005	31 December 2004	31 December 2003	31 December 2002
Capital ratios (%)						
Total capital	**10.7**	10.9	10.1	10.0	11.3	9.6
Tier 1 capital	**8.2**	7.9	8.2	8.9	9.5	7.7

[1] Annual dividends comprise both interim and estimated 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 later years).

The board

* 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

Non-executive directors

Sir Victor Blank◆◆†++
Chairman
Joined the board in March 2006 as deputy chairman and became chairman 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 and of GUS from 1993 to 2006 (chairman from 2000). Chairman of Trinity Mirror from 1999 to 2006. 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 64.

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, GfK AG and Telekom Austria. Board member of the Institute for the Future. Aged 64.

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. A non-executive director of Noble Grossart and Stagecoach Group and a member of the court of the University of St Andrews. A former chairman of tie and non-executive director of John Wood Group. Aged 64.

Jan P du Plessis✠*◆
Joined the board in 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 53.

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 65.

Sir Julian Horn-Smith✠◆†+
Joined the board in 2005. Held a number of senior and general management appointments in Vodafone from 1984 to 2006 including a directorship of that company from 1996 and deputy chief executive officer from 2005. Previously held positions in Rediffusion from 1972 to 1978, Philips from 1978 to 1982 and Mars GB from 1982 to 1984. Chairman of The Sage Group. Aged 58.

DeAnne S Julius CBE✠†
(retiring on 9 May 2007)
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. A former non-executive director of the Bank of England. Aged 57.

Lord Leitch✠*◆+
Joined the board in 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 the government's Review of Skills and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster and United Business Media. Former chairman of the National Employment Panel. Aged 59.

The board

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 55.

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 58.

Terri A Dial
Group Executive Director, UK Retail Banking
Joined the board in 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 a member of the London Skills and Employment Board. Aged 57.

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. A member of the board of the Association of British Insurers. Aged 54.

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 56.

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 44.

Alastair J Michie FCIS FCIBS
Company Secretary

Directors' report

Results and dividends

The consolidated income statement on page 63 shows a profit attributable to equity shareholders for the year ended 31 December 2006 of £2,803 million.

An interim dividend of 10.7p per ordinary share was paid on 4 October 2006 and a final dividend of 23.5p per ordinary share will be paid on 2 May 2007. These dividends will absorb £1,927 million.

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

The Company is a holding company and its subsidiary undertakings provide a wide range of banking and financial services through branches and offices in the UK and overseas. A review of the development and performance of the business during the financial year and an indication of likely future developments are given on pages 2 to 44. Key performance indicators are shown on pages i and ii. 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 28 to 38 and in note 47 on pages 113 to 117.

Authority to purchase shares

The authority for the Company to purchase, in the market, up to 568 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 46 and 47. Particulars of their emoluments and interests in shares in the Company are given on pages 52 to 61.

Mr M A van den Bergh and Mrs A A Knight left the board on 11 May 2006 and 31 October 2006, respectively. Dr Julius will retire at the annual general meeting in 2007.

Sir Victor Blank joined the board on 1 March 2006.

In accordance with the articles of association, Dr Berndt, Mr Brown, Mr Daniels and Mrs Weir retire at the annual general meeting and offer themselves for re-election.

Directors' indemnities

At the Company's annual general meeting, new arrangements for indemnifying directors were approved. The Company subsequently agreed individual contracts of indemnity with the directors which constitute 'qualifying third party indemnity provisions' for the purposes of the Companies Act 1985. These contracts were in force from 11 May 2006 until the end of the financial year and are available for inspection at the Company's registered office.

Employees

The Lloyds TSB Group is committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief.

In the UK, the Lloyds TSB Group belongs to the major employer groups campaigning for equality for the above groups of staff, including Employers' Forum on Disability, Employers' Forum on Age and Stonewall. The Group is also represented on the Board of Race for Opportunity and the Equal Opportunities Commission. Our involvement with these organisations enables us to identify and implement best practice for our 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 the Lloyds TSB Group.

Donations

The income statement includes a charge for charitable donations totalling £37,335,000 (2005: £34,870,000), including £37,133,000 (2005: £34,450,000) under deeds of covenant to the four Lloyds TSB Foundations, which will be paid during 2007.

Policy and practice on payment of creditors

The Company follows 'The Better Payment Practice Code' published by the Department of Trade and Industry, regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the Department of Trade and Industry as shown on page 128.

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 2006, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is nil.

Auditors and audit information

Each person who is a director at the date of approval of this report confirms that, so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

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
22 February 2007

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 corporate governance code issued by the Financial Reporting Council. Sir Victor Blank, who was considered to be independent on appointment as chairman of the company, was appointed as an additional member of the remuneration committee in August 2006, as permitted by the new code issued in June 2006. Otherwise, the Group has complied with the provisions of the previous code, which was relevant for the 2006 financial year, and has done so throughout the year regarding the provisions where the 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. 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 approval of their fees; and the appointment of senior executives within the organisation and related succession 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.

During the year, the board conducted a formal evaluation of its performance and that of its committees and individual directors, with advice and assistance from Dr Tracy Long, of Boardroom Review. Directors were invited to comment, through questionnaires and interviews, and responses were reviewed and discussed by the board. Where areas for improvement were identified, action has been agreed.

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

The remuneration committee reviewed the performance of the chairman, the group chief executive and the other group executive directors, when considering their remuneration arrangements. The nomination committee reviewed 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. Major shareholders are also offered the opportunity to meet new non-executive directors. 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 2006 was decided on a poll. Votes representing some fifty 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 were announced immediately after the meeting and displayed on our website, www.lloydstsb.com and are available from the company secretary.

The resolutions to be considered at the annual general meeting in 2007 will also be decided on a poll. Details of the results will be announced immediately after the meeting and will be displayed 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 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 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 51); the results of the external audit and its cost effectiveness; and reports from the external auditors on audit planning and their findings on accounting and internal control systems. 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 director of group 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 Sir Victor Blank (chairman), Dr Berndt, Mr du Plessis, Sir Julian Horn-Smith and Lord Leitch, reviews the structure, size and 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 of the company; and the appointment of any director to executive or other office in the company, although the chairman of the company would not chair the committee when it was dealing with the appointment of a successor to the chairmanship of the company.

In January 2006, it was announced that Mr van den Bergh had decided to retire as chairman and Sir Victor Blank, who became deputy chairman on 1 March, succeeded him as chairman of the company at the conclusion of the annual general meeting in May. The selection process relating to Sir Victor's appointment was described fully in the annual report for 2005.

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 52 to 61 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 Sir Victor Blank (chairman), Mr Brown, Sir Julian Horn-Smith and Lord Leitch. 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 management framework and its risk appetite, strategy, principles 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.

Attendance at meetings

The attendance of directors at board meetings and at meetings of the audit, nomination, remuneration and risk oversight committees during 2006 was as follows:

	Board	Audit committee	Nomination committee	Remuneration committee	Risk oversight committee
Number of meetings during the year	**12**	**6**	**4**	**7**	**5**
Current directors who served during 2006					
W C G Berndt[1]	11		2	7	
Sir Victor Blank[2]	9		3	2	3
Ewan Brown[3]	12	5	3		5
J E Daniels	12				
T A Dial	11				
J P du Plessis[1]	10	6	2		
M E Fairey	11				
G J N Gemmell	11	6			
Sir Julian Horn-Smith[1]	11		2	6	4
D S Julius[3]	7		3	4	
A G Kane	10				
Lord Leitch[4]	11	4	2		3
G T Tate	11				
H A Weir	11				
Former directors who served during 2006					
A A Knight[5]	10	6			
M A van den Bergh[6]	5		1		2

[1] Appointed to the nomination committee from 1 August 2006.
[2] Appointed to the board from 1 March 2006, nomination committee from 11 May 2006, remuneration committee from 1 August 2006 and risk oversight committee from 21 April 2006.
[3] Left the nomination committee on 1 August 2006.
[4] Appointed to the nomination committee from 1 August 2006 and risk oversight committee from 1 March 2006.
[5] Left the board on 31 October 2006.
[6] Left the board on 11 May 2006.

Statement of directors' responsibilities

The directors are responsible for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the consolidated and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. The directors consider that in preparing the financial statements on pages 63 to 127, 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 and the directors' remuneration report comply with the Companies Act 1985 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation. 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 including the Turnbull Guidance published in 2005. 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 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 risk 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 2006. All returns have been satisfactorily completed and appropriately certified. The overall assessment of the control framework is satisfactory, acknowledging that there are specific areas for improvement where action plans are now in place and will be tracked to completion. None of the actions or areas of focus identified constitutes a significant failing or weakness.

The effectiveness of the internal control system is reviewed regularly by the audit committee and the board, which also receive reports of reviews undertaken around the Lloyds TSB Group by its risk management function 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 the 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 2006.

Statement from Wolfgang Berndt

To ensure that our remuneration framework remains both cost effective and competitive, and following a comprehensive and independent policy review in 2005, a number of significant policy changes were implemented in 2006. An important change was the introduction of a new long-term incentive plan, which was implemented following shareholder approval and used for all long-term awards made during the year. I am confident that this plan will continue to underpin our primary objective of attracting, retaining and motivating executives of the highest calibre.

The committee met on seven occasions during 2006, and although not proposing any significant changes to the Group's executive remuneration framework, the committee recommended that the competitive market positioning of our package should continue to be measured against the FTSE 20, and at the same time take closer account of the remuneration practice of our direct competitors, namely the major UK banks. It is typically against these organisations that we are competing for high calibre talent.

Following detailed independent market analysis and review, it is apparent that certain levels of basic salary as well as our annual maximum bonus opportunity, including the level of award for on-target performance achievement, are behind the market, particularly when compared with our main competitors in the financial services sector. As a result, the salary adjustments implemented from 1 January 2007 have been designed to bring base pay levels closer in line with the competitive market place. In addition, from 2007 the maximum bonus opportunity for executive directors will be increased to 200 per cent (225 per cent for Mr Daniels). However, although the underlying structure of the scheme will remain unchanged, with half of the maximum opportunity being triggered for on-target performance achievement, significantly more stretching targets will need to be met to qualify for maximum payment. In addition, and notwithstanding Mr Daniels' increase in bonus opportunity from 2007, the level of bonus award for on-target achievement will remain 112.5 per cent of basic salary payable on the achievement of stretching targets contained in a balanced scorecard. Any payout will continue to reflect actual achievements linked explicitly to individual and organisational performance.

We believe that the remuneration framework which is set out below is entirely consistent with our policy to align executive director remuneration firmly with shareholders' interests as well as engaging the executive directors in pursuing long-term shareholder value. The remuneration committee unanimously recommends that the 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, 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)
- Sir Julian Horn-Smith
- Dr Julius

Sir Victor Blank, a non-executive director, joined the committee in August 2006 as permitted by the combined code on corporate governance issued by the Financial Reporting Council in June 2006.

Advisers to the committee

Towers Perrin and Kepler Associates were engaged 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.

In addition, in 2006, 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 long-term incentive schemes.

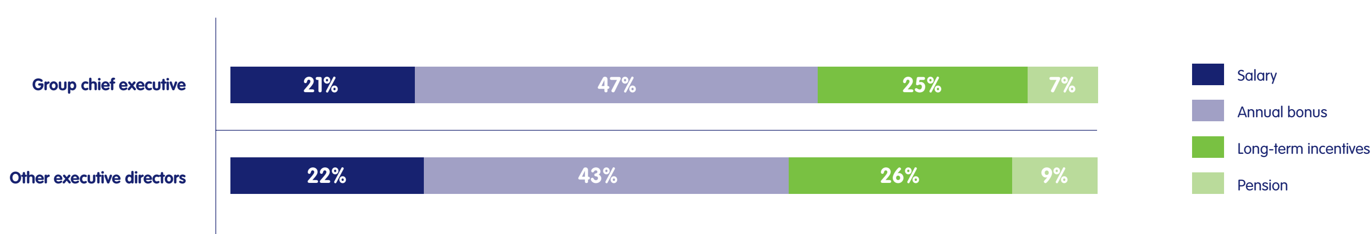
Mr van den Bergh (until 11 May 2006), Mr Daniels, Mr Hijkoop (Group Human Resources Director) and Mr Farley (Group Compensation & Benefits Director) provided guidance to the committee (other than for their own remuneration).

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 adopted as the comparator group used to benchmark overall competitiveness of the remuneration package whilst taking particular account of the remuneration practice of our direct competitors, namely the major UK banks. The FTSE 20 is regarded as providing a realistic and relevant comparison in terms of company size and sector, as well as being a key market for talent.
- Basic salaries positioned to reflect the relevant market median and total direct compensation (basic salary, annual incentives and the value of long-term incentives) designed to enable upper quartile performance to be rewarded with upper quartile remuneration levels.
- 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 1.5 times (2 times for the group chief executive) the directors' base pay. Executives are 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 2007 will be as follows:



In 2007, approximately 69 per cent (72 per cent for the group chief executive) of an executive director's potential direct remuneration (salary, annual bonus, long-term incentives and pension) will be performance related, based upon maximum opportunity. 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 remuneration

The chairman's remuneration comprises salary and benefits which are broadly similar to those extended to the executive directors. However, he does not participate in the annual bonus and long-term incentive arrangements, nor is he entitled to pension benefits.

The chairman's salary is reviewed annually, usually in December, taking into account performance and market information and then adjusted from 1 January of the following year. His salary from 1 January 2007 is £600,000.

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. 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 from 1 January 2007 are listed below with the figures applicable since the previous review in April 2005 in brackets.

Board	£60,000	(£50,000)
Audit committee chairmanship	£50,000	(£40,000)
Audit committee membership	£15,000	(£15,000)
Nomination committee membership	£5,000	(£5,000)
Remuneration committee chairmanship	£25,000	(£20,000)
Remuneration committee membership	£15,000	(£15,000)
Risk oversight committee membership	£15,000	(£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 56.

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. Whilst the salary increases awarded to executive directors are normally consistent with this policy, any variation will be supported by robust and independent competitive market analysis. Salaries payable from 1 January 2007 are as follows:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
Amount	£960,000	£600,000	£625,000	£550,000	£600,000	£575,000

Annual incentive scheme

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

Incentive awards for executive directors are based upon individual contribution and overall corporate results. Half of the bonus opportunity is driven by corporate performance based on the stretching budget relating to profit before tax and economic profit. The lower of profit before tax and economic profit will determine the extent to which the target has been met. The other half of the bonus opportunity is determined by divisional achievement driven through individual performance. Individual targets are contained in a balanced scorecard and 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 bonus opportunity is 150 per cent (200 per cent from 2007) of basic salary for the achievement of exceptional performance targets; an amount equal to 75 per cent (100 per cent from 2007) of basic salary is 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.

Regarding Mr Daniels' incentive award, and in line with the arrangements for the executive directors, half of his bonus is driven by corporate results and the other half by individual performance. His maximum bonus opportunity is 175 per cent (225 per cent from 2007) of basic salary for the achievement of exceptional performance targets. An amount equal to 112.5 per cent of basic salary is available on the achievement of a range of financial and non-financial measures contained in a balanced scorecard. The non-financial measures include key performance indicators relating to customer service, process efficiency, service quality, risk and employees (e.g. employee engagement). 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.

Following the adoption of the new long-term incentive plan, and the discontinuation of the performance share plan, awards under the annual incentive scheme are made in cash only.

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 2006, the bonus percentages awarded to the directors are shown in the table below:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
Opportunity	175%	150%	150%	150%	150%	150%
% awarded	162.5%	140%	150%	140%	140%	140%

These payments reflect the significant progress made by the Group against its key performance indicators. Both the profit before tax and economic profit exceeded the amounts required for payment of the maximum award relating to corporate performance. The tables on pages i and ii demonstrate the considerable progress made by the Group and each division.

Long-term incentive plan

The aim of the new long-term incentive plan, approved by shareholders in 2006, 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. Under the plan, awards of shares may be made, with the number of shares received subject to the satisfaction of two distinct pre-determined performance conditions, measuring performance of the Group.

50 per cent of the award (the 'TSR Award') will be based on a condition measuring the Group's TSR against the comparator group listed below. In order for the TSR Award 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. 17.5 per cent of the TSR Award (8.75 per cent of the total 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, the TSR Award will lapse.

From 2007, and to align performance and vesting periods, the TSR performance period will start on the date awards are granted, and average the share price over three months before the grant date. This replaces the current approach of calculating the TSR in line with the financial year, taking an average share price over the preceding three months.

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 other 50 per cent of the award (the 'EPS Award') will be based on earnings per share ('EPS') growth calculated on a compound annualised basis. In order for the EPS Award 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. 17.5 per cent of the EPS Award (8.75 per cent of the total 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, the EPS 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 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.

EPS is the Group's normalised earnings per ordinary share as shown in the Group's report and accounts, adjusted if necessary for consistency.

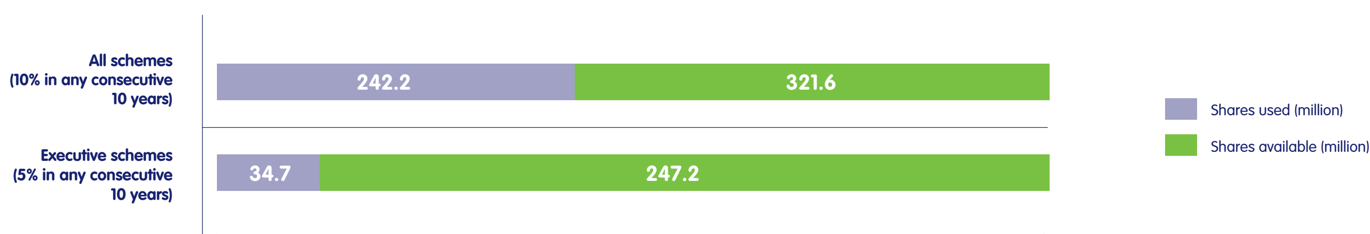
Details of previous long-term incentive plans are shown on pages 60 and 61.

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 6 months' notice if they wished to leave. Executive directors normally retire at age 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65.

Independent non-executive directors do not have service agreements and their appointment may be terminated, in accordance with the articles of association, 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

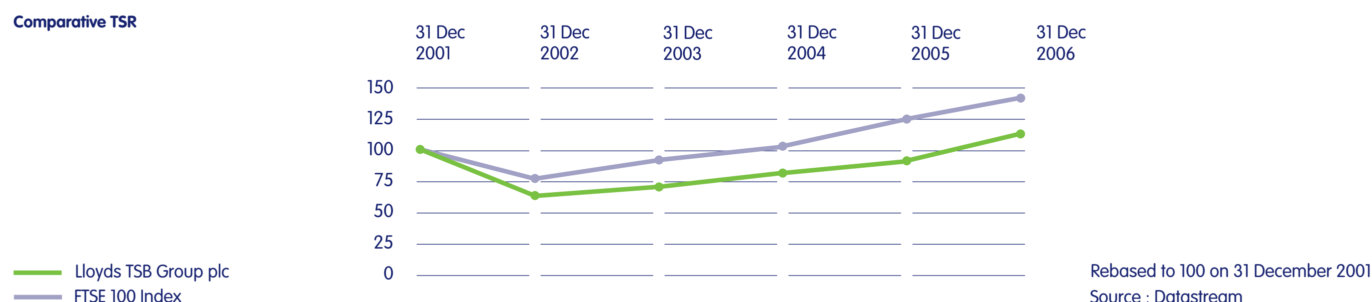
External appointments

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 2006, Ms Dial and Mrs Weir received fees of $159,475 and £36,000 respectively, which were retained by them, for serving as non-executive directors of other companies. In addition Mrs Weir received and retained £15,000 for serving as a member of the Accounting Standards Board in 2006.

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 2006

	Salaries/ fees £000	Other benefits Cash £000	Other benefits Non cash £000	Performance-related payments £000	Compensation for loss of office £000	2006 Total £000	2005 Total £000
Current directors who served during 2006							
Executive directors							
J E Daniels	880	103	5	1,456		2,444	1,930
M E Fairey	570	493	7	815		1,885	1,462
T A Dial	570	273	4	872		1,719	877
A G Kane	500	19	18	715		1,252	919
G T Tate	515	42	10	736		1,303	1,075
H A Weir	500	77	18	715		1,310	963
Non-executive directors							
Sir Victor Blank	405					405	–
W C G Berndt	72					72	67
Ewan Brown	134					134	122
J P du Plessis	67					67	16
G J N Gemmell	121					121	121
Sir Julian Horn-Smith	82					82	74
D S Julius	68					68	66
Lord Leitch	80					80	16
Former directors who served during 2006							
M A van den Bergh	183	4				187	487
A A Knight	92					92	105
Former directors who served during 2005							
P G Ayliffe					36	36	401
Others							125
	4,839	1,011	62	5,309	36	11,257	8,826

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 2006 (2005: £10,000 waived).

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 £14,750 in 2006 (2005: £14,000 waived).

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 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 earnings 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.

The amount shown for Mr Ayliffe reflects payments he received in accordance with his contractual entitlement.

Directors' pensions

The executive directors are members of one of the pension schemes provided by the Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined the 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.

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 the 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 2006, the employer has made contributions to the defined contribution scheme in respect of him totalling £79,825.

Mrs Weir is a member of a defined contribution scheme. During the year to 31 December 2006, the employer has made contributions to the defined contribution scheme in respect of her totalling £42,500.

Defined benefit scheme members

	Accrued pension at 31 December 2006 £000 (a)	Accrued pension at 31 December 2005 £000 (b)	Change in accrued pension £000 (a)-(b)	Transfer value at 31 December 2006 £000 (c)	Transfer value at 31 December 2005 £000 (d)	Change in transfer value £000 (c)-(d)	Additional pension earned to 31 December 2006 £000 (e)	Transfer value of the increase £000 (f)
J E Daniels	120	99	21	2,100	1,599	501	19	326
M E Fairey	287	256	31	6,024	5,003	1,021	24	501
A G Kane	265	240	25	4,415	3,700	715	19	310
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	13	0	196	190	6		

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 2006 and 2005, 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 2006 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 2005 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 the 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.

Major changes to the legislation governing the provision of pensions in the UK (known as pension simplification) came into effect in April 2006. Benefits from an approved pension scheme will be limited to the Lifetime Allowance, currently £1.5 million which is equivalent to an annual pension of £75,000. Any benefit in excess of this amount will incur a tax charge for the individual. The Group has agreed that if an executive director has benefits in excess of the Lifetime Allowance they may cease to accrue benefits in the Scheme and receive a salary supplement as an alternative. This will not cost the Group more than the current arrangements. The Group will not compensate any individual in respect of any increased tax liability arising from pension simplification. To date, the executive directors affected have elected to continue to accrue benefits in the approved scheme.

Directors' interests

The interests, all beneficial, of those who were directors at 31 December 2006 in shares in Lloyds TSB Group were:

Shares	At 1 January 2006 (or later date of appointment)	At 31 December 2006	At 22 February 2007†
Executive directors			
J E Daniels	160,942	**165,174**	**165,225**
M E Fairey	79,104	**82,864**	**82,883**
T A Dial	–	**577**	
A G Kane	100,101	**136,078**	**136,129**
G T Tate	1,356	**4,139**	**4,190**
H A Weir	3,992	**6,255**	
Non-executive directors			
Sir Victor Blank	100,000	**100,000**	
W C G Berndt	61,000	**96,000**	
Ewan Brown	4,260	**4,469**	
J P du Plessis	10,000	**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**	
Lord Leitch	–	**10,000**	

† The changes in beneficial interests between 31 December 2006 and 22 February 2007 related to 'partnership' and 'matching' shares acquired under the Lloyds TSB Group shareplan.

Non-beneficial interests

Directors had non-beneficial interests as follows:

Sir Victor Blank, Mr Daniels, Mr Fairey, Ms Dial, Mr Kane, Mr Tate and Mrs Weir, together with some 70,000 other employees, were potential beneficiaries in the 1,364 and 1,138,311 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 1,237,191 shares, respectively, were held by these trusts at the beginning of the year. These holdings were 1,364 and 1,040,107 respectively on 22 February 2007. In addition, the above directors, together with some 70,000 other employees, were potential participants in shareplan and were, therefore, treated as interested in the 898,320 shares held at the end of the year by the trustee of the shareplan. 582,462 shares were held by the trustee at the beginning of the year. This holding was 1,072,882 on 22 February 2007.

Interests in share options

	At 1 January 2006	Granted during the year	Exercised/ lapsed during the year	At 31 December 2006	Exercise price	Exercise periods From	To	Notes
J E Daniels	330,419		330,419	–	715p	6/3/2005	5/3/2012	d, j
	3,327		3,327	–	284p	1/6/2006	30/11/2006	a, i
	599,239			599,239	394.25p	21/2/2006	20/2/2013	d, g
	305,232			305,232	430p	14/8/2006	13/8/2013	d, g
	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
		2,236		2,236	418p	1/6/2009	30/11/2009	a, h
M E Fairey	797		797	–	474p	1/11/2005	30/4/2006	a, i
	54,000		54,000	–	510p	26/3/2000	25/3/2007	b, i
	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
	345,104		345,104	–	715p	6/3/2005	5/3/2012	d, j
	1,330		1,330	–	284p	1/6/2006	30/11/2006	a, i
	531		531	–	348p	1/11/2006	30/4/2007	a, i
	663,157			663,157	394.25p	21/2/2006	20/2/2013	d, g
	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
		1,789		1,789	418p	1/6/2009	30/11/2009	a, 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, i
	40,000		40,000	–	510p	26/3/2000	25/3/2007	b, i
	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
	275,349		275,349	–	715p	6/3/2005	5/3/2012	d, j
	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, g
	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, g
	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
		3,851		3,851	418p	1/6/2011	30/11/2011	a, 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 plan								
T A Dial	242,825			242,825	(see page 61)	1/6/2008	30/11/2008	h

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 March 2002 and August 2004.

e) Executive options 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 515.5p. In that regard Mr Daniels made a gain of £7,702.
Market price on days of exercise was 545p, 565p, 515.5p and 560.5p respectively. In that regard Mr Fairey made an overall gain of £34,473.
Market price on days of exercise was 565p. In that regard Mr Kane made a gain of £83,000.
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.

The market price for a share in the Company at 1 January 2006 and 31 December 2006 was 488.5p and 571.5p, respectively. The range of prices between 1 January 2006 and 31 December 2006 was 488.5p to 581p.

None of the other directors at 31 December 2006 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 1997. 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
March 1997 – August 1999	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 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.
March 2002 – 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) 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 2006 Lloyds TSB Group was ranked: 17th after four years of the performance period for options granted in 2003; and 10th after three years of the performance period for options granted in 2004. Options granted in 2002 lapsed as the performance condition 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) 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 2006 Lloyds TSB Group was ranked: 11th after two years of the performance period for options granted in 2005.

Lloyds TSB performance share plan

The following bonus and performance shares relating to the bonus awards for 2004 and 2005 are available under the plan.

	Bonus shares			Performance shares				
	At 1 January 2006	Purchased during the year	At 31 December 2006	At 1 January 2006	Conditional award during the year	At 31 December 2006	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
		50,944	50,944		172,694	172,694	566.10p	20/3/2009
M E Fairey	31,901		31,901	108,140		108,140	479p	18/3/2008
		22,459	22,459		76,134	76,134	566.10p	20/3/2009
T A Dial	–	16,909	16,909	–	57,322	57,322	566.10p	20/3/2009
A G Kane	22,171		22,171	75,156		75,156	479p	18/3/2008
		20,531	20,531		69,598	69,598	566.10p	20/3/2009
G T Tate	22,710		22,710	76,982		76,982	479p	18/3/2008
		27,358	27,358		92,738	92,738	566.10p	20/3/2009
H A Weir	16,628		16,628	56,366		56,366	479p	18/3/2008
		20,062	20,062		68,008	68,008	566.10p	20/3/2009

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

Performance shares awarded	Performance conditions
March 2005 and March 2006	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds TSB) must be at least eighth for any shares to be received. If ranked ninth or below no shares would be received. The maximum of two performance shares for each bonus share will be awarded only if the Company is first in the comparator group; one performance share will be awarded for each bonus share if the Company is placed fifth; and one performance share for every two bonus shares if the Company is placed eighth. Between first and fifth positions and fifth and eighth positions a sliding scale will apply. Whilst income tax was 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.

Lloyds TSB long-term incentive plan

The following are conditional share awards available under the plan. The share price for the award was 520p. Further information regarding this plan can be found on page 54.

	At 1 January 2006	Awarded during the year	At 31 December 2006	Year of vesting
J E Daniels	–	507,692	507,692	2009
M E Fairey	–	328,846	328,846	2009
T A Dial	–	328,846	328,846	2009
A G Kane	–	288,460	288,460	2009
G T Tate	–	297,114	297,114	2009
H A Weir	–	288,460	288,460	2009

The following table contains information on the performance conditions for awards made under the long-term incentive plan. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

LTIP award	Performance conditions
May 2006	For 50 per cent of the award (the 'EPS Award') - the percentage increase in EPS of the Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the retail price index over the same period. If it is less than 3 per cent per annum the EPS Award will lapse. If the increase is more than 3 but less than 6 per cent per annum then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. For the other 50 per cent of the award (the 'TSR Award') - it will be necessary for the Group's TSR to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR 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, the TSR Award will lapse.

Alithos Limited provided information for the testing of the TSR performance conditions for the Group's long-term incentive schemes. EPS is the Group's normalised earnings per share as shown in the Group's report and accounts, subject to such adjustments as the remuneration committee regard as necessary for consistency.

Other share plan

Lloyds TSB Group executive share plan 2005

Ms Dial is the only participant in this plan and holds an option, granted to her in June 2005, to acquire 242,825 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 her from the USA and is designed to encourage her to remain with Lloyds TSB Group plc. The option is not, therefore, subject to any performance condition but will normally become exercisable only if she remains an employee, and has not given notice of resignation, on 31 May 2008. Full details of the plan were set out in the 2005 annual report.

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
22 February 2007

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 of Lloyds TSB Group plc for the year ended 31 December 2006 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement 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 2006 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 on page 51.

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 whether, in our opinion, the information given in the directors' report is consistent with the consolidated financial statements. The information given in the directors' report includes that specific information presented in the Group key performance indicators, the chairman's statement, the group chief executive's review and the business review that is cross referred from the principal activities, business review, future developments and financial risk management objectives and policies section of the directors' report.

In addition we report to you if, in our opinion, 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 Combined Code (2003) 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 Group key performance indicators, the chairman's statement, the group chief executive's review, the business review, the five year financial summary, the directors' report, the corporate governance disclosures, the unaudited part of the directors' remuneration report and the information for shareholders. 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 2006 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; and
- the information given in the directors' report is consistent with the consolidated financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
22 February 2007

Consolidated income statement

for the year ended 31 December 2006

	Note	2006 £ million	2005 £ million
Interest and similar income		14,316	12,589
Interest and similar expense		(8,779)	(6,918)
Net interest income	4	5,537	5,671
Fee and commission income		3,116	2,990
Fee and commission expense		(846)	(842)
Net fee and commission income	5	2,270	2,148
Net trading income	6	6,341	9,298
Insurance premium income	7	4,719	4,469
Other operating income	8	806	1,140
Other income		14,136	17,055
Total income		19,673	22,726
Insurance claims	9	(8,569)	(12,186)
Total income, net of insurance claims		11,104	10,540
Operating expenses	10	(5,301)	(5,471)
Trading surplus		5,803	5,069
Impairment losses on loans and advances	11	(1,555)	(1,299)
Profit on sale and closure of businesses	12	–	50
Profit before tax		4,248	3,820
Taxation	13	(1,341)	(1,265)
Profit for the year		2,907	2,555
Profit attributable to minority interests		104	62
Profit attributable to equity shareholders		2,803	2,493
Profit for the year		2,907	2,555
Basic earnings per share	14	49.9p	44.6p
Diluted earnings per share	14	49.5p	44.2p
Dividends per share	43	34.2p	34.2p

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

Consolidated balance sheet

at 31 December 2006

	Note	2006 £ million	2005 £ million
Assets			
Cash and balances at central banks		**1,898**	1,156
Items in the course of collection from banks		**1,431**	1,310
Trading and other financial assets at fair value through profit or loss	15	**67,695**	60,374
Derivative financial instruments	16	**5,565**	5,878
Loans and advances to banks	17	**40,638**	31,655
Loans and advances to customers	18	**188,285**	174,944
Available-for-sale financial assets	20	**19,178**	14,940
Investment property	21	**4,739**	4,260
Goodwill	22	**2,377**	2,373
Value of in-force business	23	**2,723**	2,922
Other intangible assets	24	**138**	50
Tangible fixed assets	25	**4,252**	4,291
Other assets	26	**4,679**	5,601
Total assets		**343,598**	309,754

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

The directors approved the consolidated financial statements on 22 February 2007.

Sir Victor Blank
Chairman

J Eric Daniels
Group Chief Executive

Helen A Weir
Group Finance Director

Consolidated balance sheet

at 31 December 2006

Equity and liabilities	Note	**2006 £ million**	2005 £ million
Liabilities			
Deposits from banks	27	**36,394**	31,527
Customer accounts	28	**139,342**	131,070
Items in course of transmission to banks		**781**	658
Trading and other liabilities at fair value through profit or loss	29	**1,184**	–
Derivative financial instruments	16	**5,763**	6,396
Debt securities in issue	30	**54,118**	39,346
Liabilities arising from insurance contracts and participating investment contracts	31	**41,445**	40,550
Liabilities arising from non-participating investment contracts	32	**24,370**	21,839
Unallocated surplus within insurance businesses	33	**683**	518
Other liabilities	34	**10,985**	9,843
Retirement benefit obligations	35	**2,462**	2,910
Current tax liabilities		**817**	552
Deferred tax liabilities	36	**1,416**	1,145
Other provisions	37	**259**	368
Subordinated liabilities	38	**12,072**	12,402
Total liabilities		**332,091**	299,124
Equity			
Share capital	39	**1,429**	1,420
Share premium account	40	**1,266**	1,170
Other reserves	41	**355**	383
Retained profits	42	**8,105**	7,222
Shareholders' equity		**11,155**	10,195
Minority interests		**352**	435
Total equity		**11,507**	10,630
Total equity and liabilities		**343,598**	309,754

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 2005	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
Capital invested by minority shareholders	–	–	–	–	329	329
Balance at 31 December 2005	2,590	383	7,222	10,195	435	10,630
Movement in available-for-sale financial assets, net of tax	–	(31)	–	(31)	–	(31)
Movement in cash flow hedges, net of tax	–	1	–	1	–	1
Currency translation differences	–	2	(31)	(29)	(4)	(33)
Net income recognised directly in equity	–	(28)	(31)	(59)	(4)	(63)
Profit for the year	–	–	2,803	2,803	104	2,907
Total recognised income for 2006	–	(28)	2,772	2,744	100	2,844
Dividends	–	–	(1,919)	(1,919)	(32)	(1,951)
Purchase/sale of treasury shares	–	–	(35)	(35)	–	(35)
Employee share option schemes:						
– value of employee services	–	–	65	65	–	65
– proceeds from shares issued	105	–	–	105	–	105
Repayment of capital to minority shareholders	–	–	–	–	(151)	(151)
Balance at 31 December 2006	**2,695**	**355**	**8,105**	**11,155**	**352**	**11,507**

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

Consolidated cash flow statement

for the year ended 31 December 2006

	Note	2006 £ million	2005 £ million
Profit before tax		**4,248**	3,820
Adjustments for:			
Change in operating assets	49(a)	**(31,995)**	(17,158)
Change in operating liabilities	49(b)	**33,069**	10,039
Non-cash and other items	49(c)	**1,555**	4,364
Tax paid		**(798)**	(708)
Net cash provided by operating activities		**6,079**	357
Cash flows from investing activities:			
Purchase of available-for-sale financial assets		**(23,448)**	(10,108)
Proceeds from sale and maturity of available-for-sale financial assets		**18,106**	10,266
Purchase of fixed assets		**(1,724)**	(1,843)
Proceeds from sale of fixed assets		**1,257**	1,073
Acquisition of businesses, net of cash acquired	49(f)	**(20)**	(27)
Disposal of businesses, net of cash disposed	49(g)	**936**	(4)
Net cash used in investing activities		**(4,893)**	(643)
Cash flows from financing activities:			
Dividends paid to equity shareholders		**(1,919)**	(1,914)
Dividends paid to minority interests	49(e)	**(32)**	(37)
Interest paid on subordinated liabilities		**(713)**	(668)
Proceeds from issue of subordinated liabilities	49(e)	**1,116**	1,361
Proceeds from issue of ordinary shares	49(e)	**105**	26
Repayment of subordinated liabilities	49(e)	**(759)**	(232)
Capital element of finance lease rental payments	49(e)	**–**	(2)
Capital invested by minority shareholders	49(e)	**–**	329
Repayment of capital to minority shareholders	49(e)	**(151)**	–
Net cash used in financing activities		**(2,353)**	(1,137)
Effects of exchange rate changes on cash and cash equivalents		**(148)**	(20)
Change in cash and cash equivalents		**(1,315)**	(1,443)
Cash and cash equivalents at beginning of year		**26,753**	28,196
Cash and cash equivalents at end of year	49(d)	**25,438**	26,753

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

Notes to the group accounts

1 Accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('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 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation.

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 certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

The following IFRS pronouncements relevant to the Group have been adopted in these consolidated financial statements:

(i) Amendment to IAS 19 'Actuarial Gains and Losses, Group Plans and Disclosures'. The Group has not changed its accounting policy for the recognition of actuarial gains and losses as a result of this amendment; the additional disclosures required have been provided in note 35.

(ii) Amendment to IAS 39 'Financial Instruments: Recognition and Measurement – The Fair Value Option'. This amendment, which was effective from 1 January 2006, changed the criteria for financial assets to be designated at fair value through profit or loss and permitted financial liabilities meeting certain criteria to be designated at fair value for the first time. The adoption of these requirements had no effect upon the classification or valuation of those financial assets that were designated at fair value through profit or loss prior to 1 January 2006; at 31 December 2006, £1.2 billion of financial liabilities had been designated at inception into this category during the year. This change has had no material effect upon the Group's income statement.

(iii) Amendment to IAS 39 'Financial Instruments: Recognition and Measurement' and IFRS 4 'Insurance Contracts – Financial Guarantee Contracts'. Since 1 January 2006, all of the Group's financial guarantee contracts have been accounted for as financial instruments. This change has had no material effect upon the Group's financial statements.

(iv) IFRIC Interpretation 4 'Determining Whether an Arrangement Contains a Lease'. The Group has reviewed the terms of all contracts potentially affected by this interpretation; its adoption has had no material effect upon the Group's financial statements.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2006 and which have not been applied in preparing these financial statements are given in note 50.

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 except where it has been written off directly to reserves in the past.

(c) Other intangible assets

Other intangible assets comprise capitalised software enhancements and customer lists. Capitalised software enhancements are amortised over periods not exceeding five years, being their estimated useful lives, using the straight-line method. Customer lists are amortised over periods not exceeding 15 years, being their estimated useful lives, in line with the income expected to arise from those customers and are subject to annual reassessment. All 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.

(d) Revenue recognition

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, 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 j).

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.

Revenue recognition policies specific to life assurance and general insurance business are detailed below (see r).

1 Accounting policies (continued)

(e) Trading securities, other financial assets and liabilities 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 within net trading income in the period in which they occur.

Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons and dividend income are recognised in the income statement within net trading income in the period in which they occur.

Financial assets and liabilities are designated as at fair value through profit or loss:

- When doing so results in more relevant information because either:
  - it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on them on a different basis; or
  - the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with a documented risk management or investment strategy with management information also prepared on this basis, or
- Where the assets and liabilities contain one or more embedded derivatives that significantly modify the cash flows arising under the contract and would otherwise need to be separately accounted for.

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. 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 and liabilities 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 and liabilities 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.

(f) 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.

The Group has entered into securitisation and similar transactions to finance certain loans and advances to customers. Such financial assets continue to be recognised by the Group, together with a corresponding liability for the funding except in those cases where substantially all of the risks and rewards associated with the assets have been transferred or a significant proportion but not all of the risks and rewards have been transferred and the transferee has the ability to sell the assets when the assets are derecognised in full. If a fully proportional share of all, or of specifically identified, cash flows have been transferred, then that proportion of the assets is derecognised.

(g) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are recognised on the balance sheet where all of the risks and rewards are retained; 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.

(h) 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); (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges); or (3) hedges of net investments in foreign operations (net investment hedges). These are accounted for as follows:

1 Accounting policies (continued)

(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.

(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.

(3) Net investment hedges

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

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.

(i) 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.

(j) Impairment of financial assets

(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 financial assets

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial 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.

1 Accounting policies (continued)

(k) 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.

(l) Tangible fixed assets

Tangible fixed assets are included at cost less accumulated 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: 2-8 years

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

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.

(m) 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.

The Group evaluates non-lease arrangements such as outsourcing and similar contracts to determine if they contain a lease which is then separately accounted for.

(n) 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.

(o) 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 ('the corridor approach'). 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 Group recognises the effect of material changes to the terms of its defined benefit pension plans which reduce future benefits as curtailments; gains and losses are recognised in the income statement when the curtailments occur.

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

1 Accounting policies (continued)

(p) 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.

(q) Taxation

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.

(r) Insurance

The Group undertakes both life assurance and general insurance business.

For accounting purposes the life assurance business issues three types of contract:

Insurance contracts – these contracts contain significant insurance risk, which the Group defines as the possibility of having to pay benefits on the occurrence of an insured event which are significantly more than the benefits payable if the insured event were not to occur.

Investment contracts containing a discretionary participation feature – these contracts do not contain significant insurance risk, but contain features which entitle the holder to receive, in addition to the guaranteed benefits, further amounts that are likely to be a significant proportion of the total benefits and the amount and timing of which is at the discretion of the Group and based upon the performance of specified assets. Contracts with a discretionary participation feature are referred to as participating investment contracts.

Non-participating investment contracts – these contracts do not contain significant insurance risk or a discretionary participation feature.

For accounting purposes the general insurance business only issues insurance contracts.

(1) Life assurance business

(i) Accounting for insurance and participating investment contracts

- Premiums and claims

  Premiums received in respect of insurance and participating investment contracts are recognised as revenue when due, except as detailed below in respect of unit-linked contracts.

  Claims are recorded as an expense when they are incurred.

- Liabilities

  – insurance or participating investment contracts in the Group's With Profit Fund

  Liabilities of the Group's With Profit 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.

  – insurance or participating investment contracts which are not unit-linked or in the Group's With Profit 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.

1 Accounting policies (continued)

– insurance or participating investment contracts which are unit-linked

Allocated premiums in respect of unit-linked contracts that are either insurance 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

Any amounts in the With Profit Fund 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 business

The Group recognises as an asset the value of in-force business in respect of life insurance and participating investment contracts. The asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts written at the balance sheet date determined using appropriate economic and actuarial assumptions, after making allowance for the realistic value of financial options and guarantees. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

During 2006 the Group has changed the way in which it calculates the value of in-force business. Under the new method each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. The new market consistent discount rates replace the single discount rate previously used. The new method also includes an explicit allowance made for non-market risk. The effect of this change in methodology has been to reduce profit before tax in 2006 by £18 million.

(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.

Deposits and withdrawals are accounted for directly in the balance sheet as adjustments to the liability.

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 defers these fees and recognises them on a straight-line basis over the estimated lives of the contracts.

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 discounted 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.

1 Accounting policies (continued)

(s) 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 or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items measured at fair value are recognised in profit or loss, except for differences on available-for-sale non-monetary financial assets such as equity shares, which are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

(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.

(t) 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.

(u) Dividends

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

(v) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months.

2 Critical accounting estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions 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. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgements and estimates, are discussed below.

Loan impairment provisions

The Group regularly reviews its loan portfolios to assess for impairment. Impairment provisions are established to recognise incurred impairment losses in its loan portfolios carried at amortised cost. In determining whether an impairment has occurred at the balance sheet date the Group considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows or 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 loan repayment obligations. Where this is the case, the impairment loss is the difference between the carrying value of the loan and the present value of the estimated future cash flows discounted at the loan's original effective interest rate.

At 31 December 2006 gross loans and advances to customers and banks totalled £231,117 million (2005: £208,672 million) against which impairment provisions of £2,194 million (2005: £2,073 million) had been made.

There are two components of the Group's loan impairment provisions: individual and collective. All impaired loans which exceed a certain threshold, principally within the Group's corporate banking business, are individually assessed for impairment having regard to expected future cash flows including those that could arise from the realisation of security. The determination of these provisions often requires the exercise of considerable judgement by management involving matters such as local economic conditions and the resulting trading performance of the customer and the value of the security held, for which there may not be a readily accessible market. The actual amount of the future cash flows and their timing may differ significantly from the assumptions made for the purposes of determining the impairment provision and consequently these provisions can be subject to variation as time progresses and the circumstances of the customer become clearer.

Impairment provisions for portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances that are below the individual assessment thresholds, and for loan losses that have been incurred but not separately identified at the balance sheet date, are determined on a collective basis. Collective impairment provisions are calculated on a portfolio basis using formulae which take into account factors such as the length of time that the customer's account has been out of order, historical loss rates, the credit quality of the portfolios and the value of any security held. The variables used in the formulae are kept under regular review to ensure that as far as possible they reflect current economic circumstances; however changes in interest rates, unemployment levels, particularly in the UK, and bankruptcy trends could result in actual losses differing from reported impairment provisions.

Pensions

The net liability recognised in the balance sheet at 31 December 2006 in respect of the Group's retirement benefit obligations was £2,462 million (2005: £2,910 million) of which £2,362 million (2005: £2,809 million) related to defined benefit pension schemes. This liability excludes actuarial gains of £263 million (2005: losses of £485 million) which the Group is permitted to leave unrecognised. The defined benefit pension schemes' gross deficit totalled £2,099 million (2005: £3,294 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

The schemes' liabilities are calculated using the projected unit credit method, which takes into account projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. The resulting estimated cash flows are discounted at a rate equivalent to the market yield at the balance sheet date on high quality bonds with a similar duration and currency to the schemes' liabilities. In order to estimate the future cash flows, a number of financial and non-financial assumptions are made by management, changes to which could have a material impact upon the overall deficit or the net cost recognised in the income statement.

Two important assumptions are the rate of inflation and the expected lifetime of the schemes' members. The assumed rate of inflation affects the rate at which salaries are projected to grow and therefore the size of the pension that employees receive upon retirement and also the rate at which pensions in payment increase. Over the longer term rates of inflation can vary significantly; at 31 December 2006 it was assumed that the rate of inflation would be 2.9 per cent per annum (2005: 2.7 per cent), although if this was increased by 0.2 per cent the overall deficit would increase by approximately £559 million and the annual cost by approximately £20 million. A reduction of 0.2 per cent would reduce the overall deficit by approximately £539 million and the annual cost by approximately £15 million.

The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rates of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience. An increase of one year in the expected lifetime of scheme members would increase the overall deficit by approximately £459 million and the annual cost by approximately £30 million; a reduction of one year would reduce the overall deficit by approximately £460 million and the annual cost by approximately £30 million.

The size of the overall deficit is also sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variations. At 31 December 2006 the discount rate used was 5.1 per cent (2005: 4.8 per cent); a reduction of 0.2 per cent would increase the overall deficit by approximately £592 million and the annual cost by approximately £14 million, while an increase of 0.2 per cent would reduce the net deficit by approximately £570 million and the annual cost by approximately £13 million.

Goodwill

At 31 December 2006 the Group carried goodwill on its balance sheet totalling £2,377 million (2005: £2,373 million), substantially all of which relates to acquisitions made a number of years ago.

The Group reviews the goodwill 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 is 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.

2 Critical accounting estimates and judgements (continued)

Insurance

Life assurance business

The Group carries in its balance sheet an asset representing the value of in-force business in respect of life insurance and participating investment contracts of £2,723 million at 31 December 2006 (2005: £2,922 million). This asset, which is presented gross of attributable tax, represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. To arrive at this value it is necessary for management to make assumptions about the future experience of the insurance portfolios which will be affected by factors such as stock market levels, rates of interest and price inflation, future mortality rates and future persistency rates. These factors are inherently uncertain. If actual experience differs from that assumed this could significantly affect the value attributed. The process for determining the key assumptions that have been made at 31 December 2006 is detailed in note 23.

At 31 December 2006 the Group also carried substantial liabilities to holders of life insurance policies in its balance sheet. The methodology used to value the liabilities is described in note 1 (r) (1). Liabilities arising from insurance contracts and participating investment contracts were £25,763 million and £15,095 million respectively (2005: £25,888 million and £14,068 million) and those arising from non-participating investment contracts totalled £24,370 million (2005: £21,839 million). Elements of the liabilities require assumptions about future investment returns, future mortality rates and future policyholder behaviour. The process for determining the key assumptions that have been made at 31 December 2006 and the impact on profit before tax of changes in key assumptions is detailed in note 31.

General insurance business

At 31 December 2006 the Group held a provision of £149 million (2005: £147 million) in respect of 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.

Taxation

Significant judgement is required in determining the Group's income tax liabilities. In arriving at the current tax liability of £817 million and deferred tax liability of £1,416 million at 31 December 2006 (2005: current tax liability of £552 million and deferred tax liability of £1,145 million), the Group has taken account of tax issues that are subject to ongoing discussions with HM Revenue & Customs and other tax authorities. Calculations of these liabilities 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 expected 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 financial services group, whose businesses provide a wide range of banking and financial services predominantly in the UK.

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 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, 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.

	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
Year ended 31 December 2006								
Interest and similar income	6,913	24	820	844	8,806	994	(3,241)	14,316
Interest and similar expense	(3,271)	–	(741)	(741)	(6,421)	(1,587)	3,241	(8,779)
Net interest income	3,642	24	79	103	2,385	(593)	–	5,537
Other income (net of fee and commission expense)	1,621	594	9,893	10,487	1,827	201	–	14,136
Total income	5,263	618	9,972	10,590	4,212	(392)	–	19,673
Insurance claims	–	(200)	(8,369)	(8,569)	–	–	–	(8,569)
Total income, net of insurance claims	5,263	418	1,603	2,021	4,212	(392)	–	11,104
Operating expenses	(2,476)	(157)	(481)	(638)	(2,264)	77	–	(5,301)
Trading surplus (deficit)	2,787	261	1,122	1,383	1,948	(315)	–	5,803
Impairment losses on loans and advances	(1,238)	–	–	–	(308)	(9)	–	(1,555)
Profit (loss) before tax	1,549	261	1,122	1,383	1,640	(324)	–	4,248
External revenue	8,136	1,249	10,888	12,137	8,867	158	–	29,298
Inter-segment revenue	698	19	199	218	2,276	910	(4,102)	–
Segment revenue	8,834	1,268	11,087	12,355	11,143	1,068	(4,102)	29,298
External assets	108,381	1,115	84,959	86,074	147,836	1,307	–	343,598
Inter-segment assets	3,331	502	4,050	4,552	80,995	53,588	(142,466)	–
Total assets	111,712	1,617	89,009	90,626	228,831	54,895	(142,466)	343,598
External liabilities	87,327	875	77,633	78,508	150,779	15,477	–	332,091
Inter-segment liabilities	20,980	54	5,595	5,649	72,793	43,044	(142,466)	–
Total liabilities	108,307	929	83,228	84,157	223,572	58,521	(142,466)	332,091
Other segment items:								
Capital expenditure	82	7	845	852	647	143	–	1,724
Depreciation and amortisation	202	9	29	38	379	–	–	619
Defined benefit scheme charges	121	4	24	28	100	(140)	–	109

3 Segmental analysis (continued)

	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
Year ended 31 December 2005								
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 (deficit)	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 and amortisation	219	11	26	37	383	–	–	639
Customer remediation provision	150	–	–	–	–	–	–	150
Defined benefit scheme charges	134	4	22	26	84	15	–	259

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

4 Net interest income

	Weighted average effective interest rate 2006 %	2005 %	2006 £m	2005 £m
Interest receivable:				
Available-for-sale financial assets	**4.39**	3.58	**807**	508
Loans and advances to customers	**6.24**	6.41	**10,909**	10,095
Loans and advances to banks	**4.72**	3.59	**1,826**	1,199
Lease and hire purchase receivables	**7.42**	7.07	**774**	787
	5.91	5.82	**14,316**	12,589
Interest payable:				
Deposits from banks	**4.67**	3.44	**(1,680)**	(953)
Customer accounts	**2.91**	2.84	**(3,738)**	(3,401)
Debt securities in issue	**4.67**	4.23	**(1,983)**	(1,307)
Subordinated liabilities	**5.72**	5.22	**(694)**	(601)
Liabilities under sale and repurchase agreements	**4.35**	4.53	**(260)**	(394)
Other	**9.68**	7.24	**(424)**	(262)
	3.82	3.42	**(8,779)**	(6,918)
Net interest income			**5,537**	5,671

Included within interest receivable is £297 million (2005: £209 million) in respect of impaired financial assets.

5 Net fee and commission income

	2006 £m	2005 £m
Fee and commission income:		
Current accounts	**652**	593
Insurance broking	**629**	681
Credit and debit card fees	**493**	545
Other	**1,342**	1,171
	3,116	2,990
Fee and commission expense:		
Credit and debit card fees	**(138)**	(182)
Dealer commissions	**(217)**	(247)
Other	**(491)**	(413)
	(846)	(842)
Net fee and commission income	**2,270**	2,148

6 Net trading income

	2006 £m	2005 £m
Foreign exchange translation gains	**32**	13
Gains on foreign exchange trading transactions	**98**	150
Total foreign exchange	**130**	163
Investment property gains (note 21)	**631**	430
Securities and other gains	**5,580**	8,705
	6,341	9,298

Included within securities and other gains are net gains of £5,256 million (2005: £8,543 million) arising on assets held at fair value through profit or loss and net gains of £21 million (2005: £nil) arising on liabilities held at fair value through profit or loss.

7 Insurance premium income

	2006 £m	2005 £m
Life insurance		
Gross premiums	4,308	3,996
Ceded reinsurance premiums	(189)	(89)
Net earned premiums	4,119	3,907
Non-life insurance		
Gross premiums written	608	575
Ceded reinsurance premiums	(17)	(22)
Net premiums	591	553
Change in provision for unearned premiums	9	9
Net earned premiums	600	562
Total net earned premiums	4,719	4,469

Life insurance gross written premiums can be further analysed as follows:	2006 £m	2005 £m
Life	1,831	1,286
Pensions	1,780	2,136
Annuities	681	547
Other	16	27
Gross premiums	4,308	3,996

Non-life insurance gross written premiums can be further analysed as follows:	2006 £m	2005 £m
Credit protection	203	173
Home	394	390
Health	11	12
	608	575

8 Other operating income

	2006 £m	2005 £m
Operating lease rental income	422	433
Rental income from investment property	313	272
Other rents receivable	28	30
Gains less losses on disposal of available-for-sale financial assets	22	5
Movement in value of in-force business (note 23)	(199)	162
Other income	220	238
	806	1,140

9 Insurance claims

Insurance claims comprise:	2006 £m	2005 £m
Life insurance and participating investment contracts		
Claims and surrenders:		
Gross	5,375	4,279
Reinsurers' share	(76)	(56)
	5,299	4,223
Change in liabilities:		
Gross	2,923	7,641
Reinsurers' share	(18)	33
	2,905	7,674
Change in unallocated surplus (note 33)	165	92
Total life insurance and investment contracts	8,369	11,989
Non-life insurance		
Claims and claims paid:		
Gross	198	195
Reinsurers' share	–	(1)
	198	194
Changes in non-life insurance policyholder liabilities:		
Gross	2	3
Reinsurers' share	–	–
	2	3
Total non-life insurance	200	197
Total insurance claims expense	8,569	12,186

Life insurance gross claims can also be analysed as follows:	2006 £m	2005 £m
Deaths	286	298
Maturities	1,385	1,197
Surrenders	3,081	2,204
Annuities	558	528
Other	65	52
	5,375	4,279

A non-life insurance claims development table is included in note 31.

10 Operating expenses

	2006 £m	2005 £m
Salaries	2,117	2,068
Social security costs	161	154
Pensions and other post-retirement benefit schemes (note 35)	165	308
Other staff costs	298	325
Staff costs	2,741	2,855
Other administrative expenses:		
Operating lease rentals	254	252
Repairs and maintenance	165	136
Communications and data processing	499	467
Advertising	184	207
Professional fees	231	216
Provisions for customer remediation (note 37)	–	150
Other	608	543
	1,941	1,971
Depreciation of tangible fixed assets (note 25)	602	621
Amortisation of other intangible assets (note 24)	17	18
Impairment charges:		
Goodwill (note 22)	–	6
Total operating expenses	5,301	5,471

10 Operating expenses (continued)

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

	2006	2005
UK	**74,079**	77,620
Overseas	**2,013**	1,974
	76,092	79,594

During the year the auditors earned the following fees:	2006 £m	2005 £m
Fees payable for the audit of the Company's current year annual report	**6.0**	6.3
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	**2.3**	1.7
Additional fees in respect of the previous year's audit of subsidiaries	**0.6**	-
Other services supplied pursuant to legislation	**4.7**	0.8
Total audit fees	**13.6**	8.8
Other services – audit related fees	**1.4**	1.6
Total audit and audit related fees	**15.0**	10.4
Services relating to taxation	**0.6**	0.6
Other non-audit fees:		
Services relating to corporate finance transactions	**1.0**	0.3
Other services	**0.4**	0.5
Total other non-audit fees	**1.4**	0.8
Total fees payable to the Company's auditors by the Group	**17.0**	11.8

During the year, the auditors also earned fees payable by entities outside the consolidated Lloyds TSB Group in respect of the following:

	2006 £m	2005 £m
Audits of Group pension schemes	**0.2**	0.1
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	**0.4**	0.2
Reviews of the financial position of corporate and other borrowers	**1.6**	1.2
Acquisition due diligence and other work performed in respect of potential venture capital investments	**1.0**	0.6

Other services supplied pursuant to legislation relate primarily to the costs associated with the Sarbanes-Oxley Act audit requirements together with the cost of the audit of the Group's Form 20-F filing.

The following types of services are included in the categories listed above:

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings.

Audit related fees: This category includes fees in respect of services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements.

Services relating to taxation: This category includes tax compliance and tax advisory services.

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital, transactions and other assurance and advisory services.

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. This approval can be obtained either on an individual engagement basis or, for certain types of non-audit services, particularly those of a recurring nature, through the approval of a fee cap covering all engagements of that type provided the fee is below that cap. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant fee cap must be pre-approved by the audit committee on an individual engagement basis. 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

	2006 £m	2005 £m
Impairment losses on loans and advances (note 19)	**1,560**	1,302
Other credit risk provisions (note 37)	**(5)**	(3)
	1,555	1,299

12 Profit on sale and closure of businesses

During 2005, a net profit of £74 million arose on disposal of businesses, principally the Goldfish credit card business. This profit was partly offset by an adjustment to consideration received in respect of an earlier disposal and a provision for costs in respect of the closure of businesses, which together totalled £24 million. The businesses sold in 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

	2006 £m	2005 £m
UK corporation tax:		
Current tax on profit for the year	**1,024**	862
Adjustments in respect of prior years	**(137)**	(20)
	887	842
Double taxation relief	**(195)**	(138)
	692	704
Foreign tax:		
Current tax on profit for the year	**83**	78
Adjustments in respect of prior years	**(8)**	(8)
	75	70
Current tax charge	**767**	774
Deferred tax (note 36)	**574**	491
	1,341	1,265

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2005: 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 £222 million (2005: £298 million), including a prior year tax charge of £12 million (2005: tax credit of £25 million).

In addition to the income statement current tax charge, £15 million (2005: £nil) has been credited to equity in respect of share based payments and £33 million (2005: £nil) has been charged to equity in respect of foreign exchange differences.

(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:

	2006 £m	2005 £m
Profit before tax	**4,248**	3,820
Tax charge thereon at UK corporation tax rate of 30%	**1,274**	1,146
Factors affecting charge:		
Disallowed and non-taxable items	**(8)**	(47)
Overseas tax rate differences	**(2)**	(1)
Net tax effect of disposals and unrealised gains	**(78)**	(59)
Policyholder interests and Open Ended Investment Companies	**139**	223
Other items	**16**	3
Tax on profit on ordinary activities	**1,341**	1,265
Effective rate	**31.6%**	33.1%

The effective tax rate of the Group excluding gross policyholder and Open Ended Investment Company interests from profit before tax and the tax charge was 28.0 per cent (2005: 27.0 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 (2005: 5 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

	2006	2005
Profit attributable to equity shareholders	**£2,803m**	£2,493m
Weighted average number of ordinary shares in issue	**5,616m**	5,595m
Basic earnings per share	**49.9p**	44.6p

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 and awards 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 and awards 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.

	2006	2005
Profit attributable to equity shareholders	**£2,803m**	£2,493m
Weighted average number of ordinary shares in issue	**5,616m**	5,595m
Adjustment for share options and awards	**51m**	44m
Weighted average number of ordinary shares for diluted earnings per share	**5,667m**	5,639m
Diluted earnings per share	**49.5p**	44.2p

The weighted average number of anti-dilutive share options and awards excluded from the calculation of diluted earnings per share was 7 million at 31 December 2006 (2005: 17 million).

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

	2006 £m	2005 £m
Trading assets	**5,756**	5,442
Other financial assets at fair value through profit or loss	**61,939**	54,932
	67,695	60,374

These assets are comprised as follows:	2006		2005	
	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to banks	**34**	**3**	5	5
Loans and advances to customers	**350**	**448**	161	445
Debt securities:				
Government securities	**180**	**8,626**	535	10,638
Other public sector securities	**–**	**44**	35	84
Bank and building society certificates of deposit	**–**	**573**	–	898
Mortgage backed securities	**451**	**87**	39	197
Other asset backed securities	**595**	**861**	–	691
Corporate and other debt securities	**4,146**	**13,170**	4,667	8,469
	5,372	**23,361**	5,276	20,977
Equity shares:				
Listed	**–**	**29,275**	–	27,497
Unlisted	**–**	**8,852**	–	6,008
	–	**38,127**	–	33,505
	5,756	**61,939**	5,442	54,932

The maximum exposure to credit risk at 31 December 2006 of the loans and advances to banks and customers designated at fair value through profit or loss was £451 million (31 December 2005: £450 million); the Group does not hold any credit derivatives or other instruments in mitigation of this risk. There was no significant movement in the fair value of these loans attributable to changes in credit risk; this is determined by reference to the publicly available credit ratings of the instruments involved.

16 Derivative financial instruments

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.

Credit derivatives, principally credit default swaps, are used by the Group as part of its customer product activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. As discussed in note 18, during 2006 the Group used credit default swaps to synthetically securitise £961 million of the Group's commercial banking loans.

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.

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2006			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	116,255	794	1,432
Currency swaps	20,618	346	496
Options purchased	3,076	51	–
Options written	3,822	–	32
	143,771	1,191	1,960
Interest rate contracts:			
Interest rate swaps	331,852	2,980	3,149
Forward rate agreements	40,876	17	18
Options purchased	17,034	68	–
Options written	12,588	–	63
Futures	33,066	–	1
	435,416	3,065	3,231
Credit derivatives	13,212	25	39
Equity and other contracts	4,026	797	67
Total derivative assets/liabilities held for trading		5,078	5,297
Hedging			
Derivatives designated as fair value hedges:			
Cross currency interest rate swaps	80	10	–
Interest rate swaps (including swap options)	37,298	333	453
	37,378	343	453
Derivatives designated as cash flow hedges:			
Interest rate swaps	569	5	13
Derivatives designated as net investment hedges:			
Cross currency swaps	2,589	139	–
Total derivative assets/liabilities held for hedging		487	466
Total recognised derivative assets/liabilities		5,565	5,763

16 Derivative financial instruments (continued)

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2005			
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
Credit derivatives	562	3	–
Equity and other contracts	4,787	607	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 Loans and advances to banks

	2006 £m	2005 £m
Lending to banks	**5,966**	2,510
Money market placements with banks	**34,673**	29,146
Total loans and advances to banks	**40,639**	31,656
Allowance for impairment losses (note 19)	**(1)**	(1)
	40,638	31,655

The Group holds collateral with a fair value of £6,837 million (2005: £6,381 million), which it is permitted to sell or repledge, of which £6,209 million (2005: £5,550 million) was repledged or sold to third parties for periods not exceeding three months from the transfer.

18 Loans and advances to customers

	2006 £m	2005 £m
Agriculture, forestry and fishing	2,905	2,451
Energy and water supply	2,024	1,592
Manufacturing	7,513	7,923
Construction	2,332	2,222
Transport, distribution and hotels	10,490	9,465
Postal and telecommunications	831	546
Property companies	12,896	8,713
Financial, business and other services	22,999	21,261
Personal:		
Mortgages	95,601	88,895
Other	23,025	23,280
Lease financing	4,802	5,815
Hire purchase	5,060	4,853
	190,478	177,016
Allowance for impairment losses (note 19)	(2,193)	(2,072)
	188,285	174,944

The Group holds collateral with a fair value of £444 million (2005: £1,018 million), which it is permitted to sell or repledge, of which £238 million (2005: £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:

	2006 £m	2005 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	637	673
Later than 1 year and not later than 5 years	2,358	2,388
Later than 5 years	5,358	6,025
	8,353	9,086
Unearned future finance income on finance leases	(2,945)	(2,954)
Rentals received in advance	(163)	(200)
Commitments for expenditure in respect of equipment to be leased	(443)	(117)
Net investment in finance leases	4,802	5,815

The net investment in finance leases represents amounts recoverable as follows:	2006 £m	2005 £m
Not later than 1 year	234	648
Later than 1 year and not later than 5 years	1,232	1,610
Later than 5 years	3,336	3,557
	4,802	5,815

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £7 million (2005: £4 million). The unguaranteed residual values included in finance lease receivables were as follows:

	2006 £m	2005 £m
Not later than 1 year	–	–
Later than 1 year and not later than 5 years	–	31
Later than 5 years	168	245
Total	168	276

18 Loans and advances to customers (continued)

Securitisations

Loans and advances to customers include balances that have been securitised but not derecognised, comprising both residential mortgages and commercial loans.

Beneficial interests in residential mortgages were transferred during the year to special purpose entities which issued floating rate debt securities. Neither the Group nor any entities in the Group are obliged to support any losses that may be suffered by the note holders and do not intend to offer such support. The floating rate note holders only receive payments of interest and principal to the extent that the special purpose entities have received sufficient funds from the transferred mortgages and after certain expenses have been met. In the event of a deficiency, they have no recourse whatsoever to the Group.

At 31 December 2006 the total amount of residential mortgages subject to securitisation is £14,927 million (2005: £nil) in respect of which external funding at the year end amounted to £10,048 million (2005: £nil); external funding is shown in debt securities in issue (see note 30).

The Group participates in the securitisation through the provision of administration and other services, the provision of interest rate and currency swaps and in the form of unsecured loan financing which is subordinate to the interests of the floating rate note holders.

In addition the Group completed a £961 million synthetic securitisation of its commercial banking loans during the year (2005: £nil) utilising credit default swaps ('CDSs'). The CDSs are accounted for as derivatives and are included in derivative financial instruments (note 16).

19 Allowance for impairment losses on loans and advances

	2006 £m	2005 £m
At 1 January	**2,073**	1,919
Exchange and other adjustments	**(13)**	1
Reclassifications	**–**	43
Adjustments on disposal of businesses and portfolios	**(27)**	(27)
Advances written off	**(1,489)**	(1,236)
Recoveries of advances written off in previous years	**190**	158
Unwinding of discount	**(100)**	(87)
Charge to the income statement	**1,560**	1,302
At 31 December	**2,194**	2,073
In respect of:		
Loans and advances to banks (note 17)	**1**	1
Loans and advances to customers (note 18)	**2,193**	2,072
	2,194	2,073

20 Available-for-sale financial assets

	2006 £m	2005 £m
Debt securities:		
Government securities	**393**	1,083
Other public sector securities	**189**	47
Bank and building society certificates of deposit	**1,615**	1,470
Mortgage backed securities	**5,662**	4,161
Other asset backed securities	**4,721**	4,981
Corporate and other debt securities	**4,817**	3,065
	17,397	14,807
Equity shares:		
Listed	**1**	34
Unlisted	**14**	12
	15	46
Treasury bills and other bills:		
Treasury bills and similar securities	**1,743**	70
Other bills	**23**	17
	1,766	87
	19,178	14,940

20 Available-for-sale financial assets (continued)

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	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 (note 41)	11	–	11
At 31 December 2005	14,940	–	14,940
Exchange and other adjustments	**(1,116)**	**–**	**(1,116)**
Additions	**23,448**	**–**	**23,448**
Disposals	**(18,106)**	**–**	**(18,106)**
Amortisation of premiums and discounts	**22**	**–**	**22**
Changes in fair value (note 41)	**(10)**	**–**	**(10)**
At 31 December 2006	**19,178**	**–**	**19,178**

21 Investment property

	2006 £m	2005 £m
At 1 January	**4,260**	3,776
Changes in fair value (note 6)	**631**	430
Additions:		
Acquisitions of new properties	**675**	756
Additional expenditure on existing properties	**75**	51
Total additions	**750**	807
Disposals	**(902)**	(753)
At 31 December	**4,739**	4,260

The investment properties are valued at least annually at open-market value, by independent, professionally qualified valuers, who have 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:

	2006 £m	2005 £m
Rental income	**313**	272
Direct operating expenses arising from investment properties that generate rental income	**24**	24

Capital expenditure in respect of investment properties:

	2006 £m	2005 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	**85**	31

22 Goodwill

	2006 £m	2005 £m
At 1 January	**2,373**	2,469
Acquisitions (note 48)	**4**	3
Disposals	**–**	(93)
Impairment charge	**–**	(6)
At 31 December	**2,377**	2,373
Cost*	**2,383**	2,379
Accumulated impairment losses	**(6)**	(6)
	2,377	2,373

*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.

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 £2,377 million (2005: £2,373 million), £1,836 million (or 77 per cent of the total) has been allocated to Scottish Widows and £521 million (or 22 per cent of the total) to Asset Finance.

22 Goodwill (continued)

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 10 per cent (gross of tax). 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 weighted average cost of capital. 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 4 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.

23 Value of in-force business

The asset in the consolidated balance sheet and movement recognised in the income statement are as follows:

Gross value of in-force insurance and participating investment business	2006 £m	2005 £m
At 1 January	**2,922**	2,760
Movement in value of in-force business	**(199)**	162
At 31 December	**2,723**	2,922

The movement in value of in-force business over 2006 contains effects from the introduction of the new valuation rules in the Financial Services Authority's ('FSA's') Policy Statement 06/14 and a revised allowance for risk. This reduced the amount of reserves required to be held for certain contract types. The value of in-force for these contract types is £429 million lower than it would have been if the FSA valuation rules had not changed. The reduction in the value of in-force business is more than offset by the lower reserves held under the new FSA valuation rules; the income statement impact of these changes is quantified in note 31, and further information on the Group's life assurance business, 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 31 and on pages 40 to 44.

The principal economic assumptions used in calculating the value of in-force business at 31 December 2005 were as follows:

	%
Risk discount rate	7.02
Return on equities	6.72
Return on fixed interest securities	4.12
Expense inflation	3.79

Following the change in the methodology used to calculate the value of in-force business in 2006 the principal assumptions that it is necessary to make have changed.

The principal features of the methodology and process used for determining key assumptions used in the calculation of the value of in-force business at 31 December 2006 are set out below:

Economic assumptions

Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets. In practice, to achieve the same result, where the cash flows are either independent of or move linearly with market movements, a method has been applied known as the 'certainty equivalent' approach whereby it is assumed that all assets earn the risk-free rate and all cash flows are discounted at the risk-free rate.

A market consistent approach has been adopted for the valuation of financial options and guarantees, using a stochastic option pricing technique calibrated to be consistent with the market price of relevant options at each valuation date.

The risk-free rate assumed in valuing in-force business is 10 basis points over the 15-year gilt yield. In valuing financial options and guarantees the risk-free rate is derived from gilt yields plus 10 basis points, in line with Scottish Widows' FSA realistic balance sheet assumptions. The table below shows the range of resulting yields and other key assumptions at 31 December 2006:

	%
Risk-free rate (value of in-force)	**4.72**
Risk-free rate (financial options and guarantees)	**3.91 to 5.41**
Retail Price inflation	**3.23**
Expense inflation	**4.13**

Non-market risk

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the with-profits fund there are asymmetries in the range of potential outcomes for which an explicit allowance is made.

Non-economic assumptions

Future maintenance expenses, mortality, morbidity, lapse and paid-up rate assumptions are based on an analysis of past experience and represent management's best estimate of likely future experience.

24 Other intangible assets

	Customer lists £m	Software enhancements £m	Total £m
Cost:			
At 1 January 2005	–	107	107
Additions	–	40	40
At 31 December 2005	–	147	147
Additions	**54**	**51**	**105**
At 31 December 2006	**54**	**198**	**252**
Accumulated amortisation:			
At 1 January 2005	–	79	79
Charge for the year	–	18	18
At 31 December 2005	–	97	97
Charge for the year	**–**	**17**	**17**
At 31 December 2006	**–**	**114**	**114**
Balance sheet amount at 31 December 2006	**54**	**84**	**138**
Balance sheet amount at 31 December 2005	–	50	50

Software enhancements principally comprise identifiable and directly associated internal staff and other costs.

25 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m
Cost:				
At 1 January 2005	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
Exchange and other adjustments	**–**	**(3)**	**(96)**	**(99)**
Additions	**92**	**286**	**552**	**930**
Disposals	**(25)**	**(101)**	**(551)**	**(677)**
At 31 December 2006	**1,488**	**2,849**	**2,866**	**7,203**
Accumulated depreciation and impairment:				
At 1 January 2005	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
Exchange and other adjustments	**(1)**	**(1)**	**(63)**	**(65)**
Charge for the year	**82**	**248**	**272**	**602**
Disposals	**(7)**	**(83)**	**(254)**	**(344)**
At 31 December 2006	**675**	**1,960**	**316**	**2,951**
Balance sheet amount at 31 December 2006	**813**	**889**	**2,550**	**4,252**
Balance sheet amount at 31 December 2005	820	871	2,600	4,291

25 Tangible fixed assets (continued)

At 31 December the future minimum rentals receivable under non-cancellable operating leases were as follows:

	2006 £m	2005 £m
Receivable within 1 year	431	393
1 to 5 years	747	695
Over 5 years	30	165
	1,208	1,253

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2006 and 2005 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £120 million at 31 December 2006 (£141 million at 31 December 2005) is expected to be received under non-cancellable sub-leases of the Group's premises.

26 Other assets

	2006 £m	2005 £m
Assets arising from reinsurance contracts held	451	548
Deferred acquisition costs	443	429
Settlement balances	285	336
Other assets and prepayments	3,500	4,288
	4,679	5,601

Deferred acquisition costs:	2006 £m	2005 £m
At 1 January	429	293
Acquisition costs deferred, net of amounts amortised to the income statement	14	136
At 31 December	443	429

27 Deposits from banks

The breakdown of deposits from banks between the domestic and international offices of the Group is set out below:

	2006 £m	2005 £m
Domestic:		
Non-interest bearing	89	105
Interest bearing	28,405	24,707
	28,494	24,812
International:		
Non-interest bearing	31	24
Interest bearing	7,869	6,691
	7,900	6,715
	36,394	31,527

28 Customer accounts

	2006 £m	2005 £m
Non-interest bearing current accounts	4,338	4,203
Interest bearing current accounts	43,064	40,365
Savings and investment accounts	66,151	62,206
Other customer deposits	25,789	24,296
	139,342	131,070

The breakdown of customer accounts between the domestic and international offices of the Group is set out below:

	2006 £m	2005 £m
Domestic:		
Non-interest bearing	4,002	3,868
Interest bearing	131,781	123,522
	135,783	127,390
International:		
Non-interest bearing	336	335
Interest bearing	3,223	3,345
	3,559	3,680
	139,342	131,070

29 Trading and other liabilities at fair value through profit or loss

	2006 £m	2005 £m
Liabilities held at fair value through profit or loss	1,156	–
Trading liabilities	28	–
	1,184	–

The amount contractually payable on maturity of the liabilities held at fair value through profit or loss at 31 December 2006 is £1,200 million, which is £44 million higher than the balance sheet carrying value. There was no significant movement in the fair value of these liabilities attributable to changes in credit risk; this is determined by reference to the publicly available credit ratings of Lloyds TSB Bank plc, the issuing entity within the Group.

30 Debt securities in issue

	2006 £m	2005 £m
Euro medium-term note programme	5,650	6,683
Other bonds and medium-term notes	10,157	141
Certificates of deposit issued	25,244	22,101
Commercial paper	13,067	10,421
Total debt securities in issue	54,118	39,346

Debt securities in issue at 31 December 2006 included £10,048 million (2005: £nil) in respect of the securitisation of mortgages (see note 18).

31 Liabilities arising from insurance contracts and participating investment contracts

	2006 £m	2005 £m
Insurance contract liabilities	26,350	26,482
Participating investment contract liabilities	15,095	14,068
	41,445	40,550

Insurance contract liabilities

Insurance contract liabilities, substantially all of which relate to business written in the United Kingdom, are comprised as follows:

	2006			2005		
	Gross £m	Reinsurance* £m	Net £m	Gross £m	Reinsurance* £m	Net £m
Life insurance (see (i) below)	25,763	(425)	25,338	25,888	(511)	25,377
Non-life insurance (see (ii) below):						
Unearned premiums	438	–	438	447	–	447
Claims outstanding	149	(4)	145	147	(4)	143
	587	(4)	583	594	(4)	590
	26,350	(429)	25,921	26,482	(515)	25,967

* Reinsurance balances receivable are reported within other assets (note 26).

(i) Life insurance

The movement in life insurance contract liabilities over the year can be analysed as follows:	Gross £m	Reinsurance* £m	Net £m
At 1 January 2005	23,659	(577)	23,082
New business	1,381	(256)	1,125
Changes in existing business	848	322	1,170
At 31 December 2005	25,888	(511)	25,377
New business	1,045	(98)	947
Changes in existing business	(1,170)	184	(986)
At 31 December 2006	25,763	(425)	25,338

* Reinsurance balances receivable are reported within other assets (note 26).

31 Liabilities arising from insurance contracts and participating investment contracts (continued)

The movement in liabilities arising from participating investment contracts may be analysed as follows:	£m
At 1 January 2005	12,469
New business	1,181
Changes in existing business	418
At 31 December 2005	14,068
New business	**1,815**
Changes in existing business	**(788)**
At 31 December 2006	**15,095**

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 Profit 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 Profit Fund realistic liabilities

The Group's With Profit Fund contains life insurance contracts and participating investment contracts. The calculation of With Profit Fund 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 in-force business as discussed in note 23. The persistency rates used for the realistic valuation of the With Profit Fund liabilities make an allowance for potential changes in future experience as the guarantees and options within with-profits contracts become more valuable under adverse market conditions.

Other key assumptions are:

- Investment returns and discount rates

The realistic capital regime dictates that With Profit Fund liabilities are valued on a market-consistent basis. This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The With Profit Fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as 0.1 per cent higher than the spot yields derived from the UK gilt yield curve.

- Guaranteed annuity option take-up rates

The guaranteed annuity option take-up rates are set with regard to the Group's actual experience and make allowance for potential increases in take-up rates when the Guaranteed Annuity Options become more valuable to the policyholder.

- 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 2006, the 10 year equity-implied at-the-money assumption was set at 20 per cent (31 December 2005: 20 per cent). The long-term at-the-money assumptions for property and fixed interest stocks were 15 per cent (31 December 2005: 15 per cent) and 13 per cent (31 December 2005: 13.5 per cent) respectively.

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.

- Lapse rates

Lapse rates, set with regard to the Group's actual experience and with a margin for adverse deviation, are allowed for on some Non-Profit Fund contracts.

- 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 deviation. Explicit allowance is made for future expense inflation.

31 Liabilities arising from insurance contracts and participating investment contracts (continued)

Key changes in assumptions

Changes in certain key assumptions were made during 2006 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:

	Impact on profit before tax £m
Lapse rates[1]	(114)
Modelling of options and guarantees in the With-Profits Fund[2]	66
FSA rule changes under PS06/14[3]	4
Conversion to market consistent methodology[4]	(18)

[1] Lapse rates have been adjusted following a detailed review of the Group's current and expected experience.

[2] Changes to the valuation of options and guarantees primarily reflect improved representation of the current regulatory regime and revised assumptions of future policyholder behaviours.

[3] Changes brought in by the FSA under PS06/14 have brought significant reductions to the reserves required to be held. There has been a large offsetting reduction in the value of in-force business, as explained in note 23.

[4] The value of in-force business asset is now derived using market-consistent methodology, consistent with the approach adopted for European Embedded Value supplementary reporting.

Sensitivity analysis

The following table demonstrates the effect of changes in key assumptions on profit before tax disclosed in these financial statements 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 assets, liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts. The impact is shown in one direction but can be assumed to be reasonably symmetrical:

	Change in variable	Impact on profit before tax £m
Non-annuitant mortality	5% reduction	35
Annuitant mortality	5% reduction	(124)
Lapse rates	10% reduction	60
Maintenance expenses	10% reduction	64
Risk-free rate[1]	1% deduction	243
Guaranteed annuity option take up[2]	5% addition	(22)
Equity investment volatility[3]	1% addition	(6)

Assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and statutory reserving bases.

For the above sensitivities a 5 per cent reduction means a reduction to 95 per cent of the expected rate.

[1] This sensitivity shows the impact on the value of in-force business, financial options and guarantee costs, statutory reserves and asset values of reducing the risk-free rate by 100 basis points.

[2] This sensitivity shows the impact of a flat 5 per cent addition to the expected rate.

[3] This sensitivity shows the impact of a flat 1 per cent addition to the expected rate.

(ii) Non-life insurance

Non-life insurance contract liabilities are analysed by line of business as follows:	2006 £m	2005 £m
Credit protection	268	284
Home	314	304
Health	5	6
	587	594

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. There has been no significant change in the assumptions and methodologies used for setting reserves.

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.

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.

31 Liabilities arising from insurance contracts and participating investment contracts (continued)

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
Increase in the year	**608**	**(17)**	**591**
Release in the year	**(617)**	**17**	**(600)**
At 31 December 2006	**438**	**–**	**438**

* Reinsurance balances receivable are reported within other assets (note 26).

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
Cash paid for claims settled in the year	**(223)**	**–**	**(223)**
Increase in liabilities:			
Arising from current year claims	**231**	**–**	**231**
Arising from prior year claims	**(6)**	**–**	**(6)**
At 31 December 2006	**149**	**(4)**	**145**
Notified claims	**127**	**(4)**	**123**
Incurred but not reported	**22**	**–**	**22**
At 31 December 2006	**149**	**(4)**	**145**
Notified claims	120	(4)	116
Incurred but not reported	27	–	27
At 31 December 2005	147	(4)	143

* Reinsurance balances receivable are reported within other assets (note 26).

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	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**	**Total £m**
Estimate of ultimate claims costs:						
At end of accident year	242	234	227	211	**208**	**1,122**
One year later	230	220	209	207		
Two years later	228	223	207			
Three years later	224	221				
Four years later	224					
Current estimate of cumulative claims	**224**	**221**	**207**	**207**	**208**	**1,067**
Cumulative payments to date	**223**	**211**	**199**	**189**	**115**	**937**
Liability recognised in the balance sheet	**1**	**10**	**8**	**18**	**93**	**130**
Liability in respect of earlier years						**9**
Total liability included in the balance sheet						**139**

The liability of £139 million shown in the above table excludes £10 million of unallocated claims handling expenses.

32 Liabilities arising from non-participating investment contracts

The movement in liabilities arising from non-participating investment contracts may be analysed as follows:

	Gross £m	Reinsurance* £m	Net £m
At 1 January 2005	16,361	(26)	16,335
New business	3,413	(7)	3,406
Changes in existing business	2,065	–	2,065
At 31 December 2005	21,839	(33)	21,806
New business	**2,316**	**–**	**2,316**
Changes in existing business	**215**	**11**	**226**
At 31 December 2006	**24,370**	**(22)**	**24,348**

* Reinsurance balances receivable are reported within other assets (note 26).

33 Unallocated surplus within insurance businesses

The movement in the unallocated surplus within long-term insurance business over the year can be analysed as follows:

	2006 £m	2005 £m
At 1 January	**518**	426
Change in unallocated surplus recognised in the income statement (note 9)	**165**	92
At 31 December	**683**	518

34 Other liabilities

	2006 £m	2005 £m
Settlement balances	**475**	779
Unitholders' interest in Open Ended Investment Companies	**4,583**	3,296
Other creditors and accruals	**5,927**	5,768
	10,985	9,843

35 Retirement benefit obligations

Charge to the income statement:	2006 £m	2005 £m
Defined benefit pension schemes*	**104**	243
Other post-retirement benefit schemes	**5**	16
Total defined benefit schemes	**109**	259
Defined contribution pension schemes	**56**	49
	165	308

Amounts recognised in the balance sheet:	2006 £m	2005 £m
Defined benefit pension schemes	**2,362**	2,809
Other post-retirement benefit schemes	**100**	101
	2,462	2,910

* In 2006 this amount is shown net of a credit of £128 million following the Group's decision to cease augmenting the pension entitlement of employees taking early retirement.

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 schemes provide 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 two main schemes were carried out as at 30 June 2005; these have been updated to 31 December 2006 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 2006 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

35 Retirement benefit obligations (continued)

The Group's obligations in respect of its defined benefit schemes are funded. The Group expects to pay contributions of approximately £530 million to its defined benefit schemes in 2007.

Amount included in the balance sheet:	2006 £m	2005 £m
Present value of funded obligations	17,378	17,320
Fair value of scheme assets	(15,279)	(14,026)
	2,099	3,294
Unrecognised actuarial gains (losses)	263	(485)
Liability in the balance sheet	2,362	2,809

Movements in the defined benefit obligation:	2006 £m	2005 £m
At 1 January	17,320	14,866
Current service cost	325	292
Interest cost	817	775
Actuarial (gains) losses	(434)	1,786
Benefits paid	(555)	(446)
Past service cost	32	15
Curtailment	(129)	–
Exchange and other adjustments	2	32
At 31 December	17,378	17,320

Changes in the fair value of scheme assets:	2006 £m	2005 £m
At 1 January	14,026	11,648
Expected return	942	839
Employer contributions	550	419
Actuarial gains	314	1,538
Benefits paid	(555)	(446)
Exchange and other adjustments	2	28
At 31 December	15,279	14,026
Actual return on scheme assets	1,256	2,377

Assumptions

The principal actuarial and financial assumptions used in valuations of the defined benefit pension schemes were as follows:

	2006 %	2005 %
Discount rate	5.10	4.80
Rate of inflation	2.90	2.70
Rate of salary increases	3.93	3.98
Rate of increase for pensions in payment and deferred pensions	2.70	2.50

	Years	Years
Life expectancy for member aged 60, on the valuation date:		
Men	25.8	25.6
Women	27.8	27.6
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	27.0	26.8
Women	28.9	28.7

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with both current industry experience and the actual experience of the relevant schemes. The table shows that a member retiring at age 60 as at 31 December 2006 is assumed to live for, on average, 25.8 years for a male and 27.8 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

An analysis of the impact of a reasonable change in these assumptions is provided in note 2.

35 Retirement benefit obligations (continued)

The expected return on scheme assets has been calculated using the following assumptions:	2006 %	2005 %
Equities	**8.0**	8.2
Fixed interest gilts	**4.1**	4.6
Index linked gilts	**3.9**	4.3
Non-government bonds	**4.8**	5.3
Property	**6.4**	6.9
Cash	**3.7**	3.6

The expected return on scheme assets in 2007 will be calculated using the following assumptions:	2007 %
Equities	**8.0**
Fixed interest gilts	**4.6**
Index linked gilts	**4.2**
Non-government bonds	**5.1**
Property	**6.5**
Cash	**3.9**

Composition of scheme assets:	2006 £m	2005 £m
Equities	**9,677**	9,021
Fixed interest gilts	**1,114**	946
Index linked gilts	**921**	920
Non-government bonds	**1,543**	1,415
Property	**1,333**	1,185
Cash	**691**	539
At 31 December	**15,279**	14,026

The assets of all the funded plans are held independently of the Group's assets in separate trustee administered funds.

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields at the balance sheet date. Expected returns on equity and property investments reflect long-term real rates of return experienced in the respective markets.

Experience adjustments history (since the date of adoption of IAS 19):	2006 £m	2005 £m	2004 £m
Present value of defined benefit obligation	**17,378**	17,320	14,866
Fair value of scheme assets	**(15,279)**	(14,026)	(11,648)
	2,099	3,294	3,218
Experience losses on scheme liabilities	**(50)**	(69)	(126)
Experience gains on scheme assets	**314**	1,538	361

The expense recognised in the income statement for the year ended 31 December comprises:	2006 £m	2005 £m
Current service cost	**325**	292
Interest cost	**817**	775
Expected return on scheme assets	**(942)**	(839)
Curtailment*	**(128)**	–
Past service cost	**32**	15
Total defined benefit pension expense	**104**	243

* Following recent changes in age discrimination legislation, the Group has ceased to augment the pension entitlement of employees taking early retirement; this change has reduced the Group's defined benefit pension liability by £129 million (£1 million of which is unrecognised) and resulted in a one-off credit to the 2006 income statement of £128 million.

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 2006 the charge to the income statement in respect of these schemes was £56 million (2005: £49 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.

35 Retirement benefit obligations (continued)

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 2006 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 7.02 per cent (2005: 6.81 per cent).

Amount included in the balance sheet:	2006 £m	2005 £m
Present value of unfunded obligations	110	112
Unrecognised actuarial losses	(10)	(11)
Liability in the balance sheet	100	101

Movements in the other post-retirement benefits obligation:	2006 £m	2005 £m
At 1 January	112	104
Exchange and other adjustments	–	(3)
Actuarial (gain) loss	(1)	1
Insurance premiums paid	(6)	(6)
Charge for the year	5	16
At 31 December	110	112

36 Deferred tax liabilities

The movement in the net deferred tax balance is as follows:	2006 £m	2005 £m
At 1 January	1,145	925
Exchange and other adjustments	(3)	(2)
Disposals	(281)	(256)
Income statement charge (note 13)	574	491
Amount charged (credited) to equity:		
Available-for-sale financial assets	–	(2)
Cash flow hedges	–	1
Share based compensation	(19)	(16)
	(19)	(17)
Amounts released to the income statement in respect of cash flow hedges	–	4
At 31 December	1,416	1,145

The deferred tax charge in the income statement comprises the following temporary differences:	2006 £m	2005 £m
Accelerated capital allowances	175	59
Pensions and other post-retirement benefits	134	44
Investment reserve	59	–
Allowances for impairment losses	22	23
Unrealised gains	162	279
Tax on value of in-force business	(59)	64
Other temporary differences	81	22
	574	491

Deferred tax assets and liabilities are comprised as follows:	2006 £m	2005 £m
Deferred tax assets:		
Pensions and other post-retirement benefits	(739)	(873)
Allowances for impairment losses	(143)	(165)
Other provisions	(39)	(31)
Derivatives	(161)	(164)
Tax losses carried forward	(326)	(322)
Other temporary differences	(255)	(270)
	(1,663)	(1,825)

36 Deferred tax liabilities (continued)

	2006 £m	2005 £m
Deferred tax liabilities:		
Accelerated capital allowances	**1,252**	1,358
Investment reserve	**149**	90
Unrealised gains	**500**	338
Tax on value of in-force business	**875**	934
Other temporary differences	**303**	250
	3,079	2,970

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 £567 million (2005: £526 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 2006 of £138 million (2005: £88 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 reinvested for the foreseeable future or can be remitted free of tax. Unremitted earnings totalled £689 million (2005: £609 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 (2005: £110 million) have not been recognised.

37 Other provisions

	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2006	**33**	**194**	**141**	**368**
Exchange and other adjustments	**–**	**–**	**3**	**3**
Provisions applied	**(1)**	**(93)**	**(22)**	**(116)**
Amortisation of discount	**–**	**–**	**4**	**4**
Charge (release) for the year	**(5)**	**–**	**5**	**–**
At 31 December 2006	**27**	**101**	**131**	**259**

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 has established 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 have been found to be deficient. During 2006 management have reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and are satisfied that no additional charge is required (in 2005 a charge of £150 million was made).

At 31 December 2006 the remaining provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks 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 are made in the assessment of the adequacy of the provision relate to the number of cases that are likely to require redress, taking into account any time barring, 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 remaining expenditure will be incurred over the next year.

Vacant leasehold property and other

Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income, compared to the head rent, 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 three 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 provisional 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.

38 Subordinated liabilities

	Note	2006 £m	2005 £m
Preferred securities			
6.90% Perpetual Capital Securities callable 2007 (US$1,000 million)	b, e	483	553
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	a	587	–
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a	504	–
6% Non-cumulative Redeemable Preference Shares	m	–	–
6.625% Perpetual Capital Securities callable 2006 (€750 million)	b, d	–	518
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	b, k	312	337
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	b, d, i	345	371
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	b, l	248	248
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	b, d, i	478	522
		2,957	2,549
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:	b, c		
Series 1 (US$750 million)		383	436
Series 2 (US$500 million)		255	291
Series 3 (US$600 million)		306	349
11¾% Perpetual Subordinated Bonds (£100 million)		100	100
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	b, i	845	892
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	b, c	101	103
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)	b, h	408	407
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million)	b, f	525	553
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)	b, j	107	127
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	b	475	501
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	b, h	255	269
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	b, h	189	202
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	b, h	447	457
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	b, h	467	497
		4,863	5,184
Dated subordinated liabilities			
8½% Subordinated Bonds 2006 (£250 million)		–	250
7¾% Subordinated Bonds 2007 (£300 million)		300	300
5¼% Subordinated Notes 2008 (DM 750 million)		260	274
10⅝% Guaranteed Subordinated Loan Stock 2008 (£100 million)	g	100	100
9½% Subordinated Bonds 2009 (£100 million)		99	99
6¼% Subordinated Notes 2010 (€400 million)		283	303
12% Guaranteed Subordinated Bonds 2011 (£100 million)	g	100	100
9⅛% Subordinated Bonds 2011 (£150 million)		149	149
4¾% Subordinated Notes 2011 (€850 million)		562	597
5⅞% Subordinated Guaranteed Bonds 2014 (€750 million)		560	606
5⅞% Subordinated Notes 2014 (£150 million)		149	148
6⅝% Subordinated Notes 2015 (£350 million)		330	345
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	c	300	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	c	336	343
Subordinated Floating Rate Notes 2020 (€100 million)	c	67	68
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		328	346
9⅝% Subordinated Bonds 2023 (£300 million)		329	341
		4,252	4,669
Total subordinated liabilities		12,072	12,402

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.

38 Subordinated liabilities (continued)

a) These securities were issued during 2006 primarily to finance the development and expansion of the business of the Group. Any repayment of preference shares would require prior notification to the Financial Services Authority. The sterling preference shares can be redeemed at the option of the Company on 25 August 2015 or quarterly thereafter; at this call date, dividends will be reset at a margin of 1.28 per cent over 3 month LIBOR. The US dollar preference shares can be redeemed at the option of the Company on 14 November 2016 or every 10 years thereafter; at this call date, dividends will be reset at a margin of 1.035 per cent over 3 month LIBOR. In certain circumstances, the shares may be mandatorily exchanged for qualifying non-innovative tier 1 securities. The Company may declare no dividend or a partial dividend on these preference shares. Dividends may be reduced if the distributable profits of the Company are insufficient to cover the payment in full of the dividends and also the payment in full of all other dividends on shares issued by the Company.

b) In certain circumstances, these notes, bonds and securities would acquire the characteristics of preference share capital. Any repayments of undated loan capital would require prior notification to the Financial Services Authority. They are accounted for as liabilities since coupon payments are mandatory as a consequence of the terms of certain preference shares.

c) These notes bear interest at rates fixed periodically in advance based on London Interbank rates.

d) 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.

e) 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.

f) 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.

g) Issued by a group undertaking under the Company's subordinated guarantee.

h) At the callable date the coupon on these notes will be reset by reference to the applicable five year benchmark gilt rate.

i) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a floating rate.

j) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a margin of 1.60 per cent over the five year Yen swap rate.

k) 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 margin of 2.33 per cent over EURIBOR. 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.

l) 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 margin of 3.50 per cent over 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.

m) Throughout 2005 and 2006, the Company has had in issue 400 6 per cent non-cumulative 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 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.

39 Share capital

	2006	2005
Authorised share capital		
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	44
	1,792	1,792
US dollars	US$m	US$m
160 million Preference shares of US$25 cents each	40	40
Euro	€m	€m
160 million Preference shares of €25 cents each	40	40
Japanese yen	¥m	¥m
50 million Preference shares of ¥25 each	1,250	1,250

39 Share capital (continued)

Issued and fully paid ordinary shares	2006 Number of shares	2005 Number of shares	2006 £m	2005 £m
Ordinary shares of 25p each				
At 1 January	**5,602,613,600**	5,596,397,111	**1,400**	1,399
Issued under employee share schemes	**35,350,837**	6,216,489	**9**	1
At 31 December	**5,637,964,437**	5,602,613,600	**1,409**	1,400
Limited voting ordinary shares of 25p each				
At 1 January and 31 December	**78,947,368**	78,947,368	**20**	20
			1,429	1,420

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.

Issued and fully paid preference shares

Throughout 2005 and 2006, the Company has had in issue 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. In accordance with IFRS, these shares are reported within liabilities.

In addition, during 2006 the Company issued 600,000 Fixed/Floating Rate Non-Cumulative Callable Preference Shares of 25 pence each with a liquidation preference of £1,000 per share and 1,000,000 Fixed/Floating Rate Non-Cumulative Callable Preference Shares of 25 cents each with a liquidation preference of US$1,000 per share. Both issues of preference shares are perpetual, although the two issues can be redeemed at the option of the Company on or after 25 August 2015 and 14 November 2016 respectively and carry the right to non-cumulative dividends which are fixed until those first redemption dates. The terms of these two issues of preference shares are such that the Company cannot declare and pay a dividend on any other junior class of share (including the mandatory dividend on the 400 6 per cent non-cumulative redeemable preference shares mentioned above) until the coupon has been paid on these preference shares. As the Company is effectively committed to the payment of a coupon on these shares they are classified as liabilities on the balance sheet in accordance with IFRS (see note 38).

40 Share premium account

	2006 £m	2005 £m
At 1 January	**1,170**	1,145
Premium arising on issue of shares under share option schemes	**96**	25
At 31 December	**1,266**	1,170

41 Other reserves

	2006 £m	2005 £m
Other reserves comprise:		
Merger reserve	**343**	343
Revaluation reserve in respect of available-for-sale financial assets	**–**	29
Cash flow hedging reserve	**12**	11
	355	383

Movements in other reserves were as follows:	2006 £m	2005 £m
Merger reserve		
At 1 January and 31 December	**343**	343

41 Other reserves (continued)

	2006 £m	2005 £m
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	29	28
Exchange and other adjustments	2	(7)
Change in fair value of available-for-sale financial assets	(10)	11
Deferred tax	–	2
	(10)	13
Income statement transfer		
Disposal	(22)	(5)
Current tax	1	–
	(21)	(5)
At 31 December	–	29

	2006 £m	2005 £m
Cash flow hedging reserve		
At 1 January	11	–
Change in fair value of hedging derivatives	–	4
Deferred tax	–	(1)
	–	3
Income statement transfer	1	12
Deferred tax	–	(4)
	1	8
At 31 December	12	11

42 Retained profits

	2006 £m	2005 £m
At 1 January	7,222	6,554
Currency translation differences (see analysis below)	(31)	24
Profit for the year	2,803	2,493
Dividends	(1,919)	(1,914)
Purchase/sale of treasury shares	(35)	18
Employee share option schemes – value of employee services	65	47
At 31 December	8,105	7,222

Retained profits are stated after deducting £87 million (2005: £73 million) representing 15 million (2005: 14 million) treasury shares held.

Value of employee services includes a credit of £31 million (2005: £31 million) reflecting the income statement charge in respect of SAYE and executive options, together with a related tax credit of £34 million (2005: £16 million). Purchase/sale of treasury shares includes a credit of £27 million (2005: £45 million) relating to the cost of other share scheme awards.

The movements over the year in the cumulative amount of foreign exchange differences taken directly to retained profits are as follows:

	2006 £m	2005 £m
At 1 January	12	(12)
Currency translation differences arising in the year	(108)	24
Foreign currency gains on net investment hedges	110	–
Current tax	(33)	–
	77	–
At 31 December	(19)	12

43 Ordinary dividends

	2006 Pence per share	2005 Pence per share	2006 £m	2005 £m
Final dividend for previous year paid during the current year	**23.5**	23.5	**1,316**	1,315
Interim dividend	**10.7**	10.7	**603**	599
	34.2	34.2	**1,919**	1,914

The directors have proposed a final dividend of 23.5 pence per share (2005: 23.5 pence per share) representing a total cost of £1,324 million (2005: £1,316 million) which will be paid on 2 May 2007.

The Bank of New York Nominees have waived the right to all dividends on the Lloyds TSB Group plc shares that they hold (holding at 31 December 2006: 10 shares).

In addition, the trustees of the following holdings of Lloyds TSB Group plc shares in relation to employee share schemes retain the right to receive dividends but chose to waive their entitlement to the dividends on those shares as indicated: the Lloyds TSB Group Shareplan (holding at 31 December 2006: 1,138,311 shares, waived right to all dividends), the Lloyds TSB Group Employee Share Ownership Trust (holding at 31 December 2006: 898,320 shares, waived right to all dividends), Lloyds TSB Group Holdings (Jersey) Limited (holding at 31 December 2006: 41,801 shares, waived right to all but a nominal amount of 1 penny in total) and the Lloyds TSB Qualifying Employee Share Ownership Trust (holding at 31 December 2006: 1,364 shares, waived right to all but a nominal amount of 1 penny in total).

44 Share based payments

Charge to the income statement

The charge to the income statement is set out below:	2006 £m	2005 £m
Executive and SAYE schemes:		
Options granted in the year	**6**	4
Options granted in prior years	**25**	27
	31	31
Share incentive plan:		
Shares granted in the year	**12**	24
Shares granted in prior years	**15**	21
	27	45
	58	76

During the year ended 31 December 2006 the Group operated the following share based payment schemes, all of which are equity settled.

Executive schemes

The Executive share option schemes were long-term incentive schemes available to certain senior executives of the Group, with grants usually made annually. Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options. The last grant of executive options was made in March 2005. These 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.

44 Share based payments (continued)

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.

Movements in the number of share options outstanding under the Executive share option schemes during 2005 and 2006 are set out below:

	2006		2005	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	43,977,411	485.35	39,289,430	515.95
Granted	–	–	10,869,357	474.23
Exercised	(328,218)	437.03	(202,708)	273.37
Forfeited	(11,189,600)	560.77	(5,978,668)	673.41
Outstanding at 31 December	32,459,593	459.84	43,977,411	485.35
Exercisable at 31 December	819,139	744.90	1,430,218	685.23

The weighted average share price at the time that the options were exercised during 2006 was 552.29 pence (2005: 490.15 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 6.8 years (2005: 7.4 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 SAYE schemes are set out below:

	2006		2005	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	114,459,474	314.17	122,115,907	321.71
Granted	19,301,716	418.00	9,610,466	380.00
Exercised	(35,148,982)	294.84	(6,086,150)	418.80
Forfeited	(3,440,257)	339.47	(4,404,042)	315.36
Cancelled	(3,984,599)	427.14	(3,722,135)	415.76
Expired	(967,208)	503.13	(3,054,572)	488.49
Outstanding at 31 December	90,220,144	335.94	114,459,474	314.17
Exercisable at 31 December	889,479	475.41	2,153,227	497.86

The weighted average share price at the time that the options were exercised during 2006 was 524.36 pence (2005: 465.51 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 2.2 years (2005: 2.2 years).

44 Share based payments (continued)

Other share option plans

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 specifically to facilitate recruitment. Options granted under this plan are not subject to any performance conditions.

	2006		2005	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	268,918	Nil	206,647	Nil
Granted	165,395	Nil	62,271	Nil
Exercised	(77,190)	Nil	–	–
Outstanding at 31 December	357,123	Nil	268,918	Nil

The weighted average fair value of options granted in the year was £4.58 (2005: £4.18). The weighted average share price at the time that the options were exercised during 2006 was 557.25 pence. No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 2.0 years (2005: 1.9 years).

Lloyds TSB Group executive share plan 2005

This plan was adopted by the Group in 2005, specifically 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.

	2006		2005	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	242,825	Nil	–	–
Granted	–	–	242,825	Nil
Outstanding at 31 December	242,825	Nil	242,825	Nil

The weighted average fair value of options granted in 2005 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 1.9 years (2005: 2.9 years).

Long-Term Incentive Plan

The Long-Term Incentive Plan introduced in 2006 is a long-term incentive scheme aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of the Group over a three year period. Awards are made within limits set by the rules of the plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary, in exceptional circumstances this may increase up to four times annual salary.

For awards made in 2006 there are two performance conditions measured over a performance period commencing on 1 January 2006 and ending on 31 December 2008.

50 per cent of the award will be based on a condition measuring the Group'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. To vest in full, the Group's total shareholder return must exceed the median of the total shareholder return 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 total shareholder return is equal to the median and vesting will be on a straight-line basis between these points. Where the Group's total shareholder return is below the median, this part of the award will lapse.

The remaining 50 per cent of the award will be based on earnings per share growth calculated on a compound annualised basis. For the award to vest in full, the earnings per share growth over the performance period must be at least equivalent to an average of the Retail Price Index plus 6 per cent per annum. 8.75 per cent of the award will vest where earnings per share growth is an average of the Retail Price Index plus 3 per cent per annum and vesting will be on a straight-line basis between these points. Where the earnings per share growth is less than an average of the Retail Price Index plus 3 per cent per annum this part of the award will lapse.

	2006 Number of shares
Outstanding at 1 January	–
Granted	5,852,386
Forfeited	(64,278)
Outstanding at 31 December	5,788,108

The fair value of the share awards granted in 2006 was £2.96.

44 Share based payments (continued)

Performance share plan

Under the performance share plan, introduced during 2005, participating executives will be eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 and 2005 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 total shareholder return 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 total shareholder return 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 total shareholder return 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.

	2006 Number of shares	2005 Number of shares
Outstanding at 1 January	826,438	–
Granted	1,035,564	854 ,116
Forfeited	(12,900)	(27,678)
Outstanding at 31 December	1,849,102	826,438

The fair value of the matching element of the performance shares awarded during 2006 was £1.92 (2005: £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		
	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
31 December 2006									
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	1.9	599,948
£2 to £3	–	–	–	284.00	1.8	45,234,578	–	–	–
£3 to £4	394.25	6.2	6,265,105	345.97	2.3	23,320,638	–	–	–
£4 to £5	444.24	7.7	22,497,465	422.94	3.1	20,125,284	–	–	–
£5 to £6	541.32	2.6	1,424,507	571.24	0.7	1,522,876	–	–	–
£6 to £7	652.98	4.2	1,332,177	–	–	–	–	–	–
£7 to £8	–	–	–	718.00	0.2	16,768	–	–	–
£8 to £9	873.12	1.7	940,339	–	–	–	–	–	–

	Executive schemes			SAYE schemes			Other share option plans		
	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
31 December 2005									
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	–	–	–	–	–	–

The weighted average fair value of options granted during the year was £nil (2005: £0.67) for executive options and £1.00 (2005: £0.98) for SAYE 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:

44 Share based payments (continued)

	SAYE	Other option schemes	Other share plans
Risk-free interest rate	**4.44%**	**4.55%**	**4.79%**
Expected life	**3.5 years**	**2.9 years**	**3.0 years**
Expected volatility	**23%**	**21%**	**19%**
Expected dividend yield	**6.5%**	**6.2%**	**6.7%**
Weighted average share price	**£5.23**	**£5.50**	**£5.15**
Weighted average exercise price	**£4.18**	**–**	**–**
Expected forfeitures	**6%**	**5%**	**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, all of the shares awarded will be forfeited (for awards made up to April 2005, only a portion of the shares would be forfeited: 75 per cent within one year of the award, 50 per cent within two years and 25 per cent within three years).

The number of shares awarded relating to free shares in 2006 was 7,725,195 (2005: 8,748,521), with an average fair value of £5.28 (2005: £4.57), based on the market price at the date of award.

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 matching shares in 2006 was 2,036,423 (2005: 2,296,575), with an average fair value of £5.40 (2005: £4.73), based on market prices at the date of award.

45 Related party transactions

Key management personnel

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

The table below details, on an aggregated basis, key management personnel compensation:

	2006 £m	2005 £m
Compensation		
Salaries and other short-term benefits	14	11
Post-employment benefits	3	3
Termination benefits	–	–
Share based payments	3	2
	20	16

	2006 million	2005 million
Share options		
At 1 January	12	12
Granted (including options of appointed directors)	–	3
Exercised/lapsed (including options of retired directors)	(1)	(3)
At 31 December	11	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:

	2006 £m	2005 £m
Loans		
At 1 January	3	3
Advanced	–	1
Interest	–	–
Repayments	(1)	(1)
At 31 December	2	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 5.1 per cent and 19.9 per cent in 2006 (2005: 4.6 per cent and 17.9 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2005: nil).

	2006 £m	2005 £m
Deposits		
At 1 January	5	2
Placed	12	22
Interest	–	–
Withdrawn	(12)	(19)
At 31 December	5	5

Deposits placed by key management personnel attracted interest rates of up to 5.2 per cent (2005: 4.5 per cent).

At 31 December 2006, the Group provided guarantees totalling £19,744 in respect of one director (2005: £19,744 in respect of one director).

At 31 December 2006, 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 £2 million with four directors and four connected persons (2005: £3 million with four directors and three 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 2006, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £19 million (2005: £14 million).

The Group manages 89 (2005: 86) Open Ended Investment Companies ('OEICs'), and of these 38 (2005: 36) are consolidated. The Group invested £372 million (2005: £345 million) and redeemed £237 million (2005: £265 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £1,746 million (2005: £2,074 million) at 31 December. The Group earned fees of £149 million from the unconsolidated OEICs (2005: £85 million). The Company held no investments in OEICs at any time during 2005 or 2006.

The Group has a number of venture capital associates that it accounts for at fair value through profit or loss. At 31 December 2006, these companies had total assets of approximately £1,625 million (2005: £1,194 million), total liabilities of approximately £1,609 million (2005: £1,072 million) and for the year ended 31 December 2006 had turnover of £2,409 million (2005: £1,782 million) and made a net loss of approximately £5 million (2005: net profit £36 million). In addition, the Group has provided £460 million (2005: £363 million) of financing to these companies on which it received £20 million (2005: £19 million) of interest income in the year.

46 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.

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.

	2006 £m	2005 £m
Contingent liabilities		
Acceptances and endorsements	63	35
Guarantees	–*	9,373
Other:		
Other items serving as direct credit substitutes	618	550
Performance bonds and other transaction-related contingencies	2,096	1,737
	2,714	2,287
	2,777	11,695

* As indicated in note 1, since 1 January 2006 all of the Group's financial guarantee contracts have been accounted for as financial instruments and measured at fair value on the Group's balance sheet.

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.

	2006 £m	2005 £m
Commitments		
Documentary credits and other short-term trade-related transactions	374	283
Forward asset purchases and forward deposits placed	5,764	277
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year maturity:		
Mortgage offers made	4,071	2,983
Other commitments	49,731	55,310
	53,802	58,293
1 year or over maturity	28,477	24,123
	88,417	82,976

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend £51,288 million (2005: £43,094 million) was irrevocable.

46 Contingent liabilities and commitments (continued)

Operating lease commitments

Where a Group company is the lessee the future minimum lease payments under non-cancellable premises operating leases are as follows:

	2006 £m	2005 £m
Not later than 1 year	212	216
Later than 1 year and not later than 5 years	733	784
Later than 5 years	835	1,016
	1,780	2,016

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 is 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:

	2006 £m	2005 £m
Not later than 1 year	1	1
Later than 1 year and not later than 5 years	–	–
Later than 5 years	15	15
	16	16

Finance lease payments relate to leases of premises with a net book value of £14 million (2005: £14 million) and equipment with a net book value of £1 million (2005: £2 million). 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 2006 and 2005.

Capital commitments

Excluding commitments in respect of investment property (see note 21), capital expenditure contracted but not provided for at 31 December 2006 amounted to £75 million (2005: £223 million). Of this amount, £74 million (2005: £215 million) related 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.

47 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 market and credit risks.

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 28 to 39, 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 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 their term to maturity.

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 for interest rate risk: 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 2006 the aggregate notional principal of interest rate swaps designated as fair value hedges was £37,378 million (2005: £39,568 million) with a net fair value liability of £110 million (2005: £245 million) (see note 16). 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 six 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 2006 was £569 million (2005: £648 million) with a net fair value liability of £8 million (2005: £18 million) (see note 16).

47 Financial risk management (continued)

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 2006							
Assets							
Trading and other financial assets at fair value through profit or loss	1,455	867	1,012	5,177	21,057	38,127	67,695
Derivative financial instruments*	–	–	–	–	–	5,565	5,565
Loans and advances to banks	24,652	1,561	1,561	7,449	5,346	69	40,638
Loans and advances to customers	71,041	17,711	19,572	60,845	19,110	6	188,285
Available-for-sale financial assets	5,525	10,732	1,594	1,174	138	15	19,178
Other assets	828	48	–	–	–	21,361	22,237
Total assets	103,501	30,919	23,739	74,645	45,651	65,143	343,598
Liabilities							
Deposits from banks	28,157	3,654	1,716	827	1,920	120	36,394
Customer accounts	124,726	3,444	4,802	1,809	223	4,338	139,342
Derivative financial instruments, trading and other liabilities at fair value through profit or loss*	–	–	55	467	634	5,791	6,947
Debt securities in issue	29,672	13,562	5,059	1,339	4,486	–	54,118
Liabilities arising from insurance and investment contracts	–	–	–	–	–	66,498	66,498
Other liabilities	37	27	2	–	4,583	12,071	16,720
Subordinated liabilities	737	561	750	2,806	7,218	–	12,072
Total liabilities	183,329	21,248	12,384	7,248	19,064	88,818	332,091
Net repricing gap	(79,828)	9,671	11,355	67,397	26,587	(23,675)	11,507

* 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.

	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 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, trading and other liabilities at fair value through profit or loss*	–	–	–	–	–	6,396	6,396
Debt securities in issue	20,411	8,396	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	746	890	504	2,375	7,887	–	12,402
Total liabilities	157,617	19,076	9,887	8,277	18,591	85,676	299,124
Net repricing gap	(55,974)	11,597	15,619	48,430	14,624	(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.

47 Financial risk management (continued)

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 2005 and 2006 are disclosed on page 34.

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 equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to retained earnings.

The Group hedges part of the currency translation risk of a net investment in a foreign operation using a cross currency swap. At 31 December 2006 the notional principal of this cross currency swap was £2,589 million with a net fair value asset of £139 million (see note 16) and was designated on an after-tax basis as a hedge of a net investment in a foreign operation.

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:

	2006 £m	2005 £m
Functional currency of Group operations:		
Euro	76	80
US dollar	97	102
Swiss franc	70	56
Other non-sterling	188	183
	431	421

Credit risk

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 balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

	2006 £m	2005 £m
Loans and advances to banks	40,639	31,656
Loans and advances to customers	190,478	177,016
Deposit amounts available for offset[1]	(6,392)	(6,414)
Impairment losses	(2,194)	(2,073)
	222,531	200,185
Available-for-sale debt securities and treasury bills	19,163	14,894
Contingent liabilities	2,777	11,695
Financial guarantees	8,139	–
Undrawn irrevocable formal standby facilities, credit lines and other commitments to lend[2]	51,288	43,094
Derivative assets, before netting	5,565	5,878
Amounts available for offset under master netting arrangements[1]	(2,761)	(3,235)
	2,804	2,643
Trading and other financial assets at fair value through profit or loss	29,568	26,869
	336,270	299,380

[1] Deposit amounts 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 46 – 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 2006, amounts deposited by customers increased by £8,272 million from £131,070 million at 31 December 2005 to £139,342 million at 31 December 2006. 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 and commercial paper programmes. The Group has also raised wholesale funding via the issuance of Residential Mortgage Backed Securities; £10,048 million was outstanding at 31 December 2006.

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.

47 Financial risk management (continued)

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 2006						
Assets						
Trading and other financial assets at fair value through profit or loss	**886**	**782**	**905**	**5,589**	**59,533**	**67,695**
Derivative financial instruments	**559**	**740**	**1,198**	**1,750**	**1,318**	**5,565**
Loans and advances to banks	**22,491**	**1,349**	**1,539**	**9,807**	**5,452**	**40,638**
Loans and advances to customers	**28,099**	**8,223**	**10,716**	**40,633**	**100,614**	**188,285**
Available-for-sale financial assets	**652**	**1,301**	**3,446**	**6,919**	**6,860**	**19,178**
Other assets	**6,228**	**191**	**61**	**175**	**15,582**	**22,237**
Total assets	**58,915**	**12,586**	**17,865**	**64,873**	**189,359**	**343,598**
Liabilities						
Deposits from banks	**28,268**	**3,659**	**1,707**	**818**	**1,942**	**36,394**
Customer accounts	**128,911**	**3,394**	**4,960**	**1,854**	**223**	**139,342**
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	**932**	**709**	**751**	**1,972**	**2,583**	**6,947**
Debt securities in issue	**28,320**	**4,866**	**5,912**	**8,611**	**6,409**	**54,118**
Liabilities arising from insurance and investment contracts	**945**	**832**	**2,292**	**12,474**	**49,955**	**66,498**
Other liabilities	**5,707**	**325**	**361**	**274**	**10,053**	**16,720**
Subordinated liabilities	**–**	**–**	**300**	**1,553**	**10,219**	**12,072**
Total liabilities	**193,083**	**13,785**	**16,283**	**27,556**	**81,384**	**332,091**
Net liquidity gap	**(134,168)**	**(1,199)**	**1,582**	**37,317**	**107,975**	**11,507**
As at 31 December 2005						
Assets						
Trading 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

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 financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

47 Financial risk management (continued)

Fair value information is not provided for items that do not meet the definition 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 for each major category of financial instrument is discussed below.

Trading 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 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.

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 is 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 is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period.

Available-for-sale financial assets

Listed securities are valued at current bid 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.

Trading and other liabilities at fair value through profit or loss

Fair value is determined using valuation techniques based upon 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.

Financial commitments and contingent liabilities

Financial guarantees are valued on the basis of cash premiums receivable. The Group considers that it is not meaningful to provide an estimate of the fair value of other contingent liabilities and financial commitments, 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. Therefore only financial guarantees are included in the following table.

	Carrying value 2006 £m	Carrying value 2005 £m	Fair value 2006 £m	Fair value 2005 £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	67,695	60,374	67,695	60,374
Derivative financial instruments	5,565	5,878	5,565	5,878
Loans and advances to banks	40,638	31,655	40,641	31,691
Loans and advances to customers	188,285	174,944	187,977	175,554
Available-for-sale financial assets	19,178	14,940	19,178	14,940
Investment properties	4,739	4,260	4,739	4,260
Financial liabilities				
Deposits from banks	36,394	31,527	36,383	31,508
Customer accounts	139,342	131,070	139,263	131,052
Trading and other liabilities at fair value through profit or loss	1,184	–	1,184	–
Derivative financial instruments	5,763	6,396	5,763	6,396
Debt securities in issue	54,118	39,346	54,070	39,352
Liabilities arising from non-participating investment contracts	24,370	21,839	24,370	21,839
Financial guarantees	49	–	49	–
Subordinated liabilities	12,072	12,402	12,767	13,262

48 Acquisitions

During 2006, the Group, through its Asset Finance subsidiaries, acquired two businesses engaged in consumer finance for a total consideration of £16 million, settled in cash. Goodwill of £4 million arose on these acquisitions; no significant fair value adjustments were made.

In 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.

49 Consolidated cash flow statement

(a) Change in operating assets

	2006 £m	2005 £m
Change in loans and advances to banks	(11,063)	(1,319)
Change in loans and advances to customers	(13,910)	(14,525)
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	(7,072)	(103)
Change in other operating assets	50	(1,211)
Change in operating assets	(31,995)	(17,158)

(b) Change in operating liabilities

	2006 £m	2005 £m
Change in deposits from banks	5,222	(8,168)
Change in customer accounts	8,523	4,619
Change in debt securities in issue	15,068	10,280
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	556	(3,937)
Change in investment contract liabilities	3,795	6,094
Change in other operating liabilities	(95)	1,151
Change in operating liabilities	33,069	10,039

(c) Non-cash and other items

	2006 £m	2005 £m
Depreciation of fixed assets	619	639
Revaluation of investment property	(631)	(430)
Allowance for loan losses	1,560	1,302
Write-off of allowance for loan losses	(1,299)	(1,078)
Impairment of goodwill	–	6
Insurance claims	8,569	12,186
Insurance claims paid	(7,509)	(8,269)
Customer remediation provision	–	150
Customer remediation paid	(93)	(77)
Other provision movements	(19)	(7)
Net charge in respect of defined benefit schemes	109	259
Contributions to defined benefit schemes	(556)	(425)
Other non-cash items	104	(525)
Total non-cash items	854	3,731
Interest expense on subordinated liabilities	744	698
Profit on disposal of businesses	–	(50)
Other	(43)	(15)
Total other items	701	633
Non-cash and other items	1,555	4,364

49 Consolidated cash flow statement (continued)

(d) Analysis of cash and cash equivalents as shown in the balance sheet

	2006 £m	2005 £m
Cash and balances with central banks	1,898	1,156
Less: mandatory reserve deposits[1]	(300)	(288)
	1,598	868
Loans and advances to banks	40,638	31,655
Less: amounts with a maturity of three months or more	(16,798)	(5,770)
	23,840	25,885
Total cash and cash equivalents	25,438	26,753

[1] Mandatory reserve deposits are held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Included within cash and cash equivalents at 31 December 2006 is £9,054 million (2005: £8,860 million) held within the Group's life funds, which is not immediately available for use in the business.

(e) Analysis of changes in financing during the year

	2006 £m	2005 £m
Share capital (including share premium account):		
At 1 January	2,590	2,564
Issue of share capital	105	26
At 31 December	2,695	2,590

	2006 £m	2005 £m
Minority interests:		
At 1 January	435	81
Exchange and other adjustments	(4)	–
Capital invested by minority shareholders	–	329
Repayment of capital to minority shareholders	(151)	–
Minority share of profit after tax	104	62
Dividends to minority shareholders	(32)	(37)
At 31 December	352	435

	2006 £m	2005 £m
Subordinated liabilities and finance leases:		
At 1 January	12,418	11,232
Exchange and other adjustments	(687)	59
Issue of subordinated liabilities	1,116	1,361
Repayments of subordinated liabilities	(759)	(232)
Finance lease capital repayments	–	(2)
At 31 December	12,088	12,418

(f) Acquisition of group undertakings and businesses

	2006 £m	2005 £m
Net assets acquired:		
Loans and advances to customers	11	–
Other assets	1	8
Tangible fixed assets	–	8
Other liabilities	–	(3)
	12	13
Goodwill arising on consolidation	4	3
Net cash outflow from acquisitions in the year*	16	16
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	4	11
Net cash outflow from acquisitions	20	27

* The consideration in respect of the acquisitions in both 2005 and 2006 was settled in cash in the year concerned.

49 Consolidated cash flow statement (continued)

(g) Disposal and closure of group undertakings and businesses	2006 £m	2005 £m
Loans and advances to customers	–	803
Goodwill	–	93
Other net assets and liabilities	–	(946)
	–	(50)
Profit on sale and closure of businesses	–	50
Cash and cash equivalent consideration received	–	–
Cash and cash equivalents disposed of	–	–
Net cash outflow from disposals in the year	–	–
Consideration for 2005 disposal settled in cash	936	–
Adjustment to consideration received in respect of prior period disposals	–	(4)
Net cash inflow (outflow) from disposals	936	(4)

50 Future developments

The following pronouncements will be relevant to the Group but were not effective at 31 December 2006 and have not been applied in preparing these financial statements.

Pronouncement	Nature of change	Effective date
IFRS 7 Financial Instruments: Disclosures[1]	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 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 11 IFRS 2 – Group and Treasury Share Transactions[2,3]	Clarifies the application of IFRS 2 Share-based Payment to certain share-based payment arrangements involving own equity instruments and arrangements involving equity instruments of a parent entity.	Annual periods beginning on or after 1 March 2007.
IFRS 8 Operating Segments[2,3]	Replaces IAS 14 Segment Reporting and requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally.	Annual periods beginning on or after 1 January 2009.

[1] Includes consequential changes to other pronouncements.

[2] At the date of this report, these pronouncements are awaiting EU endorsement.

[3] Pending EU endorsement, the Group has not yet made a final decision as to whether it will apply these pronouncements in the 2007 financial statements.

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.

51 Approval of financial statements

The consolidated financial statements were approved by the directors of Lloyds TSB Group plc on 22 February 2007.

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 2006 which comprise the balance sheet, the statement of changes in equity, the cash flow statement 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 52 to 61 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 2006.

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 on page 51.

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. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the parent company financial statements. The information given in the directors' report includes that specific information presented in the chairman's statement, the group chief executive's review and the business review that is cross referred from the principal activities, business review, future developments and financial risk management objectives and policies section of the directors' report.

In addition we report to you if, in our opinion, 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 chairman's statement, the group chief executive's review, the business review, the directors' report, the corporate governance disclosures, the unaudited part of the directors' remuneration report and the information for shareholders. 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 2006 and cash flows for the year then ended;
- 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
- the information given in the directors' report is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
22 February 2007

Parent company balance sheet

at 31 December 2006

	Note	2006 £ million	2005 £ 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
		7,312	7,333
Current assets:			
Derivative financial instruments		114	188
Other assets		146	131
Amounts due from subsidiaries	3	203	164
Cash and cash equivalents		1,213	107
		1,676	590
Total assets		8,988	7,923
Equity and liabilities			
Capital and reserves:			
Share capital	4	1,429	1,420
Share premium account	4	1,266	1,170
Retained profits	5	2,026	2,055
Total equity		4,721	4,645
Non-current liabilities:			
Subordinated liabilities	6	2,297	1,502
		2,297	1,502
Current liabilities:			
Current tax liabilities		43	5
Amounts owed to subsidiaries		1,850	1,692
Other liabilities		77	79
		1,970	1,776
Total liabilities		4,267	3,278
Total equity and liabilities		8,988	7,923

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

The directors approved the parent company financial statements on 22 February 2007.

Sir Victor Blank
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 profits £ million	Total £ million
Balance at 1 January 2005	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
Profit for the year*	**–**	**1,877**	**1,877**
Dividends	**–**	**(1,919)**	**(1,919)**
Purchase/sale of treasury shares	**–**	**(20)**	**(20)**
Employee share option schemes:			
Value of employee services	**–**	**33**	**33**
Proceeds from shares issued	**105**	**–**	**105**
Balance at 31 December 2006	**2,695**	**2,026**	**4,721**

* 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 2006

	2006 £ million	2005 £ million
Profit before tax	1,893	1,882
Dividend income	(1,918)	(1,913)
Fair value adjustment	3	9
Change in other assets	(44)	(72)
Change in other liabilities	156	(44)
Tax received	46	12
Net cash provided by (used in) operating activities	136	(126)
Cash flows from financing activities:		
Dividends received from subsidiaries	1,918	1,913
Dividends paid to equity shareholders	(1,919)	(1,914)
Proceeds from issue of subordinated liabilities	1,116	–
Proceeds from issue of ordinary shares	105	26
Repayment of subordinated liabilities	(250)	–
Net cash generated by financing activities	970	25
Change in cash and cash equivalents	1,106	(101)
Cash and cash equivalents at beginning of year	107	208
Cash and cash equivalents at end of year	1,213	107

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 2006.

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 accounting policies of the parent company are the same as those of the Group which are set out in note 1 to the consolidated financial statements, except that it has no policy in respect of consolidation and investments in subsidiaries are carried at historical cost, less any provisions for impairment.

2 Deferred tax assets

The movement in the net deferred tax asset is as follows:	2006 £m	2005 £m
At 1 January	**21**	3
Income statement (charge) credit	**(8)**	2
Amount (debited) credited to equity in respect of employee share schemes	**(13)**	16
At 31 December	**–**	21

The deferred tax assets related 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 39 and 40 to the consolidated financial statements.

5 Retained profits

	£m
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
Profit for the year	**1,877**
Dividends	**(1,919)**
Purchase/sale of treasury shares	**(20)**
Employee share option schemes: value of employee services	**33**
At 31 December 2006	**2,026**

Details of the Company's dividends are as set out in note 43 to the consolidated financial statements.

6 Subordinated liabilities

	2006 £m	2005 £m
Preferred securities		
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)†	587	–
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$ 1,000 million)†	504	–
6% Non-cumulative Redeemable Preference Shares	–	–
Undated subordinated liabilities		
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)*	497	497
Dated subordinated liabilities		
8½% Subordinated Bonds 2006 (£250 million)	–	250
9⅛% Subordinated Bonds 2011 (£150 million)	149	149
5⅞% Subordinated Guaranteed Bonds 2014 (€750 million)	560	606
	709	1,005
Total subordinated liabilities	2,297	1,502

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 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.

† Any repayment of preference shares would require prior notification to the Financial Services Authority. The preference shares can be redeemed at the option of the Company on or after 25 August 2015; at this call date, dividends will be reset at a margin of 1.28 per cent over 3 month LIBOR. The US dollar preference shares can be redeemed at the option of the Company on or after 14 November 2016; at this call date, dividends will be reset at a margin of 1.035 per cent over 3 month LIBOR. In certain circumstances, the shares may be mandatorily exchanged for qualifying non-innovative tier 1 securities. The Company may declare no dividend or a partial dividend on these preference shares. Dividends may be reduced if the distributable profits of the Company are insufficient to cover the payment in full of the dividends and also the payment in full of all other dividends on shares issued by the Company. These securities were issued during 2006 primarily to finance the development and expansion of the business of the Group.

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 45 to the consolidated financial statements.

The Company has no employees (2005: nil).

As discussed in note 44 to the consolidated financial statements, the Group provides share based compensation to employees through a number of schemes; these are all in relation to shares in the Company and the cost of providing those benefits is recharged to the employing companies in the Group on a cash basis.

Investment in subsidiaries	£m
At 1 January 2006 and 31 December 2006	5,589

The above investment is carried at cost; there has been no impairment of the Company's investment in subsidiaries.

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.

7 Related party transactions (continued)

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, France, Germany, Gibraltar, Hong Kong, Japan, Luxembourg, Malaysia, Monaco, Netherlands, Paraguay, Singapore, Spain, Switzerland, Uruguay and the USA, and a representative office in China.

None of the parent company's subsidiaries has experienced any significant restrictions in paying dividends or repaying loans and advances. All regulated banking and insurance subsidiaries are required to maintain capital at levels agreed with the regulators; this may impact those subsidiaries' ability to make distributions.

Amounts owed by subsidiaries:	2006 £m	2005 £m
At 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 2006, the parent company held deposits of £1,213 million with the bank (2005: £107 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 2006 the parent company had interest rate and currency swaps with Lloyds TSB Bank plc with an aggregate notional principal amount of £2,228 million and a positive fair value of £114 million (2005: notional principal amount of £1,379 million and a positive fair value of £188 million), designated as fair value hedges to manage the interest rate risk in the Company's issuance of subordinated liabilities .

Related party information in respect of other related party transactions is given in note 45 to the consolidated financial statements.

8 Approval of the financial statements and other information

The parent company financial statements were approved by the directors of Lloyds TSB Group plc on 22 February 2007.

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 2006	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 99	66,243	7.62	2.2	0.04
100 – 499	347,926	40.00	114.9	2.04
500 – 999	277,080	31.85	182.6	3.24
1,000 – 4,999	142,500	16.38	276.6	4.91
5,000 – 9,999	20,225	2.33	137.4	2.43
10,000 – 49,999	13,653	1.57	243.9	4.33
50,000 – 99,999	723	0.08	48.4	0.86
100,000 – 999,999	961	0.11	318.8	5.65
1,000,000 and over	524	0.06	4,313.1	76.50
	869,835	100.00	5,637.9*	100.00

* Includes 913 million shares (16.19%) registered in the names of some 840,000 individuals. 266 million shares (4.72%) are held by over 66,000 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, Inc had interests of 3%, 3.84% and 4.86%, respectively, in the issued share capital with rights to vote in all circumstances at general meetings. No other notification has been received that anyone has an interest of 3% or more in 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.

- Internet dealing. Log on to www.shareview.co.uk/dealing
- Telephone dealing. Call 0870 850 0852
- Postal dealing. Call 0870 242 4244 for an application form

Internet and telephone dealing services are available between 8.00am and 4.30pm, Monday to Friday.

Details of any dealing costs are available when you log on to shareview or when you call one of the above numbers. They are also available on www.lloydstsb.com/investorrelations

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, visit 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 you to receive shareholder communications electronically. In addition, you can change your address or bank details and vote your shareholding online. Visit www.shareview.co.uk for details.

Financial calendar 2007

23 February
Results for 2006 announced

7 March
Ex-dividend date for 2006 final dividend

9 March
Record date for final dividend

4 April
Final date for joining or leaving the dividend reinvestment plan for the final dividend

2 May
Final dividend paid

9 May
Annual general meeting in Glasgow

31 July
Results for half-year to 30 June 2007 announced

8 August
Ex-dividend date for 2007 interim dividend

10 August
Record date for interim dividend

5 September
Final date for joining or leaving the dividend reinvestment plan for the interim dividend

3 October
Interim dividend paid

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