Lloyds TSB Bank plc

Report and Accounts

2001

Member of Lloyds TSB Group

Contents

Registered office: 71 Lombard Street, London EC3P 3BS. Registered in England no 2065

Directors' report

Results and dividends

The consolidated profit and loss account on page 5 shows a profit attributable to shareholders for the year ended 31 December 2001 of £2,482 million. An interim dividend of £566 million for the year ended 31 December 2001 was paid on 29 September 2001. A second interim dividend of £1,306 million will be paid on 28 March 2002.

Principal activities

The Bank and its subsidiaries provide a wide range of banking and financial services through branches and offices in the UK and overseas.

Business review

Profit before tax for the Lloyds TSB Bank Group was £3,608 million in 2001, compared with £3,987 million in 2000. The reduction in profit before tax was caused by the £648 million adverse short-term fluctuations in investment returns. Total income increased by 4 per cent to £8,827 million, although adjusting for the adverse short-term fluctuations in investment returns, total income increased by 10 per cent to £9,475 million. Operating expenses increased by 9 per cent to £4,267 million. During the year however, both income and expenses were significantly affected by the impact of exceptional restructuring costs in support of the Group's extensive efficiency programme; acquisition costs relating to the proposed acquisition of Abbey National; and the impact of a provision for redress to past purchasers of pension policies. During 2000, changes in the economic assumptions applied to our long-term assurance business and a one-off charge relating to stakeholder pensions were also significant.

Excluding exceptional restructuring costs, total profit before tax from UK Retail Banking fell by £143 million, or 18 per cent, to £633 million. This reduction in profitability largely reflects the substantial investments that have been made to support future growth including the introduction of improved products and services. There was good growth in personal lending and retail deposits and overall retail banking product sales were 14 per cent higher than in 2000. Pre-tax profit from Mortgages increased by £66 million, or 7 per cent to £955 million, from £889 million in 2000. Gross new lending increased by 22 per cent to £14.0 billion and net new lending was £3.9 billion, resulting in an estimated market share of net new lending of 7.1 per cent. Operating profit from Insurance and Investments, excluding short-term fluctuations in investment returns, exceptional restructuring costs, pension provisions and, in 2000, changes in the economic assumptions applied to our long-term assurance business and the stakeholder pension related charge, increased by 12 per cent to £1,601 million, from £1,425 million in 2000. There was 6 per cent growth in weighted sales, which reflected a 31 per cent increase in weighted sales from life and pensions, offset by a 31 per cent reduction in weighted sales from unit trusts, largely caused by the downturn in the market during the second half of 2001.

Wholesale Markets pre-tax profit, excluding exceptional restructuring costs, increased by £191 million, or 26 per cent, to £937 million. In addition to the impact of the acquisition of Chartered Trust, in September 2000, there was strong customer lending growth in corporate and commercial banking and good contributions from all other businesses.

In International Banking, pre-tax profit was £33 million lower at £444 million, as a result of a £100 million reduction in pre-tax profit caused by the recent economic difficulties in Argentina.

The total charge for bad and doubtful debts was 38 per cent higher at £747 million, compared with £541 million in 2000. The domestic charge increased to £570 million from £426 million, partly as a result of the Chartered Trust acquisition. In addition, during 2000 UK Retail Banking had a one-off benefit of £42 million following the full centralisation of its arrears processing. The Group's charge for bad and doubtful debts, expressed as a percentage of average lending and excluding a general provision relating to Argentina, was

Directors' report

Business review (continued)

0.57 per cent, compared with 0.50 per cent in 2000. Notwithstanding the general slow-down in global economic growth, the level of non-performing loans decreased slightly to £1,222 million. Non-performing lending represented 1.0 per cent of total lending, compared with 1.1 per cent in December 2000.

Shareholders funds grew by 9 per cent to £12,397 million. Risk weighted assets increased by 16 per cent to £108.8 billion. At the end of 2001, the risk asset ratios, the international standard for measuring capital adequacy, were 9.1 per cent for total capital and 9.5 per cent for tier 1 capital.

Directors

The names of the directors of the Bank are shown on page 3.

Mr Linaker and Sir Brian Pitman retired on 18 April 2001 and Mr Holt left the board on 31 August 2001. Dr Julius and Mr Daniels were appointed directors from 1 October 2001 and 1 November 2001, respectively, and Mr Gemmell will join the board on 17 April 2002. Mr Urquhart will retire on 17 April 2002.

Employees

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

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

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

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

Policy and practice on payment of creditors

The Bank 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, 1 Victoria Street, London SW1H 0ET.

The Bank'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 Bank to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is 29. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2001 bears to the aggregate of the amounts invoiced by suppliers during the year.

On behalf of the board

A J Michie
Secretary
14 February 2002

Directors

M A van den Bergh
Chairman

A E Moore CBE
Deputy Chairman

P B Ellwood CBE
Chief Executive

M E Fairey
Deputy Chief Executive

M K Atkinson

Ewan Brown CBE

A C Butler

J E Daniels

S M Forbes

G J N Gemmell CBE
(from 17 April 2002)

C S Gibson-Smith

D S Julius CBE

A G Kane

T F W McKillop

D P Pritchard

M D Ross CBE

The Earl of Selborne KBE FRS

L M Urquhart
(retiring on 17 April 2002)

Independent auditors' report

To the members of Lloyds TSB Bank plc

We have audited the financial statements which comprise the consolidated profit and loss account, the balance sheets, the statement of total recognised gains and losses and related notes which have been prepared under the accounting policies set out on pages 9 to 11.

Respective responsibilities of directors and auditors
The directors are responsible for preparing the annual report including, as described below, the financial statements. The United Kingdom Companies Act 1985 requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Bank and the Group as at the end of the year and of the profit or loss for that year. In preparing those financial statements, the directors are required to:

– select suitable accounting policies and then apply them consistently;
– make judgements and estimates that are reasonable and prudent;
– state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
– prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank and the Group will continue in business.

The directors are responsible for keeping accounting records which disclose with reasonable accuracy at any time the financial position of the Bank and which enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Our responsibilities, as independent auditors, are established in the United Kingdom by legal and regulatory requirements, and the Auditing Standards issued by the Auditing Practices Board.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the United Kingdom Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Bank 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 transactions is not disclosed.

We read the directors' report contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion
We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Bank and 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 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 financial statements.

Opinion
In our opinion the financial statements give a true and fair view of the state of affairs of the Bank and the Group as at 31 December 2001 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
Southampton
14 February 2002

Consolidated profit and loss account

for the year ended 31 December 2001

	Note	**2001 £ million**	2000* £ million
Interest receivable:			
Interest receivable and similar income arising from debt securities		**530**	443
Other interest receivable and similar income		**10,829**	10,609
Interest payable		**6,417**	6,469
Net interest income		**4,942**	4,583
Other income			
Fees and commissions receivable		**2,925**	2,771
Fees and commissions payable		**(602)**	(479)
Dealing profits (before expenses)	3	**233**	198
Income from long-term assurance business	28	**193**	615
General insurance premium income		**428**	399
Other operating income		**708**	436
		3,885	3,940
Total income		**8,827**	8,523
Operating expenses			
Administrative expenses	4	**3,500**	3,330
Exceptional restructuring costs	5	**217**	188
Total administrative expenses		**3,717**	3,518
Depreciation	23	**511**	364
Amortisation of goodwill	22	**39**	22
Depreciation and amortisation		**550**	386
Total operating expenses		**4,267**	3,904
Trading surplus		**4,560**	4,619
General insurance claims		**174**	142
Provisions for bad and doubtful debts	15		
Specific		**736**	547
General		**11**	(6)
		747	541
Amounts written off fixed asset investments	6	**60**	32
Operating profit		**3,579**	3,904
Income from associated undertakings and joint ventures	20	**(10)**	3
Profit on sale of businesses	7	**39**	80
Profit on ordinary activities before tax	8	**3,608**	3,987
Tax on profit on ordinary activities	9	**1,047**	1,159
Profit on ordinary activities after tax		**2,561**	2,828
Minority interests: equity		**17**	13
: non-equity	38	**40**	36
Profit after minority interests		**2,504**	2,779
Payments to holders of Perpetual capital securities	40	**22**	–
Profit for the year attributable to shareholders	10	**2,482**	2,779
Dividends	11	**1,872**	1,685
Retained profit	41	**610**	1,094

** restated (see note 1)*

Balance sheets

at 31 December 2001

	Note	Group 2001 £ million	Group 2000* £ million	Bank 2001 £ million	Bank 2000* £ million
Assets					
Cash and balances at central banks		**1,240**	1,027	**1,112**	899
Items in course of collection from banks		**1,664**	1,533	**1,595**	1,462
Treasury bills and other eligible bills	12	**4,412**	1,709	**4,087**	1,499
Loans and advances to banks	13	**15,224**	15,290	**56,918**	51,542
Loans and advances to customers		**124,834**	116,710	**53,876**	48,398
Non-returnable finance		**(124)**	(400)	**–**	–
	14	**124,710**	116,310	**53,876**	48,398
Debt securities	17	**24,225**	14,605	**20,926**	13,472
Equity shares	18	**225**	247	**27**	24
Interests in associated undertakings and joint ventures					
– share of gross assets		**281**	14		
– share of gross liabilities		**(242)**	(5)		
	20	**39**	9	**39**	9
Shares in group undertakings	21	**–**	–	**16,944**	16,171
Intangible fixed assets	22	**2,566**	2,599	**11**	13
Tangible fixed assets	23	**3,365**	3,037	**1,304**	1,258
Other assets	26	**4,441**	3,976	**3,597**	3,333
Prepayments and accrued income	27	**3,192**	2,945	**2,703**	2,682
Long-term assurance business attributable to the shareholder	28	**6,574**	6,549	**–**	–
		191,877	169,836	**163,139**	140,762
Long-term assurance assets attributable to policyholders	28	**46,389**	51,085	**–**	–
Total assets		**238,266**	220,921	**163,139**	140,762

** restated (see note 1)*

The directors approved the accounts on 14 February 2002.

M A van den Bergh
Chairman

P B Ellwood CBE
Chief Executive

M K Atkinson
Finance Director

Balance sheets

at 31 December 2001

		Group		Bank	
	Note	**2001 £ million**	2000* £ million	**2001 £ million**	2000* £ million
Liabilities					
Deposits by banks	*30*	**24,310**	16,735	**32,082**	24,045
Customer accounts	*31*	**109,302**	102,062	**82,091**	75,352
Items in course of transmission to banks		**534**	420	**450**	338
Debt securities in issue	*32*	**24,420**	17,899	**20,389**	13,731
Other liabilities	*33*	**6,629**	6,658	**5,352**	5,000
Accruals and deferred income	*34*	**3,563**	4,151	**2,397**	3,031
Provisions for liabilities and charges:					
Deferred tax	*35*	**1,733**	1,696	**125**	110
Other provisions for liabilities and charges	*36*	**401**	442	**178**	199
Subordinated liabilities:					
Undated loan capital	*37*	**3,651**	3,391	**4,060**	3,806
Dated loan capital	*37*	**4,391**	4,408	**3,618**	3,728
Minority interests:					
Equity		**37**	37	**–**	–
Non-equity	*38*	**509**	515	**–**	–
		546	552	**–**	–
Called-up share capital	*39*	**1,542**	1,542	**1,542**	1,542
Perpetual capital securities	*40*	**451**	–	**451**	–
Share premium account	*41*	**2,960**	2,960	**2,960**	2,960
Revaluation reserve	*41*	**–**	–	**2,048**	1,278
Profit and loss account	*41*	**7,444**	6,920	**5,396**	5,642
Shareholders' funds (equity and non-equity)	*42*	**12,397**	11,422	**12,397**	11,422
		191,877	169,836	**163,139**	140,762
Long-term assurance liabilities to policyholders	*28*	**46,389**	51,085	**–**	–
Total liabilities		**238,266**	220,921	**163,139**	140,762
Memorandum items	*47*				
Contingent liabilities:					
Acceptances and endorsements		**2,243**	357	**2,244**	354
Guarantees and assets pledged as collateral security		**3,789**	3,249	**3,739**	3,596
Other contingent liabilities		**1,931**	1,541	**1,890**	1,543
		7,963	5,147	**7,873**	5,493
Commitments:					
Commitments arising out of sale and option to resell transactions		**–**	3	**–**	3
Other commitments		**53,342**	42,586	**49,731**	39,779
		53,342	42,589	**49,731**	39,782

* *restated (see note 1)*

Statement of total recognised gains and losses

for the year ended 31 December 2001

	2001 **£ million**	2000* £ million
Profit attributable to shareholders	**2,482**	2,779
Currency translation differences on foreign currency net investments	**(86)**	(11)
Total recognised gains and losses relating to the year	**2,396**	2,768
Prior year adjustment in respect of the adoption of FRS 18 (note 1)	**248**	–
Prior year adjustment in respect of the adoption of FRS 15	**–**	(112)
Total gains and losses recognised during the year	**2,644**	2,656

** restated (see note 1)*

Historical cost profits and losses

for the year ended 31 December 2001

There was no material difference between the results as reported and the results that would have been reported on an unmodified historical cost basis. Accordingly, no note of historical cost profits and losses has been included.

Reconciliation of movements in shareholders' funds

for the year ended 31 December 2001

	2001 **£ million**	2000* £ million
Profit attributable to shareholders	**2,482**	2,779
Dividends	**(1,872)**	(1,685)
Retained profit	**610**	1,094
Currency translation differences on foreign currency net investments	**(86)**	(11)
Issue of perpetual capital securities	**451**	–
Goodwill written back on closure of business	**–**	16
Net increase in shareholders' funds	**975**	1,099
Shareholders' funds at beginning of year	**11,422**	10,075
Prior year adjustment (note 1)	**–**	248
Shareholders' funds at end of year	**12,397**	11,422

** restated (see note 1)*

Notes to the accounts

1 Accounting policies

Accounting policies are unchanged from 2000, except that the Group has implemented the requirements of Financial Reporting Standard 18 'Accounting Policies'. On implementation of this new standard, the Group has taken the opportunity to review the appropriateness of accounting policies and the following change has been made as a result. Debt securities acquired in exchange for advances to countries experiencing payment difficulties which are not (nor due to be) collateralised by US Treasury securities ('uncollateralised bonds') were, like the original debt, previously included in loans and advances, at their written down value at date of exchange as adjusted for any subsequent movements in bad debt provisions. This treatment is no longer considered to be the most appropriate and the uncollateralised bonds have been reclassified as debt securities where they are carried at an amount based on the market value at the date of the original exchange as adjusted for the amortisation of the discount on acquisition. The impact of this change on the Group and on the Bank has been the same. A prior year adjustment, increasing reserves by £248 million, has been made to reflect the revised policy.

The effect of this change on the profit and loss account for the year ended 31 December 2001 has been to increase other operating income by £77 million (2000: £58 million), increase the charge for bad and doubtful debts by £84 million (2000: £66 million), increase amounts written off fixed asset investments by £38 million (2000: £18 million) and to reduce profit before tax by £45 million (2000: £26 million). Loans and advances have been reduced by £294 million (2000: £312 million), debt securities have increased by £657 million (2000: £723 million) and shareholders' funds have increased by £254 million (2000: £287 million). In addition, certain sundry assets and liabilities have been reclassified. 2000 comparative figures have been restated.

During the year the Group has also adopted Financial Reporting Standard 17 'Retirement Benefits'. In accordance with the transitional arrangements of the standard in accounts for the year ended 31 December 2001, supplementary disclosures only are required and these are set out in note 46c. The Group has also implemented the requirements of the British Bankers' Association's revised Statement of Recommended Practice on Derivatives, although the effect has not been significant.

a Accounting convention

The consolidated accounts are prepared under the historical cost convention as modified by the revaluation of debt securities and equity shares held for dealing purposes (see g) and assets held in the long-term assurance business (see o), in compliance with Section 255A, Schedule 9 and other requirements of the Companies Act 1985 except as described below (see c), in accordance with applicable accounting standards, pronouncements of the Urgent Issues Task Force and with the Statements of Recommended Practice issued by the British Bankers' Association and the Finance & Leasing Association.

As permitted by Financial Reporting Standard 1 (revised), no cash flow statement is presented in these accounts, as the Bank is a wholly owned subsidiary of Lloyds TSB Group plc which presents such a statement in its own accounts. In addition, advantage has been taken of the exemption available under Financial Reporting Standard 8 not to disclose details of transactions with Lloyds TSB Group plc or other group or associated undertakings, as the consolidated accounts of Lloyds TSB Group plc in which the Bank is included are publicly available.

The Group continues to take advantage of the dispensation in the Urgent Issues Task Force's Abstract 17 'Employee Share Schemes' not to apply that Abstract to the Lloyds TSB Group's Inland Revenue approved SAYE schemes.

b Basis of consolidation

Assets, liabilities and results of group undertakings and joint ventures are included in the consolidated accounts on the basis of accounts made up to 31 December. In order to reflect the different nature of the shareholder's and policyholders' interests in the long-term assurance business, the value of long-term assurance business attributable to the shareholder and the assets and liabilities attributable to policyholders are classified under separate headings in the consolidated balance sheet. Details of transactions entered into by the Group which are not eliminated on consolidation are given in note 45.

1 Accounting policies (continued)

c Goodwill

Goodwill arising on acquisitions of or by group undertakings is capitalised. For acquisitions prior to 1 January 1998, goodwill was taken direct to reserves in the year of acquisition. As permitted by the transitional arrangements of Financial Reporting Standard 10, this goodwill was not reinstated when the Group adopted the standard in 1998.

The useful economic life of the goodwill arising on each acquisition is determined at the time of the acquisition. The directors consider that it is appropriate to assign an indefinite life to the goodwill which arose on the acquisition of Scottish Widows during 2000 in view of the strength of the Scottish Widows brand, developed through over 185 years of trading, and the position of the business as one of the leading providers of life, pensions, unit trust and fund management products. Both of these attributes are deemed to have indefinite durability, which has been determined based on the following factors: the nature of the business; the stability of the industry; the typical lifespans of the products; the extent to which the acquisition overcomes market entry barriers; and the expected future impact of competition on the business.

The Scottish Widows goodwill is not being amortised through the profit and loss account; however, it is subjected to annual impairment reviews in accordance with Financial Reporting Standard 11. Impairment of the goodwill is evaluated by comparing the present value of the expected future cash flows of the business, excluding financing and tax, (the 'value-in-use') to the carrying value of the underlying net assets. If the net assets were to exceed the value-in-use, an impairment would be deemed to have occurred and the resulting write-down in the goodwill would be charged to the profit and loss account immediately.

Paragraph 28 of Schedule 9 to the Companies Act 1985 requires that all goodwill carried on the balance sheet should be amortised. In the case of the goodwill arising on the acquisition of Scottish Widows, the directors consider that it is appropriate to depart from this requirement in order to comply with the over-riding requirement for the accounts to show a true and fair view. If this goodwill was amortised over a period of 20 years, profit before tax for the year ended 31 December 2001 would be £94 million lower (2000: £78 million lower), with a corresponding reduction in reserves of £172 million (2000: £78 million); intangible assets on the balance sheet would also be £172 million lower (2000: £78 million lower).

Goodwill arising on all other acquisitions after 1 January 1998 is amortised on a straight line basis over its estimated useful economic life, which does not exceed 20 years.

At the date of the disposal of group or associated undertakings, any unamortised goodwill, or goodwill taken directly to reserves prior to 1 January 1998, is included in the Group's share of the net assets of the undertaking in the calculation of the profit or loss on disposal.

d Income recognition

Interest income is recognised in the profit and loss account as it accrues, with the exception of interest on non-performing lending which is taken to income either when it is received or when there ceases to be any significant doubt about its ultimate receipt (see e).

Fees and commissions receivable from customers to reimburse the Group for costs incurred are taken to income when due. Fees and commissions relating to the ongoing provision of a service or risk borne for a customer are taken to income in proportion to the service provided or risk borne in each accounting period. Fees and commissions charged in lieu of interest are taken to income on a level yield basis over the period of the loan. Other fees and commissions receivable are accounted for as they fall due.

e Provisions for bad and doubtful debts and non-performing lending

Provisions for bad and doubtful debts

It is the Group's policy to make provisions for bad and doubtful debts, by way of a charge to the profit and loss account, to reflect the losses inherent in the loan portfolio at the balance sheet date. There are two types of provision, specific and general, and these are discussed further below.

Specific provisions

Specific provisions relate to identified risk advances and are raised when the Group considers that recovery of the whole of the outstanding balance is in serious doubt. The amount of the provision is equivalent to the amount

Notes to the accounts

1 Accounting policies (continued)

necessary to reduce the carrying value of the advance to its expected ultimate net realisable value.

For the Group's portfolios of smaller balance homogeneous loans, such as the residential mortgage, personal lending and credit card portfolios, specific provisions are calculated using a formulae driven approach. These formulae take into account factors such as the length of time that payments from the customer are overdue, the value of any collateral held and the level of past and expected losses, in order to derive an appropriate provision.

For the Group's other lending portfolios, specific provisions are calculated on a case-by-case basis. In establishing an appropriate provision, factors such as the financial condition of the customer, the nature and value of any collateral held and the costs associated with obtaining repayment and realisation of the collateral are taken into consideration.

General provisions

General provisions are raised to cover latent bad and doubtful debts which are present in any portfolio of advances but have not been specifically identified. The Group holds general provisions against each of its principal lending portfolios, which are calculated after having regard to a number of factors; in particular, the level of watchlist or potential problem debt and the observed propensity for such debt to deteriorate and become impaired and prior period loss rates. The level of general provision held is reviewed on a regular basis to ensure that it remains appropriate in the context of the perceived risk inherent in the related portfolio and the prevailing economic climate.

Non-performing lending

An advance becomes non-performing when interest ceases to be credited to the profit and loss account. There are two types of non-performing lending which are discussed further below.

Accruing loans on which interest is being placed in suspense

Where the customer continues to operate the account, but where there is doubt about the payment of interest, interest continues to be charged to the customer's account, but it is not applied to income. Interest is placed on a suspense account and only taken to income if there ceases to be significant doubt about its being paid.

Loans accounted for on a non-accrual basis

In those cases where the operation of the customer's account has ceased and it has been transferred to a specialist recovery department, the advance is written down to its estimated realisable value and interest is no longer charged to the customer's account as its recovery is considered unlikely. Interest is only taken to income if it is received.

f Mortgage incentives

Payments made under cash gift and discount mortgage schemes, which are recoverable from the customer in the event of early redemption, are amortised as an adjustment to net interest income over the early redemption charge period. Payments cease to be deferred and are charged to the profit and loss account in the event that the related loan is redeemed or becomes impaired.

g Debt securities and equity shares

Debt securities, apart from those held for dealing purposes, are stated at cost as adjusted for the amortisation of any premiums and discounts arising on acquisition, which are amortised from purchase to maturity in equal annual instalments, less amounts written off for any permanent diminution in their value. Debt securities acquired in exchange for advances to countries experiencing payment difficulties are included in the Group's portfolio of investment securities at an amount based on the market value at the date of exchange as adjusted for the amortisation of discount on acquisition. Equity shares, apart from those held for dealing purposes, are stated at cost less amounts written off for any permanent diminution in their value. Debt securities and equity shares held for dealing purposes are included at market value.

h Shares in group undertakings

Shares in group undertakings are stated in the balance sheet of the Bank at its share of net tangible assets, with the exception of the life assurance group undertakings which are stated on the basis described in o. Attributable goodwill is included, where this has not been written off directly to reserves.

1 Accounting policies (continued)

i Tangible fixed assets

Tangible fixed assets are included at cost less depreciation.

Land is not depreciated. Leasehold premises with unexpired lease terms of 50 years or less are depreciated by equal annual instalments over the remaining period of the lease. Freehold and long leasehold buildings are depreciated over 50 years. The costs of adapting premises for the use of the Group are separately identified and depreciated over 10 years, or over the term of the lease if less; such costs are included within premises in the balance sheet total of tangible fixed assets. Equipment is depreciated by equal annual instalments over the estimated useful lives of the assets, which for fixtures and furnishings are 10-20 years and for computer hardware, operating software and application software and the related development costs relating to separable new systems, motor vehicles and other equipment are 3-8 years.

Premises and equipment held for letting to customers under operating leases are depreciated over the life of the lease to give a constant rate of return on the net investment, taking into account anticipated residual values. Anticipated residual values are reviewed regularly and any impairments identified are charged to the profit and loss account.

j Vacant leasehold property

When a leasehold property ceases to be used in the business or a commitment is entered into which would cause this to occur, provision is made to the extent that the recoverable amount of the interest in the property is expected to be insufficient to cover future obligations relating to the lease.

k Leasing and instalment credit transactions

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all of the risks and rewards of ownership to the lessee; all other leases are classified as operating leases.

Income from both finance and operating leases is credited to the profit and loss account in proportion to the net cash invested so as to give a constant rate of return over each period after taking account of tax. Income from instalment credit transactions is credited to the profit and loss account using the sum of the digits method.

In those cases where the Group is the lessee, operating lease costs are charged to the profit and loss account in equal annual instalments over the life of the lease.

l Deferred tax

Deferred tax is provided at the appropriate rates of tax where there is a reasonable probability that a liability or asset will crystallise in the foreseeable future.

m Pensions and other post-retirement benefits

The cost of providing pension benefits is charged to the profit and loss account so as to spread the expected cost of pensions, calculated in accordance with actuarial advice, on a systematic basis over employees' working lives. The pension cost is assessed in accordance with the advice of qualified actuaries, using the projected unit method. Variations from the regular cost are allocated by equal annual instalments over the average remaining service lives of current employees.

The cost of providing post-retirement benefits other than pensions is charged to the profit and loss account on a systematic basis over employees' working lives. The unfunded liability is included as a provision in the balance sheet.

n Foreign currency translation

Assets, liabilities and results in foreign currencies are expressed in sterling at the rates of exchange ruling on the dates of the respective balance sheets. Exchange adjustments on the translation of opening net assets held overseas are taken direct to reserves. All other exchange profits or losses, which arise from normal trading activities, are included in the profit and loss account.

Notes to the accounts

1 Accounting policies (continued)

o Long-term assurance business

A number of the Group's subsidiary undertakings are engaged in writing long-term assurance business, including the provision of life assurance, pensions, annuities and permanent health insurance contracts. In common with other life assurance companies in the UK, these companies are structured into one or more long-term business funds depending upon the nature of the products being written, and a shareholder's fund. All premiums received, investment returns, claims and expenses, and changes in liabilities to policyholders are accounted for within the related long-term business fund. Any surplus, which is determined annually by the Appointed Actuary after taking account of these items, may either be distributed between the shareholder and the policyholders according to a predetermined formula or retained within the long-term business fund. The shareholder will also levy investment management and administration charges upon the long-term business fund.

The Group accounts for its interest in long-term assurance business using the embedded value basis of accounting. The value of the shareholder's interest in the long-term assurance business ('the embedded value') included in the Group's balance sheet is an actuarially determined estimate of the economic value of the Group's life assurance subsidiaries, excluding any value which may be attributed to future new business. The embedded value is comprised of the net tangible assets of the life assurance subsidiaries, including any surplus retained within the long-term business funds, which could be transferred to the shareholder, and the present value of the in-force business. The value of the in-force business is calculated by projecting the future surpluses and other net cash flows attributable to the shareholder arising from business written by the balance sheet date, using appropriate economic and actuarial assumptions, and discounting the result at a rate which reflects the shareholder's overall risk premium.

Changes in the embedded value, which are determined on a post-tax basis, are included in the profit and loss account. For the purpose of presentation, the change in this value is grossed up at the underlying rate of corporation tax.

The assets held within the long-term business funds are legally owned by the life assurance companies, however the shareholder will only benefit from ownership of these assets to the extent that surpluses are declared or from other cash flows attributable to the shareholder. Reflecting the different nature of these assets, they are classified separately on the Group's balance sheet as 'Long-term assurance assets attributable to policyholders', with a corresponding liability to the policyholders also shown. Investments held within the long-term business funds are included on the following basis: equity shares, debt securities and unit trusts held for unit linked funds are valued in accordance with policy conditions at market prices; other equity shares and debt securities are valued at middle market price and other unit trusts at bid price; investment properties are included at valuation by independent valuers at existing use value at the balance sheet date, and mortgages and loans are at cost less amounts written off.

p 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 profit and loss account when earned. Where the Group acts as intermediary, commission income is included in the profit and loss account at the time that 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. Claims equalisation provisions are calculated in accordance with the relevant legislative requirements.

1 Accounting policies (continued)

q Derivatives

Derivatives are used in the Group's trading activities to meet the financial needs of customers, for proprietary purposes and to manage risk in the Group's trading portfolios. Such instruments include exchange rate forwards and futures, currency swaps and options together with interest rate swaps, forward rate agreements, interest rate options and futures. These derivatives are carried at fair value and all changes in fair value are reported within dealing profits in the profit and loss account. Fair values are normally determined by reference to quoted market prices; internal models are used to determine fair value in instances where no market price is available. The unrealised gains and losses on trading derivatives are included within other assets and other liabilities respectively. These items are reported gross except in instances where the Group has entered into legally binding netting agreements, where the Group has a right to insist on net settlement that would survive the insolvency of the counterparty; in these cases the positive and negative fair values of trading derivatives with the relevant counterparties are offset within the balance sheet totals.

Derivatives used in the Group's non-trading activities are taken out to reduce exposures to fluctuations in interest and exchange rates and include exchange rate forwards and futures, currency options together with interest rate swaps, forward rate agreements and options. These derivatives are accounted for on an accruals basis, in line with the treatment of the underlying items which they are hedging. Interest receipts and payments on hedging interest derivatives are included in the profit and loss account so as to match the interest payable or receivable on the hedged item.

A derivative will only be classified as a hedge in circumstances where there was adequate evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates the exposure being hedged.

Where a hedge transaction is superseded, ceases to be effective or is terminated early the derivative is measured at fair value. Any profit or loss arising is then amortised to the profit and loss account over the remaining life of the item which it was originally hedging. When the underlying asset, liability or position that was being hedged is terminated, the hedging derivative is measured at fair value and any profit or loss arising is recognised immediately.

Notes to the accounts

2 Segmental analysis

	Profit on ordinary activities before tax	
	2001 £m	2000* £m
Class of business:		
UK Retail Banking and Mortgages		
Profit before exceptional restructuring costs	**1,588**	1,665
Exceptional restructuring costs	**(150)**	(99)
	1,438	1,566
Insurance and Investments		
Operating profit	**1,601**	1,425
Short-term fluctuations in investment returns	**(648)**	(94)
Changes in economic assumptions	**–**	127
Exceptional restructuring costs	**(50)**	(59)
Pension provisions	**(70)**	(100)
Stakeholder pension related charge	**–**	(80)
	833	1,219
UK Retail Financial Services	**2,271**	2,785
Wholesale Markets and International Banking		
Profit before exceptional restructuring costs	**1,381**	1,223
Exceptional restructuring costs	**(17)**	(30)
	1,364	1,193
Central group items	**(66)**	(71)
Profit on sale of businesses	**39**	80
	3,608	3,987

Geographical area:**	**Domestic 2001 £m**	**International 2001 £m**	**Total 2001 £m**
Interest receivable	**8,945**	**2,414**	**11,359**
Fees and commissions receivable	**2,639**	**286**	**2,925**
Dealing profits (before expenses)	**138**	**95**	**233**
Income from long-term assurance business	**181**	**12**	**193**
General insurance premium income	**428**	**–**	**428**
Other operating income	**538**	**170**	**708**
Total gross income	**12,869**	**2,977**	**15,846**
Profit on ordinary activities before tax	**3,042**	**566**	**3,608**

	Domestic 2000 £m	International 2000* £m	Total 2000* £m
Interest receivable	8,925	2,127	11,052
Fees and commissions receivable	2,483	288	2,771
Dealing profits (before expenses)	149	49	198
Income from long-term assurance business	607	8	615
General insurance premium income	399	–	399
Other operating income	269	167	436
Total gross income	12,832	2,639	15,471
Profit on ordinary activities before tax	3,554	433	3,987

2 Segmental analysis (continued)

	Net assets†		Assets‡	
	2001 £m	2000* £m	**2001 £m**	2000* £m
Class of business:				
UK Retail Banking and Mortgages	**2,437**	2,235	**77,915**	71,292
Insurance and Investments	**7,019**	6,508	**9,478**	9,437
UK Retail Financial Services	**9,456**	8,743	**87,393**	80,729
Wholesale Markets and International Banking	**3,965**	3,377	**101,471**	86,030
Central group items	**(1,438)**	(661)	**3,013**	3,077
	11,983	11,459	**191,877**	169,836
Geographical area:**				
Domestic	**10,909**	10,527	**163,269**	146,706
International	**1,074**	932	**28,608**	23,130
	11,983	11,459	**191,877**	169,836

*2000 figures have been restated to take account of the implementation of Financial Reporting Standard 18 'Accounting Policies' (note 1) and changes in internal transfer pricing.

**The geographical distribution of gross income sources, profit on ordinary activities before tax and assets by domestic and international operations is based on the location of the office recording the transaction, except for lending by the international business booked in London.

†Net assets represent equity shareholders' funds plus equity minority interests. Disclosure of information on net assets is an accounting standard requirement (SSAP25); it is not appropriate to relate it directly to the segmental profits above because the business is not managed by the allocation of net assets to business units.

‡Assets exclude long-term assurance assets attributable to policyholders.

As the business of the Group is mainly that of banking and insurance, no segmental analysis of turnover is given.

3 Dealing profits (before expenses)

	2001 £m	2000 £m
Foreign exchange trading income	**158**	141
Securities and other gains	**75**	57
	233	198

Dealing profits include the profits and losses arising both on the purchase and sale of trading instruments and from the year-end revaluation to market value, together with the interest income earned from these instruments and the related funding cost.

Notes to the accounts

4 Administrative expenses

	2001 £m	2000 £m
Salaries and profit sharing	**1,953**	1,862
Social security costs	**140**	131
Other pension costs (note 46)	**(108)**	(105)
Staff costs	**1,985**	1,888
Other administrative expenses	**1,515**	1,442
	3,500	3,330

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

	2001	2000
UK	**71,184**	67,848
Overseas	**11,768**	11,847
	82,952	79,695

The above staff numbers exclude 5,450 (2000: 6,152) staff employed in the long-term assurance business. Costs of £168 million (2000: £199 million) in relation to those staff are reflected in the valuation of the long-term assurance fund.

Details of directors' emoluments, pensions and interests are given on page 28.

The auditors' remuneration was £4 million (2000: £4 million), of which £1.2 million (2000: £1.2 million) related to Lloyds TSB Bank plc. Fees paid to PricewaterhouseCoopers in respect of non-audit services were £14 million (2000: £32 million). Non-audit fees comprise management consultancy of £4 million and regulatory and other advisory work of £10 million.

5 Exceptional restructuring costs

In February 2000 the Group announced an efficiency initiative aimed at reducing its overall cost base, which continued during 2001. The initiative focuses on improving the Group's infrastructure, consolidation of large scale processing operations and support functions and streamlining of the branch network, combined with the expansion of lower cost delivery channels, all of which contributes towards an enhancement in organisational efficiency and customer service. Costs of £167 million (2000: £108 million) were incurred in connection with this programme, mainly comprising severance, software write-off and consultancy costs.

Following the acquisition of Scottish Widows in 2000, the Group has been progressively integrating its businesses with its existing insurance and investment activities and rationalising the processes. During 2001, costs of £50 million (2000: £59 million) were incurred, principally relating to the integration and centralisation of back office support functions, the streamlining and automation of client service processes and the redefinition of the sales process.

A provision of £21 million was made in 2000 to cover the cost of integrating Chartered Trust Group plc and ACL Autolease Holdings Limited following their acquisition in September 2000.

6 Amounts written off fixed asset investments

	2001 £m	2000* £m
Debt securities	**58**	27
Equity shares	**2**	5
	60	32

*restated (see note 1)

7 Profit before tax on sale of businesses

On 3 October 2001 the Group announced the sale of its Brazilian fund management and private banking business, including its subsidiary, Lloyds TSB Asset Management S.A.. This resulted in a profit on sale of £39 million (tax: £11 million).

The profit of £80 million (tax: nil) in 2000 related to the sale of the new business capability of Abbey Life on 1 February 2000.

8 Profit on ordinary activities before tax

	2001 £m	2000* £m
Profit on ordinary activities before tax is stated after taking account of:		
Income from:		
Aggregate amounts receivable in respect of assets leased to customers and banks under:		
Finance leases and hire purchase contracts	**3,250**	3,295
Operating leases	**329**	151
Profit less losses on disposal of investment securities	**160**	127
Charges:		
Rental of premises	**203**	193
Hire of equipment	**18**	26
Interest on subordinated liabilities (loan capital)	**488**	486

*restated (see note 1)

9 Tax on profit on ordinary activities

	2001 £m	2000* £m
UK corporation tax		
Current tax on profits for the year	**911**	994
Adjustments in respect of prior years	**(14)**	4
	897	998
Double taxation relief	**(87)**	(72)
	810	926
Foreign tax		
Current tax on profits for the year	**179**	137
Adjustments in respect of prior years	**(17)**	(5)
	162	132
Current tax charge	**972**	1,058
Deferred tax	**74**	100
Associated undertakings and joint ventures	**1**	1
	1,047	1,159

*restated (see note 1)

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2000: 30 per cent).

The UK corporation tax charge includes £74 million (2000: £171 million) in respect of notional tax on the shareholder's interest in the increase in the value of the long-term assurance business.

Notes to the accounts

9 Tax on profit on ordinary activities (continued)

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

	2001 £m	2000 £m
Tax charge at UK corporation tax rate of 30%	**1,082**	1,196
Change in non-allowable provisions	**(14)**	3
Goodwill amortisation	**8**	(19)
Overseas tax rate differences	**21**	14
Non-allowable items	**16**	13
Gains covered by capital losses brought forward	**(39)**	(14)
Tier 1 capital	**(19)**	(12)
Other items	**(8)**	(22)
Tax on profit on ordinary activities	**1,047**	1,159
Effective rate	**29.0%**	29.1%

10 Profit for the financial year attributable to shareholders

The profit attributable to shareholders includes a profit of £1,678 million (2000: £2,172 million*) dealt with in the accounts of the parent company, for which no profit and loss account is shown as permitted by Section 230 of the Companies Act 1985.

*restated (see note 1)

11 Dividends

	2001 £m	2000 £m
First interim	**566**	515
Second interim	**1,306**	1,170
	1,872	1,685

12 Treasury bills and other eligible bills

	2001 Balance sheet £m	2001 Valuation £m	2000 Balance sheet £m	2000 Valuation £m
Group				
Investment securities:				
Treasury bills and similar securities	**748**	**748**	121	119
Other eligible bills	**2,034**	**2,032**	509	508
	2,782	**2,780**	630	627
Other securities:				
Treasury bills and similar securities	**1,630**		1,032	
Other eligible bills	**–**		47	
	1,630		1,079	
	4,412		1,709	
Included above: Unamortised discounts net of premiums on investment securities	**6**		2	

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Total £m
At 1 January 2001	**626**	**4**	**630**
Exchange and other adjustments	**(3)**	**–**	**(3)**
Additions	**28,367**	**–**	**28,367**
Bills sold or matured	**(26,213)**	**(80)**	**(26,293)**
Amortisation of premiums and discounts	**–**	**81**	**81**
At 31 December 2001	**2,777**	**5**	**2,782**

	2001 Balance sheet £m	2001 Valuation £m	2000 Balance sheet £m	2000 Valuation £m
Bank				
Investment securities:				
Treasury bills and similar securities	**748**	**748**	121	119
Other eligible bills	**2,021**	**2,020**	501	501
	2,769	**2,768**	622	620
Other securities:				
Treasury bills and similar securities	**1,318**		830	
Other eligible bills	**–**		47	
	1,318		877	
	4,087		1,499	
Included above: Unamortised discounts net of premiums on investment securities	**6**		2	

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Total £m
At 1 January 2001	**618**	**4**	**622**
Exchange and other adjustments	**(3)**	**–**	**(3)**
Additions	**28,353**	**–**	**28,353**
Bills sold or matured	**(26,204)**	**(80)**	**(26,284)**
Amortisation of premiums and discounts	**–**	**81**	**81**
At 31 December 2001	**2,764**	**5**	**2,769**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

Notes to the accounts

13 Loans and advances to banks

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Lending to banks	**1,616**	565	**44,517**	37,994
Deposits placed with banks	**13,610**	14,731	**12,403**	13,554
Total loans and advances to banks	**15,226**	15,296	**56,920**	51,548
Provisions for bad and doubtful debts	**(2)**	(6)	**(2)**	(6)
	15,224	15,290	**56,918**	51,542
Repayable on demand	**2,443**	2,794	**21,398**	21,232
Other loans and advances by residual maturity repayable:				
3 months or less	**8,995**	10,352	**10,335**	11,707
1 year or less but over 3 months	**2,698**	1,365	**8,877**	3,468
5 years or less but over 1 year	**708**	478	**15,070**	13,466
Over 5 years	**382**	307	**1,240**	1,675
Provisions for bad and doubtful debts	**(2)**	(6)	**(2)**	(6)
	15,224	15,290	**56,918**	51,542
Included above:				
Due from group undertakings				
– unsubordinated			**42,763**	37,298
– subordinated			**151**	151

*restated (see note 1)

14 Loans and advances to customers

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Lending to customers	**113,316**	104,526	**55,018**	49,451
Hire purchase debtors	**5,345**	5,172	**–**	–
Equipment leased to customers	**7,585**	8,122	**1**	–
Total loans and advances to customers	**126,246**	117,820	**55,019**	49,451
Provisions for bad and doubtful debts	**(1,466)**	(1,420)	**(1,101)**	(996)
Interest held in suspense	**(70)**	(90)	**(42)**	(57)
	124,710	116,310	**53,876**	48,398
Loans and advances by residual maturity repayable:				
3 months or less	**22,183**	22,781	**25,547**	26,032
1 year or less but over 3 months	**9,792**	8,216	**6,117**	5,508
5 years or less but over 1 year	**27,925**	24,328	**12,632**	11,069
Over 5 years	**66,346**	62,495	**10,723**	6,842
Provisions for bad and doubtful debts	**(1,466)**	(1,420)	**(1,101)**	(996)
Interest held in suspense	**(70)**	(90)	**(42)**	(57)
	124,710	116,310	**53,876**	48,398
Of which repayable on demand or at short notice	**9,349**	10,971	**10,423**	11,832
Included above:				
Due from group undertakings				
– all unsubordinated			**14,345**	11,486
Due from fellow group undertakings				
– subordinated	**15**	15	**–**	–
– unsubordinated	**1,760**	1,863	**637**	683

*restated (see note 1)

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £3,166 million (2000: £2,754 million).

Securitisations
Certain instalment credit receivables have been securitised and are subject to non-returnable financing arrangements. In accordance with Financial Reporting Standard 5, these items have been shown under the linked presentation method.

The Group's subsidiary, Black Horse Limited (formerly Chartered Trust plc), entered into transactions whereby it disposed of its interest in portfolios of motor vehicle and caravan instalment credit agreements for a total of £980 million to Cardiff Automobile Receivables Securitisation (UK) No 4 plc (CARS 4). CARS Trustee (UK) No 4 Limited is responsible for the collection and onward payment of all amounts falling due under the terms of the receivables sold to CARS 4. Principal receipts up to 10 December 2000 were used to purchase further receivables; subsequent to this date they are being used to redeem floating rate notes. Income receipts are applied in the following order of priority: interest due on the floating rate notes; credit manager fees; payments under swaps; amounts due to third parties; dividends; and residual income to Black Horse Limited. Black Horse Limited has been appointed by CARS Trustee (UK) No 4 Limited as credit manager and receives a fee for fulfilling this function. It has no liability to the noteholders or any creditor of CARS 4 or CARS Trustee (UK) No 4 Limited other than through failure to meet its obligations as credit manager or for breach of warranties given. Black Horse Limited has no interest in the share capital of CARS 4 or CARS Trustee (UK) No 4 Limited.

Black Horse Limited and CARS 4 have also entered into interest rate swaps in respect of this transaction, the interest rates payable and receivable under these swaps are set by reference to market rates of interest on an arm's length basis.

At 31 December 2001 CARS 4 held £124 million (2000: £400 million) of receivables, matched by non-returnable finance of the same amount.

Notes to the accounts

15 Provisions for bad and doubtful debts and non-performing lending

	2001 Specific £m	2001 General £m	2000* Specific £m	2000 General £m
Group				
At 1 January – as previously reported	**1,069**	**357**	1,762	361
Prior year adjustment (note 1)	**–**	**–**	(709)	–
At 1 January – restated	**1,069**	**357**	1,053	361
Exchange and other adjustments	**(15)**	**1**	4	(2)
Adjustments on acquisition	**–**	**–**	45	4
Advances written off	**(885)**	**–**	(745)	–
Recoveries of advances written off in previous years	**194**	**–**	165	–
Charge (release) to profit and loss account:				
New and additional provisions				
– normal coverage	**1,310**	**9**	1,093	7
– credit difficulties in Argentina	**–**	**55**	–	–
Releases and recoveries	**(574)**	**(53)**	(546)	(13)
	736	**11**	547	(6)
At 31 December	**1,099**	**369**	1,069	357
		1,468		1,426
In respect of:				
Loans and advances to banks		**2**		6
Loans and advances to customers		**1,466**		1,420
		1,468		1,426
Bank				
At 1 January – as previously reported	**744**	**258**	1,437	261
Prior year adjustment (note 1)	**–**	**–**	(709)	–
At 1 January – restated	**744**	**258**	728	261
Exchange and other adjustments	**(5)**	**–**	9	(1)
Adjustments on acquisition	**5**	**–**	38	–
Advances written off	**(618)**	**–**	(493)	–
Recoveries of advances written off in previous years	**119**	**–**	96	–
Charge (release) to profit and loss account:				
New and additional provisions				
– normal coverage	**1,028**	**6**	803	6
– credit difficulties in Argentina	**–**	**55**	–	–
Releases and recoveries	**(472)**	**(17)**	(437)	(8)
	556	**44**	366	(2)
At 31 December	**801**	**302**	744	258
		1,103		1,002
In respect of:				
Loans and advances to banks		**2**		6
Loans and advances to customers		**1,101**		996
		1,103		1,002

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Non-performing lending comprises:				
Accruing loans on which interest is being placed in suspense	**843**	855	**494**	461
Loans accounted for on a non-accrual basis	**379**	404	**361**	381
	1,222	1,259	**855**	842
Provisions	**(829)**	(807)	**(588)**	(533)
Interest held in suspense	**(70)**	(90)	**(42)**	(57)
	323	362	**225**	252

*restated (see note 1)

16 Concentrations of exposure

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Loans and advances to customers				
Domestic:				
Agriculture, forestry and fishing	**2,074**	2,026	**727**	644
Manufacturing	**3,321**	3,357	**2,855**	2,797
Construction	**1,309**	1,016	**1,210**	925
Transport, distribution and hotels	**4,440**	3,836	**3,698**	3,176
Property companies	**2,907**	2,470	**2,711**	2,318
Financial, business and other services	**8,736**	9,295	**6,757**	8,012
Personal: mortgages	**56,578**	52,659	**562**	644
: other	**12,784**	11,138	**11,922**	10,334
Lease financing	**7,552**	8,070	**–**	–
Hire purchase	**5,345**	5,172	**–**	–
Due from fellow group undertakings	**1,775**	1,878	**14,982**	12,169
Other	**2,992**	2,526	**2,599**	2,171
Total domestic	**109,813**	103,443	**48,023**	43,190
International:				
Latin America	**2,347**	2,222	**1,572**	1,547
New Zealand	**8,435**	7,368	**–**	–
Rest of the world	**5,651**	4,787	**5,424**	4,714
Total international	**16,433**	14,377	**6,996**	6,261
	126,246	117,820	**55,019**	49,451
Provisions for bad and doubtful debts**	**(1,466)**	(1,420)	**(1,101)**	(996)
Interest held in suspense**	**(70)**	(90)	**(42)**	(57)
	124,710	116,310	**53,876**	48,398

*restated (see note 1)
**Figures exclude provisions and interest held in suspense relating to loans and advances to banks.

The classification of lending as domestic or international is based on the location of the office recording the transaction, except for certain lending of the international business booked in London.

Notes to the accounts

17 Debt securities

	2001 Balance sheet £m	2001 Valuation £m	2000* Balance sheet £m	2000* Valuation £m
Group				
Investment securities:				
Government securities	**1,646**	**1,842**	1,729	2,148
Other public sector securities	**–**	**–**	1	1
Bank and building society certificates of deposit	**4,670**	**4,677**	3,034	3,034
Other debt securities	**4,673**	**4,684**	1,631	1,631
	10,989	**11,203**	6,395	6,814
Other securities:				
Government securities	**4,103**	**4,103**	3,060	3,060
Other public sector securities	**151**	**151**	131	131
Bank and building society certificates of deposit	**234**	**234**	105	105
Other debt securities	**8,748**	**8,748**	4,914	4,914
	24,225	**24,439**	14,605	15,024
Due within 1 year	**6,745**		5,405	
Due 1 year and over	**17,480**		9,200	
	24,225		14,605	
Unamortised discounts net of premiums on investment securities	**622**		904	
Investment securities:				
Listed	**4,703**	**4,900**	2,644	3,063
Unlisted	**6,286**	**6,303**	3,751	3,751
	10,989	**11,203**	6,395	6,814
Other securities:				
Listed	**11,543**	**11,543**	7,289	7,289
Unlisted	**1,693**	**1,693**	921	921
	13,236	**13,236**	8,210	8,210

*restated (see note 1)

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
At 1 January 2001 – as previously reported	**5,477**	**224**	**29**	**5,672**
Prior year adjustment (note 1)	**404**	**319**	**–**	**723**
At 1 January 2001 – restated	**5,881**	**543**	**29**	**6,395**
Exchange and other adjustments	**33**	**8**	**–**	**41**
Additions	**18,672**	**–**	**–**	**18,672**
Transfers	**(46)**	**(10)**	**–**	**(56)**
Securities sold or matured	**(13,987)**	**(84)**	**(4)**	**(14,067)**
Charge for the year	**–**	**–**	**58**	**(58)**
Amortisation of premiums and discounts	**–**	**62**	**–**	**62**
At 31 December 2001	**10,553**	**519**	**83**	**10,989**

17 Debt securities (continued)

	2001 Balance sheet £m	2001 Valuation £m	2000* Balance sheet £m	2000* Valuation £m
Bank				
Investment securities:				
Government securities	**1,628**	**1,823**	1,708	2,127
Bank and building society certificates of deposit	**4,398**	**4,405**	2,842	2,842
Other debt securities	**1,916**	**1,914**	1,087	1,087
	7,942	**8,142**	5,637	6,056
Other securities:				
Government securities	**3,882**	**3,882**	2,744	2,744
Other public sector securities	**119**	**119**	128	128
Bank and building society certificates of deposit	**15**	**15**	2	2
Other debt securities	**8,968**	**8,968**	4,961	4,961
	20,926	**21,126**	13,472	13,891
Included above:				
Due from group undertakings – all unsubordinated	**314**		173	
Due within 1 year	**6,294**		4,804	
Due 1 year and over	**14,632**		8,668	
	20,926		13,472	
Unamortised discounts net of premiums on investment securities	**609**		893	
Investment securities:				
Listed	**3,171**	**3,365**	2,450	2,869
Unlisted	**4,771**	**4,777**	3,187	3,187
	7,942	**8,142**	5,637	6,056
Other securities:				
Listed	**11,320**	**11,320**	6,971	6,971
Unlisted	**1,664**	**1,664**	864	864
	12,984	**12,984**	7,835	7,835

*restated (see note 1)

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
At 1 January 2001 – as previously reported	**4,734**	**180**	**–**	**4,914**
Prior year adjustment (note 1)	**404**	**319**	**–**	**723**
At 1 January 2001 – restated	**5,138**	**499**	**–**	**5,637**
Exchange and other adjustments	**33**	**8**	**–**	**41**
Additions	**17,936**	**–**	**–**	**17,936**
Transfers	**(46)**	**(10)**	**–**	**(56)**
Securities sold or matured	**(15,562)**	**(67)**	**–**	**(15,629)**
Charge for the year	**–**	**–**	**44**	**(44)**
Amortisation of premiums and discounts	**–**	**57**	**–**	**57**
At 31 December 2001	**7,499**	**487**	**44**	**7,942**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

Notes to the accounts

18 Equity shares

	2001 Balance sheet £m	2001 Valuation £m	2000 Balance sheet £m	2000 Valuation £m
Group				
Investment securities:				
Listed	**4**	**14**	7	45
Unlisted	**34**	**52**	34	57
	38	**66**	41	102
Other securities:				
Listed	**187**		204	
Unlisted	**–**		2	
	187		206	
	225		247	

Movements in investment securities comprise:	Cost £m	Provisions £m	Total £m
At 1 January 2001	**54**	**13**	**41**
Exchange and other adjustments	**(1)**	**–**	**(1)**
Additions	**10**	**–**	**10**
Disposals	**(13)**	**(3)**	**(10)**
Charge for the year	**–**	**2**	**(2)**
At 31 December 2001	**50**	**12**	**38**

	2001 Balance sheet £m	2001 Valuation £m	2000 Balance sheet £m	2000 Valuation £m
Bank				
Investment securities:				
Listed	**–**	**–**	5	1
Unlisted	**15**	**17**	15	17
	15	**17**	20	18
Other securities:				
Listed	**12**		2	
Unlisted	**–**		2	
	12		4	
	27		24	

Movements in investment securities comprise:	Cost £m
At 1 January 2001	**20**
Additions	**1**
Disposals	**(6)**
At 31 December 2001	**15**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes.

The difference between the cost of other securities and market value, where the market value is higher than the cost, is not disclosed as its determination is not practicable.

19 Assets transferred under sale and repurchase transactions

Included in the balance sheet are assets subject to sale and repurchase agreements as follows:

	Group		Bank	
	2001 £m	2000 £m	2001 £m	2000 £m
Treasury bills and other eligible bills	**1,036**	546	**929**	473
Debt securities	**4,498**	3,543	**3,180**	3,513
	5,534	4,089	**4,109**	3,986

These investments have been sold to third parties but, since the Group is committed to reacquire them at a future date and at a predetermined price, they are shown in the balance sheet.

20 Interests in associated undertakings and joint ventures

	Group £m	Bank £m
At 1 January 2001	**9**	**9**
Additions	**44**	**44**
Disposals	**(1)**	**(1)**
Retained profits	**(13)**	**(13)**
At 31 December 2001	**39**	**39**

The Group's and the Bank's principal investments are in two joint ventures:

	Group interest	Nature of business
iPSL	19.5% of issued ordinary share capital	Cheque processing
Goldfish Holdings Limited	25.0% of issued ordinary share capital	Financial services

During 2001 the Group established Goldfish Holdings Limited, a joint venture with Centrica plc for the provision of a broad range of financial services products through Goldfish Holdings Limited's wholly owned subsidiary, Goldfish Bank Limited. By 31 December 2001, the Group had contributed £44 million of capital to the venture.

In the year ended 31 December 2001 £27 million (2000: £4 million) of fees payable to iPSL have been included in the Group's administrative expenses and £6 million (2000: £1 million) of charges to iPSL have been included in the Group's income. The Group has also prepaid £8 million (2000: £7 million) of fees in respect of 2002 and this amount is included in prepayments and accrued income; in addition at 31 December 2001 iPSL owed £1 million (2000: £2 million) to the Group, which is included in other assets.

In the year ended 31 December 2001 £1 million of interest receivable from Goldfish Bank Limited and £22 million of charges to Goldfish Bank Limited in respect of administrative costs have been included in the Group's income. At 31 December 2001 Goldfish Bank Limited owed £611 million to the Group, which is included in loans and advances to banks.

On a historical cost basis, the Bank's interests in associated undertakings and joint ventures would have been included at £53 million (2000: £9 million).

Notes to the accounts

21 Shares in group undertakings

	Bank £m
At 1 January 2001	**16,171**
Exchange and other adjustments	**(4)**
Disposals	**(1)**
Revaluations	**778**
At 31 December 2001	**16,944**

	2001 £m	2000 £m
Shares in banks	**4,518**	4,317
Shares in other group undertakings	**12,426**	11,854
Total – all unlisted	**16,944**	16,171

On a historical cost basis, shares in group undertakings would have been included as follows:

	Cost £m	Provisions £m	Book value £m
At 1 January 2001	**14,914**	**21**	**14,893**
Disposals	**(7)**	**(6)**	**(1)**
At 31 December 2001	**14,907**	**15**	**14,892**

The principal group undertakings, all of which have prepared accounts to 31 December and whose results are included in the consolidated accounts of Lloyds TSB Bank plc, are:

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Cheltenham & Gloucester plc	England	*100%	Mortgage lending and retail investments
Lloyds Bank (BLSA) Limited	England	100%	Banking and financial services
Lloyds TSB Commercial Finance Limited	England	100%	Credit factoring
Lloyds TSB Leasing Limited	England	100%	Financial leasing
The Agricultural Mortgage Corporation PLC	England	100%	Long-term agricultural finance
The National Bank of New Zealand Limited	New Zealand	*100%	Banking and financial services
Lloyds TSB Bank (Jersey) Limited	Jersey	*100%	Banking and financial services
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
Lloyds TSB Private Banking Limited	England	100%	Private banking
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 Life Assurance Company Limited	England	*100%	Life assurance and other financial services
Scottish Widows plc	Scotland	*100%	Life assurance
Scottish Widows Annuities Limited	Scotland	*100%	Life assurance

*Indirect interest.

The country of registration/incorporation is also the principal area of operation for each of the above group undertakings except as follows:
Lloyds Bank (BLSA) Limited operates in Ecuador. The National Bank of New Zealand Limited also operates through a representative office in Hong Kong.

22 Intangible fixed assets

	Cost £m	Amortisation £m	Net book value £m
Group			
Positive goodwill			
At 1 January 2001	**2,635**	**36**	**2,599**
Exchange and other adjustments	**(3)**	**(1)**	**(2)**
Acquisition (note 49)	**8**	**–**	**8**
Charge for the year	**–**	**39**	**(39)**
At 31 December 2001	**2,640**	**74**	**2,566**
Negative goodwill			
At 1 January 2001 and 31 December 2001	**23**	**23**	**–**

	Cost £m	Amortisation £m	Net book value £m
Bank			
Goodwill			
At 1 January 2001	**15**	**2**	**13**
Exchange and other adjustments	**(2)**	**(1)**	**(1)**
Charge for the year	**–**	**1**	**(1)**
At 31 December 2001	**13**	**2**	**11**

23 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m
Group			
Cost:			
At 1 January 2001	**1,052**	**2,343**	**1,411**
Exchange and other adjustments	**(14)**	**(22)**	**8**
Additions	**91**	**310**	**680**
Disposals	**(55)**	**(361)**	**(328)**
At 31 December 2001	**1,074**	**2,270**	**1,771**
Depreciation:			
At 1 January 2001	**284**	**1,354**	**131**
Exchange and other adjustments	**(4)**	**(10)**	**–**
Charge for the year	**61**	**253**	**197**
Disposals	**(7)**	**(319)**	**(190)**
At 31 December 2001	**334**	**1,278**	**138**
Balance sheet amount at 31 December 2001	**740**	**992**	**1,633**
		3,365	
Balance sheet amount at 31 December 2000	768	989	1,280
		3,037	

Notes to the accounts

23 Tangible fixed assets (continued)

	Premises £m	Equipment £m
Bank		
Cost:		
At 1 January 2001	**769**	**1,864**
Exchange and other adjustments	**(12)**	**(10)**
Adjustments on acquisition	**–**	**1**
Additions	**84**	**269**
Disposals	**(24)**	**(322)**
At 31 December 2001	**817**	**1,802**
Depreciation:		
At 1 January 2001	**256**	**1,119**
Exchange and other adjustments	**(2)**	**(7)**
Charge for the year	**53**	**190**
Disposals	**(5)**	**(289)**
At 31 December 2001	**302**	**1,013**
Balance sheet amount at 31 December 2001	**515**	**789**
	1,304	
Balance sheet amount at 31 December 2000	513	745
	1,258	

	Group 2001 £m	Group 2000 £m	Bank 2001 £m	Bank 2000 £m
Balance sheet amount of premises comprises:				
Freeholds	**436**	490	**249**	276
Leaseholds 50 years and over unexpired	**36**	22	**17**	3
Leaseholds less than 50 years unexpired	**268**	256	**249**	234
	740	768	**515**	513
Land and buildings occupied for own activities	**664**	691	**456**	453

The Group's residual value exposure in respect of operating lease assets, all of which are expected to be disposed of at the end of the lease terms, was as follows:

Residual value expected to be recovered in:	2001 £m	2000 £m
1 year or less	**156**	134
2 years of less but over 1 year	**119**	108
5 years of less but over 2 years	**388**	367
Over 5 years	**482**	301
Total exposure	**1,145**	910

24 Lease commitments

Annual commitments under non-cancellable operating leases were:

	2001 Premises £m	2001 Equipment £m	2000 Premises £m	2000 Equipment £m
Group				
Leases on which the commitment is due to expire in:				
1 year or less	**7**	**5**	3	1
5 years or less but over 1 year	**33**	**3**	18	2
Over 5 years	**181**	**–**	184	–
	221	**8**	205	3
Bank				
Leases on which the commitment is due to expire in:				
1 year or less	**4**	**5**	2	1
5 years or less but over 1 year	**26**	**3**	11	2
Over 5 years	**156**	**–**	156	–
	186	**8**	169	3

Obligations under finance leases were:	2001 Equipment £m	2000 Equipment £m
Group		
Amounts payable in:		
1 year or less	**3**	20
5 years or less but over 1 year	**–**	3
	3	23

25 Capital commitments

Capital expenditure contracted but not provided for at 31 December 2001 amounted to £137 million for the Group and £10 million for the Bank (2000: Group £33 million; Bank £1 million). Of the capital commitments of the Group, £125 million (2000: £28 million) related to assets to be leased to customers under operating leases.

26 Other assets

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Foreign exchange and interest rate contracts (note 48a)	**2,090**	2,688	**2,067**	2,505
Balances arising from derivatives used for hedging purposes	**931**	431	**601**	40
Settlement balances	**570**	121	**526**	35
Other assets	**850**	736	**403**	753
	4,441	3,976	**3,597**	3,333

*restated (see note 1)

27 Prepayments and accrued income

	Group 2001 £m	Group 2000 £m	Bank 2001 £m	Bank 2000 £m
Interest receivable	**843**	875	**1,172**	1,429
Pensions prepayment	**894**	768	**781**	677
Deferred expenditure incurred under cash gift and discount mortgage schemes	**256**	242	**–**	–
Other debtors and prepayments	**1,199**	1,060	**750**	576
	3,192	2,945	**2,703**	2,682

28 Long-term assurance business

a Methodology

The value of the shareholder's interest in the long-term assurance business ('the embedded value') is comprised of the net tangible assets of the life assurance subsidiaries, including any surplus retained in the long-term business funds, which could be transferred to shareholders, and the present value of the in-force business. The value of the in-force business is calculated by projecting future surpluses and other net cash flows attributable to the shareholder arising from business written by the balance sheet date and discounting the result at a rate which reflects the shareholder's overall risk premium.

Surpluses arise following annual actuarial valuations of the long-term business funds, which are carried out in accordance with the statutory requirements designed to ensure and demonstrate the solvency of the funds. Future surpluses will depend upon experience in a number of areas such as investment returns, lapse rates, mortality and administrative expenses. Surpluses can be projected by making realistic assumptions about future experience, having regard to both actual experience and forecast long-term economic trends. Other net cash flows principally comprise annual management charges and other fees levied upon the policyholders by the life assurance subsidiaries.

Changes in the embedded value, which are determined on a post-tax basis, are included in the profit and loss account and described as income from long-term assurance business. For the purpose of presentation the change in this value is grossed up at the underlying rate of corporation tax.

b Analysis of embedded value

The embedded value included in the consolidated balance sheet comprises:

	2001 £m	2000 £m
Net tangible assets of life companies including surplus	**3,985**	4,128
Value of other shareholder's interests in the long-term assurance business	**2,589**	2,421
	6,574	6,549

Movements in the embedded value balance have been as follows:

	2001 £m	2000 £m
At 1 January	**6,549**	2,274
Exchange and other adjustments	**(35)**	(92)
Profit after tax	**115**	441
Capital injection	**100**	–
Dividends	**(155)**	(126)
Acquisition	**–**	4,052
	6,574	6,549

c Analysis of income from long-term assurance business

Income from long-term assurance business included in the profit and loss account can be divided into those items comprising the operating profit of the business and other items. Included within operating profit are the following items:

New business contribution: this represents the value recognised at the end of the year from new business written during the year after taking into account the cost of establishing technical provisions and reserves.

Contribution from existing business: this comprises the following elements:

- The expected return arising from the unwinding of the discount applied to the expected cash flows at the beginning of the year;
- Experience variances caused by the differences between the actual experience during the year and the expected experience; and
- The effects of changes in assumptions other than economic assumptions and other items.

28 Long-term assurance business (continued)

c Analysis of income from long-term assurance business (continued)

Investment earnings: this represents the expected investment return on both the net tangible assets and the value of the shareholder's interest in the long-term business account, based upon the economic assumptions made at the beginning of the year.

Distribution costs: this represents the actual cost of acquiring new business during the year and includes commissions paid to independent financial advisors and other direct sales costs.

Included within other items are:

Short-term fluctuations in investment returns: this represents (a) the difference between the actual investment return in the year on investments backing shareholder funds and the expected return based upon the economic assumptions made at the beginning of the year: this is recognised immediately; and (b) the effect of these fluctuations on the value of in-force business which is recognised using smoothed fund values.

Changes in economic assumptions: this represents the effect of changes in the economic assumptions referred to in f).

Exceptional items: this includes any other items which, by virtue of their size or incidence, are considered not to form part of the ongoing operating profit.

Income from long-term assurance business is set out below:

	2001 £m	2000 £m
New business contribution	**374**	305
Contribution from existing business		
– expected return	**359**	311
– experience variances	**37**	36
– changes in assumptions and other items	**95**	96
Investment earnings	**247**	212
Distribution costs	**(247)**	(225)
Operating profit	**865**	735
Short-term fluctuations in investment returns	**(602)**	(67)
Changes in economic assumptions (see f)	**–**	127
Exceptional items		
– Pension provisions (see d)	**(70)**	(100)
– Stakeholder pension related charge (see e)	**–**	(80)
Income from long-term assurance business before tax	**193**	615
Attributed tax	**(78)**	(174)
Income from long-term assurance business after tax	**115**	441

Income before tax from long-term assurance business can also be analysed as follows:

	2001 £m	2000 £m
Income net of claims and technical provisions	**636**	937
Pension provisions	**(70)**	(100)
Operating expenses	**(557)**	(471)
Tax charged to technical account	**(62)**	(191)
(Deficit retained) surplus emerging	**(53)**	175
Value of in-force business	**168**	266
Income from long-term assurance business after tax	**115**	441
Tax	**78**	174
Income from long-term assurance business before tax	**193**	615

28 Long-term assurance business (continued)

d Pension provisions

During the early 1990's, there was increasing concern in the UK that many customers had been given poor advice when they were advised to set up their own personal pension plan and that they would, in fact, have been in a better position if they had remained in, or joined, employer sponsored pension schemes. The regulator of the UK pension industry (now the responsibility of the Financial Services Authority) carried out an industry wide investigation into the conduct of business involving the transfer of pensions. The conclusion of the investigation was that a large number of customers had been poorly advised, by insurance companies and intermediaries across the industry. As a result of this investigation the regulator established an action plan for the UK pensions industry to follow in reviewing all cases of possible misselling and determining the necessary compensation. As the review of pension cases in the Group has progressed, provisions have been established for the estimated cost of compensation.

Movements in the provision over the last two years have been as follows:

	2001 £m	2000 £m
At 1 January	**352**	397
Accrual of interest on the provision	**20**	26
Charge for the year	**70**	100
Compensation paid	**(238)**	(173)
Guarantees*	**(1)**	2
At 31 December	**203**	352

*In some cases, rather than pay cash compensation directly into the customer's personal pension plan, the Group has guaranteed to 'top up' the customer's pension income on retirement, to the level that they would have received under the relevant occupational scheme.

By the end of 2000, the Group had gained further experience as to the number and size of claims likely to require compensation, in particular those affected by the revised guidelines issued towards the end of 1999 dealing with the way in which compensation should be calculated for those customers who had opted out of the State Earnings Related Pension Scheme. After taking this into account, the cost of redress was forecast to increase by £100 million and a provision of this amount was made.

A further review of the adequacy of the provision has been carried out as at 31 December 2001. Lower stockmarket levels have had a significant impact on total redress costs as the cost of restitution into company pension schemes rises as personal pension fund values reduce. As a result of this and the fact that there is now greater certainty as to the number and size of compensation claims to be paid, an additional provision of £70 million has been made.

e Stakeholder pension related charge

During 1999, the government announced changes intended to encourage more of the population to provide retirement income for themselves through increased rates of savings. One of these initiatives was the introduction of stakeholder pensions with effect from April 2001; a key feature of these products is that charges are limited to 1 per cent per annum, which is significantly lower than historic charging rates on other personal pension products. In anticipation of the introduction of stakeholder pension products in 2001, during 2000 the Group decided to reduce the charges made on certain existing policies, resulting in a cost of £80 million.

f Assumptions

The economic assumptions are based upon a long-term view of economic activity and are therefore not adjusted for market movements which are considered to be short-term. This approach is considered to be the most appropriate given the long-term nature of the portfolio of products. The principal economic assumptions, which have been used consistently throughout 2001 and 2000, are as follows:

	%
Risk-adjusted discount rate (net of tax)	8.50
Return on equities (gross of tax)	8.00
Return on fixed interest securities (gross of tax)	5.25
Expenses inflation	3.00

28 Long-term assurance business (continued)

f Assumptions (continued)

Following the acquisition of Scottish Widows in 2000, a detailed review of the economic assumptions was carried out to ensure that they remained appropriate. As a result certain changes were made which had effect from 1 January 2000 for the Group's existing long-term assurance businesses and resulted in a credit to the profit and loss account of £127 million. The same assumptions were used to account for the Scottish Widows business from the date of acquisition.

Other assumptions used to derive the embedded value are as follows:

- Assumed rates of mortality and morbidity are taken from published tables adjusted for demographic differences. Assumptions in respect of lapse rates reflect the recent actual experience of the companies concerned.
- Current tax legislation and rates have been assumed to continue unaltered, except where future changes have been announced. The UK corporation tax rate used for grossing up was 30% (2000: 30%). The investment earnings have been grossed up at a composite longer term tax rate of 17% (2000: 17%).
- The value of the in-force business does not allow for future premiums under recurring single premium business or non-contractual increments, which are included in new business when the premium is received. Department of Social Security rebates have been treated as recurring single premiums.
- Future bonus rates on with-profits business are set at levels which would fully utilise the assets supporting the with-profits business. The proportion of profits derived from with-profits business allocated to the shareholder has been assumed to continue at the current rate of one-ninth of the cost of the bonus.

g Balance sheet

The long-term assurance assets attributable to policyholders comprise:

	2001 £m	2000 £m
Investments	**47,910**	52,683
Premises and equipment	**16**	20
Other assets	**2,448**	2,510
	50,374	55,213
Net tangible assets of life companies including surplus	**(3,985)**	(4,128)
	46,389	51,085
Investments shown above comprise:		
Fixed interest securities	**12,642**	14,512
Stocks, shares and unit trusts	**27,018**	31,885
Investment properties	**3,722**	3,098
Other properties	**121**	10
Mortgages and loans	**102**	117
Deposits	**4,305**	3,061
	47,910	52,683
The liabilities to policyholders comprise:		
Technical provisions:		
Long-term business provision (net of reinsurance)	**24,151**	23,514
Claims outstanding (net of reinsurance)	**211**	172
Technical provisions for linked liabilities	**21,083**	24,413
Fund for future appropriations	**95**	1,667
Other liabilities	**849**	1,319
	46,389	51,085

Notes to the accounts

29 Assets and liabilities denominated in foreign currencies

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Assets: denominated in sterling	**135,285**	128,561	**117,020**	109,108
: denominated in other currencies	**56,592**	41,275	**46,119**	31,654
	191,877	169,836	**163,139**	140,762
Liabilities: denominated in sterling	**135,388**	129,075	**117,105**	109,505
: denominated in other currencies	**56,489**	40,761	**46,034**	31,257
	191,877	169,836	**163,139**	140,762

*restated (see note 1)

30 Deposits by banks

	Group 2001 £m	Group 2000 £m	Bank 2001 £m	Bank 2000 £m
Repayable on demand	**6,634**	4,330	**10,984**	8,816
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	**14,227**	9,712	**17,024**	12,317
1 year or less but over 3 months	**2,529**	1,790	**2,960**	2,214
5 years or less but over 1 year	**751**	695	**988**	669
Over 5 years	**169**	208	**126**	29
	24,310	16,735	**32,082**	24,045
Included above:				
Due to group undertakings			**9,090**	8,907

31 Customer accounts

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Repayable on demand	**80,811**	74,477	**59,715**	54,485
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	**19,913**	21,064	**15,181**	17,090
1 year or less but over 3 months	**2,888**	3,522	**1,971**	2,431
5 years or less but over 1 year	**3,369**	2,582	**3,088**	854
Over 5 years	**2,321**	417	**2,136**	492
	109,302	102,062	**82,091**	75,352
Included above:				
Due to group undertakings			**7,768**	6,227
Due to fellow group undertakings	**186**	73	**104**	66

*restated (see note 1)

32 Debt securities in issue

	Group 2001 £m	Group 2000 £m	Bank 2001 £m	Bank 2000 £m
Bonds and medium-term notes by residual maturity repayable:				
1 year or less	**589**	538	**415**	345
2 years or less but over 1 year	**178**	169	**88**	42
5 years or less but over 2 years	**405**	472	**375**	379
Over 5 years	**928**	1,413	**118**	82
	2,100	2,592	**996**	848
Other debt securities by residual maturity repayable:				
3 months or less	**17,070**	8,574	**15,093**	7,157
1 year or less but over 3 months	**4,931**	6,476	**4,213**	5,496
5 years or less but over 1 year	**104**	241	**79**	214
Over 5 years	**215**	16	**8**	16
	22,320	15,307	**19,393**	12,883
	24,420	17,899	**20,389**	13,731
Included above:				
Due to group undertakings			**6**	284

33 Other liabilities

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Foreign exchange and interest rate contracts (note 48a)	**2,360**	2,417	**2,330**	2,519
Balances arising from derivatives used for hedging purposes	**404**	1,000	**217**	527
Current tax	**594**	614	**225**	270
Dividends	**1,306**	1,170	**1,306**	1,170
Settlement balances	**542**	232	**501**	151
Other liabilities	**1,423**	1,225	**773**	363
	6,629	6,658	**5,352**	5,000

*restated (see note 1)

34 Accruals and deferred income

	Group 2001 £m	Group 2000* £m	Bank 2001 £m	Bank 2000* £m
Interest payable	**1,291**	1,648	**1,203**	1,720
Other creditors and accruals	**2,272**	2,503	**1,194**	1,311
	3,563	4,151	**2,397**	3,031

*restated (see note 1)

35 Deferred tax

	Group		Bank	
	2001 £m	2000* £m	**2001 £m**	2000* £m
Short-term timing differences	**(75)**	(46)	**(49)**	(33)
Pensions prepayment	**268**	230	**235**	204
Emerging Markets Debt securities	**(70)**	(74)	**(70)**	(74)
Accelerated depreciation allowances	**1,610**	1,586	**9**	13
	1,733	1,696	**125**	110

	Group £m	Bank £m
At 1 January 2001 – as previously reported	**1,572**	**(14)**
Prior year adjustment (note 1)	**124**	**124**
At 1 January 2001 – restated	**1,696**	**110**
Exchange and other adjustments	**7**	**2**
Adjustments on disposal	**(44)**	**–**
Tax provided	**74**	**13**
At 31 December 2001	**1,733**	**125**

*restated (see note 1)

	Group		Bank	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Potential tax for which no provision has been made relating to accelerated depreciation allowances on equipment leased to customers	**72**	72	**–**	–

Provision has been made for the liability to tax on overseas earnings which are expected to be remitted to the UK. No provision has been made for the liability to tax which could arise if premises, to the extent that the tax base cost has been reduced by rollover relief, or group undertakings were disposed of at their balance sheet amounts or investments in associated undertakings and joint ventures at their valuation. It is expected that the majority of these assets will be retained in the business and that, in view of the substantial number of assets involved and the law relating to rollover relief, the likelihood of any such material tax liability arising is remote; no useful purpose would be served by attempting to quantify it. If deferred tax were to be recognised in respect of general bad debt provisions the deferred tax asset would be £90m for the Group and £74m for the Bank.

36 Other provisions for liabilities and charges

	Pension obligations £m	Insurance provisions £m	Post-retirement health care £m	Vacant leasehold property £m	Other £m	Total £m
Group						
At 1 January 2001	**34**	**202**	**76**	**96**	**34**	**442**
Exchange and other adjustments	**–**	**6**	**–**	**–**	**(1)**	**5**
Provisions applied	**(1)**	**(178)**	**(4)**	**(17)**	**(17)**	**(217)**
Charge for the year	**1**	**174**	**3**	**(10)**	**3**	**171**
At 31 December 2001	**34**	**204**	**75**	**69**	**19**	**401**
Bank						
At 1 January 2001	**34**	**–**	**76**	**79**	**10**	**199**
Provisions applied	**(1)**	**–**	**(4)**	**(6)**	**(2)**	**(13)**
Charge for the year	**1**	**–**	**3**	**(10)**	**(2)**	**(8)**
At 31 December 2001	**34**	**–**	**75**	**63**	**6**	**178**

Pension obligations
A description of the Group's pension arrangements is provided in note 46a).

Insurance provisions
The Group's general insurance subsidiary maintains provisions for outstanding claims which represent the ultimate cost of settling all claims arising from events which have occurred up to the balance sheet date and these include provisions for the cost of claims notified but not settled and for claims incurred but not yet reported. In addition, in line with the requirements of the Insurance Companies (Reserves) Act 1995, claims equalisation provisions are maintained in relation to property, credit and suretyship business. The majority of provisions in respect of claims will be settled in the following year, although new provisions will then be required in respect of claims arising from that year. The level of the claims equalisation provision will be adjusted annually, taking into account the guidelines contained in the legislation, and such provisions will be held for as long as the Group continues to write the relevant types of general insurance business.

Post-retirement health care
A description of the Group's post-retirement healthcare obligations is provided in note 46b).

Vacant leasehold property
Whenever the Group ceases to occupy a property, or commits itself to doing so, it is the Group's policy to raise a provision to cover any anticipated shortfall when comparing the recoverable amount of its interest in the property to the future rental and other payments that the Group is obligated to make over the remaining term of the lease. These provisions are made by reference to a prudent estimate of expected sub-let income and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on an annual basis and will normally run off over the remaining life of the leases concerned, currently averaging six years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

Notes to the accounts

37 **Subordinated liabilities**	Group		Bank	
	2001 £m	2000 £m	**2001 £m**	2000 £m
* *Undated loan capital:*				
† Primary Capital Undated Floating Rate Notes:				
Series 1 (US$750 million)	**516**	502	**516**	502
Series 2 (US$500 million)	**344**	335	**344**	335
Series 3 (US$600 million)	**412**	401	**412**	401
11¾% Perpetual Subordinated Bonds	**100**	100	**–**	–
■ 5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	**757**	774	**757**	774
† Undated Step-up Floating Rate Notes callable 2009 (€150 million)	**91**	94	**91**	94
¶ 6⅝% Undated Subordinated Step-up Notes callable 2010	**406**	405	**406**	405
7.375% Undated Subordinated Step-up Notes callable 2012 (€430 million)	**–**	–	**261**	267
7.834% Undated Subordinated Step-up Notes callable 2015	**–**	–	**248**	248
✤ 5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	**105**	117	**105**	117
¶ 6½% Undated Subordinated Step-up Notes callable 2019	**266**	266	**266**	266
† 8% Undated Subordinated Step-up Notes callable 2023	**199**	199	**199**	199
+¶ 6½% Undated Subordinated Step-up Notes callable 2029	**455**	198	**455**	198
	3,651	3,391	**4,060**	3,806
Dated loan capital:				
Eurocurrency Zero Coupon Bonds 2003 (¥3 billion)	**15**	15	**–**	–
§ Subordinated Fixed Rate Bonds 2003 (NZ$151 million)	**43**	49	**–**	–
† Subordinated Floating Rate Notes 2004	**15**	20	**–**	–
7⅜% Subordinated Bonds 2004	**399**	399	**399**	399
†❖ Subordinated Floating Rate Notes 2004	**100**	100	**100**	100
§ Subordinated Fixed Rate Bonds 2006	**–**	22	**–**	–
† Subordinated Floating Rate Notes 2006	**150**	250	**–**	100
† Subordinated Floating Rate Notes 2007	**200**	200	**–**	–
7¾% Subordinated Bonds 2007	**299**	298	**299**	298
§ Subordinated Fixed Rate Bonds 2007 (NZ$150 million)	**43**	44	**–**	–
† Subordinated Floating Rate Notes 2008	**150**	150	**–**	–
5¼% Subordinated Notes 2008 (DM750 million)	**234**	240	**234**	240
10⅝% Guaranteed Subordinated Loan Stock 2008	**112**	113	**112**	113
9½% Subordinated Bonds 2009	**99**	99	**99**	99
† Subordinated Step-up Floating Rate Notes 2009 callable 2004 (US$500 million)	**343**	334	**343**	334
Subordinated Fixed Rate Bonds 2010 (NZ$100 million)	**29**	30	**–**	–
6¼% Subordinated Notes 2010 (€400 million)	**244**	250	**244**	250
† Subordinated Floating Rate Notes 2010 (US$400 million)	**274**	267	**274**	267
12% Guaranteed Subordinated Bonds 2011	**121**	123	**121**	123
4¾% Subordinated Notes 2011 (€850 million)	**498**	508	**498**	508
✠§ Subordinated Fixed Rate Bonds 2011 (NZ$100 million)	**28**	–	**–**	–
✠† Subordinated Floating Rate Notes 2011	**100**	–	**–**	–
6⅝% Subordinated Notes 2015	**343**	343	**343**	343
† Subordinated Floating Rate Notes 2020 (€100 million)	**61**	62	**61**	62
9⅝% Subordinated Bonds 2023	**341**	342	**341**	342
Subordinated Non-Interest Bearing Loan on rolling 6 year notice	**150**	150	**150**	150
	4,391	4,408	**3,618**	3,728
Total subordinated liabilities	**8,042**	7,799	**7,678**	7,534

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer.

* In certain circumstances, these notes and bonds would acquire the characteristics of preference share capital.

† These notes bear interest at rates fixed periodically in advance based on Interbank rates.

¶ At the callable date, the coupon on these Notes will be reset by reference to the applicable five year benchmark gilt rate.

§ These bonds bear interest, to be reset 5 years before redemption date, at a fixed margin over New Zealand Government stocks.

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

✤ In the event that these Notes are not redeemed at the callable date, the coupon will be reset to a fixed margin over the then 5 year Yen swap rate.

❖ Exchangeable at the election of the Group for further subordinated floating rate notes.

\+ A further £257 million was issued during 2001 primarily to finance the general business of the Group.

✠ Issued during 2001 primarily to finance the general business of the Group.

Notes to the accounts

37 Subordinated liabilities (continued)

Dated subordinated liabilities are repayable as follows:

	Group		Bank	
	2001 £m	2000 £m	**2001 £m**	2000 £m
1 year or less	**5**	5	**–**	–
2 years or less but over 1 year	**63**	5	**–**	–
5 years or less but over 2 years	**654**	573	**499**	499
Over 5 years	**3,669**	3,825	**3,119**	3,229
	4,391	4,408	**3,618**	3,728

38 Non-equity minority interests

Non-equity minority interests comprise:

	2001 £m	2000 £m
Euro Step-up Non-Voting Non-Cumulative Preferred Securities (€430 million)*	**261**	267
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities†	**248**	248
	509	515

*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 of the Group, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 2.33 per cent above EURIBOR, to be set annually.

†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 of the Group, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 3.50 per cent above a rate based on the yield of specified UK government stock.

Both of the above issues were made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Bank 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.

39 Called-up share capital

	2001 £m	2000 £m
Authorised: ordinary shares of £1 each*	**1,650**	1,650
Issued and fully paid: ordinary shares of £1 each		
At 1 January and 31 December	**1,542**	1,542

*Includes one cumulative floating rate preference share of £1.

The company regarded by the directors as the ultimate parent company is Lloyds TSB Group plc, which is also the parent undertaking of the only group of undertakings for which consolidated accounts are drawn up and of which the Bank is a member. Copies of the group accounts may be obtained from the company secretary, Lloyds TSB Group plc, 71 Lombard Street, London EC3P 3BS.

40 Perpetual capital securities

	Group and Bank	
	2001 £m	2000 £m
6.625% Perpetual Capital Securities (€750 million)	**451**	–

These securities were issued during 2001, by Lloyds TSB Bank plc, primarily to finance the general business of the Group. Interest payments accrue at the rate of 6.625 per cent per annum; in certain circumstances these payments 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. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 25 October 2006.

41 Reserves

	Group £m	Bank £m
Share premium account:		
At 1 January and 31 December 2001	**2,960**	**2,960**
Revaluation reserve:		
At 1 January 2001		**1,278**
Transfer from profit and loss account		**5**
Increase in net tangible assets of subsidiary and associated undertakings and joint ventures		**765**
At 31 December 2001		**2,048**
Profit and loss account:		
At 1 January 2001 – as previously reported	**6,633**	**5,355**
Prior year adjustment (note 1)	**287**	**287**
At 1 January 2001 – restated	**6,920**	**5,642**
Exchange and other adjustments	**(86)**	**(47)**
Transfer to revaluation reserve	**–**	**(5)**
Profit (loss) for the year	**610**	**(194)**
At 31 December 2001	**7,444**	**5,396**

The Group profit and loss account reserves at 31 December 2001 include £486 million (2000: £318 million) not presently available for distribution representing the Group's share of the value of long-term assurance business in force and the surplus retained within the long-term assurance funds.

The cumulative amount of premiums on acquisitions written off against profit and loss account reserves during previous years amounts to £966 million of which £881 million was within the last 10 years.

42 Shareholders' funds

	Group		Bank	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Equity	**11,946**	11,422	**11,946**	11,422
Non-equity	**451**	–	**451**	–
	12,397	11,422	**12,397**	11,422

Notes to the accounts

43 Directors' interests

The directors are also directors of Lloyds TSB Group plc and their interests in the share and loan capital of Lloyds TSB Group plc and its subsidiaries are shown in the report and accounts of that company.

44 Directors' emoluments

The aggregate of the emoluments of the directors was £5,749,000 (2000: £5,048,000).

The aggregate of the amount of the gains made by directors on the exercise of Lloyds TSB Group plc share options was £1,793,000 (2000: £27,000).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were 0 and 8 respectively (2000: 1 and 7).

The total for the highest paid director (Mr Fairey), including the £882,000 gain on the exercise of Lloyds TSB Group plc share options, was £1,673,000. The amount of his accrued pension at the year end was £127,183, being his pension entitlement based on pensionable service with the Group to 31 December 2001 but payable at normal retirement age. (The total for the highest paid director in 2000 (Mr Ellwood), was £856,000.)

45 Related party transactions

a Transactions, arrangements and agreements involving directors and others

At 31 December 2001, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	2001 Number of persons	**2001 Total £000**	2000 Number of persons	2000 Total £000
Loans and credit card transactions:				
Directors and connected persons	**7**	**1,343**	10	119
Officers	**28**	**4,113**	36	4,993

b Group undertakings

Details of the principal group undertakings are given in note 21. In accordance with FRS 8, transactions or balances with group entities that have been eliminated on consolidation are not reported.

c Associated undertakings and joint ventures

Details of the Group's associated undertakings and joint ventures are provided in note 20. Information relating to transactions entered into between Group undertakings and the joint ventures and details of outstanding balances at 31 December 2001 are also shown in note 20.

d Long-term assurance business

The Group enters into certain transactions with its long-term assurance businesses, which cannot be eliminated in the consolidated accounts because of the basis of accounting used for the Group's long-term assurance businesses. After taking into account legally enforceable netting agreements, at 31 December 2001 Group entities owned £1,186 million (2000: £1,251 million) and were owed £299 million (2000: £289 million); these amounts are included in customer accounts and loans and advances to customers respectively. In addition, fees of £62 million (2000: £68 million) were received, and fees of £28 million (2000: £29 million) were paid, in respect of asset management services.

Certain administrative properties used by Scottish Widows are owned by the long-term assurance funds. During 2001 Scottish Widows paid rent to the long-term assurance funds amounting to £4 million (2000: £3 million). In addition, at 31 December 2001 the long-term assurance funds owned 31 million ordinary shares in the Bank's parent company Lloyds TSB Group plc (2000: 31 million).

e Pension funds

Group entities provide a number of banking and other services to the Group's pension funds, which are conducted on similar terms to third party transactions. At 31 December 2001, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £572 million (2000: £344 million).

46 Pensions and other post-retirement benefits

a Pension costs in the consolidated accounts

There was a net credit in respect of pension costs for the Group in 2001 of £108 million (2000: credit of £105 million), which included a credit of £126 million (2000: credit of £121 million) relating to Lloyds TSB Group Pension Schemes No's 1 and 2.

Pension arrangements for most of the staff in the UK and the majority of those overseas are operated through defined benefit schemes funded by Group companies. The principal schemes in operation are Lloyds TSB Group Pension Schemes No's 1 and 2. The defined benefit sections of these schemes are now closed to new members. Pension arrangements for staff joining Lloyds TSB Group Pension Scheme No. 1 after 1 January 1996 and Lloyds TSB Group Pension Scheme No. 2 after 1 January 1998 are through money purchase elements of these schemes. Arrangements for pensions of certain staff employed overseas who are not included in funded schemes are made in accordance with local regulations and custom.

Full actuarial valuations of Lloyds TSB Group Pension Schemes No's 1 and 2 are carried out every three years with interim reviews in the intervening years. At 30 June 1999, the date of the latest full actuarial valuations, the principal actuarial assumptions adopted were that, over the long term, the annual real rate of return on new investments would be 3 per cent higher than the annual increase in pensionable remuneration, 4 per cent higher than the annual increase in present and future pensions in payment, and 3 per cent higher than the annual increase in dividends receivable. The market value of the assets of the schemes at this date was £11,748 million. The actuarial value of the assets represented 125 per cent of the accrued liabilities allowing for future increases in pensions and pensionable remuneration. For funding purposes, the surpluses in the two schemes are being eliminated by means of a contribution holiday.

Contribution rates to other schemes have been adjusted to take account of surpluses and deficiencies.

The following balances relating to the Group's pension schemes are included in the Group's balance sheet:

	2001 £m	2000 £m
Pension asset related to Lloyds TSB Group Pension Schemes No's 1 and 2	**894**	768
Pension obligation relating to certain overseas schemes	**(34)**	(34)
Deferred tax	**(268)**	(230)
Net asset	**592**	504

b Post-retirement healthcare costs in the consolidated accounts

The Group operates a number of schemes which provide post-retirement health care 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 dependants) who retired prior to 1 January 1996. For retirements subsequent to this date, the Group will meet a reducing proportion of the cost until 31 December 2004, after which date the only obligation will be in respect of the pre 1 January 1996 retirements. The cost of providing all post-retirement healthcare benefits is charged to the profit and loss account on a systematic basis over the employees' working lives; the provision represents the unfunded obligation and is based on valuations of the Group's liability by qualified actuaries.

The total cost for the Group in 2001 was £3 million (2000: £3 million). For the principal scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000. This valuation showed the Group's liability to be £72 million, which had been fully provided for at that date. The principal actuarial assumptions adopted were that, over the long term, the valuation

46 Pensions and other post-retirement benefits (continued)

discount rate and the rate of increase in medical costs would be 4 per cent and 3 per cent respectively higher than annual price inflation.

c Disclosures made in accordance with Financial Reporting Standard 17

As explained in note 1, the Group has adopted the requirements of Financial Reporting Standard 17 'Retirement Benefits' during the year. Under the transitional arrangements of this accounting standard the Group continues to account for pension costs in accordance with Statement of Standard Accounting Practice 24, but the following additional disclosures are required.

The majority of the Group's employees are members of the defined benefit sections of Lloyds TSB Group Pension Schemes No's 1 and 2. During the year ended 31 December 2001, the Group made no contributions to these schemes. Since the defined benefit sections of these schemes are now closed to new members and the age profile of the active members is increasing, under the projected unit method, the current service cost will increase as the members of the schemes approach retirement.

The last full valuations of the schemes were carried out as at 30 June 1999; interim reviews were performed at 30 June 2001 and these have been updated to 31 December 2001 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 2001 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. The principal assumptions used in these updated valuations were as follows:

	%
Rate of inflation	2.50
Rate of salary increases	4.04
Rate of increase for pensions in payment and deferred pensions	2.50
Discount rate	6.00

The assets of the Group's defined benefit schemes and the expected rates of return are summarised as follows:

	Fair value at 31 December 2001 £m	Expected long-term rate of return at 31 December 2001 %pa
Market values of scheme assets:		
Equities	**7,779**	**8.0**
Fixed interest securities	**1,835**	**5.1**
Property	**798**	**7.1**
Other	**714**	**4.1**
Total market value of scheme assets	**11,126**	

The following amounts at 31 December 2001 were measured in accordance with the requirements of FRS 17:

	£m
Market value of assets	**11,126**
Present value of scheme liabilities	**(10,618)**
Surplus in the schemes	**508**
Related deferred tax liability	**(152)**
Net pension asset	**356**

46 Pensions and other post-retirement benefits (continued)

If these amounts had been recognised in the financial statements, the Group's net assets and profit and loss account reserve at 31 December 2001 would have been as follows:

	£m
Net assets excluding net pension asset	**11,805**
Net pension asset	**356**
Net assets including net pension asset	**12,161**
Profit and loss reserve excluding net pension asset	**6,852**
Net pension asset	**356**
Profit and loss reserve including net pension asset	**7,208**

d Implications of Financial Reporting Standard 17 for the Bank

The majority of the Bank's employees are members of the Group's two main pension schemes, Lloyds TSB Group Pension Schemes No's 1 and 2, along with employees of a number of the Bank's subsidiaries. Because it is not possible to separately identify the amount of any surpluses or deficits in these schemes relating to each employing company, in the accounts of individual companies, including the Bank, these schemes will be accounted for as defined contribution schemes once Financial Reporting Standard 17 is implemented in full. Once this takes effect, the Bank will charge contributions to the schemes to its profit and loss account as and when they fall due. As noted above, the Bank is not currently making any contributions to Lloyds TSB Group Pension Schemes No's 1 and 2.

47 Contingent liabilities and commitments

a Contingent liabilities and commitments arising out of banking transactions

	Group		Bank	
	2001 £m	2000 £m	**2001 £m**	2000 £m
Contingent liabilities:				
Acceptances and endorsements	**2,243**	357	**2,244**	354
Guarantees	**3,789**	3,249	**3,739**	3,596
Other:				
Other items serving as direct credit substitutes	**460**	266	**441**	258
Performance bonds and other transaction-related contingencies	**1,469**	1,271	**1,447**	1,282
Other contingent liabilities	**2**	4	**2**	3
	1,931	1,541	**1,890**	1,543
	7,963	5,147	**7,873**	5,493
Commitments:				
Documentary credits and other short-term trade-related transactions	**354**	238	**362**	122
Forward asset purchases and forward forward deposits placed	**783**	779	**764**	701
Undrawn note issuing and revolving underwriting facilities	**35**	53	**–**	–
Undrawn formal standby facilities, credit lines and other commitments to lend:				
Less than 1 year maturity	**42,594**	33,815	**39,743**	32,040
1 year or over maturity	**9,576**	7,701	**8,862**	6,916
Commitments arising out of sale and option to resell transactions	**–**	3	**–**	3
	53,342	42,589	**49,731**	39,782

47 Contingent liabilities and commitments (continued)

	Bank	
	2001 £m	2000 £m
Incurred on behalf of group undertakings:		
Contingent liabilities	**78**	518
Commitments	**250**	858
	328	1,376

b Guaranteed annuity options

After an extensive review of its existing practices carried out in the light of the judgement of the House of Lords in the guaranteed annuities case *Equitable Life vs Hyman*, it was announced that Scottish Widows was revising the way it calculates benefits for guaranteed annuity policies with effect from 1 February 2002. As a result of this change, the terminal bonuses for guaranteed annuity option policies will be increased.

Under the terms of the transfer of the Scottish Widows' business, a separate memorandum account was created within the With Profits Fund called the Additional Account. This Account had a value at 31 December 2001 of approximately £1.7 billion and is available to meet any additional costs of providing guaranteed benefits on transferred policies, including guaranteed annuity option policies. The assets allocated to the Additional Account include certain hedge assets, to provide protection to the With Profits Fund against the consequences of a future fall in interest rates.

The eventual cost of providing the enhanced benefits is dependent upon a number of factors, including in particular:

- The proportion of policyholders with a guaranteed annuity option policy who choose to exercise their options;
- The effect of future interest rate and mortality trends on the cost of annuities; and
- The future investment performance of the With Profits Fund.

Having considered a range of possible outcomes, the Group currently expects that the most likely outcome is that the balance in the Additional Account available for this purpose will be sufficient to meet the cost of the enhanced benefits payable to the guaranteed annuity option policyholders, as well as other contingencies. This cost, currently estimated to be approximately £1.4 billion, will be paid out over many years as policies mature. In the event that the amount in the Additional Account proves, over time, to be insufficient, the shortfall will be met by the Group. At this time, no provision is considered necessary for such risk.

48 Derivatives and other financial instruments

The Group's activities can be divided into three broad categories: banking and mortgages, insurance and investments, and trading activities.

Banking and mortgage activities represent the most significant element of the Group's business in terms of profit, assets and exposure to risk. These activities are entered into in both the UK and overseas and principally comprise the Group's core business of lending and deposit taking, involving a full range of personal and corporate customers. In entering into this business, the Group's objective is to secure a margin between the interest paid to customers on their deposits and interest received on amounts advanced. In order to do this, more complex financial instruments, such as derivatives, are used as a means of reducing risk by hedging exposures to movements in exchange rates, interest rates or other market variables.

Within its banking activities, the Group has a number of treasury operations that are responsible for utilising surplus funds and meeting funding shortfalls by entering into transactions in the money markets. Portfolios of debt securities and treasury bills are held to provide a source of liquidity; it is the Group's intention to hold these investments until maturity although in certain circumstances they may be disposed of before then where, for example, the need to hold the investment no longer applies. Any profits or losses arising from a sale of this kind are recognised immediately.

48 Derivatives and other financial instruments (continued)

Insurance and investment businesses provide general insurance and market savings and investment products both within and outside the banking customer bases. Fund management services are also provided although, whilst involving external clients, this activity is currently dominated by the management of internal group funds.

Trading activities are restricted to a few highly specialist authorised trading centres, the principal one being the Group's Treasury department in London. Most of the Group's trading activity is to meet the requirements of customers for foreign exchange and interest rate products, from which the Group is able to earn a spread on the rates charged. However, interest rate and exchange rate positions are taken out using derivatives (forward foreign exchange contracts, interest rate swaps and forward rate agreements) and on-balance sheet instruments (mainly debt securities). The objective of these positions is to earn a profit from favourable movements in market rates. Accordingly, these transactions are reflected in the accounts at their fair value and gains and losses shown in the profit and loss account as dealing profits.

Risk

The board is responsible for determining the long-term strategy of the business, the markets in which the Group will operate and the level of risk acceptable to the Group in each area of its business. The principal risks arising from the Group's use of financial instruments are as follows:

Credit risk

Credit risk arises from extending credit in all forms in the Group's banking and trading activities, where there is a possibility that a counterparty may default. The Group has dedicated standards, policies and procedures to control and monitor all such risks. Lloyds TSB Group Risk's responsibilities in respect of credit risk include the following:

- Formulation of high level credit policies designed to ensure a balanced and managed approach to the identification and mitigation of credit risk. These policies provide a standard framework within which Group businesses structure their individual policies and rules. Lloyds TSB Group Risk reviews, approves and monitors credit policy documents established for individual businesses.
- Provision of lending guidelines. These define the responsibilities for lending officers and provide a disciplined and focused benchmark for sound credit decisions. Clear guidance is provided on the Group's attitude towards and appetite for credit exposure on different market sectors, industries and products.
- Provision of a group rating system. All business units are required to operate an authorised rating system that complies with the Group's standard methodology. The Group uses a 'Master Scale' rating structure with nine ratings, each corresponding to a probability of future default.
- Establishment and maintenance of the Group's large exposure policy. Exposure to individual counterparties or groups of counterparties 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 of the risk.
- Control of bank exposures. In-house proprietary rating systems are used to approve bank facilities on a group basis.
- Monitoring of scorecards. The Group utilises statistically-based decisioning techniques (primarily credit scoring and performance scoring) for its main consumer lending portfolios. Authorisations are determined by scorecards tailored to meet the needs of the particular business. Lloyds TSB Group Risk reviews and monitors new and material changes to scorecards.
- Control of cross-border exposures. Country limits are authorised and managed by a dedicated unit, using an in-house rating system which takes into account economic and political factors.
- Maintenance of a centralised facilities database. Lloyds TSB Group Risk operates a centralised database of large corporate, sovereign and bank facilities designed to ensure that a consistent aggregation policy is maintained throughout the Group.
- Formulation of concentration limits on certain industries and sectors. Lloyds TSB Group Risk sets limits and monitors exposures to prevent over-concentration of risk.

48 Derivatives and other financial instruments (continued)

- Portfolio analysis. In conjunction with Lloyds TSB Group Risk, group businesses 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 Lloyds TSB Group Risk.
- Communication and provision of general guidance on all credit-related risk issues, including regulatory changes and environmental risk policy, to promote consistent and best practice throughout the Group.

Day-to-day credit management and asset quality within each business unit is the primary responsibility of the business unit directors. Each business unit has in place established credit processes involving credit policies, procedures and lending guidelines. Authority to delegate lending discretions within operating divisions rests with officers holding divisional lending delegated authority. All material authorities are advised to Lloyds TSB Group Risk.

Specialist units are established within group business units to provide intensive management and control in order to maximise recoveries of doubtful debts.

Regular independent audits of credit processes are undertaken by Lloyds TSB Group Audit. Such audits include consideration of the completeness and adequacy of credit manuals and lending guidelines, together with an in-depth analysis of a representative sample of accounts in the portfolio to assess the quality of the loan book and other exposures. Individual accounts are reviewed to ensure that the facility grade is appropriate, that credit procedures have been properly followed and that, where an account is non-performing, provisions raised are adequate.

Market risk

Market risk is the risk of losses being incurred as a result of adverse movements in interest or exchange rates or other market variables. Market risk arises in all areas of the Group's activities and is managed by a variety of different techniques.

The Group's trading activities expose it to the risk of adverse movements in interest rates or exchange rates. Trading activities are restricted to a few highly specialist trading centres and the level of exposure is strictly controlled and monitored within approved limits locally and centrally.

These are supplemented by a range of value at risk techniques in use in individual businesses, where suitable methodologies have been developed to meet the specific requirements of each centre. At Group level, global positions are incorporated into a central value at risk model, taking into account natural offset positions between different trading centres, and stress tests are carried out to simulate extreme conditions.

Various parameters are used to calculate the value at risk on a given portfolio of positions, thus avoiding undue reliance on a single measure. Based on the commonly quoted 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 3 years, during 2001 the value at risk on the Group's global trading averaged £1.17 million (2000: £1.28 million) with a maximum of £1.62 million (2000: £1.67 million) and a minimum of £0.78 million (2000: £0.98 million). The figure at 31 December 2001 was £1.62 million (2000: £1.17 million).

Lloyds TSB Group Balance Sheet Management (GBSM) specifically focuses on the management of interest rate risk in the Group's retail portfolios, including mortgages, and in the Group's capital funds. GBSM reports to an Asset and Liability Committee under the chairmanship of the Finance Director. The Group's policy is to optimise the stability of future net interest income, which is achieved by entering into hedging transactions using interest rate swaps and other financial instruments.

Liquidity risk

To ensure that each business unit can meet its financial obligations as they fall due, the Group complies with the Financial Services Authority's Sterling Stock Liquidity policy in the UK, with similar liquidity policies in place across all trading centres worldwide. Compliance is monitored by regular liquidity returns to Lloyds TSB Group Risk.

48 Derivatives and other financial instruments (continued)

The sources and maturities of assets and liabilities are closely monitored and diversified to avoid any undue concentration. A substantial proportion of deposits is made up of current and savings accounts which, although repayable on demand, have traditionally formed a stable deposit base.

The Group's significant involvement in the London money market and other financial centres, together with the strength of the Group's earnings and balance sheet, are important factors in assuring the continued availability of wholesale funds at competitive rates.

Operational risk

Operational risk is the exposure to financial or other damage arising through unforeseen events or failure in the Group's operational processes/systems. Examples include inadequate internal controls and procedures, human error, deliberate malicious acts including fraud, and business interruptions.

Internal control techniques include segregation of duties, exception and exposure reporting, business continuity planning, reconciliations, and delegation of authority, and are based on the submission of timely and reliable management reporting. Where appropriate risk is mitigated by way of insurance with third parties.

Insurance risk

The Group offers insurance products to its customers, and actively reviews the extent to which the associated risk is underwritten internally, or reinsured with external underwriters.

The Financial Services Authority sets down minimum requirements for solvency and reserving for all classes of insurance, which are carefully monitored by the relevant business units within the Group. The retained risk level is carefully controlled and monitored, with close attention being paid to the analysis of underwriting experience, product design, policy wordings, adequacy of reserves, solvency management and regulatory requirements.

Investment strategy is determined by the term and nature of the underwriting liabilities and asset/liability matching positions are actively monitored. General insurance exposure to accumulations of risk and possible catastrophes is mitigated by reinsurance arrangements which are broadly spread over different reinsurers. Appropriate reinsurance arrangements also apply within the life and pensions businesses.

Derivatives

Derivatives are used to meet the financial needs of customers, as part of the Group's trading activities and to reduce its own exposure to fluctuations in interest and exchange rates. 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.

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.

Equity derivatives are also used by the Group as part of its equity based retail product activity, whereby index-linked equity options are purchased to eliminate the Group's exposure to fluctuations in various international stock exchange indices.

48 Derivatives and other financial instruments (continued)
a Derivatives
Group
Trading
The notional principal amounts and fair values (which, after netting, are the carrying values) of trading instruments entered into with third parties were as follows:

31 December 2001	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**95,895**	**1,035**	**1,038**
Currency swaps	**6,737**	**223**	**152**
Options purchased	**3,825**	**11**	**–**
Options written	**3,492**	**–**	**9**
	109,949	**1,269**	**1,199**
Interest rate contracts:			
Interest rate swaps	**287,017**	**4,085**	**4,607**
Forward rate agreements	**54,171**	**78**	**84**
Options purchased	**8,887**	**73**	**–**
Options written	**3,993**	**–**	**58**
Futures	**35,112**	**–**	**–**
	389,180	**4,236**	**4,749**
Equity contracts	**4,580**	**428**	**255**
Effect of netting		**(3,843)**	**(3,843)**
Balances arising from off-balance sheet financial instruments		**2,090**	**2,360**

31 December 2000	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	86,423	1,742	1,940
Currency swaps	6,049	304	206
Options purchased	1,208	23	–
Options written	1,023	–	19
	94,703	2,069	2,165
Interest rate contracts:			
Interest rate swaps	290,529	3,484	3,509
Forward rate agreements	48,002	57	64
Options purchased	3,539	17	–
Options written	2,229	–	8
Futures	34,390	6	–
	378,689	3,564	3,581
Equity contracts	2,768	443	59
Effect of netting		(3,388)	(3,388)
Balances arising from off-balance sheet financial instruments		2,688	2,417

48 Derivatives and other financial instruments (continued)
a Derivatives (continued)
Non-trading
Through intra company and intra group transactions the Group establishes non-trading derivatives positions with the Group's independent trading operations. Similar positions are also established with third parties. The notional principal amounts of non-trading instruments entered into with third parties were as follows:

31 December 2001	Notional principal amount £m	Fair values Positive £m	Fair values Negative £m
Exchange rate contracts:			
Spot, forwards and futures	**146**	**3**	**1**
Currency swaps	**70**	**9**	**1**
	216	**12**	**2**
Interest rate contracts:			
Interest rate swaps	**2,919**	**164**	**68**
Forward rate agreements	**62**	**–**	**–**
	2,981	**164**	**68**
Effect of netting		**(39)**	**(39)**
		137	**31**

31 December 2000	Notional principal amount £m	Fair values Positive £m	Fair values Negative £m
Exchange rate contracts:			
Spot, forwards and futures	296	4	4
Currency swaps	78	5	7
	374	9	11
Interest rate contracts:			
Interest rate swaps	2,466	96	35
Forward rate agreements	134	–	–
	2,600	96	35
Effect of netting		–	–
		105	46

48 Derivatives and other financial instruments (continued)

a Derivatives (continued)

The aggregate carrying value of non-trading derivatives with a positive fair value was an asset of £18 million (2000: an asset of £23 million) and with a negative fair value was an asset of £1 million (2000: a liability of £1 million).

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

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
31 December 2001				
Exchange rate contracts:				
Notional principal amount	**102,130**	**6,260**	**1,775**	**110,165**
Net replacement cost	**663**	**132**	**42**	**837**
Interest rate contracts:				
Notional principal amount	**187,570**	**155,329**	**49,262**	**392,161**
Net replacement cost	**545**	**229**	**188**	**962**
Equity contracts:				
Notional principal amount	**738**	**3,394**	**448**	**4,580**
Net replacement cost	**75**	**330**	**23**	**428**
Total:				
Notional principal amount	**290,438**	**164,983**	**51,485**	**506,906**
Net replacement cost	**1,283**	**691**	**253**	**2,227**
31 December 2000				
Exchange rate contracts:				
Notional principal amount	88,288	4,973	1,816	95,077
Net replacement cost	1,094	183	39	1,316
Interest rate contracts:				
Notional principal amount	177,684	159,422	44,183	381,289
Net replacement cost	731	146	157	1,034
Equity contracts:				
Notional principal amount	506	2,054	208	2,768
Net replacement cost	68	343	32	443
Total:				
Notional principal amount	266,478	166,449	46,207	479,134
Net replacement cost	1,893	672	228	2,793

The notional principal amount does not represent the Group's real exposure to credit risk, which is limited to the current cost of replacing contracts at current market rates should the counterparties default.

Net replacement cost represents the total positive fair value of all derivative contracts at the balance sheet date, after allowing for the offset of all negative fair values where the Group has a legal right of set-off with the counterparty concerned.

An analysis of the net replacement cost of both trading and non-trading instruments entered into with third parties by counterparty type is set out below; the Group's exposure is further reduced by qualifying collateral held.

	2001 £m	2000 £m
OECD banks	**1,425**	2,244
Other	**802**	549
Net replacement cost	**2,227**	2,793
Qualifying collateral held	**(339)**	(643)
Potential credit risk exposure	**1,888**	2,150

48 Derivatives and other financial instruments (continued)

a Derivatives (continued)

Bank

Trading

The notional principal amounts and fair values (which, after netting, are the carrying values) of trading instruments entered into with third parties were as follows:

31 December 2001	Notional principal amount £m	Fair values Assets £m	Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**90,637**	**969**	**969**
Currency swaps	**5,757**	**111**	**142**
Options purchased	**1,564**	**10**	**–**
Options written	**1,030**	**–**	**8**
	98,988	**1,090**	**1,119**
Interest rate contracts:			
Interest rate swaps	**286,145**	**4,241**	**4,504**
Forward rate agreements	**52,687**	**77**	**83**
Options purchased	**8,888**	**74**	**–**
Options written	**3,956**	**–**	**58**
Futures	**33,954**	**–**	**–**
	385,630	**4,392**	**4,645**
Equity contracts	**6,757**	**428**	**409**
Effect of netting		**(3,843)**	**(3,843)**
Balances arising from off-balance sheet financial instruments		**2,067**	**2,330**

31 December 2000	Notional principal amount £m	Fair values Assets £m	Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	79,150	1,510	1,720
Currency swaps	5,194	131	177
Options purchased	1,154	21	–
Options written	784	–	14
	86,282	1,662	1,911
Interest rate contracts:			
Interest rate swaps	288,054	3,649	3,427
Forward rate agreements	46,874	57	63
Options purchased	3,489	17	–
Options written	2,004	–	8
Futures	32,672	6	–
	373,093	3,729	3,498
Equity contracts	5,336	502	498
Effect of netting		(3,388)	(3,388)
Balances arising from off-balance sheet financial instruments		2,505	2,519

Notes to the accounts

48 Derivatives and other financial instruments (continued)
a Derivatives (continued)
Non-trading
The notional principal amounts of non-trading instruments entered into with third parties were as follows:

31 December 2001	Notional principal amount £m	Fair values Positive £m	Negative £m
Exchange rate contracts:			
Spot, forwards and futures	**131**	**2**	**1**
Currency swaps	**324**	**10**	**16**
	455	**12**	**17**
Interest rate contracts:			
Interest rate swaps	**3,610**	**216**	**73**
Forward rate agreements	**39**	**–**	**–**
	3,649	**216**	**73**
Effect of netting		**(39)**	**(39)**
		189	**51**

31 December 2000	Notional principal amount £m	Fair values Positive £m	Negative £m
Exchange rate contracts:			
Spot, forwards and futures	237	6	–
Currency swaps	341	6	34
	578	12	34
Interest rate contracts:			
Interest rate swaps	1,583	99	24
Forward rate agreements	139	–	–
	1,722	99	24
Effect of netting		–	–
		111	58

48 Derivatives and other financial instruments (continued)
a Derivatives (continued)

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

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
31 December 2001				
Exchange rate contracts:				
Notional principal amount	**92,365**	**5,327**	**1,751**	**99,443**
Net replacement cost	**543**	**73**	**42**	**658**
Interest rate contracts:				
Notional principal amount	**184,434**	**151,411**	**53,434**	**389,279**
Net replacement cost	**559**	**216**	**395**	**1,170**
Equity contracts:				
Notional principal amount	**1,256**	**4,606**	**895**	**6,757**
Net replacement cost	**75**	**330**	**23**	**428**
Total:				
Notional principal amount	**278,055**	**161,344**	**56,080**	**495,479**
Net replacement cost	**1,177**	**619**	**460**	**2,256**
31 December 2000				
Exchange rate contracts:				
Notional principal amount	81,083	3,992	1,785	86,860
Net replacement cost	793	82	37	912
Interest rate contracts:				
Notional principal amount	172,730	157,315	44,770	374,815
Net replacement cost	714	163	325	1,202
Equity contracts:				
Notional principal amount	842	4,079	415	5,336
Net replacement cost	68	402	32	502
Total:				
Notional principal amount	254,655	165,386	46,970	467,011
Net replacement cost	1,575	647	394	2,616

An analysis of the net replacement cost of both trading and non-trading instruments entered into with third parties by counterparty type is set out below; the Bank's exposure is further reduced by qualifying collateral held.

	2001 £m	2000 £m
OECD banks	**1,653**	2,285
Other	**603**	331
Net replacement cost	**2,256**	2,616
Qualifying collateral held	**(339)**	(643)
Potential credit risk exposure	**1,917**	1,973

48 Derivatives and other financial instruments (continued)

b Interest rate sensitivity gap analysis for the non-trading book

The table below summarises the repricing mismatches of the Group's non-trading 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.

As at 31 December 2001	3 months or less £m	6 months or less but over 3 months £m	1 year or less but over 6 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Trading book £m	Total £m
Assets:								
Treasury bills and other eligible bills	**2,709**	**37**	**26**	**4**	**6**	**–**	**1,630**	**4,412**
Loans and advances to banks	**11,311**	**1,621**	**1,076**	**142**	**289**	**452**	**333**	**15,224**
Loans and advances to customers	**74,546**	**5,252**	**8,798**	**28,497**	**7,108**	**237**	**272**	**124,710**
Debt securities and equity shares	**2,545**	**1,662**	**718**	**1,940**	**4,168**	**(6)**	**13,423**	**24,450**
Other assets	**154**	**9**	**8**	**4**	**15**	**17,243**	**5,648**	**23,081**
Total assets	**91,265**	**8,581**	**10,626**	**30,587**	**11,586**	**17,926**	**21,306**	**191,877**
Liabilities:								
Deposits by banks	**19,226**	**1,859**	**666**	**512**	**90**	**681**	**1,276**	**24,310**
Customer accounts	**92,958**	**1,644**	**1,172**	**3,228**	**2,299**	**7,695**	**306**	**109,302**
Debt securities in issue	**16,453**	**3,957**	**1,333**	**600**	**890**	**–**	**1,187**	**24,420**
Other liabilities	**350**	**–**	**3**	**–**	**5**	**7,150**	**5,352**	**12,860**
Subordinated liabilities – loan capital	**1,671**	**716**	**–**	**657**	**4,848**	**150**	**–**	**8,042**
Minority interests and shareholders' funds	**–**	**–**	**–**	**–**	**–**	**12,841**	**102**	**12,943**
Internal funding of trading business	**(3,736)**	**(741)**	**(1,171)**	**(6,051)**	**(1,384)**	**–**	**13,083**	**–**
Total liabilities	**126,922**	**7,435**	**2,003**	**(1,054)**	**6,748**	**28,517**	**21,306**	**191,877**
Off-balance sheet items	**21,937**	**(10,861)**	**(7,509)**	**(2,896)**	**(671)**	**–**	**–**	**–**
Interest rate repricing gap	**(13,720)**	**(9,715)**	**1,114**	**28,745**	**4,167**	**(10,591)**	**–**	**–**
Cumulative interest rate repricing gap	**(13,720)**	**(23,435)**	**(22,321)**	**6,424**	**10,591**	**–**	**–**	**–**

As at 31 December 2000*	3 months or less £m	6 months or less but over 3 months £m	1 year or less but over 6 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Trading book £m	Total £m
Assets:								
Treasury bills and other eligible bills	534	40	46	9	1	–	1,079	1,709
Loans and advances to banks	13,034	1,184	392	112	191	185	192	15,290
Loans and advances to customers	69,344	4,206	6,109	30,689	5,547	285	130	116,310
Debt securities and equity shares	2,497	475	464	1,202	1,747	51	8,416	14,852
Other assets	251	22	47	5	22	16,533	4,795	21,675
Total assets	85,660	5,927	7,058	32,017	7,508	17,054	14,612	169,836
Liabilities:								
Deposits by banks	12,854	1,090	604	396	92	789	910	16,735
Customer accounts	89,267	1,955	1,508	2,506	394	6,141	291	102,062
Debt securities in issue	8,519	5,950	1,769	623	82	–	956	17,899
Other liabilities	159	–	3	91	2	8,337	4,775	13,367
Subordinated liabilities – loan capital	1,728	1,010	–	653	4,258	150	–	7,799
Minority interests and shareholders' funds	–	–	–	–	–	11,954	20	11,974
Internal funding of trading business	148	(982)	(264)	(6,188)	(374)	–	7,660	–
Total liabilities	112,675	9,023	3,620	(1,919)	4,454	27,371	14,612	169,836
Off-balance sheet items	12,229	(766)	170	(10,612)	(1,021)	–	–	–
Interest rate repricing gap	(14,786)	(3,862)	3,608	23,324	2,033	(10,317)	–	–
Cumulative interest rate repricing gap	(14,786)	(18,648)	(15,040)	8,284	10,317	–	–	–

The table above does not take into account the effect of interest rate options used by the Group to hedge its exposure; details of options are given in note 48a).

*restated (see note 1)

48 Derivatives and other financial instruments (continued)

c Fair value analysis

The table below shows a comparison by category of book values and fair values of the Group's on-balance sheet financial assets and liabilities:

As at 31 December 2001	Trading book		Non-trading book	
Assets:	Book value £m	Fair value £m	Book value £m	Fair value £m
Treasury bills and other eligible bills	**1,630**	**1,630**	**2,782**	**2,780**
Loans and advances to banks and customers	**605**	**605**	**139,329**	**140,062**
Debt securities and equity shares	**13,423**	**13,423**	**11,027**	**11,269**
Liabilities:				
Deposits by banks and customers	**1,582**	**1,582**	**132,030**	**131,999**
Debt securities in issue	**1,187**	**1,187**	**23,233**	**23,266**
Subordinated liabilities	**–**	**–**	**8,042**	**8,469**

As at 31 December 2000*	Trading book		Non-trading book	
Assets:	Book value £m	Fair value £m	Book value £m	Fair value £m
Treasury bills and other eligible bills	1,079	1,079	630	627
Loans and advances to banks and customers	322	322	131,278	132,178
Debt securities and equity shares	8,416	8,416	6,436	6,916
Liabilities:				
Deposits by banks and customers	1,201	1,201	117,596	117,442
Debt securities in issue	956	956	16,943	16,982
Subordinated liabilities	–	–	7,799	7,981

*restated (see note 1)

The disclosures in this note cover all on-balance sheet financial instruments; fair values of all derivative instruments are disclosed in note 48a).

Fair values are determined by reference to quoted market prices or, where no market price is available, using internal models which discount expected future cash flows at prevailing interest rates.

Fair values have not been calculated for sundry debtors and creditors in the trading book.

d Currency exposures

Structural currency exposures
Structural currency exposures arise from the Group's investments in its overseas operations. The structural position is managed after having regard to the currency composition of the Group's risk-weighted assets, the objective being to limit the effect of exchange rate movements on the published risk asset ratio.

The Group's main overseas operations are in New Zealand, the Americas and Europe. Details of the Group's structural foreign currency exposures are as follows:

Functional currency of Group operation	**2001 £m**	2000 £m
New Zealand dollar	**748**	703
Euro (and component former currencies)	**286**	289
US dollar	**147**	194
Swiss franc	**104**	120
Other non-sterling	**438**	397
Total	**1,723**	1,703

Non-structural currency exposures
All foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled.

48 Derivatives and other financial instruments (continued)

e Unrecognised gains and losses on hedging instruments

The Group uses a variety of financial instruments to hedge exposures in its banking book; these hedges are accounted for on an accruals basis, in line with the underlying instruments being hedged. Any gains or losses that would occur if these instruments were carried at market value are therefore not recognised.

At 31 December 2001, the unrecognised gains on financial instruments used for hedging were £242 million (2000: £200 million) and unrecognised losses were £820 million (2000: £457 million).

The net losses arising in 2000 and earlier years and recognised in 2001 amounted to £88 million. Net losses of £403 million arose in 2001 but were not recognised in the year.

Of the net losses of £578 million at 31 December 2001, £342 million of net losses are expected to be recognised in the year ending 31 December 2002 and £236 million of net losses in later years.

49 Acquisition

On 21 November 2001 the Group's subsidiary, Lloyds TSB Commercial Finance Limited, acquired the issued share capital of CashFriday Limited, a provider of funding and payroll services to the UK temporary recruitment sector. The consideration was approximately £10 million, satisfied by £1 million of cash and the issue of £9 million of short-term loan notes. The premium on acquisition of £8 million has been capitalised and will be written off to the profit and loss account over its estimated useful life of 20 years. There were no fair value adjustments made to the assets acquired. The results of this business have been consolidated in full from the date of acquisition, the effect on the results of the Group is not material.

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