Lloyds TSB Bank plc

Report and Accounts

2002

Member of Lloyds TSB Group

Contents

Registered office:
To 27 March 2003, 71 Lombard Street, London EC3P 3BS.
From 28 March 2003, 25 Gresham Street, London EC2V 7HN.
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 2002 of £1,785 million. An interim dividend of £597 million for the year ended 31 December 2002 was paid on 27 September 2002. A second interim dividend of £1,311 million will be paid on 28 March 2003.

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 £2,638 million in 2002, compared with £3,219 million in 2001. Total income decreased by £20 million to £8,870 million, whilst operating expenses increased by £157 million, or 3 per cent, to £4,876 million. The substantial turmoil surrounding the operating and stockmarket environment in which we operate has been unprecedented in recent times and a number of issues have adversely affected the profit and loss account in 2002. The Group experienced a reduction in profit of £952 million as a result of the adverse investment variance following the 24 per cent fall in the FTSE All Share Index. We have increased the general provision by £50 million in respect of our business in Argentina and significantly increased our corporate provisions in respect of certain US customers as a result of their accounting and other irregularities. In addition the Group has absorbed provisions totalling £205 million for redress to past purchasers of pensions and Abbey Life endowment and long-term savings products. There was however good market share growth in many key areas; customer lending increased by 9 per cent and customer deposits increased by 7 per cent. The Group's efficiency programmes further improved the Group's focus on cost control, and were a major contributing factor to the net reduction in the Group's staff headcount of over 4,000 after adjusting for acquisitions made during the year.

Pre-tax profit from UK Retail Banking and Mortgages decreased by £30 million to £1,175 million, compared to £1,205 million in 2001. Excluding the impact of a reduction of £57 million in profits from the sale and leaseback of premises and the non-recurrence of certain provision releases in 2001, profit before tax increased by £99 million, or 9 per cent. There was strong growth in personal loans, up 15 per cent, and in credit card lending, up 27 per cent. Current account and savings and investment account balances increased by 10 per cent. Costs remained tightly controlled and asset quality generally remains satisfactory, notwithstanding the general slowdown in activity within the UK. In the mortgage business, gross new lending increased by 36 per cent to a record £19.0 billion, compared with £14.0 billion a year ago. Net new lending was £5.9 billion, compared with £3.9 billion in 2001. This resulted in an estimated market share of net new lending of 7.5 per cent. Profit before tax from Insurance and Investments decreased by £190 million, or 13 per cent, to £1,231 million, partly as a result of a £135 million increase in provisions for redress to past purchasers of endowment and pension products and a reduction of £55 million in benefits from experience variances and assumption changes, largely reflecting the implementation of revised actuarial mortality assumptions. Overall weighted sales in the Group's life, pensions and unit trust businesses were £767.6 million compared to £754.7 million last year, an increase of 2 per cent. This increase in weighted sales reflected a 7 per cent increase in weighted sales from life and pensions, partly offset by a 13 per cent reduction in weighted sales from unit trusts. Weighted sales from independent financial advisors rose by 25 per cent. There was strong profit growth from the Group's general insurance operations. A 19 per cent growth in the combined premium income from underwriting and commissions from insurance broking led to an increase in profit before tax of £103 million, or 16 per cent, to £754 million. In Wholesale Markets pre-tax profit decreased by £226 million, or 27 per cent, to £626 million, partly as a result of the substantial increase in provisions for bad and doubtful debts. In International Banking pre-tax profit was £22 million, or 6 per cent, higher at £379 million largely as a result of an increase of 32 per cent in pre-tax profits from The National Bank of New Zealand, as a result of good growth in all core businesses, particularly small business banking.

The total Group charge for bad and doubtful debts was 38 per cent higher at £1,029 million, compared with £747 million in 2001. In UK Retail Banking and Mortgages the provisions charge increased by £148 million to £563 million, as a result of volume related asset growth in the personal loan and credit card portfolios and a lower level of

Directors' report

Business review (continued)

recoveries and releases than in 2001. Overall the arrears position remains stable. In Wholesale Markets the provisions charge increased by £156 million to £311 million, reflecting the higher corporate provisions. The Group's charge for bad and doubtful debts, expressed as a percentage of average lending, was 0.77 per cent, compared with 0.62 per cent in 2001. Non-performing lending increased to £1,414 million, compared with £1,222 million in December 2001, largely reflecting higher levels of non-performing lending in the Group's corporate portfolio, and general portfolio growth throughout the Group. Non-performing lending as a percentage of total lending was unchanged at 1.0 per cent.

Profit attributable to shareholders was 19 per cent lower at £1,785 million. Shareholders' equity decreased by £2,457 million to £9,085 million following a reduction of £2,331 million in the value of the Group's pension schemes, largely caused by the significant reduction in equity market values. These pension scheme related movements are ignored for regulatory capital purposes and, excluding these market movements, shareholders' equity decreased by £126 million. Risk-weighted assets increased by 13 per cent to £122.4 billion. At the end of 2002, the risk asset ratios, the international standard for measuring capital adequacy, were 9.4 per cent for total capital and 8.7 per cent for tier I capital.

Directors

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

Mr Urquhart left the board on 17 April 2002 and Mr Atkinson, Mr Butler, Miss Forbes and Mr Moore will leave the board on 16 April 2003.

Mr Gemmell became a director on 17 April 2002.

Mr Hampton was appointed director from 1 June 2002 and Mr Targett will join the board on 10 March 2003.

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 DTI Publications Orderline 0870 1502 500, quoting ref URN 01/621.

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 30. 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 2002 bears to the aggregate of the amounts invoiced by suppliers during the year.

On behalf of the board

A J Michie
Secretary
13 February 2003

Directors

M A van den Bergh
Chairman

A E Moore CBE
Deputy Chairman
(leaving on 16 April 2003)

P B Ellwood CBE
Chief Executive

M E Fairey
Deputy Chief Executive

M K Atkinson
(leaving on 16 April 2003)

Ewan Brown CBE

A C Butler
(leaving on 16 April 2003)

J E Daniels

S M Forbes CBE
(leaving on 16 April 2003)

G J N Gemmell CBE

C S Gibson-Smith

P R Hampton

D S Julius CBE

A G Kane

Sir Tom McKillop

D P Pritchard
(Deputy Chairman from 16 April 2003)

M D Ross CBE

The Earl of Selborne KBE FRS

S C Targett
(from 10 March 2003)

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 12.

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 United Kingdom 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 responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board.

Our report, including the opinion, has been prepared for and only for the Bank's members as a body in accordance with Section 235 of the United Kingdom Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the 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 2002 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the United Kingdom Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton
13 February 2003

Consolidated profit and loss account

for the year ended 31 December 2002

	Note	2002 £ million	2001* £ million
Interest receivable:			
Interest receivable and similar income arising from debt securities		**567**	530
Other interest receivable and similar income		**9,957**	10,829
Interest payable		**5,364**	6,439
Net interest income		**5,160**	4,920
Other finance income	44	**165**	307
Other income			
Fees and commissions receivable		**3,056**	2,925
Fees and commissions payable		**(645)**	(602)
Dealing profits (before expenses)	3	**188**	233
Income from long-term assurance business	28	**(303)**	(29)
General insurance premium income		**486**	428
Other operating income		**763**	708
		3,545	3,663
Total income		**8,870**	8,890
Operating expenses			
Administrative expenses	4	**4,175**	4,169
Depreciation	23	**642**	511
Amortisation of goodwill	22	**59**	39
Depreciation and amortisation		**701**	550
Total operating expenses		**4,876**	4,719
Trading surplus		**3,994**	4,171
General insurance claims		**229**	174
Provisions for bad and doubtful debts	14		
Specific		**965**	736
General		**64**	11
		1,029	747
Amounts written off fixed asset investments	5	**87**	60
Operating profit		**2,649**	3,190
Income from joint ventures	19	**(11)**	(10)
Profit on sale of businesses	6	**–**	39
Profit on ordinary activities before tax	7	**2,638**	3,219
Tax on profit on ordinary activities	8	**791**	951
Profit on ordinary activities after tax		**1,847**	2,268
Minority interests: equity		**19**	17
: non-equity	38	**43**	40
Profit for the year attributable to shareholders	9	**1,785**	2,211
Dividends	10	**1,908**	1,872
(Loss) profit for the year	40	**(123)**	339

** restated (see note 1)*

Balance sheets

at 31 December 2002

		Group		Bank	
	Note	**2002 £ million**	2001* £ million	**2002 £ million**	2001* £ million
Assets					
Cash and balances at central banks		**1,140**	1,240	**1,005**	1,112
Items in course of collection from banks		**1,757**	1,664	**1,708**	1,595
Treasury bills and other eligible bills	*11*	**2,409**	4,412	**2,372**	4,087
Loans and advances to banks	*12*	**17,528**	15,224	**64,163**	56,918
Loans and advances to customers		**136,289**	124,834	**60,777**	53,876
Non-returnable finance		**(24)**	(124)	**–**	–
	13	**136,265**	124,710	**60,777**	53,876
Debt securities	*16*	**29,314**	24,225	**22,585**	20,926
Equity shares	*17*	**206**	225	**45**	27
Interests in joint ventures:					
– share of gross assets		**336**	281		
– share of gross liabilities		**(291)**	(242)		
	19	**45**	39	**45**	39
Shares in group undertakings	*20*	**–**	–	**18,181**	16,944
Intangible fixed assets	*22*	**2,627**	2,566	**8**	11
Tangible fixed assets	*23*	**4,095**	3,365	**1,237**	1,304
Other assets	*26*	**5,236**	4,441	**4,291**	3,597
Prepayments and accrued income	*27*	**2,315**	2,298	**1,776**	1,922
Post-retirement benefit asset	*44*	**–**	356	**–**	–
Long-term assurance business attributable to the shareholder	*28*	**6,228**	6,366	**–**	–
		209,165	191,131	**178,193**	162,358
Long-term assurance assets attributable to policyholders	*28*	**45,340**	46,389	**–**	–
Total assets		**254,505**	237,520	**178,193**	162,358

** restated (see note 1)*

The directors approved the accounts on 13 February 2003.

M A van den Bergh
Chairman

P B Ellwood CBE
Chief Executive

P R Hampton
Finance Director

Balance sheets

at 31 December 2002

		Group		Bank	
	Note	**2002 £ million**	2001* £ million	**2002 £ million**	2001* £ million
Liabilities					
Deposits by banks	*30*	**25,443**	24,310	**32,868**	32,082
Customer accounts	*31*	**116,658**	109,302	**89,068**	82,091
Items in course of transmission to banks		**775**	534	**699**	450
Debt securities in issue	*32*	**30,255**	24,420	**25,570**	20,389
Other liabilities	*33*	**8,200**	6,629	**6,714**	5,386
Accruals and deferred income	*34*	**3,696**	3,563	**2,326**	2,397
Post-retirement benefit liability	*44*	**2,077**	75	**–**	–
Provisions for liabilities and charges:					
Deferred tax	*35*	**1,330**	1,425	**(284)**	(194)
Other provisions for liabilities and charges	*36*	**361**	292	**59**	69
Subordinated liabilities:					
Undated loan capital	*37*	**5,499**	4,102	**5,925**	4,511
Dated loan capital	*37*	**5,055**	4,391	**4,235**	3,618
Minority interests:					
Equity		**37**	37	**–**	–
Non-equity	*38*	**694**	509	**–**	–
		731	546	**–**	–
Called-up share capital	*39*	**1,542**	1,542	**1,542**	1,542
Share premium account	*40*	**2,960**	2,960	**2,960**	2,960
Revaluation reserve	*40*	**–**	–	**2,001**	2,048
Profit and loss account	*40*	**4,583**	7,040	**4,510**	5,009
Shareholders' funds (equity)		**9,085**	11,542	**11,013**	11,559
		209,165	191,131	**178,193**	162,358
Long-term assurance liabilities to policyholders	*28*	**45,340**	46,389	**–**	–
Total liabilities		**254,505**	237,520	**178,193**	162,358
Memorandum items	*45*				
Contingent liabilities:					
Acceptances and endorsements		**1,879**	2,243	**1,880**	2,244
Guarantees and assets pledged as collateral security		**5,927**	3,789	**5,865**	3,739
Other contingent liabilities		**2,540**	1,931	**2,542**	1,890
		10,346	7,963	**10,287**	7,873
Commitments		**64,504**	53,342	**60,073**	49,731

** restated (see note 1)*

Statement of total recognised gains and losses

for the year ended 31 December 2002

	2002 £ million	2001* £ million
Profit attributable to shareholders	**1,785**	2,211
Currency translation differences on foreign currency net investments	**(3)**	(86)
Actuarial losses recognised in post-retirement benefit schemes (note 44)	**(3,299)**	(2,873)
Deferred tax thereon (note 44)	**968**	863
	(2,331)	(2,010)
Total recognised gains and losses relating to the year	**(549)**	115
Prior year adjustment at 1 January 2002 in respect of current year changes in accounting policy (note 1)	**(404)**	–
Prior year adjustment in respect of the adoption of FRS 18	**–**	248
Total gains and losses recognised during the year	**(953)**	363

** restated (see note 1)*

Historical cost profits and losses

for the year ended 31 December 2002

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 2002

	2002 £ million	2001* £ million
Profit attributable to shareholders	**1,785**	2,211
Dividends	**(1,908)**	(1,872)
(Loss) profit for the year	**(123)**	339
Currency translation differences on foreign currency net investments	**(3)**	(86)
Actuarial losses recognised in post-retirement benefit schemes	**(2,331)**	(2,010)
Net decrease in shareholders' funds	**(2,457)**	(1,757)
Shareholders' funds at beginning of year	**11,542**	11,422
Prior year adjustment at 1 January 2001 (note 1)	**–**	1,877
Shareholders' funds at end of year	**9,085**	11,542

** restated (see note 1)*

Notes to the accounts

1 Accounting policies

Accounting policies are unchanged from 2001, except that:

(i) The Group has implemented the requirements of the Urgent Issues Task Force's Abstract 33 'Obligations in capital instruments'. Following its implementation the Group has reclassified €750 million of Perpetual Capital Securities as undated loan capital and the related cost is included within interest expense. Previously these securities were included in the balance sheet as perpetual capital securities, within shareholders' funds, and the cost was treated as a deduction from profit after minority interests. The effect of this change on the Group's profit and loss account for the year ended 31 December 2002 has been to increase interest payable by £31 million (2001: £22 million); there has been no effect on attributable profit. The effect on the Group's and the Bank's balance sheets at 31 December 2002 has been to increase undated loan capital and reduce non-equity shareholders' funds by £482 million (2001: £451 million).

(ii) The Group has implemented the requirements of Financial Reporting Standard 19 ("FRS 19") 'Deferred Tax'. Following its implementation, the Group makes full provision for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation. Previously provision was only made where it was considered that there was a reasonable probability that a liability or asset would crystallise in the foreseeable future. A prior year adjustment has been made increasing Group shareholders' funds by £54 million to reflect the revised policy. The effect of this change on the Group's profit and loss account for the year ended 31 December 2002 has been to reduce the tax charge by £29 million (2001: increase the tax charge by £14 million). The effect on the Group's balance sheet at 31 December 2002 has been to reduce the deferred tax liability and increase shareholders' funds by £69 million (2001: £40 million). The effect on the Bank's balance sheet at 31 December 2002 has been to reduce the deferred tax liability and increase shareholders' funds by £95 million (2001: £84 million).

(iii) The Group has adopted fully the accounting requirements of Financial Reporting Standard 17 ("FRS 17") 'Retirement Benefits'. FRS 17 replaces Statement of Standard Accounting Practice 24 and the Urgent Issues Task Force's Abstract 6 as the accounting standard dealing with post-retirement benefits. The Group has decided to implement the requirements of FRS 17 in 2002 to coincide with the triennial full actuarial valuations of the Group's pension schemes and because of the significant impact that implementation has on the Group's reported results.

FRS 17 requires the assets of post-retirement defined benefit schemes to be included on the balance sheet together with the related liability to make benefit payments. The profit and loss account includes a charge in respect of the cost of accruing benefits for active employees, benefit improvements and the cost of severances borne by the schemes; the expected return on the schemes' assets is included within other finance income net of a charge in respect of the unwinding of the discount applied to the schemes' liabilities. It also includes a charge in respect of post-retirement healthcare obligations. Under Statement of Standard Accounting Practice 24 the profit and loss account included a charge in respect of the cost of accruing benefits for active employees offset by a credit representing the amortisation of the surplus in the Group's defined benefit pension schemes; a pension prepayment was included in the Group's balance sheet, together with a provision in respect of post-retirement healthcare obligations. A prior year adjustment has been made increasing Group shareholders' funds by £1,876 million to reflect the revised policy.

The effect of this change on the Group's profit and loss account for the year ended 31 December 2002 has been to introduce other finance income of £165 million (2001: £307 million), and to increase administrative expenses by £323 million (2001: £452 million). Profit before tax has been reduced by £158 million (2001: £145 million). The effect on the Group's balance sheet at 31 December 2002 has been to reflect a net post-retirement benefit liability of £2,077 million (2001: a net post-retirement benefit asset of £356 million and a post-retirement benefit liability of £75 million), to reduce prepayments and accrued income by £928 million (2001: £894 million), to reduce the deferred tax liability by £251 million (2001: £268 million), to reduce other provisions for liabilities and charges by £76 million (2001: £109 million) and to reduce shareholders' funds by £2,678 million (2001: £236 million). The effect of this change on the Bank's balance sheet has been to reduce prepayments and accrued income by £808 million (2001: £781 million), to

1 Accounting policies (continued)

reduce the deferred tax liability by £242 million (2001: £235 million), to reduce other provisions for liabilities and charges by £76 million (2001: £109 million), to increase other liabilities by £3 million (2001: £34 million) and to reduce shareholders' funds by £493 million (2001: £471 million).

(iv) In December 2001, the Association of British Insurers (ABI) published detailed guidance for the preparation of figures using the achieved profits method of accounting which are published as supplementary financial information accompanying the accounts of most listed insurance companies. The ABI guidance recommends the use of unsmoothed fund values to calculate the value of in-force business. To improve the comparability of the results of the Group's insurance operations with the supplementary financial information published by listed insurers the Group has changed the basis of its embedded value calculations to use unsmoothed fund values; previously the effect of investment fluctuations had been amortised to the profit and loss account over a two year period. A prior year adjustment has been made reducing shareholders' funds by £53 million, to reflect the revised policy.

The effect of this change on the Group's profit and loss account for the year ended 31 December 2002 has been to reduce income from long-term assurance business before tax by £104 million (2001: £222 million). The effect on the Group's balance sheet at 31 December 2002 has been to reduce the value of the long-term assurance business attributable to the shareholder by £281 million (2001: £208 million) and to reduce shareholders' funds by the same amount.

Comparative figures for 2001 have been restated in respect of all of the above changes.

The prior year adjustments to Group equity reserves in respect of these changes can be summarised as follows:

	Adjustment to shareholders' funds at 1 January 2001 £m	Impact on attributable profit for year ended 31 December 2001 £m	Actuarial losses recognised in post-retirement benefit schemes for year ended 31 December 2001 £m	Adjustment to shareholders' funds at 31 December 2001 £m
FRS 19 Deferred tax (ii)	54	(14)	–	40
FRS 17 Retirement benefits (iii)	1,876	(102)	(2,010)	(236)
ABI guidance (iv)	(53)	(155)	–	(208)
Total	1,877	(271)	(2,010)	(404)

a Accounting convention

The 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), shares in group undertakings (see h) 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. The Group's methodology for calculating embedded value follows the guidance published by the Association of British Insurers for the preparation of figures using the achieved profits method of accounting except that tangible assets attributable to the shareholder are valued at market value. The guidance would require those assets backing capital requirements to be discounted to reflect the cost of encumbered capital, but such a treatment would be inconsistent with the treatment of capital supporting the Group's banking operations. If this treatment had been followed income from long-term assurance business before tax in 2002 would have been slightly improved. Conversely, embedded value would have been some 8 per cent lower given the size of the shareholder capital required to be retained within Scottish Widows under the terms of the demutualisation.

Notes to the accounts

1 Accounting policies (continued)

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. Entities that do not meet the legal definition of a subsidiary but which give rise to benefits that are in substance no different to those that would arise from subsidiaries are also included in the consolidated accounts. 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 43.

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 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, excluding financing and tax, (the 'value-in-use') to the carrying value of the underlying net assets and goodwill. If the net assets and goodwill 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 2002 would be £93 million lower (2001: £94 million lower), with a corresponding reduction in reserves of £265 million (2001: £172 million); intangible assets on the balance sheet would also be £265 million lower (2001: £172 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.

1 Accounting policies (continued)

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 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, 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.

1 Accounting policies (continued)

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. 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. In rare circumstances where securities are transferred from dealing portfolios to investment portfolios or vice versa, the transfer is effected at an amount based on the market value at the date of transfer. Any resulting profit or loss is reflected in the profit and loss account.

h Shares in group undertakings

Shares in group undertakings are stated in the balance sheet of the Bank at its share of net 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.

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.

1 Accounting policies (continued)

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

Full provision is made for deferred tax liabilities arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted, or where they can be offset against deferred tax liabilities. Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

m Pensions and other post-retirement benefits

The Group operates a number of defined benefit pension and post-retirement healthcare schemes, and a number of employees are members of defined contribution pension schemes.

Full actuarial valuations of the Group's main defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries. For the purposes of these annual updates, scheme assets are included at market value and scheme liabilities are measured on an actuarial basis using the projected unit method; these liabilities are discounted at the current rate of return on a high quality corporate bond of equivalent currency and term. The post-retirement benefit surplus or deficit is included on the Group's balance sheet, net of the related amount of deferred tax. Surpluses are only included to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes. The current service cost and any past service costs are included in the profit and loss account within operating expenses and the expected return on the schemes' assets, net of the impact of the unwinding of the discount on scheme liabilities, is included within other finance income. Actuarial gains and losses, including differences between the expected and actual return on scheme assets, are recognised, net of the related deferred tax, in the statement of total recognised gains and losses.

The costs of the Group's defined contribution pension schemes are charged to the profit and loss account in the period in which they fall due.

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 are accounted for as defined contribution schemes in accordance with the requirements of Financial Reporting Standard 17. The Bank charges contributions to these schemes to its profit and loss account as and when they fall due.

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.

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

1 Accounting policies (continued)

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, in common with other UK banks with insurance subsidiaries. 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 attributable to this business.

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.

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 swaps together with interest rate swaps, forward rate agreements and options. These derivatives are accounted for in the same way as 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 evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates the risk associated with 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 2002 £m	2001* £m
Class of business:		
UK Retail Banking and Mortgages	**1,175**	1,205
Insurance and Investments		
Operating profit	**1,231**	1,421
Changes in economic assumptions	**55**	–
Investment variance	**(952)**	(859)
	334	562
Wholesale Markets and International Banking	**1,005**	1,209
Central group items	**124**	243
	2,638	3,219

Geographical area:**	Domestic 2002 £m	International 2002 £m	Total 2002 £m
Interest receivable	**8,201**	**2,323**	**10,524**
Other finance income	**165**	**–**	**165**
Fees and commissions receivable	**2,776**	**280**	**3,056**
Dealing profits (before expenses)	**125**	**63**	**188**
Income from long-term assurance business	**(314)**	**11**	**(303)**
General insurance premium income	**486**	**–**	**486**
Other operating income	**552**	**211**	**763**
Total gross income	**11,991**	**2,888**	**14,879**
Profit on ordinary activities before tax	**2,142**	**496**	**2,638**

	Domestic 2001* £m	International 2001 £m	Total 2001* £m
Interest receivable	8,945	2,414	11,359
Other finance income	307	–	307
Fees and commissions receivable	2,639	286	2,925
Dealing profits (before expenses)	138	95	233
Income from long-term assurance business	(41)	12	(29)
General insurance premium income	428	–	428
Other operating income	538	170	708
Total gross income	12,954	2,977	15,931
Profit on ordinary activities before tax	2,653	566	3,219

2 Segmental analysis (continued)

	Net assets† 2002 £m	Net assets† 2001* £m	Assets‡ 2002 £m	Assets‡ 2001* £m
Class of business:				
UK Retail Banking and Mortgages	**2,543**	2,437	**85,857**	77,982
Insurance and Investments	**6,936**	6,811	**9,161**	9,270
Wholesale Markets and International Banking	**4,925**	4,405	**110,845**	100,777
Central group items	**(5,282)**	(2,074)	**3,302**	3,102
	9,122	11,579	**209,165**	191,131
Geographical area:**				
Domestic	**7,747**	10,505	**179,449**	162,523
International	**1,375**	1,074	**29,716**	28,608
	9,122	11,579	**209,165**	191,131

*2001 figures have been restated to take account of the changes in accounting policy explained in note 1 and the re-classification of emerging markets debt earnings from Wholesale Markets and International Banking to Central group items.

**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)

	2002 £m	2001 £m
Foreign exchange trading income	**173**	158
Securities and other gains	**15**	75
	188	233

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

	2002 £m	2001* £m
Salaries and profit sharing	**2,064**	2,066
Social security costs	**134**	140
Other pension costs (note 44)	**318**	347
Staff costs	**2,516**	2,553
Other administrative expenses	**1,659**	1,616
	4,175	4,169

*restated (see note 1)

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

	2002	2001
UK	**71,134**	71,184
Overseas	**11,491**	11,768
	82,625	82,952

The above staff numbers exclude 5,870 (2001: 5,450) staff employed in the long-term assurance business. Costs of £209 million (2001: £168 million) in relation to those staff are reflected in the valuation of the long-term assurance business.

Details of directors' emoluments, pensions and interests are given in note 42.

The auditors' remuneration was £5 million (2001: £4 million), of which £1.4 million (2001: £1.2 million) related to Lloyds TSB Bank plc. Fees paid to the auditors in respect of non-audit services were £6 million (2001: £14 million). Non-audit fees comprise regulatory and other advisory work.

5 Amounts written off fixed asset investments

	2002 £m	2001 £m
Debt securities	**84**	58
Equity shares	**3**	2
	87	60

6 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).

7 Profit on ordinary activities before tax

	2002 £m	2001* £m
Profit on ordinary activities before tax is stated after taking account of:		
Income from:		
Aggregate amounts receivable, including capital repayments, in respect of assets leased to customers and banks under:		
Finance leases and hire purchase contracts	**3,290**	3,250
Operating leases	**440**	329
Profit less losses on disposal of investment securities	**160**	160
Charges:		
Rental of premises	**220**	203
Hire of equipment	**18**	18
Interest on subordinated liabilities (loan capital)	**521**	510

*restated (see note 1)

8 Tax on profit on ordinary activities

a Analysis of charge for the year

	2002 £m	2001* £m
UK corporation tax		
Current tax on profits for the year	**812**	844
Adjustments in respect of prior years	**12**	(14)
	824	830
Double taxation relief	**(129)**	(87)
	695	743
Foreign tax		
Current tax on profits for the year	**216**	179
Adjustments in respect of prior years	**(15)**	(17)
	201	162
Current tax charge	**896**	905
Deferred tax	**(107)**	45
Associated undertakings and joint ventures	**2**	1
	791	951

*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 (2001: 30 per cent).

In addition to the tax charge in the profit and loss account detailed above, £968 million (2001: £863 million) of deferred tax has been credited to the statement of total recognised gains and losses in respect of actuarial losses recognised in post-retirement benefit schemes (note 44).

Notes to the accounts

8 Tax on profit on ordinary activities (continued)

b Factors affecting the tax charge for the year

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

	2002 £m	2001* £m
Profit on ordinary activities before tax	**2,638**	3,219
Tax charge thereon at UK corporation tax rate of 30%	**791**	966
Factors affecting charge:		
Goodwill amortisation	**9**	8
Overseas tax rate differences	**24**	12
Non-allowable and non-taxable items	**(30)**	7
Gains exempted or covered by capital losses	**(23)**	(39)
Tax deductible coupons on non-equity minority interests	**(12)**	(12)
Capital allowances in excess of depreciation	**7**	(48)
Other timing differences	**100**	3
Life company rate differences	**44**	21
Other items	**(14)**	(13)
Current tax charge	**896**	905
Deferred tax – capital allowances in excess of depreciation	**(7)**	48
– other timing differences	**(100)**	(3)
Associated undertakings and joint ventures	**2**	1
Tax on profit on ordinary activities	**791**	951
Effective rate	**30.0%**	29.5%

*restated (see note 1)

c Factors that may affect the future tax charge

The current tax charge includes a credit of £46 million (2001: charge of £11 million) in respect of notional tax on the shareholder's interest in the movement in value of the long-term assurance business. Since this derives from the use of a combination of tax rates it can give rise to a higher or lower charge compared to an expected 30 per cent rate, depending upon the reported investment returns.

In December 2002 the Inland Revenue announced its intention to introduce legislation which may affect the tax treatment of certain transfers from Scottish Widows plc's long term business fund to its shareholder's fund. The precise impact of these proposals is yet to be determined, however it is possible that these transfers will be subject to a higher tax charge than was previously anticipated.

Factors that may affect the future deferred tax charge are dealt with in note 35.

9 Profit for the financial year attributable to shareholders

The profit attributable to shareholders includes a profit of £1,463 million (2001: £1,608 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)

10 Dividends

	2002 £m	2001 £m
First interim	**597**	566
Second interim	**1,311**	1,306
	1,908	1,872

11 Treasury bills and other eligible bills

	2002 Balance sheet £m	2002 Valuation £m	2001 Balance sheet £m	2001 Valuation £m
Group				
Investment securities:				
Treasury bills and similar securities	**257**	**258**	748	748
Other eligible bills	**1,622**	**1,620**	2,034	2,032
	1,879	**1,878**	2,782	2,780
Other securities:				
Treasury bills and similar securities	**530**		1,630	
	2,409		4,412	
Geographical analysis by issuer:				
United Kingdom	**1,726**		2,620	
Latin America	**567**		1,412	
Other	**116**		380	
	2,409		4,412	
Included above: Unamortised discounts net of premiums on investment securities	**5**		6	

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Total £m
At 1 January 2002	**2,777**	**5**	**2,782**
Exchange and other adjustments	**(3)**	**–**	**(3)**
Additions	**30,402**	**–**	**30,402**
Bills sold or matured	**(31,301)**	**(76)**	**(31,377)**
Amortisation of premiums and discounts	**–**	**75**	**75**
At 31 December 2002	**1,875**	**4**	**1,879**

	2002 Balance sheet £m	2002 Valuation £m	2001 Balance sheet £m	2001 Valuation £m
Bank				
Investment securities:				
Treasury bills and similar securities	**257**	**258**	748	748
Other eligible bills	**1,615**	**1,614**	2,021	2,020
	1,872	**1,872**	2,769	2,768
Other securities:				
Treasury bills and similar securities	**500**		1,318	
	2,372		4,087	
Geographical analysis by issuer:				
United Kingdom	**1,726**		2,620	
Latin America	**533**		1,350	
Other	**113**		117	
	2,372		4,087	

Notes to the accounts

11 Treasury bills and other eligible bills (continued)

	2002 Balance sheet £m	2001 Balance sheet £m
Included above:		
Unamortised discounts net of premiums on investment securities	**5**	6

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Total £m
At 1 January 2002	**2,764**	**5**	**2,769**
Additions	**30,396**	**–**	**30,396**
Bills sold or matured	**(31,292)**	**(76)**	**(31,368)**
Amortisation of premiums and discounts	**–**	**75**	**75**
At 31 December 2002	**1,868**	**4**	**1,872**

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.

It is expected that tax of £1 million (2001: £1 million) would be recoverable if the Group's investment securities were sold at their year end valuation.

12 Loans and advances to banks

	Group		Bank	
	2002 £m	2001 £m	2002 £m	2001 £m
Lending to banks	**2,212**	1,616	**50,134**	44,517
Deposits placed with banks	**15,317**	13,610	**14,030**	12,403
Total loans and advances to banks	**17,529**	15,226	**64,164**	56,920
Provisions for bad and doubtful debts	**(1)**	(2)	**(1)**	(2)
	17,528	15,224	**64,163**	56,918
Repayable on demand	**4,313**	2,443	**29,512**	21,398
Other loans and advances by residual maturity repayable:				
3 months or less	**8,511**	8,995	**10,361**	10,335
1 year or less but over 3 months	**2,624**	2,698	**8,249**	8,877
5 years or less but over 1 year	**1,700**	708	**13,800**	15,070
Over 5 years	**381**	382	**2,242**	1,240
Provisions for bad and doubtful debts	**(1)**	(2)	**(1)**	(2)
	17,528	15,224	**64,163**	56,918
Included above:				
Due from group undertakings				
– unsubordinated			**47,728**	42,763
– subordinated			**201**	151

13 Loans and advances to customers

	Group		Bank	
	2002 £m	2001 £m	2002 £m	2001 £m
Lending to customers	**124,798**	113,316	**62,236**	55,018
Hire purchase debtors	**5,990**	5,345	**–**	–
Equipment leased to customers	**7,300**	7,585	**1**	1
Total loans and advances to customers	**138,088**	126,246	**62,237**	55,019
Provisions for bad and doubtful debts	**(1,766)**	(1,466)	**(1,425)**	(1,101)
Interest held in suspense	**(57)**	(70)	**(35)**	(42)
	136,265	124,710	**60,777**	53,876
Loans and advances by residual maturity repayable:				
3 months or less	**25,721**	23,108	**30,010**	26,472
1 year or less but over 3 months	**10,357**	8,867	**6,654**	5,192
5 years or less but over 1 year	**30,651**	27,925	**14,837**	12,632
Over 5 years	**71,359**	66,346	**10,736**	10,723
Provisions for bad and doubtful debts	**(1,766)**	(1,466)	**(1,425)**	(1,101)
Interest held in suspense	**(57)**	(70)	**(35)**	(42)
	136,265	124,710	**60,777**	53,876
Of which repayable on demand or at short notice	**13,415**	11,661	**15,110**	12,735
Included above:				
Due from group undertakings				
– all unsubordinated			**18,610**	14,345
Due from fellow group undertakings				
– subordinated	**14**	15	**–**	–
– unsubordinated	**1,777**	1,760	**656**	637

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £3,752 million (2001: £3,166 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 2002 CARS 4 held £24 million (2001: £124 million) of receivables, matched by non-returnable finance of the same amount.

Notes to the accounts

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

	2002 Specific £m	2002 General £m	2001 Specific £m	2001 General £m
Group				
At 1 January	**1,099**	**369**	1,069	357
Exchange and other adjustments	**(55)**	**(3)**	(15)	1
Adjustments on acquisition	**–**	**3**	–	–
Advances written off	**(878)**	**–**	(885)	–
Recoveries of advances written off in previous years	**203**	**–**	194	–
Charge to profit and loss account:				
New and additional provisions	**1,544**	**64**	1,310	64
Releases and recoveries	**(579)**	**–**	(574)	(53)
	965	**64**	736	11
At 31 December	**1,334**	**433**	1,099	369
		1,767		1,468
In respect of:				
Loans and advances to banks		**1**		2
Loans and advances to customers		**1,766**		1,466
		1,767		1,468
Bank				
At 1 January	**801**	**302**	744	258
Exchange and other adjustments	**(33)**	**–**	(5)	–
Adjustments on acquisition	**1**	**–**	5	–
Advances written off	**(653)**	**–**	(618)	–
Recoveries of advances written off in previous years	**136**	**–**	119	–
Charge to profit and loss account:				
New and additional provisions	**1,289**	**68**	1,028	61
Releases and recoveries	**(485)**	**–**	(472)	(17)
	804	**68**	556	44
At 31 December	**1,056**	**370**	801	302
		1,426		1,103
In respect of:				
Loans and advances to banks		**1**		2
Loans and advances to customers		**1,425**		1,101
		1,426		1,103

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Non-performing lending comprises:				
Accruing loans on which interest is being placed in suspense	**752**	843	**473**	494
Loans accounted for on a non-accrual basis	**662**	379	**603**	361
	1,414	1,222	**1,076**	855
Provisions	**(992)**	(829)	**(758)**	(588)
Interest held in suspense	**(57)**	(70)	**(35)**	(42)
	365	323	**283**	225

15 Concentrations of exposure

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Loans and advances to customers:				
Domestic:				
Agriculture, forestry and fishing	**2,076**	2,074	**712**	727
Manufacturing	**3,373**	3,321	**2,862**	2,855
Construction	**1,482**	1,309	**1,358**	1,210
Transport, distribution and hotels	**4,696**	4,440	**4,052**	3,698
Property companies	**4,008**	2,907	**3,588**	2,711
Financial, business and other services	**8,352**	8,736	**6,129**	6,757
Personal: mortgages	**62,467**	56,578	**353**	562
: other	**14,931**	12,784	**14,244**	11,922
Lease financing	**7,285**	7,552	**–**	–
Hire purchase	**5,990**	5,345	**–**	–
Due from fellow group undertakings	**1,791**	1,775	**19,266**	14,982
Other	**3,397**	2,992	**3,039**	2,599
Total domestic	**119,848**	109,813	**55,603**	48,023
International:				
Latin America	**1,591**	2,347	**982**	1,572
New Zealand	**10,447**	8,435	**–**	–
Rest of the world	**6,202**	5,651	**5,652**	5,424
Total international	**18,240**	16,433	**6,634**	6,996
	138,088	126,246	**62,237**	55,019
Provisions for bad and doubtful debts*	**(1,766)**	(1,466)	**(1,425)**	(1,101)
Interest held in suspense*	**(57)**	(70)	**(35)**	(42)
	136,265	124,710	**60,777**	53,876

*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

16 Debt securities

	2002 Balance sheet £m	2002 Valuation £m	2001 Balance sheet £m	2001 Valuation £m
Group				
Investment securities:				
Government securities	**2,140**	**2,141**	2,781	2,976
Other public sector securities	**1**	**1**	–	–
Bank and building society certificates of deposit	**3,147**	**3,148**	4,670	4,677
Corporate debt securities	**1,495**	**1,496**	613	616
Mortgage backed securities	**893**	**892**	521	527
Other asset backed securities	**2,817**	**2,820**	1,193	1,198
Other debt securities	**1,369**	**1,367**	1,211	1,209
	11,862	**11,865**	10,989	11,203
Other securities:				
Government securities	**6,035**	**6,035**	4,103	4,103
Other public sector securities	**112**	**112**	151	151
Bank and building society certificates of deposit	**340**	**340**	234	234
Corporate debt securities	**7,842**	**7,842**	7,102	7,102
Mortgage backed securities	**1,838**	**1,838**	1,054	1,054
Other asset backed securities	**1,191**	**1,191**	592	592
Other debt securities	**94**	**94**	–	–
	29,314	**29,317**	24,225	24,439
Due within 1 year	**6,412**		6,745	
Due 1 year and over	**22,902**		17,480	
	29,314		24,225	
Geographical analysis by issuer:				
United Kingdom	**5,569**		5,947	
Other European	**13,254**		9,920	
North America and Caribbean	**6,077**		4,708	
Latin America	**1,231**		1,290	
Asia Pacific	**2,763**		1,921	
Other	**420**		439	
	29,314		24,225	
Unamortised discounts net of premiums on investment securities	**337**		622	
Investment securities:				
Listed	**6,102**	**6,101**	5,544	5,751
Unlisted	**5,760**	**5,764**	5,445	5,452
	11,862	**11,865**	10,989	11,203
Other securities:				
Listed	**16,034**	**16,034**	12,139	12,139
Unlisted	**1,418**	**1,418**	1,097	1,097
	17,452	**17,452**	13,236	13,236

16 Debt securities (continued)

Movements in investment securities comprise:

	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
At 1 January 2002	**10,553**	**519**	**83**	**10,989**
Exchange and other adjustments	**(479)**	**(28)**	**(4)**	**(503)**
Additions	**16,418**	**–**	**–**	**16,418**
Transfers to other securities	**(694)**	**(451)**	**(63)**	**(1,082)**
Securities sold or matured	**(13,913)**	**(61)**	**(11)**	**(13,963)**
Charge for the year	**–**	**–**	**84**	**(84)**
Amortisation of premiums and discounts	**–**	**87**	**–**	**87**
At 31 December 2002	**11,885**	**66**	**89**	**11,862**

	2002 Balance sheet £m	2002 Valuation £m	2001 Balance sheet £m	2001 Valuation £m
Bank				
Investment securities:				
Government securities	**1,448**	**1,450**	2,091	2,284
Bank and building society certificates of deposit	**2,850**	**2,851**	4,398	4,405
Corporate debt securities	**96**	**96**	92	92
Mortgage backed securities	**17**	**17**	20	20
Other asset backed securities	**598**	**608**	646	648
Other debt securities	**799**	**798**	695	693
	5,808	**5,820**	7,942	8,142
Other securities:				
Government securities	**5,624**	**5,624**	3,882	3,882
Other public sector securities	**109**	**109**	119	119
Bank and building society certificates of deposit	**27**	**27**	15	15
Corporate debt securities	**7,713**	**7,713**	7,008	7,008
Mortgage backed securities	**1,838**	**1,838**	1,054	1,054
Other asset backed securities	**1,191**	**1,191**	592	592
Other debt securities	**275**	**275**	314	314
	22,585	**22,597**	20,926	21,126
Included above:				
Due from group undertakings – all unsubordinated	**230**		314	
Due within 1 year	**5,585**		6,294	
Due 1 year and over	**17,000**		14,632	
	22,585		20,926	
Geographical analysis by issuer:				
United Kingdom	**4,343**		5,320	
Other European	**10,580**		9,438	
North America and Caribbean	**4,816**		3,328	
Latin America	**1,412**		1,525	
Asia Pacific	**1,014**		876	
Other	**420**		439	
	22,585		20,926	
Unamortised discounts net of premiums on investment securities	**332**		609	

Notes to the accounts

16 Debt securities (continued)

	2002 Balance sheet £m	2002 Valuation £m	2001 Balance sheet £m	2001 Valuation £m
Investment securities:				
Listed	**1,141**	**1,150**	3,171	3,365
Unlisted	**4,667**	**4,670**	4,771	4,777
	5,808	**5,820**	7,942	8,142
Other securities:				
Listed	**15,623**	**15,623**	11,916	11,916
Unlisted	**1,154**	**1,154**	1,068	1,068
	16,777	**16,777**	12,984	12,984

Movements in investment securities comprise:	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
At 1 January 2002	**7,499**	**487**	**44**	**7,942**
Exchange and other adjustments	**(279)**	**(27)**	**(5)**	**(301)**
Adjustments on acquisition	**7**	**–**	**–**	**7**
Additions	**12,636**	**–**	**–**	**12,636**
Transfers to other securities	**(684)**	**(451)**	**(61)**	**(1,074)**
Securities sold or matured	**(13,342)**	**(59)**	**–**	**(13,401)**
Charge for the year	**–**	**–**	**51**	**(51)**
Amortisation of premiums and discounts	**–**	**50**	**–**	**50**
At 31 December 2002	**5,837**	**–**	**29**	**5,808**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. Transfers to other securities mainly relates to the reclassification of the Group's portfolio of emerging market securities, following the decision to accelerate the disposal programme for these investments.

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.

It is expected that tax of £4 million (2001: £60 million) would be payable if the Group's investment securities were sold at their year end valuation.

17 Equity shares

	2002 Balance sheet £m	2002 Valuation £m	2001 Balance sheet £m	2001 Valuation £m
Group				
Investment securities:				
Listed	**5**	**5**	4	14
Unlisted	**33**	**62**	34	52
	38	**67**	38	66
Other securities:				
Listed	**168**		187	
	206		225	

Movements in investment securities comprise:	Cost £m	Provisions £m	Total £m
At 1 January 2002	**50**	**12**	**38**
Additions	**10**	**–**	**10**
Disposals	**(9)**	**(2)**	**(7)**
Charge for the year	**–**	**3**	**(3)**
At 31 December 2002	**51**	**13**	**38**

	2002 Balance sheet £m	2002 Valuation £m	2001 Balance sheet £m	2001 Valuation £m
Bank				
Investment securities:				
Unlisted	**16**	**19**	15	17
Other securities:				
Listed	**29**		12	
	45		27	

Movements in investment securities comprise:	Cost £m
At 1 January 2002	**15**
Additions	**5**
Disposals	**(4)**
At 31 December 2002	**16**

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.

If the Group's investment securities were sold at their year end valuation no tax is expected to be payable as any such gains would be covered by available capital losses.

Notes to the accounts

18 Assets transferred under sale and repurchase transactions

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

	Group		Bank	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Treasury bills and other eligible bills	**588**	1,036	**484**	929
Debt securities	**5,651**	4,498	**4,517**	3,180
	6,239	5,534	**5,001**	4,109

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.

19 Interests in joint ventures

	Group £m	Bank £m
At 1 January 2002	**39**	**39**
Additions	**21**	**21**
Losses for the year	**(15)**	**(15)**
At 31 December 2002	**45**	**45**

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 2002 the Group contributed a further £21 million of capital to Goldfish Holdings Limited.

In the year ended 31 December 2002 £31 million (2001: £27 million) of fees payable to iPSL have been included in the Group's administrative expenses and £6 million (2001: £6 million) of charges to iPSL have been included in the Group's income. The Group has also prepaid £6 million (2001: £8 million) of fees in respect of 2003 and this amount is included in prepayments and accrued income.

In the year ended 31 December 2002 £25 million (2001: £1 million) of interest receivable from Goldfish Bank Limited and £12 million (2001: £22 million) of charges to Goldfish Bank Limited in respect of administrative costs have been included in the Group's income. At 31 December 2002 Goldfish Bank Limited owed £430 million (2001: £611 million) to the Group, which is included in loans and advances to banks. In addition, at 31 December 2002, the Group had made facilities available for Goldfish Bank Limited to borrow a further £420 million (2001: £239 million); these facilities are included in undrawn commitments (note 45).

On a historical cost basis, the Bank's interests in associated undertakings and joint ventures would have been included at £74 million (2001: £53 million).

Included in the gross assets disclosed on the balance sheet is an investment of £8 million (2001: £5 million) in associated undertakings.

20 Shares in group undertakings

	Bank £m
At 1 January 2002	**16,944**
Additions	**2,323**
Capital repayments	**(646)**
Disposals	**(408)**
Revaluations	**(32)**
At 31 December 2002	**18,181**

	2002 £m	2001 £m
Shares in banks	**4,713**	4,518
Shares in other group undertakings	**13,468**	12,426
Total – all unlisted	**18,181**	16,944

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 2002	**14,907**	**15**	**14,892**
Additions	**2,323**	**–**	**2,323**
Capital repayments	**(646)**	**–**	**(646)**
Disposals	**(408)**	**–**	**(408)**
At 31 December 2002	**16,176**	**15**	**16,161**

No deferred tax provision has been made against the liability which could arise if group undertakings were disposed of at their balance sheet carrying value because of surplus capital losses and the exemptions for disposals of substantial shareholding investments.

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 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 that the National Bank of New Zealand Limited also operates through representative offices in the UK and Hong Kong.

Notes to the accounts

21 Quasi-subsidiaries

The Group has interests in a number of entities which, although they do not meet the legal definition of a subsidiary, give rise to benefits that are in substance no different from those that would arise if those entities were subsidiaries. As a consequence, these entities are consolidated in the same way as if they were subsidiaries.

The primary financial statements of these entities can be summarised as follows:

	Equipment leasing vehicles		Structured finance vehicles	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Profit and loss account				
Interest receivable	**–**	–	**12**	–
Interest payable	**(55)**	(41)	**(4)**	–
Other operating income	**80**	58	**–**	–
Total income	**25**	17	**8**	–
Operating expenses	**(24)**	(8)	**–**	–
Profit on ordinary activities before taxation	**1**	9	**8**	–
Tax on profit on ordinary activities	**5**	(6)	**–**	–
Retained profit	**6**	3	**8**	–
Balance sheet				
Assets				
Loans and advances to customers	**–**	–	**329**	–
Tangible fixed assets	**1,307**	911	**–**	–
Other assets and prepayments	**25**	45	**4**	–
Total assets	**1,332**	956	**333**	–
Liabilities				
Deposits by banks	**1,245**	923	**–**	–
Debt securities in issue	**–**	–	**73**	–
Other liabilities and accruals	**77**	29	**2**	–
Shareholders' funds	**10**	4	**258**	–
Total liabilities	**1,332**	956	**333**	–
Cash flow statement				
Net cash inflow (outflow) from operating activities	**422**	**391**	**(250)**	–

22 Intangible fixed assets

	Cost £m	Amortisation £m	Net book value £m
Group			
Positive goodwill			
At 1 January 2002	**2,640**	**74**	**2,566**
Exchange and other adjustments	**28**	**4**	**24**
Acquisitions (note 47)	**96**	**–**	**96**
Charge for the year	–	**59**	**(59)**
At 31 December 2002	**2,764**	**137**	**2,627**
Negative goodwill			
At 1 January 2002 and 31 December 2002	**23**	**23**	**–**

	Cost £m	Amortisation £m	Net book value £m
Bank			
Goodwill			
At 1 January 2002	**13**	**2**	**11**
Exchange and other adjustments	**(2)**	**–**	**(2)**
Charge for the year	**–**	**1**	**(1)**
At 31 December 2002	**11**	**3**	**8**

23 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m
Group			
Cost:			
At 1 January 2002	**1,074**	**2,270**	**1,771**
Exchange and other adjustments	**(1)**	**(7)**	**(3)**
Adjustments on acquisition	**31**	**1**	**351**
Additions	**174**	**260**	**881**
Disposals	**(82)**	**(210)**	**(428)**
At 31 December 2002	**1,196**	**2,314**	**2,572**
Depreciation:			
At 1 January 2002	**334**	**1,278**	**138**
Exchange and other adjustments	**(2)**	**1**	**–**
Charge for the year	**64**	**286**	**292**
Disposals	**(19)**	**(170)**	**(215)**
At 31 December 2002	**377**	**1,395**	**215**
Balance sheet amount at 31 December 2002	**819**	**919**	**2,357**
		4,095	
Balance sheet amount at 31 December 2001	740	992	1,633
		3,365	

	Premises £m	Equipment £m
Bank		
Cost:		
At 1 January 2002	**817**	**1,802**
Exchange and other adjustments	**(1)**	**(3)**
Adjustments on acquisition	**–**	**1**
Additions	**84**	**215**
Disposals	**(69)**	**(178)**
At 31 December 2002	**831**	**1,837**
Depreciation:		
At 1 January 2002	**302**	**1,013**
Exchange and other adjustments	**–**	**6**
Charge for the year	**55**	**220**
Disposals	**(17)**	**(148)**
At 31 December 2002	**340**	**1,091**
Balance sheet amount at 31 December 2002	**491**	**746**
	1,237	
Balance sheet amount at 31 December 2001	515	789
	1,304	

23 Tangible fixed assets (continued)

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Balance sheet amount of premises comprises:				
Freeholds	**414**	436	**225**	249
Leaseholds 50 years and over unexpired	**132**	36	**19**	17
Leaseholds less than 50 years unexpired	**273**	268	**247**	249
	819	740	**491**	515
Land and buildings occupied for own activities	**749**	664	**435**	456

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:	2002 £m	2001 £m
1 year or less	**272**	156
2 years or less but over 1 year	**173**	119
5 years or less but over 2 years	**542**	388
Over 5 years	**617**	482
Total exposure	**1,604**	1,145

24 Lease commitments

Annual commitments under non-cancellable operating leases were:

	2002 Premises £m	2002 Equipment £m	2001 Premises £m	2001 Equipment £m
Group				
Leases on which the commitment is due to expire in:				
1 year or less	**10**	**2**	7	5
5 years or less but over 1 year	**29**	**1**	33	3
Over 5 years	**188**	**–**	181	–
	227	**3**	221	8
Bank				
Leases on which the commitment is due to expire in:				
1 year or less	**7**	**2**	4	5
5 years or less but over 1 year	**16**	**1**	26	3
Over 5 years	**158**	**–**	156	–
	181	**3**	186	8

Obligations under finance leases for the Group were:	2002 Equipment £m	2001 Equipment £m
Amounts payable in 1 year or less	**1**	3

25 Capital commitments

Capital expenditure contracted but not provided for at 31 December 2002 amounted to £117 million for the Group and £9 million for the Bank (2001: Group £137 million; Bank £10 million). Of the capital commitments of the Group, £107 million (2001: £125 million) relates to assets to be leased to customers under operating leases.

26 Other assets

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Balances arising from derivatives used for trading purposes (note 46a)	**3,428**	2,090	**3,563**	2,284
Balances arising from derivatives used for hedging purposes	**778**	931	**237**	384
Settlement balances	**76**	570	**11**	526
Other assets	**954**	850	**480**	403
	5,236	4,441	**4,291**	3,597

27 Prepayments and accrued income

	Group 2002 £m	Group 2001* £m	Bank 2002 £m	Bank 2001* £m
Interest receivable	**931**	843	**1,283**	1,172
Deferred expenditure incurred under cash gift and discount mortgage schemes	**201**	256	**–**	–
Other debtors and prepayments	**1,183**	1,199	**493**	750
	2,315	2,298	**1,776**	1,922

*restated (see note 1).

Notes to the accounts

28 Long-term assurance business

a Methodology

For the purposes of the Group's consolidated accounts, the value of the shareholder's interest in the long-term assurance business is calculated on an embedded value basis. 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 attributable to this business.

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:

	2002 £m	2001* £m
Net tangible assets of life companies including surplus	**3,324**	3,628
Value of other shareholder's interests in the long-term assurance business	**2,904**	2,738
	6,228	6,366

Movements in the embedded value balance have been as follows:

	2002 £m	2001* £m
At 1 January – as previously reported	**6,366**	6,549
Prior year adjustment (note 1)	–	(53)
At 1 January – restated	**6,366**	6,496
Exchange and other adjustments	**(14)**	(35)
Loss after tax	**(257)**	(40)
Capital injections	**140**	100
Dividends	**(7)**	(155)
At 31 December	**6,228**	6,366

*restated (see note 1)

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;
- The effects of changes in assumptions, other than economic assumptions, and other items;
- Pension provisions (see d); and
- Endowment provision (see e).

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 costs of acquiring new business during the year and includes commissions paid to independent financial advisors and other direct sales costs.

Operating profit is adjusted by the following items to arrive at income from long-term assurance business:

Investment variance: 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; (b) the effect of these fluctuations on the value of in-force business; and (c) other effects of changes in extraneous economic circumstances beyond the control of management.

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

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

	2002 £m	2001* £m
New business contribution	**413**	374
Contribution from existing business		
– expected return	**312**	348
– experience variances	**(1)**	37
– changes in assumptions and other items	**78**	95
– pension provisions (see d)	**(40)**	(70)
– endowment provision (see e)	**(165)**	–
Investment earnings	**214**	247
Distribution costs	**(277)**	(247)
Operating profit	**534**	784
Investment variance	**(892)**	(813)
Changes in economic assumptions (see g)	**55**	–
Income from long-term assurance business before tax	**(303)**	(29)
Attributed tax	**46**	(11)
Income from long-term assurance business after tax	**(257)**	(40)

*restated (see note 1)

d Pension provisions

During the early 1990s, there was increasing concern 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 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 this 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 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.

28 Long-term assurance business (continued)

d Pension provisions (continued)

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

	2002 £m	2001 £m
At 1 January	**203**	352
Accrual of interest on the provision	**17**	20
Charge for the year	**40**	70
Compensation paid	**(223)**	(238)
Guarantees*	**–**	(1)
At 31 December	**37**	203

*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.

A review of the adequacy of the provision was carried out as at 31 December 2001. Lower stockmarket levels had had a significant impact on total redress costs as the cost of restitution into company pension schemes rose as personal pension fund values reduced. As a result of this and the fact that there was greater certainty as to the number and size of compensation claims to be paid, an additional provision of £70 million was made in the Group's results for the year ended 31 December 2001.

The adequacy of the provision has again been reviewed at 31 December 2002, in the light of final experience as to the amount of compensation to be paid. Lower stockmarket levels have increased the final cost of redress and a further provision of £40 million has been made in the year ended 31 December 2002.

e Endowment provision

In common with a number of companies in the life assurance industry, Abbey Life Assurance Company Limited ('Abbey Life'), one of the Group's life assurance subsidiaries, has been carrying out a review of the past sales of certain endowment based and long-term savings products made, primarily in the late 1980s and early 1990s, by the Abbey Life sales force prior to its disposal by the Group in February 2000. The Group has assessed the likely implications for redress to policyholders and as a result a provision of £165 million has been raised.

f 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 were 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 2002 of approximately £1.5 billion (2001: £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 costs 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 Funds.

28 Long-term assurance business (continued)

f Guaranteed annuity options (continued)

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. The cost of enhanced benefits, currently estimated to be approximately £1.1 billion (2001: £1.4 billion) on a net present value basis, 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.

g Assumptions

Following the publication, in December 2001, of the Association of British Insurers' detailed guidance for the preparation of figures using the achieved profits method of accounting, the Group has reviewed the way in which economic assumptions are set for the purposes of embedded value calculations. The guidance requires that the assumptions should be reviewed at each reporting date. In order to comply with this guidance, and achieve greater comparability with other major insurers, the Group has adopted this approach.

The principal economic assumptions have been revised at 31 December 2002 as follows:

	2002 %	2001 %
Risk-adjusted discount rate (net of tax)	**7.35**	8.50
Return on equities (gross of tax)	**7.10**	8.00
Return on fixed interest securities (gross of tax)	**4.50**	5.25
Expenses inflation	**3.30**	3.00

The revised assumptions have resulted in a net credit to the profit and loss account of £55 million.

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 per cent (2001: 30 per cent). The normalised investment earnings have been grossed up at a composite longer term tax rate of 17 per cent (2001: 17 per cent).
- 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.

h Sensitivities

The table below shows the effect on both the embedded value at 31 December 2002 and the new business contribution for the year then ended of theoretical changes in the main economic assumptions:

	Embedded value £m	New business contribution £m
As published	**6,228**	**413**
Effect of a 1% increase in the discount rate	**(152)**	**(27)**
Effect of a 1% reduction in the discount rate	**166**	**32**
Effect of a 1% reduction in the return on equities	**(70)**	**(12)**

Notes to the accounts

28 Long-term assurance business (continued)

i Balance sheet

The long-term assurance assets attributable to policyholders comprise:

	2002 £m	2001* £m
Investments	**47,151**	47,910
Premises and equipment	**45**	16
Other assets	**1,468**	2,091
	48,664	50,017
Net tangible assets of life companies including surplus	**(3,324)**	(3,628)
	45,340	46,389

	2002 £m	2001* £m
Investments shown above comprise:		
Fixed interest securities	**14,779**	12,642
Stocks, shares and unit trusts	**24,143**	27,018
Investment properties	**3,623**	3,722
Other properties	**121**	121
Mortgages and loans	**53**	102
Deposits	**4,432**	4,305
	47,151	47,910

	2002 £m	2001* £m
The liabilities to policyholders comprise:		
Technical provisions:		
Long-term business provision (net of reinsurance)	**23,217**	24,129
Claims outstanding (net of reinsurance)	**225**	211
Technical provisions for linked liabilities	**20,996**	21,098
Fund for future appropriations	**12**	75
Other liabilities	**890**	876
	45,340	46,389

*restated (see note 1)

j Disclosures on a modified statutory solvency basis

The individual statutory accounts of the Group's life assurance subsidiaries are prepared under the modified statutory solvency basis, in the same way as the statutory accounts of listed insurance groups in the UK. The principal difference between the modified statutory solvency basis and the embedded value basis used for the preparation of the Group's accounts is that accounts prepared under the modified statutory solvency basis do not reflect the value of in-force business.

Under the modified statutory solvency basis, the results of the Group's long-term life and pensions businesses were as follows:

	2002 £m	2001 £m
Premiums	**5,524**	4,854
Investment income	**1,942**	1,832
Other income	**33**	93
	7,499	6,779
Claims	**(5,031)**	(4,957)
Change in technical provisions	**3,877**	2,759
Expenses	**(720)**	(625)
Realised losses on investments	**(1,790)**	(1,031)
Unrealised losses on investments	**(4,445)**	(4,423)
Other charges	**(3)**	(8)
Tax attributable to long-term business	**200**	280
Transfer from the fund for future appropriations	**63**	1,365
Balance on the technical account – long-term business	**(350)**	139
Tax credit attributable to balance on the technical account – long-term business	**(190)**	(103)
Income in shareholder fund	**35**	38
Expenses in shareholder fund	**(1)**	–
(Loss) profit on ordinary activities before tax	**(506)**	74
Tax on (loss) profit on ordinary activities	**179**	94
(Loss) profit for the financial year	**(327)**	168

28 Long-term assurance business (continued)

j Disclosures on a modified statutory solvency basis (continued)

Income from long-term assurance business after tax reconciles to the loss calculated on a modified statutory solvency basis as follows:

	2002 £m	2001 £m
Income from long-term assurance business attributable to the shareholder after tax	**(257)**	(40)
(Increase) decrease in value-in-force	**(166)**	111
	(423)	71
Other differences:		
– movement in deferred acquisition costs	**45**	(79)
– tax adjustment	**55**	150
– other	**(4)**	26
(Loss) profit for the financial year – modified statutory solvency basis	**(327)**	168

A summarised balance sheet on a modified statutory solvency basis was as follows:

	2002 £m	2001 £m
Assets		
Investments	**26,555**	27,204
Assets held to cover linked liabilities	**20,996**	21,098
Other assets	**1,718**	2,210
Total assets	**49,269**	50,512
Liabilities		
Shareholder's funds	**3,929**	4,123
Fund for future appropriations	**12**	75
Long-term business provision†	**23,217**	24,129
Technical provision for linked liabilities†	**20,996**	21,098
Other creditors	**1,115**	1,087
Total liabilities	**49,269**	50,512

†Net of reinsurers' share of technical provisions

The value of long-term business atrributable to the shareholder on an embedded value basis reconciles to the net assets of the Group's life and pensions subsidiaries calculated on a modified statutory solvency basis as follows:

	2002 £m	2001 £m
Long-term assurance business attributable to the shareholder – embedded value basis	**6,228**	6,366
Value of in-force business	**(2,904)**	(2,738)
	3,324	3,628
Other differences:		
– deferred acquisition costs	**430**	385
– tax adjustment	**205**	150
– other adjustments	**(30)**	(40)
Net tangible assets of life operations – modified statutory solvency basis	**3,929**	4,123

Notes to the accounts

29 Assets and liabilities denominated in foreign currencies

	Group 2002 £m	Group 2001* £m	Bank 2002 £m	Bank 2001* £m
Assets: denominated in sterling	**144,408**	134,539	**126,497**	116,239
: denominated in other currencies	**64,757**	56,592	**51,696**	46,119
	209,165	191,131	**178,193**	162,358
Liabilities: denominated in sterling	**144,388**	134,642	**126,537**	116,324
: denominated in other currencies	**64,777**	56,489	**51,656**	46,034
	209,165	191,131	**178,193**	162,358

*restated (see note 1)

Assets and liabilities exclude long-term assurance assets attributable to policyholders and liabilities to policyholders.

30 Deposits by banks

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Repayable on demand	**8,500**	6,634	**12,847**	10,984
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	**14,692**	14,227	**16,796**	17,024
1 year or less but over 3 months	**1,634**	2,529	**2,066**	2,960
5 years or less but over 1 year	**487**	751	**997**	988
Over 5 years	**130**	169	**162**	126
	25,443	24,310	**32,868**	32,082
Included above:				
Due to group undertakings			**8,734**	9,090

31 Customer accounts

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Repayable on demand	**88,242**	80,811	**64,612**	59,715
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	**19,047**	19,913	**14,368**	15,181
1 year or less but over 3 months	**3,099**	2,888	**1,666**	1,971
5 years or less but over 1 year	**4,140**	3,369	**5,668**	3,088
Over 5 years	**2,130**	2,321	**2,754**	2,136
	116,658	109,302	**89,068**	82,091
Included above:				
Due to group undertakings			**9,796**	7,768
Due to fellow group undertakings	**324**	186	**252**	104

32 Debt securities in issue

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Bonds and medium-term notes by residual maturity repayable:				
1 year or less	**437**	589	**346**	415
2 years or less but over 1 year	**443**	178	**380**	88
5 years or less but over 2 years	**746**	405	**616**	375
Over 5 years	**1,659**	928	**1,022**	118
	3,285	2,100	**2,364**	996
Other debt securities by residual maturity repayable:				
3 months or less	**19,525**	17,070	**17,259**	15,093
1 year or less but over 3 months	**7,174**	4,931	**5,883**	4,213
5 years or less but over 1 year	**30**	104	**25**	79
Over 5 years	**241**	215	**39**	8
	26,970	22,320	**23,206**	19,393
	30,255	24,420	**25,570**	20,389
Included above:				
Due to group undertakings			**24**	6

33 Other liabilities

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Balances arising from derivatives used for trading purposes (note 46a)	**4,659**	2,360	**4,466**	2,547
Balances arising from derivatives used for hedging purposes	**414**	404	**–**	–
Current tax	**474**	594	**136**	225
Dividends	**1,311**	1,306	**1,311**	1,306
Settlement balances	**49**	542	**4**	501
Other liabilities	**1,293**	1,423	**797**	807
	8,200	6,629	**6,714**	5,386

34 Accruals and deferred income

	Group 2002 £m	Group 2001 £m	Bank 2002 £m	Bank 2001 £m
Interest payable	**1,335**	1,291	**1,276**	1,203
Other creditors and accruals	**2,361**	2,272	**1,050**	1,194
	3,696	3,563	**2,326**	2,397

Notes to the accounts

35 Deferred tax

	Group 2002 £m	Group 2001* £m	Bank 2002 £m	Bank 2001* £m
Short-term timing differences	**(340)**	(257)	**(256)**	(203)
Accelerated depreciation allowances	**1,670**	1,682	**(28)**	9
	1,330	1,425	**(284)**	(194)

	Group £m	Bank £m
At 1 January 2002 – as previously reported	**1,733**	**125**
Prior year adjustment (note 1)	**(308)**	**(319)**
At 1 January 2002 – restated	**1,425**	**(194)**
Exchange and other adjustments	**25**	**(26)**
Adjustments on acquisition	**(13)**	**–**
Tax provided	**(107)**	**(64)**
At 31 December 2002	**1,330**	**(284)**

*restated (see note 1)

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into. Deferred tax balances have not been discounted.

The deferred tax balance at 31 December 2002 for the Group does not include any amounts in respect of the Group's post-retirement benefit liability which is shown on the balance sheet after deduction of a deferred tax asset of £854 million (2001: a net post-retirement benefit asset of £281 million after deduction of a deferred tax liability of £152 million) (note 44).

36 Other provisions for liabilities and charges

	Pension obligations £m	Insurance provisions £m	Post-retirement healthcare £m	Vacant leasehold property and other £m	Total £m
Group					
At 1 January 2002 – as previously reported	**34**	**204**	**75**	**88**	**401**
Prior year adjustment (note 1)	**(34)**	**–**	**(75)**	**–**	**(109)**
At 1 January 2002 – restated	**–**	**204**	**–**	**88**	**292**
Exchange and other adjustments	**–**	**(2)**	**–**	**–**	**(2)**
Provisions applied	**–**	**(210)**	**–**	**(40)**	**(250)**
Charge for the year	**–**	**233**	**–**	**88**	**321**
At 31 December 2002	**–**	**225**	**–**	**136**	**361**
Bank					
At 1 January 2002 – as previously reported	**34**	**–**	**75**	**69**	**178**
Prior year adjustment (note 1)	**(34)**	**–**	**(75)**	**–**	**(109)**
At 1 January 2002 – restated	**–**	**–**	**–**	**69**	**69**
Exchange and other adjustments	**–**	**–**	**–**	**(2)**	**(2)**
Provisions applied	**–**	**–**	**–**	**(33)**	**(33)**
Charge for the year	**–**	**–**	**–**	**25**	**25**
At 31 December 2002	**–**	**–**	**–**	**59**	**59**

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.

The Group also carries provisions in respect of its obligations relating to UIC Insurance Company Limited ("UIC"), which is partly owned by the Group. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a re-insurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate exposure to claims in respect of the insurance business of UIC is uncertain. Accordingly, the provision has been based upon an actuarial estimate of prospective claims, taking account of re-insurance arrangements protecting UIC and UIC's available assets. Given the long-term nature of many of the claims to which UIC is exposed, it is expected to be many years before the Group's ultimate liability can be assessed with certainty.

Vacant leasehold property and other

Vacant leasehold property provisions are made by reference to a prudent estimate of expected sub-let income and the possibility of disposing of the Group's interest in the lease, taking into account conditions in the property market. These provisions are reassessed on an annual basis and will normally run off over the remaining life of the leases concerned, currently averaging five years; where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

37 Subordinated liabilities

	Notes	Group 2002 £m	Group 2001* £m	Bank 2002 £m	Bank 2001* £m
***Undated loan capital:*					
Primary Capital Undated Floating Rate Notes:	a				
Series 1 (US$750 million)		**466**	516	**466**	516
Series 2 (US$500 million)		**311**	344	**311**	344
Series 3 (US$600 million)		**373**	412	**373**	412
11¾% Perpetual Subordinated Bonds		**100**	100	**–**	–
6.625% Perpetual Capital Securities (€750 million)	b	**482**	451	**482**	451
6.90% Perpetual Capital Securities callable 2007 (US$1,000 million)	c, j	**610**	–	**610**	–
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	g	**807**	757	**807**	757
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a	**97**	91	**97**	91
6⅝% Undated Subordinated Step-up Notes callable 2010	e	**406**	406	**406**	406
7.375% Undated Subordinated Step-up Notes callable 2012 (€430 million)		**–**	–	**278**	261
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	d, g, j	**322**	–	**322**	–
7.834% Undated Subordinated Step-up Notes callable 2015		**–**	–	**248**	248
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	h	**104**	105	**104**	105
6½% Undated Subordinated Step-up Notes callable 2019	e	**267**	266	**267**	266
8% Undated Subordinated Step-up Notes callable 2023	e	**199**	199	**199**	199
6½% Undated Subordinated Step-up Notes callable 2029	e	**455**	455	**455**	455
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032	e, j	**500**	–	**500**	–
		5,499	4,102	**5,925**	4,511
Dated loan capital:					
Eurocurrency Zero Coupon Bonds 2003 (¥3 billion)		**14**	15	**–**	–
Subordinated Fixed Rate Bonds 2003 (NZ$151 million)	f	**48**	43	**–**	–
Subordinated Floating Rate Notes 2004	a	**10**	15	**–**	–
7⅜% Subordinated Bonds 2004		**400**	399	**400**	399
Subordinated Floating Rate Notes 2004	a, i	**100**	100	**100**	100
Subordinated Floating Rate Notes 2007		**200**	200	**–**	–
7¾% Subordinated Bonds 2007		**299**	299	**299**	299
Subordinated Fixed Rate Bonds 2007 (NZ$150 million)	f	**–**	43	**–**	–
Subordinated Floating Rate Notes 2008		**150**	150	**–**	–
5¼% Subordinated Notes 2008 (DM750 million)		**249**	234	**249**	234
10⅝% Guaranteed Subordinated Loan Stock 2008		**110**	112	**110**	112
9½% Subordinated Bonds 2009		**99**	99	**99**	99
Subordinated Step-up Floating Rate Notes 2009 callable 2004 (US$500 million)	a	**310**	343	**310**	343
Subordinated Fixed Rate Bonds 2010 (NZ$100 million)	f	**33**	29	**–**	–
6¼% Subordinated Notes 2010 (€400 million)		**259**	244	**259**	244
Subordinated Floating Rate Notes 2010 (US$400 million)	a	**248**	274	**248**	274
12% Guaranteed Subordinated Bonds 2011		**118**	121	**118**	121
4¾% Subordinated Notes 2011 (€850 million)		**532**	498	**532**	498
Subordinated Floating Rate Notes 2011		**150**	150	**–**	–
Subordinated Fixed Rate Bonds 2011 (NZ$100 million)	f	**33**	28	**–**	–
Subordinated Floating Rate Notes 2011		**100**	100	**–**	–
Subordinated Fixed Rate Bonds 2012 (NZ$125 million)	f, j	**41**	–	**–**	–
Subordinated Fixed Rate Bonds 2012 (NZ$125 million)	f, j	**41**	–	**–**	–
Subordinated Floating Rate Notes 2014	j	**464**	–	**464**	–
5⅞% Subordinated Notes 2014	j	**148**	–	**148**	–
6⅝% Subordinated Notes 2015		**344**	343	**344**	343
Subordinated Floating Rate Notes 2020 (€100 million)	a	**65**	61	**65**	61
9⅝% Subordinated Bonds 2023		**340**	341	**340**	341
Subordinated Non-Interest Bearing Loan on rolling 6 year notice		**150**	150	**150**	150
		5,055	4,391	**4,235**	3,618
Total subordinated liabilities		**10,554**	8,493	**10,160**	8,129

*restated (see note 1)

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.

a) These notes bear interest at rates fixed periodically in advance based on London interbank rates.

b) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until any deferred payments have been made. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 25 October 2006.

c) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until payments are resumed. Any deferred payments will be made good on redemption of the securities. 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 22 November 2007.

d) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until any deferred payments have been made. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 25 February 2013.

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

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

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

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

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

j) Issued during 2002 primarily to finance the general business of the Group.

37 Subordinated liabilities (continued)
Dated subordinated liabilities are repayable as follows:

	Group		Bank	
	2002 £m	2001 £m	**2002 £m**	2001 £m
1 year or less	**67**	5	**–**	–
2 years or less but over 1 year	**505**	63	**500**	–
5 years or less but over 2 years	**499**	654	**299**	499
Over 5 years	**3,984**	3,669	**3,436**	3,119
	5,055	4,391	**4,235**	3,618

38 Non-equity minority interests
Non-equity minority interests comprise:

	2002 £m	2001 £m
Euro Step-up Non-Voting Non-Cumulative Preferred Securities (€430 million) callable 2012*	**278**	261
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015†	**248**	248
Capital instruments	**526**	509
European Financial Institution Investments Partnership•	**123**	–
LM ABS Investment Partnership¤	**45**	–
	694	509

*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 these 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.

•These securities constitute interests in European Financial Institution Investments Partnership, an English law general partnership in which the principal partner is Langbourn Holdings Limited, a wholly owned subsidiary of the Group. The minority interests are entitled to 90 per cent of the partnership's profits. In the event of a winding-up, at least 90 per cent of the capital of the partnership would be returned to Langbourn Holdings Limited.

¤These securities constitute interests in LM ABS Investment Partnership, an English law general partnership in which the principal partner is Lime Street Holdings Limited, a wholly owned subsidiary of the Group. The minority interests are entitled to 95 per cent of the partnership's profits. In the event of a winding-up, at least 85 per cent of the capital of the partnership would be returned to Lime Street Holdings Limited.

39 Called-up share capital

	2002 £m	2001 £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, 25 Gresham Street, London EC2V 7HN.

40 Reserves

	Group £m	Bank £m
Share premium account:		
At 1 January and 31 December 2002	**2,960**	**2,960**
Revaluation reserve:		
At 1 January 2002		**2,048**
Decrease in net tangible assets of subsidiary undertakings and joint ventures		**(47)**
At 31 December 2002		**2,001**
Profit and loss account:		
At 1 January 2002 – as previously reported	**7,444**	**5,396**
Prior year adjustment (note 1)	**(404)**	**(387)**
At 1 January 2002 – restated	**7,040**	**5,009**
Exchange and other adjustments	**(3)**	**(54)**
Actuarial losses recognised in post-retirement benefit schemes (note 44)	**(2,331)**	**–**
Loss for the year	**(123)**	**(445)**
At 31 December 2002	**4,583**	**4,510**

The Group profit and loss account reserves at 31 December 2002 include £232 million (2001: £144 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 Group profit and loss account reserves at 31 December 2002 are stated after including a deficit of £2,077 million relating to the Group's post-retirement defined benefit schemes (2001: surplus of £281 million).

The cumulative amount of premiums on acquisitions written off against Group profit and loss account reserves during previous years amounts to £966 million of which £887 million was within the last 10 years.

41 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.

Notes to the accounts

42 Directors' emoluments

The aggregate of the emoluments of the directors was £5,864,000 (2001: £5,749,000).

The aggregate of the amount of the gains made by directors on the exercise of Lloyds TSB Group plc share options was £9,000 (2001: £1,793,000).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were 0 and 9 respectively (2001: 0 and 8).

The total for the highest paid director (Mr Daniels), was £1,263,000. The amount of his accrued pension at the year end was £31,250, being his pension entitlement based on pensionable service with the Group to 31 December 2002 but payable at normal retirement age. (The total for the highest paid director in 2001 (Mr Fairey), was £882,000).

43 Related party transactions

a Transactions, arrangements and agreements involving directors and others

At 31 December 2002, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	2002 Number of persons	**2002 Total £000**	2001 Number of persons	2001 Total £000
Loans and credit card transactions:				
Directors and connected persons	**4**	**3,334**	7	1,343
Officers	**31**	**3,930**	28	4,113

During the year three officers purchased cars from the Group for a total consideration of £37,000.

b Group undertakings

Details of the principal group undertakings are given in note 20. In accordance with FRS 8, transactions or balances with group entities that have been eliminated on consolidation are not reported.

c Joint ventures

Details of the Group's joint ventures are provided in note 19. Information relating to transactions entered into between Group undertakings and the joint ventures and details of outstanding balances at 31 December 2002 are also shown in note 19.

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 2002 Group entities owed £1,372 million (2001: £1,186 million) and were owed £145 million (2001: £299 million); these amounts are included in customer accounts and loans and advances to customers respectively. In addition, fees of £76 million (2001: £62 million) were received, and fees of £35 million (2001: £28 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 2002 Scottish Widows paid rent to the long-term assurance funds amounting to £5 million (2001: £4 million). In addition, at 31 December 2002, the long-term assurance funds owned 31 million ordinary shares in the Bank's parent company Lloyds TSB Group plc (2001: 31 million shares).

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 2002, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £89 million (2001: £572 million).

44 Pensions and other post-retirement benefits

a The Group accounts

The pension costs included in administrative expenses are comprised as follows:

	2002 £m	2001 £m
Defined contribution schemes	**25**	18
Defined benefit schemes	**293**	329
	318	347

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 years ended 31 December 2001 and 2002, 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 latest full valuations of the schemes were carried out as at 30 June 2002; these have been updated to 31 December 2002 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 2002 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 the scheme valuations were as follows:

	31 December 2002 %	31 December 2001 %
Rate of inflation	**2.30**	2.50
Rate of salary increases	**3.83**	4.04
Rate of increase for pensions in payment and deferred pensions	**2.30**	2.50
Discount rate	**5.60**	6.00

In addition, the Group operates a number of schemes which provide post-retirement healthcare benefits to certain employees, retired employees and their dependent relatives. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their 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.

Included within other finance income is an interest cost of £4 million (2001: £3 million) in respect of these defined benefit post-retirement healthcare schemes.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000; this valuation has been updated to 31 December 2002 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 4.86 per cent.

Notes to the accounts

44 Pensions and other post-retirement benefits (continued)
a The Group accounts (continued)

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

	Fair value at 31 December 2002 £m	**Expected long-term rate of return at 31 December 2002 %**	Fair value at 31 December 2001 £m	Expected long-term rate of return at 31 December 2001 %
Market values of scheme assets:				
Equities	**7,175**	**8.4**	7,779	8.0
Fixed interest securities	**557**	**4.5**	1,835	5.1
Property	**791**	**6.9**	798	7.1
Other	**560**	**5.4**	714	4.1
Total fair value of scheme assets	**9,083**		11,126	

Other finance income is comprised of:

	2002 £m	2001 £m
Expected return on scheme assets	**817**	844
Interest cost of scheme liabilities	**(652)**	(537)
	165	307

The pension and other post-retirement benefit cost in respect of defined benefit schemes is comprised of:

	2002 £m	2001 £m
Current service cost	**244**	212
Past service costs	**49**	117
Defined benefit costs	**293**	329

The amounts recognised in the statement of total recognised gains and losses are comprised of:

	2002 £m	2001 £m
Actual return less expected return on scheme assets	**(2,582)**	(2,015)
Experience gains and losses arising on scheme liabilities	**(240)**	(71)
Effect of changes in demographic and financial assumptions	**(477)**	(787)
Actuarial losses recognised	**(3,299)**	(2,873)
Deferred tax thereon	**968**	863
Amount recognised in the statement of total recognised gains and losses	**(2,331)**	(2,010)

The experience gains and losses recognised can also be interpreted as follows:

	2002 £m	2001 £m
Actual return less expected return on scheme assets		
Amount	**(2,582)**	(2,015)
Percentage of scheme assets at balance sheet date	**28.4%**	18.1%
Experience gains and losses arising on scheme liabilities		
Amount	**(240)**	(71)
Percentage of scheme liabilities at balance sheet date	**2.0%**	0.7%
Total amount recognised in the statement of total recognised gains and losses		
Amount	**(3,299)**	(2,873)
Percentage of scheme liabilities at balance sheet date	**27.5%**	26.9%

44 Pensions and other post-retirement benefits (continued)
a The Group accounts (continued)

The amounts reported on the Group's balance sheet are comprised of:

	2002 £m	2001 £m
Market value of assets	**9,083**	11,126
Present value of scheme liabilities	**(12,014)**	(10,693)
(Deficit) surplus in the schemes	**(2,931)**	433
Related deferred tax asset (liability)	**854**	(152)
Net post-retirement benefit (liability) asset	**(2,077)**	281
Disclosed in the accounts as follows:		
Post-retirement benefit asset	**–**	356
Post-retirement benefit liability	**(2,077)**	(75)
	(2,077)	281

The movements in the (deficit) surplus in the schemes over the year have been as follows:

	2002 £m	2001 £m
Surplus at beginning of year	**433**	3,325
Exchange and other adjustments	**26**	–
Other finance income	**165**	307
Current service costs	**(244)**	(212)
Contributions	**37**	3
Past service costs	**(49)**	(117)
Actuarial loss	**(3,299)**	(2,873)
(Deficit) surplus at end of year	**(2,931)**	433

b The Bank accounts

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 the Bank, these schemes are accounted for as defined contribution schemes.

45 Contingent liabilities and commitments

a Contingent liabilities and commitments arising out of banking transactions

	Group		Bank	
	2002 £m	2001 £m	**2002 £m**	2001 £m
Contingent liabilities:				
Acceptances and endorsements	**1,879**	2,243	**1,880**	2,244
Guarantees	**5,927**	3,789	**5,865**	3,739
Other:				
Other items serving as direct credit substitutes	**1,103**	460	**1,103**	441
Performance bonds and other transaction-related contingencies	**1,436**	1,469	**1,438**	1,447
Other contingent liabilities	**1**	2	**1**	2
	2,540	1,931	**2,542**	1,890
	10,346	7,963	**10,287**	7,873
Commitments:				
Documentary credits and other short-term trade-related transactions	**289**	354	**372**	362
Forward asset purchases and forward forward deposits placed	**394**	783	**553**	764
Undrawn note issuing and revolving underwriting facilities	**32**	35	**–**	–
Undrawn formal standby facilities, credit lines and other commitments to lend:				
Less than 1 year maturity	**49,417**	42,594	**45,876**	39,743
1 year or over maturity	**14,372**	9,576	**13,272**	8,862
	64,504	53,342	**60,073**	49,731
Incurred on behalf of group undertakings:				
Contingent liabilities			**80**	78
Commitments			**431**	250
			511	328

b Contingent liabilities arising out of past sales of savings and investment products

In common with other companies providing savings and investment products to retail consumers, matters arise from time to time as a result of customer complaints or investigations by the regulator requiring remedial action to be taken, which may include the payment of compensation.

One such matter relates to the sale of life assurance products related to the repayment of residential mortgages. Falling investment returns have led to increased concern that the value of some of these policies will be less than the amount required to repay the mortgage. Certain customers have complained that this risk was not properly explained to them at the time of sale. Following a review of past sales made by Abbey Life a provision of £165 million has been made for the estimated cost of redress (note 28e).

Other complaints, including those related to the sale of life assurance products, are dealt with on a case by case basis and where appropriate compensation is paid. Provision has been made, based upon the level of complaints, for the estimated cost of redress which is not significant. If the position changes, further provisions may be required.

Concerns have also been expressed over the appropriateness of certain sales of stockmarket related savings products. In this regard the Group is carrying out, in conjunction with the regulator, an investigation into the sales of the Extra Income & Growth Plan. This investigation is expected to be completed during 2003 when the Group will be in a position to estimate the financial effect.

46 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.

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 ratings corresponding to a range of probabilities of future default.
- Establishment and maintenance of the Group's large exposure policy. Exposure to individual counterparties, groups of counterparties or customer

46 Derivatives and other financial instruments (continued)

risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk.

- 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 principal consumer lending portfolios. 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 sector caps that reflect risk appetite and monitors exposures to prevent excessive concentration of risk.
- 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 which are consistent with corresponding Group policies. Authority to delegate lending authorities within business units rests with officers holding divisional delegated lending authority. All material authorities are advised to Lloyds TSB Group Risk.

Specialist units are established within group business units to provide, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business unit.

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.

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.

A variety of techniques are used to quantify the market risk arising from the Group's banking and trading activities. These reflect the nature of the business activity, and include simple interest rate gapping, open exchange positions, sensitivity analysis and Value at Risk (VaR). Stress testing and scenario analysis are also used in certain portfolios, and at Group level, to simulate extreme conditions to supplement these core measures.

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 with greater emphasis given to more recent data, during 2002 the value at risk on the Group's global trading averaged £1.26 million (2001: £1.17 million) with a maximum of £2.07 million (2001: £1.62 million) and a minimum of £0.93 million (2001: £0.78 million). The figure at 31 December 2002 was £1.02 million (2001: £1.62 million).

46 Derivatives and other financial instruments (continued)

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. 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

A Group Liquidity Policy is in place which requires a common methodology for measuring liquidity across the Group. The methodology derives a liquidity ratio calculated by taking the sum of liquid assets, five-day wholesale inflows and back-up lines, and then dividing this by the sum of five-day wholesale outflows and a percentage of retail maturities and contingent claims drawable over the next five days.

The Liquidity Policy requires all authorised local treasury operations to maintain a liquidity ratio of over 100 per cent, in addition to ensuring compliance with local regulatory requirements.

It is the responsibility of local line management to ensure that the Liquidity Policy is met, and the sources and maturities of assets and liabilities are continually managed and appropriately diversified to avoid any undue concentration as market conditions evolve. Compliance is monitored by regular liquidity returns to Group Risk Management.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. For internal purposes, reputational impact is also included.

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

Lloyds TSB Group Risk's responsibilities in relation to operational risk include defining high-level operational risk policies to ensure a comprehensive and consistent approach to the identification and management of operational risk; implementation of a Group-wide standard methodology to ensure consistency in the identification, assessment and management of operational risk; communication and provision of general guidance on operational risk related issues, including regulatory changes and developments in the measurement and management of operational risk, to promote best practice throughout the Group; continuous review and improvement of all aspects of operational risk management to reflect developments in industry best practice and regulatory requirements, e.g. the New Basel Accord; approval from a risk perspective of all new products launched throughout the Group, to ensure their risks are understood by the business and managed appropriately; and identification of risk through formal risk reviews, covering specific risks, activities, business sectors or products, and ensuring that prompt and pre-emptive action is taken to address any actual or perceived risks that may emerge, whether specific to the Group or to the industry generally.

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.

46 Derivatives and other financial instruments (continued)
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.

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 2002	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**94,250**	**2,064**	**2,735**
Currency swaps	**9,019**	**232**	**310**
Options purchased	**4,468**	**87**	**8**
Options written	**4,303**	**–**	**103**
	112,040	**2,383**	**3,156**
Interest rate contracts:			
Interest rate swaps	**259,911**	**5,473**	**5,999**
Forward rate agreements	**41,768**	**35**	**37**
Options purchased	**8,248**	**105**	**–**
Options written	**4,899**	**–**	**152**
Futures	**18,963**	**–**	**–**
	333,789	**5,613**	**6,188**
Equity contracts	**5,662**	**608**	**491**
Effect of netting		**(5,176)**	**(5,176)**
Balances arising from off-balance sheet financial instruments		**3,428**	**4,659**

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

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

Non-trading

Through intra company and intra group transactions, Group companies establish non-trading derivatives positions with the Group's independent trading operations, which then enter into similar positions with third parties. The notional principal amounts and fair values of non-trading instruments entered into with third parties were as follows:

31 December 2002	Notional principal amount £m	Fair values Positive £m	Fair values Negative £m
Exchange rate contracts:			
Spot, forwards and futures	**146**	**16**	**4**
Currency swaps	**59**	**4**	**1**
	205	**20**	**5**
Interest rate contracts:			
Interest rate swaps	**17,261**	**129**	**223**
Forward rate agreements	**1,279**	**2**	**2**
Options written	**41**	**–**	**1**
	18,581	**131**	**226**
Effect of netting		**(36)**	**(36)**
		115	**195**

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

Notes to the accounts

46 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 £54 million (2001: an asset of £18 million) and with a negative fair value was an asset of £9 million (2001: an asset 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 2002				
Exchange rate contracts:				
Notional principal amount	**102,559**	**6,888**	**2,798**	**112,245**
Replacement cost	**2,209**	**108**	**86**	**2,403**
Interest rate contracts:				
Notional principal amount	**150,883**	**149,631**	**51,856**	**352,370**
Replacement cost	**850**	**2,682**	**2,212**	**5,744**
Equity contracts:				
Notional principal amount	**1,130**	**3,714**	**818**	**5,662**
Replacement cost	**3**	**531**	**74**	**608**
Total:				
Notional principal amount	**254,572**	**160,233**	**55,472**	**470,277**
Replacement cost	**3,062**	**3,321**	**2,372**	**8,755**
31 December 2001				
Exchange rate contracts:				
Notional principal amount	102,130	6,260	1,775	110,165
Replacement cost	1,087	152	42	1,281
Interest rate contracts:				
Notional principal amount	187,570	155,329	49,262	392,161
Replacement cost	1,300	1,796	1,304	4,400
Equity contracts:				
Notional principal amount	738	3,394	448	4,580
Replacement cost	75	330	23	428
Total:				
Notional principal amount	290,438	164,983	51,485	506,906
Replacement cost	2,462	2,278	1,369	6,109

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.

	2002 £m	2001 £m
OECD banks	**1,939**	1,425
Other	**1,604**	802
Net replacement cost	**3,543**	2,227
Qualifying collateral held	**(521)**	(339)
Potential credit risk exposure	**3,022**	1,888

46 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 2002	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**88,728**	**1,976**	**2,429**
Currency swaps	**8,004**	**208**	**296**
Options purchased	**2,326**	**57**	**11**
Options written	**1,535**	**–**	**43**
	100,593	**2,241**	**2,779**
Interest rate contracts:			
Interest rate swaps	**255,331**	**5,750**	**6,096**
Forward rate agreements	**40,533**	**34**	**37**
Options purchased	**8,309**	**106**	**–**
Options written	**4,873**	**–**	**152**
Futures	**16,645**	**–**	**–**
	325,691	**5,890**	**6,285**
Equity contracts	**8,038**	**608**	**578**
Effect of netting		**(5,176)**	**(5,176)**
Balances arising from off-balance sheet financial instruments		**3,563**	**4,466**

31 December 2001	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	90,637	969	969
Currency swaps	5,757	116	147
Options purchased	1,564	10	–
Options written	1,030	–	8
	98,988	1,095	1,124
Interest rate contracts:			
Interest rate swaps	286,145	4,453	4,716
Forward rate agreements	52,687	77	83
Options purchased	8,888	74	–
Options written	3,956	–	58
Futures	33,954	–	–
	385,630	4,604	4,857
Equity contracts	6,757	428	409
Effect of netting		(3,843)	(3,843)
Balances arising from off-balance sheet financial instruments		2,284	2,547

Notes to the accounts

46 Derivatives and other financial instruments (continued)

a Derivatives (continued)

Non-trading

The notional principal amounts and fair values of non-trading instruments entered into with third parties were as follows:

31 December 2002	Notional principal amount £m	Fair values Positive £m	Fair values Negative £m
Exchange rate contracts:			
Spot, forwards and futures	**141**	**46**	**–**
Currency swaps	**346**	**34**	**1**
	487	**80**	**1**
Interest rate contracts:			
Interest rate swaps	**17,816**	**132**	**343**
Forward rate agreements	**1,339**	**2**	**3**
	19,155	**134**	**346**
Effect of netting		**(36)**	**(36)**
		178	**311**

31 December 2001	Notional principal amount £m	Fair values Positive £m	Fair values 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

46 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 2002				
Exchange rate contracts:				
Notional principal amount	**92,138**	**6,124**	**2,818**	**101,080**
Replacement cost	**2,152**	**83**	**86**	**2,321**
Interest rate contracts:				
Notional principal amount	**145,510**	**144,218**	**55,118**	**344,846**
Replacement cost	**849**	**2,666**	**2,509**	**6,024**
Equity contracts:				
Notional principal amount	**1,307**	**5,095**	**1,636**	**8,038**
Replacement cost	**3**	**531**	**74**	**608**
Total:				
Notional principal amount	**238,955**	**155,437**	**59,572**	**453,964**
Replacement cost	**3,004**	**3,280**	**2,669**	**8,953**
31 December 2001				
Exchange rate contracts:				
Notional principal amount	92,365	5,327	1,751	99,443
Replacement cost	972	93	42	1,107
Interest rate contracts:				
Notional principal amount	184,434	151,411	53,434	389,279
Replacement cost	1,314	1,782	1,724	4,820
Equity contracts:				
Notional principal amount	1,256	4,606	895	6,757
Replacement cost	75	330	23	428
Total:				
Notional principal amount	278,055	161,344	56,080	495,479
Replacement cost	2,361	2,205	1,789	6,355

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.

	2002 £m	2001 £m
OECD banks	**2,277**	1,870
Other	**1,464**	603
Net replacement cost	**3,741**	2,473
Qualifying collateral held	**(521)**	(339)
Potential credit risk exposure	**3,220**	2,134

46 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 2002	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	**1,759**	**23**	**94**	**1**	**2**	**–**	**530**	**2,409**
Loans and advances to banks	**12,362**	**1,362**	**761**	**775**	**200**	**666**	**1,402**	**17,528**
Loans and advances to customers	**88,527**	**4,997**	**8,247**	**26,787**	**7,210**	**(133)**	**630**	**136,265**
Debt securities and equity shares	**6,093**	**1,049**	**312**	**1,972**	**2,516**	**(42)**	**17,620**	**29,520**
Other assets	**130**	**25**	**25**	**243**	**48**	**16,493**	**6,479**	**23,443**
Total assets	**108,871**	**7,456**	**9,439**	**29,778**	**9,976**	**16,984**	**26,661**	**209,165**
Liabilities:								
Deposits by banks	**21,572**	**817**	**240**	**377**	**112**	**248**	**2,077**	**25,443**
Customer accounts	**104,257**	**1,318**	**1,193**	**3,829**	**2,008**	**3,203**	**850**	**116,658**
Debt securities in issue	**19,169**	**5,526**	**2,002**	**1,212**	**1,224**	**–**	**1,122**	**30,255**
Other liabilities	**353**	**–**	**6**	**–**	**–**	**9,060**	**7,020**	**16,439**
Subordinated liabilities – loan capital	**3,293**	**1,141**	**14**	**950**	**5,006**	**150**	**–**	**10,554**
Minority interests and shareholders' funds	**–**	**–**	**–**	**–**	**–**	**9,968**	**(152)**	**9,816**
Internal funding of trading business	**(7,973)**	**(198)**	**(1,545)**	**(5,148)**	**(880)**	**–**	**15,744**	**–**
Total liabilities	**140,671**	**8,604**	**1,910**	**1,220**	**7,470**	**22,629**	**26,661**	**209,165**
Off-balance sheet items	**10,942**	**5,939**	**(10,082)**	**(8,830)**	**2,031**	**–**	**–**	**–**
Interest rate repricing gap	**(20,858)**	**4,791**	**(2,553)**	**19,728**	**4,537**	**(5,645)**	**–**	**–**
Cumulative interest rate repricing gap	**(20,858)**	**(16,067)**	**(18,620)**	**1,108**	**5,645**	**–**	**–**	**–**

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	16,497	5,648	22,335
Total assets	91,265	8,581	10,626	30,587	11,586	17,180	21,306	191,131
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	6,808	5,352	12,518
Subordinated liabilities – loan capital	1,671	716	–	657	5,299	150	–	8,493
Minority interests and shareholders' funds	–	–	–	–	–	11,986	102	12,088
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)	7,199	27,320	21,306	191,131
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	3,716	(10,140)	–	–
Cumulative interest rate repricing gap	(13,720)	(23,435)	(22,321)	6,424	10,140	–	–	–

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 46a.

*restated (see note 1)

46 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 2002	Trading book		Non-trading book	
Assets:	Book value £m	Fair value £m	Book value £m	Fair value £m
Treasury bills and other eligible bills	**530**	**530**	**1,879**	**1,878**
Loans and advances to banks and customers	**2,032**	**2,032**	**151,761**	**153,316**
Debt securities and equity shares	**17,620**	**17,620**	**11,900**	**11,932**
Liabilities:				
Deposits by banks and customers	**2,927**	**2,927**	**139,174**	**138,752**
Debt securities in issue	**1,122**	**1,122**	**29,133**	**29,005**
Subordinated liabilities	**–**	**–**	**10,554**	**11,410**

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	–	–	8,493	8,929

*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 46a.

Fair values are determined by reference to quoted market prices or, where no market price is available, using internal models which discount expected future cashflows 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	**2002 £m**	2001 £m
New Zealand dollar	**921**	748
Euro	**304**	286
US dollar	**259**	147
Swiss franc	**100**	104
Other non-sterling	**323**	438
Total	**1,907**	1,723

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.

46 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 2002, the unrecognised gains on financial instruments used for hedging were £518 million (2001: £242 million) and unrecognised losses were £744 million (2001: £820 million).

The net losses arising in 2001 and earlier years and recognised in 2002 amounted to £344 million. Net losses of £6 million arose in 2002 but were not recognised in the year.

Of the net losses of £226 million at 31 December 2002, £38 million of net losses are expected to be recognised in the year ending 31 December 2003 and £188 million of net losses in later years.

47 Acquisitions

a) On 18 April 2002 the Group's subsidiary, Lloyds TSB Asset Finance Division Limited, completed the acquisition of First National Vehicle Holdings and Abbey National Vehicle Finance, both previously wholly owned subsidiaries of Abbey National plc operating in the UK contract hire and fleet management market; the results of these businesses have been consolidated in full from that date, the effect on the results of the Group is not material. The premium on acquisition of £86 million has been capitalised and will be written off to the profit and loss account over its estimated useful life of 20 years.

A summarised profit and loss account for First National Vehicle Holdings and Abbey National Vehicle Finance for the period from 1 January 2002 to 17 April 2002 is set out below:

	£m
Net interest income	6
Other income	25
Total income	31
Operating expenses	38
Provisions for bad and doubtful debts	1
Loss on ordinary activities before tax	(8)
Tax	2
Loss after tax for the period to 17 April 2002	(6)
Profit after tax for the year ended 31 December 2001	–

All recognised gains and losses are included in the profit and loss account.

The combined balance sheet of First National Vehicle Holdings and Abbey National Vehicle Finance at 18 April 2002 was as follows:

	Book value at 18 April 2002 £m	Fair value adjustments £m	Fair value at acquisition £m
Loans and advances to customers	64	–	64
Tangible fixed assets	355	(8)	347
Other assets and prepayments	63	–	63
Deposits by banks	(405)	–	(405)
Other liabilities and accruals	(107)	(6)	(113)
Net liabilities acquired	(30)	(14)	(44)
Goodwill			86
Consideration			42

47 Acquisitions (continued)

An initial cash payment of £47 million has been made, however following the preparation of the completion accounts it is believed that this should be subject to a downward adjustment of £5 million. Accordingly a receivable of this amount has been recognised in the Group's balance sheet. The fair value adjustments principally reflect adjustments to the carrying value of operating lease assets and related taxation. Negotiations regarding the completion of this acquisition are still ongoing and, whilst no further significant adjustments to consideration or fair value adjustments are expected, in accordance with the requirements of paragraph 27 of Financial Reporting Standard 6, it is noted that the fair value of the net assets of the acquired businesses and the goodwill arising shown above are provisional.

b) On 16 December 2002 the Group's subsidiary, Lloyds TSB Asset Finance Division Limited, completed the purchase of the business of the Dutton-Forshaw Group, a motor dealer which has a network of 38 franchised dealerships representing 14 motor vehicle manufacturers. The consideration for the purchase was £49 million which was settled in cash. The premium on acquisition of £10 million has been capitalised and will be written off to the profit and loss account over its estimated useful life of 20 years. Fair value adjustments were made to the carrying value of tangible fixed assets and in respect of certain liabilities. Negotiations regarding the completion of this acquisition are still ongoing and, whilst no further significant adjustments to consideration or fair value adjustments are expected, in accordance with the requirements of paragraph 27 of Financial Reporting Standard 6, it is noted that the goodwill arising stated above is provisional. 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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