Annual Report and Accounts 2004

Lloyds TSB Group

Forward looking statements

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

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

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

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

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Delivering earnings growth
across all major business areas

2004 highlights

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Profit before tax decreased by £855 million, or 20 per cent, to £3,493 million, reflecting the impact of businesses disposed of in 2003 which contributed £1,183 million last year.

Profit attributable to shareholders decreased by £833 million, or 26 per cent, to £2,421 million.

Earnings per share decreased by 26 per cent to 43.3p.

Post-tax return on average shareholders' equity 24.3 per cent.

Total capital ratio 10.0 per cent, tier 1 capital ratio 8.9 per cent.

Dividend maintained. Final dividend of 23.5p per share, making a total of 34.2p for the year (2003: 34.2p).

Results – continuing operations excluding investment variance, changes in economic assumptions and profit/loss on sale of businesses.

Profit before tax increased by £301 million, or 10 per cent, to £3,363 million.

Earnings per share increased by 12 per cent to 41.8p.

Economic profit increased by 9 per cent to £1,442 million.

Post-tax return on average shareholders' equity 23.5 per cent.

Post-tax return on average risk-weighted assets increased from 1.87 per cent to 1.95 per cent.

Profit before tax

By division

	2004 £ million	2003* £ million
UK Retail Banking	**1,651**	1,471
Insurance and Investments	**773**	565
Wholesale and International Banking	**1,272**	1,038
Central group items	**(333)**	(12)
Profit before tax from continuing operations**	**3,363**	3,062
Changes in economic assumptions†	**(2)**	(22)
Investment variance†	**147**	125
Loss on sale of businesses in 2004†	**(15)**	–
Discontinued operations in 2003†	**–**	1,183
Profit before tax	**3,493**	4,348
Earnings per share	**43.3p**	58.3p

* Restated to reflect changes in the Group's segmental analysis following the introduction, in 2004, of the management of the Group's distribution channels as profit centres and other changes in internal pricing arrangements.

** Excluding changes in economic assumptions, investment variance and (loss) profit on sale of businesses.

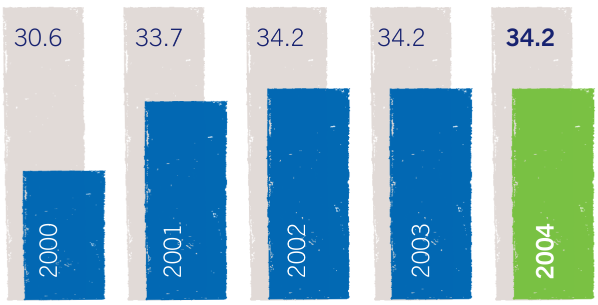
† Changes in economic assumptions and investment variance relate to Insurance and Investments, loss on sale of businesses in 2004 and discontinued operations in 2003 relate to Wholesale and International Banking.

Presentation of information

In order to provide a clearer representation of the underlying performance of the Group, the results of the Group's life and pensions, and general insurance businesses include investment earnings calculated using longer-term investment rates of return. The difference between the normalised investment earnings and the actual return ('the investment variance') together with the impact of changes in the economic assumptions used in the embedded value calculation, the profit/loss on the sale of a number of overseas businesses in 2003 and 2004 and the trading results of businesses sold in 2003 have been separately analysed and a reconciliation to the Group's profit before tax is shown on this page.

Dividends

Dividends per share (pence)



Profitably growing our retail and corporate franchises

Chairman's statement

Maarten van den Bergh

Lloyds TSB has a clearly articulated organic growth strategy that is focused on improving and deepening relationships with our personal and business customers. During 2004 this strategy has started to gain traction, with good progress being made in each of our business units. The successful delivery of profitable franchise growth has been central to the Group's return to positive earnings momentum during 2004.

The building blocks of attracting, retaining and developing customer relationships in all areas of our business are the foundations of profitable franchise development and sustainable earnings growth. With this in mind Lloyds TSB has spent much of the last few years putting our customers at the heart of our strategy, ensuring that customer needs drive our business transformation. During 2004 we have continued to improve our product range, we have significantly enhanced our customer service levels, and we have made clear progress in improving the Group's processing efficiency. As a result, customer satisfaction levels are higher than at any time during recent years and we are recruiting a higher number of quality customer relationships.

This focus on our customers, however, has not come at the expense of other stakeholders. We are constantly striving to make Lloyds TSB a great place to work and a great investment opportunity for shareholders. Throughout 2004 I have continued to be impressed by the drive, commitment and enthusiasm of our staff and, particularly, their desire to keep improving all aspects of our business. For shareholders, Lloyds TSB delivered a total shareholder return (share price appreciation plus dividends) of 15 per cent during 2004, a significantly better performance than both the FTSE Bank Index and the FTSE 100 Index. So, 2004 has been a year of good progress for customers, staff and shareholders all of whom are linked by a common desire – the successful delivery of Lloyds TSB's business and financial strategies.

Financial results

During a year when a great deal of management focus has been on positioning the Group to deliver sustainable earnings growth, I am delighted with the 10 per cent growth in profit before tax from the Group's continuing operations, excluding investment variance, changes in economic assumptions and disposal gains/losses. Each division delivered revenue growth in excess of cost growth, credit quality has remained strong and profitability has improved.

Economic outlook

Looking at the UK economy, it is likely that economic growth will continue, with many commentators believing growth in 2005 will remain above 2.5 per cent. Whilst there are downside risks to these expectations, from a possible slowdown in the housing market, there is upside potential as well, such as from higher business investment spending. We expect unemployment and inflation to remain low, and interest rates to peak during 2005. This is a relatively benign economic outlook and operating environment for Lloyds TSB.

Increasing levels of regulation, from both the UK and overseas, have already become a significant burden on all UK financial companies. With the adoption of international financial reporting standards in 2005, this burden is unlikely to ease and the financial services industry in the UK is likely to continue to face significant challenges in the arena of accounting and regulatory change. Whilst Lloyds TSB is well prepared for these challenges, the ongoing cost of compliance will remain considerable.

Our enhanced risk governance framework is now well embedded throughout the Group and risk is a key part of all executive decision making. Reporting and risk aggregation has been enhanced and through our better understanding of risk in the business, we are well placed to take advantage of opportunities to continue to grow our business profitably and safely.

Capital and dividend

During 2004 Lloyds TSB has continued to maintain satisfactory capital ratios, largely as a result of high cash flows generated throughout the business. The Group's post-tax return on equity at 24.3 per cent remains one of the highest amongst the major banks of the world and the board is satisfied with the Group's capital position. In addition, Scottish Widows continues to be one of the most strongly capitalised life assurance companies in the UK.

In line with the rest of the UK banking industry, the Group has now adopted international financial reporting standards and will in future report earnings on the basis of these new standards. Current indications are that this change will not have a material impact on either the earnings of the Group or its regulatory capital position, although some ongoing earnings volatility may arise. The board has decided to maintain the final dividend at 23.5p per share, making a total for the year of 34.2p (2003: 34.2p). This represents a dividend yield of 7.2 per cent, calculated using the 31 December 2004 share price of 473p.

Board changes

Since the annual general meeting last year, we have welcomed two new directors to the board. Truett Tate was appointed as Group Executive Director, Wholesale and International Banking in August 2004 and Sir Julian Horn-Smith joined us, as a non-executive director, in January 2005. Two executive directors, Steve Targett and Peter Ayliffe, left the board in April 2004 and January 2005 respectively, and Sir Tom McKillop retired at the end of his term as a non-executive director in December 2004. David Pritchard and Chris Gibson-Smith will also be retiring at the annual general meeting. All the departing directors leave with our sincere thanks for their contribution to the Group.

Staff

The successful implementation of the Group's strategy is the responsibility of all 70,000 staff employed by the Group. It is their approach to making Lloyds TSB a high performing organisation that has enabled the Group to make such good progress in 2004 and will ensure further progress over the next few years. We have a real opportunity to meet an increasing number of our customers' needs and it is our staff who will make that happen. They are the day-to-day face of the Bank, the heart of all we do and the key to future success. I thank them for their efforts in 2004 and their continuing commitment. Lloyds TSB Group remains one of the UK's largest corporate givers, principally through the excellent work of the independent Lloyds TSB Foundations who made grants to charities of over £27 million in 2004.

Looking forward

Our focus on delivering profitable franchise growth, against a backdrop of significant regulatory and competitive pressure, has led to a good track record of earnings growth. Despite an expected slowdown in consumer lending growth in the UK, I am confident that the delivery of revenue growth in excess of cost growth, combined with strong risk management throughout the organisation, will enable the Group to achieve a continuing high return on equity and sustainable economic profit growth.

Maarten van den Bergh
Chairman
3 March 2005

Continuing to improve

service quality and

processing efficiency

Group chief executive's review

Eric Daniels

2004 was a good year for Lloyds TSB and, in many respects, marks the closing of one chapter and the opening of another. During the past two years, we worked on a three point plan:

- to enhance the quality, and decrease the volatility, of our earnings
- to maintain our good returns, and
- to achieve growth.

I am pleased to report that we have made good progress on each of these priorities and, in doing so, we have also addressed many of the concerns of our shareholders, which centred on the adequacy of our capital, the sustainability of the dividend and the achievement of growth whilst continuing to deliver strong returns.

Our results in 2004 reflect a higher quality of earnings. The five Latin American businesses that we sold had impacted adversely on our performance, incurring losses amounting to more than £200 million over the five years to 2003, equivalent to a negative return on equity of some 28 per cent. In addition, the earnings lost from the strategic sale of our businesses in New Zealand and Brazil were replaced within a year, as the Group's organic growth strategy continued to deliver.

The work that we have done to allocate our capital more efficiently, as well as the management of our quality and costs, has allowed us to maintain high returns whilst we focused the organisation on delivering growth. Pleasingly, we are starting to demonstrate better growth across all of our divisions and key businesses.

In the *Retail Bank*, income growth exceeded cost growth, we maintained or grew market share in most of the major product categories and we improved the depth of customer relationships. We used the year to put in place a more competitive product set and a new operating model, whereby we now manage the branch network on what we term a 'local markets' basis. In essence, we have returned the branch to being part of the local community and given branch managers greater authority to manage profitability and run their areas as businesses. We recognise that the needs of customers vary by community and, by organising in this way, we believe that we will be both more responsive and effective which will, in turn, result in faster growth. In our test markets, we achieved higher growth in quality customer recruitment and a greater improvement in customer satisfaction than in the rest of the branch network, and this is now starting to deliver an improved sales performance. The new model was extended to the entire branch network in the second half of 2004.

In *Wholesale Banking*, each of the major businesses made good progress in acquiring and deepening customer relationships and all delivered year-on-year profit improvements in excess of 20 per cent. The new management team strengthened our competitive position with enhanced product offerings and more proactive calling efforts. This renewed customer focus and better alignment of relationship and product managers resulted in a 25 per cent uplift in earnings in the Corporate Markets franchise. Business Banking and Asset Finance also performed strongly, supported by good income growth and strong cost control.

In *Insurance and Investments*, our new business contribution in Scottish Widows increased by 21 per cent as we successfully focused on more profitable, and more capital efficient, business lines. The sales of life and pensions products in the branches were encouraging, although we lagged in unit trust sales. During 2004, supported by the launch of a simplified suite of bancassurance products in the second half of the year, we increased our market share of non-IFA life and pensions sales from 7.8 per cent to 8.9 per cent. Overall, life and pensions product sales increased by 9 per cent. In Lloyds TSB Insurance, increased investment resulted in strong growth in sales through direct channels and we maintained our market leading position in home insurance distribution.

In addition to the considerable progress in the divisions, we also used the year to enhance the effectiveness of the Corporate Centre, with the appointment of new directors in the Risk, Audit, Human Resources and Finance functions. This has enabled us to strengthen the operating disciplines across the Group, which provide the framework for us to grow in a sustained fashion.

We are only just beginning to unlock the growth potential of the Lloyds TSB franchise. During 2004, customer satisfaction ratings reached record levels, employee engagement scores rose to their highest level ever, credit quality remained strong and our financial disciplines guided the Group to exceed expectations in terms of financial performance. This gives us a solid underpinning for the future. We still have much to do in terms of improving our execution but I believe we can continue to deliver income growth in a controlled and sustainable way, due to the progress made by the divisions and improvements in our operating processes achieved during 2004.

As we look to the future, we are opening a new chapter focused primarily on growth. We will continue to focus our efforts on our core markets and build our skills to sustain superior performance. Our new priorities are designed to leverage our strengths in those markets and they are:

- to materially *deepen customer relationships*, meeting more of our customers' needs and winning a greater share of their business. In the last year and a half, we have put in place many of the pieces to build stronger relationships; across all of our divisions we have enhanced service performance and we have introduced improved product ranges. We have also introduced local markets in the Retail Bank and built up strong regional centres in the Wholesale Bank. Our task is now to integrate these pieces so that our customers enjoy better value and view us as the place to bring more of their business.
- to *improve our efficiency*, growing our top line whilst improving the productivity of our cost base, using the discipline of 'positive jaws'. As our income grows, we will continue to increase our investment to improve our customer satisfaction ratings and our efficiency, through further development of our quality performance, automation, straight-through processing and the more effective leveraging of our group wide cost base.
- to continue to *enhance the Group's capabilities and processes* to support faster growth. In Finance, we will further develop our capital management disciplines and our understanding of the key drivers of economic profit growth at a more granular level. In Risk, we will continue to build our skill base to enable us to grow with less volatility in our earnings and to take advantage of the strategic benefits of Basel II. In Human Resources, we are developing our people to perform to their full potential and to create the high performance organisation necessary to achieve our goals.

Looking back on the year, we achieved our three point plan and are now making marked progress on the elements of the Group's balanced scorecard. Our capital position is in good shape, with the impact of recent accounting changes incorporated into our plans, and we achieved growth and higher quality earnings. Our staff are engaged and the achievement of these favourable results is due to their commitment and dedication to serving our customers.

I look forward to seeing continued growth and progress against our revised set of priorities in 2005 and beyond.

J Eric Daniels
Group Chief Executive
3 March 2005

We have a clear opportunity to help our customers achieve their goals

The community and our business

Our business

There is a business case for corporate responsibility. We know very clearly that companies which adopt and embrace corporate responsibility, and link it to their core business, are more likely to create wealth and shareholder value than those that do not.

It is not just about having the right products at the right price, and a relentless pursuit of superior service and accessibility for customers. Having strong values, clear leadership and a responsible corporate culture are also critical if the business is to prosper over time. We want our business to be the first and natural choice for customers and investors.

With some 2,200 branches, Lloyds TSB Group has one of the largest branch networks in the UK as well as being a leading internet and telephone banking provider. Our agreement with the Post Office allows our personal customers to use around 16,000 post offices for their banking needs.

Lloyds TSB has also been at the forefront of developing alternative forms of financial provision and support for those communities where mainstream financial services have traditionally been considered inappropriate or inaccessible. We have been involved in a wide range of projects, on both a commercial and semi-commercial basis, providing capital for loan funds which in turn support individual debt-consolidation, housing improvement, business start-ups and social enterprise.

People and the workplace

People are our greatest asset and we are committed to becoming a world-class organisation in the way we manage and develop them.

We know that corporate responsibility is a factor in the perception that our staff have of Lloyds TSB as an employer and plays a key part in their engagement and satisfaction in working for the Group. We can demonstrate a direct relationship between employee satisfaction, customer satisfaction and, ultimately, shareholder satisfaction.

In the UK, where we employ over 68,000 people, our employment policies are continually monitored and benchmarked against other companies to ensure that, as one of the UK's largest employers, we remain at the leading edge of employment practice. Our workforce policies and programmes are focused on ensuring that all our employees believe that Lloyds TSB is a great place to work and an employer of choice.

Our commitment to Investors in People (IIP) is about promoting a culture of career-long learning and a need to equip our staff with the skills and knowledge that will help them to perform in the workplace. In 2004, 87 per cent of our employees worked for business units that are IIP accredited.

Almost £42 million was invested in employee training and development across the Group in 2004. The University for Lloyds TSB provided over 67,000 face-to-face training days and in excess of 29,000 delegate places on residential training courses. We seek to use awards and qualifications as a means of benchmarking staff achievement against external standards.

We are committed to improving the diversity of our workforce in terms of the representation of women, ethnic minority employees and disabled employees at all levels in our organisation. We encourage all employees to develop a balance between their personal and professional lives through our Work Options policy. This provides staff with the opportunity to adopt any one of a number of flexible working practices such as job sharing, variable and compressed hours and term-time working. As a result 34 per cent of our workforce currently work flexibly.

Community involvement

Lloyds TSB is a significant presence in every community. The customers we serve and the staff that serve them are drawn from those same communities. We have one of the largest community investment programmes in the UK, supporting our customers and staff, and making a significant contribution to improving the social fabric of the local environment in which our business operates.

Community investment is not just about giving money to good causes. It is also about the substantial time given by our staff in supporting the work of community organisations, whether raising money, providing business expertise or simply providing another willing pair of hands.

The Group Community Awards scheme celebrates staff achievement and rewards them for their work in the local community. In 2004, nearly 150 nominations were received and each of the 10 winners was presented with a £1,000 cheque for their nominated organisations.

Of course, cash giving is also important. Every year we support our staff's commitment to local communities through the matched giving scheme. In 2004 the Lloyds TSB Foundations set aside £1.25 million to match money raised for, and the time given to, charity by Lloyds TSB staff. More than 4,000 staff took part in the scheme, raising a total for charities of more than £3.4 million. One of our biggest group wide activities is our Charity of the Year fundraising. In 2004, staff raised over £1 million for NSPCC and Children 1ST.

The majority of Lloyds TSB's charitable giving is channelled through the four independent Lloyds TSB Foundations, which cover England and Wales, Scotland, Northern Ireland and the Channel Islands. Their mission is to improve the lives of people in local communities, especially those who are disadvantaged or disabled.

The Lloyds TSB Foundations together receive one per cent of the Group's pre-tax profits, averaged over three years, in lieu of their shareholder dividend. Since 1997, they have received £228 million to distribute to grassroots causes. In 2005, they will receive a further £31.2 million to distribute to community groups.

More information on these issues is available in the Group's 2004 corporate responsibility report and there are details of how to obtain a copy of this document on page 113.

The businesses of Lloyds TSB

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

UK Retail Banking

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

Branches. Lloyds TSB Group provides wide-reaching geographic branch coverage in England, Scotland and Wales, with some 2,200 branches of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester as at the end of 2004.

Internet banking. Internet banking provides online banking facilities for personal customers. Some 3 million customers have registered to use Lloyds TSB Group's internet banking services.

Telephone banking. Telephone banking continues to grow and Lloyds TSB Group provides, in terms of customer numbers, one of the largest telephony services in Europe. At the end of 2004, some 4.8 million customers had registered to use the services of PhoneBank and the automated voice response service PhoneBank Express. Lloyds TSB Group's telephone banking contact centres handled some 62 million calls during 2004.

Cash machines. Lloyds TSB Group has one of the largest cash machine networks of any leading banking group in the UK and, at 31 December 2004, personal customers of Lloyds TSB Bank and Lloyds TSB Scotland were able to withdraw cash and check balances through some 4,200 ATMs at branches and external locations around the country. In addition, our personal customers have access to a further 50,000 cash machines via LINK in the UK and to cash machines worldwide through the VISA and MasterCard networks.

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

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

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

Credit cards. Lloyds TSB Group provides a range of card-based products and services, including credit and debit cards and card transaction processing services for retailers. Lloyds TSB Group is a member of both the VISA and MasterCard payment systems and had a 12.7 per cent share of outstanding card balances at 31 December 2004.

Mortgages. Cheltenham & Gloucester is Lloyds TSB Group's specialist residential mortgage provider, offering a range of mortgage products to personal customers through its own branches and those of Lloyds TSB Bank in England and Wales, as well as through the telephone, internet and postal service, C&G TeleDirect. Lloyds TSB Group also provides mortgages through Lloyds TSB Scotland and Scottish Widows Bank. Lloyds TSB Group is the third largest residential mortgage lender in the UK on the basis of outstanding balances, with mortgages outstanding at 31 December 2004 of £80.1 billion, representing a market share of 9.1 per cent.

UK Wealth Management. Private Banking provides a range of tailor-made wealth management services and products to individuals from 30 offices throughout the UK. In addition to asset management, these include tax and estate planning, executor and trustee services, deposit taking and lending, insurance and personal equity plan and individual savings account (ISA) products.

Insurance and Investments

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

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

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

Scottish Widows Investment Partnership. Scottish Widows Investment Partnership manages funds for Lloyds TSB Group's retail life, pensions and investment products. Clients also include corporate pension schemes, local authorities and other institutions in the UK and overseas. At 31 December 2004 funds under management amounted to some £82 billion.

Wholesale and International Banking

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

Wholesale

2004 has seen a further increase in our corporate activity with the tighter integration of the businesses within the Wholesale Bank.

Corporate Markets combining the respective strengths of Corporate Banking, Structured Finance and Financial Markets, plays an integral role in leveraging and expanding our customer franchise and building deep, long-lasting relationships. Corporate Banking manages the core franchise, providing a relationship-based financial and advisory service to the corporate marketplace through dedicated regional teams throughout the UK and key strategic locations abroad, including New York. Customers have access to our capital and expertise in a broad range of financial solutions. Our relationship managers act as a conduit to partners in the Wholesale Bank and other parts of the Group. Structured Finance comprises the private equity and leveraged debt businesses and other transactional lending businesses of the Wholesale Bank. Structured Finance executes transactions within the existing corporate franchise as well as building an avenue for new to bank relationships. Financial Markets is a leading participant in the sterling money market. It is also active in currency money markets, foreign exchange markets and in certain derivatives markets, primarily to meet the needs of customers. It also plays a central role in the funding, cash and liquidity management of Lloyds TSB Group.

Asset Finance. Lloyds TSB Group's asset finance businesses provide individuals and companies with finance through leasing, hire purchase and contract hire packages. Through its invoice discounting and factoring subsidiary, Lloyds TSB Commercial Finance, Lloyds TSB Group provides working capital finance for customers. Specialist personal lending, store credit and the Dutton-Forshaw motor dealership group complete this group of businesses.

Business Banking. Relationships with some 574,000 small businesses are managed by around 1,700 dedicated business managers based in over 500 locations throughout the UK supported by nearly 2,000 business customer advisers in branches. Lloyds TSB Group is one of the leading banks for new business start-ups with nearly a quarter of new businesses opening an account with Lloyds TSB. The main activity of the Agricultural Mortgage Corporation is to provide long-term finance to the agricultural sector.

International Banking

The Group has continued to reshape its international network in 2004 as the sales of our businesses in Argentina, Colombia, Guatemala, Panama and Honduras were completed during the year.

Europe. Lloyds TSB Group has private banking operations for wealthy individuals outside their country of residence. The business is conducted through branches of Lloyds TSB Bank located in Switzerland, Luxembourg, Monaco and Gibraltar. There are also personal and corporate banking operations in Belgium, The Netherlands and Spain.

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

The Americas. Lloyds TSB Group continues to have offices in Ecuador, Paraguay and Uruguay which provide mainly corporate banking services. In addition, Lloyds TSB Group has private banking and investment operations in the US.

Middle East and Asia. There are banking operations in Hong Kong, Singapore, Tokyo, Malaysia and Dubai.

Operating and financial review and prospects

Summary of Group results

In 2004 the Group's statutory profit before tax was £3,493 million, a decrease of £855 million compared to £4,348 million in 2003. This decrease was attributable to the impact in 2003 of the profit on the sale and trading results of a number of overseas businesses, which contributed £1,183 million. For the same reason, profit attributable to shareholders decreased by £833 million, or 26 per cent, to £2,421 million and earnings per share decreased by 26 per cent to 43.3p.

To enable meaningful comparisons with 2003, it is appropriate to exclude the impact of these 2003 disposals, together with the investment variance and changes in economic assumptions in the Group's life assurance businesses. On this basis, as a result of earnings growth in each business unit, profit before tax increased by £301 million, or 10 per cent, to £3,363 million. Earnings per share increased by 12 per cent to 41.8p and economic profit increased by 9 per cent to £1,442 million. The post-tax return on average shareholders' equity was 23.5 per cent and the post-tax return on average risk-weighted assets increased to 1.95 per cent, from 1.87 per cent in 2003.

Group net interest income from continuing operations increased by £176 million, or 4 per cent, and average interest-earning assets increased by 8 per cent to £170 billion. Strong consumer lending growth led to increases of £2.6 billion in average personal lending and credit card balances and £8.9 billion in average mortgage balances.

The Group net interest margin from continuing operations decreased by 11 basis points to 2.89 per cent, after adjusting for the impact of a change in the middle of 2004 in the Group's wholesale liquidity and funding strategy towards the use of more capital efficient reverse repurchase agreements, which have been excluded from the net interest margin calculation. This margin reduction reflected the impact of changes in business mix and lower margins in the Group's credit card, personal lending and mortgages portfolios as a result of competitive pressures. During the second half of 2004, however, we started to see a slowdown in the rate of margin erosion in a number of retail product areas. There has also been further substitution of net interest income for fee income in certain product lines.

Strong growth in loans and advances to customers and banks, partly offset by a reduction in debt securities, led to an 11 per cent increase in total assets to £280 billion. The Group's strategy to increase retail lending, particularly in mortgages, credit cards and personal loans, was reflected in a 14 per cent increase in loans and advances to customers to £154 billion. Customer deposits increased by £6 billion, or 5 per cent, to £122 billion, largely as a result of strong growth in current account credit balances which was supported by further progress in the take-up of added value current accounts.

Other income from continuing operations, excluding investment variance and changes in economic assumptions, increased by £89 million to £4,463 million. Prior year comparisons are, however, further distorted by the impact of the sale, in 2003, of the Group's portfolio of emerging markets debt bonds and certain closed foreign exchange positions and customer redress provisions. Excluding these items, other income increased by 7 per cent. Fees and commissions receivable increased by 5 per cent to £3,124 million as a result of higher income from the strong volume growth in credit and debit card services, partly as a result of the acquisition of the Goldfish credit card portfolio in September 2003, an increase in mortgage related fees, reflecting the growth in new mortgage lending during the year, and an increase in fees from large corporate business and asset-based lending, as a result of growing customer transaction volumes.

Income from long-term assurance business, excluding the impact of customer redress provisions, increased by 32 per cent to £590 million as a result of significantly improved profitability in the Scottish Widows life and pensions business. There was also a £50 million increase in gains on the sales of assets, largely the realisation of venture capital investments.

Operating expenses on a continuing operations basis, excluding the impact of customer redress provisions, continued to be tightly controlled and increased by only 2 per cent to £4,817 million. Significant improvements have been made in processing and operational efficiency and the Group has continued to expand its programme of offshoring a number of its processing and back office operations to India. As a result of this constant focus on day-to-day operating cost control, the Group's cost:income ratio improved to 51.1 per cent, from 52.5 per cent in 2003. Revenue growth exceeded cost growth in each division and at Group level.

Much of the Group's new retail lending during 2004 has been to existing customers where the Group has a better understanding of each individual customer's total financial position and this, in conjunction with a relatively benign economic environment and increased corporate liquidity, has led to credit quality remaining strong throughout the Group. Notwithstanding substantial growth in loans and advances to customers, the provisions charge for bad and doubtful debts within the Group's continuing operations was 2 per cent lower than in 2003 and, as a result, the Group's provisions charge expressed as a percentage of average lending improved to 0.59 per cent, compared to 0.66 per cent in 2003. Non-performing lending was £1,240 million representing 0.8 per cent of total lending, down from 0.9 per cent at 31 December 2003.

During 2004 there has been an increase in the level of complaints relating to past sales and performance of certain endowment based and long-term savings products. Whilst the Group maintains provisions for customer redress in respect of past product sales, the adequacy of these provisions has been reviewed in the light of ongoing experience. As a result, an additional provision of £112 million has been made.

The Group's capital position remains satisfactory. At the end of 2004, the total capital ratio was 10.0 per cent and the tier 1 capital ratio was 8.9 per cent. Risk-weighted assets increased by 12 per cent to £132.2 billion, reflecting strong growth in consumer lending and mortgages, higher lending in Corporate Markets and the acquisition of a UK corporate loan portfolio from Danske Bank which added risk-weighted assets of some £2.0 billion. The Group continues to plan for risk-weighted asset growth of mid-to-high single digits over the next few years, and expected profit retentions are sufficient to support this level of risk-weighted asset growth within the Group's current capital management policy. Profit retentions for 2004 totalled £507 million.

Scottish Widows continues to be one of the most strongly capitalised life assurance companies in the UK. We remain satisfied with the overall capital position of Scottish Widows when calculated using the Financial Services Authority's (FSA) new 'realistic' basis of balance sheet reporting, and the first Individual Capital Assessment under the new FSA regime has been completed and shows that our capital requirements are well covered. At the end of December 2004 the working capital ratio of the Scottish Widows Long-Term Fund, applying the FSA's new realistic basis, was an estimated 19.0 per cent. The required risk capital margin was covered over nine times. Scottish Widows has also paid a 2004 dividend of £200 million to Lloyds TSB reflecting the start of an expected regular dividend stream.

Recognising the Group's high existing dividend payout ratio, and reflecting a desire to maintain capital flexibility to continue making value enhancing acquisitions, such as the acquisition of Danske Bank's UK corporate loan portfolio in December 2004, the board has decided to maintain the final dividend at 23.5p per share to make a total for the year of 34.2p per share. This represents a dividend yield for shareholders of 7.2 per cent, calculated using the 31 December 2004 share price of 473p.

UK Retail Banking	2004 £m	2003† £m
Net interest income	**3,198**	3,137
Other income	**1,639**	1,533
Total income	**4,837**	4,670
Operating expenses	**(2,513)**	(2,583)
Trading surplus	**2,324**	2,087
Provisions for bad and doubtful debts	**(673)**	(594)
Share of results of joint ventures	**–**	(22)
Profit before tax	**1,651**	1,471
Profit before tax, before provisions for customer redress	**1,751**	1,671
Cost:income ratio, before provisions for customer redress	**49.9%**	51.0%
Total assets (year-end)	**£101.6bn**	£90.5bn
Total risk-weighted assets (year-end)	**£60.5bn**	£54.1bn

† Restated, as explained on page 3.

Profit before tax from UK Retail Banking increased by £180 million, or 12 per cent, to £1,651 million, compared to £1,471 million in 2003, supported by continued strong growth in the Group's consumer lending portfolios, partly offset by lower product margins, higher current account credit balances, improved current account fee income, tight cost control and a lower provision for customer redress. Excluding the impact of provisions for customer redress, profit before tax in UK Retail Banking increased by 5 per cent, with income growth of 4 per cent and cost growth of 1 per cent.

During 2004, we completed the restructure of our retail branch network through the establishment of 165 profit centred local markets. Initially, we particularly focused on developing our business in the London and South East markets where Lloyds TSB is currently under represented. Good progress has been made and, in our test markets, we achieved higher growth in quality customer recruitment, and greater improvement in levels of customer satisfaction than elsewhere in the branch network, and this is now starting to deliver an improved sales performance.

In 2004, market shares were increased or maintained in most key product areas including gross and net new mortgage lending, personal loans and credit cards. Income, profit and economic profit per customer all improved during 2004. Strong growth in volumes was achieved with personal loans outstanding at 31 December 2004 of £10.7 billion, an increase of 12 per cent during the year, and card balances of £7.5 billion, an increase of 12 per cent. Gross new mortgage lending increased by 9 per cent to a record £26.3 billion, compared with £24.2 billion in 2003. Net new lending increased to £9.3 billion resulting in a market share of net new lending of 9.2 per cent, and mortgage balances outstanding increased by 13 per cent to £80.1 billion. Credit balances on current accounts and savings and investment accounts increased by 7 per cent.

Within personal loans, key initiatives have been the increased use of behavioural and risk-based pricing, leveraging our customer relationship management capabilities to enable the Group to deliver more competitive pricing to better quality customers and to price by distribution channel within our existing customer base. 99 per cent of new personal loans, and 75 per cent of new credit cards, sold during 2004 were to existing customers, where the Group has a better understanding of an individual customer's total financial profile. The Group has also continued to avoid sub-prime lending. Dynamic delinquency measures, on a rolling 12 month basis, show an improving position for new business written. We have also continued to rationalise back office operations to improve efficiency and levels of customer service and satisfaction.

Operating expenses were well controlled throughout the business and as a result, excluding provisions for customer redress, increased by only £30 million, or 1 per cent, to £2,413 million compared with 4 per cent growth in income during the year.

The bad debt provisions charge increased by £79 million, or 13 per cent, to £673 million. £37 million of this increase reflected the acquisition in September 2003 of the Goldfish credit card and personal lending portfolios with the remainder reflecting volume related asset growth in personal loan and credit card lending. The provisions charge as a percentage of average lending for personal loans and overdrafts fell to 4.20 per cent, from 4.25 per cent in 2003, while the charge in the credit card portfolio increased to 3.42 per cent, from 3.19 per cent in 2003. In the mortgages business, there was a net provision release of £42 million (2003: £18 million release), reflecting the continuing low level of losses in a climate of rising house prices and historically low interest rates. Overall, the provisions charge as a percentage of average lending was 0.71 per cent, compared to 0.72 per cent in 2003, and the arrears position remained satisfactory.

C&G continues to focus on prime lending market segments, and has maintained its policy of not exceeding a 95 per cent loan-to-value ratio on new lending. The average indexed loan-to-value ratio on the C&G mortgage portfolio was 41 per cent (31 December 2003: 43 per cent), and the average loan-to-value ratio for C&G new mortgages and further advances written during 2004 was 62 per cent (2003: 62 per cent). At 31 December 2004, 88 per cent of C&G mortgage balances had an indexed loan-to-value ratio of less than 80 per cent and only 0.3 per cent of balances had an indexed loan-to-value ratio in excess of 95 per cent.

Customers are increasingly choosing to buy via direct channels and continued investment in our direct channel capabilities has supported good levels of business growth. Our internet bank now has 3 million registered users and, in 2004, 1.2 million product sales were achieved through the internet, an increase of 39 per cent compared to 2003. Over 400 million transactions were processed through internet banking, an increase of 60 per cent on 2003. Sales through direct channels now represent 50 per cent of total sales.

Lloyds TSB remains a leader in the added value current account market, with over 4 million customers. Quality customer current account recruitment increased by 20 per cent, compared with 2003, whilst quality current account attrition was 11 per cent lower, reflecting improvements made in levels of process quality, customer service and customer satisfaction.

Insurance and Investments	2004 £m	2003† £m
Life and pensions new business income	419	396
Life and pensions distribution costs	(231)	(241)
New business contribution	188	155
Existing business:		
Expected return	300	283
Experience variances	(41)	(16)
Assumption changes and other items	(39)	(75)
	220	192
Provisions for customer redress	(12)	(100)
Development costs	(11)	(13)
Investment earnings	167	153
Profit before tax (life and pensions)*	552	387
Unit trusts	75	62
Unit trust distribution costs	(22)	(38)
Profit before tax (unit trusts)	53	24
Profit before tax (life, pensions and unit trusts)*	605	411
General insurance*	160	153
Scottish Widows Investment Partnership	8	1
Profit before tax*	773	565
Profit before tax, excluding provisions for customer redress*	785	665
New business margin (life and pensions)	28.6%	25.8%

† Restated, as explained on page 3.

* Excluding changes in economic assumptions and investment variance.

Profit before tax from Insurance and Investments, excluding changes in economic assumptions, investment variance and customer redress provisions, increased by 18 per cent to £785 million, from £665 million in 2003. On the same basis, profit before tax from our life, pensions and unit trust businesses increased by £106 million, or 21 per cent, to £617 million. The Group's strategy to improve its profit mix by focusing on more profitable, less capital intensive, business whilst constantly seeking to improve process and distribution efficiency has led to a 21 per cent increase in new business contribution to £188 million. As a result of this improved capital efficiency, strong sales of pensions and single premium investments, and a reduced emphasis on certain lower return products such as stakeholder pensions, the life and pensions new business margin increased to 28.6 per cent, from 25.8 per cent in 2003.

Profit before tax from existing business, excluding provisions for customer redress, increased by £28 million, or 15 per cent, to £220 million. The expected return from existing business, which largely reflects the unwinding of the long-term discount rate applied to the expected cash flows from the Group's portfolio of in-force business, was £17 million, or 6 per cent, higher at £300 million.

During 2004, there was a net charge of £80 million from changes in actuarial assumptions and experience variances, compared to a net charge of £91 million in 2003. Higher margins, lower distribution costs and an improved stock market performance led to a significant improvement in the profit before tax from unit trusts, despite a reduction in the level of unit trust sales.

Pre-tax profit from Scottish Widows Investment Partnership ('SWIP') increased to £8 million, compared with £1 million in 2003, reflecting improved market performance and increased revenues from new business. SWIP won a record £2.1 billion of gross new business in 2004 and increased its assets under management by 6 per cent to £82 billion. The investment performance of fixed income and property remained strong in 2004. Corporate composite bonds outperformed the market in the three year period to 31 December 2004, and the principal property unit-linked funds have performed in the top quartile in each of the last three years. UK and European equity performance has shown steady improvement over 2004 and UK equities within SWIP's largest institutional funds have been significantly ahead of the benchmark in the second half of 2004. SWIP has introduced a new simplified fund range to support Lloyds TSB's bancassurance offer.

Overall, weighted sales in 2004 increased to £743.1 million, compared to £733.4 million in 2003 with 10 per cent growth in IFA sales to £431.6 million. Direct sales grew by 17 per cent to £72.2 million, while branch network sales were 14 per cent lower at £238.9 million largely reflecting the wider market trend of lower single premium unit trust sales.

In life and pensions, supported by growth in all channels, weighted sales increased by 9 per cent to £656.7 million, resulting in an increase in the Group's market share to 7.5 per cent, from 7.0 per cent in 2003. Through the branch network and direct channels, the Group's market share increased to 8.9 per cent, from 7.8 per cent in 2003, whilst the Group's market share in the IFA market improved to 7.0 per cent, from 6.7 per cent in 2003.

	2004 £m	2003 £m
Weighted sales (regular + 1/10 single):		
Life and pensions	**656.7**	601.7
Unit trusts	**86.4**	131.7
Life, pensions and unit trusts	**743.1**	733.4
Weighted sales by distribution channel:		
Branch network	**238.9**	278.8
Independent financial advisers	**431.6**	391.6
Direct	**72.2**	61.6
Other, including International	**0.4**	1.4
Life, pensions and unit trusts	**743.1**	733.4

	2004 £bn	2003 £bn
Group funds under management:		
Scottish Widows Investment Partnership	**82**	77
UK Wealth Management	**13**	11
International	**13**	15
	108	103

General insurance

Profit before tax, excluding investment variance, from our general insurance operations increased by £7 million, or 5 per cent, to £160 million.

Continued progress in improving levels of business retention and higher product margins led to premium income from underwriting increasing by £19 million, or 4 per cent. Home insurance income increased by 8 per cent. Insurance broking commission income decreased by £18 million as a £26 million increase in income from creditor insurance was offset by a £47 million reduction in other commissions, reflecting lower profit sharing income. There was a significant improvement in broking income from creditor insurance in the second half of the year, partly reflecting improvements in personal loan and credit card penetration rates.

The business strategy to increase investment in more cost efficient distribution through direct channels is starting to create a shift from face-to-face channels towards direct channels. As a result gross written premiums from new policies sold through direct channels increased by 12 per cent in 2004. Gross written premiums for new policies sold via the internet increased by 37 per cent.

Claims fell by £12 million to £224 million, compared to 2003, and the claims ratio fell to 38 per cent compared with 42 per cent in 2003, reflecting benign weather conditions and improved leverage of the supply chain. The combined ratio relating to the underwriting business was 83.2 per cent in 2004.

	2004 £m	2003† £m
Premium income from underwriting:		
Creditor	**114**	104
Home	**442**	410
Health	**27**	43
Reinsurance premiums	**(29)**	(22)
	554	535
Commissions from insurance broking:		
Creditor	**377**	351
Home	**30**	30
Health	**19**	16
Other	**160**	207
	586	604
Profit before tax*	**160**	153

† Restated, as explained on page 3.

* Excluding investment variance.

Wholesale and International Banking

	2004 £m	Continuing operations 2003† £m	Discontinued operations 2003 £m	Total 2003† £m
Net interest income	**1,966**	1,875	511	2,386
Other income	**1,641**	1,561	142	1,703
Total income	**3,607**	3,436	653	4,089
Operating expenses	**(2,090)**	(2,048)	(272)	(2,320)
Trading surplus	**1,517**	1,388	381	1,769
Provisions for bad and doubtful debts	**(193)**	(306)	(63)	(369)
Amounts written off fixed asset investments	**(52)**	(44)	–	(44)
	1,272	1,038	318	1,356
(Loss) profit on sale of businesses	**(15)**	–	865	865
Profit before tax	**1,257**	1,038	1,183	2,221
Cost:income ratio*	**57.9%**			59.6%
Total assets (year-end)	**£113.0bn**			£101.3bn
Total risk-weighted assets (year-end)	**£71.1bn**			£62.8bn

† Restated, as explained on page 3.

* Excluding trading results of discontinued operations.

Wholesale and International Banking profit before tax, excluding profit/loss on sale of businesses and trading results of discontinued operations, increased by £234 million, or 23 per cent, to £1,272 million, from £1,038 million in 2003. On the same basis income growth of 5 per cent exceeded cost growth of 2 per cent, leading to an improvement in the cost:income ratio to 57.9 per cent. Our focus on cross-selling and capital efficiency has led to an increase in the post-tax return on average risk-weighted assets to 1.42 per cent compared with 1.23 per cent in 2003. In Wholesale, there was strong profit growth in Corporate Markets, Business Banking and Asset Finance, in addition to a reduction in provisions for bad and doubtful debts.

Excluding the trading results of businesses sold in 2003 net interest income increased by £91 million, or 5 per cent, reflecting higher income from improved margins in Corporate Banking and the Asset Finance businesses, and strong growth in customer lending in Asset Finance. Other income increased by £80 million, partly as a result of a £50 million increase in gains on the sales of assets, largely the realisation of venture capital investments by Lloyds TSB Development Capital. Costs were tightly controlled, 2 per cent higher at £2,090 million, reflecting higher staff related costs and increased investment spend within Corporate Markets, partially offset by lower operating lease depreciation within Asset Finance.

The charge for provisions for bad and doubtful debts decreased by £113 million to £193 million. The charge in Wholesale fell by £68 million to £232 million, as a result of a decrease in provisions from the corporate lending portfolio, partially offset by higher charges in the Asset Finance business. In International Banking there was a credit of £39 million mainly reflecting a £30 million release from the general provision against the Group's exposures in Argentina.

We continue to deepen customer relationships, and the creation of an integrated regional sales structure, bringing together product specialists with relationship managers, has already started to generate positive results, with a 59 per cent increase in cross-selling income within Corporate Markets including an 86 per cent increase in Financial Markets cross-selling income to £69 million in 2004. In Corporate Markets, which incorporates Corporate Banking, Structured Finance and Financial Markets, profit before tax grew by 25 per cent from £504 million in 2003 to £631 million, reflecting an increase in the contribution from both relationship and transactional business driven by a combination of higher income and a reduction in provisions.

In December 2004, we agreed the acquisition of a UK corporate loan portfolio from Danske Bank comprising some 110 relationships, with total assets of £1.2 billion and risk-weighted assets of some £2.0 billion. The transaction is expected to enable us to deepen the relationships we have with a number of our existing corporate customers and acquire some important new corporate relationships to support the growth within our Corporate Markets businesses.

Profit before tax in Business Banking grew by £23 million, or 22 per cent, to £126 million reflecting good growth in customer income and tight control of costs. Customer deposits rose by 3 per cent to £10.3 billion and customer lending increased by 9 per cent to £6.0 billion. Business Banking continued to grow its customer franchise, with net customer recruitment of some 12,000 during the year, regaining leadership in the start-up market with a share of 22 per cent in 2004.

Profit before tax in Lloyds TSB Asset Finance increased by 27 per cent to £202 million, compared with £159 million in 2003, largely reflecting the continued profitable development of the motor and leisure, and contract hire businesses. In the personal and retail finance business, new business volumes have increased by some 9 per cent, increasing market share. Lloyds TSB Commercial Finance has retained market leadership, measured by client numbers, with a 19 per cent market share, and the motor and leisure business continues to be the largest independent lender in the UK motor and leisure point of sale market with a market share of 20 per cent.

In International Banking, profit before tax, excluding the profit/loss on sale of businesses and trading results of discontinued operations, increased by £27 million, or 21 per cent, to £157 million, reflecting a £45 million reduction in provisions, including a £30 million general provision release in Argentina.

During 2004, the Group completed the sale of its businesses in Panama, Guatemala, Honduras, Argentina and Colombia resulting in a net loss on disposal of £15 million.

Central group items	2004 £m	2003† £m
Accrual for payment to Lloyds TSB Foundations	**(31)**	(31)
Other finance income	**39**	34
Funding cost of acquisitions less earnings on capital	**(342)**	(345)
Profit on sale of emerging markets debt portfolio and certain closed foreign exchange positions	**–**	295
Central costs and other unallocated items	**1**	35
	(333)	(12)

† Restated, as explained on page 3.

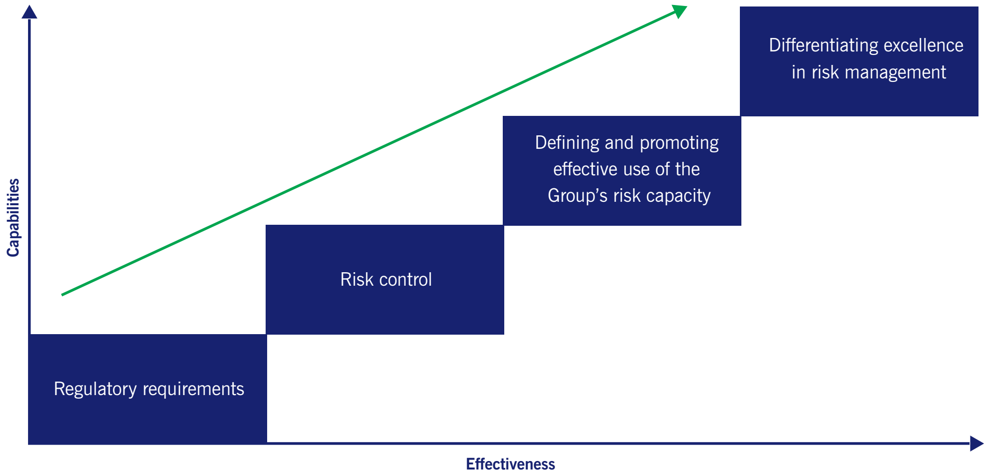
The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly disabled and disadvantaged, to play a fuller role in society. The Foundations receive 1 per cent of the Lloyds TSB Group's pre-tax profit after adjusting for gains and losses on the disposal of businesses and pre-tax minority interests, averaged over three years, instead of the dividend on their shareholdings. In 2004, the Group accrued £31 million for payment to the Lloyds TSB Foundations.

During 2003 improved secondary bond market conditions allowed the Group to sell its remaining portfolio of emerging markets debt securities. Profits on these bond sales, and certain closed foreign exchange positions, in 2003 totalled £295 million.

Risk management

Risk as a strategic differentiator

Risk awareness has improved significantly. The ground work of embedding the risk governance framework has been completed and the challenge and support provided by specialist risk functions has been located closer to business units, whilst maintaining independence. This is reflected in dual reporting lines to both the chief risk director and business managers. Risk analysis has been strengthened and a new reporting system has been developed and implemented which better identifies opportunities as well as risks, improves the ability to take an aggregate view of the overall risk portfolio and assigns clear responsibilities and timetables at Group and divisional level for risk mitigation strategies. Risk continues to be a key component of all routine management information reporting and is embedded in the balanced scorecards, which are cascaded to every member of staff. The objective is to go beyond risk mitigation and control to developing risk capabilities as a key strategic differentiator for Lloyds TSB.



Risk profile

Having worked to reduce risk and earnings volatility during 2003 by tactically selling part of our portfolio of businesses, this year's focus has been more on improving the understanding of risk. Our credit disciplines are strong, which will leave us well positioned, should there be any adverse change in the economic climate during 2005 and as we selectively seek to increase our lending portfolios. Allied to this there has been a much closer alignment between risk and the strategic planning round both in terms of identifying risks to the delivery of the plans and change in risk appetite arising from those plans.

Risk management framework

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

Risks which the business assumes are broken down into eleven common risk drivers (shown on page 21). Business and divisional risk functions use this format when reporting risks centrally, to enable risk aggregation, and assessing risk levels of new products, change initiatives or business plans. Business executive committees, with divisional oversight, monitor their risk levels against their risk appetite; seeking to ensure effective mitigating action is being taken where appropriate and also that the risk appetite allocated to them is profitability and prudently deployed. Divisional risk profile reports are reviewed by the group business risk committee to seek to ensure that group executive directors and the chief risk director are aware of risk exposures and are comfortable these are being effectively managed. During the year a new group consolidated risk report was developed and implemented to further support the identification and control of risk.

The Group is developing an improved approach towards its risk appetite (defined as the extent and categories of risk which the board regards as appropriate and acceptable for the Group to bear). Adoption of the principles and metrics under development has the objective of deriving Lloyds TSB's risk appetite and processes explicitly from its strategic objectives and the commitments it makes to all its stakeholders (customers, shareholders, staff, debt holders and regulators). This work is ongoing.

Risk language

Lloyds TSB Group has a risk language in which all risks are classified within one or more of the eleven risk drivers set out below.

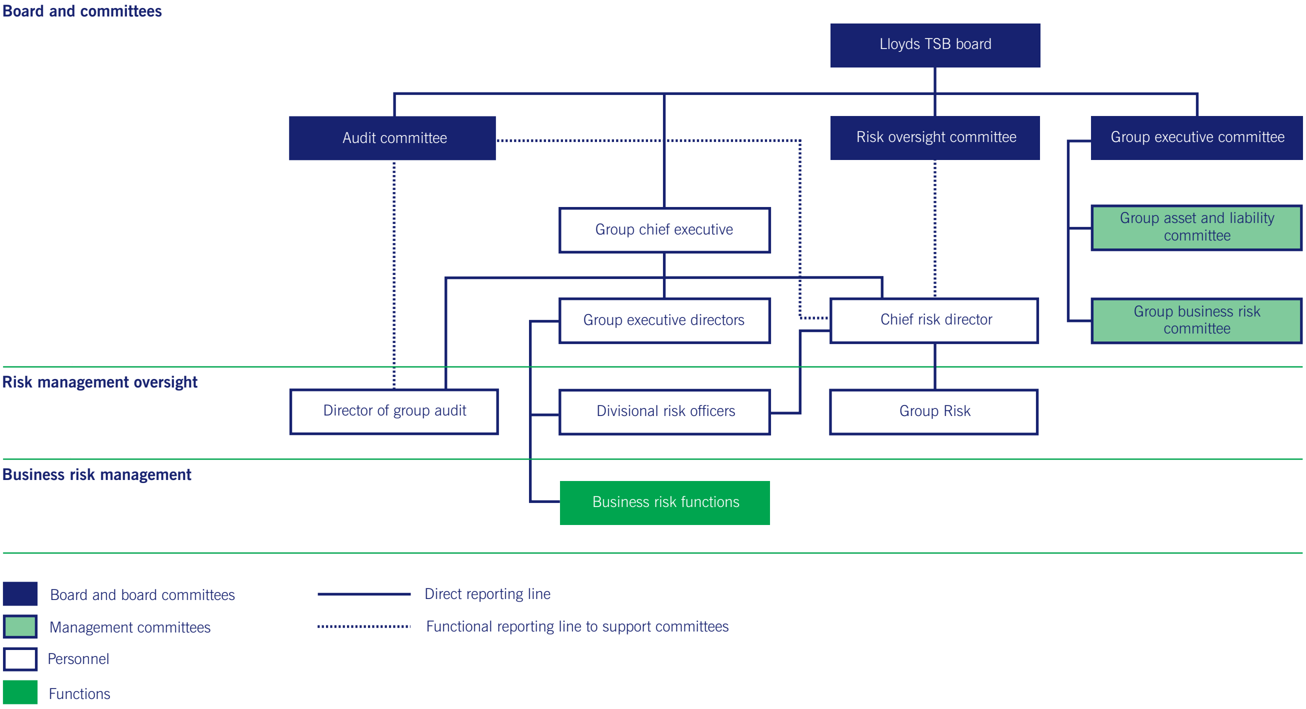
Sub-risks have been developed for these high level risks to further refine the identification and classification of risk and enable risk events to be accurately categorised to facilitate analysis of root causes.

Governance, people and organisation risk, operations risk, customer treatment risk, legal and regulatory risk, and change management risk are collectively managed as operational risks. A more detailed language has been identified for these operational risks.

The Group's high level policies and reporting to the group business risk committee, risk oversight committee, audit committee and board are aligned to the risk drivers.

Risk governance

The changing regulatory environment faced by the Group's businesses, and developments in best practice, prompted the Group during 2003 to extensively review its risk governance structures and deliver more effective risk management. The process of embedding these changes has progressed during 2004 and is now substantially complete. In addition, further enhancements were made during the year with a solid reporting line established between the divisional risk officers and the chief risk director.



The risk oversight responsibilities of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 43 and 44, whilst further key risk oversight roles are described below.

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

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

The chief risk director, a member of the group executive committee, oversees and promotes the development and implementation of a consistent group wide risk management framework and provides objective challenge to the group executive committee. Group Risk supports the chief risk director in performing the role.

Divisional risk officers provide oversight of risk management activity within each of the Group's operating divisions. Reporting directly to the group executive directors responsible for the divisions, their day-to-day contact with business management, business operations and risk initiatives, provides an effective risk oversight mechanism. They meet regularly with the chief risk director to enable best practice to be shared and to provide a wide ranging and current perspective on material risks facing the Group.

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

Accountability of line management has also been reinforced in relation to the management of risks arising from its business and in developing the risk awareness and risk management capability of its staff. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite. As shown on page 21, business management forms part of a tiered risk management model, with the divisional risk officers providing oversight and challenge, as described above, and the chief risk director and Group committees establishing the group wide perspective.

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

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

There is an annual control self-assessment exercise under which key businesses and head office functions across the Group review specific controls and certify the accuracy of their assessments.

Basel

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

Credit risk

Defintion

This is the risk of loss arising from counterparty default subsequent to the provision of credit facilities (both on- and off-balance sheet). Lloyds TSB Group has dedicated standards, policies and procedures for the measurement, control and monitoring of credit and related risks.

Control

Group rating system. All business units operate an authorised rating system complying 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.

Portfolio analysis. With Group Risk, 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 Group Risk.

To enhance further the ability to measure and predict future risk, the Group continues to develop new policies and risk management systems.

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

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

Concentration risk. The formulation of concentration limits on certain industries and sectors. Group Risk sets sector caps that reflect risk appetite, and monitors exposures to prevent excessive concentration of risk.

Credit derivatives. These are a method of transferring credit risk from one counterparty to another and of managing exposure to selected counterparties. Credit derivatives include credit swaps, credit spread options and credit linked notes. The Group has limited exposure to such instruments.

Credit risk arising from the use of derivatives. Note 47 shows the total notional principal amount of interest rate, exchange rate and equity and other contracts outstanding at 31 December 2004. The notional principal amount does not, however, represent the Group's real exposure to credit risk, which is limited to the current cost of replacing contracts with a positive value to the Group, should the counterparty default. This replacement cost is also shown in note 47. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

A number of tools, including group level credit policy where appropriate, are used to control the Group's exposure to undue levels of credit risk:

- High-level credit policies designed to ensure a balanced and managed approach to the identification and mitigation of credit risk.
- Lending guidelines defining the responsibilities of lending officers seek to provide a disciplined and focused benchmark for credit decisions.
- Independent review of credit exposures at divisional and group level.
- Sector caps, encompassing both industry sectors and specific product types are established by Group Risk to communicate the Group's risk appetite for specific types of business, primarily in the non-retail markets.
- Establishment and maintenance of the Group's large exposure and provisioning policies, in accordance with regulatory reporting requirements.
- Monitoring of scorecards. The Group uses statistically-based decisioning techniques (primarily credit scoring and performance scoring) for its principal consumer lending portfolios. Group Risk reviews and monitors new and material changes to scorecards.
- Maintenance of a facilities database. Group Risk operates a centralised database of large corporate, sovereign and bank facilities designed to monitor aggregate exposure throughout the Group.
- Monitoring and controlling residual value risk exposure. The Group's appetite for such exposure is communicated to the business by a series of time referenced sector caps, seeking to ensure an acceptable distribution of 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 is primarily the responsibility of the relevant business director. Businesses have established credit policies and processes reflecting Group policy. Businesses' lending authorities are delegated by officers holding divisional lending authority. All material authorities are advised to Group Risk.

Credit quality is supported by specialist units established within the Group businesses 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.

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

Market risk

Definition

Market risk is the risk of loss arising from unexpected changes in financial prices, including interest rates, exchange rates and bond, commodity and equity prices. It arises in all areas of Lloyds TSB Group's activities and is managed by a variety of different techniques. The Group's banking activities expose it to the risk of adverse movements in interest rates or exchange rates, with little or no exposure to equity or commodity risk. The Group's insurance activities also expose it to market risk. The Group's pension schemes are exposed to significant risks from the constituent parts of their assets, primarily equity and interest rate risk, and from the present value of their liabilities.

Control

Limits to control market risk in respect of trading positions are recommended by the group asset and liability committee, subject to review by Group Risk, to the group executive committee and authorised in total by the board. A combination of position and sensitivity limits is used, depending on the nature of the business activity. The group asset and liability committee, through Group Treasury for trading centres, ensures appropriate delegation to businesses.

Trading is restricted to a number of specialist centres, authorised by Group Treasury, the most important centre being Financial Markets in London. The level of exposure is strictly controlled and monitored within approved limits by Group Treasury. Most of the Group's trading activity is undertaken to meet the requirements of customers for foreign exchange and interest rate products. However, some interest rate and exchange rate positions are taken out using derivatives (including forward foreign exchange contracts, interest rate swaps and forward rate agreements) and on-balance sheet instruments (mainly debt securities), with the objective of earning a profit from favourable movements in market rates. Accordingly, these transactions are reflected in the accounts at their fair value and gains and losses are shown in the profit and loss account as dealing profits and losses.

Market risk in the wholesale banking books is managed in the UK by Financial Markets in London, and internationally by an authorised local treasury operation in each overseas centre. The levels of exposure within these books are controlled and monitored within approved limits, both locally and also centrally by Group Treasury. Active management of the book is necessary to meet customer requirements and changing market circumstances.

Market risk in the Group's retail portfolios and in the Group's capital funds arises from the different repricing characteristics of the Group's banking assets and liabilities and is managed by Group Balance Sheet Management.

Limits to control interest rate risk within the Group's UK retail portfolios are set out in the policy for group balance sheet management, which is established by the group asset and liability committee and ratified by the Group board. The policy is to optimise the stability of future net interest income, and this is achieved by entering into hedging transactions using interest rate swaps and other financial instruments. Both short and long-term interest rate parameters are applied to management of the balance sheet. Some centres have, in addition, adopted benchmark profiles for investment of interest rate insensitive liabilities as approved by Group Treasury.

Derivatives are used to meet customers' financial needs; as part of the Group's trading activities; and to reduce the Group's own exposure to fluctuations in interest and exchange rates. The principal derivatives used by the Group are interest rate contracts (including interest rate swaps, forward rate agreements and options) and exchange rate contracts (including forward foreign exchange contracts, currency swaps and options). Particular attention is paid to the liquidity of the markets and products in which the Group trades to seek to ensure that there are no undue concentrations of activity and risk.

Market risk exposures from the insurance businesses are controlled via approved investment policies consistent with the Group's overall risk appetite and regularly reviewed by the group asset and liability committee.

The group asset and liability committee liaises with the pension scheme trustees with regard to strategies for the overall mix of pension scheme assets.

Trading risk exposures from banking activities

The primary measure within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding three years, the VaR for the years ended 31 December 2004 and 2003 based on the Group's global trading positions was as detailed in the table below (the table also aggregates potential loss measures from options portfolios).

	31 December 2004				31 December 2003			
	Closing £m	**Average £m**	**Maximum £m**	**Minimum £m**	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	**0.7**	**0.9**	**1.7**	**0.5**	0.7	0.8	1.8	0.3
Foreign exchange risk	**0.2**	**0.3**	**0.6**	**0.2**	0.3	0.7	1.0	0.3
Equity risk	**0.0**	**0.0**	**0.0**	**0.0**	0.0	0.0	0.1	0.0
Total VaR (no diversification)	**0.9**	**1.3**	**2.0**	**0.8**	1.0	1.5	2.6	0.9

Measurement techniques. 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. Stress testing and scenario analysis are also used in certain portfolios, and at Group level, to simulate extreme conditions to supplement these core measures.

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

There are some limitations to the VaR methodology:

- The model assumes that changes in the underlying asset returns can be modelled by a normal distribution. This assumption is an approximation of reality that may not reflect all circumstances.
- The use of a confidence limit does not convey any information about potential losses on occasions when the confidence limit is exceeded. In times of extreme market movements actual losses may be significantly greater than the VaR number. Stress testing is used to supplement VaR to estimate the impact of extreme events.
- Any model that forecasts the future based on historic data is implicitly assuming that the conditions that generated the data will remain true in the future. Stress testing and using more than one VaR methodology for some local markets form part of the wider market risk framework.

- Periods of severe market illiquidity, both in terms of the extent of the illiquidity and the time that it lasts, could mean that it might not be possible to hedge, or close, all positions in the timescales assumed in the VaR model.
- VaR is calculated at the close of business each day, which excludes the profit and loss impact of intra-day trading.
- VaR is not well suited to options positions. As a result these positions are controlled by additional sensitivity limits.

In summary, although VaR is an important component of the Group's approach to managing trading market risk, it is supplemented by position and sensitivity limits and stress testing.

Structural interest risk exposures from banking activities

The Group's non-trading exposure is summarised in the form of an interest rate repricing table, as set out in note 47b to the financial statements. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. However, the table does not take into account the effect of interest rate options used by the Group to hedge its exposure.

The simulation models used by the Group include assumptions about the relationships between customer behaviour and the level of interest rates; the anticipated level of future business is also taken into account. The accuracy of these assumptions will impact the efficiency of hedging transactions. The assumptions are regularly updated and the projected exposure is actively managed in accordance with group asset and liability committee policy.

It is estimated that a hypothetical immediate and sustained 100 basis point increase in interest rates on 1 January 2005 would decrease net interest income by £80.7 million for the 12 months to 31 December 2005, while a hypothetical immediate and sustained 100 basis point decrease in interest rates would increase net interest income by £76.3 million. An analysis by currency is shown below.

	UK £m	North America £m	Asia & Australasia £m	Europe & Middle East £m	Total 2005 £m	Total 2004 £m
Change in net interest income from a +100 basis point shift in yield curves	**(48.7)**	**3.5**	**(1.0)**	**(34.5)**	**(80.7)**	(88.3)
Change in net interest income from a –100 basis point shift in yield curves	**44.3**	**(3.5)**	**1.0**	**34.5**	**76.3**	84.0

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

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

In the Group's retail portfolios, including mortgages, and in the Group's capital funds, exposure arises from the different repricing characteristics of the Group's banking assets and liabilities and is managed by Group Balance Sheet Management under the direction of the group asset and liability committee.

Liabilities arising in the course of business from the Group's retail banking business fall into two broad categories:

- those which are insensitive to interest rate movements, non-interest bearing liabilities such as shareholders' funds and interest-free or very low interest current account deposits; and
- those which are sensitive to interest rate movements, primarily savings deposits bearing interest rates which are varied at the Group's discretion ('managed rate liabilities') but which for competitive reasons generally reflect changes in the Bank of England's base rate.

There is a relatively small volume of naturally arising banking liabilities whose interest rate is contractually fixed typically for periods of up to two years.

Most banking assets, with the exception of such non-interest earning items as premises, are sensitive to interest rate movements. There is a large volume of managed rate assets such as variable rate mortgage loans and these may be considered as a natural offset to managed rate liabilities. However many assets, such as personal loans and fixed rate mortgages, bear interest which is contractually fixed for periods of up to five years or longer.

Interest rate risk arises from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets, and between the differing contractual periods for which interest rates are fixed on interest rate sensitive assets and liabilities. Group Balance Sheet Management manages this risk centrally by offsetting against each other any matching interest rate sensitive assets and liabilities; acquiring new financial assets and liabilities as matching hedges against net balances of mismatched interest rate sensitive banking liabilities and assets, respectively; and acquiring new financial assets with interest rates contractually fixed for a range of periods up to five years as hedges for net balances of interest rate insensitive liabilities.

The financial assets and liabilities referred to above are acquired by way of internal transactions between Group Balance Sheet Management and Financial Markets in London, typically in the form of interest rate swaps and loans or deposits.

Structural interest rate risk can also arise from the wholesale banking books in the UK, where it is managed by Financial Markets in London, and internationally, where it is managed by an authorised local treasury operation in each overseas centre. The levels of exposure within these books are controlled and monitored within approved limits locally and centrally. Limits are issued to the international businesses on interest rate gaps or, where more appropriate, VaR.

Foreign exchange exposures from banking activities

Foreign exchange exposures comprise those originating in treasury trading activities and structural foreign exchange exposures, which arise from investment in the Group's overseas operations.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to Group Treasury. Group Treasury calculates the associated VaR as shown in the table on the previous page.

Risk arises from the Group's investments in its overseas operations. The Group's structural foreign currency exposure is represented by the net asset value of the holding company's foreign currency exchange equity and subordinated debt investments in its subsidiaries and branches. Gains or losses on structural foreign currency exposures are taken to retained earnings.

The structural position is managed by Lloyds TSB Group Capital Funds having regard to the currency composition of the Group's risk-weighted assets and reported to the group asset and liability committee on a monthly basis. The objective is to limit the effect of exchange rate movements on the published risk asset ratio.

The Group's structural position at 31 December 2004 is set out in note 47d to the financial statements. The position implies that at 31 December 2004 a hypothetical increase of 10 per cent in the value of sterling against all other currencies would have led to an £82 million reduction in reserves, and vice versa. On this basis, there would have been no material impact on Lloyds TSB Group's risk asset ratios.

Market risk exposures in the insurance businesses

Market risk exposure depends upon the nature of the funds in question:

- With-profits funds are managed in accordance with the relevant fund's Principles and Practices of Financial Management. This leads to assets and liabilities that are mismatched with the aim of generating a higher rate of return to meet policyholders' expectations.
- Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of these assets.
- For other insurance liabilities the investment strategy is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. The aim is to invest in assets such that the cash flows on the investments will match those on the projected future liabilities. Actuarial tools are used to project and match the cash flows. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch.
- Investment strategy for surplus assets held in excess of liabilities takes account of the regulatory and internal business requirements for capital to be held to support the business now and in the future. Surplus assets are held primarily in three portfolios: the surplus in the non-participating fund within the Long-Term Fund of Scottish Widows plc, assets in shareholder funds of life assurance companies and an investment portfolio within the General Insurance business.

  Market risks are monitored using stochastic modelling.

  The surplus in the Non-Participating Fund of Scottish Widows plc exists to provide the Long-Term Fund with liquidity and working capital. The surplus also forms a capital reserve to support the investments managed on behalf of the With-Profits Fund of Scottish Widows plc. With-profits business involves guaranteed benefits; in adverse market conditions the surplus could be called upon to support with-profits benefits. As a consequence this fund is currently invested in a mix of equities, investment properties, fixed interest investments and cash that takes into account the mix in the With-Profits Fund. This investment policy helps maintain the value of the reserve as a proportion of the underlying With-Profits Fund. The existence and investment mix of the surplus in the Non-Participating Fund can therefore be considered as structural rather than as a traded portfolio. Under UK GAAP the portfolio is shown at market value and gains and losses are recognised in the profit and loss account.

  Assets held in shareholder funds are invested in money market funds, gilts and investment grade bonds so as to reduce the risk of statutory insolvency in the event of market crashes.

  The General Insurance portfolio is invested in a mixture of assets: cash, bonds and equities.

  The investment policy together with appropriate limits including the limit to be applied to the equity component are approved by the group asset and liability committee supported by Group Risk.

Investment holdings are diversified across markets and, within markets, across sectors. Holdings of individual assets are diversified to minimise specific risk and large individual exposures are monitored closely. For assets held outside unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid.

Equity derivatives are used by the Group to match equivalent liabilities arising from some of its retail products. Derivatives may also be used for efficient portfolio management purposes in client funds where such activity is in accordance with approved policy and the customer mandate.

Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present. This occurs as part of the new product approval process (see 'Product and service risk' on page 28).

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

The following table shows closing, average, maximum and minimum VaR for the years ended 31 December 2004 and 2003 on a 99 per cent confidence ten day basis.

	31 December 2004				31 December 2003			
	Closing £m	**Average £m**	**Maximum £m**	**Minimum £m**	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	**15.5**	**16.1**	**17.9**	**11.2**	15.1	16.3	24.3	13.2
Foreign exchange risk	**2.4**	**2.7**	**3.4**	**2.2**	3.6	4.0	4.6	3.3
Equity risk	**55.2**	**54.2**	**56.4**	**51.6**	52.1	63.0	80.0	51.8
Total VaR	**73.1**	**73.0**	**75.9**	**67.1**	70.8	83.3	107.5	70.8

Insurance risk

Definition

The risk of loss arising from the sensitivity of profits to movements in insurance claims, expenses and persistency experience and expectation. It also covers the risk of inadequate underwriting and/or reinsurance of insured risks and movements in the cost of providing benefits from the Group's pension schemes that result from social and demographic factors.

Control

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

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

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

Insurance risk exposures

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

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

Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present. This occurs as part of the new product approval process (see 'Product and service risk' on page 28).

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

Persistency rates are regularly assessed by reference to appropriate risk factors.

Operations risk

Definition

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

Control

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

The Group has defined high-level operations risk policies to seek to ensure a wide-ranging and consistent approach to the identification and management of operations risk and a standard methodology to ensure consistency in the identification, assessment and management of operations risk.

Group Risk provides general guidance on operations risk related issues, including regulatory changes and developments in the measurement and management of operations risk, to promote best practice throughout the Group. It keeps under continuous review and improvement all aspects of operations risk management to reflect developments in industry best practice and regulatory requirements.

The Group applies appropriate new product review processes to provide assurance that risks inherent in new products have been identified and mitigated.

Legal and regulatory risk

Definition

The risk of financial loss or reputational damage arising from failing to comply with the laws, regulations or codes applicable to the financial services industry. The Group's business is regulated overall by the Financial Services Authority ('FSA'), and additionally by local regulators in offshore and overseas jurisdictions.

Control

Each business has a nominated individual with 'compliance oversight' responsibility under FSA rules. The role of such individuals is to ensure that management has in place within the business a control structure which creates awareness of the rules and regulations to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

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

Group Compliance includes a dedicated unit, led by the group financial crime director, which is responsible for ensuring that the Group has effective processes in place to identify and report on suspicious transactions and customers, in support of the worldwide fight against financial crime.

The group compliance director has access to the chairman, group chief executive and members of senior management.

Customer treatment risk

Definition

The risk of financial loss or reputational damage arising from inappropriate or poor customer treatment or failure to treat customers fairly.

Control

Lloyds TSB Group is committed to the fair treatment of its customers. A range of management information measures is in place across the Group to support the tracking of key customer treatment indicators. Group Risk and Group Audit are required to report regularly on customer treatment risk, management information trends and on compliance with the Group's standards.

Service improvements are monitored by customer satisfaction surveys. The results of the research are fed into the Group's CARE Index, which measures ongoing performance against five principal objectives: customer understanding; accessibility; responsibility; expertise; and overall service quality improvement.

A framework is in place to guide the consideration and documentation of customer treatment risk when developing policies and procedures. The Group has defined benchmark standards in all the key areas. The divisions are required to meet or exceed these standards.

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

Strategy risk

Definition

This comprises the risks arising from the adoption of the Group's agreed strategy and its implementation at corporate or business level. At corporate and business level these risks are managed through a number of processes.

Control

An annual strategic planning process is conducted at Lloyds TSB Group and business level and includes a quantitative and qualitative assessment of the risks in the Group's plan.

The Group's strategy and those of its constituent businesses are reviewed and approved by the board. Regular reports are provided to the group executive committee and the board on the progress of the Group's key strategies and plans. Group Risk conducts oversight to ensure the business plans remain consistent with the Group's strategy.

Revenue and capital investment decisions require additional formal assessment and approval. Formal risk assessment is conducted as part of the financial approval process.

Significant company mergers and acquisitions require specific approval by the board. In addition to the standard due diligence conducted during a merger or acquisition, Group Risk conducts, where appropriate, an independent risk assessment of the target company and its proposed integration into the Lloyds TSB Group.

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

Product and service risk

Definition

The risk of loss arising from the inherent characteristics, management or distribution of products or services, or from failure to meet or exceed customer expectations and competitor offerings. For the Group to achieve its objective to maximise value for shareholders over time, product life cycles must be effectively managed and new products developed to meet customer needs.

Control

The Group is committed to the fair treatment of its customers. This is embedded into the processes indicated below to ensure businesses have developed customer centric strategies for product and business development, marketing, selling and after sales service.

Businesses maintain a range of products to meet customers' needs and the business strategy and are responsible for managing and controlling product risks and compliance with applicable regulations.

Product planning and development. Businesses have formal processes for reviewing the range of their product portfolios and subject all product development to rigorous assessment. The assessment includes seeking to ensure that the product meets clearly defined customer needs.

Product promotion, distribution and sales. Businesses have a defined channel distribution strategy for products, consistent with the Group's distribution strategy. Businesses launching new products are responsible for ensuring compliance with all applicable regulations and that the proposed sales activity is appropriate for the type of customer and their attitude to risk.

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

Businesses are required, prior to publication of any sales material, to seek confirmation that it complies with the regulatory and legal requirements of the jurisdiction in which the product is offered and marketed. Procedures require that terms and conditions (to include mandates, agreements and other documentation) are approved by legal advisers and reviewed periodically.

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

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

Change management risk

Definition

The risk of financial loss or reputational damage arising from programmes or projects failing to deliver to requirements, budget or timescale; or failing to implement change effectively.

Control

To deliver the Group's strategic aims, change must be managed in an effective, risk-aware and appropriately controlled manner throughout the organisation. The Group's Change Management Standards ensure appropriate control across the project portfolio and the approach is regularly benchmarked against other organisations around the world.

Changes that significantly impact customers or staff are managed as part of an overall change plan managed by the Group's change management committee. The committee ensures that the aggregate impact of the implementation of change on customers, staff and systems is understood, managed and controlled.

Governance, people and organisation

Definition

This is the risk of loss from poor corporate governance at Group and business level. It includes sub-optimal organisational structuring, or failure to recruit, manage and retain appropriately skilled staff to achieve business objectives. Group policy for managing governance, people and organisation risk is defined in the Group Policy Manual. It defines the way the Group is organised, the need for tight financial and operating controls, maintenance of a strong risk management and control culture, the need to benchmark against industry best practice and for businesses to conduct themselves with integrity, due skill, care and diligence.

Control

Management of risks. The Group sets high standards for the conduct of its business and values its reputation. Responsibility for establishing an effective organisational structure is vested in Group and business management. Sound internal risk management practices are promoted through business directors who are ultimately responsible for identifying, measuring, monitoring and controlling the risks within their specific areas of accountability.

The Group seeks to identify and classify risks in a timely manner. The likelihood of risks crystallising and the significance of the consequent impact on the business, the Group and its customers are evaluated. The Group's business control environment seeks to ensure effective and efficient operational management; reliability, integrity and consistency of financial and other reporting; and compliance with governing laws and regulations. Business directors seek to ensure that material risks are reported to the relevant divisional risk officer, group executive director and to Group Risk.

Information and communication. It is the Group's policy for the board and senior management at both Group and business level to receive relevant, reliable and timely management information in line with business objectives to seek to ensure that activities are appropriately controlled, key risks are identified and monitored, decisions are implemented and regulatory obligations are met.

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

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

Standards of behaviour. The Group has a code of business conduct, which applies to the group chief executive, the group finance director, and all other employees. It seeks to ensure that employees act with integrity and endeavour to deliver high levels of customer service. It promotes a working environment free from discrimination, harassment, bullying or victimisation of any kind. Employees are encouraged and expected to alert management to suspected misconduct, fraud or other serious malpractice. The code as amended from time to time is available to the public on the Group's website at www.lloydstsb.com.

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

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

Financial soundness

Definition

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

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

The international standard for measuring capital adequacy is the risk asset ratio, which relates to on- and off-balance sheet exposures weighted according to broad categories of risk. The Group's capital ratios, calculated in line with the requirements of the FSA, are set out in detail on page 31.

Control

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

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

Lloyds TSB Group and its regulated subsidiary banks have been allocated an Individual Capital Ratio by the FSA, and the board has agreed a formal buffer to be maintained in addition to the Individual Capital Ratio. Actual or prospective breaches of the formal buffer must be notified to the FSA, together with proposed remedial action; no such notifications have been made during 2004. Informally, a further buffer is maintained. In addition, the board has agreed a maximum limit of the proportion of debt instruments in the capital base. Risk-weighted assets are monitored by businesses, while capital is controlled centrally.

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

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

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

Liquidity sources

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

Lloyds TSB Group plc is also able to raise funds by issuing loan capital or equity, although in practice Lloyds TSB Group plc has never issued equity for this purpose and the majority of Lloyds TSB Group's loan capital has been issued by Lloyds TSB Bank. As at 31 December 2004, Lloyds TSB Group plc had £1,358 million of subordinated debt in issuance compared with £10,252 million for the consolidated Lloyds TSB Group. The cost and availability of subordinated debt finance are influenced by credit ratings. A reduction in these ratings could increase the cost and could reduce market access. At 31 December 2004, the credit ratings of Lloyds TSB Bank were as follows:

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

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

A significant part of the liquidity of the Group's banking businesses arises from their ability to generate customer deposits. A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally provided a stable source of funding. During 2004, amounts deposited by customers increased by £5,566 million from £116,496 million at 31 December 2003 to £122,062 million at 31 December 2004. These customer deposits are supplemented by the issue of subordinated loan capital and wholesale funding sources in the capital markets, as well as from direct customer contracts. Wholesale funding sources include deposits taken on the inter-bank market, certificates of deposit, sale and repurchase agreements, a Euro Medium Term Note programme, of which £5,097 million had been utilised for senior funding at 31 December 2004, and a commercial paper programme, under which £3,281 million had been utilised at 31 December 2004.

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

Capital ratios

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

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

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

	31 December 2004 £m	31 December 2003 £m
Capital:		
Tier 1	**11,725**	11,223
Tier 2	**8,800**	8,935
	20,525	20,158
Supervisory deductions	**(7,252)**	(6,898)
Total regulatory capital	**13,273**	13,260
Total risk-weighted assets	**132,173**	117,732
Risk asset ratios:		
Total capital	**10.0%**	11.3%
Tier 1	**8.9%**	9.5%
Post-tax return on average risk-weighted assets	**2.01%**	2.63%

At 31 December 2004, the risk asset ratios were 10.0 per cent for total capital and 8.9 per cent for tier 1 capital. The 8.9 per cent tier 1 capital ratio appears higher than would perhaps be expected and reflects the higher level of supervisory deductions resulting from the Group's significant investment in its life assurance operations.

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

There are strict limits imposed by the regulatory authorities as to the proportion of the Group's regulatory capital base that can be made up of subordinated debt and preferred securities. The Group's capacity to raise new debt capital for regulatory purposes increases as profits are retained; at 31 December 2004, the Group had capacity to raise approximately £2,900 million of tier 2 debt capital, compared to approximately £2,300 million at 31 December 2003. This increase reflects the effects of retained profits and favourable exchange rate movements. The unpredictable nature of movements in the value of the investments supporting the long-term assurance funds could cause the amount of qualifying tier 2 capital to be restricted because of falling tier 1 resources. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

During 2004, total capital for regulatory purposes increased by £13 million to £13,273 million. Tier 1 capital increased by £502 million, mainly as a result of profit retentions. However, tier 2 capital decreased by £135 million largely due to the reduction in the Group's general bad debt provision. There was an increase in supervisory deductions of £354 million, mainly as a result of an increase of £300 million in the long-term assurance business attributable to the shareholder to £6,781 million, from £6,481 million in December 2003.

Corporate responsibility

Lloyds TSB Group has long recognised the importance of corporate responsibility (sometimes described as corporate social responsibility). It is one of the UK's largest corporate givers; it has award winning policies in equality and diversity, employee relations and training and development; and, it has leading edge systems for the assessment of environmental risks in lending. This track record is reflected in sector leading performance in a variety of corporate responsibility indices, league tables and investor ratings.

The Group recognises that social, ethical and environmental (SEE) issues bring both risks and opportunities. The Group's full response to such issues is detailed in its separate corporate responsibility report, The community and our business, (see page 9 for details).

The Group has a corporate responsibility steering committee chaired by the deputy group chief executive and comprising the senior executives of those businesses most directly affected by SEE issues. The committee meets quarterly to recommend strategy and direction. The board reviews overall corporate responsibility performance annually and individual issues are subject to board discussion throughout the year. During 2003, the Group introduced a human rights policy and in 2004 has conducted a self-assessment audit that confirms compliance with the policy in all countries of operation.

The board believes that the systems in place to manage significant SEE risks are effective and provide adequate information to identify and assess the short and long-term risks arising from SEE matters. One of the most significant risks is that posed by climate change, which affects the whole business of insurance – claims, regulation, investment returns and operating costs. Storm and flood damage claims in the UK have doubled to £6 billion since 1998. Lloyds TSB Insurance recognises this risk and is working with the Association of British Insurers and the government to prevent further building on flood plains. In addition it offers advice to homeowners on how to protect their properties against extreme weather conditions. These measures have ensured that Lloyds TSB Insurance is currently able to continue offering cover to renewing customers in areas considered prone to flooding, while managing its exposure through pricing and underwriting controls.

The board is satisfied that relevant corporate responsibility risks have been assessed during 2004 and that they do not pose a material threat to the Company.

During 2004 the Group further embedded its balanced scorecard as a tool to support the business strategy and values and to provide a means to balance the needs of customers, staff and shareholders. The balanced scorecard seeks to ensure that staff performance is measured on customer service, building customer relationships, people management and assessment of risk as well as sales and financial measures. Where appropriate, management remuneration and incentives are linked directly to specific areas of corporate responsibility performance: for example service quality.

Robust internal audit systems are in place to review adherence to policies and procedures and environmental performance is subject to external independent verification. Overall, the board is satisfied that the Company complies with its corporate responsibility related policies and procedures.

Future accounting developments

International Financial Reporting Standards

From 1 January 2005, the Group is using International Financial Reporting Standards ('IFRS') as its primary financial reporting framework. The Group will report IFRS results for the first time in its interim report for the six months to 30 June 2005 and in its 2005 annual report. Comparative information in these reports will be fully reconciled to reported UK GAAP numbers.

As a 2005 first-time adopter of IFRS, the Group is required to prepare an opening balance sheet as at 1 January 2004. Most accounting policy adjustments to apply IFRS retrospectively will be made against retained earnings in this opening balance sheet. However, transitional adjustments relating to those standards for which comparatives are not required to be restated will be made on 1 January 2005. Restated comparatives are not required for IAS 32 *Financial Instruments: Disclosure and Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts*.

A steering committee has been overseeing the adoption of IFRS for the Group and has closely monitored developments in IFRS and the impact for the Group's accounting policies and financial position. Work streams evaluated the impact of specific accounting changes and undertook significant work during 2004 including technical analysis, development of IFRS-compliant solutions and project management of necessary systems and process changes. The Group has been preparing its internal management accounts using IFRS since 1 January 2005.

The overall impact on net assets and earnings up to 1 January 2005 is not expected to be significant. From 1 January 2005 there will be impacts arising from changes in the fair values of financial assets and liabilities, and volatility arising from ineffective hedges. The future impact for fee income, lease accounting and accounting for insurance business will depend on the mix of business and the rate of new business growth. The following areas have been identified as having the greatest impact upon the Group.

Area of impact	IFRS treatment
Loan impairment	IFRS adopts an incurred loss model for impairment losses on loans and provides guidance on the measurement of impairment. An allowance is raised for losses in respect of exposures that are known to be impaired. The required allowance is computed by comparing the book value of the loans with the net present value of the expected future cash flows from the loans discounted at their effective interest rates or, as a practical expedient for variable rate loans, using observable market prices. Exposures found not to be impaired are placed into pools of similar assets with similar risk characteristics to be collectively assessed for losses that have been incurred, but not yet identified. For such exposures, the required allowance is estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the collective pool. The historical loss experience is adjusted based on current observable data. These more prescriptive requirements are expected to lead to increased volatility in the charge made to the income statement.
Equity to debt reclassification	The classification of the majority of the Group's capital and subordinated debt instruments will continue to follow their current treatment. However, the limited voting ordinary shares of Lloyds TSB Group plc will be reclassified as debt. In addition, the Group's preferred securities, which are treated as non-equity minority interests under UK GAAP, will be reclassified as debt. Distributions on these securities will be shown as interest expense rather than as minority interests.
Fee income	Revised rules governing the accounting for fee income will result in more fees being deferred on initial receipt, and recognised either as an adjustment to yield or over the period of service. Fees required to be treated as an adjustment to yield will be recognised in interest income rather than fee income. On initial application, certain fees that have previously been credited to the profit and loss account under UK GAAP will be recognised in the balance sheet, with a corresponding reduction in retained earnings.
Goodwill	The current Group policy of amortising goodwill arising on acquisitions after 1 January 1998, with the exception of the goodwill which arose on the acquisition of Scottish Widows, will cease. Instead, all goodwill will be subject to impairment testing annually, or more frequently if events or circumstances indicate that it might be impaired. This change in policy will result in increased volatility of future earnings in the event that impairment losses are identified.
Derivatives, hedging and investment securities	All derivatives contracts will be carried at fair value on the Group's balance sheet and movements in their fair value reflected in the income statement. The resulting income statement volatility can be mitigated by the application of hedge accounting. IFRS permits the use of two kinds of hedge accounting: fair value and cash flow hedge accounting. The Group is expected to make greater use of fair value hedge accounting which seeks to match, in the income statement, changes in the fair values of the hedged items with the changes in the fair value of the related derivatives. Cash flow hedge accounting is expected to be used to a lesser extent; adjustments reflecting the movements in the fair values of the derivatives concerned are made to a separate reserve in equity and recycled to the income statement as the related cash flows occur. IFRS contains detailed requirements for documentation of hedge relationships and testing their effectiveness. To the extent that a hedge is ineffective, the impact is reflected in the income statement. An adjustment will be made against retained earnings on transition to eliminate the effects of the asymmetrical accounting for derivative transactions entered into between the Group's banking and trading activities. Investment securities are classified as either held-to-maturity investments, available-for-sale financial assets or at fair value through profit or loss. While many of the Group's investment securities will be classified as available-for-sale and will be required to be measured at fair value with changes in their fair values going to a separate reserve in equity, investment securities backing insurance business will be designated at fair value through profit or loss.
Derecognition of financial liabilities	Under IFRS a financial liability may only be derecognised after it has been settled or alternatively the debtor has been legally released from the liability, either by process of law or by the creditor. Upon adoption of IFRS, certain financial liabilities previously released to the profit and loss account will be reinstated.
Consolidation of subsidiaries and Special Purpose Entities	IFRS requires line-by-line consolidation for all subsidiaries. Consequently, the Group is no longer permitted to report the results and balances of the life assurance business on one line; instead these amounts must be broken down into their constituent parts and allocated to the appropriate line items. IFRS will also require consolidation of several entities that the Group was not required to consolidate under UK GAAP. These relate to the entities supporting the Group's securitisation conduits, which facilitate customers' own securitisations, and to Open Ended Investment Companies (OEICs) where the Group, through the Scottish Widows life funds, has an interest. This will have the effect of grossing-up the balances reported in the income statement and on the balance sheet.

Area of impact	IFRS treatment
Netting	IFRS prohibits financial assets and financial liabilities from being offset unless there is a legal right of set-off and the asset and liability are normally settled on a net basis. In the banking business, this will result in the grossing-up on the balance sheet of assets and liabilities subject to set-off arrangements that are presented net under UK GAAP. In the case of insurance business, insurance liabilities will be presented without offsetting them against related reinsurance assets.
Insurance	Under IFRS, investment contracts without discretionary participation features (DPF) do not meet the definition of an insurance contract and are accounted for as financial instruments. The Group's life assurance business will continue to account for insurance contracts and DPF investment contracts as it has under UK GAAP. The significant IFRS impacts are the removal of that portion of the UK GAAP embedded value which represents the value of in-force business relating to investment contracts, the recognition of an asset for deferred acquisition costs (DAC) in connection with writing new investment contract business and the deferral of fee income (as discussed above), which for the life assurance business represents up-front income in respect of investment contracts sold. The DAC asset is amortised over the lives of the related contracts. For the Group's general insurance operation, claims equalisation provisions are no longer permitted under IFRS. The majority of the required adjustments will be made against retained earnings at 1 January 2005.
Depreciation	In addition to the impact for depreciation of operating lease assets outlined below, IFRS requires property, plant and equipment to be depreciated since the date of acquisition. Under UK GAAP, long leasehold and freehold properties have been depreciated only since 1 January 2000. There will be no effect upon the Group's income statement until the properties concerned are disposed of at which point any gain on sale will increase or any loss will be reduced.
Dividends	Under IFRS equity dividends declared after the balance sheet date may not be included as a liability at the balance sheet date. Consequently, the 2003 final dividend will be adjusted against opening retained earnings at 1 January 2004.
Capitalisation of software	Currently only software costs relating to separable new systems are capitalised. Under IFRS, costs relating to enhancements that lead to additional system functionality will also be capitalised. The impact on the Group's income statement will depend on the level of IT expenditure and whether it meets the criteria for capitalisation.
Leasing	IFRS requires income from finance leases to be credited to the income statement so as to give a constant pre-tax rate of return on the net cash invested; UK GAAP requires a constant post-tax rate of return. In addition, IFRS requires depreciation on operating lease assets to be charged on the same basis as for tangible fixed assets which for the Group is a straight-line basis. Under UK GAAP depreciation is charged so as to give a constant rate of return on the leased asset.
Share-based payments	IFRS requires that a cost be recognised in the financial statements for all options granted under executive and employee Save-As-You-Earn share option schemes. The total cost recognised represents the fair value of the options (as determined using an option valuation model) at the grant date, as adjusted for the expected number of forfeitures and, for executive schemes, the probability that the performance target will not be met. This total cost is spread over the period to vesting. This will result in an increase in the costs recognised in the Group's income statement as under UK GAAP only the intrinsic value of executive share options is charged to the profit and loss account.

FRS 27

In December 2004 the UK Accounting Standards Board ('ASB') issued FRS 27 *Life Assurance* setting out changes to the way in which life assurance business should be accounted for and requiring certain additional disclosures; this standard is effective for accounting years ending on or after 23 December 2005. Although technically not applicable to those reporting under International Financial Reporting Standards in 2005, under the terms of a Memorandum of Understanding entered into between leading members of the life assurance and bancassurance sectors and the Association of British Insurers and the ASB, the Group has committed to implementing the requirements of FRS 27 in 2005 and providing additional disclosures in its 2004 accounts. These disclosures are set out below.

Following the implementation of FRS 27 in 2005 the Group will be required to:

- exclude from the value of in-force business recognised in the balance sheet any amounts that reflect future investment margins; and
- measure the liabilities of the Scottish Widows With-Profits Fund in accordance with the FSA's realistic capital regime, subject to certain specified adjustments. Consequential adjustments are made to the related assets.

The exclusion of future investment margins will result in an adjustment to retained earnings as at 1 January 2004 and will lead to increased volatility in the reported income from long-term assurance business.

The principal subsidiaries involved in the Group's life assurance operations during the year were Scottish Widows plc ('Scottish Widows', the Group's principal provider of life assurance, pensions and investment products, which holds the only large with-profits fund managed by the Group), Scottish Widows Annuities Limited (a subsidiary of Scottish Widows that accepts the reinsurance of annuity business from its parent), Abbey Life Assurance Company Limited ('Abbey Life') and Lloyds TSB Life Assurance Company Limited ('Lloyds TSB Life'). Since March 2000 both Abbey Life and Lloyds TSB Life have continued to administer existing policies and have undertaken only limited new business. No change in this activity is anticipated in respect of Abbey Life. On 31 December 2004, Lloyds TSB Life ceased trading and transferred most of its assets and insurance business to Scottish Widows.

Basis of determining regulatory capital of the life assurance business

Available capital resources

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

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

'Realistic' basis. The FSA requires each life assurance company which contains a with-profits fund in excess of £500 million, including Scottish Widows, to carry out a 'realistic' valuation of that fund. The word 'realistic' in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology. The methodology has the effect of limiting the assumed average future investment return to the risk free rate and represents a best estimate of a theoretical market value of the liabilities.

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

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

Regulatory capital requirements

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

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

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

Constraints over available capital resources

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

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

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

Other restrictions in the Non-Participating Fund. The Scheme states that no amounts can be transferred from the Non-Participating Fund of Scottish Widows unless there are sufficient assets within the Long-Term Fund to meet both policyholders reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

Financial information calculated on a 'realistic' basis

The estimated financial position of the With-Profits Fund of Scottish Widows at 31 December 2004, calculated on a 'realistic' basis, is given in the following table, in the form that the information will be reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the 'realistic' financial position of the Long-Term Fund of Scottish Widows as a whole, which consists of both the With-Profits Fund and the Non-Participating Fund.

	With-Profits Fund £m	Long-Term Fund £m
Realistic value of assets of fund	17,814	22,012
Support arrangement assets (value of 'Support Account')	1,265	–
Realistic value of assets available to the fund	19,079	22,012
Realistic value of liabilities of fund	(18,108)	(17,827)
Working capital for fund	971	4,185
Working capital ratio for fund	5.1%	19.0%

Scottish Widows continues to be well capitalised with the working capital ratios for the With-Profits Fund and the Long-Term Fund being an estimated 5.1 per cent and 19.0 per cent respectively.

The realistic liabilities of the With-Profits Fund disclosed above include amounts payable from the With-Profits Fund to the Non-Participating Fund of Scottish Widows in respect of the shareholders' share of future bonuses and other charges due as a result of the Scheme. The value of the liabilities excluding the shareholders' share of future bonuses is £17,988 million. The value of the liabilities excluding the value placed on all interfund transfers is £17,353 million, and the value of excess assets in the With-Profits Fund after eliminating those amounts (excluding the value of the Support Account) is £461 million.

The following table reconciles the value of the Long-Term Fund of Scottish Widows quoted above to the total shareholders' funds attributable to the life assurance business of the Group, calculated on a modified statutory solvency basis:

	Life assurance business £m
Total shareholders' funds on a modified statutory solvency basis* (note 29)	4,581
Adjustments to restate amounts onto an FSA statutory basis	(502)
Available capital resources on an FSA statutory basis excluding the With-Profits Fund	4,079
Fund for future appropriations**	1,354
Total available capital resources on an FSA statutory basis	5,433
Capital resources held outside the Long-Term Fund of Scottish Widows	(1,260)
Net effect of adjustments to restate amounts onto a realistic basis	12
Excess assets in the Long-Term Fund of Scottish Widows on a realistic basis	4,185

* A reconciliation of the total shareholders' funds on a modified statutory solvency basis (£4,581 million) to the amount included in the Group's balance sheet on an embedded value basis (£6,781 million) is included in note 29(h) to the financial statements.

** The fund for future appropriations included in the table relates to the With-Profits Fund of Scottish Widows only; the figure disclosed in note 29(h) to the financial statements (£1,379 million) includes £25 million in respect of the other life funds of the Group.

Capital sensitivities

Shareholders' funds

Shareholders' funds outside the long-term business fund are mainly invested in assets that are less sensitive to market conditions.

With-Profits Fund

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

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

Other long-term funds

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

Formal intra-group capital arrangements

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

Options and guarantees

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

Options and guarantees within the With-Profits Fund

The most significant options and guarantees provided from within the With-Profits Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies. As noted above, under the realistic capital regime of the FSA, the liabilities of the With-Profits Fund are valued using a market-consistent stochastic simulation model. This model is used in order to place a value on the options and guarantees which captures both their intrinsic value and their time value.

The most significant economic assumptions included in the model are:

- *Risk-free yield curve.* This is derived from the yield on UK gilts, with an additional 0.1 per cent yield assumed to be risk-free;
- *Investment volatility.* This is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. As at 31 December 2004, the assumptions were set at 18 per cent for equities, 15 per cent for properties and 13 per cent for interest rates.

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

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

Abbey Life currently has a number of policies in-force which have a guaranteed annuity option. In total it holds statutory reserves of £288 million to cover this liability at 31 December 2004. These reserves have been determined using prudent future interest rate, mortality rate and rate of annuity option take-up assumptions and exceed the value that would be placed on them using a market-consistent stochastic model. It is estimated that a 0.5 per cent reduction in future interest rates would increase the liability by some £45 million.

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

In both Abbey Life and Scottish Widows, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £89 million in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £6 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £15 million.

Five year financial summary

The financial information set out in the table below has been derived from the annual reports and accounts of Lloyds TSB Group plc for each of the past five years adjusted for subsequent changes in accounting policy and presentation. The financial statements for each of the years 2000 and 2001 were audited by PricewaterhouseCoopers, independent accountants; the financial statements for each of the years 2002 to 2004 have been audited by their successor firm PricewaterhouseCoopers LLP, independent accountants.

	2004	2003	2002	2001	2000
Profit and loss account data for the year ended 31 December (£m)[1]					
Net interest income	**4,920**	5,255	5,171	4,922	4,587
Other finance income	**39**	34	165	307	424
Other income	**4,608**	4,619	3,551	3,659	3,760
Trading surplus	**4,650**	4,735	3,974	4,119	4,503
Provisions for bad and doubtful debts	**(866)**	(950)	(1,029)	(747)	(541)
Profit on ordinary activities before tax	**3,493**	4,348	2,618	3,167	3,791
Profit on ordinary activities after tax	**2,489**	3,323	1,852	2,290	2,707
Profit for the year attributable to shareholders	**2,421**	3,254	1,790	2,233	2,658
Dividends	**1,914**	1,911	1,908	1,872	1,683
Balance sheet data at 31 December (£m)[1]					
Called-up share capital	**1,419**	1,418	1,416	1,411	1,396
Shareholders' funds (equity and non-equity)	**9,977**	9,624	7,943	10,326	11,877
Customer accounts	**122,062**	116,496	116,334	109,116	101,989
Undated subordinated loan capital	**5,852**	5,959	5,496	4,102	3,391
Dated subordinated loan capital	**4,400**	4,495	4,672	4,006	4,119
Loans and advances to customers	**154,240**	135,251	134,474	122,935	114,432
Assets[2]	**225,079**	201,934	207,343	189,317	169,495
Total assets	**279,843**	252,012	252,561	235,501	220,383
Share information[1]					
Basic earnings per ordinary share	**43.3p**	58.3p	32.1p	40.4p	48.4p
Diluted earnings per ordinary share	**43.0p**	58.1p	32.0p	40.0p	47.9p
Net asset value per ordinary share	**176p**	170p	140p	183p	213p
Dividends per ordinary share[3]	**34.2p**	34.2p	34.2p	33.7p	30.6p
Market price (year-end)	**473p**	448p	446p	746p	708p
Number of shareholders (thousands)	**953**	974	973	981	1,026
Number of ordinary shares in issue (millions)[6]	**5,596**	5,594	5,583	5,564	5,507
Financial ratios (%)[1,4]					
Dividend payout ratio	**79.1**	58.7	106.6	83.8	63.3
Post-tax return on average shareholders' equity	**24.3**	38.5	16.8	18.1	21.2
Post-tax return on average assets	**1.17**	1.57	0.93	1.28	1.68
Post-tax return on average risk-weighted assets	**2.01**	2.63	1.62	2.26	3.08
Average shareholders' equity to average assets	**4.7**	4.0	5.4	6.9	7.8
Cost:income ratio[5]	**51.4**	52.2	55.3	53.7	48.7
Capital ratios (%)[1]					
Total capital	**10.0**	11.3	9.6	8.8	8.6
Tier 1 capital	**8.9**	9.5	7.7	7.7	7.9

[1] Figures for 2002 and earlier years have been restated to reflect the implementation of UITF 37, *Purchases and sales of own shares*. UITF 38, *Accounting for ESOP trusts*, FRS 18, *Accounting Policies*, FRS 17, *Retirement Benefits*, FRS 19 *Deferred Tax*, UITF 33 *Obligations in Capital Instruments*, detailed guidance from the Association of British Insurers for best practice in the preparation of results using the achieved profits method of accounting and other minor adjustments.

[2] Assets exclude long-term assurance assets attributable to policyholders.

[3] Annual dividends comprise both interim and final dividend payments. Final dividends (which are always paid in the following year) are included in the year to which they relate rather than in the year in which they are paid.

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

[5] The cost:income ratio is calculated as total operating expenses as a percentage of total income.

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

The board

Non-executive directors

Maarten A van den Bergh◆◆+
Chairman
Joined the Group in 2000 as deputy chairman and was appointed chairman in 2001. Joined the Royal Dutch/Shell Group of companies in 1968 and after a number of senior and general management appointments in that group, became group managing director in 1992. Appointed president of Royal Dutch Petroleum Company and vice chairman of the committee of managing directors of the Royal Dutch/Shell Group in 1998 and continued in these roles until 2000. A non-executive director of Royal Dutch Petroleum Company, BT Group and British Airways. Aged 62.

David P Pritchard++
Deputy Chairman
(leaving on 5 May 2005)
Joined TSB Group in 1995 as group treasurer. Seconded to the Securities and Investments Board as head of supervision & standards, markets & exchanges, from 1996 to 1998. Appointed to the board in 1998, as group executive director, Wholesale and International Banking. Retired from executive duties in 2003, when he was appointed deputy chairman. Held senior and general management appointments with Citicorp from 1978 to 1986 and Royal Bank of Canada from 1986 to 1995. A non-executive director of LCH. Clearnet Group. Aged 60.

Wolfgang C G Berndt✠††
Joined the board in 2003. Joined Procter and Gamble in 1967 and held a number of senior and general management appointments in Europe, South America and North America, before retiring in 2001. A non-executive director of Cadbury Schweppes and GfK AG. Board member of the Institute for the Future. Aged 62.

Ewan Brown CBE FRSE▲◆+**
Chairman of Lloyds TSB Scotland
A director since 1999. A non-executive director of Lloyds TSB Scotland since 1997. Joined Noble Grossart in 1969 and was an executive director of that company until December 2003. Chairman of Transport Initiatives Edinburgh. A non-executive director of John Wood Group, Noble Grossart and Stagecoach Holdings. Aged 62.

Gavin J N Gemmell CBE✠*
Chairman of Scottish Widows
Joined the board in 2002. A non-executive director of Scottish Widows, having been appointed to the board of that company before it became a member of the Lloyds TSB Group. Retired as senior partner of Baillie Gifford in 2001, after 37 years with that firm. A non-executive director of Archangel Informal Investment. Chairman of the Court of Heriot-Watt University. Aged 63.


Maarten A van den Bergh


Christopher S Gibson-Smith


David P Pritchard


Sir Julian Horn-Smith


Wolfgang C G Berndt


DeAnne S Julius


Ewan Brown


Angela A Knight


Gavin J N Gemmell

Christopher S Gibson-Smith✠†◆
(leaving on 5 May 2005)
A director since 1999. Chairman of National Air Traffic Services and the London Stock Exchange. Joined BP in 1970, serving as managing director from 1997 to 2001, having held senior and general management appointments in the UK, USA, Canada and Europe. A non-executive director of The British Land Company. Aged 59.

Sir Julian Horn-Smith✠†+
Joined the board on 1 January 2005. Joined Vodafone in 1984 and held a number of senior and general management appointments before being appointed to the board of that company in 1996 and deputy chief executive officer in 2005. Previously held positions in Rediffusion from 1972 to 1982 and Mars GB from 1982 to 1984. A non-executive director of Smiths Group. Aged 56.

DeAnne S Julius CBE✠†◆
Joined the board in 2001. Held a number of senior appointments in the UK and USA with the World Bank, Royal Dutch/Shell Group and British Airways, before membership of the Bank of England Monetary Policy Committee from 1997 to 2001. Chaired HM Treasury's banking services consumer codes review group in 2000/1. Chairman of the Royal Institute of International Affairs. A non-executive director of BP, Serco Group and Roche Holdings SA. Aged 55.

Angela A Knight✠*
Joined the board in 2003. Deputy chairman of Scottish Widows, having been appointed to the board of that company before it became a member of the Lloyds TSB Group. A member of parliament from 1992 to 1997 and Economic Secretary to the Treasury from 1995 to 1997. Chief Executive of the Association of Private Client Investment Managers and Stockbrokers. A non-executive director of LogicaCMG and the Port of London Authority. Aged 54.

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

Executive directors

J Eric Daniels
Group Chief Executive
Joined the board in 2001 as group executive director, UK Retail Banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. Aged 53.

Michael E Fairey
Deputy Group Chief Executive
Joined TSB Group in 1991 and held a number of senior and general management appointments before being appointed to the board in 1997 and deputy group chief executive in 1998. He is also acting as interim group executive director, UK Retail Banking. Joined Barclays Bank in 1967 and held a number of senior and general management appointments, including managing director of Barclays Direct Lending Services from 1990 to 1991. President of The British Quality Foundation. Aged 56.

Archie G Kane
Group Executive Director, Insurance and Investments
Joined TSB Commercial Holdings in 1986 and held a number of senior and general management appointments in Lloyds TSB Group before being appointed to the board in 2000, as group executive director, IT and Operations. Appointed group executive director, Insurance and Investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. Aged 52.

J Eric Daniels

G Truett Tate

Michael E Fairey

Helen A Weir

Archie G Kane

G Truett Tate
Group Executive Director, Wholesale and International Banking
Joined the Group in 2003 as managing director, Corporate Banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. Aged 54.

Helen A Weir
Group Finance Director
Joined the board in 2004. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q from 1997, having joined that company in 1995, and held a senior position at McKinsey & Co from 1990 to 1995. Began her career at Unilever in 1983. A non-executive director of The City of London Investment Trust. Aged 42.

Company Secretary
Alastair J Michie FCIS FCIBS

Directors' report

Results and dividends

The consolidated profit and loss account on page 59 shows a profit attributable to shareholders for the year ended 31 December 2004 of £2,421 million.

An interim dividend of 10.7p per ordinary share was paid on 6 October 2004 and a final dividend of 23.5p per ordinary share will be paid on 4 May 2005. These dividends will absorb £1,914 million.

Principal activities, business review and future developments

The Company is a holding company and its subsidiaries provide a wide range of banking and financial services through branches and offices in the UK and overseas. A review of the business and an indication of future developments are given on pages 5 to 38.

Authority to purchase shares

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

Directors

Biographical details of directors are shown on pages 40 and 41. Particulars of their emoluments and interests in shares in the Company are given on pages 47 to 57.

The Earl of Selborne left the board at the annual general meeting in 2004. Mr Hampton, Mr Targett, Sir Tom McKillop and Mr Ayliffe left the board on 12 January 2004, 30 April 2004, 31 December 2004 and 31 January 2005, respectively. Dr Gibson-Smith and Mr Pritchard will leave the board at the annual general meeting in 2005.

Mrs Weir joined the board on 26 April 2004 and was elected at the annual general meeting on 21 May 2004.

Mr Tate and Sir Julian Horn-Smith joined the board on 1 August 2004 and 1 January 2005, respectively. In accordance with the articles of association, they offer themselves for election at the annual general meeting.

Also in accordance with the articles of association, Mr Gemmell, Mr Fairey and Dr Julius retire at the annual general meeting and offer themselves for re-election.

Employees

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

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

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

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

Donations

The profit and loss account includes a charge for charitable donations totalling £31,571,000 (2003: £31,712,000) including £31,230,000 (2003: £31,450,000) under deeds of covenant to the four Lloyds TSB Foundations, which will be paid during 2005.

Policy and practice on payment of creditors

The Company follows 'The Better Payment Practice Code' published by the Department of Trade and Industry, regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the Department of Trade and Industry as shown on page 113.

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

As the Company owed no amounts to trade creditors at 31 December 2004, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is nil.

Auditors

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

On behalf of the board

A J Michie
Company Secretary
3 March 2005

Corporate governance

Compliance with the combined code

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

The board and its committees

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

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

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

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

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

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

The chairman's performance is evaluated by the non-executive directors, led by the senior independent director, taking account of the views of executive directors.

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

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

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

Meetings with shareholders

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

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

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

Each resolution considered at the annual general meeting in 2004 was decided on a poll. Votes representing some 50 per cent of the total number of shares in issue were cast and each resolution was passed by a substantial majority. Details of the poll results are available from the company secretary.

The resolutions to be considered at the annual general meeting in 2005 will also be decided on a poll. Details of the results will be announced on our website, www.lloydstsb.com and will also be available from the company secretary.

Audit committee

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

The audit committee met five times in 2004, during which it received reports from, and held discussions with, management and the auditors. In discharging its duties, the committee has reviewed the auditors' remuneration and, in discussion with them, has assessed their independence and objectivity (more information about which is given in note 4 to the accounts, in relation to the procedure for approving fees for audit and non-audit work) and recommended their re-appointment at the annual general meeting. The committee also reviewed the financial statements published in the name of the board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; the scope of the work of the Group's internal audit department, reports from that department and the adequacy of its resources; the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations (more information about which is given in the note about internal control on page 46); procedures by which staff may raise concerns in confidence; the results of the external audit and its cost effectiveness; reports from the external auditors on audit planning and their findings on accounting and internal control systems; and the committee's own role and performance. The committee also had a meeting with the auditors, without executives present, and a meeting with the head of internal audit alone.

Chairman's committee

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

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

Group executive committee

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

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

Nomination committee

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

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

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

Remuneration committee

The remuneration committee, which comprises Dr Berndt (chairman), Dr Gibson-Smith, Sir Julian Horn-Smith and Dr Julius, reviews the remuneration policy for the top management group, to ensure that members of the executive management are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation. It is made aware of, and advises on, major changes to employee benefit schemes and it also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated powers for setting remuneration for the chairman, the deputy chairman, the group executive directors, the company secretary and any Group employee whose salary exceeds a specified amount.

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

The remuneration committee met five times in 2004 and further information about its membership and work is given in the directors' remuneration report on pages 47 to 57.

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

Risk oversight committee

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

Attendance at meetings

The attendance of directors at board meetings and at meetings of the audit, nomination, remuneration and risk oversight committees during 2004 was as follows:

	Board	Audit committee	Nomination committee	Remuneration committee	Risk oversight committee
Number of meetings during the year	**9**	**5**	**3**	**5**	**4**
Current directors who served during 2004					
W C G Berndt	8			5	
Ewan Brown[1]	9	5			4
J E Daniels	9				
M E Fairey	9				
G J N Gemmell	9	5			
C S Gibson-Smith[2]	9		2	5	
D S Julius	8		3	4	
A G Kane	9				
A A Knight	8	5			
D P Pritchard	9				4
G T Tate[3]	3				
M A van den Bergh	9		3		1
H A Weir[4]	6				
Former directors who served during 2004					
P G Ayliffe[5]	9				
Sir Tom McKillop[6]	7			4	2
Lord Selborne[7]	4	2	1		
S C Targett[8]	3				

[1] Appointed to the nomination committee from 3 March 2005

[2] Appointed to the nomination committee from 21 May 2004

[3] Appointed to the board from 1 August 2004

[4] Appointed to the board from 26 April 2004

[5] Left the board on 31 January 2005

[6] Left the board on 31 December 2004

[7] Left the board on 21 May 2004

[8] Left the board on 30 April 2004

Statement of directors' responsibilities

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Lloyds TSB Group ('the Group') as at the end of the year and of the profit or loss for the year. The directors consider that in preparing the financial statements on pages 59 to 112, the Company and the Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

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

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

Internal control

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

The directors and senior management are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of published policies and procedures and regular management briefings. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. In addition, there is an annual control self-assessment exercise under which the key businesses and head office functions review specific controls and attest to the accuracy of their assessments. The material controls covered by this assessment include risk management, organisational control, legal and regulatory, finance and information technology. As in previous years, this exercise was completed for the year ended 31 December 2004. All returns have been satisfactorily completed and appropriately certified. There are well established budgeting and forecasting procedures in place and reports are presented regularly to the board detailing the results of each principal business, variances against budget and prior year, and other performance data. Internal controls contain procedures which assist the board in identifying new and emerging risks.

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

Going concern

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

Directors' remuneration report

This is a report made by the board of Lloyds TSB Group plc, on recommendation of the remuneration committee. The role of the remuneration committee is shown on page 44.

The remuneration committee

The members of the remuneration committee during 2004 were Sir Tom McKillop (chairman until 31 December 2004), Dr Berndt, Dr Gibson-Smith, and Dr Julius. From 1 January 2005, Dr Berndt became chairman and Sir Julian Horn-Smith joined the committee.

Towers, Perrin, Forster & Crosby, Inc. (TPFC) were appointed by the committee to advise it on matters relating to executive remuneration. TPFC also provide the management of the Company with competitive market data relating to other employees and administrative services for the Company's flexible benefits plan for its employees.

In addition, in 2004, Alithos Limited provided information for the testing of the total shareholder return (TSR) (calculated by reference to both dividends and growth in share price) performance conditions for the Company's executive share option schemes.

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

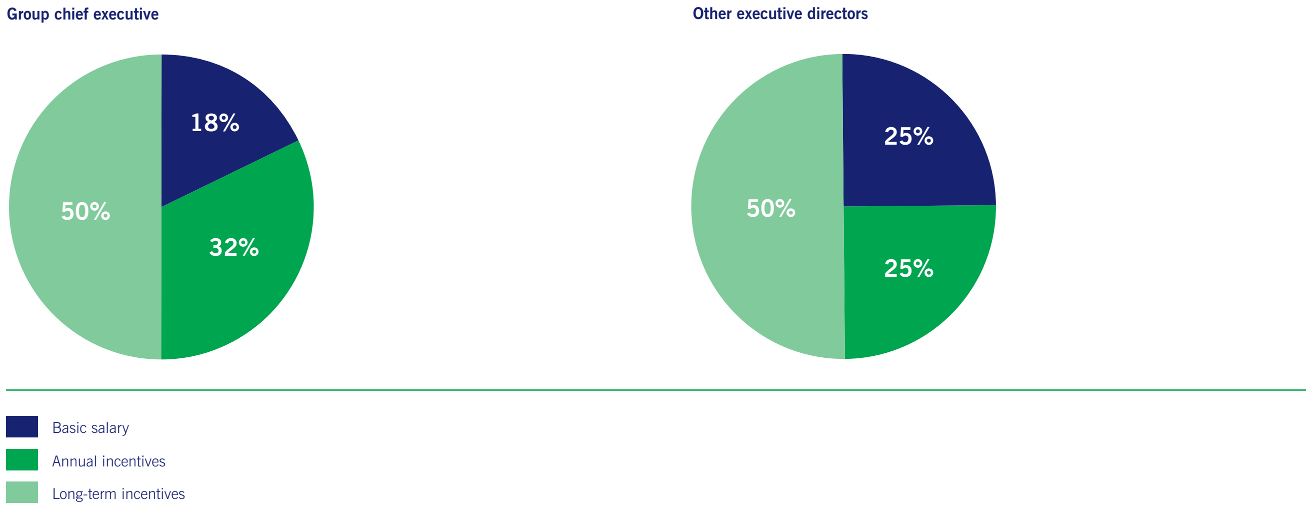
Directors' remuneration policy

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

- Basic salary reflects the market median of companies in the FTSE 30 and total compensation should be at the market upper quartile providing performance is at that level.
- The majority of total compensation is linked to the achievement of stretching performance targets.
- The long-term rewards are aligned to shareholders' interests and executive directors are expected to build a shareholding in the Group over a period of four years equivalent to the value of one times the director's annual basic salary.
- The overall package reflects market practice and takes account of the terms and conditions applying to other employees of the Group.

There is no intention to change these principles in 2005.

Executive directors' remuneration is made up of basic salary, annual bonus, long-term incentives, pensions and other benefits. In 2005, approximately 75 per cent (82 per cent for the group chief executive) of an executive director's potential direct remuneration (salary, annual bonus and long-term incentives) will be performance related (see illustrative charts below). The value of long-term incentives is the expected value calculated by using a 'binomial' model, which is a widely accepted methodology for this purpose.



The chairman and deputy chairman receive remuneration which comprises basic salary and benefits which are broadly similar to the executive directors, but they do not participate in the annual bonus and long-term incentive arrangements. The deputy chairman has pension benefits which accrued during his service as an executive director and pension benefits are accruing for the chairman as described on page 53.

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. They may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the responsibilities of the role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees are listed below:

	Annual fees from 1 April 2005	Annual fees pre-April 2005
Board	£50,000	£45,000
Audit committee chairmanship	£40,000	£15,000
Audit committee membership	£15,000	£10,000
Nomination committee membership	£5,000	–
Remuneration committee chairmanship	£20,000	£12,500
Remuneration committee membership	£15,000	£10,000
Risk oversight committee membership	£15,000	–

Independent non-executive directors who serve on boards of subsidiary companies may also receive fees from the subsidiaries.

Basic salary

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by TPFC) and then adjusted from 1 January of the following year. Basic salary increases for other employees across the Group will be in the range of 0-10 per cent, and the salary increases awarded to executive directors are consistent with this policy. Details of salaries payable to executive directors in 2005 are shown on page 50.

Annual incentive and performance share plan

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

For executive directors except Mr Daniels, individual bonus awards for 2005 will be made from a bonus pool based on Group performance with pre-determined targets relating to profit before tax and economic profit. As in 2004, the maximum size of the bonus pool applicable to these executive directors will remain at 100 per cent of the aggregate of their basic salaries. An amount equal to 75 per cent of these executive directors' basic salaries will form the bonus pool on the achievement of a stretching budget for 2005; failure to achieve at least 90 per cent of this budget will result in no bonus pool. These executive directors will be considered for awards based on individual targets which will include profitability, franchise growth, risk, service and other specific goals that are relevant to improving overall business performance. The maximum level of any bonus award distributable from the pool to any individual has been set at 150 per cent (100 per cent for 2004) of salary for exceptional performance, to reflect the competitive market position for total earnings opportunity.

The maximum annual bonus opportunity for 2005 for Mr Daniels has also been set at 150 per cent (125 per cent for 2004) of basic salary for exceptional peformance, to increase the proportion of pay which is performance linked and to reflect the competitive market position for total earnings opportunity. An amount equal to 112.5 per cent of basic salary will be available on the achievement of stretching budget targets relating to profit before tax and economic profit; failure to achieve at least 90 per cent of these performance targets would result in no bonus payment. The actual level of bonus award made will take account of individual performance and contribution.

PricewaterhouseCoopers LLP check the calculation of the annual incentive payments for executive directors based on the achievement of performance against targets set. In respect of performance in 2004, bonuses ranging from 40 per cent to 125 per cent have been paid to the directors with an average payment of 89 per cent of salary.

Under the performance share plan agreed at the annual general meeting in May 2004, executive directors are required to defer 50 per cent of any bonus payable into shares in the Company, known as bonus shares. The bonus shares will be held on behalf of the executive for a period of three years before release. The amounts deferred into bonus shares in respect of the 2004 bonus, before the deduction of income tax, will be:

Name	J E Daniels	M E Fairey	A G Kane	G T Tate	H A Weir
Amount	£468,750	£259,000	£180,000	£93,750	£135,000

Under the new plan, executives will be eligible for an award of free shares, to be known as performance shares, to match the bonus shares. The maximum match will be two performance shares for each bonus share, awarded at the end of the three year retention period. The number of performance shares actually awarded will depend on the Company's TSR performance measured over the three year period ending 31 December 2007, compared with the TSR of the other companies in the comparator group listed below. The maximum of two performance shares for each bonus share will be awarded only if the Company's TSR performance places it first in the comparator group; one performance share will be awarded for each bonus share if the Company is placed fifth; and one performance share for every two bonus shares if the Company is placed eighth (median). Between first and fifth positions and fifth and eighth positions a sliding scale will apply. If the TSR performance is below median no performance shares will be awarded. There will be no retest. In December 2004, the Inland Revenue issued new guidance which will require income tax to be deducted before the deferral into bonus shares. This is a change that effectively would alter the balance under the long-term arrangements, and as a result would reduce any performance related match. Therefore, to avoid this inbalance, where a match with performance shares is justified it will be made on a notional deferral as if income tax had not been deducted at the outset. This maintains the intention of the original design of the plan.

The other companies in the comparator group will be:

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

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

Long-term rewards

Executive share option schemes

In 2004, options were granted to executive directors and senior executives within the scheme limits. These limits relate to the number of shares under option and the price payable on exercise. The maximum limit for the grant of options to an executive director in any one year was one and a half times annual basic salary multiplied by a performance multiplier of 3.5 (although in exceptional circumstances, for example on the recruitment of a new executive, that could be increased to four times annual basic salary multiplied by 3.5). The table on pages 55 and 56 gives the number of options granted.

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

The full grant of options for executive directors will only become exercisable if the Company is ranked first within the comparator group.

The other constituents of the comparator group are:

Abbey National	ABN Amro	Alliance & Leicester	Aviva
Barclays	Citigroup	Fortis	HBOS
HSBC Holdings	ING	Legal & General	National Australia Bank
Prudential	Royal Bank of Scotland	Royal & Sun Alliance	Standard Chartered

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

A performance condition is set when the grant of options is made and the options cannot normally be exercised unless the condition has been met.

The performance condition for options granted from 2005 will be based on TSR over the relevant (three year) period measured against the group of 14 financial services companies listed on page 48. The options will become exercisable in full if the Company is placed fourth or above in the comparator group (at or above the upper quartile) and as to 30 per cent if the Company is placed eighth (i.e. median). The options will lapse if the Company is placed below eighth. A sliding scale will apply between fourth and eighth positions. There will be no retest.

The following table illustrates the percentage of the grant which would be exercisable depending on the Company's TSR ranking within the comparator group, shown on page 48.

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

The remuneration committee believes that the out-performance of Lloyds TSB Group's TSR compared with those of the companies in the comparator group will demonstrate the success of the Group's strategy. The Company uses data provided by Alithos Limited to assess the Company's performance against the comparator group for the purposes of the executive share option scheme and the performance share plan, and PricewaterhouseCoopers LLP check the results of the testing of the performance condition.

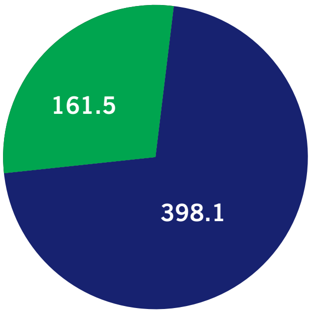
Other share plans

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

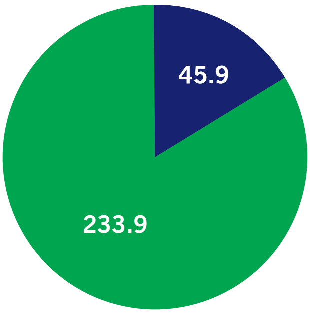
Dilution

The following charts illustrate the available dilution capacity for the Company's share schemes.

Dilution capacity – all schemes
(10% in any consecutive 10 years)



Dilution capacity – executive schemes
(5% in any consecutive 10 years)



Shares used (million)

Shares remaining (million)

Pensions

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

Service agreements

Lloyds TSB Group's policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months' notice from the Company, but would be required to give six months' notice if they wished to leave. As the chairman and deputy chairman are regarded as employees, they are entitled to receive up to eight weeks' notice.

	Notice to be given by the Company	Salary from 1 January 2005	Date of service agreement
J E Daniels	12 months	£825,000	19 October 2001
M E Fairey	12 months	£545,000	28 August 1991
A G Kane	12 months	£475,000	9 February 2000
G T Tate	12 months	£475,000	29 July 2004
H A Weir	12 months	£475,000	4 March 2004
M A van den Bergh	8 weeks	£475,000	28 July 2000
D P Pritchard	8 weeks	£253,000	7 April 2003

It is now the Group's policy (subject to existing contractual arrangements) that where compensation on early termination is due, it should be restricted to basic salary and bonus to the extent earned. Payments will be on a phased basis and mitigated in the event that alternative employment is secured. Bonus payments should relate to the period of actual service, rather than the full notice period, and will be determined on the basis of performance.

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

External appointments

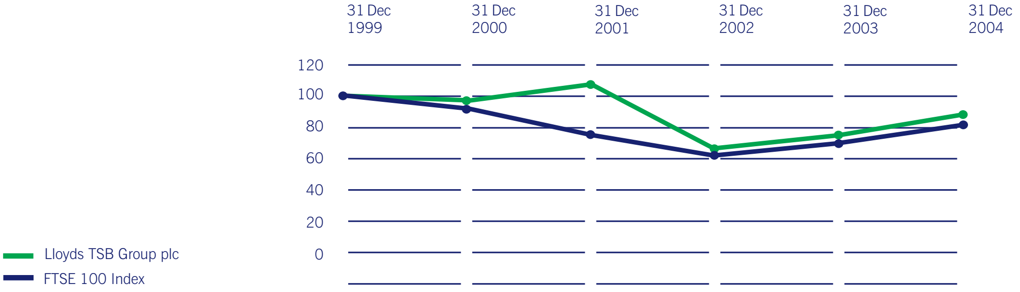
Lloyds TSB Group recognises that executive directors may be invited to become non-executive directors of other publicly quoted companies and that these appointments may broaden their knowledge and experience, to the benefit of the Lloyds TSB Group. Fees are normally retained by the individual directors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

During 2004, one of the current executive directors received a fee of £11,300, which was retained, for serving as a non-executive director of another company.

Performance graph

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

Comparative TSR



Rebased to 100 on 31 December 1999

Source : Datastream

Directors' emoluments for 2004

	Salaries/ fees £000	Other benefits Cash £000	Non cash £000	Performance-related payments £000	Compensation for loss of office £000	2004 Total £000	2003 £000
Current directors who served during 2004							
Executive directors							
J E Daniels	**750**	**181**	**12**	**960**		**1,903**	1,064
M E Fairey	**518**	**413**	**13**	**534**		**1,478**	1,140
A G Kane	**450**	**16**	**19**	**373**		**858**	622
G T Tate	**187**	**20**	**3**	**193**		**403**	–
H A Weir	**309**	**50**	**16**	**279**		**654**	–
Non-executive directors							
M A van den Bergh	**442**	**12**				**454**	435
D P Pritchard	**243**	**9**	**20**	**7**		**279**	377
W C G Berndt	**55**					**55**	32
Ewan Brown	**84**					**84**	70
G J N Gemmell	**110**					**110**	100
C S Gibson-Smith	**55**					**55**	45
D S Julius	**55**					**55**	45
A A Knight	**93**					**93**	58
Former directors who served during 2004							
P G Ayliffe	**400**	**27**	**1**	**160**		**588**	328
P R Hampton	**15**	**2**			**342**	**359**	733
Sir Tom McKillop	**57**					**57**	49
Lord Selborne	**22**					**22**	42
S C Targett	**160**	**121**	**2**			**283**	587
Former directors who served during 2003							
M D Ross				**332**	**356**	**688**	683
Others							635
	4,005	**851**	**86**	**2,838**	**698**	**8,478**	7,045

The cash column under 'other benefits' includes flexible benefits payments (4 per cent of basic salary), the housing allowance and tax planning allowance for Mr Daniels, pension contributions for those in the defined contribution scheme (Mrs Weir and Mr Tate) and an additional payment in respect of the contribution to the separate fund relating to Mr Fairey's pension. The separate fund, which was mentioned in previous annual reports, was established to cover pension obligations of those who joined the Group after 1 June 1989 and who are subject to the Inland Revenue cap relating to pensions, introduced by the Finance Act 1989. The amount shown for Mr Targett relates primarily to his relocation expenses. The non cash column includes amounts relating to the use of a company car, private medical insurance and life insurance cover. It also includes the value of any matching shares which are received under the terms of shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.

Performance-related payments relate to cash bonuses based on Group performance and the attainment of pre-determined targets relating to profit before tax and economic profit. For 2004, bonuses ranging from 40 per cent to 125 per cent are payable to the directors with an average payment of 89 per cent of salary. These payments also include the value of any award made under shareplan, the first £3,000 of which is made in the form of shares in Lloyds TSB Group plc.

Mr Ayliffe's employment has been terminated from 31 March 2005 and the payments to which he is entitled will be settled in accordance with his contractual entitlement. Full details will be reported in the 2005 report and accounts.

Mr Hampton's employment was terminated on 12 January 2004. He has received payments in accordance with his contractual entitlement.

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

Directors' pensions

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

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

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

Defined contribution scheme members

Mr Targett was a member of a defined contribution scheme. During the period 1 January 2004 to 30 April 2004 the employer made contributions totalling £24,000. As he left before completing two years service no benefits will be vested under the defined contribution scheme in respect of him.

Mr Tate is a member of a defined contribution scheme. He joined the Lloyds TSB Group on 4 August 2003. During the year to 31 December 2004, the employer has made contributions to the defined contribution scheme in respect of him totalling £47,760 of which £24,843 related to the period since his appointment as a director.

Mrs Weir is a member of a defined contribution scheme. She joined the Lloyds TSB Group on 26 April 2004. During the year to 31 December 2004, the employer has made contributions to the defined contribution scheme in respect of her totalling £26,224.

Defined benefit scheme members	**Accrued pension at 31 December 2004 £000 (a)**	Accrued pension at 31 December 2003 £000 (b)	Change in accrued pension £000 (a)-(b)	**Transfer value at 31 December 2004 £000 (c)**	Transfer value at 31 December 2003 £000 (d)	Change in transfer value £000 (c)-(d)	**Additional pension earned to 31 December 2004 £000 (e)**	Transfer value of the increase £000 (f)
P G Ayliffe	**132**	98	34	**1,780**	1,245	535	**30**	406
J E Daniels	**77**	51	26	**1,139**	711	428	**24**	358
M E Fairey	**226**	186	40	**3,996**	3,052	944	**34**	609
P R Hampton	**28**	17	11	**365**	208	157	**10**	133
A G Kane	**216**	170	46	**3,029**	2,233	796	**41**	582
In addition, the following unfunded benefits have accrued for Mr van den Bergh instead of a salary increase in 2002:								
M A van den Bergh	**10**	7	3	**136**	85	51	**3**	42

Mr Hampton's pension entitlement at 31 December 2004 includes an additional 12 months service in respect of his notice period in accordance with the terms of his contract.

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

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2004 and 2003, respectively (ignoring the two-year requirement to qualify for a deferred pension).

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2004 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme in accordance with actuarial guidance note GN11. The underlying bases used to arrive at the factors have not changed during the year.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2003 on the assumption that the director left service at that date.

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

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

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

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

Directors' interests

The interests, all beneficial, of those who were directors at 31 December 2004 in shares in Lloyds TSB Group were:

Shares	At 1 January 2004 (or later date of appointment)	At 31 December 2004	At 3 March 2005†
Executive directors			
J E Daniels	37,007	**38,136**	**38,198**
M E Fairey	76,605	**77,858**	**77,881**
A G Kane	97,769	**98,979**	**99,041**
G T Tate	701	**701**	
H A Weir	–	**1,699**	
Non-executive directors			
M A van den Bergh	5,079	**5,079**	
D P Pritchard	5,178	**10,566**	
W C G Berndt	40,000	**46,000**	
Ewan Brown	3,787	**4,027**	
G J N Gemmell	70,000	**70,000**	
C S Gibson-Smith	3,151	**3,151**	
D S Julius	2,000	**2,000**	
A A Knight	3,540	**4,940**	
Former executive director			
P G Ayliffe	91,216	**92,453**	

† The changes in beneficial interests between 31 December 2004 and 3 March 2005 related to 'partnership' and 'matching' shares acquired under shareplan.

Sir Julian Horn-Smith joined the board on 1 January 2005 and at 3 March 2005 he had a beneficial interest in 5,000 shares in Lloyds TSB Group plc.

Non-beneficial interests

Directors had non-beneficial interests as follows:

Mr Ayliffe, Mr Daniels, Mr Fairey, Mr Kane, Mr Pritchard, Mr Tate, Mr van den Bergh and Mrs Weir, together with some 77,000 other employees, were potential beneficiaries in the 1,364 and 1,467,422 shares held at the end of the year by the Lloyds TSB qualifying employee share ownership trust and the Lloyds TSB Group employee share ownership trust respectively. 162,692 and 1,609,602 shares, respectively, were held by these trusts at the beginning of the year. These holdings were 1,364 and 1,453,954 respectively on 3 March 2005. In addition, the above directors, with the exception of Mr van den Bergh, together with some 77,000 other employees, were potential participants in shareplan and were, therefore, treated as interested in the 471,989 shares held at the end of the year by the trustee of the shareplan. 2,163,267 shares were held by the trustee at the beginning of the year. This holding was 582,350 on 3 March 2005.

Interests in share options

Current directors who served during 2004	At 1 January 2004 (or later date of appointment)	Granted during the year	Exercised/ lapsed during the year	At 31 December 2004	Exercise price	Exercise periods From	To	Notes
J E Daniels	907,780			**907,780**	694p	1/11/2004	31/10/2011	e, g, i
	330,419			**330,419**	715p	6/3/2005	5/3/2012	e, h, i
	3,327			**3,327**	284p	1/6/2006	30/11/2006	a, h
	599,239			**599,239**	394.25p	21/2/2006	20/2/2013	e, h
	305,232			**305,232**	430p	14/8/2006	13/8/2013	e, h
		939,177		**939,177**	419.25p	18/3/2007	17/3/2014	e, h
M E Fairey	797			**797**	474p	1/11/2005	30/4/2006	a, h, i
	54,000			**54,000**	510p	26/3/2000	25/3/2007	c, f, i
	48,000			**48,000**	859.5p	15/5/2001	14/5/2008	c, f, i
	57,000			**57,000**	817p	2/8/2002	1/8/2009	c, g, i
	85,896			**85,896**	549.5p	6/3/2003	5/3/2010	d, g, i
	10,931			**10,931**	615.5p	8/8/2003	7/8/2010	d, g, i
	42,884			**42,884**	655p	6/3/2004	5/3/2011	d, g, i
	148,618			**148,618**	733p	21/8/2004	20/8/2011	e, g, i
	345,104			**345,104**	715p	6/3/2005	5/3/2012	e, h, i
	1,330			**1,330**	284p	1/6/2006	30/11/2006	a, h
	531			**531**	348p	1/11/2006	30/4/2007	a, h
	663,157			**663,157**	394.25p	21/2/2006	20/2/2013	e, h
		555,992		**555,992**	419.25p	18/3/2007	17/3/2014	e, h
A G Kane	25,000			**25,000**	321p	28/3/1999	27/3/2006	c, f
	40,000			**40,000**	510p	26/3/2000	25/3/2007	c, f, i
	50,000			**50,000**	880p	4/3/2001	3/3/2008	c, f, i
	27,000			**27,000**	887.5p	4/3/2002	3/3/2009	c, g, i
	64,786			**64,786**	549.5p	6/3/2003	5/3/2010	d, g, i
	11,841			**11,841**	615.5p	8/8/2003	7/8/2010	d, g, i
	34,759			**34,759**	655p	6/3/2004	5/3/2011	d, g, i
	118,178			**118,178**	733p	21/8/2004	20/8/2011	e, g, i
	275,349			**275,349**	715p	6/3/2005	5/3/2012	e, h, i
	5,783			**5,783**	284p	1/6/2008	30/11/2008	a, h
	529,105			**529,105**	394.25p	21/2/2006	20/2/2013	e, h
		523,255		**523,255**	419.25p	18/3/2007	17/3/2014	e, h
D P Pritchard	4,687		**4,687**	**–**	416p			j
	50,000			**50,000**	859.5p	15/5/2001	14/5/2008	c, f, i
	40,000			**40,000**	817p	2/8/2002	1/8/2009	c, g, i
	71,519			**71,519**	549.5p	6/3/2003	5/3/2010	d, g, i
	10,385			**10,385**	615.5p	8/8/2003	7/8/2010	d, g, i
	36,374			**36,374**	655p	6/3/2004	5/3/2011	d, g, i
	127,131			**127,131**	733p	21/8/2004	20/8/2011	e, g, i
	286,363			**286,363**	715p	6/3/2005	5/3/2012	e, h, i
G T Tate	348,837			**348,837**	430p	14/8/2006	13/8/2013	e, h
	268,336			**268,336**	419.25p	18/3/2007	17/3/2014	e, h
		195,409		**195,409**	403p	12/8/2007	11/8/2014	e, h
H A Weir	–	**556,208**		**556,208**	424.75p	29/4/2007	28/4/2014	e, h
		5,093		**5,093**	321p	1/11/2009	30/4/2010	a, h
Share retention plan								
J E Daniels	216,763			**216,763**	(see page 57)	1/1/2005	30/6/2005	

Interests in share options (continued)

Former directors who served during 2004	At 1 January 2004	Granted during the year	Exercised/ lapsed during the year	At 31 December 2004 (or earlier date of leaving the board)	Exercise price	Exercise periods From	To	Notes
P G Ayliffe	3,327			**3,327**	284p	1/6/2006	30/11/2006	a, h
	13,000			**13,000**	321p	28/3/1999	27/3/2006	c, f
	12,000			**12,000**	510p	26/3/2000	25/3/2007	c, f, i
	20,000			**20,000**	880p	4/3/2001	3/3/2008	c, f, i
	3,000			**3,000**	887.5p	4/3/2002	3/3/2009	c, g, i
	23,657			**23,657**	549.5p	6/3/2003	5/3/2010	d, g, i
	10,560			**10,560**	615.5p	8/8/2003	7/8/2010	d, g, i
	16,717			**16,717**	655p	6/3/2004	5/3/2011	d, g, i
	44,562			**44,562**	733p	21/8/2004	20/8/2011	e, g, i
	104,895			**104,895**	715p	6/3/2005	5/3/2012	e, h, i
	218,769			**218,769**	394.25p	21/2/2006	20/2/2013	e, h
	177,034			**177,034**	430p	14/8/2006	13/8/2013	e, h
		429,338		**429,338**	419.25p	18/3/2007	17/3/2014	e, h
P R Hampton	326,351		**326,351**§	–	740p			
	3,327		**3,327**§	–	284p			
	642,739		**642,739**§	–	394.25p			
S C Targett	759,036		**759,036**§	–	311.25p			
	2,658		**2,658**§	–	348p			
		558,139	**558,139**§	–	419.25p			
Share plan 2003								
S C Targett	331,125		**331,125**§	–	(see page 57)			

a) Sharesave.

b) Executive option granted prior to March 1996.

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

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

e) Executive option granted after March 2001.

f) Exercisable.

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

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

i) Market price of shares is below the share option exercise price.

j) Market price on day of exercise was 426.5p. In that regard Mr Pritchard made a gain of £492. This is the difference between the market price of the shares on the day on which the share option was exercised and the price paid for the shares.

§ These share options lapsed when Mr Hampton and Mr Targett left the board on 12 January 2004 and 30 April 2004, respectively.

The market price for a share in the Company at 1 January 2004 and 31 December 2004 was 448p and 473p, respectively. The range of prices between 1 January 2004 and 31 December 2004 was 391.75p to 476.25p.

None of the other directors at 31 December 2004 had options to acquire shares in Lloyds TSB Group plc or its subsidiaries.

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

Options granted	Performance conditions
Prior to March 1996	None
March 1996	Growth in earnings per share which is equal to the aggregate percentage change in the retail price index plus two percentage points for each complete year of the relevant period.
March 1997 – August 1999	As for March 1996 plus a further condition that the Company's ranking based on TSR over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the retail price index plus three percentage points for each complete year of the relevant period.
August 2001 – August 2004	That the Company's ranking based on TSR over the relevant period against a comparator group (17 UK and international financial services companies including Lloyds TSB) must be at least ninth, when 14 per cent of the option will be exercisable. If the Company is ranked first in the group, then 100 per cent of the option will be exercisable and if ranked tenth or below the performance condition is not met. At the end of 2004 Lloyds TSB Group was ranked: 10th after four years of the performance period for options granted in 2001; 14th after three years of the performance period for options granted in 2002; 15th after two years of the performance period for options granted in 2003; and 6th after one year of the performance period for options granted in 2004

Other share plans

Share retention plan

Mr Daniels is the only participant in this plan and holds an option, granted to him on 2 November 2001, to acquire 216,763 ordinary shares in Lloyds TSB Group plc for a total price of £1. The option was granted as part of the remuneration package considered necessary to attract him from the USA and was designed to encourage him to remain with Lloyds TSB Group plc. The option was not subject to any performance condition and vested on 31 December 2004, with a six month exercise period finishing on 30 June 2005. Full details of the plan were set out in the 2002 annual report.

Lloyds TSB Group plc share plan 2003

The option granted to Mr Targett to acquire 331,125 ordinary shares when he joined the Group lapsed following his departure.

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

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

On behalf of the board

A J Michie
Company Secretary
3 March 2005

Report of the independent auditors

To the members of Lloyds TSB Group plc

We have audited the financial statements which comprise the consolidated profit and loss account, the consolidated balance sheet, the Company balance sheet, the consolidated cash flow statement, the statement of total recognised gains and losses and the related notes which have been prepared under the accounting policies set out on pages 65 to 68. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the directors' remuneration report under the headings directors' emoluments, directors' pensions and directors' interests in share options ('the auditable part').

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities on page 45. The directors are also responsible for preparing the directors' remuneration report.

Our responsibility is to audit the financial statements and the auditable part of the directors' remuneration report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the 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 whether the financial statements and the auditable part of the directors' remuneration report have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information 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. The other information comprises only the directors' report, the chairman's statement, the group chief executive's review, the operating and financial review and prospects, the unaudited part of the directors' remuneration report and the corporate governance statement.

We review whether the corporate governance statement on pages 43 to 46 reflects the Company's compliance with the nine provisions of the 2003 Financial Reporting Council's Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company's or Group's corporate governance procedures or its risk and control procedures.

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 and the auditable part of the directors' remuneration report. 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 Company's 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 and the auditable part of the directors' remuneration report 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 Company and the Group as at 31 December 2004 and of the profit and cash flows of the Group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
3 March 2005

Consolidated profit and loss account

for the year ended 31 December 2004

	Note	**2004 £ million**	Continuing operations 2003 £ million	Discontinued operations 2003* £ million	Total 2003 £ million
Interest receivable:					
Interest receivable and similar income arising from debt securities		**423**	389	63	452
Other interest receivable and similar income		**9,972**	8,484	1,213	9,697
Interest payable		**5,475**	4,129	765	4,894
Net interest income		**4,920**	4,744	511	5,255
Other finance income	45	**39**	34	–	34
Other income					
Fees and commissions receivable		**3,124**	2,987	112	3,099
Fees and commissions payable		**(744)**	(688)	(34)	(722)
Dealing profits (before expenses)	3	**271**	525	35	560
Income from long-term assurance business	29	**715**	436	17	453
General insurance premium income		**554**	535	–	535
Other operating income		**688**	682	12	694
		4,608	4,477	142	4,619
Total income		**9,567**	9,255	653	9,908
Operating expenses					
Administrative expenses	4	**4,284**	4,229	247	4,476
Depreciation and amortisation	23,24	**633**	672	25	697
Total operating expenses		**4,917**	4,901	272	5,173
Trading surplus		**4,650**	4,354	381	4,735
General insurance claims		**224**	236	–	236
Provisions for bad and doubtful debts	15				
Specific		**953**	883	63	946
General		**(87)**	4	–	4
		866	887	63	950
Amounts written off fixed asset investments	5	**52**	44	–	44
Operating profit		**3,508**	3,187	318	3,505
Share of results of joint ventures	20	**–**	(22)	–	(22)
(Loss) profit on sale of businesses	6	**(15)**	–	865	865
Profit on ordinary activities before tax	7	**3,493**	3,165	1,183	4,348
Tax on profit on ordinary activities	8	**1,004**			1,025
Profit on ordinary activities after tax		**2,489**			3,323
Minority interests:					
Equity		**26**			22
Non-equity	39	**42**			47
Profit for the year attributable to shareholders	9	**2,421**			3,254
Dividends	10	**1,914**			1,911
Profit for the year	41	**507**			1,343
Earnings per share	11	**43.3p**			58.3p
Diluted earnings per share	11	**43.0p**			58.1p

* See note 6

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

Consolidated balance sheet

at 31 December 2004

	Note	**2004 £ million**	2003 £ million
Assets			
Cash and balances at central banks		**1,078**	1,195
Items in course of collection from banks		**1,462**	1,447
Treasury bills and other eligible bills	12	**92**	539
Loans and advances to banks	13	**23,565**	15,547
Loans and advances to customers	14	**154,240**	135,251
Debt securities	17	**25,194**	28,669
Equity shares	18	**215**	458
Interests in joint ventures:	20		
Share of gross assets		**84**	85
Share of gross liabilities		**(31)**	(31)
		53	54
Intangible fixed assets	23	**2,425**	2,513
Tangible fixed assets	24	**4,181**	3,918
Other assets	27	**3,220**	3,944
Prepayments and accrued income	28	**2,573**	1,918
Long-term assurance business attributable to the shareholder	29	**6,781**	6,481
		225,079	201,934
Long-term assurance assets attributable to policyholders	29	**54,764**	50,078
Total assets		**279,843**	252,012

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

The directors approved the accounts on 3 March 2005.

Maarten A van den Bergh
Chairman

J Eric Daniels
Group Chief Executive

Helen A Weir
Group Finance Director

Consolidated balance sheet

at 31 December 2004

	Note	**2004 £ million**	2003 £ million
Liabilities			
Deposits by banks	31	**39,738**	23,955
Customer accounts	32	**122,062**	116,496
Items in course of transmission to banks		**631**	626
Debt securities in issue	33	**27,217**	25,922
Other liabilities	34	**6,619**	7,007
Accruals and deferred income	35	**3,866**	3,206
Post-retirement benefit liability	45	**2,231**	2,139
Provisions for liabilities and charges:			
Deferred tax	36	**1,473**	1,376
Other provisions for liabilities and charges	37	**417**	402
Subordinated liabilities:			
Undated loan capital	38	**5,852**	5,959
Dated loan capital	38	**4,400**	4,495
		10,252	10,454
Minority interests:			
Equity		**46**	44
Non-equity	39	**550**	683
		596	727
Called-up share capital	40	**1,419**	1,418
Share premium account	41	**1,145**	1,136
Merger reserve	41	**343**	343
Profit and loss account	41	**7,070**	6,727
Shareholders' funds (equity and non-equity)	42	**9,977**	9,624
		225,079	201,934
Long-term assurance liabilities to policyholders	29	**54,764**	50,078
Total liabilities		**279,843**	252,012
Memorandum items	46		
Contingent liabilities:			
Acceptances and endorsements		**71**	299
Guarantees and assets pledged as collateral security		**6,786**	6,122
Other contingent liabilities		**1,669**	2,604
		8,526	9,025
Commitments		**85,290**	79,335

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

Company balance sheet

at 31 December 2004

	Note	**2004 £ million**	2003 £ million
Fixed assets			
Investments:			
Shares in group undertakings	21	**11,080**	10,753
Loans to group undertakings	21	**1,723**	1,723
		12,803	12,476
Current assets			
Debtors falling due within one year:			
Amounts owed by group undertakings		**1,390**	1,387
Other debtors		**97**	88
Cash balances with group undertakings		**208**	362
		1,695	1,837
Current liabilities			
Amounts falling due within one year:			
Amounts owed to group undertakings		**1,741**	1,913
Other creditors		**107**	106
Dividend payable		**1,315**	1,314
		3,163	3,333
Net current liabilities		**(1,468)**	(1,496)
Total assets less current liabilities		**11,335**	10,980
Creditors			
Amounts falling due after more than one year:			
Loan capital	38	**1,358**	1,356
Net assets		**9,977**	9,624
Capital and reserves			
Called-up share capital	40	**1,419**	1,418
Share premium account	41	**1,145**	1,136
Revaluation reserve	41	**5,014**	4,687
Profit and loss account	41	**2,399**	2,383
Shareholders' funds (equity and non-equity)	42	**9,977**	9,624

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

The directors approved the accounts on 3 March 2005.

Maarten A van den Bergh
Chairman

J Eric Daniels
Group Chief Executive

Helen A Weir
Group Finance Director

Other statements

Statement of total recognised gains and losses

for the year ended 31 December 2004

	Note	**2004 £ million**	2003 £ million
Profit attributable to shareholders		**2,421**	3,254
Currency translation differences on foreign currency net investments		**(11)**	118
Actuarial losses recognised in post-retirement benefit schemes		**(237)**	(6)
Deferred tax thereon		**71**	2
	45	**(166)**	(4)
Total recognised gains and losses relating to the year		**2,244**	3,368
Prior year adjustments in respect of changes in accounting policy in 2003		**–**	(29)
Total gains and losses recognised during the year		**2,244**	3,339

Historical cost profits and losses

for the year ended 31 December 2004

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 consolidated shareholders' funds

for the year ended 31 December 2004

	Note	**2004 £ million**	2003 £ million
Profit attributable to shareholders		**2,421**	3,254
Dividends		**(1,914)**	(1,911)
Profit for the year		**507**	1,343
Currency translation differences on foreign currency net investments		**(11)**	118
Actuarial losses recognised in post-retirement benefit schemes	45	**(166)**	(4)
Issue of shares	40,41	**10**	45
Movements in relation to own shares	43	**10**	(2)
Goodwill written back on sale of businesses	6	**3**	181
Net increase in shareholders' funds		**353**	1,681
Shareholders' funds at beginning of year		**9,624**	7,943
Shareholders' funds at end of year		**9,977**	9,624

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

Consolidated cash flow statement

for the year ended 31 December 2004

	Note	**2004 £ million**	2003 £ million
Net cash inflow from operating activities	49a	**3,469**	772
Dividends received from joint ventures and associated undertakings		**2**	5
Returns on investments and servicing of finance:			
– Dividends paid to equity minority interests	49d	**(24)**	(14)
– Payments made to non-equity minority interests	49d	**(44)**	(81)
– Interest paid on subordinated liabilities (loan capital)		**(606)**	(600)
Net cash outflow from returns on investments and servicing of finance		**(674)**	(695)
Taxation:			
– UK corporation tax		**(656)**	(598)
– Overseas tax		**(107)**	(186)
Total taxation		**(763)**	(784)
Capital expenditure and financial investment:			
– Additions to fixed asset investments		**(10,088)**	(35,420)
– Disposals and maturities of fixed asset investments		**9,732**	36,281
– Additions to tangible fixed assets		**(1,183)**	(778)
– Disposals of tangible fixed assets		**243**	287
Net cash (outflow) inflow from capital expenditure and financial investment		**(1,296)**	370
Acquisitions and disposals:			
– Additions to interests in joint ventures		**–**	(12)
– Acquisition of group undertakings and businesses	49e	**(16)**	(1,106)
– Disposal of group undertakings and businesses	49g	**(25)**	2,382
Net cash (outflow) inflow from acquisitions and disposals		**(41)**	1,264
Equity dividends paid		**(1,913)**	(1,908)
Net cash outflow before financing		**(1,216)**	(976)
Financing:			
– Issue of subordinated liabilities (loan capital)	49d	**699**	533
– Cash proceeds from issue of ordinary share capital and transactions in own shares held in respect of employee share schemes		**11**	32
– Repayments of subordinated liabilities (loan capital)	49d	**(764)**	(75)
– Repayment of minority investment in subsidiaries	49d	**(132)**	–
– Capital element of finance lease rental payments	49d	**(1)**	(1)
Net cash (outflow) inflow from financing		**(187)**	489
Decrease in cash	49c	**(1,403)**	(487)

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

Notes to the accounts

1 Accounting policies

Accounting policies are unchanged from 2003.

In December 2004, the Accounting Standards Board ('ASB') issued Financial Reporting Standard 27 'Life Assurance'. The Group will implement the requirements of this standard in its 2005 accounts; however, in accordance with the Memorandum of Understanding entered into by leading members of the life assurance and bancassurance sectors and the Association of British Insurers with the ASB, certain additional disclosures have been given in 'Operating and financial review and prospects' attached to these accounts.

a Accounting convention

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

The accounts of the Company are prepared under the historical cost convention as modified by the revaluation of shares in group undertakings (see h), in compliance with Section 226, Schedule 4 and other requirements of the Companies Act 1985 and in accordance with applicable accounting standards and pronouncements of the Urgent Issues Task Force.

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 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 44.

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, 'Goodwill and Intangible Assets', 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 life spans of the products; the extent to which the acquisition overcomes market entry barriers; and the expected future impact of competition on the business.

As a result, 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 Fixed Assets and Goodwill'. 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 2004 would be £92 million lower (2003: £93 million lower), with a corresponding reduction in reserves of £450 million (2003: £358 million); intangible assets on the balance sheet would also be £450 million lower (2003: £358 million lower).

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

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

d Income recognition

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

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

1 Accounting policies (continued)

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 has general provisions, held 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 classified as 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 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 doubt about its being paid.

Loans accounted for on a non-accrual basis

In those cases where the operation of the customer's account has ceased and it has been transferred to a specialist recovery department, the advance is written down to its expected net realisable value and interest is no longer charged to the customer's account as the likelihood of its recovery is considered remote. 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 and in the long-term assurance business (see o), 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 and in the long-term assurance business (see o), 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 circumstances where securities are transferred between the dealing and investment portfolios, 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 Company 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.

1 Accounting policies (continued)

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 cash investment, taking into account tax and 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 finance 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. Rental income from operating leases is credited to the profit and loss account on an accruals basis.

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 both defined benefit and defined contribution post-retirement benefit schemes.

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates, scheme assets are included at 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 an AA 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 included only 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, after deducting 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.

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 foreign exchange gains and losses, which arise from normal trading activities, are included in the profit and loss account.

o Long-term assurance business

The Group accounts for its interest in long-term assurance business using the embedded value basis of accounting. The value of the shareholder's interest in the long-term assurance business ('the embedded value') included in the Group's balance sheet is an actuarially determined estimate of the economic value of the Group's life assurance subsidiaries, excluding any value which may be attributed to future new business. The embedded value is comprised of the net tangible assets of the life assurance subsidiaries, including any surplus retained within the long-term business funds, which could be transferred to the shareholder, and the present value of the in-force business. The present 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.

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. 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 of the Group's life assurance operations are legally owned by the Group, 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.

1 Accounting policies (continued)

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 Sale and repurchase transactions

Securities which have been sold with an agreement to repurchase continue to be shown on the balance sheet and the sale proceeds recorded within deposits by banks or customer accounts as appropriate. Securities acquired in reverse sale and repurchase transactions are not recognised on the balance sheet and the purchase price is recorded within loans and advances. The difference between the sale price and repurchase price is accrued evenly over the life of the transaction and charged or credited to the profit and loss account as interest payable or receivable.

r 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 reasonable evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates a proportion of 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.

2 Segmental analysis

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

Year ended 31 December 2004	UK Retail Banking £m	General insurance £m	Life, pensions, unit trusts and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Continuing operations £m	Discontinued operations§ £m	Total £m
Net interest income	**3,198**	**44**	**55**	**99**	**1,966**	**(343)**	**4,920**	**–**	**4,920**
Other finance income	**–**	**–**	**–**	**–**	**–**	**39**	**39**	**–**	**39**
Other operating income	**1,639**	**497**	**818**	**1,315**	**1,641**	**13**	**4,608**	**–**	**4,608**
Total income	**4,837**	**541**	**873**	**1,414**	**3,607**	**(291)**	**9,567**	**–**	**9,567**
Operating expenses	**(2,513)**	**(149)**	**(123)**	**(272)**	**(2,090)**	**(42)**	**(4,917)**	**–**	**(4,917)**
Trading surplus (deficit)	**2,324**	**392**	**750**	**1,142**	**1,517**	**(333)**	**4,650**	**–**	**4,650**
General insurance claims	**–**	**(224)**	**–**	**(224)**	**–**	**–**	**(224)**	**–**	**(224)**
Provisions for bad and doubtful debts	**(673)**	**–**	**–**	**–**	**(193)**	**–**	**(866)**	**–**	**(866)**
Amounts written off fixed asset investments	**–**	**–**	**–**	**–**	**(52)**	**–**	**(52)**	**–**	**(52)**
Loss on sale of businesses	**–**	**–**	**–**	**–**	**(15)**	**–**	**(15)**	**–**	**(15)**
Profit (loss) before tax	**1,651**	**168**	**750**	**918**	**1,257**	**(333)**	**3,493**	**–**	**3,493**
Year ended 31 December 2003*									
Net interest income	3,137	38	43	81	1,875	(349)	4,744	511	5,255
Other finance income	–	–	–	–	–	34	34	–	34
Other operating income	1,533	505	579	1,084	1,561	299	4,477	142	4,619
Total income	4,670	543	622	1,165	3,436	(16)	9,255	653	9,908
Operating expenses	(2,583)	(141)	(120)	(261)	(2,048)	(9)	(4,901)	(272)	(5,173)
Trading surplus (deficit)	2,087	402	502	904	1,388	(25)	4,354	381	4,735
General insurance claims	–	(236)	–	(236)	–	–	(236)	–	(236)
Provisions for bad and doubtful debts	(594)	–	–	–	(306)	13	(887)	(63)	(950)
Amounts written off fixed asset investments	–	–	–	–	(44)	–	(44)	–	(44)
Share of results of joint ventures	(22)	–	–	–	–	–	(22)	–	(22)
Profit on sale of businesses	–	–	–	–	–	–	–	865	865
Profit (loss) before tax	1,471	166	502	668	1,038	(12)	3,165	1,183	4,348

Geographical area:**	Domestic 2004 £m	International 2004 £m	Total 2004 £m	Domestic 2003 £m	International 2003 £m	Continuing operations 2003 £m	Discontinued operations§ 2003 £m	Total 2003 £m
Interest receivable	**9,992**	**403**	**10,395**	8,490	383	8,873	1,276	10,149
Other finance income	**39**	**–**	**39**	34	–	34	–	34
Fees and commissions receivable	**2,980**	**144**	**3,124**	2,831	156	2,987	112	3,099
Dealing profits (before expenses)	**249**	**22**	**271**	276	249	525	35	560
Income from long-term assurance business	**715**	**–**	**715**	436	–	436	17	453
General insurance premium income	**554**	**–**	**554**	535	–	535	–	535
Other operating income	**682**	**6**	**688**	677	5	682	12	694
Total gross income	**15,211**	**575**	**15,786**	13,279	793	14,072	1,452	15,524
Profit on ordinary activities before tax	**3,295**	**198**	**3,493**	2,810	355	3,165	1,183	4,348

2 Segmental analysis (continued)

	Net Assets† 2004 £m	Net Assets† 2003 £m	Assets‡ 2004 £m	Assets‡ 2003 £m
Class of business				
UK Retail Banking	**2,991**	2,555	**101,615**	90,541
Insurance and Investments:				
General insurance	**427**	470	**1,084**	1,009
Life, pensions, unit trusts and asset management	**6,908**	6,531	**9,141**	8,835
	7,335	7,001	**10,225**	9,844
Wholesale and International Banking	**4,469**	4,390	**112,968**	101,286
Central group items	**(4,772)**	(4,278)	**271**	263
	10,023	9,668	**225,079**	201,934
Geographical area**				
Domestic	**9,369**	9,069	**212,197**	189,162
International	**654**	599	**12,882**	12,772
	10,023	9,668	**225,079**	201,934

* From the beginning of 2004 the Group changed its UK branch and other distribution networks from cost centres to profit centres and, consequently, amended the internal commission arrangements between these networks and the insurance product manufacturing businesses within the Group. The effect of this change has been to redistribute income from the insurance segments to UK Retail Banking and, to a lesser extent, to Wholesale. In addition, certain costs previously included in Central group items were reallocated to the operating segments. The 2003 segmental analysis has been restated to reflect these changes on a consistent basis.

** 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 shareholders' funds plus equity minority interests. Disclosure of information on net assets is an accounting standard requirement (SSAP 25); 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.

§ Discontinued operations related to the Wholesale and International Banking segment.

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)

	2004 £m	2003 £m
Foreign exchange trading income	**178**	228
Securities and other gains	**93**	332
	271	560

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.

4 Administrative expenses

	2004 £m	2003 £m
Salaries	**2,069**	2,092
Social security costs	**140**	143
Other pension costs (note 45)	**338**	353
Staff costs	**2,547**	2,588
Other administrative expenses	**1,737**	1,888
	4,284	4,476

	2004	2003
The average number of persons on a headcount basis employed by the Group during the year was as follows:		
UK	**74,924**	73,814
Overseas	**3,372**	10,288
	78,296	84,102

The above staff numbers exclude 4,657 (2003: 5,202) staff employed in the long-term assurance business. Costs of £190 million (2003: £194 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 on pages 52 to 57.

4 Administrative expenses (continued)	2004 £m	2003 £m
Statutory audit	**5.2**	5.5
Other audit related fees:		
– Audit related regulatory reporting	**0.9**	0.9
– Further assurance services	**6.4**	3.3
Total other audit related fees	**7.3**	4.2
Audit and audit related fees	**12.5**	9.7
Tax advisory	**0.8**	1.6
Other non-audit fees:		
– Due diligence services	**0.9**	0.7
– Other	**0.3**	0.2
Total other non-audit fees	**1.2**	0.9
Total fees	**14.5**	12.2

The auditors' remuneration for the holding company was £51,500 (2003: £51,500).

During the year the auditors also earned fees of £0.6 million (2003: £0.6 million) in respect of the audit of unit trusts and pension schemes managed by the Group.

Included in 'Other audit related fees' are the costs of the advice provided in relation to the Group's preparations for the implementation of International Financial Reporting Standards and the requirements of the Sarbanes-Oxley Act together with the costs of the audit of the Group's Form 20-F filing.

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

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

5 Amounts written off fixed asset investments	2004 £m	2003 £m
Debt securities	**43**	42
Equity shares	**9**	2
	52	44

6 (Loss) profit before tax on sale of businesses

	2004 £m	2003 £m
Profit on sale of businesses in Argentina (tax: £6 million)	6	–
Loss on sale of businesses in Colombia (after charging £3 million of goodwill previously written off to reserves) (tax: nil)	(20)	–
Loss on sale of businesses in Panama, Guatemala and Honduras (tax: £1 million)	(1)	–
Loss on sale of French fund management and private banking businesses (tax: nil)	–	(15)
Loss on sale of Brazilian businesses (after charging £161 million of goodwill previously written off to reserves) (tax: nil)	–	(41)
Profit on sale of New Zealand operations (after charging £20 million of goodwill previously written off to reserves) (tax: nil)	–	921
	(15)	865

During 2004 the Group completed the sale, announced on 19 July 2004 and completed on 19 November 2004, of the business of the branch of Lloyds TSB Bank plc in Argentina; the sale, announced on 19 July 2004 and completed on 30 November 2004 of the Group's principal businesses in Colombia comprising its interests in Lloyds TSB Bank S.A. and in Lloyds Trust S.A. and certain offshore assets; and the sales, announced on 1 December 2003, of substantially all of the businesses of the branches of Lloyds TSB Bank plc in Panama, Guatemala and Honduras which were completed on 30 April 2004, 4 June 2004 and 1 October 2004 respectively.

During 2003 the Group completed the sales of its French fund management and private banking businesses, including its subsidiaries Lloyds Bank SA, Chaillot Assurances SA and Capucines Investissements SA; its Brazilian subsidiaries Banco Lloyds TSB S.A. and Losango Promotora de Vendas Ltda, together with substantially all of the business of the Brazilian branch of Lloyds TSB Bank plc and certain offshore Brazilian assets; and its subsidiary, NBNZ Holdings Limited, comprising the Group's New Zealand banking and insurance operations.

The trading results of the businesses sold in 2004 were not material to the Group. Discontinued operations in 2003 comprised the businesses in New Zealand, Brazil and France sold in that year.

7 Profit on ordinary activities before tax

	2004 £m	2003 £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	3,742	3,495
– Operating leases	422	446
Profits less losses on disposal of investment securities	126	47
Charges:		
Rental of premises	212	220
Hire of equipment	17	18
Interest on subordinated liabilities (loan capital)	601	622

8 Tax on profit on ordinary activities

a Analysis of charge for the year

	2004 £m	2003 £m
UK corporation tax:		
– Current tax on profits for the year	**841**	1,079
– Adjustments in respect of prior years	**(38)**	(72)
	803	1,007
Double taxation relief	**(58)**	(223)
	745	784
Foreign tax:		
– Current tax on profits for the year	**119**	144
– Adjustments in respect of prior years	**(5)**	(15)
	114	129
Current tax charge	**859**	913
Deferred tax	**146**	119
Associated undertakings and joint ventures	**(1)**	(7)
	1,004	1,025

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2003: 30 per cent).

In addition to the tax charge in the profit and loss account detailed above, £71 million (2003: £2 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 45).

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:

	2004 £m	2003 £m
Profit on ordinary activities before tax	**3,493**	4,348
Tax charge thereon at UK corporation tax rate of 30%	**1,048**	1,304
Factors affecting charge:		
– Goodwill amortisation	**9**	9
– Overseas tax rate differences	**(14)**	(9)
– Specifically allowable, unallowable and non-taxable items	**(5)**	(10)
– Net tax effect of disposals	**(12)**	(276)
– Tax deductible coupons on non-equity minority interests	**(12)**	(12)
– Capital allowances in excess of depreciation	**(86)**	(105)
– Other timing differences	**(60)**	(14)
– Life companies rate differences	**(16)**	16
– Other items	**7**	10
Current tax charge	**859**	913
Deferred tax:		
– Capital allowances in excess of depreciation	**86**	105
– Other timing differences	**60**	14
Associated undertakings and joint ventures	**(1)**	(7)
Tax on profit on ordinary activities	**1,004**	1,025
Effective rate	**28.7%**	23.6%

8 Tax on profit on ordinary activities (continued)

c Factors that may affect the future tax charge

The current tax charge includes a charge of £199 million (2003: charge of £157 million) in respect of notional tax on the shareholder's interest in the movement in value of the long-term assurance business (note 29b). 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.

Future transfers from Scottish Widows plc's long-term business fund to its shareholder's fund will be subject to a shareholder tax charge. Under FRS 19, no provision is required to be made since the timing of such transfers is under Scottish Widows plc's control. The potential deferred tax liability (undiscounted) not recognised on the balance sheet is approximately £230 million (2003: £110 million).

9 Profit for the financial year attributable to shareholders

The profit attributable to shareholders includes a profit of £1,921 million (2003: £1,880 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.

10 Ordinary dividends

	2004 pence per share	2003 pence per share	**2004 £m**	2003 £m
Interim: paid	**10.7**	10.7	**599**	597
Final: proposed	**23.5**	23.5	**1,315**	1,314
	34.2	34.2	**1,914**	1,911

No dividends have been paid on the £100 of 6 per cent non-cumulative redeemable preference shares issued in the year (see note 40). Dividends are being accrued at the rate of 6 per cent per annum and the first payment is due in March 2005.

11 Earnings per share

	2004	2003
Profit attributable to shareholders†	**£2,421m**	£3,254m
Weighted average number of ordinary shares in issue during the year‡	**5,590m**	5,581m
Dilutive effect of options outstanding	**35m**	18m
Diluted weighted average number of ordinary shares in issue during the year	**5,625m**	5,599m
Earnings per share	**43.3p**	58.3p
Diluted earnings per share	**43.0p**	58.1p

† No adjustment was made to profit attributable to shareholders in calculating diluted earnings per share.

‡ The weighted average number of shares for the year has been calculated after deducting 6 million (2003: 8 million) ordinary shares representing the Group's holdings of own shares (note 43).

12 Treasury bills and other eligible bills

	2004 Balance sheet £m	2004 Valuation £m	2003 Balance sheet £m	2003 Valuation £m
Investment securities:				
Treasury bills and similar securities	**75**	**77**	308	305
Other eligible bills	**13**	**13**	222	218
	88	**90**	530	523
Other securities:				
Treasury bills and similar securities	**4**	**4**	9	9
	92	**94**	539	532
Geographical analysis by issuer:				
United Kingdom	**–**		336	
Latin America	**18**		70	
Other	**74**		133	
	92		539	
Included above:				
Unamortised discounts net of premiums on investment securities	**–**		2	

	Cost £m	Premiums and discounts £m	Total £m
Movements in investment securities:			
At 1 January 2004	**528**	**2**	**530**
Exchange and other adjustments	**(3)**	**–**	**(3)**
Additions	**430**	**–**	**430**
Bills sold or matured	**(830)**	**(5)**	**(835)**
Adjustments on disposal of businesses	**(37)**	**–**	**(37)**
Amortisation of premiums and discounts	**–**	**3**	**3**
At 31 December 2004	**88**	**–**	**88**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. It is expected that tax of £1 million would be payable (2003: £2 million recoverable) if the investment securities were sold at their year end valuation.

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.

13 Loans and advances to banks

	2004 £m	2003 £m
Lending to banks	**2,483**	2,292
Deposits placed with banks	**21,083**	13,273
Total loans and advances to banks	**23,566**	15,565
Provisions for bad and doubtful debts	**(1)**	(18)
	23,565	15,547
Repayable on demand	**2,477**	3,768
Other loans and advances by residual maturity repayable:		
– 3 months or less	**16,763**	7,637
– 1 year or less but over 3 months	**2,243**	2,329
– 5 years or less but over 1 year	**1,422**	1,496
– Over 5 years	**661**	335
Provisions for bad and doubtful debts	**(1)**	(18)
	23,565	15,547

14 Loans and advances to customers

	2004 £m	2003 £m
Lending to customers	**144,708**	125,785
Hire purchase debtors	**4,828**	4,701
Equipment leased to customers	**6,387**	6,470
Total loans and advances to customers	**155,923**	136,956
Provisions for bad and doubtful debts	**(1,662)**	(1,677)
Interest held in suspense	**(21)**	(28)
	154,240	135,251
Loans and advances by residual maturity repayable:		
– 3 months or less	**28,748**	23,284
– 1 year or less but over 3 months	**9,878**	9,458
– 5 years or less but over 1 year	**35,301**	31,384
– Over 5 years	**81,996**	72,830
Provisions for bad and doubtful debts	**(1,662)**	(1,677)
Interest held in suspense	**(21)**	(28)
	154,240	135,251
Of which repayable on demand or at short notice	**15,805**	13,365

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £5,472 million (2003: £4,478 million).

Equipment leased to customers, which is stated after deducting £4,551 million (2003: £4,907 million) of unearned charges, is repayable as follows:

	2004 £m	2003 £m
3 months or less	**247**	91
1 year or less but over 3 months	**282**	345
5 years or less but over 1 year	**1,516**	1,465
Over 5 years	**4,342**	4,569
	6,387	6,470

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

	2004 Specific £m	2004 General £m	2003 Specific £m	2003 General £m
At 1 January	**1,313**	**382**	1,334	433
Exchange and other adjustments	**(11)**	**–**	(1)	–
Adjustments on acquisitions and disposals	**(21)**	**(12)**	(49)	(5)
Transfer from general to specific provisions	**3**	**(3)**	50	(50)
Advances written off	**(1,028)**	**–**	(1,145)	–
Recoveries of advances written off in previous years	**174**	**–**	178	–
Charge (release) to profit and loss account:				
New and additional provisions	**1,571**	**12**	1,552	9
Releases and recoveries	**(618)**	**(99)**	(606)	(5)
	953	**(87)**	946	4
At 31 December	**1,383**	**280**	1,313	382
	1,663		1,695	
In respect of:				
Loans and advances to banks	**1**		18	
Loans and advances to customers	**1,662**		1,677	
	1,663		1,695	

	2004 £m	2003 £m
Non-performing lending comprises:		
Accruing loans on which interest is being placed in suspense	**567**	633
Loans accounted for on a non-accrual basis	**673**	585
	1,240	1,218
Provisions	**(914)**	(916)
Interest held in suspense	**(21)**	(28)
	305	274

16 Concentrations of exposure

	2004 £m	2003 £m
Loans and advances to customers		
Domestic		
Agriculture, forestry and fishing	**2,076**	2,025
Manufacturing	**3,292**	3,211
Construction	**1,877**	1,497
Transport, distribution and hotels	**6,753**	4,741
Property companies	**5,775**	4,577
Financial, business and other services	**12,103**	9,652
Personal:		
– Mortgages	**80,065**	70,750
– Other	**22,833**	20,139
Lease financing	**6,387**	6,470
Hire purchase	**4,828**	4,701
Other	**5,321**	3,351
Total domestic	**151,310**	131,114
International		
Latin America	**125**	557
USA	**2,385**	2,681
Europe	**1,587**	1,981
Rest of the world	**516**	623
Total international	**4,613**	5,842
	155,923	136,956
Provisions for bad and doubtful debts*	**(1,662)**	(1,677)
Interest held in suspense*	**(21)**	(28)
	154,240	135,251

* 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.

17 Debt securities

	2004 Balance sheet £m	2004 Valuation £m	2003 Balance sheet £m	2003 Valuation £m
Investment securities				
Government securities	**2,211**	**2,213**	1,895	1,902
Bank and building society certificates of deposit	**1,901**	**1,902**	2,515	2,515
Corporate debt securities	**2,581**	**2,587**	1,895	1,890
Mortgage backed securities	**2,774**	**2,781**	2,211	2,212
Other asset backed securities	**3,761**	**3,756**	3,942	3,951
Other debt securities	**1,140**	**1,141**	1,283	1,284
	14,368	**14,380**	13,741	13,754
Other securities				
Government securities	**4,524**	**4,524**	7,253	7,253
Other public sector securities	**51**	**51**	106	106
Corporate debt securities	**5,733**	**5,733**	6,785	6,785
Mortgage backed securities	**504**	**504**	664	664
Other asset backed securities	**14**	**14**	120	120
	25,194	**25,206**	28,669	28,682
Due within 1 year	**4,090**		5,045	
Due 1 year and over	**21,104**		23,624	
	25,194		28,669	
Geographical analysis by issuer				
United Kingdom	**5,048**		5,232	
Other European	**11,825**		15,949	
North America and Caribbean	**5,080**		5,130	
Latin America	**76**		98	
Asia Pacific	**2,763**		1,994	
Other	**402**		266	
	25,194		28,669	
Unamortised discounts net of premiums on investment securities	**56**		341	
Investment securities				
Listed	**8,925**	**8,931**	8,162	8,173
Unlisted	**5,443**	**5,449**	5,579	5,581
	14,368	**14,380**	13,741	13,754
Other securities				
Listed	**10,378**	**10,378**	14,374	14,374
Unlisted	**448**	**448**	554	554
	10,826	**10,826**	14,928	14,928

17 Debt securities (continued)

	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
Movements in investment securities:				
At 1 January 2004	**13,731**	**109**	**99**	**13,741**
Exchange and other adjustments	**(484)**	**–**	**(2)**	**(482)**
Additions	**9,637**	**–**	**–**	**9,637**
Transfers from other securities	**281**	**–**	**–**	**281**
Securities sold or matured	**(8,787)**	**(2)**	**(25)**	**(8,764)**
Adjustments on disposal of businesses	**(23)**	**–**	**(7)**	**(16)**
Charge for the year	**–**	**–**	**43**	**(43)**
Amortisation of premiums and discounts	**–**	**14**	**–**	**14**
At 31 December 2004	**14,355**	**121**	**108**	**14,368**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. It is expected that tax of £4 million (2003: £3 million) would be payable if the investment securities were sold at their year end valuation.

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.

18 Equity shares

	2004 Balance sheet £m	**2004 Valuation £m**	2003 Balance sheet £m	2003 Valuation £m
Investment securities				
Listed	**5**	**7**	5	5
Unlisted	**34**	**56**	30	126
	39	**63**	35	131
Other securities				
Listed	**176**	**176**	423	423
	215	**239**	458	554

	Cost £m	Provisions £m	Total £m
Movements in investment securities:			
At 1 January 2004	**41**	**6**	**35**
Exchange and other adjustments	**(1)**	**(1)**	**–**
Additions	**21**	**–**	**21**
Disposals	**(12)**	**(5)**	**(7)**
Adjustments on disposal of businesses	**(1)**	**–**	**(1)**
Charge for the year	**–**	**9**	**(9)**
At 31 December 2004	**48**	**9**	**39**

Investment securities are those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. If the investment securities were sold at their year end valuation no tax is expected to be payable as any such gains would be exempt or covered by available capital losses.

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

19 Assets transferred under sale and repurchase transactions

	2004 £m	2003 £m
Assets subject to sale and repurchase agreements:		
Treasury bills and other eligible bills	**117**	136
Debt securities	**10,454**	4,503
	10,571	4,639

These investments have been sold to third parties but the Group is committed to reacquire them at a future date and at a predetermined price. At 31 December 2004 the Group held £12,783 million (2003: £2,643 million) of securities as collateral under reverse repurchase agreements. The above disclosure includes assets held through these agreements and subsequently resold as collateral for the Group's own transactions.

20 Interests in joint ventures

	£m
At 1 January 2004	**54**
Share of losses	**(1)**
At 31 December 2004	**53**

The Group's largest investments are in two joint ventures:

	Group interest	Nature of business
iPSL	19.5% of issued ordinary share capital	Cheque processing
GF Two Limited (formerly Goldfish Holdings Limited)	25.0% of issued ordinary share capital	No longer trading

In the year ended 31 December 2004 £16 million (2003: £25 million) of fees payable to iPSL have been included in the Group's administrative expenses and £3 million (2003: £3 million) of charges to iPSL have been included in the Group's income. The Group has also prepaid £17 million (2003: £13 million) of fees in respect of 2005 and this amount is included in prepayments and accrued income.

GF One Limited (formerly Goldfish Bank Limited, a wholly owned subsidiary of GF Two Limited) has lent £44 million (2003: nil) to the Group and this amount is included in customer accounts. Interest payable to GF One Limited of £1 million (2003: nil) has been charged to the Group's profit and loss account and capitalised in this balance.

In the year ended 31 December 2003 £7 million of interest receivable from GF One Limited and £6 million of charges to GF One Limited in respect of administrative costs were included in the Group's income.

Included in the gross assets disclosed on the balance sheet is an investment of £3 million (2003: £3 million) in associated undertakings.

21 Interests in group undertakings

	Shares £m	Loans £m
At 1 January 2004	**10,753**	**1,723**
Revaluation	**328**	**–**
Disposal	**(1)**	**–**
At 31 December 2004	**11,080**	**1,723**

	2004 £m	2003 £m
Shares in banks	**11,080**	10,752
Shares in other group undertakings	**–**	1
Total – all unlisted	**11,080**	10,753

On an historical basis, shares in group undertakings would have been included at cost of £6,066 million (2003: £6,066 million). 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 disposal of substantial shareholding investments.

21 Interests in group undertakings (continued)

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 Group plc, are:

	Country of registration/ incorporation	Percentage of equity share capital and voting rights held	Nature of business
Lloyds TSB Bank plc	England	100%	Banking and financial services
Cheltenham & Gloucester plc	England	100%†	Mortgage lending and retail investments
Lloyds TSB Commercial Finance Limited	England	100%†	Credit factoring
Lloyds TSB Leasing Limited	England	100%†	Financial leasing
Lloyds TSB Private Banking Limited	England	100%†	Private banking
The Agricultural Mortgage Corporation PLC	England	100%†	Long-term agricultural finance
Lloyds TSB Offshore Limited	Jersey	100%†	Banking and financial services
Lloyds TSB Scotland plc	Scotland	100%†	Banking and financial services
Lloyds TSB General Insurance Limited	England	100%†	General insurance
Scottish Widows Investment Partnership Group Limited	England	100%†	Investment management
Abbey Life Assurance Company Limited	England	100%†	Life assurance
Lloyds TSB Insurance Services Limited	England	100%†	Insurance broking
Lloyds TSB Asset Finance Division Limited	England	100%†	Consumer credit, leasing and related services
Black Horse Limited	England	100%†	Consumer credit, leasing and related services
Scottish Widows plc	Scotland	100%†	Life assurance
Scottish Widows Annuities Limited	Scotland	100%†	Life assurance

† Indirect interest

The country of registration/incorporation is also the principal area of operation for each of the above group undertakings except as follows:

Lloyds TSB Bank plc operates principally in the UK but also through branches in Belgium, Dubai, Ecuador, Gibraltar, Hong Kong, Japan, Luxembourg, Malaysia, Monaco, Netherlands, Paraguay, Singapore, Spain, Switzerland, Uruguay, the USA and a representative office in Iran.

22 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	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Profit and loss account				
Interest receivable	**–**	–	**132**	82
Interest payable	**(74)**	(59)	**(83)**	(52)
Other operating income	**116**	93	**(8)**	(2)
Total income	**42**	34	**41**	28
Operating expenses	**(57)**	(36)	**–**	–
(Loss) profit on ordinary activities before taxation	**(15)**	(2)	**41**	28
Tax on (loss) profit on ordinary activities	**5**	6	**(5)**	(2)
(Loss) profit on ordinary activites after taxation	**(10)**	4	**36**	26
Dividends paid	**–**	–	**(24)**	–
(Loss) profit for the year	**(10)**	4	**12**	26
Balance sheet				
Assets:				
Loans and advances to customers	**–**	–	**410**	345
Debt securities	**–**	–	**3,770**	3,718
Tangible fixed assets	**1,742**	1,408	**–**	–
Other assets and prepayments	**49**	23	**36**	34
Total assets	**1,791**	1,431	**4,216**	4,097
Liabilities:				
Deposits by banks	**1,527**	1,309	**–**	672
Debt securities in issue	**–**	–	**3,272**	3,123
Other liabilities and accruals	**260**	108	**31**	18
Shareholders' funds	**4**	14	**913**	284
Total liabilities	**1,791**	1,431	**4,216**	4,097
Cash flow statement				
Net cash inflow from operating activities	**388**	132	**52**	1,173

23 Intangible fixed assets

	Cost £m	Amortisation £m	Net book value £m
Goodwill			
At 1 January 2004	**2,626**	**113**	**2,513**
Acquisition adjustment	**(34)**	**–**	**(34)**
Adjustments on disposal of businesses	**(14)**	**(4)**	**(10)**
Charge for the year	**–**	**44**	**(44)**
At 31 December 2004	**2,578**	**153**	**2,425**

24 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m
Cost:			
At 1 January 2004	**1,192**	**2,186**	**2,518**
Exchange and other adjustments	**–**	**(1)**	**(46)**
Adjustments on disposal of businesses	**(10)**	**(13)**	**–**
Additions	**73**	**262**	**801**
Disposals	**(18)**	**(109)**	**(471)**
At 31 December 2004	**1,237**	**2,325**	**2,802**
Depreciation:			
At 1 January 2004	**416**	**1,296**	**266**
Exchange and other adjustments	**–**	**(1)**	**(4)**
Adjustments on disposal of businesses	**(4)**	**(8)**	**–**
Charge for the year (£589 million in total; 2003: £646 million)	**66**	**257**	**266**
Disposals	**(5)**	**(81)**	**(281)**
At 31 December 2004	**473**	**1,463**	**247**
Balance sheet amount at 31 December 2004	**764**	**862**	**2,555**
		4,181	
Balance sheet amount at 31 December 2003	776	890	2,252
		3,918	

	2004 £m	2003 £m
Balance sheet amount of premises comprises:		
Freeholds	**349**	369
Leaseholds 50 years and over unexpired	**140**	133
Leaseholds less than 50 years unexpired	**275**	274
	764	776
Land and buildings occupied for own activities	**695**	705

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:

	2004 £m	2003 £m
Residual value expected to be recovered in:		
1 year or less	**378**	181
2 years or less but over 1 year	**128**	330
5 years or less but over 2 years	**647**	505
Over 5 years	**588**	445
Total exposure	**1,741**	1,461

25 Lease commitments

Annual commitments under non-cancellable operating lease agreements were:

	2004 Premises £m	**2004 Equipment £m**	2003 Premises £m	2003 Equipment £m
Leases on which the commitment is due to expire in:				
1 year or less	**6**	**–**	7	–
5 years or less but over 1 year	**26**	**–**	29	–
Over 5 years	**176**	**–**	190	–
	208	**–**	226	–

Obligations under finance leases were:

	2004 Premises £m	**2004 Equipment £m**	2003 Premises £m	2003 Equipment £m
Amounts payable in:				
1 year or less	**1**	**1**	–	–
5 years or less but over 1 year	**3**	**1**	–	–
	4	**2**	–	–

26 Capital commitments

Capital expenditure contracted but not provided for at 31 December 2004 amounted to £150 million (2003: £77 million) of which £146 million (2003: £71 million) relates to assets to be leased to customers under operating leases.

27 Other assets

	2004 £m	2003 £m
Balances arising from derivatives used for trading purposes (note 47)	**2,015**	2,489
Balances arising from derivatives used for hedging purposes	**254**	475
Settlement balances	**40**	54
Other assets	**911**	926
	3,220	3,944

28 Prepayments and accrued income

	2004 £m	2003 £m
Interest receivable	**1,075**	869
Deferred expenditure incurred under cash gift and discount mortgage schemes	**78**	128
Other debtors and prepayments	**1,420**	921
	2,573	1,918

29 Long-term assurance business

a Analysis of embedded value

	2004 £m	2003 £m
The embedded value included in the consolidated balance sheet comprises:		
Net tangible assets of life companies including surplus	**3,842**	3,602
Value of other shareholder's interests in the long-term assurance business	**2,939**	2,879
	6,781	6,481

	2004 £m	2003 £m
Movements in the embedded value balance:		
At 1 January	**6,481**	6,213
Exchange and other adjustments	**(16)**	12
Profit after tax	**516**	296
Adjustments on disposal of businesses	**–**	(38)
Dividends	**(200)**	(2)
At 31 December	**6,781**	6,481

b 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, less the costs of acquiring the business, including commissions paid to independent financial advisers and other direct sales costs.

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; and
- Customer remediation provisions (see c).

Development costs. This represents the costs associated with new product development and implementation of the bancassurance strategy.

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.

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 e.

29 Long-term assurance business (continued)	**2004 £m**	2003 £m
Income from long-term assurance business:		
New business contribution	**225**	150
Existing business:		
Expected return	**289**	264
Experience variances	**(41)**	(16)
Assumption changes and other items	**(39)**	(75)
Customer remediation provisions (see c)	**(12)**	(100)
	197	73
Development costs	**(11)**	(13)
Investment earnings	**167**	153
Operating profit	**578**	363
Investment variance	**139**	112
Changes in economic assumptions (see e)	**(2)**	(22)
Income from long-term assurance business before tax	**715**	453
Attributed tax	**(199)**	(157)
Income from long-term assurance business after tax	**516**	296

This analysis details the components of embedded value income for 2004 and the comparative period. These numbers are not comparable in all respects to the analysis of life and pensions profitability given on page 16, in the operating and financial review, since that analysis includes certain items which are accounted for outside of the embedded value calculations. In addition, comparatives in the operating and financial review have been restated to reflect the impact of the introduction, in 2004, of the management of the Group's distribution channels as profit centres.

c Customer remediation provisions

Redress to past purchasers of pension policies

Following an industry wide investigation in the 1990's it was concluded that a large number of customers who had purchased personal pension products had been poorly advised by insurance companies and intermediaries; an action plan was established requiring the UK pensions industry to review all cases of possible misselling and, where appropriate, pay compensation. As the review of pension cases in the Group has progressed, provisions have been established for the estimated cost of compensation.

	2004 £m	2003 £m
Movements in the provision over the last two years:		
At 1 January	**25**	37
Accrual of interest on the provision	**–**	2
Charge for the year	**–**	44
Compensation paid	**(12)**	(58)
At 31 December	**13**	25

The review is now nearing completion and management do not expect any further material changes in the provisioning requirement.

29 Long-term assurance business (continued)

Mortgage endowments and other savings products

During 2002, a review was carried out in conjunction with the FSA into sales of mortgage endowment and other long-term savings products made by the Abbey Life sales force between 1988 and its disposal by Lloyds TSB Group in February 2000. As a result of this review, the Group is required to pay compensation to customers in those cases where sales practices are found to have been deficient. A provision has been established to meet the cost of the payments to those customers; a provision is also held against the estimated cost of redress payments to customers in respect of products sold by the Abbey Life sales force prior to 1988. During 2004 management has reviewed the adequacy of the provisions held in the light of experience and changing market conditions and an additional charge of £12 million (2003: £56 million) has been made.

	2004 £m	2003 £m
Movements in the provision over the last two years:		
At 1 January	**149**	165
Accrual of interest on the provision	**3**	5
Charge for the year	**12**	56
Compensation paid	**(140)**	(77)
At 31 December	**24**	149

Details of the provisions held in respect of the estimated cost of making redress payments to customers in respect of past product sales by the Group's banking operations are given in note 37.

d With-profits options and guarantees

In common with other organisations in the life assurance industry, prior to its demutualisation Scottish Widows wrote policies which contained potentially valuable options and guarantees, including guaranteed annuity option policies. 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 which is available, inter alia, to meet any additional costs of providing guaranteed benefits on transferred policies; the Additional Account had a value at 31 December 2004 of £1.4 billion (2003: £1.4 billion). To the extent that the Additional Account is insufficient to provide these benefits any shortfall would be met by Lloyds TSB Group.

Since demutualisation in 2000, Scottish Widows continued to write policies containing similar features, although the volume of products written has since reduced and is now not significant. The Additional Account is not available to meet any additional cost of providing the benefits on these policies.

The eventual cost of providing benefits on the policies written both pre and post demutualisation is dependent upon a large number of variables, including in particular:

- future interest rate and equity market trends;
- demographic factors, such as future persistency and mortality; and
- the proportion of policyholders who seek to exercise their options.

The ultimate cost, and any impact upon Lloyds TSB Group, will not be known for many years. However, Scottish Widows has developed, and will continue to develop, an actuarial model to assist in the management of the With-Profits Fund and to meet regulatory requirements. The model allows management to estimate the effects of different economic scenarios upon the financial position of the fund and consider the implications of different management actions. Output from this model indicates that the possible cost of providing benefits on policies containing features such as options and guarantees varies widely and, depending on the economic scenario encountered, could result in Lloyds TSB Group incurring a liability. Based on the information available at present, having considered the range of possible outcomes, and after making allowance for the effect of proposed future management actions, Lloyds TSB Group currently considers that no provision is necessary. However, the model is subject to ongoing development and the position will be kept under review.

e Assumptions

In accordance with the Association of British Insurers' detailed guidance for the preparation of figures using the achieved profits method of accounting, the Group has reviewed the economic assumptions used in the embedded value calculations. The guidance requires that the assumptions should be reviewed at each reporting date.

The principal economic assumptions have been revised at 31 December 2004 as follows:

	2004 %	2003 %
Risk-adjusted discount rate (net of tax)	**7.40**	7.60
Return on equities (gross of tax)	**7.17**	7.45
Return on fixed interest securities (gross of tax)	**4.57**	4.85
Expenses inflation	**3.76**	3.80

The revised assumptions have resulted in a net charge to the profit and loss account of £2 million.

29 Long-term assurance business (continued)

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 take into account both the effects of recent actual experience and future expectations 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 (2003: 30 per cent). The normalised investment earnings have been grossed up at a composite longer term tax rate of 18 per cent (2003: 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 eligible bonus, in accordance with the terms of the transfer of the Scottish Widows business.

f Sensitivities

The table below shows the effect on both the embedded value at 31 December 2004 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	**6,781**	**225**
Effect of a 1% increase in the discount rate	**(189)**	**(26)**
Effect of a 1% reduction in the discount rate	**213**	**30**
Effect of a 1% reduction in the return on equities	**(84)**	**(12)**

g Balance sheet

The long-term assurance assets attributable to policyholders comprise:

	2004 £m	2003 £m
Investments	**56,960**	52,082
Premises and equipment	**35**	40
Other assets	**1,741**	1,680
	58,736	53,802
Net tangible assets of life companies including surplus	**(3,842)**	(3,602)
	54,894	50,200
Investments shown above comprise:		
Fixed interest securities	**15,985**	15,947
Stocks, shares and unit trusts	**31,896**	27,590
Investment properties	**3,150**	3,540
Other properties	**120**	121
Mortgages and loans	**76**	65
Deposits	**5,733**	4,819
	56,960	52,082
The liabilities to policyholders comprise:		
Technical provisions:		
– Long-term business provision (net of reinsurance)	**23,705**	23,730
– Claims outstanding (net of reinsurance)	**246**	238
Technical provisions for linked liabilities	**28,256**	25,023
Fund for future appropriations	**1,379**	346
Other liabilities	**1,308**	863
	54,894	50,200

For the purposes of consolidating the long-term assurance policyholder assets and liabilities into the Group's balance sheet a deduction has been made of £130 million (2003: £122 million) for own shares held within the with-profit funds.

29 Long-term assurance business (continued)

h 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:

	2004 £m	2003 £m
Premiums	**5,575**	5,139
Investment income	**1,981**	2,073
Unrealised gains on investments	**2,815**	4,833
Other income	**–**	6
	10,371	12,051
Claims	**(5,222)**	(4,433)
Change in technical provisions	**(3,208)**	(4,540)
Expenses	**(535)**	(689)
Realised gains (losses) on investments	**244**	(1,679)
Unrealised losses on investments	**–**	(22)
Other charges	**–**	(4)
Tax attributable to long-term business	**(110)**	(41)
Transfer to the fund for future appropriations	**(1,084)**	(414)
Balance on the technical account – long-term business	**456**	229
Tax attributable to balance on the technical account – long-term business	**155**	112
Income in shareholder fund	**55**	34
Profit on ordinary activities before tax	**666**	375
Tax on profit on ordinary activities	**(170)**	(125)
Profit on ordinary activities after tax	**496**	250
Dividends proposed	**(200)**	–
Profit for the financial year	**296**	250

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

	2004 £m	2003 £m
Income from long-term assurance business attributable to the shareholder after tax	**516**	296
Increase in value-in-force taken to profit	**(60)**	(2)
	456	294
Other differences:		
Movement in deferred acquisition costs	**89**	66
Tax adjustment	**7**	(60)
Other	**(56)**	(50)
Profit on ordinary activities after tax on a modified statutory solvency basis	**496**	250

29 Long-term assurance business (continued)

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

	2004 £m	2003 £m
Assets		
Investments	**29,069**	27,468
Assets held to cover linked liabilities	**28,256**	25,023
Other assets	**1,992**	2,018
Total assets	**59,317**	54,509
Liabilities		
Shareholder's funds	**4,581**	4,234
Fund for future appropriations	**1,379**	346
Long-term business provision†	**23,705**	23,730
Technical provision for linked liabilities†	**28,256**	25,023
Other creditors	**1,396**	1,176
Total liabilities	**59,317**	54,509

† Net of reinsurers' share of technical provisions

The value of long-term business attributable 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:

	2004 £m	2003 £m
Long-term assurance business attributable to the shareholder – embedded value basis	**6,781**	6,481
Value of in-force business	**(2,939)**	(2,879)
	3,842	3,602
Other differences:		
Deferred acquisition costs	**585**	496
Tax adjustment	**152**	145
Other adjustments	**2**	(9)
Net tangible assets of life operations on a modified statutory solvency basis	**4,581**	4,234

30 Assets and liabilities denominated in foreign currencies

	2004 £m	2003 £m
Assets		
Denominated in sterling	**171,704**	153,775
Denominated in other currencies	**53,375**	48,159
	225,079	201,934
Liabilities		
Denominated in sterling	**171,587**	153,769
Denominated in other currencies	**53,492**	48,165
	225,079	201,934

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

31 Deposits by banks

	2004 £m	2003 £m
Repayable on demand	**5,183**	7,455
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	**31,833**	15,002
1 year or less but over 3 months	**2,500**	1,197
5 years or less but over 1 year	**21**	69
Over 5 years	**201**	232
	39,738	23,955

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

	2004 £m	2003 £m
Domestic:		
Non-interest bearing	**180**	144
Interest bearing	**33,029**	18,715
	33,209	18,859
International:		
Non-interest bearing	**32**	61
Interest bearing	**6,497**	5,035
	6,529	5,096
	39,738	23,955

32 Customer accounts

	2004 £m	2003 £m
Repayable on demand	**93,846**	90,539
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:		
3 months or less	**18,938**	17,316
1 year or less but over 3 months	**2,442**	1,846
5 years or less but over 1 year	**5,632**	5,431
Over 5 years	**1,204**	1,364
	122,062	116,496

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

	2004 £m	2003 £m
Domestic:		
Non-interest bearing	**3,529**	3,328
Interest bearing	**115,699**	109,384
	119,228	112,712
International:		
Non-interest bearing	**296**	358
Interest bearing	**2,538**	3,426
	2,834	3,784
	122,062	116,496

33 Debt securities in issue

	2004 £m	2003 £m
Bonds and medium-term notes by residual maturity repayable:		
1 year or less	**167**	711
2 years or less but over 1 year	**144**	81
5 years or less but over 2 years	**1,053**	1,099
Over 5 years	**3,999**	3,623
	5,363	5,514
Other debt securities by residual maturity repayable:		
3 months or less	**18,489**	17,942
1 year or less but over 3 months	**2,941**	2,015
5 years or less but over 1 year	**424**	283
Over 5 years	**–**	168
	21,854	20,408
	27,217	25,922

Debt securities in issue include certificates of deposit of £15,226 million (2003: £16,415 million) and commercial paper of £6,473 million (2003: £3,625 million). An amount of £5,097 million (2003: £5,184 million) relating to debt securities issued under the Group's Euro Medium Term Note programme is included in these figures.

34 Other liabilities

	2004 £m	2003 £m
Balances arising from derivatives used for trading purposes (note 47)	**3,135**	3,499
Balances arising from derivatives used for hedging purposes	**667**	503
Current tax	**399**	503
Dividends	**1,315**	1,314
Settlement balances	**38**	40
Other liabilities	**1,065**	1,148
	6,619	7,007

35 Accruals and deferred income

	2004 £m	2003 £m
Interest payable	**1,581**	1,216
Other creditors and accruals	**2,285**	1,990
	3,866	3,206

36 Deferred tax

	2004 £m	2003 £m
Short-term timing differences	**(196)**	(229)
Accelerated depreciation allowances	**1,669**	1,605
	1,473	1,376

	£m
At 1 January 2004	**1,376**
Exchange and other adjustments	**(26)**
Adjustments on disposal of assets	**(23)**
Charge for the year	**146**
At 31 December 2004	**1,473**

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 the future has been entered into. Deferred tax balances have not been discounted.

The deferred tax balance at 31 December 2004 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 £956 million (2003: £916 million) (note 45).

37 Other provisions for liabilities and charges

	Customer remediation provisions £m	Insurance provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2004	**97**	**219**	**86**	**402**
Exchange and other adjustments	**–**	**(6)**	**–**	**(6)**
Adjustments on disposal of businesses	**–**	**–**	**(1)**	**(1)**
Provisions applied	**(105)**	**(203)**	**(13)**	**(321)**
Charge for the year	**100**	**224**	**19**	**343**
At 31 December 2004	**92**	**234**	**91**	**417**

Customer remediation provisions

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, where the original sales processes are found to have been deficient. During 2004 management have again reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and as a result an additional charge of £100 million (2003: £200 million) has been made.

At 31 December 2004 the provisions held mainly related to past sales of mortgage endowment policies. Mortgage endowments were sold to customers through the branch network of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester, and underwritten by life assurance companies within the Group and also by third parties. The principal assumptions that have been made in the calculation of the provision relate to the number of cases that are likely to require redress and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the expenditure will be incurred over the next two years.

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, a claims equalisation provision is maintained in relation to property 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 run off during the remaining life of the leases concerned; the run off period currently averages 5 years. Where a property is disposed of earlier than anticipated, any remaining balance in the provision relating to that property is released.

38 Subordinated liabilities

	Notes	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Undated loan capital		**5,852**	5,959	**497**	497
Dated loan capital		**4,400**	4,495	**861**	859
Total subordinated liabilities		**10,252**	10,454	**1,358**	1,356
Undated loan capital*†					
Primary Capital Undated Floating Rate Notes:	a				
Series 1 (US$750 million)		**389**	419	**–**	–
Series 2 (US$500 million)		**259**	279	**–**	–
Series 3 (US$600 million)		**311**	335	**–**	–
11³/₄% Perpetual Subordinated Bonds		**100**	100	**–**	–
6.625% Perpetual Capital Securities (€750 million)	b	**526**	523	**–**	–
6.90% Perpetual Capital Securities callable 2007 (US$1,000 million)	c	**512**	550	**–**	–
5⁵/₈% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	g	**877**	874	**–**	–
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a	**105**	105	**–**	–
6⁵/₈% Undated Subordinated Step-up Notes callable 2010	f	**407**	407	**–**	–
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	d, g	**350**	349	**–**	–
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)	h	**101**	104	**–**	–
5.125% Undated Subordinated Step-up Notes callable 2016		**497**	496	**–**	–
6¹/₂% Undated Subordinated Step-up Notes callable 2019	f	**267**	267	**–**	–
8% Undated Subordinated Step-up Notes callable 2023	f	**199**	199	**–**	–
6¹/₂% Undated Subordinated Step-up Notes callable 2029	f	**455**	455	**–**	–
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032	f	**497**	497	**497**	497
		5,852	5,959	**497**	497
Dated loan capital					
Subordinated Floating Rate Notes 2004		**–**	5	**–**	–
7³/₈% Subordinated Bonds 2004		**–**	400	**–**	–
Subordinated Floating Rate Notes 2004		**–**	100	**–**	–
8¹/₂% Subordinated Bonds 2006		**250**	249	**250**	249
7³/₄% Subordinated Bonds 2007		**299**	299	**–**	–
5¹/₄% Subordinated Notes 2008 (DM 750 million)		**270**	269	**–**	–
10⁵/₈% Guaranteed Subordinated Loan Stock 2008	e	**100**	100	**–**	–
9¹/₂% Subordinated Bonds 2009		**100**	100	**–**	–
Subordinated Step-up Floating Rate Notes 2009 callable 2004 (US$500 million)		**–**	279	**–**	–
6¹/₄% Subordinated Notes 2010 (€400 million)		**281**	281	**–**	–
Subordinated Floating Rate Notes 2010 (US$400 million)	a	**207**	223	**–**	–
12% Guaranteed Subordinated Bonds 2011	e	**100**	100	**–**	–
9¹/₈% Subordinated Bonds 2011		**149**	149	**149**	149
4³/₄% Subordinated Notes 2011 (€850 million)		**582**	578	**–**	–
5⁷/₈% Subordinated Guaranteed Bonds 2014 (€750 million)		**462**	461	**462**	461
5⁷/₈% Subordinated Notes 2014		**148**	148	**–**	–
6⁷/₈% Subordinated Notes 2015		**345**	345	**–**	–
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	a, i	**353**	–	**–**	–
Subordinated Floating Rate Notes 2020 (€100 million)	a	**70**	70	**–**	–
9⁵/₈% Subordinated Bonds 2023		**338**	339	**–**	–
5.75% Subordinated Step-up Notes 2025 callable 2020	i	**346**	–	**–**	–
		4,400	4,495	**861**	859

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

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

† Any repayments of undated loan capital would require the prior consent of the Financial Services Authority.

38 Subordinated liabilities (continued)

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

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

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

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

i) Issued during 2004 primarily to finance the general business of the Group.

	Group 2004 £m	Group 2003 £m	**Company 2004 £m**	Company 2003 £m
Dated subordinated liabilities are repayable as follows:				
1 year or less	**–**	505	**–**	–
2 years or less but over 1 year	**250**	–	**250**	–
5 years or less but over 2 years	**769**	917	**–**	249
Over 5 years	**3,381**	3,073	**611**	610
	4,400	4,495	**861**	859

39 Non-equity minority interests

Non-equity minority interests comprise:

	2004 £m	2003 £m
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)*	**302**	301
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015**	**248**	248
Capital instruments	**550**	549
European Financial Institution Investments Partnership†	**–**	100
LM ABS Investment Partnership‡	**–**	34
	550	683

* These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 233 basis points above EURIBOR, to be set annually.

** These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 350 basis points above a rate based on the yield of specified UK government stock.

Both of the above issues were made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

† These securities constituted 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. During 2004 the partnership was dissolved and the capital returned to the partners.

‡ These securities constituted interests in LM ABS Investment Partnership, an English law general partnership in which the principal partner was Lime Street (Funding) Limited, a wholly owned subsidiary of the Group. During 2004 the partnership was dissolved and the capital returned to the partners.

40 Called-up share capital

	2004	2003
Authorised:		
Sterling	£m	£m
6,911 million Ordinary shares of 25p each	**1,728**	1,728
79 million Limited voting ordinary shares of 25p each	**20**	20
175 million Preference shares of 25p each	**44**	44
	1,792	1,792
US dollars	US$m	US$m
160 million Preference shares of US25 cents each	**40**	40
Euro	€m	€m
160 million Preference shares of €25 cents each	**40**	40
Japanese yen	¥m	¥m
50 million Preference shares of ¥25 each	**1,250**	1,250

	2004 £m
Issued and fully paid:	
Ordinary shares of 25p each	
At 1 January	**1,398**
Issued under employee share schemes (3 million shares)	**1**
At 31 December	**1,399**
Limited voting ordinary shares of 25p each	
At 1 January and 31 December	**20**
	1,419

In addition, during the year the directors approved the allotment at par of 400 6 per cent non-cumulative redeemable preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company.

Number of shares in issue:	2004	2003
Ordinary shares of 25p each	**5,596,397,111**	5,593,737,422
Limited voting ordinary shares of 25p each	**78,947,368**	78,947,368
6% Non-Cumulative Redeemable Preference shares of 25p each	**400**	–

The limited voting ordinary shares are held by the Lloyds TSB Foundations. These shares carry no rights to dividends but rank pari passu with the ordinary shares in respect of other distributions and in the event of winding up. These shares do not have any right to vote at general meetings other than on resolutions concerning acquisitions or disposals of such importance that they require shareholder consent, or for the winding up of the Company, or for a variation in the class rights of the limited voting ordinary shares.

Lloyds TSB Group plc has entered into deeds of covenant with the Lloyds TSB Foundations, under the terms of which the Company makes annual donations to the foundations equal, in total, to 1 per cent of the Group's pre-tax profits (after certain adjustments) averaged over three years. The deeds of covenant can be cancelled by the Company at nine years' notice.

At 31 December 2004, options to acquire 162 million Lloyds TSB Group ordinary shares of 25p each were outstanding under the executive share option schemes, the share retention plan and the staff sharesave share option schemes exercisable up to 2014. These include the option, described on page 57, to acquire 216,763 shares under the share retention plan: otherwise the options are exercisable at prices ranging from 243p to 888p per share.

41 Reserves

	£m
Share premium account (the Group and the Company):	
At 1 January 2004	**1,136**
Premium arising on issue of shares	**9**
At 31 December 2004	**1,145**
Merger reserve (the Group):	
At 1 January and 31 December 2004	**343**
Profit and loss account (the Group):	
At 1 January 2004	**6,727**
Exchange and other adjustments	**(11)**
Actuarial losses recognised in post-retirement benefit schemes (note 45)	**(166)**
Movements in relation to own shares (note 43)	**10**
Goodwill written back on sale of businesses	**3**
Profit for the year	**507**
At 31 December 2004	**7,070**
Revaluation reserve (the Company):	
At 1 January 2004	**4,687**
Transfer to profit and loss account	**(1)**
Increase in net tangible assets of subsidiary undertakings	**328**
At 31 December 2004	**5,014**
Profit and loss account (the Company):	
At 1 January 2004	**2,383**
Movements in relation to own shares (note 43)	**8**
Transfer from revaluation reserve	**1**
Profit for the year	**7**
At 31 December 2004	**2,399**

The profit and loss account reserves of the Group at 31 December 2004 include approximately £1 billion (2003: £1 billion) 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's profit and loss account reserves at 31 December 2004 are stated after including a deficit of £2,231 million relating to the Group's post-retirement defined benefit schemes (2003: £2,139 million) and after deducting £31 million (2003: £39 million) in respect of own shares held.

The cumulative amount of premiums on acquisitions written off against Group reserves during previous years amounts to £2,087 million (2003: £2,090 million) of which £1,682 million (2003: £1,662 million) was within the last 10 years.

42 Shareholders' funds

	Group 2004 £m	Group 2003 £m	**Company 2004 £m**	Company 2003 £m
Equity	**9,977**	9,624	**9,977**	9,624
Non-equity	**–**	–	**–**	–
	9,977	9,624	**9,977**	9,624

Non-equity shareholders' funds comprise 400 non-cumulative redeemable preference shares of 25p each which were issued during 2004 at par.

43 Own shares

The amounts deducted from profit and loss account reserves in respect of own shares, which are held at cost, are comprised as follows:

	2004 £m	2003 £m
Own shares held in relation to employee shares schemes*	**14**	22
Own shares – the Company	**14**	22
Lloyds TSB Group interest in shares held by the long-term assurance funds†	**17**	17
Own shares – the Group	**31**	39

* Lloyds TSB Group plc sponsors the Lloyds TSB Group Employee Share Ownership Trust, a discretionary trust for the benefit of employees and former employees of Lloyds TSB Group. The Company has lent £20.6 million to the trustees, interest free, to enable them to purchase Lloyds TSB Group plc ordinary shares, which are used to satisfy options granted by the Company or to meet commitments arising under other employee share schemes. Under the terms of the trust, the trustees have waived all but a nominal dividend on the shares they hold. At 31 December 2004, 1.5 million shares were held by the trustees with a cost of £11.5 million (2003: 1.6 million shares with a cost of £12.6 million).

Lloyds TSB Group has also established the Lloyds TSB Qualifying Employee Share Ownership Trust ('the QUEST') for the purpose of providing shares on the exercise of options under certain of the Group's Save As You Earn (SAYE) share option schemes. At 31 December 2004, 1,364 shares were held by the QUEST (2003: 0.2 million shares with a cost of £0.7 million). Under the terms of the QUEST's trust deed, the trustees have waived all but a nominal dividend on the shares they hold.

The Lloyds TSB Group Shareplan ('Shareplan') has been established for the purpose of providing an enhanced remuneration package for employees. The shares are used to provide shares awarded to employees for no consideration, as a percentage of salaries by reference to the profits of Lloyds TSB Group, together with partnership shares which are acquired by employees via monthly contributions; and matching shares, which are additional shares awarded for no consideration to employees acquiring partnership shares. At 31 December 2004, 0.5 million shares (2003: 2.2 million shares) were held but not allocated to individual employees by the Shareplan trustees with a cost to the Group of £2.3 million (2003: £9.2 million). The trustees have waived all but a nominal dividend on the shares they hold.

In addition, a further 0.2 million ordinary shares were held by Lloyds TSB Group Holdings (Jersey) Limited at 31 December 2004 (2003: 0.4 million shares). These shares, on which the dividend entitlement has been waived, were gifted to Lloyds TSB Group some years ago at nil cost and are used to satisfy outstanding options or to meet commitments arising under other employee share schemes.

† The long-term assurance funds of Scottish Widows hold 30.5 million shares (2003: 30.5 million shares) in Lloyds TSB Group plc which were bought prior to the acquisition of Scottish Widows by Lloyds TSB Group. Due to the structure of these funds, Lloyds TSB Group is effectively exposed to the risks and rewards of ownership of one tenth of these shares; the risks and rewards of ownership of the remaining nine tenths are borne by the policyholders.

Movements in the amount deducted from reserves in respect of own shares have been as follows:

	£m
The Group	
At 1 January 2004	**39**
Purchases of, and subscriptions for, shares	**57**
Use of shares on exercise of employee options and for other employee share plans	**(67)**
Shares forfeited in the year	**2**
At 31 December 2004	**31**
The Company	
At 1 January 2004	**22**
Purchases of, and subscriptions for, shares	**57**
Use of shares on exercise of employee options and for other employee share plans	**(67)**
Shares forfeited in the year	**2**
At 31 December 2004	**14**

The credit of £10 million to Lloyds TSB Group's profit and loss account reserves represents the net reduction in the cost of own shares of £8 million and an increase in the accrual in respect of the free shares to be awarded in respect of Shareplan of £2 million.

The credit of £8 million to the Company's profit and loss account reserves represents the net reduction in the cost of own shares.

44 Related party transactions

a Transactions, arrangements and agreements involving directors and others

At 31 December 2004, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	2004 Number of persons	**2004 Total £000**	2003 Number of persons	2003 Total £000
Loans and credit card transactions:				
Directors and connected persons	**4**	**3,217**	6	3,199
Officers	**22**	**6,747**	30	5,355

During 2003 one officer purchased a car from the Group for a total consideration of £27,000.

b Group undertakings

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

c Joint ventures

Details of the Group's joint ventures are provided in note 20. Information relating to transactions entered into between Group undertakings and the joint ventures and details of outstanding balances at 31 December 2004 are also shown in note 20.

d Long-term assurance business

The Group enters into 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 2004 Group entities owed £2,254 million (2003: £1,995 million) and were owed £97 million (2003: £136 million); these amounts are included in customer accounts and loans and advances to customers respectively. Furthermore Scottish Widows plc has provided £50 million (2003: £30 million) of subordinated loan capital to Scottish Widows Bank plc, which is included in other liabilities. In addition, fees of £201 million (2003: £107 million) were received, and fees of £49 million (2003: £71 million) were paid, in respect of distribution, asset management and other services.

Certain administrative properties used by Scottish Widows are owned by the long-term assurance funds. During 2004 Scottish Widows paid rent to the long-term assurance funds amounting to £5 million (2003: £5 million). In addition, at 31 December 2004, the long-term assurance funds owned 30.5 million ordinary shares in the Company (2003: 30.5 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 2004, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £14 million (2003: £16 million).

45 Pensions and other post-retirement benefits

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

	2004 £m	2003 £m
Defined contribution schemes	**32**	33
Defined benefit schemes	**306**	320
	338	353

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 2003 and 2004, no contributions have been made to the Lloyds TSB Group Pension Scheme No. 2. However, with effect from 1 July 2003 the Group recommenced contributions to the Lloyds TSB Group Pension Scheme No. 1 at a rate of 31.7 per cent of pensionable salary; this was increased to 56.5 per cent of pensionable salary with effect from 1 January 2004. 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 these schemes were carried out as at 30 June 2002; these have been updated to 31 December 2004 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 2004 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 2004 %	31 December 2003 %	31 December 2002 %
Rate of inflation	**2.60**	2.50	2.30
Rate of salary increases	**4.14**	4.04	3.83
Rate of increase for pensions in payment and deferred pensions	**2.60**	2.50	2.30
Discount rate	**5.30**	5.40	5.60

45 Pensions and other post-retirement benefits (continued)

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 dependents) who retired prior to 1 January 1996. For retirements subsequent to this date, the Group also met a reducing proportion of the cost until 31 December 2004, since which date the only obligation is in respect of the pre 1 January 1996 retirements.

Included within other finance income is an interest cost of £4 million (2003: £5 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 2004 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.7 per cent.

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

	Fair value at 31 December 2004 £m	**Expected long-term rate of return at 31 December 2004 %**	Fair value at 31 December 2003 £m	Expected long-term rate of return at 31 December 2003 %	Fair value at 31 December 2002 £m	Expected long-term rate of return at 31 December 2002 %
Market values of scheme assets:						
Equities	**8,042**	**8.2**	7,454	8.1	7,175	8.4
UK fixed interest gilts	**550**	**4.6**	551	4.8	557	4.5
UK index linked gilts	**561**	**4.3**	545	4.4	–	–
Sterling non-government bonds	**941**	**5.3**	1,033	5.4	491	5.6
Property	**959**	**6.9**	713	7.1	791	6.9
Cash	**611**	**3.6**	307	3.5	69	3.8
Total fair value of scheme assets	**11,664**		10,603		9,083	

Other finance income comprises:

	2004 £m	2003 £m
Expected return on scheme assets	**764**	696
Interest cost of scheme liabilities	**(725)**	(662)
	39	34

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

	2004 £m	2003 £m
Current service cost	**289**	269
Past service costs	**17**	51
Defined benefit costs	**306**	320

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

	2004 £m	2003 £m
Actual return less expected return on scheme assets	**369**	802
Experience gains and losses arising on scheme liabilities	**(114)**	94
Effect of changes in demographic and financial assumptions	**(492)**	(902)
Actuarial losses recognised	**(237)**	(6)
Deferred tax thereon	**71**	2
Amount recognised in the statement of total recognised gains and losses	**(166)**	(4)

45 Pensions and other post-retirement benefits (continued)

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

	2004 £m	2003 £m	2002 £m	2001 £m
Actual return less expected return on scheme assets:				
Amount	**369**	802	(2,582)	(2,015)
Percentage of scheme assets at balance sheet date	**3.2%**	7.6%	28.4%	18.1%
Experience gains and losses arising on scheme liabilities:				
Amount	**(114)**	94	(240)	(71)
Percentage of scheme liabilities at balance sheet date	**0.8%**	0.7%	2.0%	0.7%
Total amount recognised in the statement of total recognised gains and losses:				
Amount	**(237)**	(6)	(3,299)	(2,873)
Percentage of scheme liabilities at balance sheet date	**1.6%**	0.0%	27.5%	26.9%

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

	2004 £m	2003 £m
Market value of assets	**11,664**	10,603
Present value of scheme liabilities	**(14,851)**	(13,658)
Deficit in the schemes	**(3,187)**	(3,055)
Related deferred tax asset	**956**	916
Net post-retirement benefit liability	**(2,231)**	(2,139)

The movements in the deficit in the schemes over the last two years have been as follows:

	2004 £m	2003 £m
Deficit at beginning of year	**(3,055)**	(2,931)
Exchange and other adjustments	**(2)**	(4)
Other finance income	**39**	34
Current service costs	**(289)**	(269)
Contributions	**374**	138
Past service costs	**(17)**	(51)
Actuarial loss	**(237)**	(6)
Adjustments on disposal of businesses	**–**	34
Deficit at end of year	**(3,187)**	(3,055)

46 Contingent liabilities and commitments

Acceptances and endorsements arise where the Lloyds TSB Group agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Guarantees include those given on behalf of a customer to stand behind the current obligations of the customer and to carry out those obligations should the customer fail to do so.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, serving as financial guarantees where the Lloyds TSB Group has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Performance bonds and other transaction related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

Where guarantees are issued on behalf of customers, Lloyds TSB Group usually holds collateral against the exposure or has a right of recourse to the customer.

Lloyds TSB Group's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held or pledged.

46 Contingent liabilities and commitments (continued)

	2004 £m	2003 £m
Contingent liabilities		
Acceptances and endorsements	**71**	299
Guarantees	**6,786**	6,122
Other:		
Other items serving as direct credit substitutes	**345**	1,069
Performance bonds and other transaction-related contingencies	**1,324**	1,534
Other contingent liabilities	**–**	1
	1,669	2,604
	8,526	9,025
Commitments		
Documentary credits and other short-term trade-related transactions	**431**	368
Forward asset purchases and forward deposits placed	**1,654**	546
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year maturity	**63,196**	62,440
1 year or over maturity	**20,009**	15,981
	85,290	79,335

47 Derivatives and other financial instruments

Information about the Group's use of financial instruments and management of the associated risks is given on pages 24 to 26.

a 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. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

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

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

Derivative contracts expose the Group to both market risk and credit risk. Only a few highly specialist trading centres within the Group are permitted to enter into derivative contracts and the level of exposure to interest rate and exchange rate movements and other market variables is strictly controlled and monitored within approved limits.

47 Derivatives and other financial instruments (continued)

Unlike on-balance sheet instruments the principal amount of the contract does not represent the Group's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group, should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

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 2004	Notional principal amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**113,601**	**1,995**	**2,632**
Currency swaps	**11,386**	**426**	**581**
Options purchased	**2,059**	**44**	**–**
Options written	**1,922**	**–**	**41**
	128,968	**2,465**	**3,254**
Interest rate contracts:			
Interest rate swaps	**275,547**	**3,118**	**3,631**
Forward rate agreements	**62,797**	**28**	**24**
Options purchased	**9,679**	**78**	**–**
Options written	**7,430**	**–**	**163**
Futures	**48,278**	**–**	**–**
	403,731	**3,224**	**3,818**
Equity and other contracts	**4,239**	**282**	**19**
Effect of netting		**(3,956)**	**(3,956)**
Balances arising from off-balance sheet financial instruments		**2,015**	**3,135**

31 December 2003	Notional principal amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	76,368	1,669	2,127
Currency swaps	10,329	328	511
Options purchased	1,678	55	14
Options written	1,542	–	39
	89,917	2,052	2,691
Interest rate contracts:			
Interest rate swaps	236,956	3,346	4,006
Forward rate agreements	54,213	29	29
Options purchased	10,475	145	–
Options written	5,265	–	162
Futures	38,626	–	–
	345,535	3,520	4,197
Equity and other contracts	5,407	693	387
Effect of netting		(3,776)	(3,776)
Balances arising from off-balance sheet financial instruments		2,489	3,499

47 Derivatives and other financial instruments (continued)

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 2004	Notional principal amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**155**	**3**	**3**
Currency swaps	**60**	**2**	**–**
Options purchased	**1**	**–**	**–**
	216	**5**	**3**
Interest rate contracts:			
Interest rate swaps	**34,196**	**143**	**350**
Forward rate agreements	**2,921**	**6**	**–**
Options written	**111**	**–**	**–**
	37,228	**149**	**350**
Effect of netting		**(123)**	**(123)**
		31	**230**

31 December 2003	Notional principal amount £m	Fair value assets £m	Fair value liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	171	13	5
Currency swaps	459	28	10
	630	41	15
Interest rate contracts:			
Interest rate swaps	30,816	256	260
Forward rate agreements	7,188	1	1
Options written	40	–	–
	38,044	257	261
Effect of netting		(165)	(165)
		133	111

The aggregate carrying value of non-trading derivatives with a positive fair value was an asset of £96 million (2003: an asset of £132 million) and with a negative fair value was a liability of £35 million (2003: a liability of £71 million).

The Company held non-trading derivatives with a notional principal amount of £1,393 million (2003: £1,892 million).

47 Derivatives and other financial instruments (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 2004				
Exchange rate contracts				
Notional principal amount	**117,027**	**8,143**	**4,014**	**129,184**
Replacement cost	**2,015**	**179**	**276**	**2,470**
Interest rate contracts				
Notional principal amount	**224,427**	**165,274**	**51,258**	**440,959**
Replacement cost	**521**	**1,426**	**1,426**	**3,373**
Equity and other contracts				
Notional principal amount	**583**	**3,358**	**298**	**4,239**
Replacement cost	**6**	**258**	**18**	**282**
Total				
Notional principal amount	**342,037**	**176,775**	**55,570**	**574,382**
Replacement cost	**2,542**	**1,863**	**1,720**	**6,125**
31 December 2003				
Exchange rate contracts				
Notional principal amount	79,677	7,005	3,865	90,547
Replacement cost	1,753	141	199	2,093
Interest rate contracts				
Notional principal amount	175,306	161,584	46,689	383,579
Replacement cost	578	1,660	1,539	3,777
Equity and other contracts				
Notional principal amount	2,886	1,965	556	5,407
Replacement cost	523	115	55	693
Total				
Notional principal amount	257,869	170,554	51,110	479,533
Replacement cost	2,854	1,916	1,793	6,563

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.

	2004 £m	2003 £m
OECD banks	**855**	1,272
Other	**1,191**	1,350
Net replacement cost	**2,046**	2,622
Qualifying collateral held	**(592)**	(416)
Potential credit risk exposure	**1,454**	2,206

47 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. The table 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 47a.

31 December 2004	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	**43**	**40**	**–**	**5**	**–**	**–**	**4**	**92**
Loans and advances to banks	**19,663**	**1,351**	**154**	**470**	**82**	**602**	**1,243**	**23,565**
Loans and advances to customers	**99,216**	**6,443**	**6,937**	**36,783**	**6,203**	**(1,655)**	**313**	**154,240**
Debt securities and equity shares	**8,193**	**1,009**	**770**	**1,976**	**2,527**	**(68)**	**11,002**	**25,409**
Other assets	**121**	**–**	**–**	**5**	**1**	**17,375**	**4,271**	**21,773**
Total assets	**127,236**	**8,843**	**7,861**	**39,239**	**8,813**	**16,254**	**16,833**	**225,079**
Liabilities								
Deposits by banks	**36,802**	**2,009**	**289**	**122**	**81**	**212**	**223**	**39,738**
Customer accounts	**109,563**	**1,083**	**823**	**5,639**	**538**	**3,825**	**591**	**122,062**
Debt securities in issue	**18,764**	**1,848**	**1,171**	**1,435**	**3,999**	**–**	**–**	**27,217**
Other liabilities	**292**	**–**	**–**	**–**	**–**	**9,008**	**5,937**	**15,237**
Subordinated liabilities – loan capital	**1,698**	**458**	**–**	**1,884**	**6,212**	**–**	**–**	**10,252**
Minority interests and shareholders' funds	**–**	**–**	**–**	**–**	**–**	**10,550**	**23**	**10,573**
Internal funding of trading business	**(6,577)**	**635**	**129**	**(3,330)**	**(916)**	**–**	**10,059**	**–**
Total liabilities	**160,542**	**6,033**	**2,412**	**5,750**	**9,914**	**23,595**	**16,833**	**225,079**
Off-balance sheet items	**13,254**	**(3,902)**	**(2,424)**	**(9,468)**	**2,540**	**–**	**–**	**–**
Interest rate repricing gap	**(20,052)**	**(1,092)**	**3,025**	**24,021**	**1,439**	**(7,341)**	**–**	**–**
Cumulative interest rate repricing gap	**(20,052)**	**(21,144)**	**(18,119)**	**5,902**	**7,341**	**–**	**–**	**–**

31 December 2003	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	408	48	65	6	3	–	9	539
Loans and advances to banks	10,686	1,311	463	746	86	366	1,889	15,547
Loans and advances to customers	88,298	4,680	5,549	30,777	6,171	(1,648)	1,424	135,251
Debt securities and equity shares	8,718	606	279	1,856	2,372	(55)	15,351	29,127
Other assets	101	–	16	8	–	16,058	5,287	21,470
Total assets	108,211	6,645	6,372	33,393	8,632	14,721	23,960	201,934
Liabilities								
Deposits by banks	22,254	635	262	286	99	205	214	23,955
Customer accounts	104,236	705	876	5,227	1,173	3,686	593	116,496
Debt securities in issue	18,375	1,507	1,040	1,210	3,790	–	–	25,922
Other liabilities	300	–	–	–	–	8,108	6,348	14,756
Subordinated liabilities – loan capital	2,088	1,086	–	910	6,370	–	–	10,454
Minority interests and shareholders' funds	–	–	–	–	–	10,333	18	10,351
Internal funding of trading business	(11,528)	(810)	(412)	(3,217)	(820)	–	16,787	–
Total liabilities	135,725	3,123	1,766	4,416	10,612	22,332	23,960	201,934
Off-balance sheet items	6,930	(1,365)	(4,049)	(2,596)	1,080	–	–	–
Interest rate repricing gap	(20,584)	2,157	557	26,381	(900)	(7,611)	–	–
Cumulative interest rate repricing gap	(20,584)	(18,427)	(17,870)	8,511	7,611	–	–	–

47 Derivatives and other financial instruments (continued)

c Fair value analysis

Financial instruments include financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Wherever possible, fair values have been estimated using market prices for instruments held by the Group. Where market prices are not available, fair values have been estimated using quoted values for instruments with characteristics either identical or similar to those of the instruments held by the Group. In certain cases, where no ready markets currently exist, various techniques (such as discounted cash flows, or observations of similar recent market transactions) have been developed to estimate what the approximate fair value of such instruments might be. These estimation techniques are necessarily subjective in nature and involve several assumptions.

The fair values presented in the following table are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these accounts are thus advised to use caution when using this data to evaluate the Group's financial position.

Fair value information is not provided for items that do not meet the definitions of a financial instrument. These items include intangible assets, such as the value of the Group's branch network, the long-term relationships with depositors and credit card relationships, premises and equipment and shareholders' equity. These items are material and accordingly the Group believes that the fair value information presented does not represent the underlying value of the Group.

The valuation technique for each major category of financial instrument is discussed below:

Treasury bills and other eligible bills

Fair value is estimated using market prices, where available.

Loans and advances to banks and customers

The Group provides loans and advances to commercial, corporate and personal customers at both fixed and variable rates. The carrying value of the variable rate loans and those relating to lease financing is assumed to be their fair value. For fixed rate lending, several different techniques are used to estimate fair value, as considered appropriate. For commercial and personal customers, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Group and other financial institutions. The fair value for corporate loans was estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans has been estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period.

Debt securities and equity shares held for investment purposes

Listed investment securities are valued at quoted mid-market prices. Unlisted securities and equity shares are valued based on discounted cash flows, market prices of similar securities and other appropriate valuation techniques.

Deposits by banks and customer accounts

The fair value of deposits repayable on demand is considered to be equal to their carrying value. The fair value for all other deposits and customer accounts was estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities.

Debt securities in issue and subordinated liabilities

The fair value of short-term debt securities in issue is approximately equal to their carrying value. Fair value for other debt securities and for subordinated liabilities is estimated using quoted market prices.

Financial commitments and contingent liabilities

The Group considers that, given the lack of an established market, the diversity of fee structures and the difficulty of separating the value of the instruments from the value of the overall transaction, it is not meaningful to provide an estimate of the fair value of financial commitments and contingent liabilities. These are therefore excluded from the following table.

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.

31 December 2004	Trading book Book value £m	Trading book Fair value £m	Non-trading book Book value £m	Non-trading book Fair value £m
Assets				
Treasury bills and other eligible bills	**4**	**4**	**88**	**90**
Loans and advances to banks and customers	**1,556**	**1,556**	**176,249**	**176,712**
Debt securities and equity shares	**11,002**	**11,002**	**14,407**	**14,443**
Liabilities				
Deposits by banks and customers	**814**	**814**	**160,986**	**160,950**
Debt securities in issue	**–**	**–**	**27,217**	**26,924**
Subordinated liabilities	**–**	**–**	**10,252**	**11,544**

47 Derivatives and other financial instruments (continued)

31 December 2003	Trading book Book value £m	Trading book Fair value £m	Non-trading book Book value £m	Non-trading book Fair value £m
Assets				
Treasury bills and other eligible bills	9	9	530	523
Loans and advances to banks and customers	3,313	3,313	147,485	148,870
Debt securities and equity shares	15,351	15,351	13,776	13,885
Liabilities				
Deposits by banks and customers	807	807	139,644	139,695
Debt securities in issue	–	–	25,922	26,254
Subordinated liabilities	–	–	10,454	11,684

The disclosures in this note cover all on-balance sheet financial instruments; fair values of all derivative instruments are disclosed in note 47a.

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

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

d Currency exposures

Structural currency exposures

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

Functional currency of Group operations	**2004 £m**	2003 £m
Euro	**289**	287
US dollar	**271**	255
Swiss franc	**58**	104
Other non-sterling	**202**	200
	820	846

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.

Information about the management of market risk in the Group's trading activities is given on pages 24 to 26.

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 2004, the unrecognised gains on financial instruments used for hedging were £272 million (2003: £303 million) and unrecognised losses were £424 million (2003: £219 million).

The net gains arising in 2003 and earlier years and recognised in 2004 amounted to £3 million. Net losses of £228 million arose in 2004 but were not recognised in the year.

Of the net losses of £152 million at 31 December 2004, £49 million of net losses are expected to be recognised in the year ending 31 December 2005 and £103 million of net losses in later years.

f Value at risk in trading activities

Details of value at risk in the Group's global trading activities are given on page 24.

48 Acquisitions

During the year ended 31 December 2003, the Group completed the acquisition of the credit card and personal loan businesses of Goldfish Bank Limited, together with the Goldfish brand and loyalty programme, for a consideration of £1,096 million, settled in cash. The premium arising of £96 million from the effective payment to the majority shareholder was capitalised and is being written off to the profit and loss account over its estimated useful life of 10 years. No significant fair value adjustments were made.

During the year ended 31 December 2002, the Group's retail operations acquired the business of Accucard, a credit card technology development and marketing company. Further cash payments of £1 million in respect of this acquisition were made in each of 2003 and 2004.

49 Consolidated cash flow statement

The cash flow statement reflects cash flows attributable to the banking, life and general insurance businesses. Cash flows from long-term assurance business attributable to the shareholder include the surplus emerging from the life and pension businesses; 'Income from long-term assurance business' reflects the movement in the value of long-term assurance business attributable to the shareholder (see note 29) as adjusted for dividends. Cash flows relating to the long-term assurance business attributable to policyholders are not reflected within this statement.

a Reconciliation of operating profit to net cash inflow from operating activities

	2004 £m	2003 £m
Operating profit	**3,508**	3,505
(Increase) decrease in prepayments and accrued income	**(721)**	147
Increase (decrease) in accruals and deferred income	**732**	(226)
Provisions for bad and doubtful debts	**866**	950
Net advances written off	**(854)**	(967)
Insurance claims	**224**	236
Insurance claims paid	**(203)**	(231)
Customer remediation provision	**100**	200
Customer remediation paid	**(105)**	(119)
Amounts written off fixed asset investments	**52**	44
Income from long-term assurance business	**(715)**	(453)
Net charge in respect of defined benefit schemes	**267**	286
Contributions to defined benefit schemes	**(374)**	(138)
Interest on subordinated liabilities (loan capital)	**601**	622
Profit on disposal of investment securities	**(126)**	(47)
Depreciation and amortisation	**633**	697
Other non-cash movements	**(3)**	(131)
Net cash inflow from trading activities	**3,882**	4,375
Net increase in loans and advances	**(28,921)**	(11,710)
Net decrease in investments other than investment securities	**3,981**	248
Net decrease in other assets	**956**	816
Net increase (decrease) in deposits by banks	**15,864**	(1,000)
Net increase in customer accounts	**6,121**	7,658
Net increase in debt securities in issue	**1,859**	685
Net decrease in other liabilities	**(115)**	(645)
Net (increase) decrease in items in course of collection/transmission	**(13)**	169
Other non-cash movements	**(145)**	176
Net cash inflow from operating activities	**3,469**	772

b Analysis of cash as shown in the balance sheet

	2004 £m	2003 £m
Cash and balances with central banks	**1,078**	1,195
Loans and advances to banks repayable on demand	**2,477**	3,768
	3,555	4,963

The Group is required to maintain balances with the Bank of England which, at 31 December 2004, amounted to £187 million (2003: £177 million).

c Analysis of changes in cash during the year

	2004 £m	2003 £m
At 1 January	**4,963**	5,453
Net cash outflow before adjustments for the effect of foreign exchange movements	**(1,403)**	(487)
Effect of foreign exchange movements	**(5)**	(3)
At 31 December	**3,555**	4,963

49 Consolidated cash flow statement (continued)

d Analysis of changes in financing during the year

	2004 £m	2003 £m
Share capital (including premium and merger reserve):		
At 1 January	**2,897**	2,852
Issue of share capital	**10**	45
At 31 December	**2,907**	2,897

The amounts shown as cash inflows from financing include proceeds in respect of the above issues of share capital together with a net cash inflow of £1 million (2003: outflow of £13 million) relating to transactions in own shares held in respect of employee share schemes.

	2004 £m	2003 £m
Equity minority interests:		
At 1 January	**44**	37
Exchange and other adjustments	**–**	(1)
Minority share of profit after tax	**26**	22
Dividends paid to minority shareholders	**(24)**	(14)
At 31 December	**46**	44

	2004 £m	2003 £m
Non-equity minority interests:		
At 1 January	**683**	694
Exchange and other adjustments	**1**	23
Repayment of capital to minority shareholders	**(132)**	–
Minority share of profit after tax	**42**	47
Payments to minority shareholders	**(44)**	(81)
At 31 December	**550**	683

	2004 £m	2003 £m
Subordinated liabilities and finance leases:		
At 1 January	**10,454**	10,169
Exchange and other adjustments	**(137)**	34
Issue of subordinated liabilities	**699**	533
Repayments of subordinated liabilities	**(764)**	(75)
Lease financing	**7**	–
Finance lease capital repayments	**(1)**	(1)
Adjustments on disposal	**–**	(206)
At 31 December	**10,258**	10,454

e Acquisition of group undertakings and businesses

	2004 £m	2003 £m
Cash consideration paid (see f)	**–**	1,096
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**15**	14
Cash consideration refunded in respect of acquisition in 2002	**–**	(5)
Deferred consideration in respect of acquisition in 2002	**1**	1
Net cash outflow	**16**	1,106

49 Consolidated cash flow statement (continued)

f Acquisition of group undertakings

	2004 £m	2003 £m
Net assets acquired:		
Loans and advances	–	993
Other assets	–	18
Tangible fixed assets	–	2
Deposits by banks, customer accounts and other liabilities	–	(13)
	–	1,000
Goodwill arising on consolidation	–	96
	–	1,096

The consideration of £1,096 million was settled in cash in 2003.

g Disposal of group undertakings and businesses

	2004 £m	2003 £m
Cash	**46**	52
Loans and advances to banks	**132**	1,035
Loans and advances to customers	**257**	13,770
Debt securities and treasury bills	**59**	852
Intangible assets	**10**	189
Deposits by banks	**(42)**	(519)
Customer accounts	**(327)**	(8,372)
Debt securities in issue	**(111)**	(5,108)
Subordinated liabilities	**–**	(206)
Other net assets (liabilities)	**9**	(305)
Goodwill written back on sale of businesses	**3**	181
	36	1,569
(Loss) profit on sale	**(15)**	865
Cash consideration received	**21**	2,434
Cash disposed of	**(46)**	(52)
Net cash (outflow) inflow from disposals	**(25)**	2,382

Information for shareholders

Analysis of shareholders

at 31 December 2004

Size of shareholding	Shareholders		Number of ordinary shares	
	Number	%	Millions	%
1 – 99	72,622	7.62	2.4	0.04
100 – 499	423,490	44.45	143.9	2.57
500 – 999	283,044	29.71	186.7	3.34
1,000 – 4,999	136,727	14.35	268.3	4.79
5,000 – 9,999	20,108	2.11	136.9	2.45
10,000 – 49,999	14,251	1.50	256.2	4.58
50,000 – 99,999	809	0.09	54.4	0.97
100,000 – 999,999	1,105	0.12	367.5	6.57
1,000,000 and over	511	0.05	4,180.1	74.69
	952,667	100.00	5,596.4*	100.00

* Includes 747 million shares (13.35%) registered in the names of some 847,000 individuals. 222 million shares (3.97%) are held by over 78,000 staff and Group pensioners, or on their behalf by the trustee of the staff profit sharing schemes or by the trustee of the staff incentive plan.

Substantial shareholdings

At the date of this report notifications had been received that Legal & General Investment Management Limited and The Capital Group Companies had interests of 3% and 5.75%, respectively, of the nominal value of the issued share capital. No other notification has been received that anyone has an interest in 3% or more of the nominal value of the issued share capital.

Share price information

In addition to information published in the financial pages of the press, the latest price of Lloyds TSB shares on the London Stock Exchange can be obtained by telephoning 0906 877 1515. These telephone calls are charged at 50p per minute, including VAT, or for details visit www.londonstockexchange.com

Share dealing facilities

A full range of dealing services is available through Lloyds TSB Registrars.

For internet dealing the current rate of commission for both purchases and sales is 0.5%, minimum £17.50. Visit www.shareview.co.uk/dealing for full details.

For telephone dealing the current rate for both purchases and sales is 0.5%, minimum £20. For full details please contact Lloyds TSB Registrars on: Telephone 0870 850 0852.

For postal dealing the current rate for both purchases and sales is 0.75%, no minimum. For full details please contact Lloyds TSB Registrars on: Telephone 0870 242 4244.

American Depositary Receipts (ADRs)

Lloyds TSB shares are traded in the USA through an NYSE-listed sponsored ADR facility, with The Bank of New York as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4.

For details please contact The Bank of New York, Investor Services, PO Box 11258, Church Street Station, New York, NY 10286-1258. Telephone (1) 888 BNY ADRS (US toll free), international callers (1) 610 382 7836. For details visit www.adrbny.com or email shareowners@bankofny.com

Individual Savings Accounts (ISAs)

The Company provides a facility for investing in Lloyds TSB shares through an ISA. For details please contact Lloyds TSB Private Banking ISAs, Freepost, PO Box 249, Haywards Heath, West Sussex RH16 3ZU. Telephone 0845 7418418.

The community and our business

A copy of the Group's corporate responsibility report may be obtained by writing to Corporate Responsibility, Lloyds TSB Group plc, 25 Gresham Street, London EC2V 7HN. This information together with the Group's code of business conduct is also available on the Group's website.

The Better Payment Practice Code

A copy of the code and information about it may be obtained from the DTI Publications Orderline 0870 1502500, quoting ref URN 04/606. Alternatively, log on to www.payontime.co.uk for details.

Shareholder enquiries

The Company's share register is maintained by Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA.
Telephone 0870 600 3990; textphone 0870 600 3950.

Please contact them if you have enquiries about your Lloyds TSB shareholding, including those concerning the following matters:

- change of name or address
- loss of share certificate, dividend warrant or tax voucher
- to obtain a form for dividends to be paid directly to your bank or building society account (tax vouchers will still be sent to your registered address unless you request otherwise)
- to obtain details of the dividend reinvestment plan which enables you to use your cash dividends to buy Lloyds TSB shares in the market
- request for copies of the report and accounts in alternative formats for shareholders with disabilities.

Lloyds TSB Registrars operates a web based enquiry and portfolio management service for shareholders. For details visit www.shareview.co.uk.

Financial calendar 2005

4 March
Results for 2004 announced

16 March
Ex-dividend date for 2004 final dividend

18 March
Record date for final dividend

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

4 May
Final dividend paid

5 May
Annual general meeting in Glasgow

29 July
Results for half-year to 30 June 2005 announced

10 August
Ex-dividend date for 2005 interim dividend

12 August
Record date for interim dividend

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

5 October
Interim dividend paid

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