Lloyds TSB Bank plc

Report and Accounts

2003

Member of Lloyds TSB Group

Contents

Registered office:
25 Gresham Street, London EC2V 7HN.
Registered in England no 2065

Directors' report

Results and dividends

The consolidated profit and loss account on page 5 shows a profit attributable to shareholders for the year ended 31 December 2003 of £3,290 million. An interim dividend of £597 million for the year ended 31 December 2003 was paid on 27 September 2003. A second interim dividend of £1,314 million will be paid on 26 March 2004.

Principal activities

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

Structure

During the year the Bank sold a number of businesses overseas, including all of its New Zealand operations, its French fund management and private banking businesses and substantially all of its Brazilian business. Details of these disposals are given in the notes to the accounts.

Business review

Profit before tax for the Lloyds TSB Bank Group was £4,371 million in 2003, compared with £2,640 million in 2002. Total income increased by £985 million, or 11 per cent, to £9,855 million, whilst operating expenses increased by £223 million, or 5 per cent, to £5,097 million. In 2003, the Group's performance was significantly affected by the profit on sale of a number of overseas businesses amounting to £865 million in 2003, and the absence of a negative investment variance in the Group's insurance businesses which totalled £952 million in 2002. In a number of key product areas the Group continued to grow market share and, as a result, adjusting for the impact of disposals over the last 12 months, customer lending grew by 10 per cent to £137.0 billion, of which £1 billion represented the Goldfish lending portfolios acquired, and customer deposits increased by 6 per cent to £116.9 billion. Cost control continues to have a high priority throughout the Group and during 2003 the Group reduced costs, excluding acquisitions and provisions for customer redress, by 2 per cent. This strong cost performance reflected good progress in a number of efficiency related initiatives, together with a reduction of some 1,200 in the Group's total staffing, after allowing for the acquisition and disposal of businesses.

Profit before tax from UK Retail Banking and Mortgages increased by £9 million, or 1 per cent, to £1,020 million, compared with £1,011 million in 2002. Continued strong growth in the Group's consumer lending portfolios, particularly mortgages and credit cards, higher current and savings account credit balances, and a strict focus on cost control, were largely offset by a £200 million provision for customer redress. Excluding the impact of the provision for customer redress, profit before tax from UK Retail Banking and Mortgages increased by 21 per cent, as a result of a 9 per cent growth in income and flat costs. In the Mortgage business, gross new lending increased by 27 per cent to a record £24.2 billion, compared with £19.0 billion in 2002. Net new lending increased to £8.3 billion resulting in a market share of net new lending of 8.6 per cent. Over the last 12 months, mortgage balances outstanding increased by 13 per cent to £70.8 billion.

Operating profit from Insurance and Investments decreased by £135 million, or 11 per cent, to £1,095 million, from £1,230 million in 2002. A reduction of £168 million in benefits from experience variances and assumption changes, and a £61 million decrease in normalised investment earnings, were partly offset by a £105 million reduction in provisions for customer redress. The market for medium and long-term investments continued to be adversely affected by uncertainties in global stock markets. Overall, weighted sales in the Group's life, pensions and unit trust businesses were £733.4 million compared with £767.6 million last year, a reduction of 4 per cent. This decrease in weighted sales reflected a 1 per cent increase in weighted sales from life and pensions, offset by a 24 per cent reduction in weighted sales from unit trusts and equity based ISAs. Profit before tax from the Group's general insurance operations decreased by £33 million, or 4 per cent, to £720 million, as continued revenue growth from home insurance was offset by lower levels of creditor insurance. In Wholesale and International Banking pre tax profit increased by £933 million to £2,197 million, largely reflecting the £865 million profit on the disposal of a number of overseas businesses. In Wholesale, the impact of the Competition Commission's SME report remedies and lower treasury income was more than offset by strong profit growth in asset finance and a reduction in provisions for bad and doubtful debts. This led to an increase of 1 per cent in profit before tax from £883 million in 2002, to £890 million in 2003. In International Banking, profit before tax increased by £924 million, to £1,305 million, largely as a result of the £865 million overseas business disposal profits, and a lower provisions charge in Argentina.

Directors' report

Business review (continued)

The total Group charge for bad and doubtful debts was 8 per cent lower at £950 million, compared with £1,029 million in 2002. In UK Retail Banking, the provisions charge increased by £115 million, or 23 per cent, to £612 million, largely as a result of volume related asset growth in the personal loan and credit card portfolios, but also as a result of a higher charge for fraud in the personal lending portfolios. In Mortgages, an improved arrears position and the beneficial effect of house price increases resulted in an £18 million provisions release for the year. In Wholesale, the provisions charge decreased by £78 million to £300 million. International Banking provisions decreased to £69 million, from £162 million in 2002, as a result of the reduction in provisions relating to the Group's exposure to Argentina. The Group's charge for bad and doubtful debts, expressed as a percentage of average lending, was 0.66 per cent, compared with 0.77 per cent in 2002. Non-performing lending decreased by 14 per cent to £1,218 million, reflecting the impact of business disposals and lower levels of non-performing lending in the Group's corporate portfolio.

Profit attributable to shareholders was 84 per cent higher at £3,290 million. Shareholders' equity increased by £1,674 million, or 18 per cent to £10,733 million. Risk-weighted assets decreased to £117.7 billion, from £122.4 billion in 2002, reflecting the impact of business disposals. At the end of 2003, the risk asset ratios, the international standard for measuring capital adequacy, were 11.1 per cent for total capital and 10.5 per cent for tier 1 capital.

Directors

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

Mr Atkinson, Mr Butler, Miss Forbes and Mr Moore retired on 16 April 2003, Mr Ellwood left the board on 31 May 2003, and Mr Ross and Mr Hampton left the board on 30 September 2003 and 12 January 2004 respectively. The Earl of Selborne will leave the board on 21 May 2004.

Mr Targett became a director on 10 March 2003.

Dr Berndt and Mrs Knight were appointed directors from 1 May 2003, Mr Ayliffe's appointment was effective from 1 June 2003 and Mrs Weir joins the board on 26 April 2004.

Employees

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

In the UK, the Bank supports Opportunity Now and is represented on the board of Race for Opportunity, campaigns to improve opportunities for women and ethnic minorities in the work place. The Bank 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.

Policy and practice on payment of creditors

The Bank follows 'The Better Payment Practice Code' published by the Department of Trade and Industry regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from The DTI Publications Orderline 0870 1502 500, quoting ref URN 04/606.

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

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is 26. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2003 bears to the aggregate of the amounts invoiced by suppliers during the year.

On behalf of the board

A J Michie
Secretary
5 March 2004

Directors

M A van den Bergh
Chairman

D P Pritchard
Deputy Chairman

J E Daniels
Chief Executive

M E Fairey
Deputy Chief Executive

P G Ayliffe

W C G Berndt

Ewan Brown CBE

G J N Gemmell CBE

C S Gibson-Smith

D S Julius CBE

A G Kane

A A Knight

Sir Tom McKillop

The Earl of Selborne KBE FRS
(leaving on 21 May 2004)

S C Targett

H A Weir
(from 26 April 2004)

Independent auditors' report

To the members of Lloyds TSB Bank plc

We have audited the financial statements which comprise the consolidated profit and loss account, the balance sheets, the statement of total recognised gains and losses and related notes which have been prepared under the accounting policies set out on pages 9 to 12.

Respective responsibilities of directors and auditors

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

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

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

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

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Bank has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Bank and the Group as at 31 December 2003 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the United Kingdom Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton
5 March 2004

Consolidated profit and loss account

for the year ended 31 December 2003

	Note	Continuing operations 2003 £ million	Discontinued operations 2003 £ million	Total 2003 £ million	2002*† £ million
Interest receivable:					
Interest receivable and similar income arising from debt securities		**389**	**63**	**452**	567
Other interest receivable and similar income		**8,438**	**1,213**	**9,651**	9,957
Interest payable		**4,103**	**765**	**4,868**	5,364
Net interest income		**4,724**	**511**	**5,235**	5,160
Other finance income	*45*	**34**	**–**	**34**	165
Other income					
Fees and commissions receivable		**2,990**	**112**	**3,102**	3,056
Fees and commissions payable		**(729)**	**(34)**	**(763)**	(645)
Dealing profits (before expenses)	*3*	**525**	**35**	**560**	188
Income from long-term assurance business	*29*	**436**	**17**	**453**	(303)
General insurance premium income		**535**	**–**	**535**	486
Other operating income		**687**	**12**	**699**	763
		4,444	**142**	**4,586**	3,545
Total income		**9,202**	**653**	**9,855**	8,870
Operating expenses					
Administrative expenses	*4*	**4,155**	**247**	**4,402**	4,173
Depreciation	*24*	**633**	**13**	**646**	642
Amortisation of goodwill	*23*	**37**	**12**	**49**	59
Depreciation and amortisation		**670**	**25**	**695**	701
Total operating expenses		**4,825**	**272**	**5,097**	4,874
Trading surplus		**4,377**	**381**	**4,758**	3,996
General insurance claims		**236**	**–**	**236**	229
Provisions for bad and doubtful debts	*15*				
Specific		**883**	**63**	**946**	965
General		**4**	**–**	**4**	64
		887	**63**	**950**	1,029
Amounts written off fixed asset investments	*5*	**44**	**–**	**44**	87
Operating profit		**3,210**	**318**	**3,528**	2,651
Share of results of joint ventures	*20*	**(22)**	**–**	**(22)**	(11)
Profit on sale of businesses	*6*	**–**	**865**	**865**	–
Profit on ordinary activities before tax	*8*	**3,188**	**1,183**	**4,371**	2,640
Tax on profit on ordinary activities	*9*			**1,012**	791
Profit on ordinary activities after tax				**3,359**	1,849
Minority interests: equity				**22**	19
: non-equity	*39*			**47**	43
Profit for the year attributable to shareholders	*10*			**3,290**	1,787
Dividends	*11*			**1,911**	1,908
Profit (loss) for the year	*41*			**1,379**	(121)

*restated (see note 1)

†An analysis of the results for the year ended 31 December 2002 between continuing and discontinued operations is given in note 7.

Balance sheets

at 31 December 2003

		Group		Bank	
	Note	**2003 £ million**	2002* £ million	**2003 £ million**	2002 £ million
Assets					
Cash and balances at central banks		**1,195**	1,140	**1,106**	1,005
Items in course of collection from banks		**1,447**	1,757	**1,396**	1,708
Treasury bills and other eligible bills	*12*	**539**	2,409	**525**	2,372
Loans and advances to banks	*13*	**15,547**	17,528	**62,981**	64,163
Loans and advances to customers	*14*	**137,017**	136,265	**72,428**	60,777
Debt securities	*17*	**28,669**	29,314	**19,558**	22,585
Equity shares	*18*	**458**	206	**264**	45
Interests in joint ventures:					
– share of gross assets		**85**	336		
– share of gross liabilities		**(31)**	(291)		
	20	**54**	45	**36**	45
Shares in group undertakings	*21*	**–**	–	**19,805**	18,181
Intangible fixed assets	*23*	**2,507**	2,627	**118**	8
Tangible fixed assets	*24*	**3,916**	4,095	**1,297**	1,237
Other assets	*27*	**3,925**	5,217	**3,455**	4,291
Prepayments and accrued income	*28*	**1,928**	2,297	**1,584**	1,776
Long-term assurance business attributable to the shareholder	*29*	**6,496**	6,228	**–**	–
		203,698	209,128	**184,553**	178,193
Long-term assurance assets attributable to policyholders	*29*	**50,200**	45,340	**–**	–
Total assets		**253,898**	254,468	**184,553**	178,193

*restated (see note 1)

The directors approved the accounts on 5 March 2004.

M A van den Bergh
Chairman

J E Daniels
Chief Executive

M E Fairey
Deputy Chief Executive

Balance sheets

at 31 December 2003

		Group		Bank	
	Note	**2003 £ million**	2002* £ million	**2003 £ million**	2002 £ million
Liabilities					
Deposits by banks	*31*	**23,955**	25,443	**30,211**	32,868
Customer accounts	*32*	**116,944**	116,658	**100,141**	89,068
Items in course of transmission to banks		**626**	775	**552**	699
Debt securities in issue	*33*	**25,922**	30,255	**22,160**	25,570
Other liabilities	*34*	**6,789**	8,200	**6,051**	6,714
Accruals and deferred income	*35*	**3,242**	3,696	**2,135**	2,326
Post-retirement benefit liability	*45*	**2,139**	2,077	**–**	–
Provisions for liabilities and charges:					
Deferred tax	*36*	**1,383**	1,319	**(188)**	(284)
Other provisions for liabilities and charges	*37*	**402**	361	**142**	59
Subordinated liabilities:					
Undated loan capital	*38*	**5,962**	5,499	**6,411**	5,925
Dated loan capital	*38*	**4,874**	5,055	**4,269**	4,235
Minority interests:					
Equity		**44**	37		
Non-equity	*39*	**683**	694		
		727	731		
Called-up share capital	*40*	**1,542**	1,542	**1,542**	1,542
Share premium account	*41*	**2,960**	2,960	**2,960**	2,960
Revaluation reserve	*41*	**–**	–	**3,374**	2,001
Profit and loss account	*41*	**6,231**	4,557	**4,793**	4,510
Shareholders' funds (equity)		**10,733**	9,059	**12,669**	11,013
		203,698	209,128	**184,553**	178,193
Long-term assurance liabilities to policyholders	*29*	**50,200**	45,340	**–**	–
Total liabilities		**253,898**	254,468	**184,553**	178,193
Memorandum items	*46*				
Contingent liabilities:					
Acceptances and endorsements		**299**	1,879	**269**	1,880
Guarantees and assets pledged as collateral security		**6,122**	5,927	**6,150**	5,865
Other contingent liabilities		**2,604**	2,540	**2,648**	2,542
		9,025	10,346	**9,067**	10,287
Commitments		**79,335**	64,504	**76,635**	60,073

*restated (see note 1)

Statement of total recognised gains and losses

for the year ended 31 December 2003

	2003 £ million	2002* £ million
Profit attributable to shareholders	**3,290**	1,787
Currency translation differences on foreign currency net investments	**118**	(3)
Actuarial losses recognised in post-retirement benefit schemes (note 45)	**(6)**	(3,299)
Deferred tax thereon (note 45)	**2**	968
	(4)	(2,331)
Total recognised gains and losses relating to the year	**3,404**	(547)
Prior year adjustment in respect of change in accounting policy in 2003 (note 1)	**(26)**	–
Prior year adjustment in respect of changes in accounting policy in 2002	**–**	(404)
Total gains and losses recognised during the year	**3,378**	(951)

Historical cost profits and losses

for the year ended 31 December 2003

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 2003

	2003 £ million	2002* £ million
Profit attributable to shareholders	**3,290**	1,787
Dividends	**(1,911)**	(1,908)
Profit (loss) for the year	**1,379**	(121)
Currency translation differences on foreign currency net investments	**118**	(3)
Actuarial losses recognised in post-retirement benefit schemes	**(4)**	(2,331)
Goodwill written back on sale of businesses (note 6)	**181**	–
Net increase (decrease) in shareholders' funds	**1,674**	(2,455)
Shareholders' funds at beginning of year	**9,059**	11,542
Prior year adjustment at 1 January 2002 (note 1)	**–**	(28)
Shareholders' funds at end of year	**10,733**	9,059

*restated (see note 1)

Notes to the accounts

1 Accounting policies

Accounting policies are unchanged from 2002 except as follows:

It has been the Group's policy to defer certain expenses incurred in connection with the acquisition of new asset finance and unit trust business and charge these costs to the profit and loss account over the expected life of the related transactions. Following a review of the Group's accounting policies this treatment is no longer considered to be the most appropriate and these costs will now be charged to the profit and loss account as incurred.

The effect of this change in policy has been to increase profit before tax in 2003 by £10 million (2002: £2 million); a prior year adjustment reducing shareholders' funds at 1 January 2002 by £28 million has been made. The effect upon the Group's balance sheet at 31 December 2003 has been to reduce total assets by £27 million (2002: £37 million) and reduce shareholders' funds by £19 million (2002: £26 million).

a Accounting convention

The accounts are prepared under the historical cost convention as modified by the revaluation of debt securities and equity shares held for dealing purposes (see g), shares in group undertakings (see h) and assets held in the long-term assurance business (see o), in compliance with Section 255A, Schedule 9 and other requirements of the Companies Act 1985 except as described below (see c), in accordance with applicable accounting standards, pronouncements of the Urgent Issues Task Force and with the Statements of Recommended Practice issued by the British Bankers' Association and the Finance & Leasing Association. The Group's methodology for calculating embedded value follows the guidance published by the Association of British Insurers for the preparation of figures using the achieved profits method of accounting except that tangible assets attributable to the shareholder are valued at market value. The guidance would require those assets backing capital requirements to be discounted to reflect the cost of encumbered capital, but such a treatment would be inconsistent with the treatment of capital supporting the Group's banking operations. If this treatment had been followed income from long-term assurance business before tax in 2003 would have been slightly reduced and embedded value would have been some 8 per cent lower given the size of the shareholder capital required to be retained within Scottish Widows under the terms of the demutualisation.

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

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

b Basis of consolidation

Assets, liabilities and results of group undertakings and joint ventures are included in the consolidated accounts on the basis of accounts made up to 31 December. Entities that do not meet the legal definition of a subsidiary but which give rise to benefits that are in substance no different to those that would arise from subsidiaries are also included in the consolidated accounts. In order to reflect the different nature of the shareholder's and policyholders' interests in the long-term assurance business, the value of long-term assurance business attributable to the shareholder and the assets and liabilities attributable to policyholders are classified under separate headings in the consolidated balance sheet. Details of transactions entered into by the Group which are not eliminated on consolidation are given in note 44.

1 Accounting policies (continued)

c Goodwill

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

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

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 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 2003 would be £93 million lower (2002: £93 million lower), with a corresponding reduction in reserves of £358 million (2002: £265 million); intangible assets on the balance sheet would also be £358 million lower (2002: £265 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.

Notes to the accounts

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 holds general provisions against each of its principal lending portfolios, which are calculated after having regard to a number of factors; in particular, the level of watchlist or potential problem debt, the observed propensity for such debt to deteriorate and become impaired and prior period loss rates. The level of general provision held is reviewed on a regular basis to ensure that it remains appropriate in the context of the perceived risk inherent in the related portfolio and the prevailing economic climate.

Non-performing lending

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

Accruing loans on which interest is being placed in suspense

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

Loans accounted for on a non-accrual basis

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

f Mortgage incentives

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

g Debt securities and equity shares

Debt securities, apart from those held for dealing purposes 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.

1 Accounting policies (continued)

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

h Shares in group undertakings

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

i Tangible fixed assets

Tangible fixed assets are included at cost less depreciation.

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

Premises and equipment held for letting to customers under operating leases are depreciated over the life of the lease to give a constant rate of return on the net 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 a number of defined benefit pension and post-retirement healthcare schemes, and a number of employees are members of defined contribution pension schemes.

Notes to the accounts

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

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

The majority of the Bank's employees are members of the Group's two main pension schemes, Lloyds TSB Group Pension Schemes No's 1 and 2, along with employees of a number of the Bank's subsidiaries. Because it is not possible to separately identify the amount of any surpluses or deficits in these schemes relating to each employing company, in the accounts of individual companies, including the Bank, these schemes are accounted for as defined contribution schemes in accordance with the requirements of Financial Reporting Standard 17. The Bank charges contributions to these schemes to its profit and loss account as and when they fall due.

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

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

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

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

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

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

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

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

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

Notes to the accounts

1 Accounting policies (continued)
A derivative will only be classified as a hedge in circumstances where there was evidence of the intention to hedge at the outset of the transaction and the derivative substantially matches or eliminates the risk associated with the exposure being hedged.

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

2 Segmental analysis

	Profit on ordinary activities before tax 2003 £m	2002* £m
Class of business:		
UK Retail Banking and Mortgages	**1,020**	1,011
Insurance and Investments		
Operating profit	**1,095**	1,230
Changes in economic assumptions	**(22)**	55
Investment variance	**125**	(952)
	1,198	333
Wholesale and International Banking	**1,014**	985
Central group items	**(44)**	32
Continuing operations	**3,188**	2,361
Discontinued operations	**1,183**	279
	4,371	2,640

Geographical area:**

	Domestic 2003 £m	International 2003 £m	Continuing operations 2003 £m	Discontinued operations 2003 £m	Total 2003 £m
Interest receivable	**8,444**	**383**	**8,827**	**1,276**	**10,103**
Other finance income	**34**	**–**	**34**	**–**	**34**
Fees and commissions receivable	**2,834**	**156**	**2,990**	**112**	**3,102**
Dealing profits (before expenses)	**276**	**249**	**525**	**35**	**560**
Income from long-term assurance business	**436**	**–**	**436**	**17**	**453**
General insurance premium income	**535**	**–**	**535**	**–**	**535**
Other operating income	**682**	**5**	**687**	**12**	**699**
Total gross income	**13,241**	**793**	**14,034**	**1,452**	**15,486**
Profit on ordinary activities before tax	**2,833**	**355**	**3,188**	**1,183**	**4,371**

	Domestic 2002 £m	International 2002 £m	Continuing operations 2002 £m	Discontinued operations 2002 £m	Total 2002* £m
Interest receivable	8,201	582	8,783	1,741	10,524
Other finance income	165	–	165	–	165
Fees and commissions receivable	2,776	169	2,945	111	3,056
Dealing profits (before expenses)	125	39	164	24	188
Income from long-term assurance business	(314)	–	(314)	11	(303)
General insurance premium income	486	–	486	–	486
Other operating income	552	207	759	4	763
Total gross income	11,991	997	12,988	1,891	14,879
Profit on ordinary activities before tax	2,144	217	2,361	279	2,640

Notes to the accounts

2 Segmental analysis (continued)

	Net assets†		Assets‡	
	2003 £m	2002* £m	**2003 £m**	2002* £m
Class of business:				
UK Retail Banking and Mortgages	**2,554**	2,244	**90,262**	79,618
Insurance and Investments	**7,016**	6,923	**9,859**	9,142
Wholesale and International Banking	**4,390**	4,125	**101,555**	102,464
Central group items	**(3,183)**	(5,548)	**2,022**	3,302
Continuing operations	**10,777**	7,744	**203,698**	194,526
Discontinued operations	**–**	1,352	**–**	14,602
	10,777	9,096	**203,698**	209,128
Geographical area:**				
Domestic	**10,178**	7,154	**190,926**	179,412
International	**599**	590	**12,772**	15,114
Continuing operations	**10,777**	7,744	**203,698**	194,526
Discontinued operations	**–**	1,352	**–**	14,602
	10,777	9,096	**203,698**	209,128

*2002 figures have been restated to take account of the change in accounting policy explained in note 1 and to reflect the transfer of Business Banking from UK Retail Banking and Mortgages to Wholesale and International Banking, together with changes in internal transfer pricing arrangements.

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

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

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

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

3 Dealing profits (before expenses)

	2003 £m	2002 £m
Foreign exchange trading income	**228**	173
Securities and other gains	**332**	15
	560	188

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

	2003 £m	2002* £m
Salaries	**2,076**	2,064
Social security costs	**142**	134
Other pension costs (note 45)	**353**	318
Staff costs	**2,571**	2,516
Other administrative expenses	**1,831**	1,657
	4,402	4,173

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

	2003	2002
UK	**73,814**	71,134
Overseas	**10,288**	11,491
	84,102	82,625

The above staff numbers exclude 5,202 (2002: 5,870) staff employed in the long-term assurance business. Costs of £194 million (2002: £209 million) in relation to those staff are reflected in the valuation of the long-term assurance business.

Details of directors' emoluments, pensions and interests are given in note 43.

The auditors' remuneration was £5 million (2002: £5 million), of which £1.6 million (2002: £1.4 million) related to Lloyds TSB Bank plc. Fees paid to the auditors in respect of non-audit services were £7 million (2002: £5 million). Non-audit fees comprise regulatory and other advisory work.

*restated (see note 1)

5 Amounts written off fixed asset investments

	2003 £m	2002 £m
Debt securities	**42**	84
Equity shares	**2**	3
	44	87

Notes to the accounts

6 Profit before tax on sale of businesses

	2003 £m	2002 £m
Loss on sale of French fund management and private banking businesses (tax: nil)	**(15)**	–
Profit on sale of New Zealand operations (after charging £20 million of goodwill previously written off to reserves) (tax: nil)	**921**	–
Loss on sale of Brazilian businesses (after charging £161 million of goodwill previously written off to reserves) (tax: nil)	**(41)**	–
	865	–

During 2003 the Group completed the following transactions:

1) The sale, announced on 16 May 2003 and completed on 30 June 2003, of its French fund management and private banking businesses, including its subsidiaries Lloyds Bank SA, Chaillot Assurances SA and Capucines Investissements SA.

2) The sale, announced on 9 October 2003 and completed on 15 December 2003, of 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 the Bank and certain offshore Brazilian assets.

3) The sale, announced on 23 October 2003 and completed on 1 December 2003, of its subsidiary, NBNZ Holdings Limited, comprising the Group's New Zealand banking and insurance operations.

On 1 December 2003, the Lloyds TSB Group also announced the sale of the Bank's branch operations in Guatemala, Honduras and Panama; these sales are expected to complete in 2004.

7 Analysis of comparative profit and loss account

The analysis of the profit and loss account for the comparative period between continuing and discountinued operations is set out below. Discountinued operations comprise the operations in France, New Zealand and Brazil sold in 2003; for further details see note 6.

	Continuing operations 2002 £m	Discontinued operations 2002 £m	Total 2002* £m
Interest receivable:			
Interest receivable and similar income arising from debt securities	523	44	567
Other interest receivable and similar income	8,260	1,697	9,957
Interest payable	4,111	1,253	5,364
Net interest income	4,672	488	5,160
Other finance income	165	–	165
Other income			
Fees and commissions receivable	2,945	111	3,056
Fees and commissions payable	(614)	(31)	(645)
Dealing profits (before expenses)	164	24	188
Income from long-term assurance business	(314)	11	(303)
General insurance premium income	486	–	486
Other operating income	759	4	763
	3,426	119	3,545
Total income	8,263	607	8,870
Operating expenses			
Administrative expenses	3,934	239	4,173
Depreciation	630	12	642
Amortisation of goodwill	33	26	59
Depreciation and amortisation	663	38	701
Total operating expenses	4,597	277	4,874
Trading surplus	3,666	330	3,996
General insurance claims	229	–	229
Provision for bad and doubtful debts			
Specific	914	51	965
General	64	–	64
	978	51	1,029
Amounts written off fixed asset investments	87	–	87
Operating profit	2,372	279	2,651
Share of results of joint ventures	(11)	–	(11)
Profit on ordinary activities before tax	2,361	279	2,640

*restated (see note 1)

8 Profit on ordinary activities before tax

Profit on ordinary activities before tax is stated after taking account of:

	2003 £m	2002 £m
Income from:		
Aggregate amounts receivable, including capital repayments, in respect of assets leased to customers and banks under:		
Finance leases and hire purchase contracts	**3,495**	3,290
Operating leases	**446**	440
Profits less losses on disposal of investment securities	**47**	160
Charges:		
Rental of premises	**220**	220
Hire of equipment	**18**	18
Interest on subordinated liabilities (loan capital)	**599**	521

Notes to the accounts

9 Tax on profit on ordinary activities

a Analysis of charge for the year

	2003 £m	2002 £m
UK corporation tax		
Current tax on profits for the year	1,080	812
Adjustments in respect of prior years	(88)	12
	992	824
Double taxation relief	(223)	(129)
	769	695
Foreign tax		
Current tax on profits for the year	144	216
Adjustments in respect of prior years	(15)	(15)
	129	201
Current tax charge	898	896
Deferred tax	121	(107)
Associated undertakings and joint ventures	(7)	2
	1,012	791

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2002: 30 per cent).

In addition to the tax charge in the profit and loss account detailed above, £2 million (2002: £968 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:

	2003 £m	2002* £m
Profit on ordinary activities before tax	4,371	2,640
Tax charge thereon at UK corporation tax rate of 30%	1,311	792
Factors affecting charge:		
Goodwill amortisation	9	9
Overseas tax rate differences	(9)	24
Non-allowable and non-taxable items	(10)	(30)
Gains exempted or covered by capital losses	(276)	(23)
Tax deductible coupons on non-equity minority interests	(12)	(12)
Capital allowances in excess of depreciation	(105)	7
Other timing differences	(16)	100
Life company rate differences	16	44
Other items	(10)	(15)
Current tax charge	898	896
Deferred tax		
– capital allowances in excess of depreciation	105	(7)
– other timing differences	16	(100)
Associated undertakings and joint ventures	(7)	2
Tax on profit on ordinary activities	1,012	791
Effective rate	23.2%	30.0%

*restated (see note 1)

9 Tax on profit on ordinary activities (continued)

c Factors that may affect the future tax charge
The current tax charge includes a charge of £157 million (2002: credit of £46 million) in respect of notional tax on the shareholder's interest in the movement in value of the long-term assurance business. Since this derives from the use of a combination of tax rates it can give rise to a higher or lower charge compared to an expected 30 per cent rate.

The Finance Act 2003 introduced legislation which will potentially affect the tax treatment of certain transfers from Scottish Widows plc's long-term business fund to its shareholder's fund; it is possible that these transfers will be subject to a higher tax charge than was previously anticipated. The potential deferred liability not recognised on the balance sheet is approximately £110 million.

Factors that may affect the future deferred tax charge are dealt with in note 36.

10 Profit for the financial year attributable to shareholders
The profit attributable to shareholders includes a profit of £2,177 million (2002: £1,463 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.

11 Dividends

	2003 £m	2002 £m
First interim	597	597
Second interim	1,314	1,311
	1,911	1,908

12 Treasury bills and other eligible bills

	2003 Balance sheet £m	2003 Valuation £m	2002 Balance sheet £m	2002 Valuation £m
Group				
Investment securities:				
Treasury bills and similar securities	308	305	257	258
Other eligible bills	222	218	1,622	1,620
	530	523	1,879	1,878
Other securities:				
Treasury bills and similar securities	9		530	
	539		2,409	
Geographical analysis by issuer:				
United Kingdom	336		1,726	
Latin America	70		567	
Other	133		116	
	539		2,409	
Included above:				
Unamortised discounts net of premiums on investment securities	2		5	

Notes to the accounts

12 Treasury bills and other eligible bills (continued)

Movements in investment securities comprise:

	Cost £m	Premiums and discounts £m	Total £m
At 1 January 2003	**1,875**	**4**	**1,879**
Exchange and other adjustments	**3**	**–**	**3**
Additions	**23,453**	**–**	**23,453**
Bills sold or matured	**(24,803)**	**(61)**	**(24,864)**
Amortisation of premiums and discounts	**–**	**59**	**59**
At 31 December 2003	**528**	**2**	**530**

	2003 Balance sheet £m	**2003 Valuation £m**	2002 Balance sheet £m	2002 Valuation £m
Bank				
Investment securities:				
Treasury bills and similar securities	**307**	**305**	257	258
Other eligible bills	**213**	**213**	1,615	1,614
	520	**518**	1,872	1,872
Other securities:				
Treasury bills and similar securities	**5**		500	
	525		2,372	
Geographical analysis by issuer:				
United Kingdom	**336**		1,726	
Latin America	**59**		533	
Other	**130**		113	
	525		2,372	
Included above:				
Unamortised discounts net of premiums on investment securities	**2**		5	

Movements in investment securities comprise:

	Cost £m	Premiums and discounts £m	Total £m
At 1 January 2003	**1,868**	**4**	**1,872**
Exchange and other adjustments	**3**	**–**	**3**
Additions	**23,444**	**–**	**23,444**
Bills sold or matured	**(24,797)**	**(61)**	**(24,858)**
Amortisation of premiums and discounts	**–**	**59**	**59**
At 31 December 2003	**518**	**2**	**520**

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

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

It is expected that tax of £2 million (2002: £1 million) would be recoverable if the Group's investment securities were sold at their year end valuation.

13 Loans and advances to banks

	Group		Bank	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Lending to banks	**2,292**	2,212	**50,520**	50,134
Deposits placed with banks	**13,273**	15,317	**12,479**	14,030
Total loans and advances to banks	**15,565**	17,529	**62,999**	64,164
Provisions for bad and doubtful debts	**(18)**	(1)	**(18)**	(1)
	15,547	17,528	**62,981**	64,163
Repayable on demand	**3,768**	4,313	**24,574**	29,512
Other loans and advances by residual maturity repayable:				
3 months or less	**7,637**	8,511	**9,456**	10,361
1 year or less but over 3 months	**2,329**	2,624	**6,804**	8,249
5 years or less but over 1 year	**1,496**	1,700	**19,412**	13,800
Over 5 years	**335**	381	**2,753**	2,242
Provisions for bad and doubtful debts	**(18)**	(1)	**(18)**	(1)
	15,547	17,528	**62,981**	64,163
Included above:				
Due from group undertakings				
– unsubordinated			**48,033**	47,728
– subordinated			**225**	201

14 Loans and advances to customers

	Group		Bank	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Lending to customers	**127,551**	126,446	**73,804**	62,236
Hire purchase debtors	**4,701**	4,342	**58**	–
Equipment leased to customers	**6,470**	7,300	**–**	1
Total loans and advances to customers	**138,722**	138,088	**73,862**	62,237
Provisions for bad and doubtful debts	**(1,677)**	(1,766)	**(1,419)**	(1,425)
Interest held in suspense	**(28)**	(57)	**(15)**	(35)
	137,017	136,265	**72,428**	60,777
Loans and advances by residual maturity repayable:				
3 months or less	**25,005**	25,721	**42,015**	30,010
1 year or less but over 3 months	**9,458**	10,357	**6,752**	6,654
5 years or less but over 1 year	**31,384**	30,651	**15,075**	14,837
Over 5 years	**72,875**	71,359	**10,020**	10,736
Provisions for bad and doubtful debts	**(1,677)**	(1,766)	**(1,419)**	(1,425)
Interest held in suspense	**(28)**	(57)	**(15)**	(35)
	137,017	136,265	**72,428**	60,777
Of which repayable on demand or at short notice	**14,917**	13,415	**28,624**	15,110
Included above:				
Due from group undertakings				
– all unsubordinated			**27,399**	18,610
Due from fellow group undertakings				
– subordinated	**–**	14	**–**	–
– unsubordinated	**1,766**	1,777	**684**	656

The cost of assets acquired during the year for letting to customers under finance leases and hire purchase contracts amounted to £4,478 million (2002: £3,752 million).

Notes to the accounts

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

	2003 Specific £m	2003 General £m	2002 Specific £m	2002 General £m
Group				
At 1 January	**1,334**	**433**	1,099	369
Exchange and other adjustments	**(1)**	**–**	(55)	(3)
Adjustments on acquisitions and disposals	**(49)**	**(5)**	–	3
Transfers from general to specific	**50**	**(50)**	–	–
Advances written off	**(1,145)**	**–**	(878)	–
Recoveries of advances written off in previous years	**178**	**–**	203	–
Charge to profit and loss account:				
New and additional provisions	**1,552**	**9**	1,544	64
Releases and recoveries	**(606)**	**(5)**	(579)	–
	946	**4**	965	64
At 31 December	**1,313**	**382**	1,334	433
	1,695		1,767	
In respect of:				
Loans and advances to banks	**18**		1	
Loans and advances to customers	**1,677**		1,766	
	1,695		1,767	
Bank				
At 1 January	**1,056**	**370**	801	302
Exchange and other adjustments	**(9)**	**–**	(33)	–
Adjustments on acquisitions and disposals	**33**	**(5)**	1	–
Transfers from general to specific	**50**	**(50)**	–	–
Advances written off	**(918)**	**–**	(653)	–
Recoveries of advances written off in previous years	**127**	**–**	136	–
Charge to profit and loss account:				
New and additional provisions	**1,300**	**8**	1,289	68
Releases and recoveries	**(520)**	**(5)**	(485)	–
	780	**3**	804	68
At 31 December	**1,119**	**318**	1,056	370
	1,437		1,426	
In respect of:				
Loans and advances to banks	**18**		1	
Loans and advances to customers	**1,419**		1,425	
	1,437		1,426	

	Group 2003 £m	Group 2002 £m	Bank 2003 £m	Bank 2002 £m
Non-performing lending comprises:				
Accruing loans on which interest is being placed in suspense	**633**	752	**396**	473
Loans accounted for on a non-accrual basis	**585**	662	**581**	603
	1,218	1,414	**977**	1,076
Provisions	**(916)**	(992)	**(737)**	(758)
Interest held in suspense	**(28)**	(57)	**(15)**	(35)
	274	365	**225**	283

16 Concentrations of exposure

	Group 2003 £m	Group 2002 £m	Bank 2003 £m	Bank 2002 £m
Loans and advances to customers:				
Domestic:				
Agriculture, forestry and fishing	**2,025**	2,076	**684**	712
Manufacturing	**3,211**	3,373	**2,680**	2,862
Construction	**1,497**	1,482	**1,308**	1,358
Transport, distribution and hotels	**4,741**	4,696	**3,980**	4,052
Property companies	**4,577**	4,008	**4,118**	3,588
Financial, business and other services	**9,652**	8,352	**7,424**	6,129
Personal: mortgages	**70,750**	62,467	**333**	353
: other	**20,139**	16,579	**16,990**	14,244
Lease financing	**6,470**	7,285	**–**	–
Hire purchase	**4,701**	4,342	**58**	–
Due from fellow group undertakings	**1,766**	1,791	**28,083**	19,266
Other	**3,351**	3,397	**3,025**	3,039
Total domestic	**132,880**	119,848	**68,683**	55,603
International:				
Latin America	**557**	1,591	**410**	982
New Zealand	**–**	10,447	**–**	–
USA	**2,681**	3,412	**2,295**	3,040
Europe	**1,981**	2,142	**1,981**	1,979
Rest of the world	**623**	648	**493**	633
Total international	**5,842**	18,240	**5,179**	6,634
	138,722	138,088	**73,862**	62,237
Provisions for bad and doubtful debts*	**(1,677)**	(1,766)	**(1,419)**	(1,425)
Interest held in suspense*	**(28)**	(57)	**(15)**	(35)
	137,017	136,265	**72,428**	60,777

*Figures exclude provisions and interest held in suspense relating to loans and advances to banks.

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

Notes to the accounts

17 Debt securities

	2003 Balance sheet £m	2003 Valuation £m	2002 Balance sheet £m	2002 Valuation £m
Group				
Investment securities:				
Government securities	**1,895**	**1,902**	2,140	2,141
Other public sector securities	**–**	**–**	1	1
Bank and building society certificates of deposit	**2,515**	**2,515**	3,147	3,148
Corporate debt securities	**1,895**	**1,890**	1,495	1,496
Mortgage backed securities	**2,211**	**2,212**	893	892
Other asset backed securities	**3,942**	**3,951**	2,817	2,820
Other debt securities	**1,283**	**1,284**	1,369	1,367
	13,741	**13,754**	11,862	11,865
Other securities:				
Government securities	**7,253**	**7,253**	6,035	6,035
Other public sector securities	**106**	**106**	112	112
Bank and building society certificates of deposit	**–**	**–**	340	340
Corporate debt securities	**6,785**	**6,785**	7,842	7,842
Mortgage backed securities	**664**	**664**	1,838	1,838
Other asset backed securities	**120**	**120**	1,191	1,191
Other debt securities	**–**	**–**	94	94
	28,669	**28,682**	29,314	29,317
Due within 1 year	**5,045**		6,412	
Due 1 year and over	**23,624**		22,902	
	28,669		29,314	
Geographical analysis by issuer:				
United Kingdom	**5,232**		5,569	
Other European	**15,949**		13,254	
North America and Caribbean	**5,130**		6,077	
Latin America	**98**		1,231	
Asia Pacific	**1,994**		2,763	
Other	**266**		420	
	28,669		29,314	
Unamortised discounts net of premiums on investment securities	**341**		337	
Investment securities:				
Listed	**8,162**	**8,173**	6,102	6,101
Unlisted	**5,579**	**5,581**	5,760	5,764
	13,741	**13,754**	11,862	11,865
Other securities:				
Listed	**14,374**	**14,374**	16,034	16,034
Unlisted	**554**	**554**	1,418	1,418
	14,928	**14,928**	17,452	17,452

17 Debt securities (continued)

Movements in investment securities comprise:

	Cost £m	Premiums and discounts £m	Provisions £m	Total £m
At 1 January 2003	**11,885**	**66**	**89**	**11,862**
Exchange and other adjustments	**(500)**	**–**	**(3)**	**(497)**
Additions	**11,962**	**–**	**–**	**11,962**
Transfers from other securities	**1,873**	**–**	**–**	**1,873**
Securities sold or matured	**(11,389)**	**(5)**	**(29)**	**(11,365)**
Adjustments on disposal of businesses	**(100)**	**–**	**–**	**(100)**
Charge for the year	**–**	**–**	**42**	**(42)**
Amortisation of premiums and discounts	**–**	**48**	**–**	**48**
At 31 December 2003	**13,731**	**109**	**99**	**13,741**

	2003 Balance sheet £m	2003 Valuation £m	2002 Balance sheet £m	2002 Valuation £m
Bank				
Investment securities:				
Government securities	**1,372**	**1,378**	1,448	1,450
Bank and building society certificates of deposit	**2,101**	**2,101**	2,850	2,851
Corporate debt securities	**90**	**87**	96	96
Mortgage backed securities	**13**	**13**	17	17
Other asset backed securities	**343**	**351**	598	608
Other debt securities	**711**	**711**	799	798
	4,630	**4,641**	5,808	5,820
Other securities:				
Government securities	**7,253**	**7,253**	5,624	5,624
Other public sector securities	**106**	**106**	109	109
Bank and building society certificates of deposit	**–**	**–**	27	27
Corporate debt securities	**6,785**	**6,785**	7,713	7,713
Mortgage backed securities	**664**	**664**	1,838	1,838
Other asset backed securities	**120**	**120**	1,191	1,191
Other debt securities	**–**	**–**	275	275
	19,558	**19,569**	22,585	22,597
Included above:				
Due from group undertakings – all unsubordinated	**–**		230	
Due within 1 year	**4,521**		5,585	
Due 1 year and over	**15,037**		17,000	
	19,558		22,585	
Geographical analysis by issuer:				
United Kingdom	**2,871**		4,343	
Other European	**12,197**		10,580	
North America and Caribbean	**3,513**		4,816	
Latin America	**96**		1,412	
Asia Pacific	**617**		1,014	
Other	**264**		420	
	19,558		22,585	
Unamortised discounts net of premiums on investment securities	**1**		332	

Notes to the accounts

17 Debt securities (continued)

	2003 Balance sheet £m	2003 Valuation £m	2002 Balance sheet £m	2002 Valuation £m
Investment securities:				
Listed	**915**	**925**	1,141	1,150
Unlisted	**3,715**	**3,716**	4,667	4,670
	4,630	**4,641**	5,808	5,820
Other securities:				
Listed	**14,374**	**14,374**	15,623	15,623
Unlisted	**554**	**554**	1,154	1,154
	14,928	**14,928**	16,777	16,777

Movements in investment securities comprise:	Cost £m	Provisions £m	Total £m
At 1 January 2003	**5,837**	**29**	**5,808**
Exchange and other adjustments	**(272)**	**(3)**	**(269)**
Additions	**9,771**	**–**	**9,771**
Securities sold or matured	**(10,668)**	**–**	**(10,668)**
Charge for the year	**–**	**12**	**(12)**
At 31 December 2003	**4,668**	**38**	**4,630**

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 £3 million (2002: £4 million) would be payable if the Group's investment securities were sold at their year end valuation.

Transfers from other securities relate to debt securities that have been transferred into the Group's new conduit securitisation vehicle, Cancara Asset Securitisation Limited. These securities were previously held within the Group's trading portfolios but have been reclassified as investment securities since the intention is now to hold them for the longer term.

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

	2003 Balance sheet £m	2003 Valuation £m	2002 Balance sheet £m	2002 Valuation £m
Group				
Investment securities:				
Listed	**5**	**5**	5	5
Unlisted	**30**	**126**	33	62
	35	**131**	38	67
Other securities:				
Listed	**423**		168	
	458		206	

Movements in investment securities comprise:	Cost £m	Provisions £m	Total £m
At 1 January 2003	**51**	**13**	**38**
Exchange and other adjustments	**1**	**1**	**–**
Additions	**5**	**–**	**5**
Disposals	**(7)**	**(2)**	**(5)**
Adjustments on disposal of businesses	**(9)**	**(8)**	**(1)**
Charge for the year	**–**	**2**	**(2)**
At 31 December 2003	**41**	**6**	**35**

	2003 Balance sheet £m	2003 Valuation £m	2002 Balance sheet £m	2002 Valuation £m
Bank				
Investment securities:				
Unlisted	**16**	**21**	16	19
Other securities:				
Listed	**248**		29	
	264		45	

Movements in investment securities comprise:	Cost £m
At 1 January 2003	**16**
Additions	**1**
Disposals	**(1)**
At 31 December 2003	**16**

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

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

Notes to the accounts

19 Assets transferred under sale and repurchase transactions

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

	Group		Bank	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Treasury bills and other eligible bills	**136**	588	**132**	484
Debt securities	**4,503**	5,651	**2,926**	4,517
	4,639	6,239	**3,058**	5,001

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

20 Interests in joint ventures

	Group £m	Bank £m
At 1 January 2003	**45**	**45**
Exchange and other adjustments	**17**	**(1)**
Additions	**12**	**12**
Losses for the year	**(20)**	**(20)**
At 31 December 2003	**54**	**36**

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

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

During 2003 the Group contributed a further £12 million of capital to Goldfish Holdings Limited.

In the year ended 31 December 2003 £25 million (2002: £31 million) of fees payable to iPSL have been included in the Group's administrative expenses and £3 million (2002: £6 million) of charges to iPSL have been included in the Group's income. The Group has also prepaid £13 million (2002: £6 million) of fees in respect of 2004 and this amount is included in prepayments and accrued income.

In the year ended 31 December 2003 £7 million (2002: £25 million) of interest receivable from Goldfish Bank Limited and £6 million (2002: £12 million) of charges to Goldfish Bank Limited in respect of administrative costs have been included in the Group's income. At 31 December 2002 Goldfish Bank Limited owed £430 million to the Group, which was included in loans and advances to banks. In addition, at 31 December 2002, the Group had made facilities available for Goldfish Bank Limited to borrow a further £420 million; this facility was cancelled during 2003.

On 30 September 2003, the Bank completed the purchase of the credit card and personal loan businesses of Goldfish Bank Limited (see note 48).

On a historical cost basis, the Bank's interests in associated undertakings and joint ventures would have been included at £78 million (2002: £74 million).

Included in the gross assets disclosed on the balance sheet is an investment of £3 million (2002: £8 million) in associated undertakings.

21 Shares in group undertakings

	Bank £m
At 1 January 2003	**18,181**
Additions	**292**
Capital repayments	**(3)**
Disposals	**(21)**
Amounts written off	**(43)**
Revaluations	**1,399**
At 31 December 2003	**19,805**

	2003 £m	2002 £m
Shares in banks	**2,942**	4,713
Shares in other group undertakings	**16,863**	13,468
Total – all unlisted	**19,805**	18,181

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

	Cost £m	Provisions £m	Book value £m
At 1 January 2003	**16,176**	**15**	**16,161**
Additions	**292**	–	**292**
Capital repayments	**(3)**	–	**(3)**
Disposals	**(10)**	–	**(10)**
Amounts written off	**(43)**	–	**(43)**
At 31 December 2003	**16,412**	**15**	**16,397**

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

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

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

*Indirect interest.

The country of registration/incorporation is also the principal area of operation for each of the above group undertakings.

Notes to the accounts

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	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Profit and loss account				
Interest receivable	**–**	–	**82**	12
Interest payable	**(59)**	(55)	**(52)**	(4)
Other operating income	**93**	80	**(2)**	–
Total income	**34**	25	**28**	8
Operating expenses	**(36)**	(24)	**–**	–
(Loss) profit on ordinary activities before taxation	**(2)**	1	**28**	8
Tax on (loss) profit on ordinary activities	**6**	5	**(2)**	–
Retained profit	**4**	6	**26**	8
Balance sheet				
Assets				
Loans and advances to customers	**–**	–	**345**	329
Debt securities	**–**	–	**3,718**	–
Tangible fixed assets	**1,408**	1,307	**–**	–
Other assets and prepayments	**23**	25	**34**	4
Total assets	**1,431**	1,332	**4,097**	333
Liabilities				
Deposits by banks	**1,309**	1,245	**672**	–
Debt securities in issue	**–**	–	**3,123**	73
Other liabilities and accruals	**108**	77	**18**	2
Shareholders' funds	**14**	10	**284**	258
Total liabilities	**1,431**	1,332	**4,097**	333
Cash flow statement				
Net cash inflow (outflow) from operating activities	**132**	422	**1,173**	(250)

23 Intangible fixed assets

	Cost £m	Amortisation £m	Net book value £m
Group			
Positive goodwill:			
At 1 January 2003	**2,764**	**137**	**2,627**
Exchange and other adjustments	**31**	**9**	**22**
Acquisitions (note 48)	**96**	**–**	**96**
Disposals (note 6)	**(273)**	**(84)**	**(189)**
Charge for the year	**–**	**49**	**(49)**
At 31 December 2003	**2,618**	**111**	**2,507**
Negative goodwill:			
At 1 January 2003 and 31 December 2003	**23**	**23**	**–**

	Cost £m	Amortisation £m	Net book value £m
Bank			
Positive goodwill:			
At 1 January 2003	**11**	**3**	**8**
Acquisitions	**113**	**–**	**113**
Charge for the year	**–**	**3**	**(3)**
At 31 December 2003	**124**	**6**	**118**

24 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m
Group			
Cost:			
At 1 January 2003	**1,196**	**2,314**	**2,572**
Exchange and other adjustments	**4**	**13**	**(61)**
Disposal of businesses	**(53)**	**(121)**	**(1)**
Additions	**82**	**308**	**502**
Disposals	**(38)**	**(330)**	**(494)**
At 31 December 2003	**1,191**	**2,184**	**2,518**
Depreciation:			
At 1 January 2003	**377**	**1,395**	**215**
Exchange and other adjustments	**–**	**9**	**(2)**
Disposal of businesses	**(14)**	**(74)**	**–**
Charge for the year	**65**	**270**	**311**
Disposals	**(12)**	**(305)**	**(258)**
At 31 December 2003	**416**	**1,295**	**266**
Balance sheet amount at 31 December 2003	**775**	**889**	**2,252**
		3,916	
Balance sheet amount at 31 December 2002	819	919	2,357
		4,095	

	Premises £m	Equipment £m
Bank		
Cost:		
At 1 January 2003	**831**	**1,837**
Exchange and other adjustments	**7**	**5**
Additions	**69**	**263**
Disposals	**(16)**	**(299)**
At 31 December 2003	**891**	**1,806**
Depreciation:		
At 1 January 2003	**340**	**1,091**
Exchange and other adjustments	**–**	**5**
Charge for the year	**55**	**202**
Disposals	**(11)**	**(282)**
At 31 December 2003	**384**	**1,016**
Balance sheet amount at 31 December 2003	**507**	**790**
	1,297	
Balance sheet amount at 31 December 2002	491	746
	1,237	

Notes to the accounts

24 Tangible fixed assets (continued)

	Group 2003 £m	Group 2002 £m	Bank 2003 £m	Bank 2002 £m
Balance sheet amount of premises comprises:				
Freeholds	**368**	414	**225**	225
Leaseholds 50 years and over unexpired	**133**	132	**27**	19
Leaseholds less than 50 years unexpired	**274**	273	**255**	247
	775	819	**507**	491
Land and buildings occupied for own activities	**705**	749	**450**	435

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

Residual value expected to be recovered in:	2003 £m	2002 £m
1 year or less	**181**	272
2 years or less but over 1 year	**330**	173
5 years or less but over 2 years	**505**	542
Over 5 years	**445**	617
Total exposure	**1,461**	1,604

25 Lease commitments

Annual commitments under non-cancellable operating leases were:

	2003 Premises £m	2003 Equipment £m	2002 Premises £m	2002 Equipment £m
Group				
Leases on which the commitment is due to expire in:				
1 year or less	**7**	**–**	10	2
5 years or less but over 1 year	**29**	**–**	29	1
Over 5 years	**190**	**–**	188	–
	226	**–**	227	3
Bank				
Leases on which the commitment is due to expire in:				
1 year or less	**6**	**–**	7	2
5 years or less but over 1 year	**27**	**–**	16	1
Over 5 years	**174**	**–**	158	–
	207	**–**	181	3

Obligations under finance leases for the Group were:	2003 Equipment £m	2002 Equipment £m
Amounts payable in 1 year or less	**–**	1

26 Capital commitments

Capital expenditure contracted but not provided for at 31 December 2003 amounted to £77 million for the Group and £6 million for the Bank (2002: Group £117 million; Bank £9 million). Of the capital commitments of the Group, £71 million (2002: £107 million) relates to assets to be leased to customers under operating leases.

27 Other assets

	Group 2003 £m	Group 2002* £m	Bank 2003 £m	Bank 2002 £m
Balances arising from derivatives used for trading purposes (note 47a)	**2,489**	3,428	**2,937**	3,563
Balances arising from derivatives used for hedging purposes	**475**	778	**27**	237
Settlement balances	**54**	76	**13**	11
Other assets	**907**	935	**478**	480
	3,925	5,217	**3,455**	4,291

*restated (see note 1)

28 Prepayments and accrued income

	Group 2003 £m	Group 2002* £m	Bank 2003 £m	Bank 2002 £m
Interest receivable	**869**	931	**1,179**	1,283
Deferred expenditure incurred under cash gift and discount mortgage schemes	**128**	201	**–**	–
Other debtors and prepayments	**931**	1,165	**405**	493
	1,928	2,297	**1,584**	1,776

*restated (see note 1)

29 Long-term assurance business

a Methodology

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

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

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

Notes to the accounts

29 Long-term assurance business (continued)

b Analysis of embedded value

The embedded value included in the consolidated balance sheet comprises:

	2003 £m	2002 £m
Net tangible assets of life companies including surplus	**3,617**	3,324
Value of other shareholder's interests in the long-term assurance business	**2,879**	2,904
	6,496	6,228

Movements in the embedded value balance have been as follows:

	2003 £m	2002 £m
At 1 January	**6,228**	6,366
Exchange and other adjustments	**12**	(14)
Profit (loss) after tax	**296**	(257)
Capital injections	**–**	140
Adjustment on disposal	**(38)**	–
Dividends	**(2)**	(7)
At 31 December	**6,496**	6,228

c Analysis of income from long-term assurance business

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

New business income: 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.

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

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 d).

Development costs: this represents investments in strategic developments primarily relating to Sandler products, depolarisation and e-commerce.

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.

29 Long-term assurance business (continued)

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

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

	2003 £m	2002 £m
New business income	**477**	413
Life and pensions distribution costs	**(327)**	(277)
New business contribution	**150**	136
Contribution from existing business		
– expected return	**264**	312
– experience variances	**(16)**	(1)
– changes in assumptions and other items	**(75)**	78
– customer remediation provisions (see d)	**(100)**	(205)
	73	184
Development costs	**(13)**	–
Investment earnings	**153**	214
Operating profit	**363**	534
Investment variance	**112**	(892)
Changes in economic assumptions (see f)	**(22)**	55
Income from long-term assurance business before tax	**453**	(303)
Attributed tax	**(157)**	46
Income from long-term assurance business after tax	**296**	(257)

d 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.

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

	2003 £m	2002 £m
At 1 January	**37**	203
Accrual of interest on the provision	**2**	17
Charge for the year	**44**	40
Compensation paid	**(58)**	(223)
At 31 December	**25**	37

29 Long-term assurance business (continued)
A review of the adequacy of the provision has been carried out at each year end and greater experience has lead to the refinement of the underlying assumptions about the number of cases requiring compensation and the estimated cost per case. The size of the provision has also been affected by periodic revisions to the actuarial guidelines issued by the FSA for the calculation of redress payments and lower stock market values which have resulted in an increase in the cost of restitution into company pension schemes as personal pension fund values and trustees' expectations of future returns reduce. These factors have lead to additional provisions being made of £70 million in 2001, £40 million in 2002 and £44 million in 2003.

The review is now nearing completion and management do not expect any further material changes in the provisioning requirement. However, the cases that are still to be settled are generally large and complex and there is therefore a risk that the assumptions made in determining the provision may prove to be inaccurate.

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 the Lloyds TSB Group in February 2000. As a result of this review, in December 2002 the FSA fined Abbey Life £1 million for mortgage endowment misselling and other deficiencies in its compliance procedures and controls. A provision of £165 million was established, in the year ended 31 December 2002, for the cost of compensation due to customers based upon assumptions as to the number of cases requiring redress and the estimated average cost: this provision was increased by £22 million in 2003 as greater experience has enabled management to refine the underlying assumptions. In addition, there has been an increase in complaints in respect of products sold by the Abbey Life sales force prior to 1988; a provision of £34 million has been established in 2003 to cover the estimated cost of redress.

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

	2003 £m	2002 £m
At 1 January	**165**	–
Accrual of interest on the provision	**5**	–
Charge for the year	**56**	165
Compensation paid	**(77)**	–
At 31 December	**149**	165

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.

e 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 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 2003 of £1.4 billion (2002: £1.5 billion). To the extent that the Additional Account is insufficient to provide these benefits any shortfall would be met by the Group.

29 Long-term assurance business (continued)
Since the 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 which would, to a large extent, have to be met by the Group.

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 the Group, will not be known for many years. However, Scottish Widows has been developing an actuarial model to assist in the management of the with-profits fund and to meet regulatory requirements. This 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. Preliminary output from this model indicates 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 the 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 the Group currently considers that no provision is necessary. However, the model is subject to ongoing development and the position will be kept under review.

Notes to the accounts

29 Long-term assurance business (continued)

f 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 way in which economic assumptions are set for the purposes of embedded value calculations. The guidance requires that the assumptions should be reviewed at each reporting date.

The principal economic assumptions have been revised at 31 December 2003 as follows:

	2003 %	2002 %
Risk-adjusted discount rate (net of tax)	**7.60**	7.35
Return on equities (gross of tax)	**7.45**	7.10
Return on fixed interest securities (gross of tax)	**4.85**	4.50
Expenses inflation	**3.80**	3.30

The revised assumptions have resulted in a net debit to the profit and loss account of £22 million.

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

- Assumed rates of mortality and morbidity are taken from published tables adjusted for demographic differences. Assumptions in respect of lapse rates reflect the recent actual experience of the companies concerned.
- Current tax legislation and rates have been assumed to continue unaltered, except where future changes have been announced. The UK corporation tax rate used for grossing up was 30 per cent (2002: 30 per cent). The normalised investment earnings have been grossed up at a composite longer term tax rate of 17 per cent (2002: 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.

g Sensitivities

The table below shows the effect on both the embedded value at 31 December 2003 and the new business contribution for the year then ended of theoretical changes in the main economic assumptions:

	Embedded value £m	New business income £m
As published	**6,496**	**477**
Effect of a 1% increase in the discount rate	**(190)**	**(33)**
Effect of a 1% reduction in the discount rate	**199**	**31**
Effect of a 1% reduction in the return on equities	**(80)**	**(18)**

29 Long-term assurance business (continued)

h Balance sheet

The long-term assurance assets attributable to policyholders comprise:

	2003 £m	2002 £m
Investments	**52,097**	47,151
Premises and equipment	**40**	45
Other assets	**1,680**	1,468
	53,817	48,664
Net tangible assets of life companies including surplus	**(3,617)**	(3,324)
	50,200	45,340
Investments shown above comprise:		
Fixed interest securities	**15,947**	14,779
Stocks, shares and unit trusts	**27,605**	24,143
Investment properties	**3,540**	3,623
Other properties	**121**	121
Mortgages and loans	**65**	53
Deposits	**4,819**	4,432
	52,097	47,151
The liabilities to policyholders comprise:		
Technical provisions:		
Long-term business provision (net of reinsurance)	**23,730**	23,217
Claims outstanding (net of reinsurance)	**238**	225
Technical provisions for linked liabilities	**25,023**	20,996
Fund for future appropriations	**346**	12
Other liabilities	**863**	890
	50,200	45,340

i 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:

	2003 £m	2002 £m
Premiums	**5,139**	5,524
Investment income	**2,073**	1,942
Unrealised gains on investments	**4,833**	–
Other income	**6**	33
	12,051	7,499
Claims	**(4,433)**	(5,031)
Change in technical provisions	**(4,540)**	3,877
Expenses	**(689)**	(720)
Realised losses on investments	**(1,679)**	(1,790)
Unrealised losses on investments	**(22)**	(4,362)
Other charges	**(4)**	(3)
Tax attributable to long-term business	**(41)**	200
Transfer to the fund for future appropriations	**(414)**	(84)
Balance on the technical account – long-term business	**229**	(414)
Tax attributable to balance on the technical account – long-term business	**112**	(190)
Income in shareholder fund	**34**	35
Expenses in shareholder fund	**–**	(1)
Profit (loss) on ordinary activities before tax	**375**	(570)
Tax on profit (loss) on ordinary activities	**(125)**	179
Profit (loss) for the financial year	**250**	(391)

Notes to the accounts

29 Long-term assurance business (continued)

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

	2003 £m	2002 £m
Income from long-term assurance business attributable to the shareholder after tax	**296**	(257)
Increase in value-in-force taken to profit	**(2)**	(166)
	294	(423)
Other differences:		
– movement in deferred acquisition costs	**66**	45
– tax adjustment	**(60)**	55
– other	**(50)**	(68)
Profit (loss) for the financial year – modified statutory solvency basis	**250**	(391)

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

	2003 £m	2002 £m
Assets		
Investments	**27,483**	26,555
Assets held to cover linked liabilities	**25,023**	20,996
Other assets	**2,018**	1,718
Total assets	**54,524**	49,269
Liabilities		
Shareholder's funds	**4,249**	3,929
Fund for future appropriations	**346**	12
Long-term business provision†	**23,730**	23,217
Technical provision for linked liabilities†	**25,023**	20,996
Other creditors	**1,176**	1,115
Total liabilities	**54,524**	49,269

†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:

	2003 £m	2002 £m
Long-term assurance business attributable to the shareholder – embedded value basis	**6,496**	6,228
Value of in-force business	**(2,879)**	(2,904)
	3,617	3,324
Other differences:		
– deferred acquisition costs	**496**	430
– tax adjustment	**145**	205
– other adjustments	**(9)**	(30)
Net tangible assets of life operations – modified statutory solvency basis	**4,249**	3,929

30 Assets and liabilities denominated in foreign currencies

	Group		Bank	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Assets: denominated in sterling	**155,539**	144,371	**139,392**	126,497
: denominated in other currencies	**48,159**	64,757	**45,161**	51,696
	203,698	209,128	**184,553**	178,193
Liabilities: denominated in sterling	**155,533**	144,351	**139,383**	126,537
: denominated in other currencies	**48,165**	64,777	**45,170**	51,656
	203,698	209,128	**184,553**	178,193

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

31 Deposits by banks

	Group		Bank	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Repayable on demand	**7,455**	8,500	**11,020**	12,847
Other deposits by banks with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	**15,002**	14,692	**16,469**	16,796
1 year or less but over 3 months	**1,197**	1,634	**1,492**	2,066
5 years or less but over 1 year	**69**	487	**1,048**	997
Over 5 years	**232**	130	**182**	162
	23,955	25,443	**30,211**	32,868
Included above:				
Due to group undertakings			**7,030**	8,734

32 Customer accounts

	Group		Bank	
	2003 £m	2002 £m	**2003 £m**	2002 £m
Repayable on demand	**90,987**	88,242	**74,977**	64,612
Other customer accounts with agreed maturity dates or periods of notice by residual maturity repayable:				
3 months or less	**17,316**	19,047	**16,595**	14,368
1 year or less but over 3 months	**1,846**	3,099	**1,877**	1,666
5 years or less but over 1 year	**5,431**	4,140	**4,258**	5,668
Over 5 years	**1,364**	2,130	**2,434**	2,754
	116,944	116,658	**100,141**	89,068
Included above:				
Due to group undertakings			**13,980**	9,796
Due to fellow group undertakings	**448**	324	**376**	252

Notes to the accounts

33 Debt securities in issue

	Group 2003 £m	Group 2002 £m	Bank 2003 £m	Bank 2002 £m
Bonds and medium-term notes by residual maturity repayable:				
1 year or less	**711**	437	**711**	346
2 years or less but over 1 year	**81**	443	**81**	380
5 years or less but over 2 years	**1,099**	746	**769**	616
Over 5 years	**3,623**	1,659	**3,623**	1,022
	5,514	3,285	**5,184**	2,364
Other debt securities by residual maturity repayable:				
3 months or less	**17,942**	19,525	**14,729**	17,259
1 year or less but over 3 months	**2,015**	7,174	**1,982**	5,883
5 years or less but over 1 year	**283**	30	**265**	25
Over 5 years	**168**	241	**–**	39
	20,408	26,970	**16,976**	23,206
	25,922	30,255	**22,160**	25,570
Included above:				
Due to group undertakings			**–**	24

34 Other liabilities

	Group 2003 £m	Group 2002 £m	Bank 2003 £m	Bank 2002 £m
Balances arising from derivatives used for trading purposes (note 47a)	**3,719**	4,659	**4,002**	4,466
Balances arising from derivatives used for hedging purposes	**283**	414	**–**	–
Current tax	**317**	474	**(49)**	136
Dividends	**1,314**	1,311	**1,314**	1,311
Settlement balances	**40**	49	**3**	4
Other liabilities	**1,116**	1,293	**781**	797
	6,789	8,200	**6,051**	6,714

35 Accruals and deferred income

	Group 2003 £m	Group 2002 £m	Bank 2003 £m	Bank 2002 £m
Interest payable	**1,165**	1,335	**1,222**	1,276
Other creditors and accruals	**2,077**	2,361	**913**	1,050
	3,242	3,696	**2,135**	2,326

36 Deferred tax

	Group 2003 £m	Group 2002* £m	Bank 2003 £m	Bank 2002 £m
Short-term timing differences	**(222)**	(351)	**(197)**	(256)
Accelerated depreciation allowances	**1,605**	1,670	**9**	(28)
	1,383	1,319	**(188)**	(284)

	Group £m	Bank £m
At 1 January 2003 – as previously reported	**1,330**	**(284)**
Prior year adjustment (note 1)	**(11)**	**–**
At 1 January 2003 – restated	**1,319**	**(284)**
Exchange and other adjustments	**63**	**–**
Adjustments on acquisition and disposals	**(120)**	**96**
Tax provided	**121**	**–**
At 31 December 2003	**1,383**	**(188)**

*restated (see note 1)

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

The deferred tax balance at 31 December 2003 for the Group does not include any amounts in respect of the Group's post-retirement benefit liability which is shown on the balance sheet after deduction of a deferred tax asset of £916 million (2002: £854 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
Group				
At 1 January 2003	**16**	**225**	**120**	**361**
Exchange and other adjustments	**–**	**(11)**	**–**	**(11)**
Adjustments on disposal	**–**	**–**	**(3)**	**(3)**
Provisions applied	**(119)**	**(231)**	**(46)**	**(396)**
Charge for the year	**200**	**236**	**15**	**451**
At 31 December 2003	**97**	**219**	**86**	**402**
Bank				
At 1 January 2003	**4**	**–**	**55**	**59**
Exchange and other adjustments	**–**	**–**	**21**	**21**
Provisions applied	**(117)**	**–**	**(11)**	**(128)**
Charge for the year	**180**	**–**	**10**	**190**
At 31 December 2003	**67**	**–**	**75**	**142**

Customer remediation provisions
The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes are found to have been deficient. During the year the Group has provided a further £200 million in this respect, of which £65 million relates to past sales of mortgage endowment policies and £135 million to long-term savings products.

37 Other provisions for liabilities and charges (continued)
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 Lloyds TSB Group and also by third parties. The principal assumptions underlying the provision relate to the number of cases requiring redress and the estimated average cost per case. It is expected that the majority of the expenditure will be incurred over the next two years. Whilst the current provision has been calculated based on recent actual experience, uncertainty remains as to the ultimate cost and timing of the payments, which will be influenced by external factors beyond the control of management, such as regulatory actions and the performance of financial markets.

The provision in respect of long-term savings predominantly relates to redress payments in respect of the Extra Income and Growth Plan ('EIGP') product. During the year the Group has completed an investigation, in conjunction with the FSA, into sales of this product made in 2000 and 2001 and as a result has agreed to pay compensation to those customers who invested in the EIGP when it was not appropriate. The provision reflects the costs of this investigation, the estimated cost of redress payments to customers who qualify for compensation calculated using the criteria agreed with the FSA, and the incremental costs expected to be incurred processing the payments to customers. The compensation exercise is in progress and is expected to be completed during 2004.

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

The Group also carries provisions in respect of its obligations relating to UIC Insurance Company Limited ('UIC'), which is partly owned by the Group. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a reinsurance 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 reinsurance arrangements protecting UIC and UIC's available assets. Given the long-term nature of many of the claims to which UIC is exposed, it is expected to be many years before the Group's ultimate liability can be assessed with certainty.

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

Notes to the accounts

38 Subordinated liabilities	Notes	Group		Bank	
		2003 £m	2002 £m	**2003 £m**	2002 £m
**Undated loan capital:*					
Primary Capital Undated Floating Rate Notes:	a				
Series 1 (US$750 million)		**419**	466	**419**	466
Series 2 (US$500 million)		**279**	311	**279**	311
Series 3 (US$600 million)		**335**	373	**335**	373
$11\frac{3}{4}$% Perpetual Subordinated Bonds		**100**	100	**–**	–
6.625% Perpetual Capital Securities (€750 million)	b	**523**	482	**523**	482
6.90% Perpetual Capital Securities callable 2007 (US$1,000 million)	c	**550**	610	**550**	610
$5\frac{5}{8}$% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	f	**874**	807	**874**	807
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a	**105**	97	**105**	97
$6\frac{5}{8}$% Undated Subordinated Step-up Notes callable 2010	e	**407**	406	**407**	406
7.375% Undated Subordinated Step-up Notes callable 2012 (€430 million)		**–**	–	**301**	278
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	d, f	**349**	322	**349**	322
7.834% Undated Subordinated Step-up Notes callable 2015		**–**	–	**248**	248
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	g	**104**	104	**104**	104
5.125% Undated Subordinated Step-up Notes callable 2016	i	**496**	–	**496**	–
$6\frac{1}{2}$% Undated Subordinated Step-up Notes callable 2019	e	**267**	267	**267**	267
8% Undated Subordinated Step-up Notes callable 2023	e	**199**	199	**199**	199
$6\frac{1}{2}$% Undated Subordinated Step-up Notes callable 2029	e	**455**	455	**455**	455
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032	e	**500**	500	**500**	500
		5,962	5,499	**6,411**	5,925
Dated loan capital:					
Eurocurrency Zero Coupon Bonds 2003 (¥3 billion)		**–**	14	**–**	–
Subordinated Fixed Rate Bonds 2003 (NZ$151 million)		**–**	48	**–**	–
Subordinated Floating Rate Notes 2004	a	**5**	10	**–**	–
$7\frac{3}{8}$% Subordinated Bonds 2004		**400**	400	**400**	400
Subordinated Floating Rate Notes 2004	a, h	**100**	100	**100**	100
Subordinated Floating Rate Notes 2007		**200**	200	**–**	–
$7\frac{3}{4}$% Subordinated Bonds 2007		**299**	299	**299**	299
Subordinated Floating Rate Notes 2008		**150**	150	**–**	–
$5\frac{1}{4}$% Subordinated Notes 2008 (DM750 million)		**269**	249	**269**	249
$10\frac{5}{8}$% Guaranteed Subordinated Loan Stock 2008		**108**	110	**108**	110
$9\frac{1}{2}$% Subordinated Bonds 2009		**100**	99	**100**	99
Subordinated Step-up Floating Rate Notes 2009 callable 2004 (US$500 million)	a	**279**	310	**279**	310
Subordinated Fixed Rate Bonds 2010 (NZ$100 million)		**–**	33	**–**	–
$6\frac{1}{4}$% Subordinated Notes 2010 (€400 million)		**281**	259	**281**	259
Subordinated Floating Rate Notes 2010 (US$400 million)	a	**223**	248	**223**	248
12% Guaranteed Subordinated Bonds 2011		**116**	118	**116**	118
$4\frac{3}{4}$% Subordinated Notes 2011 (€850 million)		**578**	532	**578**	532
Subordinated Floating Rate Notes 2011		**150**	150	**–**	–
Subordinated Fixed Rate Bonds 2011 (NZ$100 million)		**–**	33	**–**	–
Subordinated Floating Rate Notes 2011		**100**	100	**–**	–
Subordinated Fixed Rate Bonds 2012 (NZ$125 million)		**–**	41	**–**	–
Subordinated Fixed Rate Bonds 2012 (NZ$125 million)		**–**	41	**–**	–
Subordinated Floating Rate Notes 2014		**464**	464	**464**	464
$5\frac{7}{8}$% Subordinated Notes 2014		**148**	148	**148**	148
$6\frac{5}{8}$% Subordinated Notes 2015		**345**	344	**345**	344
Subordinated Floating Rate Notes 2020 (€100 million)	a	**70**	65	**70**	65
$9\frac{5}{8}$% Subordinated Bonds 2023		**339**	340	**339**	340
Subordinated Non-Interest Bearing Loan on rolling 6 year notice		**150**	150	**150**	150
		4,874	5,055	**4,269**	4,235
Total subordinated liabilities		**10,836**	10,554	**10,680**	10,160

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

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

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

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

c) In certain circumstances the interest payments on these securities can be deferred although in this case neither Lloyds TSB Bank plc nor Lloyds TSB Group plc can declare or pay a dividend until payments are resumed. Any deferred payments will be made good on redemption of the securities. In the event of a winding up of Lloyds TSB Bank plc, these securities will acquire the characteristics of preference shares. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 22 November 2007.

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

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

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

g) 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.

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

i) Issued during 2003 primarily to finance the general business of the Group.

Notes to the accounts

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

	Group		Bank	
	2003 £m	2002 £m	**2003 £m**	2002 £m
1 year or less	**505**	67	**500**	–
2 years or less but over 1 year	**–**	505	**–**	500
5 years or less but over 2 years	**1,026**	499	**676**	299
Over 5 years	**3,343**	3,984	**3,093**	3,436
	4,874	5,055	**4,269**	4,235

39 Non-equity minority interests
Non-equity minority interests comprise:

	2003 £m	2002 £m
Euro Step-up Non-Voting Non-Cumulative Preferred Securities (€430 million) callable 2012*	**301**	278
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015†	**248**	248
Capital instruments	**549**	526
European Financial Institution Investments Partnership•	**100**	123
LM ABS Investment Partnership□	**34**	45
	683	694

*These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary of the Group, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 2.33 per cent above EURIBOR, to be set annually.

†These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary of the Group, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 3.50 per cent above a rate based on the yield of specified UK government stock.

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

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

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

40 Called-up share capital

	2003 £m	2002 £m
Authorised: ordinary shares of £1 each*	**1,650**	1,650
Issued and fully paid: ordinary shares of £1 each At 1 January and 31 December	**1,542**	1,542

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

The company regarded by the directors as the ultimate parent company is Lloyds TSB Group plc, which is also the parent undertaking of the only group of undertakings for which consolidated accounts are drawn up and of which the Bank is a member. Copies of the group accounts may be obtained from the company secretary, Lloyds TSB Group plc, 25 Gresham Street, London EC2V 7HN.

41 Reserves

	Group £m	Bank £m
Share premium account:		
At 1 January and 31 December 2003	**2,960**	**2,960**
Revaluation reserve:		
At 1 January 2003		**2,001**
Transfer to profit and loss account		**(6)**
Increase in net tangible assets of subsidiary undertakings and joint ventures		**1,379**
At 31 December 2003		**3,374**
Profit and loss account:		
At 1 January 2003 – as previously reported	**4,583**	**4,510**
Prior year adjustment (note 1)	**(26)**	**–**
At 1 January 2003 – restated	**4,557**	**4,510**
Exchange and other adjustments	**118**	**11**
Transfer from revaluation reserve	**–**	**6**
Actuarial losses recognised in post-retirement benefit schemes (note 45)	**(4)**	**–**
Goodwill written back on sale of businesses	**181**	**–**
Profit for the year	**1,379**	**266**
At 31 December 2003	**6,231**	**4,793**

The Group profit and loss account reserves at 31 December 2003 include £180 million (2002: £232 million) not presently available for distribution representing the Group's share of the value of long-term assurance business in force and the surplus retained within the long-term assurance funds. The Group profit and loss account reserves at 31 December 2003 are stated after including a deficit of £2,139 million relating to the Group's post-retirement defined benefit schemes (2002: £2,077 million).

The cumulative amount of premiums on acquisitions written off against Group profit and loss account reserves during previous years amounts to £785 million of which £727 million was within the last 10 years.

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

Notes to the accounts

43 Directors' emoluments

The aggregate of the emoluments of the directors was £7,045,000 (2002: £5,864,000).

The aggregate of the amount of the gains made by directors on the exercise of Lloyds TSB Group plc share options was £295,000 (2002: £9,000).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were 1 and 9 respectively (2002: 0 and 9).

The total for the highest paid director (Mr Fairey), was £1,140,000. The amount of his accrued pension at the year end was £186,000, being his pension entitlement based on pensionable service with the Group to 31 December 2003 but payable at normal retirement age. (The total for the highest paid director in 2002 (Mr Daniels), was £1,263,000).

44 Related party transactions

a Transactions, arrangements and agreements involving directors and others

At 31 December 2003, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons and with officers included:

	2003 Number of persons	**2003 Total £000**	2002 Number of persons	2002 Total £000
Loans and credit card transactions:				
Directors and connected persons	**6**	**3,199**	4	3,334
Officers	**30**	**5,355**	31	3,930

During the year one officer purchased a car from the Group for a consideration of £27,000 (2002: three officers, total consideration £37,000).

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 2003 are also shown in note 20.

d Long-term assurance business

The Group enters into certain transactions with its long-term assurance businesses, which cannot be eliminated in the consolidated accounts because of the basis of accounting used for the Group's long-term assurance businesses. After taking into account legally enforceable netting agreements, at 31 December 2003 Group entities owed £1,995 million (2002: £1,372 million) and were owed £136 million (2002: £145 million); these amounts are included in customer accounts and loans and advances to customers respectively. In addition, fees of £107 million (2002: £76 million) were received, and fees of £71 million (2002: £35 million) were paid, in respect of asset management and other services.

Certain administrative properties used by Scottish Widows are owned by the long-term assurance funds. During 2003 Scottish Widows paid rent to the long-term assurance funds amounting to £5 million (2002: £5 million). In addition, at 31 December 2003, the long-term assurance funds owned 31 million ordinary shares in the Bank's parent company Lloyds TSB Group plc (2002: 31 million shares).

e Pension funds

Group entities provide a number of banking and other services to the Group's pension funds, which are conducted on similar terms to third party transactions. At 31 December 2003, the Group's pension funds had call deposits with the Bank amounting to £16 million (2002: £89 million).

45 Pensions and other post-retirement benefits

a The Group accounts

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

	2003 £m	2002 £m
Defined contribution schemes	**33**	25
Defined benefit schemes	**320**	293
	353	318

The majority of the Group's employees are members of the defined benefit sections of Lloyds TSB Group Pension Schemes No's 1 and 2. During the year ended 31 December 2002, the Group made no contributions to these schemes. During 2003, no contributions have been made to the Lloyds TSB Group Pension Scheme No. 2; however the Group has commenced contributions to the Lloyds TSB Group Pension Scheme No. 1, at a rate of 31.7 per cent of pensionable salary, with effect from 1 July 2003. Since the defined benefit sections of these schemes are now closed to new members and the age profile of the active members is increasing, under the projected unit method, the current service cost will increase as the members of the schemes approach retirement.

The latest full valuations of the schemes were carried out as at 30 June 2002; these have been updated to 31 December 2003 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 2003 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 2003 %	31 December 2002 %	31 December 2001 %
Rate of inflation	**2.50**	2.30	2.50
Rate of salary increases	**4.04**	3.83	4.04
Rate of increase for pensions in payment and deferred pensions	**2.50**	2.30	2.50
Discount rate	**5.40**	5.60	6.00

In addition, the Group operates a number of schemes which provide post-retirement healthcare benefits to certain employees, retired employees and their dependent relatives. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependants) who retired prior to 1 January 1996. For retirements subsequent to this date, the Group will meet a reducing proportion of the cost until 31 December 2004, after which date the only obligation will be in respect of the pre 1 January 1996 retirements.

Included within other finance income is an interest cost of £5 million (2002: £4 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 2003 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 5.58 per cent.

45 Pensions and other post-retirement benefits (continued)

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

	Fair value at 31 December 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 %	Fair value at 31 December 2001 £m	Expected long-term rate of return at 31 December 2001 %
Market values of scheme assets:						
Equities	**7,454**	**8.1**	7,175	8.4	7,779	8.0
UK fixed interest gilts	**551**	**4.8**	557	4.5	1,835	5.1
UK index linked gilts	**545**	**4.4**	–	–	126	5.0
Sterling non-government bonds	**1,033**	**5.4**	491	5.6	–	–
Property	**713**	**7.1**	791	6.9	798	7.1
Cash	**307**	**3.5**	69	3.8	588	4.1
Total fair value of scheme assets	**10,603**		9,083		11,126	

Other finance income is comprised of:	2003 £m	2002 £m
Expected return on scheme assets	**696**	817
Interest cost of scheme liabilities	**(662)**	(652)
	34	165

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

	2003 £m	2002 £m
Current service cost	**269**	244
Past service costs	**51**	49
Defined benefit costs	**320**	293

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

	2003 £m	2002 £m
Actual return less expected return on scheme assets	**802**	(2,582)
Experience gains and losses arising on scheme liabilities	**94**	(240)
Effect of changes in demographic and financial assumptions	**(902)**	(477)
Actuarial losses recognised	**(6)**	(3,299)
Deferred tax thereon	**2**	968
Amount recognised in the statement of total recognised gains and losses	**(4)**	(2,331)

45 Pensions and other post-retirement benefits (continued)

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

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

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

	2003 £m	2002 £m
Market value of assets	**10,603**	9,083
Present value of scheme liabilities	**(13,658)**	(12,014)
Deficit in the schemes	**(3,055)**	(2,931)
Related deferred tax asset	**916**	854
Net post-retirement benefit liability	**(2,139)**	(2,077)

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

	2003 £m	2002 £m
(Deficit) surplus at beginning of year	**(2,931)**	433
Exchange and other adjustments	**(4)**	26
Other finance income	**34**	165
Current service costs	**(269)**	(244)
Contributions	**138**	37
Past service costs	**(51)**	(49)
Actuarial loss	**(6)**	(3,299)
Adjustment on disposal of business	**34**	–
Deficit at end of year	**(3,055)**	(2,931)

b The Bank accounts

The majority of the Bank's employees are members of the Group's two main pension schemes, Lloyds TSB Group Pension Schemes No's 1 and 2, along with employees of a number of the Bank's subsidiaries. Because it is not possible to separately identify the amount of any surpluses or deficits in these schemes relating to each employing company, in the accounts of the Bank, these schemes are accounted for as defined contribution schemes.

46 Contingent liabilities and commitments

	Group 2003 £m	Group 2002 £m	Bank 2003 £m	Bank 2002 £m
Contingent liabilities:				
Acceptances and endorsements	**299**	1,879	**269**	1,880
Guarantees	**6,122**	5,927	**6,150**	5,865
Other:				
Other items serving as direct credit substitutes	**1,069**	1,103	**1,095**	1,103
Performance bonds and other transaction-related contingencies	**1,534**	1,436	**1,552**	1,438
Other contingent liabilities	**1**	1	**1**	1
	2,604	2,540	**2,648**	2,542
	9,025	10,346	**9,067**	10,287
Commitments:				
Documentary credits and other short-term trade-related transactions	**368**	289	**422**	372
Forward asset purchases and forward forward deposits placed	**546**	394	**546**	553
Undrawn note issuing and revolving underwriting facilities	**–**	32	**–**	–
Undrawn formal standby facilities, credit lines and other commitments to lend:				
– Less than 1 year maturity	**62,440**	49,417	**60,771**	45,876
– 1 year or over maturity	**15,981**	14,372	**14,896**	13,272
	79,335	64,504	**76,635**	60,073
Incurred on behalf of group undertakings:				
Contingent liabilities			**127**	80
Commitments			**72**	431
			199	511

47 Derivatives and other financial instruments

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

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

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

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

47 Derivatives and other financial instruments (continued)

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

Risk

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

Credit risk

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

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

47 Derivatives and other financial instruments (continued)

- Formulation of concentration limits on certain industries and sectors and monitoring and controlling residual value risk exposure. Lloyds TSB Group Risk sets sector caps that reflect risk appetite and monitors exposures to prevent excessive concentration of risk.

- Portfolio analysis. In conjunction with Lloyds TSB Group Risk, group businesses identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by Lloyds TSB Group Risk.

- Communication and provision of general guidance on all credit-related risk issues, including regulatory changes and environmental risk policy, to promote consistent and best practice throughout the Group.

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

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

Market risk

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

Trading activities are restricted to a few highly specialist trading centres and the level of exposure is strictly controlled and monitored within approved limits locally and centrally.

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

Various parameters are used to calculate the value at risk on a given portfolio of positions, thus avoiding undue reliance on a single measure. Based on the commonly quoted 95 per cent confidence level, assuming positions are held overnight and using observation periods with greater emphasis given to more recent data, during 2003 the value at risk on the Group's global trading averaged £1.5 million (2002: £1.2 million) with a maximum of £2.6 million (2002: £2.1 million) and a minimum of £0.9 million (2002: £0.9 million). The figure at 31 December 2003 was £1.0 million (2002: £1.0 million).

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

Liquidity risk

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

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

47 Derivatives and other financial instruments (continued)

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

Operational risk

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

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

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

Insurance risk

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

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

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

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.

47 Derivatives and other financial instruments (continued)

Exchange rate related contracts include forward foreign exchange contracts, currency swaps and options. A forward foreign exchange contract is an agreement to buy or sell a specified amount of foreign currency on a specified future date at an agreed rate. Currency swaps generally involve the exchange of interest payment obligations denominated in different currencies; the exchange of principal can be notional or actual.

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

a Derivatives

Group

Trading

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

	Notional principal amount	Fair values	
31 December 2003	£m	Assets £m	Liabilities £m
Exchange rate contracts:			
Spot, forwards and futures	**76,368**	**1,669**	**2,127**
Currency swaps	**10,793**	**328**	**557**
Options purchased	**1,678**	**55**	**14**
Options written	**1,542**	**–**	**39**
	90,381	**2,052**	**2,737**
Interest rate contracts:			
Interest rate swaps	**238,384**	**3,346**	**4,180**
Forward rate agreements	**54,213**	**29**	**29**
Options purchased	**10,475**	**145**	**–**
Options written	**5,265**	**–**	**162**
Futures	**38,626**	**–**	**–**
	346,963	**3,520**	**4,371**
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**	**3,719**

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

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:

	Notional principal amount	Fair values	
31 December 2003	£m	Positive £m	Negative £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**

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

The aggregate carrying value of non-trading derivatives with a positive fair value was an asset of £132 million (2002: an asset of £54 million) and with a negative fair value was a liability of £71 million (2002: a liability of £9 million).

Notes to the accounts

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 2003				
Exchange rate contracts:				
Notional principal amount	**79,677**	**7,005**	**4,329**	**91,011**
Replacement cost	**1,753**	**141**	**199**	**2,093**
Interest rate contracts:				
Notional principal amount	**175,306**	**161,834**	**47,867**	**385,007**
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**	**170,804**	**52,752**	**481,425**
Replacement cost	**2,854**	**1,916**	**1,793**	**6,563**
31 December 2002				
Exchange rate contracts:				
Notional principal amount	102,559	6,888	2,798	112,245
Replacement cost	2,209	108	86	2,403
Interest rate contracts:				
Notional principal amount	150,883	149,631	51,856	352,370
Replacement cost	850	2,682	2,212	5,744
Equity contracts:				
Notional principal amount	1,130	3,714	818	5,662
Replacement cost	3	531	74	608
Total:				
Notional principal amount	254,572	160,233	55,472	470,277
Replacement cost	3,062	3,321	2,372	8,755

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.

	2003 £m	2002 £m
OECD banks	**1,272**	1,939
Other	**1,350**	1,604
Net replacement cost	**2,622**	3,543
Qualifying collateral held	**(416)**	(521)
Potential credit risk exposure	**2,206**	3,022

47 Derivatives and other financial instruments (continued)

Bank

Trading

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

	Notional principal amount £m	Fair values Assets £m	Fair values Liabilities £m
31 December 2003			
Exchange rate contracts:			
Spot, forwards and futures	**77,641**	**1,730**	**2,157**
Currency swaps	**11,637**	**451**	**561**
Options purchased	**1,742**	**56**	**16**
Options written	**1,542**	**–**	**39**
	92,562	**2,237**	**2,773**
Interest rate contracts:			
Interest rate swaps	**245,766**	**3,607**	**4,279**
Forward rate agreements	**54,246**	**29**	**29**
Options purchased	**10,475**	**145**	**–**
Options written	**5,307**	**2**	**162**
Futures	**38,626**	**–**	**–**
	354,420	**3,783**	**4,470**
Equity and other contracts	**7,967**	**693**	**535**
Effect of netting		**(3,776)**	**(3,776)**
Balances arising from off-balance sheet financial instruments		**2,937**	**4,002**

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

Notes to the accounts

47 Derivatives and other financial instruments (continued)

Non-trading

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

31 December 2003	Notional principal amount £m	Fair values Positive £m	Fair values Negative £m
Exchange rate contracts:			
Spot, forwards and futures	**156**	**21**	**4**
Currency swaps	**469**	**29**	**10**
	625	**50**	**14**
Interest rate contracts:			
Interest rate swaps	**32,754**	**263**	**258**
Forward rate agreements	**7,188**	**1**	**1**
	39,942	**264**	**259**
Effect of netting		**(165)**	**(165)**
		149	**108**

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

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:

31 December 2003	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Exchange rate contracts:				
Notional principal amount	**80,994**	**7,864**	**4,329**	**93,187**
Replacement cost	**1,823**	**265**	**199**	**2,287**
Interest rate contracts:				
Notional principal amount	**176,688**	**166,655**	**51,019**	**394,362**
Replacement cost	**587**	**1,775**	**1,685**	**4,047**
Equity contracts:				
Notional principal amount	**3,317**	**3,539**	**1,111**	**7,967**
Replacement cost	**523**	**115**	**55**	**693**
Total:				
Notional principal amount	**260,999**	**178,058**	**56,459**	**495,516**
Replacement cost	**2,933**	**2,155**	**1,939**	**7,027**

31 December 2002	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
Exchange rate contracts:				
Notional principal amount	92,138	6,124	2,818	101,080
Replacement cost	2,152	83	86	2,321
Interest rate contracts:				
Notional principal amount	145,510	144,218	55,118	344,846
Replacement cost	849	2,666	2,509	6,024
Equity contracts:				
Notional principal amount	1,307	5,095	1,636	8,038
Replacement cost	3	531	74	608
Total:				
Notional principal amount	238,955	155,437	59,572	453,964
Replacement cost	3,004	3,280	2,669	8,953

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

	2003 £m	2002 £m
OECD banks	**1,741**	2,277
Other	**1,345**	1,464
Net replacement cost	**3,086**	3,741
Qualifying collateral held	**(416)**	(521)
Potential credit risk exposure	**2,670**	3,220

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.

As at 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	**88,466**	**4,681**	**5,549**	**30,777**	**6,171**	**(51)**	**1,424**	**137,017**
Debt securities and equity shares	**8,718**	**606**	**279**	**1,856**	**2,372**	**(55)**	**15,351**	**29,127**
Other assets	**101**	**–**	**17**	**8**	**–**	**16,055**	**5,287**	**21,468**
Total assets	**108,379**	**6,646**	**6,373**	**33,393**	**8,632**	**16,315**	**23,960**	**203,698**
Liabilities:								
Deposits by banks	**22,254**	**635**	**262**	**286**	**99**	**205**	**214**	**23,955**
Customer accounts	**104,621**	**705**	**876**	**5,227**	**1,173**	**3,749**	**593**	**116,944**
Debt securities in issue	**18,375**	**1,507**	**1,040**	**1,210**	**3,790**	**–**	**–**	**25,922**
Other liabilities	**300**	**–**	**–**	**–**	**–**	**7,933**	**6,348**	**14,581**
Subordinated liabilities – loan capital	**2,689**	**1,089**	**–**	**677**	**6,231**	**150**	**–**	**10,836**
Minority interests and shareholders' funds	**–**	**–**	**–**	**–**	**–**	**11,442**	**18**	**11,460**
Internal funding of trading business	**(11,528)**	**(810)**	**(412)**	**(3,217)**	**(820)**	**–**	**16,787**	**–**
Total liabilities	**136,711**	**3,126**	**1,766**	**4,183**	**10,473**	**23,479**	**23,960**	**203,698**
Off-balance sheet items	**6,930**	**(1,365)**	**(4,049)**	**(2,596)**	**1,080**	**–**	**–**	**–**
Interest rate repricing gap	**(21,402)**	**2,155**	**558**	**26,614**	**(761)**	**(7,164)**	**–**	**–**
Cumulative interest rate repricing gap	**(21,402)**	**(19,247)**	**(18,689)**	**7,925**	**7,164**	**–**	**–**	**–**

As at 31 December 2002*	3 months or less £m	6 months or less but over 3 months £m	1 year or less but over 6 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Trading book £m	Total £m
Assets:								
Treasury bills and other eligible bills	1,759	23	94	1	2	–	530	2,409
Loans and advances to banks	12,362	1,362	761	775	200	666	1,402	17,528
Loans and advances to customers	88,527	4,997	8,247	26,787	7,210	(133)	630	136,265
Debt securities and equity shares	6,093	1,049	312	1,972	2,516	(42)	17,620	29,520
Other assets	130	25	25	243	48	16,456	6,479	23,406
Total assets	108,871	7,456	9,439	29,778	9,976	16,947	26,661	209,128
Liabilities:								
Deposits by banks	21,572	817	240	377	112	248	2,077	25,443
Customer accounts	104,257	1,318	1,193	3,829	2,008	3,203	850	116,658
Debt securities in issue	19,169	5,526	2,002	1,212	1,224	–	1,122	30,255
Other liabilities	353	–	6	–	–	9,049	7,020	16,428
Subordinated liabilities – loan capital	3,293	1,141	14	950	5,006	150	–	10,554
Minority interests and shareholders' funds	–	–	–	–	–	9,942	(152)	9,790
Internal funding of trading business	(7,973)	(198)	(1,545)	(5,148)	(880)	–	15,744	–
Total liabilities	140,671	8,604	1,910	1,220	7,470	22,592	26,661	209,128
Off-balance sheet items	10,942	5,939	(10,082)	(8,830)	2,031	–	–	–
Interest rate repricing gap	(20,858)	4,791	(2,553)	19,728	4,537	(5,645)	–	–
Cumulative interest rate repricing gap	(20,858)	(16,067)	(18,620)	1,108	5,645	–	–	–

The table above does not take into account the effect of interest rate options used by the Group to hedge its exposure; details of options are given in note 47a.

*restated (see note 1)

47 Derivatives and other financial instruments (continued)

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

As at 31 December 2003	Trading book		Non-trading book	
	Book value £m	Fair value £m	Book value £m	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**	**149,251**	**150,636**
Debt securities and equity shares	**15,351**	**15,351**	**13,776**	**13,885**
Liabilities:				
Deposits by banks and customers	**807**	**807**	**140,092**	**140,143**
Debt securities in issue	**–**	**–**	**25,922**	**26,254**
Subordinated liabilities	**–**	**–**	**10,836**	**11,916**

As at 31 December 2002	Trading book		Non-trading book	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Assets:				
Treasury bills and other eligible bills	530	530	1,879	1,878
Loans and advances to banks and customers	2,032	2,032	151,761	153,316
Debt securities and equity shares	17,620	17,620	11,900	11,932
Liabilities:				
Deposits by banks and customers	2,927	2,927	139,174	138,752
Debt securities in issue	1,122	1,122	29,133	29,005
Subordinated liabilities	–	–	10,554	11,410

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 cashflows at prevailing interest rates.

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

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

The Group's main overseas operations are in the Americas, Europe and, in 2002, New Zealand. Details of the Group's structural foreign currency exposures are as follows:

	2003 £m	2002 £m
Functional currency of Group operation:		
New Zealand dollar	**–**	921
Euro	**287**	304
US dollar	**255**	363
Swiss franc	**104**	100
Other non-sterling	**200**	323
Total	**846**	2,011

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.

47 Derivatives and other financial instruments (continued)

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

At 31 December 2003, the unrecognised gains on financial instruments used for hedging were £303 million (2002: £418 million) and unrecognised losses were £219 million (2002: £516 million).

The net losses arising in 2002 and earlier years and recognised in 2003 amounted to £150 million. Net gains of £30 million arose in 2003 but were not recognised in the year.

Of the net gains of £84 million at 31 December 2003, £63 million of net gains are expected to be recognised in the year ending 31 December 2004 and £21 million of net gains in later years.

48 Acquisition
On 1 August 2003, the Lloyds TSB Group announced the acquisition of the credit card and personal loan businesses of Goldfish Bank Limited, together with the Goldfish brand and loyalty programme. The acquisition became effective on 30 September 2003 with the transfer of the portfolios to the Bank, for a consideration of £1,096 million, settled in cash. The Group premium arising of £96 million has been capitalised and will be written off to the profit and loss account over its estimated useful life of 10 years. No significant fair value adjustments were made. The results of these businesses have been consolidated in full from the date of acquisition, the effect on the results of the Group is not material.

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