

Lloyds TSB Bank plc

Report and Accounts

2006

Member of Lloyds TSB Group

Contents

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Directors' report

Results and dividends

The consolidated income statement on page 7 shows a profit attributable to equity shareholders for the year ended 31 December 2006 of £2,916 million. An interim dividend of £602 million for the year ended 31 December 2006 was paid on 2 October 2006. A second interim dividend of £1,325 million will be paid on 2 May 2007.

Principal activities

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

Business review

Profit before tax for the Lloyds TSB Bank Group was £4,282 million, an increase of £428 million, or 11 per cent, compared with £3,854 million in 2005; profit attributable to equity shareholders was £412 million (or 16 per cent) higher at £2,916 million compared with £2,504 million in 2005; and the post-tax return on equity increased to 25.0 per cent compared with 23.0 per cent in 2005. The Lloyds TSB Bank Group's customer service index (which is based on the results of a customer satisfaction survey performed monthly for the Lloyds TSB Group by an external agency) improved to 69.7 per cent from 68.0 per cent in 2005; and the service quality index (a measure of 'defects per million opportunities', where a 'defect' is registered whenever there is a failure to deliver a process or product within a certain time or to the required standard) improved to 4.30 from 4.02 in 2005.

In 2006, the Lloyds TSB Bank Group continued to deliver good levels of earnings growth underpinned by continued momentum in all divisions. The Group's strategy to deepen customer relationships at the same time as improving productivity has led to strong trading surplus growth of 14 per cent.

The Group's income statement includes substantial amounts of income and expenditure attributable to the policyholders of the Group's long-term assurance funds, which are consolidated in order to meet the requirements of accounting standards. These amounts are volatile and can cause significant variations in net interest income, other income and insurance claims. However they have no overall effect upon profit attributable to equity shareholders. In addition, the impact of the implementation of International Financial Reporting Standards (IFRS) in 2005, and in particular the increased use of fair values, has also led to greater earnings volatility than was previously the case under UK Generally Accepted Accounting Principles. In

order to provide a more comparable representation of underlying business performance, the impact of these items has been excluded, where appropriate, in the discussion below.

Group net interest income, excluding insurance grossing adjustments of £78 million (2005: £310 million), increased by £99 million, or 2 per cent, compared with 2005. Strong levels of customer lending growth in Business Banking and Corporate Markets, and good growth in mortgages, offset the expected slowdown in the rate of growth in unsecured personal lending.

Operating expenses, excluding the impact of a £128 million pension schemes related credit and, in 2005, a £150 million provision for customer redress, continued to be tightly controlled and increased by only 2 per cent. Significant improvements continued to be made in processing and operational efficiency and, over the past 12 months, staff numbers on a full-time equivalent basis reduced by 4,167 to 62,630. As a result of this constant focus on day-to-day operating cost control, the cost:income ratio, excluding the pension schemes related credit, provision for customer redress and insurance grossing adjustments, improved to 48.9 per cent, from 51.7 per cent in 2005.

Impairment losses on loans and advances increased by 20 per cent to £1,555 million. In UK Retail Banking, impairment losses increased by £127 million, or 11 per cent, to £1,238 million, reflecting more customers, with higher levels of indebtedness, experiencing repayment difficulties as well as higher levels of customer insolvency. Towards the end of 2006 we experienced some signs of stabilisation in the rate of our customers filing for bankruptcy and a slowdown in the rate of growth in Individual Voluntary Arrangements (IVAs) and whilst the rate of growth in the number of customers filing for bankruptcy and IVAs remains a key factor in the outlook for retail impairment, we expect that the rate of growth in the unsecured retail lending impairment charge in 2007 will be significantly lower than that experienced in 2006.

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

Directors' report

a low level in 2006, although we expect a return to more normal levels of impairment over time.

Profit before tax from UK Retail Banking, before provisions for customer redress, increased by £5 million to £1,549 million, as strong levels of business growth were partly offset by the impact of higher impairment losses. Increased income from the Group's mortgage lending and customer deposit portfolios more than offset the impact of lower levels of unsecured consumer lending and related insurance products. Total income increased by £137 million, or 3 per cent, notwithstanding a significant decrease in income from unsecured creditor insurance, whilst costs fell by 3 per cent. As a result, the trading surplus increased by 8 per cent.

Profit before tax from Insurance and Investments, excluding volatility (2006: £410 million; 2005: £749 million), and strengthening of reserves for mortality in 2005 (£155 million), increased by 11 per cent to £973 million. There was a 24 per cent increase in the present value of new business premiums reflecting, in particular, strong growth in the sales of Open Ended Investment Companies (OEICs) and corporate pension products. Bancassurance sales improved significantly and were 62 per cent higher, including excellent growth in the sales of OEICs through the branch network and to Lloyds TSB private banking clients. As a result of improved capital efficiency and strong sales of pensions and single premium investments, the life, pensions and OEICs new business margin increased to 3.6 per cent, from 3.2 per cent in 2005.

In General Insurance, profit before tax excluding volatility of £18 million (2005: £28 million), increased by 16 per cent to £243 million. Operating income, net of claims, increased by 8 per cent whilst costs fell by 2 per cent. Good progress continues to be made in implementing new platforms for underwriting and claims processes. The claims ratio improved to 32 per cent (2005: 34 per cent) and the combined ratio relating to the underwriting business improved to 80 per cent (2005: 81 per cent).

In Wholesale and International Banking, pre-tax profits increased by £122 million, or 8 per cent, to £1,640 million. Income growth of 8 per cent exceeded cost growth of 4 per cent, leading to a significant reduction in the cost:income ratio to 53.8 per cent. The trading surplus increased by 14 per cent. There was strong profit growth in Corporate Markets and Business Banking, while Asset Finance profit decreased by 13 per cent,

reflecting higher levels of consumer finance impairment losses. Good progress has continued to be made in delivering the strategy to build an integrated wholesale bank for corporate markets, with a 46 per cent increase in income from cross-selling in the Corporate Markets business.

Shareholders' equity increased by £939 million to £12,124 million, largely as a result of retained earnings. Risk-weighted assets increased by 8 per cent to £156 billion reflecting strong growth in mortgages and corporate lending. At the end of 2006, the risk asset ratios were 9.8 per cent for total capital and 8.1 per cent for tier 1 capital.

Financial risk management objectives and policies

Information regarding the financial risk management objectives and policies of the Bank and its subsidiary undertakings, in relation to the use of financial instruments, is given in note 47 on pages 60 to 70.

Directors

The names of the directors of the Bank are shown on page 5.

Sir Victor Blank joined the board on 1 March 2006 and Mr M A van den Bergh and Mrs A A Knight left the board on 11 May 2006 and 31 October 2006, respectively. Dr Julius will retire from the board on 9 May 2007.

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.

Directors' indemnities

The directors have entered into individual contracts of indemnity with Lloyds TSB Group plc which constitute 'qualifying third party indemnity provisions' for the purposes of the Companies Act 1985. These contracts were in force from 11 May 2006 until the end of the financial year and are available for inspection at the Bank's registered office.

Statement of directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the consolidated and parent company financial statements in accordance with IFRS as adopted by the European Union. The financial statements are required by law to

Directors' report

give a true and fair view of the state of affairs of the parent company and the group and of the profit or loss of the group for that period. The directors consider that, in preparing the financial statements on pages 7 to 73, the Bank and the Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

The directors have responsibility for ensuring that the Bank and the Group keep proper accounting records which disclose with reasonable accuracy the financial position of the Bank and the Group which enable them to ensure that the financial statements comply with the Companies Act 1985 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Bank and the Group and to prevent and detect fraud and other irregularities.

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

Employees

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

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

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

employees are taken into account in reaching decisions.

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

Policy and practice on payment of creditors

The Bank follows 'The Better Payment Practice Code' published by the Department of Trade and Industry (DTI) regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from The DTI Publications Orderline 0845 0150010, 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 29. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2006 bears to the aggregate of the amounts invoiced by suppliers during the year.

Auditors and audit information

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

On behalf of the board

A J Michie
Secretary
22 February 2007

Directors

Sir Victor Blank
Chairman

J E Daniels
Chief Executive

M E Fairey
Deputy Chief Executive

H A Weir
Finance Director

W C G Berndt

Ewan Brown CBE

T A Dial

J P du Plessis

G J N Gemmell CBE

Sir Julian Horn-Smith

D S Julius CBE
(retiring on 9 May 2007)

A G Kane

Lord Leitch

G T Tate

Independent auditors' report

To the members of Lloyds TSB Bank plc

We have audited the consolidated and parent company financial statements (the 'financial statements') of Lloyds TSB Bank plc for the year ended 31 December 2006 which comprise the consolidated income statement, the consolidated and parent company balance sheets, the consolidated and parent company statements of changes in equity, the consolidated and parent company cash flow statements and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of directors' responsibilities within the directors' report.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the financial statements.

In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited financial statements. The other information comprises only the directors' report. We consider the implications for our report if we become aware of any apparent misstatements or material

inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the 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 consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit and cash flows for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2006 and cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation; and
- the information given in the directors' report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton
22 February 2007

Consolidated income statement
for the year ended 31 December 2006

| | Note | 2006 £ million | 2005 £ million |
|--|------|-------------------|-------------------|
| Interest and similar income | | 14,319 | 12,592 |
| Interest and similar expense | | (8,780) | (6,920) |
| Net interest income | 4 | 5,539 | 5,672 |
| Fee and commission income | | 3,119 | 2,993 |
| Fee and commission expense | | (846) | (842) |
| Net fee and commission income | 5 | 2,273 | 2,151 |
| Net trading income | 6 | 6,331 | 9,293 |
| Insurance premium income | 7 | 4,719 | 4,469 |
| Other operating income | 8 | 806 | 1,140 |
| Other income | | 14,129 | 17,053 |
| Total income | | 19,668 | 22,725 |
| Insurance claims | 9 | (8,569) | (12,186) |
| Total income, net of insurance claims | | 11,099 | 10,539 |
| Operating expenses | 10 | (5,262) | (5,436) |
| Trading surplus | | 5,837 | 5,103 |
| Impairment losses on loans and advances | 11 | (1,555) | (1,299) |
| Profit on sale and closure of businesses | 12 | – | 50 |
| Profit before tax | | 4,282 | 3,854 |
| Taxation | 13 | (1,262) | (1,288) |
| Profit for the year | | 3,020 | 2,566 |
| Profit attributable to minority interests | | 104 | 62 |
| Profit attributable to equity shareholders | | 2,916 | 2,504 |
| Profit for the year | | 3,020 | 2,566 |

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

Balance sheets
at 31 December 2006

| | Note | The Group | | The Bank | |
|---|------|-------------------|-------------------|-------------------|-------------------|
| | | 2006 £ million | 2005 £ million | 2006 £ million | 2005 £ million |
| Assets | | | | | |
| Cash and balances at central banks | | 1,898 | 1,156 | 1,678 | 966 |
| Items in the course of collection from banks | | 1,431 | 1,310 | 1,358 | 1,256 |
| Trading and other financial assets at fair value through profit or loss | 14 | 67,928 | 60,567 | 8,819 | 5,924 |
| Derivative financial instruments | 15 | 5,565 | 5,878 | 5,665 | 6,050 |
| Loans and advances to banks | 16 | 40,638 | 31,655 | 86,588 | 86,090 |
| Loans and advances to customers | 17 | 190,135 | 176,635 | 106,576 | 91,759 |
| Available-for-sale financial assets | 19 | 19,178 | 14,940 | 3,972 | 4,503 |
| Investment property | 20 | 4,739 | 4,260 | – | – |
| Goodwill | 21 | 2,377 | 2,373 | 8 | 8 |
| Value of in-force business | 22 | 2,723 | 2,922 | – | – |
| Other intangible assets | 23 | 138 | 50 | 37 | 23 |
| Tax recoverable | | – | – | 2 | – |
| Deferred tax asset | 36 | – | – | 861 | 984 |
| Tangible fixed assets | 24 | 4,252 | 4,291 | 1,284 | 1,243 |
| Investment in subsidiary undertakings | 25 | – | – | 18,527 | 16,078 |
| Other assets | 26 | 4,662 | 5,584 | 1,966 | 2,887 |
| Total assets | | 345,664 | 311,621 | 237,341 | 217,771 |

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

The directors approved the financial statements on 22 February 2007.

Sir Victor Blank
Chairman

J Eric Daniels
Chief Executive

Helen A Weir
Finance Director

Balance sheets
at 31 December 2006

| | Note | The Group | | The Bank | |
|---|------|-------------------|-------------------|-------------------|-------------------|
| | | 2006 £ million | 2005 £ million | 2006 £ million | 2005 £ million |
| Equity and liabilities | | | | | |
| Liabilities | | | | | |
| Deposits from banks | 27 | 36,394 | 31,527 | 44,070 | 37,973 |
| Customer accounts | 28 | 140,767 | 131,350 | 127,938 | 115,505 |
| Items in course of transmission to banks | | 781 | 658 | 660 | 533 |
| Trading and other liabilities at fair value through profit or loss | 29 | 1,184 | – | 1,184 | – |
| Derivative financial instruments | 15 | 5,877 | 6,584 | 6,405 | 7,212 |
| Debt securities in issue | 30 | 54,118 | 39,346 | 32,719 | 31,316 |
| Liabilities arising from insurance contracts and participating investment contracts | 31 | 41,602 | 40,684 | – | – |
| Liabilities arising from non-participating investment contracts | 32 | 24,370 | 21,839 | – | – |
| Unallocated surplus within insurance businesses | 33 | 683 | 518 | – | – |
| Other liabilities | 34 | 11,034 | 9,876 | 3,280 | 2,990 |
| Retirement benefit obligations | 35 | 2,462 | 2,910 | 1,845 | 2,206 |
| Current tax liabilities | | 735 | 536 | – | 73 |
| Deferred tax liabilities | 36 | 1,416 | 1,170 | – | – |
| Other provisions | 37 | 259 | 368 | 196 | 298 |
| Subordinated liabilities | 38 | 11,506 | 12,635 | 10,281 | 11,382 |
| Total liabilities | | 333,188 | 300,001 | 228,578 | 209,488 |
| Equity | | | | | |
| Share capital | 39 | 1,542 | 1,542 | 1,542 | 1,542 |
| Share premium account | 40 | 2,960 | 2,960 | 2,960 | 2,960 |
| Other reserves | 41 | 12 | 40 | 9 | 37 |
| Retained profits | 42 | 7,610 | 6,643 | 4,252 | 3,744 |
| Shareholders' equity | | 12,124 | 11,185 | 8,763 | 8,283 |
| Minority interests | | 352 | 435 | – | – |
| Total equity | | 12,476 | 11,620 | 8,763 | 8,283 |
| Total equity and liabilities | | 345,664 | 311,621 | 237,341 | 217,771 |

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

Statements of changes in equity

| The Group | Attributable to equity shareholders | | | | | Total £m |
|---|--|-------------------------|---------------------------|---------------|-----------------------------|---------------|
| | Share capital and premium £m | Other reserves £m | Retained profits £m | Total £m | Minority interests £m | |
| Balance at 1 January 2005 | 4,502 | 28 | 6,036 | 10,566 | 81 | 10,647 |
| Movement in available-for-sale financial assets, net of tax | – | 8 | – | 8 | – | 8 |
| Movement in cash flow hedges, net of tax | – | 11 | – | 11 | – | 11 |
| Currency translation differences | – | (7) | 16 | 9 | – | 9 |
| Net income recognised directly in equity | – | 12 | 16 | 28 | – | 28 |
| Profit for the year | – | – | 2,504 | 2,504 | 62 | 2,566 |
| Total recognised income for 2005 | – | 12 | 2,520 | 2,532 | 62 | 2,594 |
| Dividends | – | – | (1,913) | (1,913) | (37) | (1,950) |
| Capital invested by minority shareholders | – | – | – | – | 329 | 329 |
| Balance at 31 December 2005 | 4,502 | 40 | 6,643 | 11,185 | 435 | 11,620 |
| Movement in available-for-sale financial assets, net of tax | – | (31) | – | (31) | – | (31) |
| Movement in cash flow hedges, net of tax | – | 1 | – | 1 | – | 1 |
| Currency translation differences | – | 2 | (31) | (29) | (4) | (33) |
| Net income recognised directly in equity | – | (28) | (31) | (59) | (4) | (63) |
| Profit for the year | – | – | 2,916 | 2,916 | 104 | 3,020 |
| Total recognised income for 2006 | – | (28) | 2,885 | 2,857 | 100 | 2,957 |
| Dividends | – | – | (1,918) | (1,918) | (32) | (1,950) |
| Repayment of capital to minority shareholders | – | – | – | – | (151) | (151) |
| Balance at 31 December 2006 | 4,502 | 12 | 7,610 | 12,124 | 352 | 12,476 |

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

Statements of changes in equity

| The Bank | Attributable to equity shareholders | | | |
|---|-------------------------------------|----------------------|------------------------|--------------|
| | Share capital and premium £m | Other reserves £m | Retained profits £m | Total £m |
| Balance at 1 January 2005 | 4,502 | 22 | 2,896 | 7,420 |
| Movement in available-for-sale financial assets, net of tax | – | 11 | – | 11 |
| Movement in cash flow hedges, net of tax | – | 11 | – | 11 |
| Currency translation differences | – | (7) | 25 | 18 |
| Net income recognised directly in equity | – | 15 | 25 | 40 |
| Profit for the year | – | – | 2,736 | 2,736 |
| Total recognised income for 2005 | – | 15 | 2,761 | 2,776 |
| Dividends | – | – | (1,913) | (1,913) |
| Balance at 31 December 2005 | 4,502 | 37 | 3,744 | 8,283 |
| Movement in available-for-sale financial assets, net of tax | – | (29) | – | (29) |
| Movement in cash flow hedges, net of tax | – | 1 | – | 1 |
| Currency translation differences | – | – | (23) | (23) |
| Net income recognised directly in equity | – | (28) | (23) | (51) |
| Profit for the year | – | – | 2,449 | 2,449 |
| Total recognised income for 2006 | – | (28) | 2,426 | 2,398 |
| Dividends | – | – | (1,918) | (1,918) |
| Balance at 31 December 2006 | 4,502 | 9 | 4,252 | 8,763 |

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

Cash flow statements
for the year ended 31 December 2006

| | Note | The Group | | The Bank | |
|--|------|-------------------|-------------------|-------------------|-------------------|
| | | 2006 £ million | 2005 £ million | 2006 £ million | 2005 £ million |
| Profit before tax | | 4,282 | 3,854 | 2,730 | 3,042 |
| Adjustments for: | | | | | |
| Change in operating assets | 49a | (32,194) | (17,084) | (21,601) | (14,022) |
| Change in operating liabilities | 49b | 34,164 | 10,035 | 21,939 | 5,896 |
| Non-cash and other items | 49c | 1,632 | 4,290 | (155) | 1,064 |
| Tax paid | | (844) | (723) | (231) | (301) |
| Net cash provided by (used in) operating activities | | 7,040 | 372 | 2,682 | (4,321) |
| Cash flows from investing activities: | | | | | |
| Purchase of available-for-sale financial assets | | (23,448) | (10,108) | (9,917) | (8,210) |
| Proceeds from sale and maturity of available-for-sale financial assets | | 18,106 | 10,266 | 10,353 | 9,958 |
| Purchase of fixed assets | | (1,724) | (1,843) | (312) | (318) |
| Proceeds from sale of fixed assets | | 1,257 | 1,073 | 28 | 46 |
| Additional capital injections to subsidiaries | | – | – | (2,444) | (250) |
| Capital repayments by subsidiaries | | – | – | 3 | 350 |
| Acquisition of businesses, net of cash acquired | 49f | (20) | (27) | (8) | (4) |
| Disposal of businesses, net of cash disposed | 49g | 936 | (4) | 936 | – |
| Net cash (used in) generated by investing activities | | (4,893) | (643) | (1,361) | 1,572 |
| Cash flows from financing activities: | | | | | |
| Dividends paid to equity shareholders | | (1,918) | (1,913) | (1,918) | (1,913) |
| Dividends paid to minority interests | 49e | (32) | (37) | – | – |
| Interest paid on subordinated liabilities | | (704) | (658) | (619) | (573) |
| Proceeds from issue of subordinated liabilities | 49e | – | 1,361 | – | 810 |
| Repayment of subordinated liabilities | 49e | (509) | (232) | (509) | (232) |
| Capital element of finance lease rental payments | 49e | – | (2) | – | (2) |
| Capital invested by minority shareholders | 49e | – | 329 | – | – |
| Repayment of capital to minority shareholders | 49e | (151) | – | – | – |
| Net cash used in financing activities | | (3,314) | (1,152) | (3,046) | (1,910) |
| Effect of exchange rate changes on cash and cash equivalents | | (148) | (20) | (147) | (20) |
| Change in cash and cash equivalents | | (1,315) | (1,443) | (1,872) | (4,679) |
| Cash and cash equivalents at beginning of year | | 26,753 | 28,196 | 17,307 | 21,986 |
| Cash and cash equivalents at end of year | 49d | 25,438 | 26,753 | 15,435 | 17,307 |

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

Notes to the accounts

1 Accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union ('EU').

IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board ('IASB') and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 *Financial Instruments: Recognition and Measurement* relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and certain other financial assets and liabilities at fair value through profit or loss and all derivative contracts.

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

- (i) Amendment to IAS 19 *Actuarial Gains and Losses, Group Plans and Disclosures*. The Group has not changed its accounting policy for the recognition of actuarial gains and losses as a result of this amendment; the additional disclosures required have been provided in note 35.
- (ii) Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – The Fair Value Option*. This amendment, which was effective from 1 January 2006, changed the criteria for financial assets to be designated at fair value through profit or loss and permitted financial liabilities meeting certain criteria to be designated at fair value for the first time. The adoption of these requirements had no effect upon the classification or valuation of those financial assets that were designated at fair value through profit or loss prior to 1 January 2006; at 31 December 2006, £1.2 billion of financial liabilities for the Group and the Bank had been designated at inception into this category during the year. This change has had no material effect upon the Group's income statement.
- (iii) Amendment to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts – Financial Guarantee Contracts*. Since 1 January 2006, all of the Group's financial guarantee contracts have been accounted for as financial instruments. This change has had no material effect upon the Group's financial statements.
- (iv) IFRIC Interpretation 4 *Determining Whether an Arrangement Contains a Lease*. The Group has reviewed the terms of all contracts potentially affected by this interpretation; its adoption has had no material effect upon the Group's financial statements.

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

The accounting policies are set out below:

a Consolidation

The assets, liabilities and results of Group undertakings (including special purpose entities) are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include all entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Group undertakings are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Open Ended Investment Companies (OEICs) and unit trusts where the Group, through the Group's life funds, has a controlling interest are consolidated; the unitholders' interest is reported in other liabilities. Intra-Group transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

1 Accounting policies (continued)**b Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired entity at the date of acquisition. Goodwill is recognised as an asset at cost and is tested at least annually for impairment. If an impairment is identified the carrying value of the goodwill is written down immediately through the income statement and is not subsequently reversed. At the date of disposal of a Group undertaking, the carrying value of attributable goodwill is included in the calculation of the profit or loss on disposal except where it has been written off directly to reserves in the past.

c Other intangible assets

Other intangible assets comprise capitalised software enhancements and customer lists. Capitalised software enhancements are amortised over periods not exceeding five years, being their estimated useful lives, using the straight-line method. Customer lists are amortised over periods not exceeding 15 years, being their estimated useful lives, in line with the income expected to arise from those customers and are subject to annual reassessment. All other intangible assets are reviewed for impairment whenever events or any changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, it is written down immediately.

d Revenue recognition

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see j).

Fees and commissions which are not an integral part of the effective interest rate are generally recognised when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group retains no part of the loan package for itself or retains a part at the same effective interest rate for all interest-bearing financial instruments, including loans and advances, as for the other participants.

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

e Trading securities, other financial assets and liabilities at fair value through profit or loss, and available-for-sale financial assets

Debt securities and equity shares acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value are recognised in the income statement within net trading income in the period in which they occur.

Notes to the accounts

1 Accounting policies (continued)

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

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

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

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Group establishes a fair value by using valuation techniques. These include the use of recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Debt securities and equity shares, other than those classified as trading securities or at fair value through profit or loss, are classified as available-for-sale and recognised in the balance sheet at their fair value. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest calculated using the effective interest method is recognised in the income statement; dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payment is established.

Purchases and sales of securities and other financial assets and liabilities are recognised on trade date, being the date that the Group is committed to purchase or sell an asset. Trading securities and other financial assets and liabilities at fair value through profit or loss are initially recognised at fair value. Available-for-sale financial assets are initially recognised at fair value inclusive of transaction costs. These financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

f Loans and advances to banks and customers

Loans and advances to banks and customers are accounted for at amortised cost using the effective interest method, except those which the Group intends to sell in the short term and which are accounted for at fair value, with the gains and losses arising from changes in their fair value reflected in the income statement. Loans and advances are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs. Loans and advances are derecognised when the rights to receive cash flows from them have expired or where the Group has transferred substantially all risks and rewards of ownership.

1 Accounting policies (continued)

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

g Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are recognised on the balance sheet where all of the risks and rewards are retained; the counterparty liability is included in deposits from banks or customer accounts, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the obligation to return them is recorded at fair value as a trading liability.

h Derivative financial instruments and hedge accounting

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

The method of recognising the movements in the fair value of the derivatives depends on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Derivatives may only be designated as hedges provided certain strict criteria are met. At the inception of a hedge its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship must be tested throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its objective the hedge relationship is terminated.

The Group designates certain derivatives as either: (1) hedges of the fair value of the interest rate risk inherent in recognised assets or liabilities (fair value hedges); (2) hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges); or (3) hedges of net investments in foreign operations (net investment hedges). These are accounted for as follows:

(1) Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged risk are no longer recognised in the income statement; the adjustment that has been made to the carrying amount of a hedged item is amortised to the income statement over the period to maturity.

Notes to the accounts

1 Accounting policies (continued)*(2) Cash flow hedges*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(3) Net investment hedges

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

Changes in the fair value of any derivative instrument that is not part of a hedging relationship are recognised immediately in the income statement.

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

i Offset

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right of set-off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

j Impairment of financial assets*(1) Assets accounted for at amortised cost*

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired. Evidence of impairment may include indications that the borrower or group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, or the fact that the debt is being restructured to reduce the burden on the borrower.

If there is objective evidence that an impairment loss has been incurred, a provision is established which is calculated as the difference between the balance sheet carrying value of the asset and the present value of estimated future cash flows discounted at that asset's original effective interest rate. For the Group's portfolios of smaller balance homogenous loans, such as the residential mortgage, personal lending and credit card portfolios, provisions are calculated for groups of assets taking into account historical cash flow experience. For the Group's other lending portfolios, provisions are established on a case-by-case basis. If an asset has a variable interest rate, the discount rate used for measuring the impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral, whether or not foreclosure is probable.

1 Accounting policies (continued)

If there is no objective evidence of individual impairment the asset is included in a group of financial assets with similar credit risk characteristics and collectively assessed for impairment. Segmentation takes into account such factors as the type of asset, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for groups of such assets as they are indicative of the borrower's ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, such as an improvement in the borrower's credit rating, the provision is adjusted and the amount of the reversal is recognised in the income statement.

When a loan or advance is uncollectable, it is written off against the related provision once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

(2) Available-for-sale financial assets

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the factors set out above, a significant or prolonged decline in the fair value of the asset below its cost is considered in determining whether an impairment loss has been incurred. If an impairment loss has been incurred, the cumulative loss measured as the difference between the original cost and the current fair value, less any impairment loss on that asset previously recognised, is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

k Investment property

Property held for long-term rental yields and capital appreciation within the long-term assurance funds is classified as investment property. Investment property comprises freehold and long leasehold land and buildings and is carried in the balance sheet at fair value. Fair value is based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices on less active markets. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair values are recorded in the income statement.

l Tangible fixed assets

Tangible fixed assets are included at cost less depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land):

- Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease
- Leasehold improvements: shorter of 10 years or the remaining period of the lease

Notes to the accounts

1 Accounting policies (continued)

Equipment:

- Fixtures and furnishings: 10-20 years
- Other equipment and motor vehicles: 2-8 years

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

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately.

m Leases

(1) *As lessee*

The leases entered into by the Group are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

(2) *As lessor*

Assets leased to customers are classified as finance leases if the lease agreements transfer substantially all the risks and rewards of ownership to the lessee; all other leases are classified as operating leases. When assets are subject to finance leases, the present value of the lease payments is recognised as a receivable within loans and advances to banks and customers. Finance lease income is recognised over the term of the lease using the net investment method (before tax) reflecting a constant periodic rate of return.

Operating lease assets are included within fixed assets at cost and depreciated over the life of the lease after taking into account anticipated residual values. Operating lease rental income is recognised on a straight-line basis over the life of the lease.

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

n Investment in subsidiary undertakings

Investments in subsidiaries are carried at historical cost, less any provisions for impairment.

o Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

p Pensions and other post-retirement benefits

The Group operates a number of post-retirement benefit schemes for its employees including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

1 Accounting policies (continued)

Full actuarial valuations of the Group's principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries, or in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows. For the purposes of these annual updates scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method adjusted for unrecognised actuarial gains and losses. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. The resulting net surplus or deficit is included in the Group's balance sheet. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

The Group's income statement includes the current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10 per cent of the scheme assets or liabilities ('the corridor approach'). In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives. Past service costs are charged immediately to the income statement, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

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

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

q Share-based compensation

The Lloyds TSB Group operates a number of equity-settled, share-based compensation plans. The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity. This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest. The fair value of equity instruments granted is based on market prices, if available, at the date of grant. In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model. The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest. At each balance sheet date, this estimate is reassessed and if necessary revised. Any revision of the original estimate is recognised in the income statement over the remaining vesting period.

r Taxation

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise.

For the Group's long-term assurance businesses, the tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on equity holders' returns. This allocation is based on an assessment of the rates of tax which will be applied to the returns under current UK tax rules.

Notes to the accounts

1 Accounting policies (continued)

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Income tax payable on profits is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred tax related to fair value re-measurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

s Insurance

The Group undertakes both life assurance and general insurance business.

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

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

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

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

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

(1) Life assurance business**(i) Accounting for insurance and participating investment contracts****Premiums and claims**

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

Claims are recorded as an expense when they are incurred.

1 Accounting policies (continued)**Liabilities****– insurance or participating investment contracts in the Group's With Profit Fund**

Liabilities of the Group's With Profit Fund, including guarantees and options embedded within products written by that fund, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime.

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

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is calculated by estimating the future cash flows over the duration of in-force policies and discounting them back to the valuation date allowing for probabilities of occurrence. The liability will vary with movements in interest rates and with the cost of life assurance and annuity benefits where future mortality is uncertain. Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

– insurance or participating investment contracts which are unit-linked

Allocated premiums in respect of unit-linked contracts that are either insurance or participating investment contracts are recognised as liabilities. These liabilities are increased or reduced by the change in the unit prices and are reduced by policy administration fees, mortality and surrender charges and any withdrawals. The mortality charges deducted in each period from the policyholders as a group are considered adequate to cover the expected total death benefit claims in excess of the contract account balances in each period and hence no additional liability is established for these claims. Revenue consists of fees deducted for mortality, policy administration and surrender charges. Interest or changes in the unit prices credited to the account balances and excess benefit claims in excess of the account balances incurred in the period are charged as expenses in the income statement.

Unallocated surplus

Any amounts in the With Profit Fund not yet determined as being due to policyholders are recognised as an unallocated surplus which is shown separately from other liabilities.

Value of in-force business

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

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

(ii) Accounting for non-participating investment contracts

All of the Group's non-participating investment contracts are unit-linked. In accordance with industry practice, these contracts are accounted for as financial liabilities whose value is contractually linked to the fair values of financial assets within the Group's unitised investment funds. The value of the unit-linked financial liabilities is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

Notes to the accounts

1 Accounting policies (continued)

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

The Group receives investment management fees in respect of services rendered in conjunction with the issue and management of investment contracts where the Group actively manages the consideration received from its customers to fund a return that is based on the investment profile that the customer selected on origination of the instrument. These services comprise an indeterminate number of acts over the lives of the individual contracts and, therefore, the Group defers these fees and recognises them on a straight-line basis over the estimated lives of the contracts.

Directly incremental commissions that vary with and are related to either securing new or renewing existing non-participating investment contracts are deferred; all other costs are recognised as expenses when incurred. This asset is subsequently amortised over the period of the provision of investment management services and is reviewed for impairment in circumstances where its carrying amount may not be recoverable. If the asset is greater than its recoverable amount it is written down immediately.

(2) General insurance business

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

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

(3) Liability adequacy test

At each balance sheet date liability adequacy tests are performed to ensure the adequacy of insurance and participating investment contract liabilities. In performing these tests current best estimates of discounted future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to profit or loss by establishing a provision for losses arising from liability adequacy tests.

(4) Reinsurance

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held. Insurance contracts entered into by the Group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

1 Accounting policies (continued)**t Foreign currency translation****(1) Functional and presentation currency**

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). These financial statements are presented in sterling, which is the Bank's functional and presentation currency.

(2) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow or net investment hedges. Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Translation differences on equities and similar non-monetary items measured at fair value are recognised in profit or loss, except for differences on available-for-sale non-monetary financial assets such as equity shares, which are included in the fair value reserve in equity unless the asset is a hedged item in a fair value hedge.

(3) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

u Provisions

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Notes to the accounts

1 Accounting policies (continued)**v Dividends**

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

w Cash and cash equivalents

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

2 Critical accounting estimates and judgements

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

Loan impairment provisions

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

At 31 December 2006 gross loans and advances to customers and banks totalled £232,967 million (2005: £210,363 million) against which impairment provisions of £2,194 million (2005: £2,073 million) had been made.

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

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

Pensions

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

Notes to the accounts

2 Critical accounting estimates and judgements (continued)

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

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

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

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

Goodwill

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

The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The impairment review is performed by projecting future cash flows, excluding finance and tax, based upon budgets and plans and making appropriate assumptions about rates of growth and discounting these using a rate that takes into account prevailing market interest rates and the risks inherent in the business. If the present value of the projected cash flows is less than the carrying value of the underlying net assets and related goodwill an impairment charge is required in the income statement. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or changes in the performance of the subsidiaries affect the amount and timing of future cash flows, goodwill may become impaired in future periods.

2 Critical accounting estimates and judgements (continued)**Insurance****Life assurance business**

The Group carries in its balance sheet an asset representing the value of in-force business in respect of life insurance and participating investment contracts of £2,723 million at 31 December 2006 (2005: £2,922 million). This asset, which is presented gross of attributable tax, represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. To arrive at this value it is necessary for management to make assumptions about the future experience of the insurance portfolios which will be affected by factors such as stock market levels, rates of interest and price inflation, future mortality rates and future persistency rates. These factors are inherently uncertain. If actual experience differs from that assumed this could significantly affect the value attributed. The process for determining the key assumptions that have been made at 31 December 2006 is detailed in note 22.

At 31 December 2006 the Group also carried substantial liabilities to holders of life insurance policies in its balance sheet. The methodology used to value the liabilities is described in 1 (s) (1). Liabilities arising from insurance contracts and participating investment contracts were £25,920 million and £15,095 million respectively (2005: £26,022 million and £14,068 million) and those arising from non-participating investment contracts totalled £24,370 million (2005: £21,839 million). Elements of the liabilities require assumptions about future investment returns, future mortality rates and future policyholder behaviour. The process for determining the key assumptions that have been made at 31 December 2006 is detailed in note 31.

The impact on profit before tax of changes in key assumptions is detailed in note 31.

General insurance business

At 31 December 2006 the Group held a provision of £149 million (2005: £147 million) in respect of the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date.

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgment. An increase of 10 per cent in the cost of claims would result in the recognition of an additional loss of approximately £14 million. Similarly, an increase of 10 per cent in the ultimate number of such claims would lead to an additional loss of approximately £15 million. There is no relief arising from reinsurance contracts held.

Taxation

Significant judgement is required in determining the Group's income tax liabilities. In arriving at the current tax liability of £735 million and deferred tax liability of £1,416 million at 31 December 2006 (2005: current tax liability of £536 million and deferred tax liability of £1,170 million), the Group has taken account of tax issues that are subject to ongoing discussions with HM Revenue & Customs and other tax authorities. Calculations of these liabilities have been based on management's assessment of legal and professional advice, case law and other relevant guidance. In these situations, the various risks are categorised and approximate weightings applied in arriving at the assessment of the expected liability. Where the expected tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax amounts in the period in which such determination is made.

Notes to the accounts

3 Segmental analysis

Lloyds TSB Bank Group is a leading financial services group, whose businesses provide a wide range of banking and financial services predominantly in the UK.

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

Under the Group's transfer pricing arrangements, inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds. In addition, for those derivative contracts entered into by business units for risk management purposes, the difference between the result that would have been recognised on an accruals accounting basis and the actual result calculated using fair values is charged or credited to the central segment where the resulting volatility is managed.

| | UK Retail Banking £m | General insurance £m | Life, pensions and asset management £m | Insurance and Investments £m | Wholesale and International Banking £m | Central group items £m | Inter-segment eliminations £m | Total £m |
|--|----------------------------|----------------------------|---|---------------------------------------|--|------------------------------|-------------------------------------|-------------|
| Year ended 31 December 2006 | | | | | | | | |
| Interest and similar income | 6,913 | 24 | 820 | 844 | 8,806 | 997 | (3,241) | 14,319 |
| Interest and similar expense | (3,271) | – | (741) | (741) | (6,421) | (1,588) | 3,241 | (8,780) |
| Net interest income | 3,642 | 24 | 79 | 103 | 2,385 | (591) | – | 5,539 |
| Other income (net of fee and commission expense) | 1,621 | 594 | 9,893 | 10,487 | 1,827 | 194 | – | 14,129 |
| Total income | 5,263 | 618 | 9,972 | 10,590 | 4,212 | (397) | – | 19,668 |
| Insurance claims | – | (200) | (8,369) | (8,569) | – | – | – | (8,569) |
| Total income, net of insurance claims | 5,263 | 418 | 1,603 | 2,021 | 4,212 | (397) | – | 11,099 |
| Operating expenses | (2,476) | (157) | (481) | (638) | (2,264) | 116 | – | (5,262) |
| Trading surplus (deficit) | 2,787 | 261 | 1,122 | 1,383 | 1,948 | (281) | – | 5,837 |
| Impairment losses on loans and advances | (1,238) | – | – | – | (308) | (9) | – | (1,555) |
| Profit (loss) before tax | 1,549 | 261 | 1,122 | 1,383 | 1,640 | (290) | – | 4,282 |
| External revenue | 8,136 | 1,249 | 10,888 | 12,137 | 8,867 | 154 | – | 29,294 |
| Inter-segment revenue | 698 | 19 | 199 | 218 | 2,276 | 910 | (4,102) | – |
| Segment revenue | 8,834 | 1,268 | 11,087 | 12,355 | 11,143 | 1,064 | (4,102) | 29,294 |
| External assets | 108,381 | 1,115 | 84,959 | 86,074 | 147,836 | 3,373 | – | 345,664 |
| Inter-segment assets | 3,331 | 502 | 4,050 | 4,552 | 80,995 | 53,588 | (142,466) | – |
| Total assets | 111,712 | 1,617 | 89,009 | 90,626 | 228,831 | 56,961 | (142,466) | 345,664 |
| External liabilities | 87,327 | 875 | 77,633 | 78,508 | 150,779 | 16,574 | – | 333,188 |
| Inter-segment liabilities | 20,980 | 54 | 5,595 | 5,649 | 72,793 | 43,044 | (142,466) | – |
| Total liabilities | 108,307 | 929 | 83,228 | 84,157 | 223,572 | 59,618 | (142,466) | 333,188 |
| Other segment items: | | | | | | | | |
| Capital expenditure | 82 | 7 | 845 | 852 | 647 | 143 | – | 1,724 |
| Depreciation and amortisation | 202 | 9 | 29 | 38 | 379 | – | – | 619 |
| Defined benefit scheme charges | 121 | 4 | 24 | 28 | 100 | (140) | – | 109 |

Notes to the accounts

3 Segmental analysis (continued)

| | UK Retail Banking £m | General insurance £m | Life, pensions and asset management £m | Insurance and Investments £m | Wholesale and International Banking £m | Central group items £m | Inter-segment eliminations £m | Total £m |
|--|----------------------------|----------------------------|---|---------------------------------------|--|------------------------------|-------------------------------------|-------------|
| Year ended 31 December 2005 | | | | | | | | |
| Interest and similar income | 6,652 | 27 | 850 | 877 | 6,944 | 1,094 | (2,975) | 12,592 |
| Interest and similar expense | (3,131) | (4) | (478) | (482) | (4,679) | (1,603) | 2,975 | (6,920) |
| Net interest income | 3,521 | 23 | 372 | 395 | 2,265 | (509) | – | 5,672 |
| Other income (net of fee and commission expense) | 1,605 | 571 | 13,288 | 13,859 | 1,628 | (39) | – | 17,053 |
| Total income | 5,126 | 594 | 13,660 | 14,254 | 3,893 | (548) | – | 22,725 |
| Insurance claims | – | (197) | (11,989) | (12,186) | – | – | – | (12,186) |
| Total income, net of insurance claims | 5,126 | 397 | 1,671 | 2,068 | 3,893 | (548) | – | 10,539 |
| Operating expenses | (2,697) | (160) | (434) | (594) | (2,181) | 36 | – | (5,436) |
| Trading surplus (deficit) | 2,429 | 237 | 1,237 | 1,474 | 1,712 | (512) | – | 5,103 |
| Impairment losses on loans and advances | (1,111) | – | – | – | (188) | – | – | (1,299) |
| Profit (loss) on sale and closure of businesses | 76 | – | – | – | (6) | (20) | – | 50 |
| Profit (loss) before tax | 1,394 | 237 | 1,237 | 1,474 | 1,518 | (532) | – | 3,854 |
| External revenue | 7,833 | 1,272 | 14,127 | 15,399 | 7,283 | (28) | – | 30,487 |
| Inter-segment revenue | 744 | 16 | 330 | 346 | 1,686 | 1,175 | (3,951) | – |
| Segment revenue | 8,577 | 1,288 | 14,457 | 15,745 | 8,969 | 1,147 | (3,951) | 30,487 |
| External assets | 103,930 | 968 | 79,180 | 80,148 | 124,044 | 3,499 | – | 311,621 |
| Inter-segment assets | 2,146 | 593 | 3,893 | 4,486 | 81,728 | 50,855 | (139,215) | – |
| Total assets | 106,076 | 1,561 | 83,073 | 84,634 | 205,772 | 54,354 | (139,215) | 311,621 |
| External liabilities | 72,335 | 829 | 71,894 | 72,723 | 141,878 | 13,065 | – | 300,001 |
| Inter-segment liabilities | 30,492 | 280 | 5,133 | 5,413 | 59,224 | 44,086 | (139,215) | – |
| Total liabilities | 102,827 | 1,109 | 77,027 | 78,136 | 201,102 | 57,151 | (139,215) | 300,001 |
| Other segment items: | | | | | | | | |
| Capital expenditure | 77 | 13 | 844 | 857 | 702 | 207 | – | 1,843 |
| Depreciation and amortisation | 219 | 11 | 26 | 37 | 383 | – | – | 639 |
| Customer remediation provision | 150 | – | – | – | – | – | – | 150 |
| Defined benefit scheme charges | 134 | 4 | 22 | 26 | 84 | 15 | – | 259 |

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

Notes to the accounts

| 4 Net interest income | Weighted average effective interest rate | | 2006 £m | 2005 £m |
|--|--|-----------|------------|------------|
| | 2006 % | 2005 % | | |
| Interest receivable: | | | | |
| Available-for-sale financial assets | 4.39 | 3.58 | 807 | 508 |
| Loans and advances to customers | 6.24 | 6.40 | 10,912 | 10,098 |
| Loans and advances to banks | 4.72 | 3.59 | 1,826 | 1,199 |
| Lease and hire purchase receivables | 7.42 | 7.07 | 774 | 787 |
| | 5.91 | 5.82 | 14,319 | 12,592 |
| Interest payable: | | | | |
| Deposits from banks | 4.67 | 3.44 | (1,680) | (953) |
| Customer accounts | 2.91 | 2.81 | (3,756) | (3,389) |
| Debt securities in issue | 4.67 | 4.23 | (1,983) | (1,307) |
| Subordinated liabilities | 5.56 | 5.29 | (677) | (615) |
| Liabilities under sale and repurchase agreements | 4.35 | 4.53 | (260) | (394) |
| Other | 9.68 | 7.24 | (424) | (262) |
| | 3.82 | 3.41 | (8,780) | (6,920) |
| Net interest income | | | 5,539 | 5,672 |

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

| 5 Net fee and commission income | 2006 £m | 2005 £m |
|---------------------------------|------------|------------|
| Fee and commission income: | | |
| Current accounts | 652 | 593 |
| Insurance broking | 629 | 681 |
| Credit and debit card fees | 493 | 545 |
| Other | 1,345 | 1,174 |
| | 3,119 | 2,993 |
| Fee and commission expense: | | |
| Credit and debit card fees | (138) | (182) |
| Dealer commissions | (217) | (247) |
| Other | (491) | (413) |
| | (846) | (842) |
| Net fee and commission income | 2,273 | 2,151 |

| 6 Net trading income | 2006 £m | 2005 £m |
|--|------------|------------|
| Foreign exchange translation gains | 32 | 16 |
| Gains on foreign exchange trading transactions | 98 | 150 |
| Total foreign exchange | 130 | 166 |
| Investment property gains (note 20) | 631 | 430 |
| Securities and other gains | 5,570 | 8,697 |
| | 6,331 | 9,293 |

Included within securities and other gains are net gains of £5,259 million (2005: £8,543 million) arising on assets held at fair value through profit or loss and net gains of £21 million (2005: £nil) arising on liabilities held at fair value through profit or loss.

| 7 Insurance premium income | 2006 £m | 2005 £m |
|----------------------------|------------|------------|
| Life insurance | | |
| Gross premiums | 4,308 | 3,996 |
| Ceded reinsurance premiums | (189) | (89) |
| Net earned premiums | 4,119 | 3,907 |

| | | |
|---|-------|-------|
| Non-life insurance | | |
| Gross premiums written | 608 | 575 |
| Ceded reinsurance premiums | (17) | (22) |
| Net premiums | 591 | 553 |
| Change in provision for unearned premiums | 9 | 9 |
| Net earned premiums | 600 | 562 |
| Total net earned premiums | 4,719 | 4,469 |

Life insurance gross written premiums can be further analysed as follows:

| | 2006 £m | 2005 £m |
|----------------|------------|------------|
| Life | 1,831 | 1,286 |
| Pensions | 1,780 | 2,136 |
| Annuities | 681 | 547 |
| Other | 16 | 27 |
| Gross premiums | 4,308 | 3,996 |

Non-life insurance gross written premiums can be further analysed as follows:

| | 2006 £m | 2005 £m |
|-------------------|------------|------------|
| Credit protection | 203 | 173 |
| Home | 394 | 390 |
| Health | 11 | 12 |
| | 608 | 575 |

Notes to the accounts

| 8 Other operating income | 2006 | 2005 | 10 Operating expenses | 2006 | 2005 |
|--|-------------|--------------|---|--------------|--------------|
| | £m | £m | | £m | £m |
| Operating lease rental income | 422 | 433 | Salaries | 2,117 | 2,068 |
| Rental income from investment property | 313 | 272 | Social security costs | 161 | 154 |
| Other rents receivable | 28 | 30 | Pensions and other post-retirement benefit schemes (note 35) | 165 | 308 |
| Gains less losses on disposal of available-for-sale financial assets | 22 | 5 | Other staff costs | 298 | 325 |
| Movement in value of in-force business (note 22) | (199) | 162 | Staff costs | 2,741 | 2,855 |
| Other income | 220 | 238 | Other administrative expenses: | | |
| | 806 | 1,140 | Operating lease rentals | 254 | 252 |
| | | | Repairs and maintenance | 165 | 136 |
| | | | Communications and data processing | 499 | 467 |
| | | | Advertising | 184 | 207 |
| | | | Professional fees | 230 | 216 |
| | | | Provisions for customer remediation (note 37) | - | 150 |
| | | | Other | 570 | 508 |
| | | | | 1,902 | 1,936 |
| | | | Depreciation of tangible fixed assets (note 24) | 602 | 621 |
| | | | Amortisation of other intangible assets (note 23) | 17 | 18 |
| | | | Impairment charges: | | |
| | | | Goodwill (note 21) | - | 6 |
| | | | Total operating expenses | 5,262 | 5,436 |
| | | | | | |
| | | | The average number of persons on a headcount basis employed by the Group during the year was 76,092 (2005: 79,594) of which 74,079 (2005: 77,620) were employed in the UK and 2,013 (2005: 1,974) overseas. | | |
| | | | <i>Fees payable to the Bank's auditors</i> | | |
| | | | During the year the auditors earned the following fees: | | |
| | | | | 2006 | 2005 |
| | | | | £m | £m |
| | | | Fees payable for the audit of the Bank's annual report | 5.9 | 6.2 |
| | | | Fees payable for other services: | | |
| | | | Audit of the Bank's subsidiaries pursuant to legislation | 2.3 | 1.7 |
| | | | Additional fees in respect of the previous year's audit of subsidiaries | 0.6 | - |
| | | | Other services supplied pursuant to legislation | 4.7 | 0.8 |
| | | | Other services relating to taxation | 0.6 | 0.6 |
| | | | Services relating to corporate finance transactions | 1.0 | 0.3 |
| | | | All other services | 1.8 | 2.1 |
| | | | Total fees payable to the Bank's auditors | 16.9 | 11.7 |
| | | | | | |
| | | | During the year the auditors also earned fees payable by entities outside the consolidated Lloyds TSB Bank Group in respect of the following: | | |
| | | | | 2006 | 2005 |
| | | | | £m | £m |
| | | | Audits of the Group pension schemes | 0.2 | 0.1 |
| | | | Audits of unconsolidated Open Ended Investment Companies managed by the Group | 0.4 | 0.2 |
| | | | Reviews of the financial position of corporate and other borrowers | 1.6 | 1.2 |
| | | | Acquisition due diligence and other work performed in respect of potential venture capital investments | 1.0 | 0.6 |

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

Notes to the accounts

| 11 Impairment losses on loans and advances | 2006 | 2005 |
|---|--------------|-------|
| | £m | £m |
| Impairment losses on loans and advances (note 18) | 1,560 | 1,302 |
| Other credit risk provisions (note 37) | (5) | (3) |
| | 1,555 | 1,299 |

12 Profit on sale and closure of businesses

During 2005, a net profit of £74 million arose on disposal of businesses, principally the Goldfish credit card business. This profit was partly offset by an adjustment to consideration received in respect of an earlier disposal and a provision for costs in respect of the closure of businesses, which together totalled £24 million. The businesses sold in 2005 were not material to the Group, and consequently they have not been treated as discontinued operations.

| 13 Taxation | 2006 | 2005 |
|--|--------------|-------|
| | £m | £m |
| a Analysis of charge for the year | | |
| UK corporation tax: | | |
| Current tax on profit for the year | 1,006 | 868 |
| Adjustments in respect of prior years | (155) | (4) |
| | 851 | 864 |
| Double taxation relief | (195) | (138) |
| | 656 | 726 |
| Foreign tax: | | |
| Current tax on profit for the year | 83 | 78 |
| Adjustments in respect of prior years | (8) | (8) |
| | 75 | 70 |
| Current tax charge | 731 | 796 |
| Deferred tax (note 36) | 531 | 492 |
| | 1,262 | 1,288 |

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2005: 30 per cent).

The Group, as a proxy for policyholders in the UK, is required to record taxes on investment income and gains each year. Accordingly, the tax attributable to UK life insurance policyholder earnings is included in income tax expense. The tax expense attributable to policyholder earnings was £222 million (2005: tax expense of £298 million), including a prior year tax charge of £12 million (2005: tax credit of £25 million).

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

b Factors affecting the tax charge for the year

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

| | 2006 | 2005 |
|--|--------------|-------|
| | £m | £m |
| Profit before tax | 4,282 | 3,854 |
| Tax charge thereon at UK corporation tax rate of 30% | 1,285 | 1,156 |
| Factors affecting charge: | | |
| Disallowed and non-taxable items | (92) | (31) |
| Overseas tax rate differences | (2) | (1) |
| Net tax effect of disposals and unrealised gains | (78) | (59) |
| Policyholder interests and Open Ended Investment Companies | 139 | 223 |
| Other items | 10 | – |
| Tax on profit on ordinary activities | 1,262 | 1,288 |
| Effective rate | 29.5% | 33.4% |

The effective tax rate of the Group excluding gross policyholder and Open Ended Investment Company interests from profit before tax and the tax charge was 25.7 per cent (2005: 27.4 per cent).

Notes to the accounts

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

| The Group | 2006 | 2005 |
|---|---------------|--------|
| | £m | £m |
| Trading assets | 5,756 | 5,442 |
| Other financial assets at fair value through profit or loss | 62,172 | 55,125 |
| | 67,928 | 60,567 |

These assets are comprised as follows:

| | 2006 | | 2005 | |
|--|-------------------------|---|-------------------------|---|
| | Trading assets £m | Other financial assets at fair value through profit or loss £m | Trading assets £m | Other financial assets at fair value through profit or loss £m |
| Loans and advances to banks | 34 | 3 | 5 | 5 |
| Loans and advances to customers | 350 | 448 | 161 | 445 |
| Debt securities: | | | | |
| Government securities | 180 | 8,626 | 535 | 10,638 |
| Other public sector securities | – | 44 | 35 | 84 |
| Bank and building society certificates of deposit | – | 573 | – | 898 |
| Mortgage backed securities | 451 | 87 | 39 | 197 |
| Other asset backed securities | 595 | 861 | – | 691 |
| Corporate and other debt securities | 4,146 | 13,170 | 4,667 | 8,469 |
| | 5,372 | 23,361 | 5,276 | 20,977 |
| Equity shares: | | | | |
| Listed | – | 29,508 | – | 27,690 |
| Unlisted | – | 8,852 | – | 6,008 |
| | – | 38,360 | – | 33,698 |
| | 5,756 | 62,172 | 5,442 | 55,125 |

14 Trading and other financial assets at fair value through profit or loss
(continued)

| The Bank | 2006 | 2005 |
|---|--------------|-------|
| | £m | £m |
| Trading assets | 5,756 | 5,442 |
| Other financial assets at fair value through profit or loss | 3,063 | 482 |
| | 8,819 | 5,924 |

These assets are comprised as follows:

| | 2006 | | 2005 | |
|--|-------------------------|---|-------------------------|---|
| | Trading assets £m | Other financial assets at fair value through profit or loss £m | Trading assets £m | Other financial assets at fair value through profit or loss £m |
| Loans and advances to banks | 34 | 3 | 5 | 5 |
| Loans and advances to customers | 350 | 448 | 161 | 445 |
| Debt securities: | | | | |
| Government securities | 180 | 11 | 535 | – |
| Other public sector securities | – | – | 35 | – |
| Mortgage backed securities | 451 | 7 | 39 | – |
| Other asset backed securities | 595 | 435 | – | 32 |
| Corporate and other debt securities | 4,146 | 2,150 | 4,667 | – |
| | 5,372 | 2,603 | 5,276 | 32 |
| Equity shares: | | | | |
| Listed | – | – | – | – |
| Unlisted | – | 9 | – | – |
| | – | 9 | – | – |
| | 5,756 | 3,063 | 5,442 | 482 |

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

Notes to the accounts

15 Derivative financial instruments

The principal derivatives used by the Group and the Bank are interest rate and exchange rate contracts; particular attention is paid to the liquidity of the markets and products in which the Group and the Bank trade to ensure that there are no undue concentrations of activity and risk.

Interest rate related contracts include interest rate swaps, forward rate agreements and options. An interest rate swap is an agreement between two parties to exchange fixed and floating interest payments, based upon interest rates defined in the contract, without the exchange of the underlying principal amounts. Forward rate agreements are contracts for the payment of the difference between a specified rate of interest and a reference rate, applied to a notional principal amount at a specific date in the future. An interest rate option gives the buyer, on payment of a premium, the right, but not the obligation, to fix the rate of interest on a future loan or deposit, for a specified period and commencing on a specified future date.

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

Credit derivatives, principally credit default swaps, are used by the Group as part of its customer product activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. As discussed in note 17, during 2006 the Group used credit default swaps to synthetically securitise £961 million of its commercial banking loans (Bank: £939 million).

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

The principal amount of the contract does not represent the Group's and the Bank's real exposure to credit risk which is limited to the current cost of replacing contracts with a positive value to the Group or the Bank should the counterparty default. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate.

15 Derivative financial instruments (continued)

| | Contract/ notional amount £m | Fair values | |
|--|---------------------------------------|--------------|-------------------|
| | | Assets £m | Liabilities £m |
| The Group | | | |
| 31 December 2006 | | | |
| Trading | | | |
| Exchange rate contracts: | | | |
| Spot, forwards and futures | 116,255 | 794 | 1,432 |
| Currency swaps | 21,081 | 346 | 522 |
| Options purchased | 3,076 | 51 | – |
| Options written | 3,822 | – | 32 |
| | <u>144,234</u> | <u>1,191</u> | <u>1,986</u> |
| Interest rate contracts: | | | |
| Interest rate swaps | 333,617 | 2,980 | 3,237 |
| Forward rate agreements | 40,876 | 17 | 18 |
| Options purchased | 17,034 | 68 | – |
| Options written | 12,588 | – | 63 |
| Futures | 33,066 | – | 1 |
| | <u>437,181</u> | <u>3,065</u> | <u>3,319</u> |
| Credit derivatives | <u>13,212</u> | <u>25</u> | <u>39</u> |
| Equity and other contracts | <u>4,026</u> | <u>797</u> | <u>67</u> |
| Total derivative assets/liabilities held for trading | | <u>5,078</u> | <u>5,411</u> |
| Hedging | | | |
| Derivatives designated as fair value hedges: | | | |
| Cross currency interest rate swaps | 80 | 10 | – |
| Interest rate swaps (including swap options) | 37,298 | 333 | 453 |
| | <u>37,378</u> | <u>343</u> | <u>453</u> |
| Derivatives designated as cash flow hedges: | | | |
| Interest rate swaps | 569 | 5 | 13 |
| Derivatives designated as net investment hedges: | | | |
| Cross currency swaps | 2,589 | 139 | – |
| Total derivative assets/liabilities held for hedging | | <u>487</u> | <u>466</u> |
| Total recognised derivative assets/liabilities | | <u>5,565</u> | <u>5,877</u> |

Notes to the accounts

15 Derivative financial instruments (continued)

| | Contract/ notional amount £m | Fair values | |
|--|---------------------------------------|--------------|-------------------|
| | | Assets £m | Liabilities £m |
| The Group | | | |
| 31 December 2005 | | | |
| Trading | | | |
| Exchange rate contracts: | | | |
| Spot, forwards and futures | 145,591 | 1,515 | 1,345 |
| Currency swaps | 12,770 | 267 | 237 |
| Options purchased | 3,623 | 58 | – |
| Options written | 3,892 | – | 45 |
| | <u>165,876</u> | <u>1,840</u> | <u>1,627</u> |
| Interest rate contracts: | | | |
| Interest rate swaps | 289,640 | 2,814 | 4,015 |
| Forward rate agreements | 50,006 | 16 | 20 |
| Options purchased | 12,679 | 108 | – |
| Options written | 8,812 | – | 85 |
| Futures | 29,358 | – | – |
| | <u>390,495</u> | <u>2,938</u> | <u>4,120</u> |
| Credit derivatives | 562 | 3 | – |
| Equity and other contracts | 4,787 | 607 | 84 |
| Total derivative assets/liabilities held for trading | | <u>5,388</u> | <u>5,831</u> |
| Hedging | | | |
| Derivatives designated as fair value hedges: | | | |
| Cross currency interest rate swaps | 69 | 12 | – |
| Interest rate swaps (including swap options) | 39,499 | 473 | 730 |
| | <u>39,568</u> | <u>485</u> | <u>730</u> |
| Derivatives designated as cash flow hedges: | | | |
| Interest rate swaps | 648 | 5 | 23 |
| Total derivative assets/liabilities held for hedging | | <u>490</u> | <u>753</u> |
| Total recognised derivative assets/liabilities | | <u>5,878</u> | <u>6,584</u> |

15 Derivative financial instruments (continued)

| | Contract/ notional amount £m | Fair values | |
|--|---------------------------------------|--------------|-------------------|
| | | Assets £m | Liabilities £m |
| The Bank | | | |
| 31 December 2006 | | | |
| Trading | | | |
| Exchange rate contracts: | | | |
| Spot, forwards and futures | 119,409 | 822 | 1,437 |
| Currency swaps | 13,230 | 432 | 446 |
| Options purchased | 3,294 | 51 | – |
| Options written | 3,664 | – | 32 |
| | <u>139,597</u> | <u>1,305</u> | <u>1,915</u> |
| Interest rate contracts: | | | |
| Interest rate swaps | 348,065 | 3,094 | 3,228 |
| Forward rate agreements | 40,961 | 17 | 12 |
| Options purchased | 17,463 | 68 | – |
| Options written | 12,740 | – | 64 |
| Futures | 33,066 | – | – |
| | <u>452,295</u> | <u>3,179</u> | <u>3,304</u> |
| Credit derivatives | 13,212 | 25 | 39 |
| Equity and other contracts | 7,349 | 671 | 667 |
| Total derivative assets/liabilities held for trading | | <u>5,180</u> | <u>5,925</u> |
| Hedging | | | |
| Derivatives designated as fair value hedges: | | | |
| Cross currency interest rate swaps | 80 | 10 | – |
| Interest rate swaps (including swap options) | 36,618 | 331 | 467 |
| | <u>36,698</u> | <u>341</u> | <u>467</u> |
| Derivatives designated as cash flow hedges: | | | |
| Interest rate swaps | 569 | 5 | 13 |
| Derivatives designated as net investment hedges: | | | |
| Cross currency swaps | 2,589 | 139 | – |
| Total derivative assets/liabilities held for hedging | | <u>485</u> | <u>480</u> |
| Total recognised derivative assets/liabilities | | <u>5,665</u> | <u>6,405</u> |

Notes to the accounts

15 Derivative financial instruments (continued)

| | Contract/ notional amount £m | Fair values | |
|--|---------------------------------------|--------------|-------------------|
| | | Assets £m | Liabilities £m |
| The Bank | | | |
| 31 December 2005 | | | |
| Trading | | | |
| Exchange rate contracts: | | | |
| Spot, forwards and futures | 133,585 | 1,490 | 1,328 |
| Currency swaps | 13,799 | 356 | 244 |
| Options purchased | 3,949 | 58 | – |
| Options written | 3,898 | – | 45 |
| | <u>155,231</u> | <u>1,904</u> | <u>1,617</u> |
| Interest rate contracts: | | | |
| Interest rate swaps | 300,842 | 3,103 | 4,260 |
| Forward rate agreements | 50,041 | 16 | 20 |
| Options purchased | 12,769 | 108 | – |
| Options written | 9,260 | – | 92 |
| Futures | 29,358 | – | – |
| | <u>402,270</u> | <u>3,227</u> | <u>4,372</u> |
| Credit derivatives | 562 | 3 | – |
| Equity and other contracts | 7,171 | 496 | 496 |
| Total derivative assets/liabilities held for trading | | <u>5,630</u> | <u>6,485</u> |
| Hedging | | | |
| Derivatives designated as fair value hedges: | | | |
| Cross currency interest rate swaps | 69 | 12 | – |
| Interest rate swaps (including swap options) | 36,251 | 403 | 704 |
| | <u>36,320</u> | <u>415</u> | <u>704</u> |
| Derivatives designated as cash flow hedges: | | | |
| Interest rate swaps | 648 | 5 | 23 |
| Total derivative assets/liabilities held for hedging | | <u>420</u> | <u>727</u> |
| Total recognised derivative assets/liabilities | | <u>6,050</u> | <u>7,212</u> |

16 Loans and advances to banks

| | The Group | | The Bank | |
|---|----------------------|---------------|----------------------|---------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Lending to banks | 5,966 | 2,510 | 62,562 | 66,954 |
| Money market placements with banks | 34,673 | 29,146 | 24,027 | 19,137 |
| Total loans and advances to banks | 40,639 | 31,656 | 86,589 | 86,091 |
| Allowance for impairment losses (note 18) | (1) | (1) | (1) | (1) |
| | <u>40,638</u> | <u>31,655</u> | <u>86,588</u> | <u>86,090</u> |

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

17 Loans and advances to customers

| | The Group | | The Bank | |
|---|-----------------------|----------------|-----------------------|---------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Agriculture, forestry and fishing | 2,905 | 2,451 | 1,355 | 1,024 |
| Energy and water supply | 2,024 | 1,592 | 2,024 | 1,590 |
| Manufacturing | 7,513 | 7,923 | 6,135 | 6,624 |
| Construction | 2,332 | 2,222 | 2,040 | 1,901 |
| Transport, distribution and hotels | 10,490 | 9,465 | 9,131 | 8,385 |
| Postal and telecommunications | 831 | 546 | 775 | 508 |
| Property companies | 12,896 | 8,713 | 12,164 | 7,941 |
| Financial, business and other services | 22,999 | 21,260 | 16,240 | 15,631 |
| Personal: | | | | |
| Mortgages | 95,601 | 88,895 | 846 | 730 |
| Other | 23,025 | 23,280 | 19,038 | 19,225 |
| Lease financing | 4,802 | 5,815 | – | – |
| Hire purchase | 5,060 | 4,853 | 323 | 273 |
| Due from fellow Group undertakings | 1,850 | 1,692 | 38,205 | 29,645 |
| | <u>192,328</u> | <u>178,707</u> | <u>108,276</u> | <u>93,477</u> |
| Allowance for impairment losses (note 18) | (2,193) | (2,072) | (1,700) | (1,718) |
| | <u>190,135</u> | <u>176,635</u> | <u>106,576</u> | <u>91,759</u> |

The Group holds collateral with a fair value of £444 million (2005: £1,018 million) and the Bank £444 million (2005: £1,018 million), which it is permitted to sell or repledge, of which £238 million (2005: £741 million) for the Group and £238 million (2005: £741 million) for the Bank was repledged or sold to third parties for periods not exceeding three months from the transfer.

Of the Bank's amounts due from fellow Group undertakings at 31 December 2006, US\$5.5 billion has been pledged as security against a demand loan made to the Bank by another of its fellow Group undertakings.

Notes to the accounts

17 Loans and advances to customers (continued)

Loans and advances to customers include finance lease receivables, which may be analysed as follows:

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

The net investment in finance leases may be analysed as follows:

| | The Group | |
|--|--------------|------------|
| | 2006 £m | 2005 £m |
| Not later than 1 year | 234 | 648 |
| Later than 1 year and not later than 5 years | 1,232 | 1,610 |
| Later than 5 years | 3,336 | 3,557 |
| | 4,802 | 5,815 |

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

The unguaranteed residual values included in finance lease receivables were as follows:

| | The Group | |
|--|------------|------------|
| | 2006 £m | 2005 £m |
| Not later than 1 year | - | - |
| Later than 1 year and not later than 5 years | - | 31 |
| Later than 5 years | 168 | 245 |
| Total | 168 | 276 |

Securitisations

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

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

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

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

17 Loans and advances to customers (continued)

In addition the Group completed a £961 million synthetic securitisation of commercial banking loans during the year (£939 million by the Bank: 2005 £nil for both the Group and the Bank) utilising credit default swaps (CDSs). The CDSs are accounted for as derivatives and are included in derivative financial instruments (note 15).

18 Allowance for impairment losses on loans and advances

| The Group | 2006 | 2005 |
|--|--------------|---------|
| | £m | £m |
| At 1 January | 2,073 | 1,919 |
| Exchange and other adjustments | (13) | 1 |
| Reclassifications | - | 43 |
| Adjustments on disposal of businesses and portfolios | (27) | (27) |
| Advances written off | (1,489) | (1,236) |
| Recoveries of advances written off in previous years | 190 | 158 |
| Unwinding of discount | (100) | (87) |
| Charge to the income statement | 1,560 | 1,302 |
| At 31 December | 2,194 | 2,073 |
| In respect of: | | |
| Loans and advances to banks (note 16) | 1 | 1 |
| Loans and advances to customers (note 17) | 2,193 | 2,072 |
| | 2,194 | 2,073 |
| | 2006 | 2005 |
| | £m | £m |
| The Bank | | |
| 1 January | 1,719 | 1,645 |
| Exchange and other adjustments | (13) | (1) |
| Reclassifications | - | 43 |
| Adjustments on disposal of businesses and portfolios | (27) | (27) |
| Advances written off | (1,303) | (1,054) |
| Recoveries of advances written off in previous years | 157 | 138 |
| Unwinding of discount | (100) | (87) |
| Charge to the income statement | 1,268 | 1,062 |
| At 31 December | 1,701 | 1,719 |
| In respect of: | | |
| Loans and advances to banks (note 16) | 1 | 1 |
| Loans and advances to customers (note 17) | 1,700 | 1,718 |
| | 1,701 | 1,719 |

Notes to the accounts

19 Available-for-sale financial assets

| | The Group | | The Bank | |
|---|---------------|---------------|--------------|--------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Debt securities: | | | | |
| Government securities | 393 | 1,083 | 6 | 348 |
| Other public sector securities | 189 | 47 | - | 47 |
| Bank and building society certificates of deposit | 1,615 | 1,470 | 1,611 | 1,470 |
| Mortgage backed securities | 5,662 | 4,161 | 1,604 | 1,610 |
| Other asset backed securities | 4,721 | 4,981 | 433 | 705 |
| Corporate and other debt securities | 4,817 | 3,065 | 220 | 194 |
| | 17,397 | 14,807 | 3,874 | 4,374 |
| Equity shares: | | | | |
| Listed | 1 | 34 | 1 | 34 |
| Unlisted | 14 | 12 | 14 | 12 |
| | 15 | 46 | 15 | 46 |
| Treasury bills and other bills: | | | | |
| Treasury bills and similar securities | 1,743 | 70 | 60 | 66 |
| Other bills | 23 | 17 | 23 | 17 |
| | 1,766 | 87 | 83 | 83 |
| | 19,178 | 14,940 | 3,972 | 4,503 |

The movement in available-for-sale financial assets is summarised as follows:

| The Group | Carrying | Provisions | Balance |
|--|-------------------------------|------------|-------------------|
| | value before provisions £m | | sheet value £m |
| At 1 January 2005 | 14,624 | (31) | 14,593 |
| Exchange and other adjustments | 559 | - | 559 |
| Additions | 10,108 | - | 10,108 |
| Disposals | (10,266) | - | (10,266) |
| Reclassifications | (31) | 31 | - |
| Amortisation of premiums and discounts | (65) | - | (65) |
| Changes in fair value (note 41) | 11 | - | 11 |
| At 31 December 2005 | 14,940 | - | 14,940 |
| Exchange and other adjustments | (1,116) | - | (1,116) |
| Additions | 23,448 | - | 23,448 |
| Disposals | (18,106) | - | (18,106) |
| Amortisation of premiums and discounts | 22 | - | 22 |
| Changes in fair value (note 41) | (10) | - | (10) |
| At 31 December 2006 | 19,178 | - | 19,178 |

19 Available-for-sale financial assets (continued)

| The Bank | Carrying | Provisions | Balance |
|--|-------------------------------|------------|-------------------|
| | value before provisions £m | | sheet value £m |
| At 1 January 2005 | 6,136 | (31) | 6,105 |
| Exchange and other adjustments | 134 | - | 134 |
| Additions | 8,210 | - | 8,210 |
| Disposals | (9,958) | - | (9,958) |
| Reclassifications | (31) | 31 | - |
| Amortisation of premiums and discounts | (1) | - | (1) |
| Changes in fair value (note 41) | 13 | - | 13 |
| At 31 December 2005 | 4,503 | - | 4,503 |
| Exchange and other adjustments | (88) | - | (88) |
| Additions | 9,917 | - | 9,917 |
| Disposals | (10,353) | - | (10,353) |
| Changes in fair value (note 41) | (7) | - | (7) |
| At 31 December 2006 | 3,972 | - | 3,972 |

During 2006, the Bank sold £621 million of debt securities to one of its subsidiary undertakings; however the related agreements are such that the Bank has retained substantially all of the risks and rewards of ownership and, as a consequence, the debt securities continue to be recognised on the Bank's balance sheet.

20 Investment property of the Group

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

The investment properties are valued at least annually at open-market value, by independent, professionally qualified valuers, who have recent experience in the location and categories of the investment properties being valued.

In addition the following amounts have been recognised in the income statement:

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

Capital expenditure in respect of investment properties:

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

Notes to the accounts

| 21 Goodwill | The Group | | The Bank | |
|-------------------------------|------------|------------|------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| At 1 January | 2,373 | 2,469 | 8 | 118 |
| Acquisitions (note 48) | 4 | 3 | – | – |
| Disposals | – | (93) | – | (110) |
| Impairment charge | – | (6) | – | – |
| At 31 December | 2,377 | 2,373 | 8 | 8 |
| Cost* | 2,383 | 2,379 | 8 | 8 |
| Accumulated impairment losses | (6) | (6) | – | – |
| | 2,377 | 2,373 | 8 | 8 |

*For acquisitions made prior to 1 January 2004, the date of transition to IFRS, cost is included net of amounts amortised up to 31 December 2003.

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,377 million (2005: £2,373 million), £1,836 million (or 77 per cent of the total) has been allocated to Scottish Widows and £521 million (or 22 per cent of the total) to Asset Finance.

The recoverable amount of Scottish Widows has been based on a value in use calculation. The calculation uses projections of future cash flows based upon budgets and plans approved by management covering a five-year period, and a discount rate of 11 per cent (gross of tax). The budgets and plans are based upon past experience adjusted to take into account anticipated changes in sales volumes, product mix and margins having regard to expected market conditions and competitor activity. The discount rate is determined with reference to internal measures and available industry information. Cash flows beyond the five-year period have been extrapolated using a steady 3 per cent growth rate which does not exceed the long-term average growth rate for the life assurance market. Management believes that any reasonably possible change in the key assumptions would not cause the recoverable amount of Scottish Widows to fall below its balance sheet carrying value.

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 10 per cent (gross of tax). Due to similarities in the risk profile and the funding model management believes that Asset Finance is closely aligned to Lloyds TSB Group; the discount rate represents the Lloyds TSB Group's weighted average cost of capital. The cash flows for each of the businesses of Asset Finance beyond the five-year period are extrapolated using steady growth rates, in each case not exceeding 4 per cent nor the long-term average growth rates for the markets in which the respective businesses of Asset Finance participate. Management also believes that any reasonably possible change in the key assumptions on which the recoverable amount of Asset Finance is based would not cause the carrying amount of Asset Finance to exceed its recoverable amount.

22 Value of in-force business of the Group

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

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

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

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

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

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

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

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

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

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

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22 Value of in-force business of the Group (continued)

The table below shows the range of resulting yields and other key assumptions at 31 December 2006:

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

- *Non-market risk.* An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the with-profits fund there are asymmetries in the range of potential outcomes for which an explicit allowance is made.
- *Non-economic assumptions.* Future, mortality, morbidity, lapse and paid-up rate assumptions are based on an analysis of past experience and represent management's best estimate of likely future experience.

Regulatory capital position of the Group's life assurance businesses**Basis of determining regulatory capital of the life assurance businesses***Available capital resources*

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

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

'Realistic' basis. The FSA requires each life assurance company which contains a with-profits fund in excess of £500 million, including Scottish Widows plc ('Scottish Widows'), to carry out a 'realistic' valuation of that fund. The word 'realistic' in this context reflects the terminology used for reporting to the FSA and is an assessment of the financial position of a with-profits fund calculated under a prescribed methodology.

The valuation of with-profits assets in a with-profits fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in a with-profits fund (a relatively small amount of business in the case of Scottish Widows), it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

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

22 Value of in-force business of the Group (continued)*Regulatory capital requirements*

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

For Scottish Widows, no amount is required to cover the impact of stress tests on the actuarial reserves. However, a further test is required in respect of the With Profit Fund which compares the level of 'realistic excess capital' to the 'statutory excess capital' of the With Profit Fund. In circumstances where the 'realistic excess capital' position is less than 'statutory excess capital', the Company is required to hold additional capital to cover the shortfall but only to the extent it exceeds the value, calculated in a prescribed way, of internal transfers from the With Profit Fund. Any additional capital requirement under this test is referred to as the With Profit Insurance Capital Component. The 'realistic excess capital' is calculated as the difference between realistic assets and realistic liabilities of the With Profit Fund with a further deduction to cover various stress tests.

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

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22 Value of in-force business of the Group (continued)*Capital statement*

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

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

The figures shown above for available capital resources within the insurance business relate to Scottish Widows plc only. The amounts relating to the other life assurance subsidiaries within the Group are not significant.

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

| | With Profit Fund £m | Non- Partici- pating Fund £m | Total Long Term Fund £m | Share- holders' funds £m | Total £m |
|---|------------------------------|--|-------------------------------------|-----------------------------------|--------------|
| As at 31 December 2005 | | | | | |
| Assets attributable to the shareholder held outside the long-term funds | – | – | – | 1,513 | 1,513 |
| Assets attributable to the shareholder held within the long-term funds | – | 2,619 | 2,619 | – | 2,619 |
| Total shareholders' funds | – | 2,619 | 2,619 | 1,513 | 4,132 |
| Adjustments onto a regulatory basis: | | | | | |
| Life assurance business | | | | | |
| Unallocated surplus within insurance business | 494 | – | 494 | – | 494 |
| Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities | – | (456) | (456) | (767) | (1,223) |
| Adjustment to include estimated 'realistic' liabilities payable to the shareholder | (729) | – | (729) | – | (729) |
| Adjustment to replace 'realistic' liabilities with statutory liabilities | 2,580 | – | 2,580 | – | 2,580 |
| Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With Profit Fund | (43) | – | (43) | – | (43) |
| Recognition of future profits for regulatory capital purposes | – | 500 | 500 | – | 500 |
| Qualifying loan capital | – | – | – | 561 | 561 |
| Available capital resources | <u>2,302</u> | <u>2,663</u> | <u>4,965</u> | <u>1,307</u> | <u>6,272</u> |

Notes to the accounts

22 Value of in-force business of the Group (continued)*Formal intra-group capital arrangements*

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

Constraints over available capital resources

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

Requirement to maintain a Support Account. The Scheme requires the maintenance of a 'Support Account' within the Non-Participating Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Participating Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account in assessing the realistic value of assets available to the With Profit Fund. At 31 December 2006, the estimated value of surplus admissible assets in the Non-Participating Fund was £2,208 million (31 December 2005: £2,163 million) and the estimated value of the Support Account was £964 million (31 December 2005: £1,115 million).

Further Support Account. The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Participating Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Participating Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2006, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £4,219 million (31 December 2005: £4,140 million) and the estimated combined value of the Support Account and Further Support Account was £2,869 million (31 December 2005: £2,836 million).

Other restrictions in the Non-Participating Fund. In addition to the policies which existed at the date of demutualisation, the With Profit Fund includes policies which have been written since that date. As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2006 is £210 million (31 December 2005: £267 million). Scottish Widows has obtained from the FSA permission to include the value of this support in assessing the realistic value of assets available to the With Profit Fund. There is a further test requiring that no amounts can be transferred from the Non-Participating Fund of Scottish Widows unless there are sufficient assets within the Long Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

22 Value of in-force business of the Group (continued)*Movements in regulatory capital*

The movements in Scottish Widows plc's available capital resources can be analysed as follows:

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

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

With Profit Fund

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

Non-Participating Fund

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

Shareholder Fund

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

Notes to the accounts

22 Value of in-force business of the Group (continued)**Financial information calculated on a 'realistic' basis**

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

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

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

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

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

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

22 Value of in-force business of the Group (continued)

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

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

| | Scottish Widows plc With Profit Fund (in accordance with FRS 27) | | |
|---|--|-----------------------------|---------------------------|
| | £m | Other long-term funds £m | Total life business £m |
| At 31 December 2006 | 17,984 | 116 | 18,100 |
| With Profit Fund liabilities | 17,984 | 116 | 18,100 |
| Unit-linked business (excluding that accounted for as investment contracts) | – | 12,734 | 12,734 |
| Other life assurance business | – | 10,181 | 10,181 |
| Insurance and participating investment contract liabilities | 17,984 | 23,031 | 41,015 |
| Non-participating investment contract liabilities | – | 24,370 | 24,370 |
| Total policyholder liabilities | 17,984 | 47,401 | 65,385 |

| | Scottish Widows plc With Profit Fund (in accordance with FRS 27) | | |
|---|--|-----------------------------|---------------------------|
| | £m | Other long-term funds £m | Total life business £m |
| At 31 December 2005 | 18,854 | 133 | 18,987 |
| With Profit Fund liabilities | 18,854 | 133 | 18,987 |
| Unit-linked business (excluding that accounted for as investment contracts) | – | 10,779 | 10,779 |
| Other life assurance business | – | 10,324 | 10,324 |
| Insurance and participating investment contract liabilities | 18,854 | 21,236 | 40,090 |
| Non-participating investment contract liabilities | – | 21,839 | 21,839 |
| Total policyholder liabilities | 18,854 | 43,075 | 61,929 |

Capital sensitivities*Shareholders' funds*

Shareholders' funds outside the long-term business fund, other than those used to match regulatory requirements, are mainly invested in assets that are less sensitive to market conditions.

Notes to the accounts

22 Value of in-force business of the Group (continued)*With Profit Fund*

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

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

Other long-term funds

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

Assets held in excess of those backing actuarial reserves are invested across a range of investment categories including fixed interest securities, equities, properties and cash. The mix of investments is determined in line with the policy of Lloyds TSB Group to optimise shareholder risk and return. The value of the investments is sensitive to prevailing conditions in the markets selected.

Options and guarantees

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

Options and guarantees within the With Profit Fund

The most significant options and guarantees provided from within the With Profit Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies. For those policies written pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With Profit Fund of Scottish Widows called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2006 of £1.8 billion (2005: £1.7 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as persistency and mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

As noted above, under the realistic capital regime of the FSA, the liabilities of the With Profit Fund are valued using a market-consistent stochastic simulation model. This model is used in order to place a value on the options and guarantees which captures both their intrinsic value and their time value.

22 Value of in-force business of the Group (continued)

The most significant economic assumptions included in the model are:

- *Risk-free yield.* The risk-free yield is defined as 0.1 per cent higher than spot yields derived from the UK gilt yield curve;
- *Investment volatility.* This is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example as at 31 December 2006, the 10 year equity-implied at-the-money assumption was set at 20 per cent (31 December 2005: 20 per cent). The long-term at-the-money assumption for property was 15 per cent (31 December 2005: 15 per cent). The equivalent assumption for fixed rate interest stocks was 13 per cent (31 December 2005: 13.5 per cent).

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take-up rates and assumptions regarding persistency (both of which are based on recent actual experience and include an adjustment to reflect future uncertainties where the exercise of options by policyholders might increase liabilities), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

Options and guarantees outside the With Profit Fund of Scottish Widows

Abbey Life currently has a number of policies in force which have a guaranteed annuity option. In total it holds traditional regulatory reserves of £257 million to cover this liability at 31 December 2006 (£332 million at 31 December 2005). These reserves have been determined using prudent future interest rate, mortality rate and rate of annuity option take-up assumptions and exceed the value that would be placed on them using a market-consistent stochastic model. It is estimated that a 0.5 per cent reduction in future interest rates would increase the liability by some £27 million.

Under some of Abbey Life's older contracts, the maturity value or the surrender value at the end of the selected period is guaranteed to be not less than total premiums paid or sums assured. The total provision for these options was £4 million at 31 December 2006 (£5 million at 31 December 2005) and was established using stochastic techniques after making prudent assumptions.

In both Abbey Life and Scottish Widows, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £98 million (31 December 2005: £108 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £6 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £17 million.

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23 Other intangible assets

| | Customer lists £m | Software enhancements £m | Total £m |
|---|----------------------|-----------------------------|--------------------|
| The Group | | | |
| Cost: | | | |
| At 1 January 2005 | – | 107 | 107 |
| Additions | – | 40 | 40 |
| At 31 December 2005 | – | 147 | 147 |
| Additions | 54 | 51 | 105 |
| At 31 December 2006 | 54 | 198 | 252 |
| Accumulated amortisation: | | | |
| At 1 January 2005 | – | 79 | 79 |
| Charge for the year | – | 18 | 18 |
| At 31 December 2005 | – | 97 | 97 |
| Charge for the year | – | 17 | 17 |
| At 31 December 2006 | – | 114 | 114 |
| Balance sheet amount at 31 December 2006 | 54 | 84 | 138 |
| Balance sheet amount at 31 December 2005 | – | 50 | 50 |
| | | 2006 £m | 2005 £m |
| The Bank | | | |
| Software enhancements | | | |
| Cost: | | | |
| At 1 January | | 103 | 90 |
| Additions | | 24 | 13 |
| At 31 December | | 127 | 103 |
| Accumulated amortisation: | | | |
| At 1 January | | 80 | 69 |
| Charge for the year | | 10 | 11 |
| At 31 December | | 90 | 80 |
| Balance sheet amount at 31 December | | 37 | 23 |

Software enhancements of the Bank and the Group principally comprise identifiable and directly associated internal staff and other costs.

24 Tangible fixed assets

| | Premises £m | Equipment £m | Operating lease assets £m | Total tangible fixed assets £m |
|---|----------------|-----------------|------------------------------|-----------------------------------|
| The Group | | | | |
| Cost: | | | | |
| At 1 January 2005 | 1,360 | 2,526 | 2,767 | 6,653 |
| Exchange and other adjustments | 1 | (3) | 63 | 61 |
| Adjustments on acquisition and disposal of businesses | 8 | – | – | 8 |
| Additions | 89 | 280 | 615 | 984 |
| Disposals | (37) | (136) | (484) | (657) |
| At 31 December 2005 | 1,421 | 2,667 | 2,961 | 7,049 |
| Exchange and other adjustments | – | (3) | (96) | (99) |
| Additions | 92 | 286 | 552 | 930 |
| Disposals | (25) | (101) | (551) | (677) |
| At 31 December 2006 | 1,488 | 2,849 | 2,866 | 7,203 |
| Accumulated depreciation and impairment: | | | | |
| At 1 January 2005 | 533 | 1,627 | 313 | 2,473 |
| Exchange and other adjustments | 3 | (1) | 9 | 11 |
| Charge for the year | 76 | 267 | 278 | 621 |
| Disposals | (11) | (97) | (239) | (347) |
| At 31 December 2005 | 601 | 1,796 | 361 | 2,758 |
| Exchange and other adjustments | (1) | (1) | (63) | (65) |
| Charge for the year | 82 | 248 | 272 | 602 |
| Disposals | (7) | (83) | (254) | (344) |
| At 31 December 2006 | 675 | 1,960 | 316 | 2,951 |
| Balance sheet amount at 31 December 2006 | 813 | 889 | 2,550 | 4,252 |
| Balance sheet amount at 31 December 2005 | 820 | 871 | 2,600 | 4,291 |

Notes to the accounts

24 Tangible fixed assets (continued)

| | Premises £m | Equipment £m | Total tangible fixed assets £m |
|---|----------------|-----------------|--|
| The Bank | | | |
| Cost: | | | |
| At 1 January 2005 | 946 | 1,960 | 2,906 |
| Exchange and other adjustments | (6) | 1 | (5) |
| Additions | 78 | 246 | 324 |
| Disposals | (13) | (95) | (108) |
| At 31 December 2005 | 1,005 | 2,112 | 3,117 |
| Exchange and other adjustments | - | (3) | (3) |
| Additions | 82 | 262 | 344 |
| Disposals | (6) | (48) | (54) |
| At 31 December 2006 | 1,081 | 2,323 | 3,404 |
| Accumulated depreciation and impairment: | | | |
| At 1 January 2005 | 469 | 1,171 | 1,640 |
| Exchange and other adjustments | 2 | - | 2 |
| Charge for the year | 64 | 234 | 298 |
| Disposals | (6) | (60) | (66) |
| At 31 December 2005 | 529 | 1,345 | 1,874 |
| Exchange and other adjustments | (1) | (2) | (3) |
| Charge for the year | 70 | 215 | 285 |
| Disposals | (3) | (33) | (36) |
| At 31 December 2006 | 595 | 1,525 | 2,120 |
| Balance sheet amount at 31 December 2006 | 486 | 798 | 1,284 |
| Balance sheet amount at 31 December 2005 | 476 | 767 | 1,243 |

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

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

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

In addition, total future minimum sub-lease income of £120 million for the Group and £103 million for the Bank at 31 December 2006 (£141 million for the Group and £120 million for the Bank at 31 December 2005) is expected to be received under non-cancellable sub-leases of premises.

25 Investment in subsidiary undertakings

| | 2006 £m | 2005 £m |
|---|---------------|---------------|
| At 1 January | 16,078 | 16,174 |
| Additions | 8 | 4 |
| Additional capital injections and transfers | 2,444 | 250 |
| Capital repayments | (3) | (350) |
| At 31 December | 18,527 | 16,078 |

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 |
| Lloyds TSB Private Banking Limited | England | 100% | Private banking |
| The Agricultural Mortgage Corporation PLC | England | 100% | Long-term agricultural finance |
| Lloyds TSB Offshore Limited | Jersey | 100%* | Banking and financial services |
| Lloyds TSB Scotland plc | Scotland | 100% | Banking and financial services |
| Lloyds TSB General Insurance Limited | England | 100%* | General insurance |
| Scottish Widows Investment Partnership Group Limited | England | 100%* | Investment management |
| Abbey Life Assurance Company Limited | England | 100%* | Life assurance |
| Lloyds TSB Insurance Services Limited | England | 100%* | Insurance broking |
| Lloyds TSB Asset Finance Division Limited | England | 100% | Consumer credit, leasing and related services |
| Black Horse Limited | England | 100%* | Consumer credit, leasing and related services |
| Scottish Widows plc | Scotland | 100%* | Life assurance |
| Scottish Widows Annuities Limited | Scotland | 100%* | Life assurance |

*Indirect interest.

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

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

Notes to the accounts

26 Other assets

| | The Group | | The Bank | |
|--|--------------|--------------|--------------------|--------------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Assets arising from reinsurance contracts held | 451 | 548 | – | – |
| Deferred acquisition costs | 443 | 429 | – | – |
| Settlement balances | 285 | 336 | 55 | 156 |
| Other assets and prepayments | 3,483 | 4,271 | 1,911 | 2,731 |
| | 4,662 | 5,584 | 1,966 | 2,887 |
| | | | 2006 £m | 2005 £m |
| Deferred acquisition costs of the Group: | | | | |
| At 1 January | | | 429 | 293 |
| Acquisition costs deferred, net of amounts amortised to the income statement | | | 14 | 136 |
| At 31 December | | | 443 | 429 |

27 Deposits from banks

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

| | The Group | | The Bank | |
|----------------------|---------------|---------------|---------------|---------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Domestic: | | | | |
| Non-interest bearing | 89 | 105 | 89 | 577 |
| Interest bearing | 28,405 | 24,707 | 35,945 | 30,659 |
| | 28,494 | 24,812 | 36,034 | 31,236 |
| International: | | | | |
| Non-interest bearing | 31 | 24 | 31 | 24 |
| Interest bearing | 7,869 | 6,691 | 8,005 | 6,713 |
| | 7,900 | 6,715 | 8,036 | 6,737 |
| | 36,394 | 31,527 | 44,070 | 37,973 |

28 Customer accounts

| | The Group | | The Bank | |
|---------------------------------------|----------------|----------------|----------------|----------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Non-interest bearing current accounts | 4,338 | 4,203 | 4,103 | 3,942 |
| Interest bearing current accounts | 43,064 | 40,365 | 40,699 | 37,907 |
| Savings and investment accounts | 66,151 | 62,206 | 42,627 | 39,752 |
| Other customer deposits | 27,214 | 24,576 | 40,509 | 33,904 |
| | 140,767 | 131,350 | 127,938 | 115,505 |

28 Customer accounts (continued)

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

| | The Group | | The Bank | |
|----------------------|----------------|----------------|----------------|----------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Domestic: | | | | |
| Non-interest bearing | 4,069 | 3,868 | 4,183 | 3,607 |
| Interest bearing | 133,139 | 123,802 | 119,615 | 107,822 |
| | 137,208 | 127,670 | 123,798 | 111,429 |
| International: | | | | |
| Non-interest bearing | 336 | 335 | 337 | 335 |
| Interest bearing | 3,223 | 3,345 | 3,803 | 3,741 |
| | 3,559 | 3,680 | 4,140 | 4,076 |
| | 140,767 | 131,350 | 127,938 | 115,505 |

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

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

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

30 Debt securities in issue

| | 2006 £m | 2005 £m |
|-----------------------------------|---------------|---------------|
| The Group | | |
| Euro medium-term note programme | 5,650 | 6,683 |
| Other bonds and medium-term notes | 10,157 | 141 |
| Certificates of deposit issued | 25,244 | 22,101 |
| Commercial paper | 13,067 | 10,421 |
| Total debt securities in issue | 54,118 | 39,346 |
| The Bank | | |
| Euro medium-term note programme | 5,650 | 6,683 |
| Certificates of deposit issued | 24,729 | 21,629 |
| Commercial paper | 2,340 | 3,004 |
| Total debt securities in issue | 32,719 | 31,316 |

Debt securities in issue by the Group at 31 December 2006 included £10,048 million (2005: £nil) in respect of the securitisation of mortgages (see note 17).

Notes to the accounts

31 Liabilities of the Group arising from insurance contracts and participating investment contracts

| | 2006 £m | 2005 £m |
|---|---------------|---------------|
| Insurance contract liabilities | 26,507 | 26,616 |
| Participating investment contract liabilities | 15,095 | 14,068 |
| | 41,602 | 40,684 |

Insurance contract liabilities

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

| | 2006 | | | 2005 | | |
|---------------------|---------------|-------------------------|---------------|-------------|-------------------------|-----------|
| | Gross £m | Rein- surance* £m | Net £m | Gross £m | Rein- surance* £m | Net £m |
| Life insurance | 25,920 | (425) | 25,495 | 26,022 | (511) | 25,511 |
| Non-life insurance: | | | | | | |
| Unearned premiums | 438 | – | 438 | 447 | – | 447 |
| Claims outstanding | 149 | (4) | 145 | 147 | (4) | 143 |
| | 587 | (4) | 583 | 594 | (4) | 590 |
| | 26,507 | (429) | 26,078 | 26,616 | (515) | 26,101 |

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

Life insurance

The movement in life insurance contract liabilities over the year can be analysed as follows:

| | Gross £m | Rein- surance* £m | Net £m |
|------------------------------|---------------|-------------------------|---------------|
| At 1 January 2005 | 23,789 | (577) | 23,212 |
| New business | 1,381 | (256) | 1,125 |
| Changes in existing business | 852 | 322 | 1,174 |
| At 31 December 2005 | 26,022 | (511) | 25,511 |
| New business | 1,045 | (98) | 947 |
| Changes in existing business | (1,147) | 184 | (963) |
| At 31 December 2006 | 25,920 | (425) | 25,495 |

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

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

| | £m |
|------------------------------|---------------|
| At 1 January 2005 | 12,469 |
| New business | 1,181 |
| Changes in existing business | 418 |
| At 31 December 2005 | 14,068 |
| New business | 1,815 |
| Changes in existing business | (788) |
| At 31 December 2006 | 15,095 |

Process for determining key assumptions

The process for determining the key assumptions for insurance contracts and participating investment contracts is set out below.

Insurance policy liabilities can be split into With Profit Fund liabilities, accounted for using the FSA's realistic capital regime (realistic liabilities) and Non-Profit Fund liabilities, accounted for using a traditional prospective actuarial discounted cash flow methodology as described in the accounting policies.

31 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)**With Profit Fund realistic liabilities**

The Group's With Profit Fund contains life insurance contracts and participating investment contracts. The calculation of With Profit Fund realistic liabilities uses best estimate assumptions for mortality and morbidity, persistency rates and expenses. These are calculated in a similar manner to those used for the value of in-force business as discussed in note 22. The persistency rates used for the realistic valuation of the With Profit Fund liabilities make an allowance for potential changes in future experience as the guarantees and options within with-profits contracts become more valuable under adverse market conditions.

Other key assumptions are:

- *Investment returns and discount rates.* The realistic capital regime dictates that With Profit Fund liabilities are valued on a market-consistent basis. This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The With Profit Fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as 0.1 per cent higher than the spot yields derived from the UK gilt yield curve.
- *Guaranteed annuity option take-up rates.* The guaranteed annuity option take up rates are set with regard to the Group's actual experience and make allowance for potential increases in take-up rates when the Guaranteed Annuity Options become more valuable to the policyholder.
- *Investment volatility.* Investment volatility is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2006, the 10 year equity-implied at-the-money assumption was set at 20 per cent (31 December 2005: 20 per cent). The long-term at-the-money assumptions for property and fixed interest stocks were 15 per cent (31 December 2005: 15 per cent) and 13 per cent (31 December 2005: 13.5 per cent) respectively.

Non-Profit Fund liabilities

Generally, assumptions used to value Non-Profit Fund liabilities are prudent in nature and therefore contain a margin for adverse deviation. This margin for adverse deviation is based on management's judgement and reflects management's views on the inherent level of uncertainty. The key assumptions used in the measurement of Non-Profit Fund liabilities are:

- *Interest rates.* The rates used are derived in accordance with the FSA Rules. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.
- *Margins for risk.* Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the FSA Rules, including reductions made to the available yields to allow for default risk based upon the credit rating of each stock.
- *Mortality and morbidity.* The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation.
- *Lapse rates.* Lapse rates, set with regard to the Group's actual experience and with a margin for adverse deviation, are allowed for on some Non-Profit Fund contracts.
- *Maintenance expenses.* Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviation. Explicit allowance is made for future expense inflation.

Notes to the accounts

31 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)*Key changes in assumptions*

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

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

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

³Changes brought in by the FSA under PS06/14 have brought significant reductions to the reserves required to be held. There has been a large offsetting reduction in the value of in-force business, as explained in note 22.

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

Sensitivity analysis

The following table demonstrates the effect of changes in key assumptions on profit before tax disclosed in these financial statements assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. These amounts include movements in assets, liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts. The impact is shown in one direction but can be assumed to be reasonably symmetrical:

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

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

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

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

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

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

31 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)**Non-life insurance**

Non-life insurance contract liabilities are analysed by line of business as follows:

| | 2006 £m | 2005 £m |
|-------------------|------------|------------|
| Credit protection | 268 | 284 |
| Home | 314 | 304 |
| Health | 5 | 6 |
| | 587 | 594 |

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. There has been no significant change in the assumptions and methodologies used for setting reserves.

The reserving methodology and associated assumptions are set out below:

The unearned premium reserve is determined on a basis that reflects the length of time for which contracts have been in force and the projected incidence of risk over the term of each contract.

Claims outstanding comprise those claims that have been notified and those that have been incurred but not reported. Claims incurred but not reported are determined based on the historical emergence of claims and their average cost. The notified claims element represents the best estimate of the cost of claims reported using projections and estimates based on historical experience.

The movements in non-life insurance contract liabilities and reinsurance assets over the year have been as follows:

| | Gross £m | Rein- surance* £m | Net £m |
|---|--------------|-------------------------|--------------|
| <i>Provisions for unearned premiums</i> | | | |
| At 1 January 2005 | 456 | – | 456 |
| Increase in the year | 575 | – | 575 |
| Release in the year | (584) | – | (584) |
| At 31 December 2005 | 447 | – | 447 |
| Increase in the year | 608 | (17) | 591 |
| Release in the year | (617) | 17 | (600) |
| At 31 December 2006 | 438 | – | 438 |

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

These provisions represent the liability for short-term insurance contracts for which the Group's obligations are not expired at the year end.

Notes to the accounts

31 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)*Claims and loss adjustment expenses*

| | Gross £m | Rein- surance* £m | Net £m |
|--|-------------|-------------------------|------------|
| Notified claims | 117 | (4) | 113 |
| Incurred but not reported | 24 | – | 24 |
| At 1 January 2005 | 141 | (4) | 137 |
| Cash paid for claims settled in the year | (221) | – | (221) |
| Increase in liabilities: | | | |
| Arising from current year claims | 239 | – | 239 |
| Arising from prior year claims | (12) | – | (12) |
| At 31 December 2005 | 147 | (4) | 143 |
| Cash paid for claims settled in the year | (223) | – | (223) |
| Increase in liabilities: | | | |
| Arising from current year claims | 231 | – | 231 |
| Arising from prior year claims | (6) | – | (6) |
| At 31 December 2006 | 149 | (4) | 145 |
| Notified claims | 127 | (4) | 123 |
| Incurred but not reported | 22 | – | 22 |
| At 31 December 2006 | 149 | (4) | 145 |
| Notified claims | 120 | (4) | 116 |
| Incurred but not reported | 27 | – | 27 |
| At 31 December 2005 | 147 | (4) | 143 |

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

Non-life insurance claims development table

The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Group's estimate of total claims outstanding for each accident year has changed at successive year ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the balance sheet. The accident year basis is considered the most appropriate for the business written by the Group.

Non-life insurance all risks – gross

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

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

32 Liabilities of the Group arising from non-participating investment contracts

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

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

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

33 Unallocated surplus within insurance businesses for the Group

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

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

34 Other liabilities

| | The Group | | The Bank | |
|--------------------------------|---------------|--------------|--------------|--------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Settlement balances | 475 | 779 | 81 | 5 |
| Unitholders' interest in OEICs | 4,583 | 3,296 | – | – |
| Other creditors and accruals | 5,976 | 5,801 | 3,199 | 2,985 |
| | 11,034 | 9,876 | 3,280 | 2,990 |

35 Retirement benefit obligations

Charge to the Group income statement:

| | 2006 £m | 2005 £m |
|---------------------------------------|------------|------------|
| Defined benefit pension schemes* | 104 | 243 |
| Other post-retirement benefit schemes | 5 | 16 |
| Total defined benefit schemes | 109 | 259 |
| Defined contribution pension schemes | 56 | 49 |
| | 165 | 308 |

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

Notes to the accounts

35 Retirement benefit obligations (continued)

Amounts recognised in the balance sheet:

| | The Group | | The Bank | |
|---------------------------------------|--------------|------------|--------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Defined benefit pension schemes | 2,362 | 2,809 | 1,745 | 2,105 |
| Other post-retirement benefit schemes | 100 | 101 | 100 | 101 |
| | 2,462 | 2,910 | 1,845 | 2,206 |

For accounting purposes, the assets and liabilities of the Group's post-retirement benefit schemes are allocated between the participating employers, including the Bank, in proportion to the cash contributions made in to the schemes.

Pension schemes*Defined benefit schemes*

The Group has established a number of defined benefit pension schemes in the UK and overseas. The majority of the Group's and the Bank's employees are members of the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2. These schemes provide retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes is 50.

The latest full valuations of the schemes were carried out as at 30 June 2005; these have been updated to 31 December 2006 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2006 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The Group's and the Bank's obligations in respect of defined benefit schemes are funded. The Group expects to pay contributions of approximately £530 million (the Bank: £410 million) to its defined benefit schemes in 2007.

Amounts included in the balance sheet:

| | The Group | | The Bank | |
|---------------------------------------|-----------------|------------|-----------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Present value of funded obligations | 17,378 | 17,320 | 13,166 | 13,134 |
| Fair value of scheme assets | (15,279) | (14,026) | (11,579) | (10,619) |
| | 2,099 | 3,294 | 1,587 | 2,515 |
| Unrecognised actuarial gains (losses) | 263 | (485) | 158 | (410) |
| Liability in the balance sheet | 2,362 | 2,809 | 1,745 | 2,105 |

Movements in the defined benefit obligation:

| | The Group | | The Bank | |
|--------------------------------|---------------|------------|---------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| At 1 January | 17,320 | 14,866 | 13,134 | 11,282 |
| Current service cost | 325 | 292 | 236 | 209 |
| Interest cost | 817 | 775 | 623 | 586 |
| Actuarial (gains) losses | (434) | 1,786 | (324) | 1,372 |
| Benefits paid | (555) | (446) | (429) | (336) |
| Past service cost | 32 | 15 | 32 | 15 |
| Curtailment | (129) | - | (108) | - |
| Exchange and other adjustments | 2 | 32 | 2 | 6 |
| At 31 December | 17,378 | 17,320 | 13,166 | 13,134 |

35 Retirement benefit obligations (continued)

Changes in the fair value of scheme assets:

| | The Group | | The Bank | |
|--------------------------------|---------------|------------|---------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| At 1 January | 14,026 | 11,648 | 10,619 | 8,839 |
| Expected return | 942 | 839 | 717 | 635 |
| Employer contributions | 550 | 419 | 426 | 310 |
| Actuarial gains | 314 | 1,538 | 244 | 1,169 |
| Benefits paid | (555) | (446) | (429) | (336) |
| Exchange and other adjustments | 2 | 28 | 2 | 2 |
| At 31 December | 15,279 | 14,026 | 11,579 | 10,619 |
| Actual return on scheme assets | 1,256 | 2,377 | 961 | 1,804 |

Assumptions:

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

| | 2006 % | 2005 % |
|--|--------------|-----------|
| Discount rate | 5.10 | 4.80 |
| Rate of inflation | 2.90 | 2.70 |
| Rate of salary increases | 3.93 | 3.98 |
| Rate of increase for pensions in payment and deferred pensions | 2.70 | 2.50 |
| | Years | Years |
| Life expectancy for member aged 60, on the valuation date: | | |
| Men | 25.8 | 25.6 |
| Women | 27.8 | 27.6 |
| Life expectancy for member aged 60, 15 years after the valuation date: | | |
| Men | 27.0 | 26.8 |
| Women | 28.9 | 28.7 |

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

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

Notes to the accounts

35 Retirement benefit obligations (continued)

The expected return on scheme assets has been calculated using the following assumptions:

| | 2006 % | 2005 % |
|----------------------|-----------|-----------|
| Equities | 8.0 | 8.2 |
| Fixed interest gilts | 4.1 | 4.6 |
| Index linked gilts | 3.9 | 4.3 |
| Non-government bonds | 4.8 | 5.3 |
| Property | 6.4 | 6.9 |
| Cash | 3.7 | 3.6 |

The expected return on scheme assets in 2007 will be calculated using the following assumptions:

| | 2007 % |
|----------------------|-----------|
| Equities | 8.0 |
| Fixed interest gilts | 4.6 |
| Index linked gilts | 4.2 |
| Non-government bonds | 5.1 |
| Property | 6.5 |
| Cash | 3.9 |

Composition of scheme assets:

| | The Group | | The Bank | |
|----------------------|---------------|------------|---------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Equities | 9,677 | 9,021 | 7,376 | 6,830 |
| Fixed interest gilts | 1,114 | 946 | 845 | 716 |
| Index linked gilts | 921 | 920 | 679 | 697 |
| Non-government bonds | 1,543 | 1,415 | 1,148 | 1,071 |
| Property | 1,333 | 1,185 | 1,052 | 897 |
| Cash | 691 | 539 | 479 | 408 |
| At 31 December | 15,279 | 14,026 | 11,579 | 10,619 |

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

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

Experience adjustments history (since the date of adoption of IAS 19):

| | 2006 £m | 2005 £m | 2004 £m |
|---|--------------|------------|------------|
| The Group | | | |
| Present value of defined benefit obligation | 17,378 | 17,320 | 14,866 |
| Fair value of scheme assets | (15,279) | (14,026) | (11,648) |
| | 2,099 | 3,294 | 3,218 |
| Experience losses on scheme liabilities | (50) | (69) | (126) |
| Experience gains on scheme assets | 314 | 1,538 | 361 |

35 Retirement benefit obligations (continued)

| | 2006 £m | 2005 £m | 2004 £m |
|---|--------------|------------|------------|
| The Bank | | | |
| Present value of defined benefit obligation | 13,166 | 13,134 | 11,282 |
| Fair value of scheme assets | (11,579) | (10,619) | (8,839) |
| | 1,587 | 2,515 | 2,443 |
| Experience losses on scheme liabilities | (42) | (53) | (124) |
| Experience gains on scheme assets | 243 | 1,166 | 282 |

The expense recognised in the consolidated income statement for the year ended 31 December comprises:

| | 2006 £m | 2005 £m |
|---------------------------------------|------------|------------|
| Current service cost | 325 | 292 |
| Interest cost | 817 | 775 |
| Expected return on scheme assets | (942) | (839) |
| Curtailment* | (128) | - |
| Past service cost | 32 | 15 |
| Total defined benefit pension expense | 104 | 243 |

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

Defined contribution schemes

The Group operates a number of defined contribution pension schemes in the UK and overseas, principally the defined contribution sections of the Lloyds TSB Group Pension Schemes No's 1 and 2.

During the year ended 31 December 2006 the charge to the income statement in respect of these schemes was £56 million (2005: £49 million), representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

The Group operates a number of schemes which provide post-retirement healthcare benefits to certain employees, retired employees and their dependent relatives. The principal scheme relates to former Lloyds Bank staff and under this scheme the Group has undertaken to meet the cost of post-retirement healthcare for all eligible former employees (and their dependents) who retired prior to 1 January 1996. The Group has entered into an insurance contract to provide these benefits and a provision has been made for the estimated cost of future insurance premiums payable.

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000; this valuation has been updated to 31 December 2006 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 7.02 per cent (2005: 6.81 per cent).

Notes to the accounts

| 37 Other provisions | Provisions for contingent liabilities and commit- ments £m | Customer remediation provisions £m | Vacant leasehold property and other £m | Total £m |
|--------------------------------|---|---|--|--------------|
| The Group | | | | |
| At 1 January 2006 | 33 | 194 | 141 | 368 |
| Exchange and other adjustments | – | – | 3 | 3 |
| Provisions applied | (1) | (93) | (22) | (116) |
| Amortisation of discount | – | – | 4 | 4 |
| Charge (release) for the year | (5) | – | 5 | – |
| At 31 December 2006 | 27 | 101 | 131 | 259 |
| The Bank | | | | |
| At 1 January 2006 | 33 | 165 | 100 | 298 |
| Exchange and other adjustments | – | – | (2) | (2) |
| Provisions applied | (1) | (76) | (17) | (94) |
| Amortisation of discount | – | – | 2 | 2 |
| Charge (release) for the year | (5) | (8) | 5 | (8) |
| At 31 December 2006 | 27 | 81 | 88 | 196 |

Provisions for contingent liabilities and commitments

Provisions are held in cases where the Group is irrevocably committed to provide additional funds, but where there is doubt as to the potential borrower's ability to meet its repayment obligations.

Customer remediation provisions

The Group has established provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes have been found to be deficient. During 2006 management have reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and are satisfied that no additional charge is required for the Group (in 2005 charges of £150 million for the Group and £147 million for the Bank were made).

At 31 December 2006 the provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester and underwritten by life assurance companies within the Group and also by third parties. The principal assumptions that are made in the assessment of the adequacy of the provision relate to the number of cases that are likely to require redress taking into account any time barring, and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the remaining expenditure will be incurred over the next year.

37 Other provisions (continued)*Vacant leasehold property and other*

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

The Group also carries provisions in respect of its obligations relating to UIC Insurance Company Limited ('UIC'), which is in provisional liquidation. The Group has indemnified a third party against losses in the event that UIC does not honour its obligations under a reinsurance contract, which is subject to asbestosis and pollution claims in the US. The ultimate cost of settling the Group's exposure in respect of the insurance business of UIC and the timing remains uncertain. The provision held represents management's current best estimate of the cost after having regard to the financial condition of UIC and actuarial estimates of future claims.

Notes to the accounts

38 Subordinated liabilities

| The Group | Note | 2006 £m | 2005 £m |
|---|-------|---------------|------------|
| Preferred securities | | | |
| 6.90% Perpetual Capital Securities callable 2007 (US\$1,000 million) | a,d | 483 | 553 |
| 6% Non-cumulative Redeemable Preference Shares | l | – | – |
| 6.625% Perpetual Capital Securities callable 2006 (€750 million) | a,c | – | 518 |
| Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million) | a,j | 312 | 337 |
| 6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million) | a,c,h | 345 | 371 |
| Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million) | a,k | 248 | 248 |
| 4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million) | a,c,h | 478 | 522 |
| | | 1,866 | 2,549 |
| Undated subordinated liabilities | | | |
| Primary Capital Undated Floating Rate Notes: | a,b | | |
| Series 1 (US\$750 million) | | 383 | 436 |
| Series 2 (US\$500 million) | | 255 | 291 |
| Series 3 (US\$600 million) | | 306 | 349 |
| 11 ³ / ₄ % Perpetual Subordinated Bonds (£100 million) | | 100 | 100 |
| 5 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2009 (€1,250 million) | a,h | 845 | 892 |
| Undated Step-up Floating Rate Notes callable 2009 (€150 million) | a,b | 101 | 103 |
| 6 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2010 (£410 million) | a,g | 408 | 407 |
| 5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million) | a,e | 525 | 553 |
| 5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion) | a,i | 107 | 127 |
| 5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million) | | 475 | 501 |
| 6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2019 (£270 million) | a,g | 255 | 269 |
| 8% Undated Subordinated Step-up Notes callable 2023 (£200 million) | a,g | 189 | 202 |
| 6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2029 (£450 million) | a,g | 447 | 457 |
| 6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million) | a,g | 470 | 500 |
| | | 4,866 | 5,187 |
| Dated subordinated liabilities | | | |
| 7 ³ / ₄ % Subordinated Bonds 2007 (£300 million) | | 300 | 300 |
| 5 ¹ / ₄ % Subordinated Notes 2008 (DM 750 million) | | 260 | 274 |
| 10 ⁵ / ₈ % Guaranteed Subordinated Loan Stock 2008 (£100 million) | f | 104 | 106 |
| 9 ¹ / ₂ % Subordinated Bonds 2009 (£100 million) | | 99 | 99 |
| 6 ¹ / ₄ % Subordinated Notes 2010 (€400 million) | | 283 | 303 |
| 12% Guaranteed Subordinated Bonds 2011 (£100 million) | f | 113 | 115 |
| 4 ³ / ₄ % Subordinated Notes 2011 (€850 million) | | 562 | 597 |
| Subordinated Floating Rate Notes 2011 (£150 million) | | 150 | 150 |
| Subordinated Floating Rate Notes 2011 (£100 million) | | 100 | 100 |
| Subordinated Floating Rate Notes 2012 (£200 million) | | 200 | 200 |
| Subordinated Floating Rate Notes 2013 (£150 million) | | 150 | 150 |
| Subordinated Floating Rate Notes 2014 (£464 million) | | 464 | 464 |
| 5 ⁷ / ₈ % Subordinated Notes 2014 (£150 million) | | 149 | 148 |
| 6 ⁵ / ₈ % Subordinated Notes 2015 (£350 million) | | 330 | 345 |
| Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million) | b | 300 | 300 |
| Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million) | b | 336 | 343 |
| Subordinated Floating Rate Notes 2020 (€100 million) | b | 67 | 68 |
| 5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million) | | 328 | 346 |
| 9 ⁵ / ₈ % Subordinated Bonds 2023 (£300 million) | | 329 | 341 |
| Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million) | | 150 | 150 |
| | | 4,774 | 4,899 |
| Total subordinated liabilities | | 11,506 | 12,635 |

Notes to the accounts

38 Subordinated liabilities (continued)

| The Bank | Note | 2006 £m | 2005 £m |
|---|-------|---------------|------------|
| Preferred securities | | | |
| 6.90% Perpetual Capital Securities callable 2007 (US\$1,000 million) | a,d | 483 | 553 |
| 6% Non-cumulative Redeemable Preference Shares | l | – | – |
| 6.625% Perpetual Capital Securities callable 2006 (€750 million) | a,c | – | 518 |
| Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million) | a,j | 312 | 337 |
| 6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million) | a,c,h | 345 | 371 |
| Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (€250 million) | a,k | 248 | 248 |
| 4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million) | a,c,h | 478 | 522 |
| | | 1,866 | 2,549 |
| Undated subordinated liabilities | | | |
| Primary Capital Undated Floating Rate Notes: | | | |
| Series 1 (US\$750 million) | a,b | 383 | 436 |
| Series 2 (US\$500 million) | | 255 | 291 |
| Series 3 (US\$600 million) | | 306 | 349 |
| 5 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2009 (€1,250 million) | a,h | 845 | 892 |
| Undated Step-up Floating Rate Notes callable 2009 (€150 million) | a,b | 101 | 103 |
| 6 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2010 (€410 million) | a,g | 408 | 407 |
| 5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion) | a,i | 107 | 127 |
| 5.125% Undated Subordinated Step-up Notes callable 2016 (€500 million) | | 475 | 501 |
| 6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2019 (€270 million) | a,g | 255 | 269 |
| 8% Undated Subordinated Step-up Notes callable 2023 (€200 million) | a,g | 189 | 202 |
| 6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2029 (€450 million) | a,g | 447 | 457 |
| 6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (€500 million) | a,g | 470 | 500 |
| | | 4,241 | 4,534 |
| Dated subordinated liabilities | | | |
| 7 ³ / ₄ % Subordinated Bonds 2007 (€300 million) | | 300 | 300 |
| 5 ¹ / ₄ % Subordinated Notes 2008 (DM 750 million) | | 260 | 274 |
| 10 ³ / ₈ % Guaranteed Subordinated Loan Stock 2008 (€100 million) | f | 104 | 106 |
| 9 ¹ / ₂ % Subordinated Bonds 2009 (€100 million) | | 99 | 99 |
| 6 ¹ / ₄ % Subordinated Notes 2010 (€400 million) | | 283 | 303 |
| 12% Guaranteed Subordinated Bonds 2011 (€100 million) | f | 113 | 115 |
| 4 ³ / ₄ % Subordinated Notes 2011 (€850 million) | | 562 | 597 |
| Subordinated Floating Rate Notes 2014 (€464 million) | | 464 | 464 |
| 5 ⁷ / ₈ % Subordinated Notes 2014 (€150 million) | | 149 | 148 |
| 6 ⁵ / ₈ % Subordinated Notes 2015 (€350 million) | | 330 | 345 |
| Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€300 million) | b | 300 | 300 |
| Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million) | b | 336 | 343 |
| Subordinated Floating Rate Notes 2020 (€100 million) | b | 67 | 68 |
| 5.75% Subordinated Step-up Notes 2025 callable 2020 (€350 million) | | 328 | 346 |
| 9 ⁵ / ₈ % Subordinated Bonds 2023 (€300 million) | | 329 | 341 |
| Subordinated Non-Interest Bearing Loan on rolling 6 year notice (€150 million) | | 150 | 150 |
| | | 4,174 | 4,299 |
| Total subordinated liabilities | | 10,281 | 11,382 |

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.

- a) In certain circumstances, these notes, bonds and securities would acquire the characteristics of preference share capital. Any repayments of undated loan capital would require the prior consent of the Financial Services Authority. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of certain preference shares.
- b) These notes bear interest at rates fixed periodically in advance based on London Interbank rates.
- 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 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.
- 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 payments are resumed. Any deferred payments will be made good on redemption of the securities. The securities can be redeemed at par at the option of Lloyds TSB Bank plc on or after 22 November 2007.
- e) In certain circumstances the interest payments on these securities can be deferred although in this case Scottish Widows plc cannot declare or pay a dividend until any deferred payments have been made.
- f) Guaranteed by Lloyds TSB Group plc on a subordinated basis.
- g) At the callable date the coupon on these notes will be reset by reference to the applicable five year benchmark gilt rate.
- h) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a floating rate.

Notes to the accounts

38 Subordinated liabilities (continued)

- i) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a margin of 1.60 per cent over the five year Yen swap rate.
- j) These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 2.33 per cent above EURIBOR, to be set annually. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.
- k) These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 3.50 per cent above a rate based on the yield of specified UK government stock. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.
- l) Throughout 2005 and 2006, the Bank has had in issue 100 6 per cent non-cumulative redeemable preference shares of £1 each. The shares, which are redeemable at the option of the Bank at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Bank.

Notes to the accounts

39 Share capital

| | Group and Bank | |
|---|----------------|------------|
| | 2006 £m | 2005 £m |
| Authorised share capital | | |
| 1,650 million ordinary shares of £1 each | 1,650 | 1,650 |
| 1 cumulative floating rate preference share of £1 | – | – |
| 100 6 per cent Non-Cumulative Redeemable Preference shares of £1 each | – | – |
| Issued and fully paid ordinary shares | | |
| Ordinary shares of £1 each | | |
| At 1 January and 31 December | 1,542 | 1,542 |
| Cumulative floating rate preference share of £1 | | |
| At 1 January and 31 December | – | – |

Issued and fully paid preference shares

Throughout 2005 and 2006, the Bank has had in issue 100 6 per cent non-cumulative redeemable preference shares of £1 each. The shares, which are redeemable at the option of the Bank at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Bank. In accordance with the requirements of International Financial Reporting Standards, these shares are reported within liabilities (see note 38).

40 Share premium account

| | Group and Bank | |
|------------------------------|----------------|------------|
| | 2006 £m | 2005 £m |
| At 1 January and 31 December | 2,960 | 2,960 |

41 Other reserves

Other reserves comprise:

| | The Group | | The Bank | |
|---|------------|------------|------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Revaluation reserve in respect of available-for-sale financial assets | – | 29 | (3) | 26 |
| Cash flow hedging reserve | 12 | 11 | 12 | 11 |
| | 12 | 40 | 9 | 37 |

41 Other reserves (continued)

Movements in other reserves were as follows:

| | The Group £m | The Bank £m |
|--|-----------------|----------------|
| Revaluation reserve in respect of available-for-sale financial assets: | | |
| At 1 January 2005 | 28 | 22 |
| Exchange and other adjustments | (7) | (7) |
| Change in fair value of available-for-sale financial assets | 11 | 13 |
| Deferred tax | 2 | 1 |
| | 13 | 14 |
| Income statement transfer (tax £nil) | (5) | (3) |
| At 31 December 2005 | 29 | 26 |
| Exchange and other adjustments | 2 | – |
| Change in fair value of available-for-sale financial assets (tax £nil) | (10) | (7) |
| Income statement transfer | | |
| Disposal | (22) | (22) |
| Current tax | 1 | – |
| | (21) | (22) |
| At 31 December 2006 | – | (3) |
| Cash flow hedging reserve: | | |
| At 1 January 2005 | – | – |
| Change in fair value of hedging derivatives | 4 | 4 |
| Deferred tax | (1) | (1) |
| | 3 | 3 |
| Income statement transfer | 12 | 12 |
| Deferred tax | (4) | (4) |
| | 8 | 8 |
| At 31 December 2005 | 11 | 11 |
| Income statement transfer (tax £nil) | 1 | 1 |
| At 31 December 2006 | 12 | 12 |

Notes to the accounts

| 42 Retained profits | The Group | | The Bank | |
|--|----------------|------------|----------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| At 1 January | 6,643 | 6,036 | 3,744 | 2,896 |
| Currency translation differences (see analysis below) | (31) | 16 | (23) | 25 |
| Profit for the year* | 2,916 | 2,504 | 2,449 | 2,736 |
| Dividends | (1,918) | (1,913) | (1,918) | (1,913) |
| At 31 December | 7,610 | 6,643 | 4,252 | 3,744 |

*No income statement has been shown for the Bank, as permitted by Section 230 of the Companies Act 1985.

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

| | The Group £m | The Bank £m |
|--|-----------------|----------------|
| At 1 January 2005 | (12) | (7) |
| Currency translation differences arising in the year | 16 | 25 |
| At 31 December 2005 | 4 | 18 |
| Currency translation differences arising in the year | (108) | (23) |
| Foreign currency gains on net investment hedges | 110 | - |
| Current tax | (33) | - |
| | 77 | - |
| At 31 December 2006 | (27) | (5) |

| 43 Ordinary dividends | 2006 £m | 2005 £m |
|--|--------------|------------|
| Second interim dividend in respect of previous year, declared during the current year | 1,316 | 1,314 |
| First interim dividend in respect of current year | 602 | 599 |
| | 1,918 | 1,913 |

The directors have proposed a second interim dividend of £1,325 million (2005: £1,316 million) which will be paid on 2 May 2007; this is equivalent to 85.94 pence per ordinary share (2005: 85.36 pence).

Notes to the accounts

44 Share based payments**Charge to the income statement**

The charge to the income statement is set out below:

| | 2006 £m | 2005 £m |
|--------------------------------|------------|------------|
| Executive and SAYE schemes: | | |
| Options granted in the year | 6 | 4 |
| Options granted in prior years | 25 | 27 |
| | 31 | 31 |
| Share incentive plan: | | |
| Shares granted in the year | 12 | 24 |
| Shares granted in prior years | 15 | 21 |
| | 27 | 45 |
| | 58 | 76 |

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

Executive schemes

The Executive share option schemes are long-term incentive schemes available to certain senior executives of the Group, with grants usually made annually. Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options. The last grant of executive options was made in March 2005. These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary. Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5. Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied.

Performance conditions for executive options**For options granted up to March 2001**

| Options granted | Performance conditions |
|--------------------------|--|
| Prior to March 1996 | None |
| March 1996 | Growth in earnings per share of Lloyds TSB Group which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period. |
| March 1997 – August 1999 | As for March 1996, plus a further condition that Lloyds TSB Group plc's ranking based on shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100. |
| March 2000 – March 2001 | As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period. |

In respect of options granted between March 1996 and March 2001, the relevant period for the performance conditions begins at the end of the financial year preceding the date of grant and will continue until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions are met. Once the conditions have been satisfied the options will remain exercisable without further conditions. If they are not satisfied by the tenth anniversary of the grant the option will lapse.

For options granted from August 2001 to August 2004

The performance condition is linked to the performance of Lloyds TSB Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds TSB Group plc.

The performance condition is measured over a three year period commencing at the end of the financial year preceding the grant of the option and continuing until the end of the third subsequent year. If the performance condition is not then met, it will be measured at the end of the fourth financial year. If the condition has not then been met, the options will lapse.

To meet the performance conditions, the Group's ranking against the comparator group must be at least ninth. The full grant of options will only become exercisable if Lloyds TSB Group plc is ranked first. A performance multiplier (of between nil and 100 per cent) will be applied below this level to calculate the number of shares in respect of which options granted to executive directors will become exercisable, and will be calculated on a sliding scale. If Lloyds TSB Group plc is ranked below median the options will not be exercisable.

Options granted to senior executives other than executive directors are not so highly leveraged and, as a result, different performance multipliers are applied to their options. For the majority of executives, options are granted with the performance condition but no performance multiplier.

Notes to the accounts

44 Share based payments (continued)**For options granted in 2005**

The same conditions apply as for grants made up to August 2004, except that:

- the performance condition is linked to the performance of Lloyds TSB Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds TSB Group plc;
- if the performance condition has not been met at the end of the third subsequent year, the options will lapse; and
- the full grant of options becomes exercisable only if the Group is ranked in the top four places of the comparator group. A sliding scale applies between fourth and eighth positions. If Lloyds TSB Group is ranked below the median (ninth or below) the options will not be exercisable and will lapse.

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

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

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

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn (SAYE) schemes to save up to £250 per month and, at the expiry of a fixed term of three or five years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in Lloyds TSB Group plc at a price equal to 80 per cent of the market price at the date the options were granted. Grants in periods up to 31 December 2001 also had options exercising after seven years.

Movements in the number of share options outstanding under the SAYE schemes are set out below:

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

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

Other share option plans**Lloyds TSB Group Executive Share Plan 2003**

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees, who may also be directors of Lloyds TSB Group. Options granted to date under this scheme were granted specifically to facilitate recruitment. Options granted under this plan are not subject to any performance conditions.

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

Notes to the accounts

44 Share based payments (continued)

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

Lloyds TSB Group executive share plan 2005

This plan was adopted by the Group in 2005, specifically to facilitate the recruitment of Ms Dial. Ms Dial is the only participant in the plan. Options granted under this plan are not subject to any performance conditions and will normally become exercisable only if Ms Dial remains as an employee, and has not given notice of resignation, on 31 May 2008. The option will also be exercisable if Ms Dial ceases to be an employee before that date in certain circumstances described in her service agreement, in which case the options will be exercisable for six months and then lapse.

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

The weighted average fair value of options granted in 2005 was £3.63. No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 1.9 years (2005: 2.9 years).

Long-Term Incentive Plan

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

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

50 per cent of the award will be based on a condition measuring the Group's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds TSB Group plc. To vest in full, the Group's total shareholder return must exceed the median of the total shareholder return of the comparator group by an average of 7.5 per cent per annum. 8.75 per cent of the award will vest where the Group's total shareholder return is equal to the median and vesting will be on a straight-line basis between these points. Where the Group's total shareholder return is below the median, this part of the award will lapse.

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

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

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

Performance share plan

Under the performance share plan, introduced during 2005, participating executives will be eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 and 2005 bonus. The maximum match will be two performance shares for each bonus share, awarded at the end of a three year period. The actual number of Lloyds TSB Group plc's shares awarded will depend on Lloyd TSB Group's total shareholder return performance measured over a three year period, compared to other companies in the comparator group. The maximum of two performance shares for each bonus share will be awarded only if the Group's total shareholder return performance places it first in the comparator group; one performance share for each bonus share will be granted if the Group is placed fifth; and one performance share for every two bonus shares if the Group is placed eighth (median). Between first and fifth and fifth and eighth sliding scales will apply. If the total shareholder return performance is below median, no performance shares will be awarded. There will be no retest. Whilst income tax is deducted from the bonus before deferral into the plan, where a match of performance shares is justified, these shares will be awarded as if income tax had not been deducted.

Notes to the accounts

44 Share based payments (continued)

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

The fair value of the matching element of the performance shares awarded during 2006 was £1.92 (2005: £1.78).

The ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life and number of options outstanding for the option schemes were as follows:

| | Executive schemes | | | SAYE schemes | | | Other share option plans | | |
|-------------------------|---|---|-------------------|---|---|-------------------|---|---|-------------------|
| | Weighted average exercise price (pence) | Weighted average remaining life (years) | Number of options | Weighted average exercise price (pence) | Weighted average remaining life (years) | Number of options | Weighted average exercise price (pence) | Weighted average remaining life (years) | Number of options |
| 31 December 2006 | | | | | | | | | |
| Exercise price range | | | | | | | | | |
| £0 to £2 | – | – | – | – | – | – | Nil | 1.9 | 599,948 |
| £2 to £3 | – | – | – | 284.00 | 1.8 | 45,234,578 | – | – | – |
| £3 to £4 | 394.25 | 6.2 | 6,265,105 | 345.97 | 2.3 | 23,320,638 | – | – | – |
| £4 to £5 | 444.24 | 7.7 | 22,497,465 | 422.94 | 3.1 | 20,125,284 | – | – | – |
| £5 to £6 | 541.32 | 2.6 | 1,424,507 | 571.24 | 0.7 | 1,522,876 | – | – | – |
| £6 to £7 | 652.98 | 4.2 | 1,332,177 | – | – | – | – | – | – |
| £7 to £8 | – | – | – | 718.00 | 0.2 | 16,768 | – | – | – |
| £8 to £9 | 873.12 | 1.7 | 940,339 | – | – | – | – | – | – |

| | Executive schemes | | | SAYE schemes | | | Other share option plans | | |
|-------------------------|---|---|-------------------|---|---|-------------------|---|---|-------------------|
| | Weighted average exercise price (pence) | Weighted average remaining life (years) | Number of options | Weighted average exercise price (pence) | Weighted average remaining life (years) | Number of options | Weighted average exercise price (pence) | Weighted average remaining life (years) | Number of options |
| 31 December 2005 | | | | | | | | | |
| Exercise price range | | | | | | | | | |
| £0 to £2 | – | – | – | – | – | – | Nil | 2.2 | 511,743 |
| £2 to £3 | – | – | – | 284.00 | 2.0 | 78,553,860 | – | – | – |
| £3 to £4 | 393.33 | 7.1 | 10,112,857 | 346.71 | 3.1 | 28,535,928 | – | – | – |
| £4 to £5 | 444.04 | 8.6 | 24,177,788 | 469.50 | 1.4 | 3,415,737 | – | – | – |
| £5 to £6 | 542.22 | 3.7 | 2,320,524 | 544.77 | 1.1 | 3,821,055 | – | – | – |
| £6 to £7 | 652.79 | 5.1 | 1,823,756 | 632.00 | 0.2 | 95,572 | – | – | – |
| £7 to £8 | 715.04 | 6.2 | 4,111,758 | 720.20 | 1.0 | 37,322 | – | – | – |
| £8 to £9 | 868.08 | 2.8 | 1,430,728 | – | – | – | – | – | – |

The weighted average fair value of options granted during the year was £nil (2005: £0.67) for executive options and £1.00 (2005: £0.98) for SAYE options. The values for executive options have been determined using a binomial model that uses a stochastic projection model to determine the effect of the market based conditions. The values for the SAYE options have been determined using a standard Black-Scholes model. The fair value calculations are based on the following assumptions:

| | SAYE | Other option schemes | Other share plans |
|---------------------------------|-----------|----------------------|-------------------|
| Risk-free interest rate | 4.44% | 4.55% | 4.79% |
| Expected life | 3.5 years | 2.9 years | 3.0 years |
| Expected volatility | 23% | 21% | 19% |
| Expected dividend yield | 6.5% | 6.2% | 6.7% |
| Weighted average share price | £5.23 | £5.50 | £5.15 |
| Weighted average exercise price | £4.18 | – | – |
| Expected forfeitures | 6% | 5% | 5% |

Expected volatility is a measure of the amount by which Lloyds TSB Group plc's shares are expected to fluctuate during the life of an option. The expected volatility is estimated based on the historical volatility of the closing daily share price over the most recent period that is commensurate with the expected life of the option. The historical volatility is compared to the implied volatility generated from market traded options in Lloyds TSB Group plc's shares to assess the reasonableness of the historical volatility and adjustments made where appropriate.

Notes to the accounts

44 Share based payments (continued)

Share incentive plan

Free shares

An award of Lloyds TSB Group plc shares may be made annually to employees based on a percentage of the employees' salary in the preceding year up to maximum of £3,000. The percentage is normally announced concurrently with Lloyds TSB Group's annual results and the price of the shares awarded is announced at the time of grant. The shares awarded are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition: if an employee leaves the Lloyds TSB Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited (for awards made up to April 2005, only a portion of the shares will be forfeited: 75 per cent within one year of the award, 50 per cent within two years and 25 per cent within three years).

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

Matching shares

Lloyds TSB Group undertakes to match shares purchased by employees up to the value of £30 per month, these shares are held in trust for a mandatory period of three years on the employees' behalf. The award is subject to a non-market based condition; if an employee leaves within this three year period for other than a 'good' reason or the accompanying partnership shares are sold within that time, 100 per cent of the matching shares are forfeited (or the portion relating to the shares sold).

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

Notes to the accounts

45 Related party transactions**Key management personnel**

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

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

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

The aggregate of the emoluments of the directors was £11,257,000 (2005: £8,826,000).

The aggregate of the amount of the gains made by directors on the exercise of Lloyds TSB Group plc share options was £125,175 (2005: £1,077,312).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were two and four respectively (2005: two and five). Aggregate company contributions in respect of directors to defined contribution pension schemes were £122,000 (2005: £103,000).

The total for the highest paid director (Mr Daniels), including the £7,702 (2005: £1,077,312) gain on the exercise of Lloyds TSB Group plc share options, was £2,452,000 (2005: £3,007,000). The amount of his accrued pension at the year end was £120,000, being his pension entitlement based on pensionable service with the Group to 31 December 2006 but payable at normal retirement age.

| | 2006 millions | 2005 millions |
|--|------------------|------------------|
| <i>Share options over Lloyds TSB Group plc shares</i> | | |
| At 1 January | 12 | 12 |
| Granted (includes options of appointed directors) | – | 3 |
| Exercised/lapsed (includes options of retired directors) | (1) | (3) |
| At 31 December | 11 | 12 |

The tables below detail, on an aggregated basis, balances outstanding at the year end and related income and expense, together with information relating to other transactions between the Group and its key management personnel:

| | 2006 £m | 2005 £m |
|----------------|------------|------------|
| <i>Loans</i> | | |
| At 1 January | 3 | 3 |
| Advanced | – | 1 |
| Interest | – | – |
| Repayments | (1) | (1) |
| At 31 December | 2 | 3 |

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 5.1 per cent and 19.9 per cent in 2006 (2005: 4.6 per cent and 17.9 per cent).

45 Related party transactions (continued)

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

| | 2006 £m | 2005 £m |
|-----------------|------------|------------|
| <i>Deposits</i> | | |
| At 1 January | 5 | 2 |
| Placed | 12 | 22 |
| Interest | – | – |
| Withdrawn | (12) | (19) |
| At 31 December | 5 | 5 |

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

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

At 31 December 2006, transactions, arrangements and agreements entered into by the Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £2 million with four directors and four connected persons (2005: £3 million with four directors and three connected persons).

Balances and transactions with fellow Lloyds TSB Group undertakings*Balances and transactions between members of the Lloyds TSB Bank group*

In accordance with IAS 27, transactions and balances between the Bank and its subsidiary undertakings, and between those subsidiary undertakings, have all been eliminated on consolidation and thus are not reported as related party transactions of the Group.

The Bank, as a result of its position as parent of a banking group, has a large number of transactions with various of its subsidiary undertakings; these are included on the balance sheet of the Bank as follows:

| | 2006 £m | 2005 £m |
|--------------------------------------|---------------|---------------|
| <i>Assets, included within:</i> | | |
| Derivative financial instruments | 273 | 323 |
| Loans and advances to banks | 60,804 | 64,728 |
| Loans and advances to customers | 37,301 | 28,990 |
| Other assets | 477 | 445 |
| | 98,855 | 94,486 |
| <i>Liabilities, included within:</i> | | |
| Deposits from banks | 9,513 | 8,407 |
| Customer accounts | 18,294 | 15,318 |
| Derivative financial instruments | 706 | 702 |
| Subordinated liabilities | 560 | 585 |
| Other liabilities | 510 | 376 |
| | 29,583 | 25,388 |

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2006 the Bank earned interest income on the above asset balances of £4,585 million (2005: £4,128 million) and incurred interest expense on the above liability balances of £940 million (2005: £921 million).

In addition, the Bank raised recharges of £517 million (2005: £531 million) on its subsidiaries in respect of costs incurred and also received fees of £583 million (2005: £625 million), and paid fees of £14 million (2005: £61 million), for various services provided between the Bank and its subsidiaries.

Details of contingent liabilities and commitments entered into on behalf of fellow Lloyds TSB Group undertakings are given in note 46.

Notes to the accounts

46 Contingent liabilities and commitments (continued)

The contingent liabilities of the Group and the Bank, as detailed above, arise in the normal course of banking business and it is not practicable to quantify their future financial effect.

| | The Group | | The Bank | |
|--|------------|------------|------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Commitments | | | | |
| Documentary credits and other short-term trade-related transactions | 374 | 283 | 273 | 191 |
| Forward asset purchases and forward deposits placed | 5,764 | 277 | 5,764 | 377 |
| Undrawn formal standby facilities, credit lines and other commitments to lend: | | | | |
| Less than 1 year maturity: | | | | |
| Mortgage offers made | 4,071 | 2,983 | – | – |
| Other commitments | 49,731 | 55,310 | 58,115 | 60,016 |
| | 53,802 | 58,293 | 58,115 | 60,016 |
| 1 year or over maturity | 28,477 | 24,123 | 24,996 | 22,512 |
| | 88,417 | 82,976 | 89,148 | 83,096 |

Incurring on behalf of fellow Lloyds TSB Group undertakings

| The Bank | |
|------------|------------|
| 2006 £m | 2005 £m |
| 12,589 | 8,348 |

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend £51,288 million (2005: £43,094 million) for the Group and £52,419 million (2005: £46,189 million) for the Bank were irrevocable.

Operating lease commitments

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

| | The Group | | The Bank | |
|--|------------|------------|------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Not later than 1 year | 212 | 216 | 192 | 187 |
| Later than 1 year and not later than 5 years | 733 | 784 | 677 | 694 |
| Later than 5 years | 835 | 1,016 | 759 | 863 |
| | 1,780 | 2,016 | 1,628 | 1,744 |

Operating lease payments represent rental payable by the Group for certain of its properties. Some of these operating lease arrangements have renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments.

Finance lease commitments

Where a Group company is the lessee the future obligations payable under finance leases are as follows:

| | The Group | | The Bank | |
|--|------------|------------|------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Not later than 1 year | 1 | 1 | – | – |
| Later than 1 year and not later than 5 years | – | – | – | – |
| Later than 5 years | 15 | 15 | 15 | 15 |
| | 16 | 16 | 15 | 15 |

46 Contingent liabilities and commitments (continued)

Finance lease payments relate to leases of premises with a net book value of £14 million for the Group and £14 million for the Bank (2005: £14 million for the Group and £14 million for the Bank) and equipment with a net book value of £1 million for the Group and £1 million for the Bank (2005: £2 million for the Group and £2 million for the Bank). No arrangements have been entered into for contingent rental payments. The fair value of these finance lease obligations approximates their carrying amount at 31 December 2006 and 2005.

Capital commitments

Excluding commitments of the Group in respect of investment property (see note 20), capital expenditure contracted but not provided for at 31 December 2006 amounted to £75 million for the Group and £1 million for the Bank (2005: £223 million for the Group and £8 million for the Bank). Of the capital commitments of the Group, £74 million (2005: £215 million) relates to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

47 Financial risk management**Strategy in using financial instruments**

The Group uses financial instruments (including derivatives) to meet the financial needs of its customers, as part of its trading activities and to reduce its own exposure to market and credit risks.

The Group accepts deposits from and makes loans to commercial and retail customers at both fixed and floating rates and for various periods. Such exposures to customers involve both on balance sheet loans and advances and guarantees and other commitments such as letters of credit and irrevocable commitments.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and foreign exchange risk; insurance risk; and liquidity risk. Information about the Group's management of these risks is given below.

Credit risk

Credit risk is the risk of reductions in earnings and/or value, through financial or reputational loss, as a result of the failure of the party with whom we have contracted to meet its obligations (both on and off balance sheet).

Credit risk is managed according to baseline credit framework standards, against which all activity is assessed. This framework identifies the following key elements: governance, organisational framework, policies, people, processes and procedures, management information, and systems and technology.

Credit risk can arise from lending or investing or through off balance sheet activities such as guarantees or the undertaking of settlement or delivery risk. The primary off balance sheet instruments used by the Group are guarantees together with standby, documentary and commercial letters of credit.

In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring), although thresholds are set above which an individual credit assessment takes place. Divisional risk departments review scorecard effectiveness and approve changes, with material changes subject to Lloyds TSB Group Risk approval. Credit risk in non-retail portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward.

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

Notes to the accounts

47 Financial risk management (continued)

Credit risk also arises from the use of derivatives. Note 15 shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2006. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. To mitigate credit risk the Group makes use of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

Credit risk may also arise through the existence of contracts for the provision of services or products to Lloyds TSB and this is also considered through individual credit assessments, where the risks of loss are material.

Day-to-day credit management and asset quality within each business is primarily the responsibility of the relevant business director.

Credit quality is supported by specialist units to provide, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business.

Impairment provisions are provided for losses that have been incurred at the balance sheet date. Changes in general economic conditions in the UK or in interest rates could result in losses that are different from those provided for at the balance sheet date.

Lloyds TSB Group has dedicated standards, policies and procedures for the measurement, control and monitoring of credit and related risks. The Group controls its exposure to individual counterparties, groups of counterparties and customer risk segments through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregated facilities, credit risk ratings and the nature and term of the risk. Regular reports on significant credit exposures are provided to the Lloyds TSB Group executive committee and board. In addition, Lloyds TSB Group Risk sets sector caps that reflect the Group's risk appetite to control excessive concentrations of risk.

The Group monitors its credit risk exposure through the use of a Group rating system with ratings corresponding to a range of probabilities of future default, portfolio analysis to identify and define portfolios of credit and related risk exposures and the appropriate benchmarks by which the Group manages the credit risk exposure of those portfolios. Monitoring reports are produced regularly for review by Lloyds TSB Group Risk.

Where it is efficient and likely to be effective (generally with counterparties with which it undertakes a significant volume of transactions), the Group enters into master netting arrangements. Although master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis, they do reduce the credit risk to the extent that if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Group's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period since it is affected by each transaction subject to the arrangement.

At 31 December 2006, the maximum credit risk exposure of the Group and the Bank in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions and financial guarantees, their contractual nominal amounts.

47 Financial risk management (continued)

| | 2006 £m | 2005 £m |
|--|----------------|-------------|
| The Group | | |
| Loans and advances to banks | 40,639 | 31,656 |
| Loans and advances to customers | 192,328 | 178,707 |
| Deposit amounts available for offset ¹ | (6,392) | (6,414) |
| Impairment losses | (2,194) | (2,073) |
| | 224,381 | 201,876 |
| Available-for-sale debt securities and treasury bills | 19,163 | 14,894 |
| Contingent liabilities | 2,777 | 11,695 |
| Financial guarantees ² | 8,139 | – |
| Undrawn irrevocable formal standby facilities, credit lines and other commitments to lend ² | 51,288 | 43,094 |
| Derivative assets, before netting | 5,565 | 5,878 |
| Amounts available for offset under master netting arrangements ¹ | (2,761) | (3,235) |
| | 2,804 | 2,643 |
| Trading and other financial assets at fair value through profit or loss | 29,568 | 26,869 |
| | 338,120 | 301,071 |
| | 2006 | 2005 |
| The Bank | £m | £m |
| Loans and advances to banks | 86,589 | 86,091 |
| Loans and advances to customers | 108,276 | 93,477 |
| Deposit amounts available for offset ¹ | (6,040) | (6,073) |
| Impairment losses | (1,701) | (1,719) |
| | 187,124 | 171,776 |
| Available-for-sale debt securities and treasury bills | 3,958 | 4,457 |
| Contingent liabilities | 2,836 | 12,251 |
| Financial guarantees ² | 8,633 | – |
| Undrawn irrevocable formal standby facilities, credit lines and other commitments to lend ² | 52,419 | 46,189 |
| Derivative assets, before netting | 5,665 | 6,050 |
| Amounts available for offset under master netting arrangements ¹ | (2,761) | (3,235) |
| | 2,904 | 2,815 |
| Trading and other financial assets at fair value through profit or loss | 8,810 | 5,923 |
| | 266,684 | 243,411 |

¹ Deposit amounts available for offset and amounts available for offset under master netting arrangements do not meet the criteria under IAS 32 to enable loans and advances and derivative assets respectively to be presented net of these balances in the financial statements.

² See note 46 – Contingent liabilities and commitments for further information.

Market risk

Market risk is the risk of reductions in earnings and/or value, through financial or reputational loss, arising from unexpected changes in financial prices, including interest rates, exchange rates and bond, commodity and equity prices. The Group's banking activities expose it to the risk of adverse movements in interest rates or exchange rates, with little or no exposure to equity or commodity risk. The Group's insurance activities also expose it to market risk. The Group's defined benefit pension schemes are exposed to significant risks from the constituent parts of their assets, primarily equity and interest rate risk, and from the present value of their liabilities.

Notes to the accounts

47 Financial risk management (continued)

The primary market risk measure used within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. The use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. VaR is also not well suited to options positions. The Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity and include interest rate re-pricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at Group level to simulate extreme conditions to supplement these core measures. The risk of loss measured by the VaR model is the potential loss in earnings. The total and average trading VaR does not assume any diversification benefit across the three risk types. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole.

Trading

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding three years, the VaR for the years ended 31 December 2006 and 2005 based on the Group's global trading positions was as detailed in the following table (the table also aggregates potential loss measures from options portfolios).

The Group

| | 31 December 2006 | | | |
|--------------------------------|------------------|---------------|---------------|---------------|
| | Closing £m | Average £m | Maximum £m | Minimum £m |
| Interest rate risk | 3.3 | 2.3 | 4.6 | 0.6 |
| Foreign exchange risk | 0.3 | 0.3 | 0.7 | 0.0 |
| Equity risk | 0.0 | 0.0 | 0.0 | 0.0 |
| Total VaR (no diversification) | 3.6 | 2.6 | 5.0 | 0.9 |
| | 31 December 2005 | | | |
| | Closing £m | Average £m | Maximum £m | Minimum £m |
| Interest rate risk | 0.9 | 1.8 | 4.5 | 0.5 |
| Foreign exchange risk | 0.2 | 0.3 | 0.4 | 0.2 |
| Equity risk | 0.0 | 0.0 | 0.0 | 0.0 |
| Total VaR (no diversification) | 1.1 | 2.1 | 4.7 | 0.8 |

VaR figures for the Bank are not materially different to those of the Group.

Non-trading

The Group's banking non-trading exposure is summarised in the form of an interest rate repricing table, as set out on page 64. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. However, the table does not take into account the effect of interest rate options used by the Group to hedge its exposure.

It is estimated that a hypothetical immediate and sustained 100 basis points increase in interest rates on 1 January 2007 would decrease net interest income by £237.8 million for the 12 months to 31 December 2007, while a hypothetical immediate and sustained 100 basis point decrease in interest rates would increase net interest income by £237.4 million. An analysis by currency is shown below.

47 Financial risk management (continued)

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

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

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

For the insurance business the composition, and value, of surplus assets held in excess of liabilities are reported to Lloyds TSB Group Risk on a monthly basis. The figures quoted below are the sum of the two portfolios with no allowance for diversification between portfolios or asset classes and represents the potential loss in earnings.

The following table shows closing, average, maximum and minimum VaR for the years ended 31 December 2006 and 2005 on a 99 per cent confidence ten day basis.

The Group

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

The Group's structural foreign exchange position at 31 December 2006 is set out on page 66. The position implies that at 31 December 2006 a hypothetical increase of 10 per cent in the value of sterling against all other currencies would have led to a £43 million reduction in reserves, and vice versa. On this basis, there would have been no material impact on the Group's risk asset ratios.

Banking activities

Most of the Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange and interest rate products. However, some interest rate and exchange rate positions are taken using derivatives and on balance sheet instruments with the object of earning a profit from favourable movements in market rates. Trading is restricted to a number of specialist centres, the most important centre being financial markets division in London. These centres also manage market risk in the wholesale banking books, both in the UK and internationally. The level of exposure is strictly controlled and monitored within approved limits. Active management of the wholesale book is necessary to meet customer requirements and changing market circumstances.

Notes to the accounts

47 Financial risk management (continued)

Market risk in the Group's retail portfolios and in the Group's capital funds is managed within limits defined in the detailed group policy for interest rate risk in the banking book, which is reviewed annually and approved by the Lloyds TSB Group asset and liability committee. The structural foreign exchange position is managed having regard to the currency composition of the Group's risk-weighted assets. The objective is to limit the effect of exchange rate movements on the published risk asset ratio.

Insurance activities

Market risk exposures from the insurance businesses are controlled via approved investment policies set with reference to the Group's overall risk appetite and regularly reviewed by the Lloyds TSB Group asset and liability committee.

With-profits funds are managed in accordance with the relevant fund's Principles and Practices of Financial Management.

The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match cash flows.

Investment strategy for surplus assets held in excess of liabilities takes account of the regulatory and internal business requirements for capital to be held to support the business now and in the future.

The Group liaises with the pension scheme trustees with regard to strategies for the overall mix of pension assets.

Interest rate risk

In the Group's retail banking business interest rate risk arises from the different repricing characteristics of the assets and liabilities. Liabilities are either insensitive to interest rate movements, for example interest free or very low interest customer deposits, or are sensitive to interest rate changes but bear rates which may be varied at the Group's discretion and that for competitive reasons generally reflect changes in the Bank of England's base rate. There are a relatively small volume of deposits whose rate is contractually fixed for their term to maturity.

Many banking assets are sensitive to interest rate movements; there is a large volume of managed rate assets such as variable rate mortgages which may be considered as a natural offset to the interest rate risk arising from the managed rate liabilities. However a significant proportion of the Group's lending assets, for example personal loans and mortgages, bear interest rates which are contractually fixed for periods of up to five years or longer.

The interest rate risk arising from the Group's retail banking activities is managed centrally, in part by the use of internal interest rate swaps. For accounting purposes IAS 39 does not permit the use of internal derivatives in hedge relationships and, although economically the position is hedged, this leads to volatility in the income statement. In response to this the Group has created a function the purpose of which is to establish accounting hedge relationships in order to reduce the volatility arising in the income statement.

47 Financial risk management (continued)

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio. At 31 December 2006 the aggregate notional principal of interest rate swaps designated as fair value hedges was £37,378 million (2005: £39,568 million) with a net fair value liability of £110 million (2005: £245 million) (see note 15). In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next six years and will be reported in the income statement as they take place. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2006 was £569 million (2005: £648 million) with a net fair value liability of £8 million (2005: £18 million) (see note 15).

Notes to the accounts

47 Financial risk management (continued)

The tables below summarise the repricing mismatches of the Group's and the Bank's financial assets and liabilities. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date.

The Group

| | 1 month or less £m | 3 months or less but over 1 month £m | 1 year or less but over 3 months £m | 5 years or less but over 1 year £m | Over 5 years £m | Non-interest bearing £m | Total £m |
|---|-----------------------|--|---|--|--------------------|----------------------------|----------------|
| As at 31 December 2006 | | | | | | | |
| <i>Assets</i> | | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 1,455 | 867 | 1,012 | 5,177 | 21,057 | 38,360 | 67,928 |
| Derivative financial instruments* | – | – | – | – | – | 5,565 | 5,565 |
| Loans and advances to banks | 24,652 | 1,561 | 1,561 | 7,449 | 5,346 | 69 | 40,638 |
| Loans and advances to customers | 71,081 | 17,711 | 19,572 | 60,845 | 19,110 | 1,816 | 190,135 |
| Available-for-sale financial assets | 5,525 | 10,732 | 1,594 | 1,174 | 138 | 15 | 19,178 |
| Other assets | 828 | 48 | – | – | – | 21,344 | 22,220 |
| Total assets | 103,541 | 30,919 | 23,739 | 74,645 | 45,651 | 67,169 | 345,664 |
| <i>Liabilities</i> | | | | | | | |
| Deposits from banks | 28,157 | 3,654 | 1,716 | 827 | 1,920 | 120 | 36,394 |
| Customer accounts | 124,974 | 3,444 | 4,802 | 1,809 | 1,333 | 4,405 | 140,767 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss* | – | – | 55 | 467 | 634 | 5,905 | 7,061 |
| Debt securities in issue | 29,672 | 13,562 | 5,059 | 1,339 | 4,486 | – | 54,118 |
| Liabilities arising from insurance and investment contracts | – | – | – | – | – | 66,655 | 66,655 |
| Other liabilities | 37 | 27 | 2 | – | 4,583 | 12,038 | 16,687 |
| Subordinated liabilities | 1,337 | 561 | 750 | 2,657 | 6,051 | 150 | 11,506 |
| Total liabilities | 184,177 | 21,248 | 12,384 | 7,099 | 19,007 | 89,273 | 333,188 |
| Net repricing gap | (80,636) | 9,671 | 11,355 | 67,546 | 26,644 | (22,104) | 12,476 |
| | 1 month or less £m | 3 months or less but over 1 month £m | 1 year or less but over 3 months £m | 5 years or less but over 1 year £m | Over 5 years £m | Non-interest bearing £m | Total £m |
| As at 31 December 2005 | | | | | | | |
| <i>Assets</i> | | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 1,734 | 2,418 | 1,035 | 3,796 | 17,886 | 33,698 | 60,567 |
| Derivative financial instruments* | – | – | – | – | – | 5,878 | 5,878 |
| Loans and advances to banks | 25,107 | 2,483 | 2,923 | 370 | 57 | 715 | 31,655 |
| Loans and advances to customers | 72,997 | 17,048 | 20,327 | 51,044 | 13,594 | 1,625 | 176,635 |
| Available-for-sale financial assets | 1,695 | 8,674 | 1,221 | 1,497 | 1,678 | 175 | 14,940 |
| Other assets | 195 | 50 | – | – | – | 21,701 | 21,946 |
| Total assets | 101,728 | 30,673 | 25,506 | 56,707 | 33,215 | 63,792 | 311,621 |
| <i>Liabilities</i> | | | | | | | |
| Deposits from banks | 23,859 | 4,866 | 1,472 | 131 | 1,070 | 129 | 31,527 |
| Customer accounts | 112,831 | 4,901 | 3,941 | 4,061 | 1,413 | 4,203 | 131,350 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss* | – | – | – | – | – | 6,584 | 6,584 |
| Debt securities in issue | 20,411 | 8,396 | 3,905 | 1,709 | 4,925 | – | 39,346 |
| Liabilities arising from insurance and investment contracts | – | – | – | – | – | 63,041 | 63,041 |
| Other liabilities | 50 | 23 | 65 | 1 | 3,296 | 12,083 | 15,518 |
| Subordinated liabilities | 1,346 | 640 | 504 | 2,381 | 7,614 | 150 | 12,635 |
| Total liabilities | 158,497 | 18,826 | 9,887 | 8,283 | 18,318 | 86,190 | 300,001 |
| Net repricing gap | (56,769) | 11,847 | 15,619 | 48,424 | 14,897 | (22,398) | 11,620 |

*Derivative financial instruments which are exposed to interest rate risk are carried in the balance sheet at fair value and for the purposes of this analysis have been treated as non-interest bearing.

Notes to the accounts

47 Financial risk management (continued)

The Bank

| | 1 month or less £m | 3 months or less but over 1 month £m | 1 year or less but over 3 months £m | 5 years or less but over 1 year £m | Over 5 years £m | Non-interest bearing £m | Total £m |
|---|-----------------------|---|--|---------------------------------------|--------------------|----------------------------|----------------|
| As at 31 December 2006 | | | | | | | |
| <i>Assets</i> | | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 491 | 465 | 676 | 3,496 | 3,682 | 9 | 8,819 |
| Derivative financial instruments* | – | – | – | – | – | 5,665 | 5,665 |
| Loans and advances to banks | 27,340 | 4,865 | 11,647 | 34,991 | 7,443 | 302 | 86,588 |
| Loans and advances to customers | 46,092 | 11,261 | 7,000 | 19,069 | 14,880 | 8,274 | 106,576 |
| Available-for-sale financial assets | 1,207 | 1,836 | 666 | 114 | 134 | 15 | 3,972 |
| Other assets | 824 | 48 | – | – | – | 24,849 | 25,721 |
| Total assets | 75,954 | 18,475 | 19,989 | 57,670 | 26,139 | 39,114 | 237,341 |
| <i>Liabilities</i> | | | | | | | |
| Deposits from banks | 35,622 | 3,948 | 2,090 | 1,388 | 902 | 120 | 44,070 |
| Customer accounts | 100,910 | 12,692 | 5,261 | 3,084 | 1,471 | 4,520 | 127,938 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss* | – | – | 55 | 467 | 634 | 6,433 | 7,589 |
| Debt securities in issue | 17,361 | 4,689 | 4,844 | 1,339 | 4,486 | – | 32,719 |
| Other liabilities | – | 27 | 2 | – | – | 5,952 | 5,981 |
| Subordinated liabilities | 737 | 561 | 750 | 2,657 | 5,426 | 150 | 10,281 |
| Total liabilities | 154,630 | 21,917 | 13,002 | 8,935 | 12,919 | 17,175 | 228,578 |
| Net repricing gap | (78,676) | (3,442) | 6,987 | 48,735 | 13,220 | 21,939 | 8,763 |
| | 1 month or less £m | 3 months or less but over 1 month £m | 1 year or less but over 3 months £m | 5 years or less but over 1 year £m | Over 5 years £m | Non-interest bearing £m | Total £m |
| As at 31 December 2005 | | | | | | | |
| <i>Assets</i> | | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 1,207 | 2,059 | 530 | 1,762 | 366 | – | 5,924 |
| Derivative financial instruments* | – | – | – | – | – | 6,050 | 6,050 |
| Loans and advances to banks | 39,465 | 4,926 | 12,778 | 25,466 | 2,496 | 959 | 86,090 |
| Loans and advances to customers | 41,991 | 10,350 | 8,031 | 14,235 | 11,301 | 5,851 | 91,759 |
| Available-for-sale financial assets | 828 | 2,391 | 923 | 161 | 26 | 174 | 4,503 |
| Other assets | 185 | 46 | – | – | – | 23,214 | 23,445 |
| Total assets | 83,676 | 19,772 | 22,262 | 41,624 | 14,189 | 36,248 | 217,771 |
| <i>Liabilities</i> | | | | | | | |
| Deposits from banks | 29,972 | 5,103 | 1,751 | 546 | – | 601 | 37,973 |
| Customer accounts | 94,395 | 9,719 | 3,420 | 3,143 | 886 | 3,942 | 115,505 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss* | – | – | – | – | – | 7,212 | 7,212 |
| Debt securities in issue | 13,122 | 7,878 | 3,682 | 1,709 | 4,925 | – | 31,316 |
| Other liabilities | 3 | 26 | 1 | – | – | 6,070 | 6,100 |
| Subordinated liabilities | 746 | 640 | 504 | 2,381 | 6,961 | 150 | 11,382 |
| Total liabilities | 138,238 | 23,366 | 9,358 | 7,779 | 12,772 | 17,975 | 209,488 |
| Net repricing gap | (54,562) | (3,594) | 12,904 | 33,845 | 1,417 | 18,273 | 8,283 |

*Derivative financial instruments which are exposed to interest rate risk are carried in the balance sheet at fair value and for the purposes of this analysis have been treated as non-interest bearing.

Notes to the accounts

47 Financial risk management (continued)*Currency risk*

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

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to Group Treasury. Group Treasury calculates the associated VaR and the closing, average, maximum and minimum for 2005 and 2006 are disclosed on page 62.

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

The Group and the Bank hedge part of the currency translation risk of a net investment in a foreign operation using a cross currency swap. At 31 December 2006 the notional principal of this cross currency swap was £2,589 million with a net fair value asset of £139 million (see note 15) and was designated on an after-tax basis as a hedge of a net investment in a foreign operation.

The structural position is managed by Lloyds TSB Group Capital Funds having regard to the currency composition of the Group's risk weighted assets and reported to the Lloyds TSB Group asset and liability committee on a monthly basis. The Group's main overseas operations are in the Americas and Europe. Details of the Group's structural foreign currency exposures are as follows:

| | The Group | | The Bank | |
|--|------------|------------|------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Functional currency of Group operations: | | | | |
| Euro | 76 | 80 | 48 | 49 |
| US dollar | 97 | 102 | 35 | 37 |
| Swiss franc | 70 | 56 | 45 | 44 |
| Other non-sterling | 188 | 183 | 161 | 149 |
| | 431 | 421 | 289 | 279 |

Insurance risk

Insurance risk is the risk of reductions in earnings and/or value, through financial or reputational loss, due to fluctuations in the timing, frequency and severity of insured/underwritten events and to fluctuations in the timing and amount of claim settlements. This includes fluctuations in profits due to customer behaviour.

The major sources of insurance risk within the Group are the insurance businesses and the Group's defined benefit pension schemes. The nature of insurance business involves the accepting of insurance risks which relate primarily to mortality, morbidity, persistency, expenses, property damage and unemployment. The prime insurance risk carried by the Group's pension schemes is related to mortality.

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

47 Financial risk management (continued)

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

New insurance proposals are underwritten to ensure an appropriate premium is charged for the risk or the risk is declined.

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

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

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

Options and guarantees are incorporated in new insurance products only after careful consideration of the risk management issues that they present.

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

Persistency rates of life assurance policies, which relate to the rate of policy termination and the rate at which policies cease to pay regular premiums, are regularly assessed by reference to appropriate risk factors.

Liquidity risk

The Group is exposed to daily calls on its cash resources from current account and other amounts repayable on demand, overnight and other maturing deposits, loan draw-downs and cash-settled derivative instruments.

The Group's policy requires that each business unit meets its financial obligations as they fall due, that the Group complies with the Financial Services Authority Sterling Stock Liquidity Policy in the UK and that all local regulatory requirements are met.

A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally provided a stable source of funding. During 2006, amounts deposited by customers increased by £9,417 million from £131,350 million at 31 December 2005 to £140,767 million at 31 December 2006. These customer deposits are supplemented by the issue of subordinated loan capital and wholesale funding sources in the capital markets, as well as from direct customer contracts. Wholesale funding sources include deposits taken on the inter-bank market, certificates of deposit, sale and repurchase agreements, a Euro Medium-Term Note programme and commercial paper programmes. The Group has also raised wholesale funding via the issuance of Residential Mortgage Backed Securities; £10,048 million was outstanding at 31 December 2006.

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

Notes to the accounts

47 Financial risk management (continued)

The tables below analyse assets and liabilities of the Group and the Bank into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included within the over 5 years category.

Maturities of assets and liabilities

| | Up to 1 month £m | 1-3 months £m | 3-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
|--|------------------------|---------------------|----------------------|--------------------|-----------------------|----------------|
| The Group | | | | | | |
| As at 31 December 2006 | | | | | | |
| <i>Assets</i> | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 886 | 782 | 905 | 5,589 | 59,766 | 67,928 |
| Derivative financial instruments | 559 | 740 | 1,198 | 1,749 | 1,319 | 5,565 |
| Loans and advances to banks | 22,491 | 1,349 | 1,539 | 9,807 | 5,452 | 40,638 |
| Loans and advances to customers | 29,924 | 8,223 | 10,716 | 40,633 | 100,639 | 190,135 |
| Available-for-sale financial assets | 652 | 1,301 | 3,446 | 6,919 | 6,860 | 19,178 |
| Other assets | 6,200 | 191 | 71 | 175 | 15,583 | 22,220 |
| Total assets | 60,712 | 12,586 | 17,875 | 64,872 | 189,619 | 345,664 |
| <i>Liabilities</i> | | | | | | |
| Deposits from banks | 28,268 | 3,659 | 1,707 | 818 | 1,942 | 36,394 |
| Customer accounts | 129,158 | 3,394 | 4,960 | 1,854 | 1,401 | 140,767 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss | 932 | 709 | 751 | 1,991 | 2,678 | 7,061 |
| Debt securities in issue | 28,320 | 4,866 | 5,912 | 8,611 | 6,409 | 54,118 |
| Liabilities arising from insurance and investment contracts | 945 | 832 | 2,292 | 12,474 | 50,112 | 66,655 |
| Other liabilities | 5,586 | 325 | 437 | 274 | 10,065 | 16,687 |
| Subordinated liabilities | – | – | 300 | 1,673 | 9,533 | 11,506 |
| Total liabilities | 193,209 | 13,785 | 16,359 | 27,695 | 82,140 | 333,188 |
| Net liquidity gap | (132,497) | (1,199) | 1,516 | 37,177 | 107,479 | 12,476 |
| As at 31 December 2005 | | | | | | |
| <i>Assets</i> | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 520 | 818 | 1,051 | 6,271 | 51,907 | 60,567 |
| Derivative financial instruments | 848 | 618 | 603 | 1,906 | 1,903 | 5,878 |
| Loans and advances to banks | 24,372 | 1,513 | 3,955 | 1,357 | 458 | 31,655 |
| Loans and advances to customers | 24,560 | 7,696 | 10,944 | 39,132 | 94,303 | 176,635 |
| Available-for-sale financial assets | 130 | 1,092 | 1,839 | 6,638 | 5,241 | 14,940 |
| Other assets | 6,256 | 246 | 68 | 154 | 15,222 | 21,946 |
| Total assets | 56,686 | 11,983 | 18,460 | 55,458 | 169,034 | 311,621 |
| <i>Liabilities</i> | | | | | | |
| Deposits from banks | 23,839 | 4,778 | 1,710 | 141 | 1,059 | 31,527 |
| Customer accounts | 117,624 | 5,065 | 3,317 | 3,773 | 1,571 | 131,350 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss | 690 | 657 | 799 | 1,893 | 2,545 | 6,584 |
| Debt securities in issue | 20,629 | 8,395 | 3,887 | 1,586 | 4,849 | 39,346 |
| Liabilities arising from insurance and investment contracts | 1,030 | 359 | 1,263 | 9,502 | 50,887 | 63,041 |
| Other liabilities | 5,561 | 306 | 602 | 265 | 8,784 | 15,518 |
| Subordinated liabilities | – | – | – | 1,082 | 11,553 | 12,635 |
| Total liabilities | 169,373 | 19,560 | 11,578 | 18,242 | 81,248 | 300,001 |
| Net liquidity gap | (112,687) | (7,577) | 6,882 | 37,216 | 87,786 | 11,620 |

Notes to the accounts

47 Financial risk management (continued)

| The Bank | Up to 1 month £m | 1-3 months £m | 3-12 months £m | 1-5 years £m | Over 5 years £m | Total £m |
|--|---------------------------------|------------------------------|-------------------------------|-----------------------------|--------------------------------|---------------------|
| As at 31 December 2006 | | | | | | |
| <i>Assets</i> | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 291 | 378 | 549 | 3,781 | 3,820 | 8,819 |
| Derivative financial instruments | 564 | 633 | 1,287 | 1,746 | 1,435 | 5,665 |
| Loans and advances to banks | 27,211 | 4,333 | 11,655 | 35,469 | 7,920 | 86,588 |
| Loans and advances to customers | 54,009 | 10,623 | 6,753 | 19,584 | 15,607 | 106,576 |
| Available-for-sale financial assets | 460 | 629 | 814 | 1,081 | 988 | 3,972 |
| Other assets | 4,318 | 152 | 111 | 245 | 20,895 | 25,721 |
| Total assets | 86,853 | 16,748 | 21,169 | 61,906 | 50,665 | 237,341 |
| <i>Liabilities</i> | | | | | | |
| Deposits from banks | 35,742 | 3,948 | 2,090 | 1,388 | 902 | 44,070 |
| Customer accounts | 104,564 | 5,301 | 11,423 | 4,502 | 2,148 | 127,938 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss | 796 | 744 | 802 | 2,495 | 2,752 | 7,589 |
| Debt securities in issue | 17,361 | 4,689 | 4,844 | 1,339 | 4,486 | 32,719 |
| Other liabilities | 3,579 | 125 | 86 | 127 | 2,064 | 5,981 |
| Subordinated liabilities | – | – | 300 | 1,423 | 8,558 | 10,281 |
| Total liabilities | 162,042 | 14,807 | 19,545 | 11,274 | 20,910 | 228,578 |
| Net liquidity gap | (75,189) | 1,941 | 1,624 | 50,632 | 29,755 | 8,763 |
| As at 31 December 2005 | | | | | | |
| <i>Assets</i> | | | | | | |
| Trading and other financial assets at fair value through profit or loss | 219 | 456 | 540 | 4,104 | 605 | 5,924 |
| Derivative financial instruments | 825 | 506 | 652 | 2,021 | 2,046 | 6,050 |
| Loans and advances to banks | 40,701 | 3,371 | 6,214 | 33,688 | 2,116 | 86,090 |
| Loans and advances to customers | 42,889 | 6,606 | 7,162 | 18,519 | 16,583 | 91,759 |
| Available-for-sale financial assets | 126 | 1,085 | 757 | 1,161 | 1,374 | 4,503 |
| Other assets | 4,456 | 151 | 100 | 249 | 18,489 | 23,445 |
| Total assets | 89,216 | 12,175 | 15,425 | 59,742 | 41,213 | 217,771 |
| <i>Liabilities</i> | | | | | | |
| Deposits from banks | 29,955 | 4,920 | 2,105 | 993 | – | 37,973 |
| Customer accounts | 95,589 | 4,952 | 4,990 | 5,986 | 3,988 | 115,505 |
| Derivative financial instruments, trading and other liabilities at fair value through profit or loss | 688 | 600 | 800 | 2,372 | 2,752 | 7,212 |
| Debt securities in issue | 13,338 | 7,879 | 3,664 | 1,586 | 4,849 | 31,316 |
| Other liabilities | 3,487 | 109 | 243 | 63 | 2,198 | 6,100 |
| Subordinated liabilities | – | – | – | 1,082 | 10,300 | 11,382 |
| Total liabilities | 143,057 | 18,460 | 11,802 | 12,082 | 24,087 | 209,488 |
| Net liquidity gap | (53,841) | (6,285) | 3,623 | 47,660 | 17,126 | 8,283 |

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. An unmatched position potentially enhances profitability, but also increases the risk of losses.

Notes to the accounts

47 Financial risk management (continued)**Fair values of financial assets and liabilities**

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

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

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

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

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

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

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

Fair value is determined using market prices.

Derivative financial instruments

All derivatives are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow and options pricing models, as appropriate. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

Loans and advances to banks and customers

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

47 Financial risk management (continued)*Available-for-sale financial assets*

Listed securities are valued at current bid prices. Unlisted securities and other financial assets are valued based on discounted cash flows, market prices of similar instruments and other appropriate valuation techniques.

Investment properties

Fair values represent open-market values determined by an independent, professionally qualified valuer.

Deposits from banks and customer accounts

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

Debt securities in issue and subordinated liabilities

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

Trading and other liabilities at fair value through profit or loss

Fair value is determined using valuation techniques based upon market prices.

Liabilities arising from non-participating investment contracts

The value of the Group's non-participating investment contracts, all of which are unit-linked, is contractually linked to the fair values of financial assets within the Group's unitised investment funds and is determined using current unit prices multiplied by the number of units attributed to the contract holders at the balance sheet date. Their value is never less than the amount payable on surrender, discounted for the required notice period where applicable.

Financial commitments and contingent liabilities

Financial guarantees are valued on the basis of cash premiums received. The Group considers that it is not meaningful to provide an estimate of the fair value of other contingent liabilities and financial commitments, given the lack of an established market, the diversity of fee structures and the difficulty of separating the value of the instruments from the value of the overall transaction. Therefore only financial guarantees are included in the following table.

Notes to the accounts

47 Financial risk management (continued)

| | Carrying value | | Fair value | |
|---|----------------|------------|----------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| The Group | | | | |
| <i>Financial assets</i> | | | | |
| Trading and other financial assets at fair value through profit or loss | 67,928 | 60,567 | 67,928 | 60,567 |
| Derivative financial instruments | 5,565 | 5,878 | 5,565 | 5,878 |
| Loans and advances to banks | 40,638 | 31,655 | 40,641 | 31,691 |
| Loans and advances to customers | 190,135 | 176,635 | 189,827 | 177,245 |
| Available-for-sale financial assets | 19,178 | 14,940 | 19,178 | 14,940 |
| Investment properties | 4,739 | 4,260 | 4,739 | 4,260 |
| <i>Financial liabilities</i> | | | | |
| Deposits from banks | 36,394 | 31,527 | 36,383 | 31,508 |
| Customer accounts | 140,767 | 131,350 | 140,688 | 131,332 |
| Trading and other liabilities at fair value through profit or loss | 1,184 | – | 1,184 | – |
| Derivative financial instruments | 5,877 | 6,584 | 5,877 | 6,584 |
| Debt securities in issue | 54,118 | 39,346 | 54,070 | 39,352 |
| Liabilities arising from non-participating investment contracts | 24,370 | 21,839 | 24,370 | 21,839 |
| Financial guarantees | 49 | – | 49 | – |
| Subordinated liabilities | 11,506 | 12,635 | 12,250 | 13,436 |
| | | | | |
| | Carrying value | | Fair value | |
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| The Bank | | | | |
| <i>Financial assets</i> | | | | |
| Trading and other financial assets at fair value through profit or loss | 8,819 | 5,924 | 8,819 | 5,924 |
| Derivative financial instruments | 5,665 | 6,050 | 5,665 | 6,050 |
| Loans and advances to banks | 86,588 | 86,090 | 86,591 | 86,126 |
| Loans and advances to customers | 106,576 | 91,759 | 106,675 | 92,275 |
| Available-for-sale financial assets | 3,972 | 4,503 | 3,972 | 4,503 |
| <i>Financial liabilities</i> | | | | |
| Deposits from banks | 44,070 | 37,973 | 44,059 | 37,961 |
| Customer accounts | 127,938 | 115,505 | 127,929 | 115,523 |
| Trading and other liabilities at fair value through profit or loss | 1,184 | – | 1,184 | – |
| Derivative financial instruments | 6,405 | 7,212 | 6,405 | 7,212 |
| Debt securities in issue | 32,719 | 31,316 | 32,671 | 31,323 |
| Financial guarantees | 49 | – | 49 | – |
| Subordinated liabilities | 10,281 | 11,382 | 10,921 | 12,034 |

48 Acquisitions

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

In 2005 the Group, through its subsidiary The Dutton-Forshaw Motor Company Limited, completed the purchases of the assets and trade of three separate motor dealership businesses for a total consideration of £16 million, settled in cash. Goodwill of £3 million arose on these acquisitions; no significant fair value adjustments were made.

49 Cash flow statements

| | The Group | | The Bank | |
|---|-----------------|------------|-----------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| a Change in operating assets | | | | |
| Change in loans and advances to banks | (11,063) | (1,319) | (3,465) | (10,953) |
| Change in loans and advances to customers | (14,069) | (14,475) | (15,431) | (8,851) |
| Change in trading assets | (7,112) | (88) | (2,574) | 5,837 |
| Change in other operating assets | 50 | (1,202) | (131) | (55) |
| Change in operating assets | (32,194) | (17,084) | (21,601) | (14,022) |
| b Change in operating liabilities | | | | |
| | | | | |
| | The Group | | The Bank | |
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Change in deposits from banks | 5,222 | (8,168) | 6,750 | (9,418) |
| Change in customer accounts | 9,668 | 4,607 | 12,728 | 8,616 |
| Change in debt securities in issue | 15,068 | 10,280 | 1,699 | 7,652 |
| Change in trading liabilities | 482 | (3,957) | 382 | (1,149) |
| Change in investment contract liabilities | 3,795 | 6,094 | – | – |
| Change in other operating liabilities | (71) | 1,179 | 380 | 195 |
| Change in operating liabilities | 34,164 | 10,035 | 21,939 | 5,896 |

Notes to the accounts

49 Cash flow statements (continued)**g Disposal and closure of group undertakings and businesses**

| | The Group | | The Bank | |
|---|------------|------------|------------|------------|
| | 2006 £m | 2005 £m | 2006 £m | 2005 £m |
| Loans and advances to customers | - | 803 | - | 803 |
| Goodwill | - | 93 | - | 110 |
| Other net assets and liabilities | - | (946) | - | (970) |
| | - | (50) | - | (57) |
| Profit on sale and closure of businesses | - | 50 | - | 57 |
| Cash and cash equivalent consideration received | - | - | - | - |
| Cash and cash equivalents disposed of | - | - | - | - |
| Net cash outflow from disposals in the year | - | - | - | - |
| Consideration for 2005 disposal settled in cash | 936 | - | 936 | - |
| Adjustment to consideration received in respect of prior period disposals | - | (4) | - | - |
| Net cash inflow (outflow) from disposals | 936 | (4) | 936 | - |

Notes to the accounts

50 Future developments

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

| Pronouncement | Nature of change | Effective date |
|---|--|--|
| IFRS 7 <i>Financial Instruments: Disclosures</i> ¹ | Consolidates the current financial instruments disclosures into a single standard and requires more detailed qualitative and quantitative disclosures about exposure to risks arising from financial instruments. | Annual periods beginning on or after 1 January 2007. |
| Amendments to IAS 1 <i>Presentation of Financial Statements – Capital Disclosures</i> | Introduces additional disclosures of the objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, and compliance with capital requirements. | Annual periods beginning on or after 1 January 2007. |
| IFRIC 11 <i>IFRS 2 – Group and Treasury Share Transactions</i> ^{2,3} | Clarifies the application of IFRS 2 <i>Share-based Payment</i> to certain share-based payment arrangements involving own equity instruments and arrangements involving equity instruments of a parent entity. | Annual periods beginning on or after 1 March 2007. |
| IFRS 8 <i>Operating Segments</i> ^{2,3} | Replaces IAS 14 <i>Segment Reporting</i> and requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally. | Annual periods beginning on or after 1 January 2009. |

¹ Includes consequential changes to other pronouncements.

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

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

The full impact of these accounting changes is being assessed by the Group; none of these pronouncements are expected to cause any material adjustments to the financial statements.

51 Approval of the financial statements and other information

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

Lloyds TSB Bank plc and its subsidiaries form a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

