LLOYDS TSB GROUP PLC
Form 20-F
June 08, 2007

As filed with the Securities and Exchange Commission on 8 June 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

o REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended 31 December 2006

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

o SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-15246

LLOYDS TSB GROUP plc

(Exact name of Registrant as Specified in Its Charter)

Scotland
(Jurisdiction of Incorporation or Organization)

25 Gresham Street
London EC2V 7HN
United Kingdom
(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class

	Name of each exchange on which registered
Ordinary shares of nominal value 25 pence each, represented by American Depositary Shares.	The New York Stock Exchange.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

The number of outstanding shares of each of Lloyds TSB Group plc s classes of capital or common stock as of 31 December 2006 was:

Ordinary shares, nominal value 25 pence each, as of 31 December 2006	5,637,964,437
Limited voting shares, nominal value 25 pence each, as of 31 December 2006	78,947,368
Preference shares, nominal value 25 pence each, as of 31 December 2006	600,400
Preference shares, nominal value 25 cents each, as of 31 December 2006	1,000,000
Preference shares, nominal value 25 euro cents each, as of 31 December 2006	0
Preference shares, nominal value Japanese ¥25 each, as of 31 December 2006	0

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes x No o

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Yes o No x

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-Accelerated filer o

Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 x

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

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Presentation of information

In this annual report, references to Lloyds TSB Group or Group are to Lloyds TSB Group plc and its subsidiary and associated undertakings; references to Lloyds TSB Bank are to Lloyds TSB Bank plc; and references to the Consolidated Financial Statements or financial statements are to Lloyds TSB Group s Consolidated Financial Statements included in this annual report. References to the Financial Services Authority are to the United Kingdom (the UK) Financial Services Authority.

The Lloyds TSB Group publishes Consolidated Financial Statements prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS). IFRS are issued by the International Accounting Standards Board (IASB) and decisions regarding their adoption for use by European companies are taken in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of the European Union dated 19 July 2002 on the application of international accounting standards (the IAS Regulation). Article 4 of the IAS Regulation requires that the consolidated accounts of the Lloyds TSB Group are prepared in conformity with IFRS as adopted by the European Union. The accounting policies adopted by the Lloyds TSB Group in the Consolidated Financial Statements also comply with IFRS as issued by the IASB.

Unless noted otherwise, financial information contained in this annual report is presented in accordance with IFRS. IFRS differs from accounting principles generally accepted in the United States (US GAAP). See note 52 to the Consolidated Financial Statements for a description of the significant differences between IFRS and US GAAP, a reconciliation of net income and shareholders equity from IFRS to US GAAP and condensed consolidated US GAAP financial statements.

Lloyds TSB Group publishes its Consolidated Financial Statements expressed in British pounds (pounds sterling , sterling or £), the lawful currency of the UK. In this annual report, references to pence and p are to one-hundredth of one pound sterling; references to US dollars , US$ or $ are to the lawful currency of the United States (the US); references to cent are to one-hundredth of one dollar; references to euro or are to the lawful currency of the member states of the European Union that have adopted a single currency in accordance with the Treaty establishing the European Communities, as amended by the Treaty of European Union; references to euro cent are to one-hundredth of one euro; and references to Japanese yen Japanese ¥ or ¥ are to the lawful currency of Japan. Solely for the convenience of the reader, this annual report contains translations of certain pounds sterling amounts into US dollars at specified rates. These translations should not be construed as representations by Lloyds TSB Group that the pounds sterling amounts actually represent such US dollar amounts or could be converted into US dollars at the rate indicated or at any other rate. Unless otherwise stated, the translations of pounds sterling into US dollars have been made at the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate) in effect on 31 December 2006, which was $1.9586 = £1.00. The Noon Buying Rate on 31 December 2006 differs from certain of the actual rates used in the preparation of the Consolidated Financial Statements, which are expressed in pounds sterling, and therefore US dollar amounts appearing in this annual report may differ significantly from actual US dollar amounts which were translated into pounds sterling in the preparation of the Consolidated Financial Statements in accordance with IFRS.

Business overview

Lloyds TSB Group is a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and a limited number of locations overseas. At 31 December 2006 total Lloyds TSB Group assets were £343,598 million and Lloyds TSB Group had some 63,000 employees. Lloyds TSB Group plc s market capitalisation at that date was some £32,200 million. The profit before tax for the 12 months to 31 December 2006 was £4,248 million and the risk asset ratios as at that date were 10.7 per cent for total capital and 8.2 per cent for tier 1 capital.

The operations of Lloyds TSB Group in the UK were conducted through over 2,000 branches of Lloyds TSB Bank, Lloyds TSB Scotland plc and Cheltenham & Gloucester plc at the end of December 2006. International business is conducted mainly in the US and continental Europe. Lloyds TSB Group s services in these countries are offered largely through branches of Lloyds TSB Bank. Lloyds TSB Group also offers offshore banking facilities in a number of countries. For additional information see Regulation .

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

The following table shows the results of Lloyds TSB Group s UK Retail Banking, Insurance and Investments and Wholesale and International Banking segments and Central group items in each of the last three fiscal years. The impact of adopting IFRS, and in particular the increased use of fair values, has resulted in greater earnings volatility. In order to provide a more comparable representation of business performance this volatility has been separately analysed from the results of the individual business units so that, where appropriate, information is presented both in accordance with applicable accounting standards (statutory) and on a basis which excludes volatility (excluding volatility) (see Operating and financial review and prospects Line of business information Volatility).

	Profit before tax (statutory)			**Profit before tax (excluding volatility)**		
	2006 £m	2005 £m	2004 £m	**2006 £m**	2005 £m	2004 £m
UK Retail Banking	**1,549**	1,394	1,639	**1,549**	1,394	1,639
Insurance and Investments	**1,383**	1,474	916	**973**	725	778
Wholesale and International Banking	**1,640**	1,518	1,272	**1,640**	1,518	1,272
Central group items	**(324)**	(566)	(350)	**(321)**	(442)	(350)
Profit before tax, excluding volatility				**3,841**	3,195	3,339
Volatility*				**407**	625	138
Profit before tax	**4,248**	3,820	3,477	**4,248**	3,820	3,477

* Volatility relates to Insurance and Investments (2006: £410 million; 2005: £749 million; 2004: £138 million) and Central group items (2006: £(3) million; 2005: £(124) million; 2004: £nil).

Lloyds TSB Group plc was incorporated as a public limited company and registered in Scotland under the UK Companies Act 1985 on 21 October 1985 with the registered number 95000. Lloyds TSB Group plc s registered office is Henry Duncan House, 120 George Street, Edinburgh EH2 4LH, Scotland, and its principal executive offices in the UK are located at 25 Gresham Street, London, EC2V 7HN, United Kingdom, telephone number + 44 (0) 20 7626 1500.

Selected consolidated financial data

The financial information set out in the tables below has been derived from the annual reports and accounts of Lloyds TSB Group plc for each of the past five years adjusted for subsequent changes in accounting policy and presentation. The financial statements for each of the years 2002 to 2006 have been audited by PricewaterhouseCoopers LLP, independent accountants.

As stated in Presentation of information , the financial statements for the years 2005 and 2006, together with the comparative information for 2004, have been prepared in accordance with IFRS which differs in certain significant respects from US GAAP. A discussion of the differences between IFRS and US GAAP and a reconciliation of certain IFRS amounts to US GAAP are included in note 52 to the financial statements.

IFRS	**2006**	2005	2004
Income statement data for the year ended 31 December (£m)[1]			
Total income, net of insurance claims	**11,104**	10,540	9,661
Operating expenses	**(5,301)**	(5,471)	(5,297)
Trading surplus	**5,803**	5,069	4,364
Impairment losses on loans and advances	**(1,555)**	(1,299)	(866)
Profit before tax	**4,248**	3,820	3,477
Profit for the year	**2,907**	2,555	2,459
Profit for the year attributable to equity shareholders	**2,803**	2,493	2,392
Total dividend for the year[2]	**1,927**	1,915	1,914
Balance sheet data at 31 December (£m)[1]			
Share capital	**1,429**	1,420	1,419
Shareholders equity	**11,155**	10,195	11,047
Customer accounts	**139,342**	131,070	119,811
Preferred securities	**2,957**	2,549	1,388
Undated subordinated liabilities	**4,863**	5,184	4,464
Dated subordinated liabilities	**4,252**	4,669	4,400
Loans and advances to customers	**188,285**	174,944	155,318
Total assets	**343,598**	309,754	284,422
Share information			
Basic earnings per ordinary share	**49.9p**	44.6p	42.8p
Diluted earnings per ordinary share	**49.5p**	44.2p	42.5p
Net asset value per ordinary share	**195p**	180p	195p
Total dividend per ordinary share[2]	**34.2p**	34.2p	34.2p
Equivalent cents per share[2,3]	**67.0c**	62.2c	63.7c
Market price (year-end)	**571.5p**	488.5p	473p
Number of shareholders (thousands)	**870**	920	953
Number of ordinary shares in issue (millions)[4]	**5,638**	5,603	5,596
Financial ratios (%)[5]			
Dividend payout ratio	**68.7**	76.8	80.0
Post-tax return on average shareholders equity	**26.6**	25.6	22.8
Post-tax return on average assets	**0.88**	0.84	0.92
Post-tax return on average risk-weighted assets	**1.89**	1.81	1.99
Average shareholders equity to average assets	**3.2**	3.2	3.9
Cost:income ratio[6]	**47.7**	51.9	54.8
Capital ratios (%)[7]			
Total capital	**10.7**	10.9	10.1
Tier 1 capital	**8.2**	7.9	8.2

1

Comparative data for 2004 excludes the provisions of IAS 32, IAS 39 and IFRS 4, which were adopted with effect from 1 January 2005.

2 Annual dividends comprise both interim and final dividend payments. For the purposes of the IFRS disclosures in this table, the total dividend for the year represents the interim dividend paid during the year and the final dividend, which is paid and accounted for in the following year.

3 Translated into US dollars at the Noon Buying Rate on the date each payment was made.

4 This figure excludes the 79 million limited voting ordinary shares owned by the Lloyds TSB Foundations.

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

6 The cost:income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims).

7 In order to provide a more meaningful comparison, capital ratios are shown at 1 January 2005, rather than 31 December 2004, in order to reflect the application of those accounting standards applied with effect from 1 January 2005.

Selected consolidated financial data

SELECTED US GAAP FINANCIAL DATA	2006	2005	2004	2003	2002
Income statement data for the year ended 31 December (£m)[1]					
Total revenues, net of interest expense	**19,321**	20,413	16,668	14,139	10,498
Policyholder benefits and claims expense	**(5,647)**	(7,476)	(4,473)	(3,036)	(1,565)
Allowance for loan losses	**(1,555)**	(1,613)	(866)	(950)	(1,029)
Income before tax	**3,657**	2,605	3,214	4,220	2,378
Net income	**1,815**	1,351	1,508	3,231	1,753
Dividends	**1,919**	1,914	1,913	1,908	1,903
Balance sheet data at 31 December (£m)					
Shareholders equity	**10,752**	10,981	11,458	11,892	10,164
Deposits	**175,736**	162,491	159,546	140,451	141,777
Loans, net of provisions	**188,886**	173,981	152,428	134,043	134,202
Total assets	**340,205**	305,917	281,598	251,158	254,352
Share information (pence per ordinary share)					
Basic earnings	**32.3**	24.1	27.0	57.9	31.5
Diluted earnings	**32.1**	24.0	26.8	57.7	31.3
Net asset value	**188**	193	202	210	180
Dividends	**34.2**	34.2	34.2	34.2	34.2
Financial ratios (%)[2]					
Dividend payout ratio	**105.7**	141.7	126.9	59.1	108.6
Post-tax return on average shareholders equity	**16.7**	12.0	12.9	29.3	14.8
Post-tax return on average assets	**0.80**	0.60	0.65	1.29	0.73
Average shareholders equity to average assets	**3.4**	3.8	4.4	4.4	4.8

1 For the purposes of this five year summary, income statement items in respect of discontinued operations have been aggregated with those of continuing operations.

2 Lloyds TSB Group does not have sufficient information to calculate US GAAP average balances on a monthly basis. Where applicable, these financial ratios have been based upon simple averages of the opening and closing balances.

Exchange rates

In this annual report, unless otherwise indicated, all amounts are expressed in pounds sterling. For the months shown the US dollar high and low Noon Buying Rates per pound sterling were:

	2007 May	2007 April	2007 March	2007 February	2007 January	2006 December
US dollars per pound sterling:						
High	2.00	2.01	1.97	1.97	1.98	1.98
Low	1.97	1.96	1.92	1.94	1.93	1.95

For the years shown the averages of the US dollar Noon Buying Rates per pound sterling on the last day of each month were:

	2006	2005	2004	2003	2002
US dollars per pound sterling:					
Average	1.86	1.81	1.84	1.64	1.51

On 31 May 2007, the latest practicable date, the US dollar Noon Buying Rate was $1.9797 = £1.00. Lloyds TSB Group makes no representation that amounts in pounds sterling have been, could have been or could be converted into US dollars at that rate or at any of the above rates.

Business

History and development of Lloyds TSB Group

The history of the Lloyds TSB Group can be traced back to the 18th century when the banking partnership of Taylor and Lloyds was established in the UK. Lloyds Bank Plc was incorporated in 1865 and during the late 19th and early 20th centuries entered into a number of acquisitions and mergers, significantly increasing the number of banking offices in the UK.

In 1988 Lloyds Bank Plc acquired a majority shareholding in Abbey Life Group plc (renamed Lloyds Abbey Life plc (LAL)) in return for the sale to LAL of five of Lloyds TSB Bank s businesses; and in 1995 it acquired the business of Cheltenham and Gloucester Building Society.

TSB Group plc became operational in 1986 when, following UK government legislation, the operations of four Trustee Savings Banks and other related companies were transferred to TSB Group plc and its new banking subsidiaries. By 1995, the TSB Group had, either through organic growth or acquisition, developed life and general insurance operations, investment management activities, a motor vehicle hire purchase and leasing operation, and an estate agency business to supplement its retail banking activities.

In 1995, TSB Group plc merged with Lloyds Bank Plc. Under the terms of the merger, the TSB and Lloyds Bank groups were combined under TSB Group plc, which was re-named Lloyds TSB Group plc with Lloyds Bank Plc, which was subsequently renamed Lloyds TSB Bank plc, the principal subsidiary. In 1999, the businesses, assets and liabilities of TSB Bank plc, the principal banking subsidiary of the TSB Group prior to the merger, and its subsidiary Hill Samuel Bank Limited were vested in Lloyds TSB Bank plc. In 1996, the Lloyds TSB Group acquired the minority interest in LAL and in 2000, Lloyds TSB Group acquired Scottish Widows. In addition to being one of the leading providers of banking services in the UK, this transaction also positioned Lloyds TSB Group as one of the leading suppliers of long-term savings and protection products in the UK.

In more recent years, the Lloyds TSB Group has disposed of a number of its overseas operations, as part of the process of managing its portfolio of businesses to focus on its core markets. These disposals have resulted in a significant reduction in the size of the Lloyds TSB Group s international business. For additional information on the Lloyds TSB Group see Business Overview .

Management and resources

Lloyds TSB Group recognises that it will create value for its shareholders if it creates value for its customers. Its constant aim is to meet the rapidly changing needs and expectations of its customers. Lloyds TSB Group believes that success depends upon service, consistency and commitment and it aims, wherever possible, to maintain long-term relationships with its customers.

Lloyds TSB Group operates in a marketplace which is continually changing. No organisation can successfully manage change without the support and commitment of its staff. The pace and scope of change will not diminish as competition in the financial services market continues to increase. Lloyds TSB Group recognises that it is the staff of the organisation who have delivered, and will continue to deliver, its success. The Lloyds TSB Group invests a significant amount in training to develop the knowledge and skills of its employees, which it considers to be a key element in the achievement of its overall strategy.

Lloyds TSB Group recognises that long-term success depends on the quality of its management. It is therefore committed to developing the potential of all managers; in particular ensuring that it has the succession management capability to meet future needs for top management.

Two non-executive directors, Mr M.A. van den Bergh and Mrs A.A. Knight, left the board on 11 May and 31 October 2006 respectively. Dr Julius retired at the annual general meeting on 9 May 2007. Mr P.N. Green was appointed a non-executive director on 10 May 2007.

Sir Victor Blank joined the board as deputy chairman on 1 March 2006 and became chairman of Lloyds TSB Group at the annual general meeting on 11 May 2006, on the retirement of Mr van den Bergh.

Strategy of Lloyds TSB Group

In an environment of strong competition, Lloyds TSB Group believes that shareholder value can best be achieved by:

focusing on markets where it can build and sustain competitive advantage;

developing business strategies for those markets which are founded on being profitably different in the way it creates customer value; and

building a high-performance organisation focused on the right goals and the best possible execution of those strategies.

Reflecting this, in 2003 the Lloyds TSB Group put in place a three-phase strategy. In phase 1, now completed, the Lloyds TSB Group focused on enhancing the quality of its earnings by exiting businesses which were not regarded as core or which added unnecessary volatility to its earnings. During this phase, the Lloyds TSB Group divested businesses in New Zealand and Latin America, markets in which it did not expect to be able to build and sustain competitive advantage. In phase 2, Lloyds TSB Group s focus is on accelerating growth by deepening its customer relationships and improving its productivity and, in the process, building competitive advantage through enhancing its capabilities. This has already resulted in improved earnings growth in the Lloyds TSB Group s core markets. In phase 3, the Lloyds TSB Group expects to leverage its financial strength and enhanced capabilities in new markets.

Lloyds TSB Group remains alert for opportunities to grow inorganically to complement its organic strategies and help provide new opportunities for profitable growth, both in the UK and overseas. In delivering this strategy Lloyds TSB Group believes that shareholder value will be maximised over time.

Business

Markets

Lloyds TSB Group continues to focus on building competitive advantage in its core markets by seeking opportunities to consolidate its position in businesses where it is already strong, through a combination of organic growth and acquisitions, and by divesting businesses in markets where it is not a leader and cannot aspire reasonably to leadership.

Strategy

Lloyds TSB Group s strategy for phase 2 is based on a belief that sustained growth comes from simultaneously focusing on (i) building strong customer franchises, (ii) continuous productivity improvement and (iii) maximising capital efficiency.

(i) Strong customer franchises

In an increasingly competitive financial services market, and with customers able to exercise choice amongst alternative providers, shareholder value creation is closely linked to customer value creation. Shareholder value can only be created by attracting and retaining customers and winning a greater share of their financial services business. Across its main businesses, Lloyds TSB Group has strong core banking franchises, but smaller market shares in associated product areas. The Lloyds TSB Group s strategy is focused on being differentiated in the creation of customer value to win a bigger share of its customers total financial services spend.

Strong franchises depend on having highly motivated employees. Since 2003, measures of the Lloyds TSB Group s employee engagement from an independent survey by Towers Perrin ISR have shown a sustained steady improvement across all divisions, so that by 2006, the Lloyds TSB Group s score was on a par with the UK s highest performing companies and 6 per cent above the UK financial services norm. Towers Perrin ISR research shows that high employee engagement scores are positively correlated with business performance.

Motivated employees, combined with investments in improving service, help to build customer satisfaction. The Lloyds TSB Group s customer satisfaction scores have also improved consistently in recent periods, as shown by our internal CARE scores and supported by external estimates from MORI. The Lloyds TSB Group will continue to invest in the drivers of customer satisfaction, with a goal of moving beyond satisfaction to customer advocacy. Against a background of improving customer satisfaction the Lloyds TSB Group has stronger sales and income growth in its three business divisions, UK Retail Banking, Insurance and Investments and Wholesale and International Banking.

(ii) Continuous productivity improvement

Superior economic profit growth also requires a continuous focus on productivity improvement, which drives both improved customer service and cost reduction. In recent years, the Lloyds TSB Group has been building a set of capabilities in six sigma (error reduction) lean manufacturing (operations efficiency) and procurement. Alongside those capabilities, the Lloyds TSB Group applies an income growth must exceed cost growth discipline in setting goals for each business, requiring a wider gap between income growth and cost growth for lower growth/return businesses than for higher growth/return businesses. Finally, the Lloyds TSB Group has been simplifying management structures, aiming to reduce layers of management and increase spans of control. A further discussion of economic profit is set out on page 23.

The results are showing across all three divisions in much reduced error rates in key processes, growing levels of income per employee and falling unit costs, without impacting investment in future growth. Further improvements in the Lloyds TSB Group s cost:income ratio are expected going forward as these capabilities and disciplines are extended further.

(iii) Capital efficiency

Lloyds TSB Group measures value internally by economic profit growth, a measure of financial performance which signals unambiguously where value is being created or destroyed. It has developed a framework to be able to measure economic equity requirements across all its businesses, taking into account market, credit, insurance, business and operational risk. Using economic profit as a key performance measure enables the Lloyds TSB Group to understand which strategies, products, channels and customer segments are destroying value and which are creating the most value and to make better capital allocation decisions as a result. Economic profit metrics also drive management of our balance sheet, and the Lloyds TSB Group has recently initiated an active programme of securitisation and the structuring and distribution of risk. See Operating and Financial Review and Prospects Risk management .

The application of these economic profit disciplines, alongside goal-setting linked to ensuring that revenue growth constantly exceeds cost growth, has already been reflected in significant improvement in the capital efficiency of the Lloyds TSB Group s Insurance and Investments division and by a shift in business mix towards sectors offering higher risk-adjusted returns in wholesale banking. By the continued rigorous application of these disciplines at every level, the Lloyds TSB Group expects to further improve capital efficiency going forward.

It is the Lloyds TSB Group s belief that the set of management processes and capabilities being built to drive differentiated customer satisfaction, continuously improve productivity and maximise capital efficiency will enable the Lloyds TSB Group to achieve its phase 2 goal of double digit economic profit growth over time and, in phase 3, expand from strength into new markets.

Business

Business and activities of Lloyds TSB Group

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

UK Retail Banking

UK Retail Banking provides banking, financial services, mortgages and private banking to some 16 million personal customers through the Lloyds TSB Group s multi-channel distribution capabilities.

Branches. Lloyds TSB Group provides wide-reaching geographic branch coverage in England, Scotland and Wales, with over 2,000 branches of Lloyds TSB Bank, Lloyds TSB Scotland plc (Lloyds TSB Scotland) and Cheltenham & Gloucester plc (Cheltenham & Gloucester or C&G) as at the end of 2006.

Internet banking. Internet banking provides online banking facilities for personal customers. Some 4.4 million customers have registered to use Lloyds TSB Group s internet banking services. At the end of 2006, these customers were conducting more than 57 million transactions per month online, a 24 per cent increase on 2005.

Telephone banking. Telephone banking continues to grow and Lloyds TSB Group now provides one of the largest telephone banking services in Europe. At the end of 2006, some 5.3 million customers had registered to use the services of PhoneBank and the automated voice response service, PhoneBank Express. Lloyds TSB Group s telephone banking centres handled some 62 million calls during 2006.

Cash machines. Lloyds TSB Group has one of the largest cash machine networks of any leading banking group in the UK and, at 31 December 2006, personal customers of Lloyds TSB Bank and Lloyds TSB Scotland were able to withdraw cash and check balances through some 4,100 ATMs at branches and external locations around the country. In addition, our personal customers have access to over 60,000 cash machines via LINK in the UK and to cash machines worldwide through the VISA and MasterCard networks.

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

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

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

Cards. Lloyds TSB Group provides a range of card-based products and services, including credit and debit cards and card transaction processing services for retailers. Lloyds TSB Group is a member of both the VISA and MasterCard payment systems and has access to the American Express payment system. The Lloyds TSB Group had a 12.4 per cent share of outstanding UK card balances at 31 December 2006.

Mortgages. Cheltenham & Gloucester is Lloyds TSB Group s specialist residential mortgage provider, offering a range of mortgage products to personal customers through its own branches and those of Lloyds TSB Bank in England and Wales, as well as through the telephone, internet and postal service, Mortgage Direct. Lloyds TSB Group also provides mortgages through Lloyds TSB Scotland and Scottish Widows Bank. Lloyds TSB Group is one of the largest residential mortgage lenders in the UK on the basis of outstanding balances, with mortgages outstanding at 31 December 2006 of £95,333 million, representing a market share of 8.8 per cent.

UK Wealth Management. Wealth Management provides financial planning and advice for Lloyds TSB Group s affluent customers, providing financial solutions across investments, retirement planning and income, trusts, tax and estate planning as well as share dealing. Expert advice is provided through a large population of Lloyds TSB financial planners who can be accessed via the retail branch network and Private Banking offices nationwide. Customers are also provided with access to relationship banking as part of Lloyds TSB Private Banking, one of the largest private banks in the UK.

Insurance and Investments

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

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

In common with other life assurance companies in the UK, the life and pensions business of each of the life assurance companies in the Lloyds TSB Group is written in a long-term business fund. The main long-term business fund is divided into With-Profits and Non-Profit sub-funds.

With-profits life and pensions products are written from the With-Profits sub-fund. The benefits accruing from these policies are designed to provide a smoothed return to policyholders who hold their policies to maturity through a mix of annual and final (or terminal) bonuses added to guaranteed basic benefits. The guarantees generally only apply on death or maturity. The actual bonuses declared will reflect the experience of the With-Profits sub-fund.

Other life and pensions products are generally written from the Non-Profit sub-fund. Examples include unit-linked policies, annuities, term assurances and health insurance (under which a predetermined amount of benefit is payable in the event of an insured event such as being unable to work through sickness). The benefits provided by linked policies are wholly or partly determined by reference to a specific portfolio of assets known as unit-linked funds.

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

Business

Scottish Widows Investment Partnership. Scottish Widows Investment Partnership manages funds for Lloyds TSB Group s retail life, pensions and investment products. Clients also include corporate pension schemes, local authorities and other institutions in the UK and overseas.

Wholesale and International Banking

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

Wholesale

Corporate Markets. Combining the respective strengths of some 3,000 people in Corporate Banking, Structured Finance and Financial Markets, plays an integral role in leveraging and expanding the customer franchise and building deep, long-lasting relationships with around 18,000 corporate customers.

Corporate Banking manages the core customer franchise, providing a relationship-based financial and advisory service to the corporate market place through dedicated regional teams throughout the UK and key strategic locations abroad, including New York. Customers have access to expert advice and a broad range of financial solutions. Relationship Managers act as a conduit to product and service partners in Corporate Markets and other parts of the Lloyds TSB Group.

Structured Finance comprises the structured asset finance, leveraged lending and private equity and other transactional lending and structuring businesses of Corporate Markets. Structured Finance executes transactions with existing corporate customers as well as introducing new-to-bank relationships to the franchise.

Financial Markets provides market access to sources of liquidity, hedging tools and investment products on behalf of Lloyds TSB Group and its customers. Financial Markets also provides risk management solutions to corporate customers. Through its Debt Capital Markets capability, Financial Markets delivers a range of solutions across a number of markets encompassing debt origination and syndication, securitisation, structured credit, credit derivatives and private placements.

Registrars. Lloyds TSB Registrars is the UK s leading provider of share registration services and employee share plans. It acts for over 650 client companies, including around 60 per cent of the FTSE 100.

Asset Finance. Lloyds TSB Group s asset finance businesses provide individuals and companies with finance through leasing, hire purchase and contract hire packages. Hire purchase, or instalment credit, is a form of consumer financing where a customer takes possession of goods on payment of an initial deposit but the legal title to the goods does not pass to the customer until the agreed number of instalments have been paid and the option to purchase has been exercised. Through its invoice discounting and factoring subsidiary, Lloyds TSB Commercial Finance, Lloyds TSB Group provides working capital finance for its customers. Specialist personal lending, store credit and the Dutton-Forshaw motor dealerships complete this group of businesses. Altogether, Asset Finance has over 1.7 million individual customers and relationships with some 40,000 companies and small businesses.

Business Banking. A growing business which has relationships with some 600,000 small businesses managed by business managers based in 500 locations throughout the UK. Lloyds TSB Group has a leading share of the new business start-up market, with some 100,000 new businesses opening an account with the Lloyds TSB Group in 2006. The main activity of The Agricultural Mortgage Corporation is to provide long-term finance to the agricultural sector.

International Banking

The Lloyds TSB Group has continued to shape its international network to support its UK operations.

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

International private banking. Lloyds TSB Group has international private banking operations for wealthy individuals. The business is conducted through branches of Lloyds TSB Bank located in Switzerland, Luxembourg, Monaco, Gibraltar, Uruguay, Dubai and the US, supported by representative offices in Latin America.

International corporate banking. Serves the corporate and institutional market in Europe, the Middle East and Japan through offices in Belgium, France, the Netherlands, Spain, Dubai and Japan.

Latin American banking. Lloyds TSB Group continues to have offices in Ecuador and Uruguay which provide mainly corporate banking services. The sale of the business in Paraguay was completed on 3 May 2007 following receipt of the required regulatory approval.

A new organisational structure for Wholesale and International Banking is effective in 2007. The division s corporate customers with turnover between £2 million and £15 million per annum have been transferred from Corporate Markets to Business Banking, which has been renamed Commercial Banking; in addition, Lloyds TSB Commercial Finance has been transferred from Asset Finance to Commercial Banking.

In May 2007, the Lloyds TSB Group announced the sale of Lloyds TSB Registrars (see Recent developments below).

Business

Material contracts

Lloyds TSB Group and its subsidiaries are party to various contracts in the ordinary course of business. In 2006, there have been no material contracts entered into outside the ordinary course of business.

Recent developments

Sale of the business and assets of Lloyds TSB Registrars

The Lloyds TSB Group announced on 22 May 2007 that it has agreed the sale of the business and assets of Lloyds TSB Registrars for a total cash consideration of £550 million, subject to completion and other adjustments. The transaction is expected to be completed in the second half of 2007 and is subject to regulatory approval. Subject to completion and other adjustments, it is expected that a profit before tax of circa £440 million (tax: £nil) will be recognised in the income statement of Lloyds TSB Group for the year ending 31 December 2007.

Trading statement

Lloyds TSB Group issued a trading statement on 8 June 2007, which included the following comments:

Lloyds TSB has continued to make strong progress in the first half of 2007 and expects to deliver a good trading performance and accelerated profit momentum. We have continued to extend the reach and depth of our customer relationships, achieving good sales growth throughout the organisation, whilst improving productivity and efficiency. This has led to revenue growth remaining well ahead of cost growth. In addition, credit quality remains satisfactory. As a result, we expect to deliver double digit growth in profit before tax, earnings per share and economic profit, before volatility, in the first half of 2007, compared to the first half of 2006.

Continued progress in UK Retail Banking: The Retail Bank continues to make good progress, with further strong growth in product sales, and continued good revenue growth in the first half of 2007. We continue to increase our market share of new current account customers, and have been successful in increasing our share of the added value current account market. We have also delivered a good performance in the growing savings and investment market, especially in bank savings and bancassurance, although consumer demand for unsecured lending has remained subdued. In mortgages, the Group has continued to maintain high levels of asset quality by focusing largely on the prime UK mortgage market. Our overall market share of net new mortgage lending in the first half of 2007 is expected to be broadly in line with our outstanding stock position.

Good sales growth in Insurance and Investments: In Insurance and Investments, we have continued to achieve good levels of sales growth in life, pensions and long-term savings, particularly in the bancassurance channel. Sales of protection products have been strong following the launch of the Group’s new protection platform ‘Protection for Life’ in the second half of 2006. New business margins remain robust. In General Insurance, we have delivered improved home insurance sales and good cost control, although there has been an increase in weather related claims.

Good trading momentum in Wholesale and International Banking: In Wholesale and International Banking, good trading momentum has been maintained with continued strong growth in Corporate Markets and Commercial Banking. In Corporate Markets, we have continued to develop new revenue streams in areas such as securitisation, structured credit and credit loan trading, and this has led to increased cross-selling revenues. In Commercial Banking, we have maintained our market leading share of new business start-ups, as well as increasing the number of customers switching to Lloyds TSB from other financial services providers. Revenue growth continues to exceed cost growth despite income pressure in the Asset Finance consumer businesses, reflecting lower levels of consumer demand and the tightening of credit criteria, and further investment in our higher growth businesses.

Strong Group cost performance: The Group’s strong cost performance has continued, resulting in a further substantial improvement in the Group’s cost: income ratio. The Group’s programme of efficiency improvements is progressing well and we continue to expect to deliver net benefits of approximately £125 million in 2007.

Overall credit quality remains satisfactory: Overall, Group asset quality remains satisfactory and we expect the Group's impairment charge as a percentage of average lending for the half-year to be lower than in the first half of last year. During the first quarter of 2007, we saw a reduction in the level of bankruptcies and Individual Voluntary Arrangements (IVAs), compared to the fourth quarter of 2006. The quality of new unsecured lending has continued to be strong and our arrears and delinquency trends have remained good. In addition, the asset quality in our mortgage portfolio has remained excellent. The retail impairment charge for the first half of 2007 is expected to be broadly flat, compared to the charge in the first half of 2006. In Wholesale, corporate and small business asset quality has remained strong with no signs of deterioration in the overall quality of our lending. The quality of business remains good, and the level of corporate provisions is expected to remain relatively low during 2007, albeit at a higher level than last year, largely as a result of lower releases and recoveries.

Capital ratios remain robust: The Group's capital ratios remain robust and the annualised rate of risk-weighted asset growth in the first half of 2007 is expected to be in our targeted mid-to-high single digit range. This has been supported by the Group's continued move towards an 'origination and distribution' model of balance sheet management. During May 2007, we completed a residential mortgage-backed securitisation (RMBS) of £3.1 billion. The capital position of Scottish Widows remains strong and we repatriated a further £400 million of surplus capital to the Group during the first quarter of 2007.

Business

Wholesale and International Banking restructure: We have recently re-aligned the Wholesale and International Banking organisational structure to better meet customer needs and improve efficiency. Customers with turnover between £2 million and £15 million per annum have moved from Corporate Markets to Business Banking, which has been renamed Commercial Banking. Our asset-backed lending business is now also part of Commercial Banking, thus combining the considerable relationship and product expertise within our teams to serve our customers better.

Continuing to build our strong customer franchises and delivering on our financial goals: Eric Daniels, Group Chief Executive, said In addition to delivering our short-term financial goals, we are continuing to build and enhance our long-term customer franchises throughout the Group. By doing so, we believe that we can deliver sustained double digit economic profit growth over time. The Group remains firmly on track to deliver a good trading performance for the first half of 2007 and, as we look to the future, we are increasingly confident in the Group s earnings growth prospects.

Other than the recent developments described in this section there has been no significant change since the date of the Consolidated Financial Statements.

Properties

As at 31 December 2006, Lloyds TSB Group occupied 3,499 properties in the UK. Of these, 579 were held as freeholds, 69 as long-term leaseholds and 2,851 as short-term leaseholds. The majority of these properties are retail branches and ATM sites, widely distributed throughout England, Scotland and Wales. Other buildings include the Lloyds TSB Group s head office in the City of London, and customer service and support properties located to suit business needs, but clustered largely in London, Birmingham and Bristol (in England), Edinburgh (in Scotland) and Cardiff and Newport (in Wales).

In addition, Lloyds TSB Group owns, leases or uses under licence properties for business operations elsewhere in the world, principally in Spain, Switzerland, Dubai and Asia.

Legal actions

Lloyds TSB Group is periodically subject to threatened or filed legal actions in the ordinary course of business. Lloyds TSB Group does not expect the final outcome of any legal proceedings currently known to it to have a material adverse effect on its consolidated results of operations or financial condition.

Competitive environment

Lloyds TSB Group s key markets are in the UK, in both the retail and wholesale financial services sectors, where the markets are relatively mature. Retail banking markets have shown strong rates of growth in recent years, notably in consumer borrowing and mortgages; the resultant higher rates of consumer indebtedness may affect the rate of growth going forward. The markets for life, pensions and investment products are expected to continue to grow in a number of key areas. Investment sales have recovered reflecting rising stock markets and the return of investor confidence; sales of pensions products were boosted by changes in legislation in 2006. Wholesale markets have shown strong growth recently, and cyclically low levels of bad debt. Going forward, some slowing of market growth is likely, together with a return to more normal levels of bad debt.

Lloyds TSB Group s competitors include all the major financial services companies operating in the UK. In the retail banking market, Lloyds TSB Group competes with banks and building societies, major retailers and internet-only providers. In the mortgage market, competitors include the traditional banks and building societies and new entrants to the market, with the market becoming increasingly competitive as both new entrants and incumbents endeavour to gain market share.

The fragmented nature of the life, pensions and investments market in the UK has resulted in some consolidation within certain product sectors, but the overall share of new business of the top ten providers remains broadly similar. However, on closed books there has been some activity led by non-traditional players. In the general insurance sector, the long-term trend of consolidation amongst underwriters and brokers continues, while distribution remains fragmented through growth in the number of affinity partnerships.

In the wholesale banking market, the Lloyds TSB Group competes with both UK and foreign financial institutions; in asset finance the main competition comes from other banks and specialised asset finance providers.

In the UK and elsewhere, there is continuing political and regulatory scrutiny of financial services:

Competition Commission

In February 2007 the Office of Fair Trading, following its own market study launched in April 2006, referred the payment protection insurance market to the Competition Commission, which will report within two years.

Office of Fair Trading (OFT)

The following reviews and inquiries are being carried out:

The OFT is carrying out a review of undertakings given by some banks in 2002 regarding the supply of banking services to small and medium-sized entities (SMEs).

The OFT is conducting an inquiry into credit card interchange fees charged by both the MasterCard and Visa networks.

The OFT is also undertaking an in-depth study of retail bank pricing which will sit alongside a formal investigation into the fairness of bank current account charges. The market study will enable the OFT to consider wider questions about competition and price transparency in the provision of personal current accounts and obtain the necessary context for assessing the fairness of unauthorised overdraft charges.

Business

The European Commission

The European Commission is conducting its own inquiry into retail banking services across the European Union.

The European Commission is also considering a number of regulatory proposals including a Consumer Credit Directive, a Payment Services Directive and revised capital adequacy requirements for insurance companies (Solvency II). This is in addition to a number of EU directives, including the Markets in Financial Instruments Directive (MiFID) and the Capital Requirements Directive, which are currently being implemented in the UK.

These investigations and any connected matters are likely to affect the industry and have an impact on the Lloyds TSB Group s business. Lloyds TSB Group is considering actions to mitigate any financial impact. The net effect from a product and cost/income perspective is currently under consideration. However the Lloyds TSB Group is presently unable to quantify with any reasonable certainty the aggregate cost or income implications in relation to the above inquiries.

Operating and financial review and prospects

The results discussed below are not necessarily indicative of Lloyds TSB Group s results in future periods. The following information contains certain forward-looking statements. For a discussion of certain cautionary statements relating to forward-looking statements, see Forward-Looking Statements .

The following discussion is based on and should be read in conjunction with the Consolidated Financial Statements and the related notes thereto included elsewhere in this annual report. For a discussion of the accounting policies used in the preparation of the Consolidated Financial Statements, see Accounting policies in note 1 to the Consolidated Financial Statements. The Consolidated Financial Statements are prepared in accordance with IFRS, which varies in certain significant respects from US GAAP. A discussion of such differences and a reconciliation of certain IFRS amounts to US GAAP is included in note 52 to the Consolidated Financial Statements. Certain information for years prior to 2004 has been prepared under UK GAAP, which is not comparable with IFRS.

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Operating and financial review and prospects

Overview and trend information

Lloyds TSB Group has operations in both the UK and overseas; however, its earnings are heavily dependent upon its domestic activities and in 2006 substantially all of Lloyds TSB Group s profit before tax was derived from its UK operations. The state of the UK economy, therefore, has significant implications for the way in which Lloyds TSB Group runs its business and its performance.

After increasing to growth of around 2.7 per cent in 2006, the UK economy is expected to slow somewhat to growth of around 2.6 per cent in 2007. Retail price inflation rose during 2006, partly following increases in fuel prices, and the Bank of England increased base rates from 4.5 per cent at the start of 2006 to 4.75 per cent in August 2006 and to 5.0 per cent in November 2006. House price inflation, however, remained buoyant and there was continuing growth in mortgage lending, although unsecured personal lending growth has levelled off. Looking forward to 2007, the Bank of England has raised interest rates by 0.25 per cent in January 2007 and a further 0.25 per cent in May 2007 and it is clear that rates will be raised further if this is deemed necessary in order to control inflation. Consumer confidence is expected to remain good as there will be an increase in demand for labour, although labour supply is also expected to grow as a result of immigration and the return to work of older workers. Slower global growth and the strength of sterling are, however, expected to act as a drag on exports in 2007.

Against this economic backdrop, there has been continued growth in each of Lloyds TSB Group s three divisions: (i) UK Retail Banking, as a result of strong growth in mortgage and customer deposit balances with costs remaining tightly controlled, although unsecured personal lending is largely flat, and impairment charges rose significantly reflecting a marketwide deterioration in retail credit quality as a result of more customers, with higher levels of indebtedness, experiencing repayment difficulties; (ii) Insurance and Investments, as a result of increased sales, particularly of Open Ended Investment Company products, and an increase in the new business margin; and (iii) Wholesale and International Banking, which has seen further good progress in building the Corporate Markets business and strong franchise growth in Business Banking.

Critical accounting policies

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates.

The accounting policies that are deemed critical to the Lloyds TSB Group s results and financial position, based upon materiality and significant judgements and estimates, are discussed in note 2 to the Consolidated Financial Statements.

Results of operations 2006, 2005 and 2004

The Lloyds TSB Group first applied IFRS as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2005. IFRSs as adopted by the EU are identical in all respects to the current IFRSs as issued by the IASB, except for the EU s amendment to IAS 39. The Lloyds TSB Group has not taken advantage of the EU s amendment to IAS 39; accordingly, there would be no change to the reported income or equity if Lloyds TSB Group were to adopt fully the current IFRSs as issued by the IASB. The rules for first time adoption of IFRS required the application of certain exceptions and permitted certain other transition exemptions. The application of these exceptions and exemptions means that the 2004 figures disclosed are not fully comparable with those presented in respect of 2005 and 2006.

Summary

	2006	2005	2004
	£m	£m	£m
Net interest income	**5,537**	5,671	5,110
Other income	**14,136**	17,055	14,173
Total income	**19,673**	22,726	19,283
Insurance claims	**(8,569)**	(12,186)	(9,622)
Total income, net of insurance claims	**11,104**	10,540	9,661

Operating expenses	**(5,301)**	(5,471)	(5,297)
Trading surplus	**5,803**	5,069	4,364
Impairment losses on loans and advances	**(1,555)**	(1,299)	(866)
Profit (loss) on sale and closure of businesses		50	(21)
Profit before tax	**4,248**	3,820	3,477
Taxation	**(1,341)**	(1,265)	(1,018)
Profit for the year	**2,907**	2,555	2,459
Profit attributable to minority interests	**104**	62	67
Profit attributable to equity shareholders	**2,803**	2,493	2,392
Profit for the year	**2,907**	2,555	2,459
Economic profit[1]	**1,855**	1,616	1,448

[1] Lloyds TSB Group defines economic profit as the earnings on the equity invested in the business less a notional charge for the cost of the equity invested in that business. See Operating and financial review and prospects Economic profit .

Operating and financial review and prospects

2006 compared with 2005

In 2006 the Lloyds TSB Group s profit before tax was £4,248 million which was £428 million, or 11 per cent, higher than £3,820 million in 2005. Profit attributable to shareholders was £310 million, or 12 per cent, higher at £2,803 million compared to £2,493 million in 2005. Earnings per share were 12 per cent higher at 49.9p in 2006, compared to 44.6p in 2005.

Net interest income decreased by £134 million, or 2 per cent, to £5,537 million compared to £5,671 million in 2005. Average interest-earning assets increased by £26,218 million, or £25,177 million excluding fine margin reverse repurchase agreement balances. This reflects growth in mortgage lending, in Corporate and Business Banking lending and in relatively low margin treasury and structured finance balances. The net interest margin was 34 basis points lower at 2.28 per cent, or 37 basis points lower at 2.44 per cent when the fine margin reverse repurchase agreement balances are excluded. This overall margin decline reflects a decrease in policyholder-related net interest income in the Insurance and Investments business together with a change in portfolio mix.

Other income was £2,919 million, or 17 per cent, lower at £14,136 million compared to £17,055 million in 2005. Fees and commission income was £126 million, or 4 per cent, higher at £3,116 million; UK current account fees were £59 million higher, reflecting growth in added value account packages, and other UK fees and commissions were £169 million higher with increased company registration, OEIC, private banking and asset management fees. However, insurance broking commissions were £52 million lower and card fees were also £52 million lower as a result of the sale of the Goldfish portfolio at the end of 2005. Fee and commission expense was little changed as decreases in asset finance dealer commissions and card fees payable were largely offset by activity-related increases in the insurance businesses. Net trading income was £2,957 million lower; this largely reflects lower policyholder gains within the insurance and investment businesses for which there is a largely offsetting movement within insurance claims expense. Insurance premium income was £250 million higher and other operating income was £334 million lower; this decrease reflects the impact of the UK Financial Services Authority s (FSA s) new valuation rules upon the value of in-force business.

Insurance claims expense of £8,569 million in 2006 was £3,617 million, or 30 per cent, lower than £12,186 million in 2005. This decrease is principally attributable to lower returns on policyholder investments and the consequential reduction in amounts credited to policyholders. Claims expense has also been reduced by releases from actuarial reserves that offset the negative impact of the FSA s Policy Statement on the value of in-force business.

Operating expenses were £170 million, or 3 per cent, lower at £5,301 million in 2006 compared to £5,471 million in 2005. Excluding the pension schemes related credit of £128 million in 2006 and the customer remediation provision of £150 million in 2005, operating expenses were £108 million, or 2 per cent, higher at £5,429 million in 2006 compared to £5,321 million in 2005. Staff costs, excluding the pension schemes related credit, were £14 million higher; the impact of annual pay rises and increased bonus and incentive payments was largely offset by reduced staff numbers and lower levels of redundancy and outsourcing costs. Premises and equipment costs were £33 million higher, as a result of business rate increases and higher levels of systems related spend. Other costs, excluding the £150 million customer remediation provision in 2005, were £87 million higher as a result of increased communication and data processing costs, higher levels of professional fees and a lower net credit in respect of the amortisation of deferred acquisition costs within the insurance businesses.

The impairment charge in respect of loans and advances and other credit risk provisions was £256 million, or 20 per cent, higher at £1,555 million compared to £1,299 million in 2005. The charge within UK Retail Banking was £127 million higher, or £173 million higher if the impact of the Goldfish portfolio sold in 2005 is excluded; charges in respect of unsecured loans, overdrafts and credit cards increased as a result of more customers with higher levels of indebtedness experiencing repayment difficulties and higher levels of bankruptcies and Individual Voluntary Arrangements. The overall charge in respect of Wholesale and International Banking was £120 million higher as a result of lower levels of corporate recoveries, lending growth in Business Banking and a deterioration in asset quality within Asset Finance. Overall, the Lloyds TSB Group s charge in respect of impairment losses on loans and advances expressed as a percentage of average lending increased to 0.83 per cent in 2006 compared to 0.76 per cent in 2005.

The tax charge, at £1,341 million, represented 31.6 per cent of profit before tax compared to 33.1 per cent in 2005; the increase in effective tax rate caused by the consolidation of policyholder related items was less significant in 2006.

At the end of 2006, the total capital ratio was 10.7 per cent. Risk-weighted assets increased by £11,122 million, or 8 per cent, since the end of 2005 to £156,043 million at the end of 2006. Strong levels of customer lending growth in Business Banking and Corporate Markets, and good growth in mortgages, more than offset the expected slowdown in the rate of growth in unsecured personal lending. Total assets increased by 11 per cent to £343,598 million, with an 8 per cent increase in loans and advances to customers. Customer deposits increased by 6 per cent to £139,342 million, supported by good growth in current account credit balances and savings balances within UK Retail Banking.

2005 compared with 2004

In 2005 the Lloyds TSB Group s profit before tax was £3,820 million, an increase of £343 million, or 10 per cent, compared to £3,477 million in 2004. Profit attributable to shareholders was £101 million, or 4 per cent, higher at £2,493 million compared to £2,392 million in 2004. Earnings per share were 44.6p compared to 42.8p in 2004, an increase of 4 per cent.

Net interest income was £561 million, or 11 per cent, higher at £5,671 million compared to £5,110 million in 2004. The international accounting standards implemented with effect from 1 January 2005 had a marked effect on the Lloyds TSB Group s net interest income as certain amounts previously accounted for within fees receivable and administrative expenses were now included within the effective interest rate calculations. Adjusting for this effect, underlying net interest income was £403 million, or 8 per cent, higher. Average interest-earning assets increased as a result of continued strong lending growth, particularly in respect of mortgages, personal loans and credit cards as well as corporate lending and asset finance. The Lloyds TSB Group s net interest margin fell by 10 basis points to 2.62 per cent; however, excluding the impact of the accounting standards applied with effect from 1 January 2005 and the growth in reverse repurchase agreement balances, the underlying net interest margin was 2.82 per cent in 2005, compared to 2.86 per cent in 2004; a fall of 4 basis points. This fall in the underlying margin reflected competitive pressures in both the personal and corporate lending books.

Other income, at £17,055 million, was £2,882 million, or 20 per cent, higher than £14,173 million in 2004. Fees and commissions receivable were £64 million, or 2 per cent, lower at £2,990 million; however, excluding the effect of the accounting standards applied with effect from 1 January 2005, underlying fees and commissions receivable were £261 million, or 9 per cent, higher at £3,315 million compared to £3,054 million in 2004. The increase in underlying fee income reflected good growth in current account fees, mortgage and other lending fees and wealth management products. Fees and commissions payable, again excluding the impact of the accounting standards applied with effect from 1 January 2005, were £74 million higher, largely as a result of increased volumes within Scottish Widows. Net trading income was £4,262 million higher, principally within the insurance and investment businesses, and insurance premium income (excluding the impact of the accounting standards applied with effect from 1 January 2005) was £1,131 million higher. These increases reflected substantial inflows of funds from policyholders and strong investment gains over the year; this income, however, was largely for the benefit of policyholders and was matched by the commensurate increase in insurance claims.

Insurance claims, at £12,186 million, were £2,564 million, or 27 per cent, higher than £9,622 million in 2004. The impact of the accounting standards applied with effect from 1 January 2005 in respect of the insurance businesses caused a significant reduction in both the premium income and claims figures, as a large number of insurance products were reclassified as investment products. Adjusting for this effect, underlying insurance claims were £5,172 million, or 54 per cent, higher at £14,794 million compared to £9,622 million in 2004.

Operating expenses were £174 million, or 3 per cent, higher at £5,471 million compared to £5,297 million in 2004. Staff costs were £151 million, or 6 per cent, higher reflecting annual pay awards, increased bonus and incentive payments in certain areas as a result of business success and increased severance costs in relation to rationalisation programmes. Staff numbers, on a full time equivalent basis, decreased by 3,188 to 66,797 at 31 December 2005 compared to 69,985 at 31 December 2004; however, much of this fall occurred towards the end of the year and consequently there was little impact on staff costs. Premises and equipment costs were £35 million higher. Other costs were £19 million lower; an increase of £38 million in the charge in respect of provisions for customer redress, following a review of the expected cost by the Lloyds TSB Group, was more than offset by a net credit of £45 million in respect of deferred acquisition costs within the insurance businesses.

Impairment losses on loans and advances, at £1,299 million, were £433 million, or 50 per cent, higher than 2004. Excluding the impact of the accounting standards applied with effect from 1 January 2005 and a small release of £3 million from other credit risk provisions, underlying impairment losses on loans and advances were £227 million, or 26 per cent, higher at £1,093 million in 2005 compared to £866 million in 2004. The overall charge in respect of Wholesale and International Banking was little changed with the majority of the increase arising within UK Retail Banking. The underlying impairment charge in UK Retail Banking was £229 million higher as a result of volume growth in both personal loans and credit card lending and the absence of a mortgage related provision release which in 2004 totalled £39 million.

A net profit of £50 million arose on the sale and closure of businesses in 2005, principally as a result of the disposal of the Goldfish credit card portfolio, compared to a loss of £21 million in 2004, which largely reflected the sale of the Lloyds TSB Group s businesses in Argentina and Colombia.

The tax charge, at £1,265 million, represented 33.1 per cent of profit before tax compared to 29.3 per cent in 2004; the increase in the effective tax rate largely reflected the IFRS requirement to include, within the tax charge, tax attributable to UK life insurance policyholder earnings and interests in Open Ended Investment Companies (OEICs).

At the end of 2005, the total capital ratio was 10.9 per cent. Risk-weighted assets increased by £13,091 million, or 10 per cent, since the beginning of 2005 to £144,921 million at the end of the year; this increase reflected new mortgage and other personal lending together with substantial growth in corporate, SME, asset finance and structured finance lending. Total assets grew by £25,332 million, or 9 per cent, to £309,754 million compared to £284,422 million at 31 December 2004. Of this growth, £9,649 million was due to the grossing-up of balances no longer eligible for set-off following the implementation of IAS 32 with effect from 1 January 2005. The remaining increase of £15,683 million was due to the lending growth and higher securities balances within the long-term insurance business.

Net interest income

	2006	2005	2004
Net interest income £m	**5,537**	5,671	5,110
Average interest-earning assets £m	**242,371**	216,153	187,643
Average rates:			
Gross yield on interest-earning assets%	**5.91**	5.82	5.71
Interest spread%	**2.09**	2.40	2.50
Net interest margin%	**2.28**	2.62	2.72
Margin excluding average balances held under reverse repurchase agreements[4]:			
Net interest income £m	**5,537**	5,671	5,110

Average interest-earning assets £m	**226,990**	201,813	178,887
Net interest margin%	**2.44**	2.81	2.86

[1] Gross yield is the rate of interest earned on average interest-earning assets.

[2] Interest spread is the difference between the rate of interest earned on average interest-earning assets and the rate of interest paid on average interest-bearing liabilities.

[3] The net interest margin represents the interest spread together with the contribution of interest-free liabilities. It is calculated by expressing net interest income as a percentage of average interest-earning assets.

[4] Comparisons of net interest income and margins are impacted by the holdings of fine margin reverse repurchase agreements. To improve comparability, figures are also shown excluding average balances held under reverse repurchase agreements (2006: £15,381 million; 2005: £14,340 million; 2004: £8,756 million).

Operating and financial review and prospects

2006 compared to 2005

Net interest income decreased by £134 million, or 2 per cent, to £5,537 million in 2006 compared to £5,671 million in 2005. The overall decrease was primarily as a result of lower levels of interest earned on policyholder investments, within the insurance and investment businesses, and an increase in the amounts payable to unitholders in those OEICs included in the consolidated results of the Lloyds TSB Group; since these are policyholder items there is no impact on profit attributable to shareholders. Net interest income within the Lloyds TSB Group s retail and wholesale banking operations increased by £241 million, or 4 per cent, to £6,027 million in 2006 compared to £5,786 million in 2005.

Average interest-earning assets were £26,218 million, or 12 per cent, higher at £242,371 million in 2006 compared to £216,153 million in 2005. Excluding the fine margin reverse repurchase agreement assets held for liquidity purposes, average interest-earning assets were £25,177 million, or 12 per cent, higher at £226,990 million in 2006 compared to £201,813 million in 2005. Average interest-earning assets in UK Retail Banking were £6,447 million higher, £7,327 million higher when the impact of the sale of the Goldfish portfolio at the end of 2005 is excluded. Average mortgage balances were £6,831 million higher, reflecting net new lending over 2005 and 2006, and average balances in other personal lending, excluding the impact of the sale of the Goldfish portfolio, were £496 million higher due to the full-year benefit of growth over 2005. Average interest-earning assets within the insurance and investments businesses were £1,093 million higher, largely due to growth in the mortgage book within Scottish Widows Bank. Within Wholesale and International Banking, average interest-earning assets increased by £18,823 million, or £17,782 million excluding the fine margin reverse repurchase agreement balances. Average balances within Corporate Markets, excluding the reverse repurchase agreement balances, were £16,398 million higher reflecting strong growth in corporate lending, coupled with growth in lower margin balances within the treasury and structured finance areas. Strong growth in lending also led to a £994 million increase in average balances in Business Banking.

The Lloyds TSB Group s net interest margin fell by 34 basis points to 2.28 per cent in 2006, compared to 2.62 per cent in 2005; if the average balances held under reverse repurchase agreements are excluded from both years, the margin in 2006 was 37 basis points lower at 2.44 per cent compared to 2.81 per cent in 2005. The net interest margin in UK Retail Banking was 11 basis points lower, or 10 basis points lower if the Goldfish portfolio sold at the end of 2005 is excluded; this fall in margin reflects competitive pressures and the fact that growth in average interest-earning assets has been within the mortgage portfolio. The margin within Wholesale and International Banking, excluding the fine margin reverse repurchase agreement balances, was 31 basis points lower; this again reflects competitive pressures and the fact that growth has been in corporate lending, treasury and structured finance balances where margins are finer. Within Insurance and Investments, the impact on net interest income of the adjustments required to consolidate policyholder items on a line-by-line basis was £232 million lower in 2006, contributing some 10 basis points to the fall in Lloyds TSB Group s net interest margin.

2005 compared to 2004

Net interest income increased by £561 million, or 11 per cent, to £5,671 million compared to £5,110 million in 2004. However, net interest income was impacted by the accounting standards applied with effect from 1 January 2005 and adjusting for this, net interest income was £403 million, or 8 per cent, higher at £5,513 million compared to £5,110 million in 2004.

Average interest-earning assets grew by £28,510 million, or 15 per cent, to £216,153 million in 2005 compared to £187,643 million in 2004. However, comparisons are distorted by the substantial growth, during 2004 and 2005, in assets held under reverse repurchase agreements for liquidity purposes. Excluding the balances held under reverse repurchase agreements, average interest-earning assets grew by £22,926 million, of which the grossing-up of balances subject to set-off arrangements in 2005 following the implementation of IAS 32 accounted for £6,396 million. The underlying growth in average interest-earning assets was therefore £16,530 million, or 9 per cent, adding £475 million to net interest income. Good levels of consumer lending growth increased average personal lending and credit card balances by £1,691 million and average mortgage balances by £7,808 million. Average interest-earning assets within the insurance and investment businesses, which include policyholder and long-term fund balances, increased by £1,891 million as a result of business growth and increased fund activity. Strong lending growth led to an increase of £4,373 million in average interest-earning assets in the Business Banking and Corporate Markets franchises and average balances in Asset Finance were £484 million higher, reflecting the full year impact of lending growth over 2004.

The Lloyds TSB Group s net interest margin fell by 10 basis points to 2.62 per cent in 2005, compared to 2.72 per cent in 2004; excluding the average balances held under reverse repurchase agreements from both years, the margin in 2005 was 5 basis points lower at 2.81 per cent compared to 2.86 per cent in 2004. After taking into account the impact of the accounting standards applied with effect from 1 January 2005 the underlying margin fell by 4 basis points reducing net interest income by £72 million. The underlying net interest margin in UK Retail Banking was 23 basis points lower, as a result of competitive pressures and a reduced benefit from current account funding balances. Within Wholesale and International Banking the underlying net interest margin was

5 basis points higher. On this basis, margins on treasury balances improved, as a result of a change in mix; the margin in Structured Finance improved as a result of the impact of new transactions; Corporate Banking margins were lower, as a result of competitive pressures on new lending balances; and margins were also down in Business Banking.

Other income

	2006 £m	2005 £m	2004 £m
Fee and commission income:			
UK current account fees	**652**	593	637
Other UK fees and commissions	**1,210**	1,041	1,087
Insurance broking	**629**	681	672
Card services	**493**	545	520
International fees and commissions	**132**	130	138
	3,116	2,990	3,054
Fee and commission expense	**(846)**	(842)	(844)
Net fee and commission income	**2,270**	2,148	2,210
Net trading income	**6,341**	9,298	5,036
Insurance premium income	**4,719**	4,469	6,070
Other operating income	**806**	1,140	857
Total other income	**14,136**	17,055	14,173

2006 compared to 2005

Other income was £2,919 million, or 17 per cent, lower at £14,136 million in 2006 compared to £17,055 million in 2005.

Fee and commission income was £126 million, or 4 per cent, higher at £3,116 million in 2006 compared to £2,990 million in 2005. UK current account fees were £59 million, or 10 per cent, higher at £652 million in 2006 compared to £593 million in 2005; this reflects a change in mix of added-value accounts, as customers are increasingly opening the more comprehensive account packages, together with the benefit of some tariff changes. Other UK fees and commissions were £169 million, or 16 per cent, higher at £1,210 million in 2006 compared to £1,041 million in 2005; this reflects good growth in company registration income and in fees from OEICs, asset management and private banking. Insurance broking commissions were £52 million, or 8 per cent, lower at £629 million in 2006 compared to £681 million in 2005; this reflects lower creditor protection income in respect of personal loans and credit cards and reduced levels of retrospective commissions. Fees in respect of card services were £52 million, or 10 per cent, lower at £493 million compared to £545 million in 2005; this primarily reflects the sale of the Goldfish portfolio towards the end of 2005. International fees were little changed at £132 million in 2006, compared to £130 million in 2005.

Fee and commission expense was £4 million higher at £846 million in 2006, compared to £842 million in 2005. Dealer commissions in the asset finance businesses were £30 million, or 12 per cent, lower at £217 million in 2006 compared to £247 million in 2005, as new business levels were not high enough to trigger bonus commissions. Card services fees payable were £44 million, or 24 per cent, lower at £138 million compared to £182 million in 2005, primarily due to the disposal of the Goldfish portfolio towards the end of 2005. These decreases, however, were offset by increased levels of fees payable within the general insurance business (commissions on new reinsurance products) and within the Scottish Widows businesses (reflecting increases in investment and other activities).

Net trading income, at £6,341 million, was £2,957 million, or 32 per cent, lower than £9,298 million in 2005. This decrease primarily relates to investment fluctuations in the long-term insurance businesses; IFRS requires that gross investment gains are reported within net trading income and the related allocation to policyholders within claims.

Insurance premium income was £250 million, or 6 per cent, higher at £4,719 million compared to £4,469 million in 2005. Life and pensions premiums were £212 million higher and general insurance premiums were £38 million higher, reflecting the commencement of underwriting of card and commercial loan protection products during 2006.

Other operating income was £334 million, or 29 per cent, lower at £806 million compared to £1,140 million in 2005. The main driver for this decrease was the £361 million year-on-year decrease in the movement of value in force to a reduction of £199 million compared to an increase of £162 million in 2005; this reflects a reduction of £429 million arising from the introduction of the new valuation rules in the FSA s Policy Statement 06/14. Reductions of £11 million in operating lease rental income and £7 million in sale and lease-back profits were more than offset by a £41 million increase in income from investment property, held within the insurance and investment funds, reflecting property additions over 2005 and 2006.

2005 compared to 2004

Other income was £2,882 million, or 20 per cent, higher at £17,055 million compared to £14,173 million in 2004.

Fee and commission income was £64 million, or 2 per cent, lower at £2,990 million compared to £3,054 million in 2004. However, year-on-year comparisons were affected by the impact of IAS 39, which had been applied with effect from 1 January 2005 and resulted in some £325 million of income previously classified within fees and commissions being included within net interest income via the effective interest rate calculations. Adjusting for this, underlying fee and commission income was £261 million, or 9 per cent, higher at £3,315 million compared to £3,054 million in 2004. Underlying UK current account fees were £117 million higher reflecting continuing growth in added-value account products, the impact of pricing reviews in 2004 and 2005 and increased charges in respect of returned cheques and unauthorised borrowings. Also on this underlying basis, other UK fees and commissions were up £114 million, or 10 per cent, at £1,201 million compared to £1,087 million in 2004, reflecting increased levels of mortgage-related fees, increased wealth management fees as a result of higher sales and improved retention rates and increased levels of corporate lending and other fees. Insurance broking income was £9 million, or 1 per cent, higher at £681 million, compared to £672 million in 2004, as lower levels of loan protection income were more than offset by increased income in respect of motor insurance and retrospective commissions. Fees for card services were £25 million higher as a result of increased volumes and some tariff changes.

Operating and financial review and prospects

Fee and commission expense was £2 million lower at £842 million compared to £844 million in 2004; however, adjusting for fees payable of £76 million included within the effective interest rate calculations in 2005, underlying fees payable were £74 million, or 9 per cent, higher at £918 million compared to £844 million in 2004. The impact of increased business and trading volumes within Scottish Widows more than offset the lower level of dealership commissions within Asset Finance as a result of reduced new business levels.

Net trading income increased by £4,262 million, or 85 per cent, to £9,298 million compared to £5,036 million in 2004. The majority of this increase is attributable to the insurance businesses and reflected significant trading gains on policyholder investments over the year, which were largely matched by an increase in claims expense.

Insurance premium income was £1,601 million, or 26 per cent, lower at £4,469 million compared to £6,070 million in 2004. However, year-on-year comparisons were affected by the impact of IFRS 4, which caused a significant proportion of contracts to be reclassified as investment products with effect from 1 January 2005. Adjusting for this, underlying insurance premium income was £1,131 million, or 19 per cent, higher at £7,201 million in 2005. Long-term insurance income grew substantially as a result of strong sales through the Bancassurance and independent financial adviser channels; however general insurance premium income was little changed as growth in creditor insurance income was largely offset by reduced levels of health insurance premiums.

Other operating income was £283 million, or 33 per cent, higher at £1,140 million compared to £857 million in 2004; excluding the impact of accounting standards applied with effect from 1 January 2005, underlying other operating income was £139 million, or 16 per cent, higher in 2005. Income from investment properties was £114 million higher, in part reflecting portfolio growth, and there were increased gains from the sale and leaseback of premises.

Operating expenses

	2006 £m	2005 £m	2004 £m
Administrative expenses:			
Staff:			
Salaries	**2,117**	2,068	1,970
National insurance	**161**	154	144
Pensions, net of pension schemes related credit	**165**	308	307
Other staff costs	**298**	325	283
	2,741	2,855	2,704
Premises and equipment:			
Rent and rates	**310**	305	294
Hire of equipment	**15**	13	17
Repairs and maintenance	**165**	136	129
Other	**149**	152	131
	639	606	571
Other expenses:			
Communications and external data processing	**499**	467	449
Advertising and promotion	**184**	207	205
Professional fees	**231**	216	222
Provisions for customer redress		150	112
Other	**388**	325	396
	1,302	1,365	1,384

Administrative expenses	**4,682**	4,826	4,659
Depreciation of tangible fixed assets	**602**	621	616
Amortisation of intangible assets	**17**	18	22
Impairment of goodwill		6	
Total operating expenses	**5,301**	5,471	5,297
Cost: income ratio (%)*	**47.7**	51.9	54.8

Following recent changes in age discrimination legislation in the United Kingdom, the Lloyds TSB Group has taken the decision to cease to augment the pension entitlement of employees taking early retirement. This change has resulted in a credit to the income statement in 2006 of £128 million (2005: £nil; 2004: £nil).

* Total operating expenses divided by total income, net of insurance claims.

Operating and financial review and prospects

2006 compared to 2005

Operating expenses were £170 million, or 3 per cent, lower at £5,301 million compared to £5,471 million in 2005. Two significant items impact the comparison of operating expenses in 2006 to 2005. In 2006, following recent changes in age discrimination legislation in the United Kingdom, the Lloyds TSB Group took the decision to cease to augment the pension entitlement of employees taking early retirement; this resulted in a credit to the income statement in 2006 of £128 million. During 2005, following a review by the Lloyds TSB Group of the estimated cost of redress payments to customers, an additional £150 million provision for customer redress was charged; no such charge was required in 2006. Excluding the pension schemes related credit in 2006 and the provision for customer redress in 2005, operating expenses were £108 million, or 2 per cent, higher at £5,429 million compared to £5,321 million in 2005.

Staff costs were £114 million, or 4 per cent, lower at £2,741 million in 2006 compared to £2,855 million in 2005. However, excluding the £128 million pension schemes related credit in 2006, staff costs were £14 million higher at £2,869 million compared to £2,855 million in 2005. Salaries were £49 million, or 2 per cent, higher at £2,117 million compared to £2,068 million in 2005 as a result of the decrease in staff numbers (average staff numbers on a full-time equivalent basis for 2006 were 64,877 compared to 69,303 in 2005) largely offsetting the annual pay awards and increased bonus and incentive payments. Pension costs were £143 million, or 46 per cent, lower at £165 million compared to £308 million in 2005. Excluding the £128 million pension schemes related credit in 2006 pension costs were £15 million, or 5 per cent, lower at £293 million; a decrease of £22 million in the IAS 19 defined benefit charge, reflecting an improved expected return on the schemes assets, was in part offset by an increase of £7 million in contributions to the defined contribution schemes. Other staff costs were £27 million, or 8 per cent, lower at £298 million in 2006 compared to £325 million in 2005; this reflects a reduction in outsourcing costs and lower levels of redundancy costs.

Premises and equipment costs were £33 million, or 5 per cent, higher at £639 million compared to £606 million in 2005. There was a £5 million rise in business rates, reflecting annual increases together with the inclusion of new premises in London; and repair and maintenance costs were £29 million higher as a result of a number of systems initiatives and upgrades.

Other costs were £63 million, or 5 per cent, lower at £1,302 million in 2006 compared to £1,365 million in 2005; excluding the £150 million customer remediation provision in 2005, other costs were £87 million, or 7 per cent, higher at £1,302 million in 2006 compared to £1,215 million in 2005. Communications and external data processing costs were £32 million, or 7 per cent, higher at £499 million in 2006 compared to £467 million in 2005, principally due to additional spend on the outsourcing of IT work. Advertising and promotion costs were £23 million, or 11 per cent, lower at £184 million compared to £207 million in 2005, as lower print costs for promotional materials, as the Lloyds TSB Group moves increasingly towards paperless advertising streams, were only partly offset by increased brand-related spend within Scottish Widows. Professional fees were £15 million, or 7 per cent, higher at £231 million compared to £216 million in 2005, mainly due to fluctuations in project related spend. Other costs were £63 million, or 19 per cent, higher at £388 million compared to £325 million in 2005; this reflects a lower net credit in respect of the amortisation of deferred acquisition costs within the insurance businesses, due to new business fluctuations and actuarial model changes, increased administration charges in respect of clearing operations and certain contract closure costs.

The charge in respect of depreciation of tangible fixed assets was £19 million, or 3 per cent, lower at £602 million in 2006 compared to £621 million in 2005 as an increase of £7 million in respect of premises adaptation costs, reflecting the ongoing branch refurbishment programme, was more than offset by the impact, in 2006, of tranches of equipment becoming fully depreciated.

The cost: income ratio improved to 47.7 per cent in 2006 compared to 51.9 per cent in 2005.

2005 compared with 2004

Operating expenses were £174 million, or 3 per cent, higher at £5,471 million in 2005 compared to £5,297 million in 2004.

Staff costs were £151 million, or 6 per cent, higher at £2,855 million compared to £2,704 million in 2004. Salaries were £98 million higher at £2,068 million reflecting annual pay awards and an increase in levels of bonus and incentive payments in some parts of the Lloyds TSB Group. A reduction in overall staff numbers had little impact upon costs as this was biased towards the end of the year. National insurance costs were £10 million higher, reflecting the increase in salary costs, but pension costs were largely unchanged as a decrease in the charge in respect of defined benefit schemes was offset by an increase in cash payments to defined contribution schemes. Other staff costs were £42 million higher as decreases in agency and other costs were more than offset by an increase in severance charges, reflecting rationalisation programmes in a number of parts of the Lloyds TSB Group.

Premises and equipment costs were £35 million, or 6 per cent, higher at £606 million compared to £571 million in 2004. Rent and rates were £11 million higher as a result of general increases in property rental charges and a higher level of costs in relation to the expanding investment property portfolios within the insurance operations. A small decrease in equipment hire charges resulted from a favourable renegotiation of certain contracts, but this was more than offset by increased repairs and maintenance expenditure, in particular in relation to ATMs and network costs. Other premises and equipment costs were £21 million higher as a result of increased energy costs and other increased costs in relation to the investment property portfolios.

Other expenses were £19 million, or 1 per cent, lower at £1,365 million compared to £1,384 million in 2004. Communications and external data processing costs were £18 million higher as a result of increased network charges. Advertising costs were little changed at £207 million and professional fees were £6 million lower, reflecting some reduction in consultancy charges. The charge of £150 million in 2005 in respect of provisions for customer redress (£38 million higher than the £112 million charge in 2004) followed a review by the Lloyds TSB Group of the estimated cost of redress payments to customers, principally relating to past sales of mortgage endowment policies through the branch network. This review took in to account the introduction of time barring and the consequent increase in claims. Other costs were £71 million lower at £325 million. Much of this decrease reflected a credit of £45 million representing the net movement in deferred acquisition costs relating to the insurance businesses, the accounting for which changed as a result of the prospective IFRS accounting changes applied with effect from 1 January 2005. There were efficiency savings in stationery and other administrative costs and costs were also lower following the sale of certain Latin American businesses towards the end of 2004.

The depreciation charge was little changed at £639 million as a small reduction in the charge in respect of operating lease assets was offset by the effect of general portfolio growth in relation to own-use assets. There was a goodwill impairment charge in relation to an acquisition made in earlier years.

The cost: income ratio improved to 51.9 per cent in 2005 compared to 54.8 per cent in 2004.

Operating and financial review and prospects

Impairment losses on loans and advances

	2006 £m	2005 £m	2004 £m
Impairment losses on loans and advances	**1,560**	1,302	866
Other credit risk provisions	**(5)**	(3)	
Impairment losses on loans and advances and other credit risk provisions	**1,555**	1,299	866

Impairment losses on loans and advances	2006 £m	2005 £m	2004 £m
UK Retail Banking	**1,238**	1,111	676
Insurance and Investments			(3)
Wholesale and International Banking	**313**	191	193
Central group items	**9**		
Total charge for impairment losses on loans and advances	**1,560**	1,302	866

	%	%	%
Charge as a percentage of average lending	**0.83**	0.76	0.59

2006 compared to 2005

The impairment charge in respect of loans and advances and other credit risk provisions was £256 million, or 20 per cent, higher at £1,555 million in 2006 compared to £1,299 million in 2005. This represents a charge in respect of loans and advances of £1,560 million (2005: £1,302 million) slightly offset by a release of £5 million (2005: £3 million) from provisions held in respect of contingent liabilities and commitments.

The impairment charge in respect of loans and advances within UK Retail Banking was £1,238 million which was £127 million, or 11 per cent, higher than £1,111 million in 2005. The impairment charge in 2005 included £46 million in respect of the Goldfish portfolio which was sold at the end of that year; excluding this item the impairment charge of £1,238 million in 2006 was £173 million, or 16 per cent, higher than £1,065 million in 2005. The charge in respect of personal loans and overdrafts of £740 million was £84 million, or 13 per cent, higher than £656 million in 2005 and represented 5.85 per cent of average lending (2005: 5.33 per cent). The charge in respect of card balances (excluding the Goldfish portfolio sold in 2005) was £490 million, which was £94 million, or 24 per cent, higher than £396 million in 2005 and represented 6.99 per cent of average lending (2005: 5.80 per cent). This deterioration in respect of personal loans, overdrafts and card balances reflects the impact of more customers with higher levels of indebtedness experiencing repayment difficulties together with higher levels of bankruptcies and Individual Voluntary Arrangements, as well as some worsening of recovery experience. Mortgage credit quality remains good and, as a result, the impairment charge in 2006 of £8 million was £5 million, or 62 per cent, lower than £13 million in 2005.

The impairment charge in respect of loans and advances within Wholesale and International Banking was £313 million in 2006 which was £122 million, or 64 per cent, higher than £191 million in 2005; expressed as a percentage of average lending this represents a charge of 0.39 per cent compared to 0.28 per cent in 2005. There was a lower level of net releases within Corporate Markets, which reduced to £13 million in 2006, compared to £57 million in 2005, as some significant one-off releases in 2005 were not repeated. The charge within Business Banking of £87 million was £11 million, or 14 per cent, higher than £76 million in 2005, reflecting business growth. Within Asset Finance, rising levels of consumer arrears and voluntary terminations have led to an increase in the impairment charge of £40 million, or 20 per cent, to £245 million in 2006 compared to £205 million in 2005.

Overall, the Lloyds TSB Group s charge in respect of impairment losses on loans and advances expressed as a percentage of average lending increased to 0.83 per cent in 2006 compared to 0.76 per cent in 2005.

Operating and financial review and prospects

2005 compared to 2004

The impairment charge in respect of loans and advances and other credit risk provisions was £433 million, or 50 per cent, higher at £1,299 million compared to £866 million in 2004. This represented a charge in respect of loans and advances of £1,302 million slightly offset by a release of £3 million from provisions held in respect of contingent liabilities and commitments.

The impairment charge in respect of loans and advances in 2005 was significantly affected by the adoption of the requirements of IAS 39 with effect from 1 January 2005. IAS 39 requires the impairment provision to be calculated by comparing the carrying value of the loan with the discounted value of future cash flows. As a result, in circumstances where a customer s borrowings have been rescheduled onto a concessionary rate which is below market interest rate, an impairment allowance will be required even where full recovery of the principal is anticipated; this had the effect of increasing the 2005 charge by £209 million.

Excluding this effect, underlying impairment losses on loans and advances in 2005 totalled £1,093 million, £227 million or 26 per cent higher than £866 million in 2004.

The underlying charge in UK Retail Banking rose by £229 million, or 34 per cent, to £905 million in 2005. The charges in respect of personal loans and overdrafts and credit cards increased by £112 million and £65 million respectively as a result of volume growth and some deterioration in credit quality. There was a charge of £13 million in respect of the mortgage portfolio, compared to a release of £39 million in 2004.

The underlying charge in Wholesale and International Banking was £188 million compared to £193 million in 2004. The underlying charge within Corporate Markets was £91 million lower as a result of lower new provisions and maintaining a good level of recoveries; this was partially offset by higher charges in Asset Finance. The charge within Business Banking, which deals with small business customers, was little changed. Within International Banking, there was a credit of £15 million in 2005 compared to a credit of £39 million in 2004; both years benefited from good recoveries in Latin America although 2004 also benefited from a release of £30 million from the Lloyds TSB Group s centrally held provision in respect of exposures in Argentina.

Overall, the Lloyds TSB Group s charge in respect of impairment losses on loans and advances expressed as a percentage of average lending increased to 0.76 per cent compared to 0.59 per cent in 2004; although excluding the impact of IAS 39 the charge represented 0.66 per cent of average lending in 2005.

Taxation

	2006 £m	2005 £m	2004 £m
UK corporation tax:			
Current tax on profits for the year	**1,024**	862	759
Adjustments in respect of prior years	**(137)**	(20)	(69)
	887	842	690
Double taxation relief	**(195)**	(138)	(57)
	692	704	633
Foreign tax:			
Current tax on profits for the year	**83**	78	118
Adjustments in respect of prior years	**(8)**	(8)	(2)
	75	70	116
Current tax charge	**767**	774	749
Deferred tax	**574**	491	269

Total charge	**1,341**	1,265	1,018

2006 compared to 2005

The rate of tax is influenced by the geographic and business mix of profits. The effective rate of tax in 2006 was 31.6 per cent, compared to an effective rate of tax in 2005 of 33.1 per cent and the corporation tax rate in 2006 of 30 per cent (2005: 30 per cent). The effective tax rate is distorted by the requirement to include, within the income tax expense, the tax attributable to UK life insurance policyholder earnings and the Lloyds TSB Group s interests in OEICs. Excluding these items the effective tax rate in 2006 was 28.0 per cent compared to 27.0 per cent in 2005. The increased effective tax rate in 2006 on this adjusted basis reflects normal fluctuations in disallowed and non-taxable items. Lloyds TSB Group does not expect the tax rate, excluding the impact of policyholders tax and OEICs, to vary significantly from the average UK corporation tax rate.

2005 compared to 2004

The effective rate of tax in 2005 was 33.1 per cent, compared to an effective rate of tax in 2004 of 29.3 per cent and the corporation tax rate in 2005 of 30 per cent (2004: 30 per cent). Excluding the policyholders tax and OEIC interests, the effective tax rate in 2005 was 27.0 per cent compared to 28.3 per cent in 2004. The reduced effective tax rate in 2005 on this adjusted basis was primarily due to tax benefits arising on disposal and other gains.

Operating and financial review and prospects

Economic profit

In pursuit of the Group s aim to maximise shareholder value over time, management has for a number of years used a system of value based management as a framework to identify and measure value creation. Management uses economic profit, a non-GAAP measure, as a measure of performance, and believes that it provides important information for investors, because it captures both growth in investment and return; profit before tax is the comparable GAAP measure used by management. Lloyds TSB Group defines economic profit as the earnings on the equity invested in the business less a notional charge for the cost of the equity invested in that business.

The Lloyds TSB Group s cost of equity is determined as:

risk-free interest rate + (equity risk premium x Lloyds TSB Group plc s beta)

The principal limitations of economic profit, as calculated in the Lloyds TSB Group s Form 20-F, as a financial measure are that:

(i) it is reliant on an estimate of the Lloyds TSB Group s cost of equity, which is itself dependent upon assumptions made for the risk-free interest rate, the equity risk premium and the beta of Lloyds TSB Group plc. The beta is a quantitative measure of the volatility of Lloyds TSB Group plc shares relative to the overall market a beta above 1 indicates that the stock is more volatile than the overall market, whilst a stock with a beta below 1 is less volatile than the overall market; and

(II) it uses average shareholders equity calculated on an accounting basis as opposed to an economic equity amount, which takes into account the level of risk inherent in the business; the Lloyds TSB Group is currently developing an economic equity model to address this limitation.

The Lloyds TSB Group does not attempt to estimate the assumptions on a prospective basis; the assumptions used are:

(a) the yield on the 10 year index for UK government stock as an approximation of the risk-free rate;

(b) an equity risk premium of 3 per cent; and

(c) the beta of Lloyds TSB Group plc s shares based on experience over the last five years.

The Lloyds TSB Group recognises that a wide range of approaches for economic profit can be justified and, therefore, believes that its usefulness as a financial measure relies upon a consistent approach, so as not to unnecessarily distort its trend.

Lloyds TSB Group believes that economic profit instils financial discipline in determining investment decisions throughout Lloyds TSB Group and that it enables Lloyds TSB Group to evaluate alternative strategies objectively, with a clear understanding of the value created by each strategy, and then to select the strategy which creates the greatest value. Awards to senior executives under the Lloyds TSB Group s annual bonus arrangements are partly determined by the achievement of economic profit targets.

Management compensates for both of the above limitations by using a consistent basis of calculation, reviewing the results of the calculation regularly and, to ensure consistency of reporting, only adjusting the cost of capital if it changes significantly. As noted above, the Lloyds TSB Group is also currently developing its economic equity capabilities, which will address the current limitations. As noted, the principal factor in estimating the cost of equity is the risk-free interest rate. If this rate increases, management will consider raising its estimate of the cost of equity; if the rate falls, management will consider reducing its estimate of the cost of equity. The principal other external market factors considered are equity risk premium and Lloyds TSB Group plc s share price volatility relative to the UK stock market as a whole. Any change to the estimated cost of equity will be disclosed. For the last three years, management has used a cost of equity of 9 per cent to reflect the shareholders minimum required rate of return on equity invested.

The table below summarises Lloyds TSB Group s calculation of economic profit for the years indicated.

	2006 **£m**	2005 £m	2004 £m
Average shareholders equity	**10,531**	9,747	10,493

Profit before tax	**4,248**	3,820	3,477
Taxation	**(1,341**)	(1,265)	(1,018)
Profit attributable to minority interests	**(104**)	(62)	(67)
Profit attributable to equity shareholders	**2,803**	2,493	2,392
Less: notional charge for the cost of equity	**(948**)	(877)	(944)
Economic profit	**1,855**	1,616	1,448

The notional charge for the cost of equity has been calculated by multiplying average shareholders equity by the cost of equity. The Lloyds TSB Group s average equity is determined using month-end retained profit and other equity balances.

Operating and financial review and prospects

2006 compared to 2005

Economic profit increased to £1,855 million in 2006 compared to £1,616 million in 2005. Profit attributable to equity shareholders increased by £310 million, or 12 per cent, to £2,803 million; the notional charge on average equity was £71 million higher, as a result of an 8 per cent increase in average equity to £10,531 million compared to £9,747 million in 2005. The increase in average equity primarily reflects profit retentions, after dividends, over 2005 and 2006.

2005 compared to 2004

Economic profit increased to £1,616 million in 2005 compared to £1,448 million in 2004. Profit attributable to equity shareholders increased by £101 million, or 4 per cent, to £2,493 million; the notional charge on average equity, however, was £67 million lower, as a result of a 7 per cent decrease in average equity to £9,747 million compared to £10,493 million in 2004. The decrease in average equity primarily reflected the decrease of £1,558 million arising from the implementation of IAS 32, IAS 39 and IFRS 4 with effect from 1 January 2005.

Line of business information

Summary

The impact of IFRS, and in particular the increased use of fair values, has resulted in greater earnings volatility. Profit before tax is analysed below on both a statutory basis and, in order to provide a more comparable representation of business performance, a basis which separately discloses this volatility. See page 33 for a description of volatility and its most significant limitations. The results of the businesses are set out below:

	Profit before tax (statutory)			**Profit before tax (excluding volatility**		
	2006 £m	2005 £m	2004* £m	**2006 £m**	2005 £m	2004* £m
UK Retail Banking	**1,549**	1,394	1,639	**1,549**	1,394	1,639
Insurance and Investments	**1,383**	1,474	916	**973**	725	778
Wholesale and International Banking	**1,640**	1,518	1,272	**1,640**	1,518	1,272
Central group items	**(324)**	(566)	(350)	**(321)**	(442)	(350)
Profit before tax, excluding volatility				**3,841**	3,195	3,339
Volatility				**407**	625	138
Profit before tax	**4,248**	3,820	3,477	**4,248**	3,820	3,477

* Comparative figures for 2004 were restated to reflect the adoption of those IFRS standards which were required to be applied retrospectively, but do not reflect the additional impacts arising from first time application of IAS 32 Financial Instruments: Disclosure and Presentation , IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts (including UK Financial Reporting Standard 27 Life Assurance), which were implemented with effect from 1 January 2005, with the opening balance sheet at that date adjusted accordingly.

UK Retail Banking

	2006 £m	2005 £m	2004 £m

Net interest income	**3,642**	3,521	3,228
Other income	**1,621**	1,605	1,696
Total income	**5,263**	5,126	4,924
Operating expenses	**(2,476)**	(2,697)	(2,609)
Trading surplus	**2,787**	2,429	2,315
Impairment losses on loans and advances	**(1,238)**	(1,111)	(676)
Profit on sale of businesses		76	
Profit before tax	**1,549**	1,394	1,639
Cost:income ratio	**47.0**%	52.6%	53.0%
Total assets (year-end)*	**£108,381m**	£103,930m	£96,472m
Total risk-weighted assets (year-end)*	**£59,101m**	£60,582m	£57,241m

No volatility arises within UK Retail Banking and so these results are both statutory and excluding volatility.

* To ensure comparability, 2004 asset and risk-weighted asset figures are shown as at 1 January 2005, following implementation of those international accounting standards for which restated comparatives were not required.

2006 compared to 2005

Profit before tax from UK Retail Banking increased by £155 million, or 11 per cent, to £1,549 million in 2006 compared to £1,394 million in 2005; this comparison includes, in 2005, a customer remediation provision of £150 million (2006: £nil) and the profit on disposal of the Goldfish portfolio of £76 million (2006: £nil); excluding these items, profit before tax of £1,549 million in 2006 was £81 million, or 6 per cent, higher than £1,468 million in 2005.

Operating and financial review and prospects

Net interest income was £121 million, or 3 per cent, higher at £3,642 million in 2006 compared to £3,521 million in 2005. Average interest-earning assets were £6,447 million, or 7 per cent, higher at £104,935 million in 2006 compared to £98,488 million in 2005; when the average balances in respect of the Goldfish portfolio sold at the end of 2005 are excluded, average-interest earning assets increased by £7,327 million compared to 2005. Average mortgage balances were £6,831 million higher, reflecting good growth over 2005 and 2006. Gross new mortgage lending for the Lloyds TSB Group totalled £27,599 million (2005: £25,979 million); and net new lending totalled £6,957 million (2005: £8,311 million) resulting in a market share of net new mortgage lending of 6.3 per cent (2005: 9.1 per cent); year end mortgage balances outstanding increased by 8 per cent to £95,333 million. Average balances in respect of other personal lending were £384 million lower; although they are £496 million higher in 2006 once the effect of the sale of the Goldfish portfolio is excluded. This underlying increase in average non-mortgage balances largely reflects net growth over 2005; period end balances on personal loans were 1 per cent higher at £11,099 million at the end of 2006 although period end credit card balances were 5 per cent lower at £6,877 million, compared to £7,209 million at 31 December 2005. Credit balances on savings and investment accounts at 31 December 2006 were 7 per cent higher at £75,661 million, compared to £71,019 million at 31 December 2005. The effect of this volume growth was, however, partly offset by an 11 basis point decrease in the net interest margin as a result of competitive pressures and a change in mix, as most of the growth has been in the relatively low margin mortgage sector.

Other income was £16 million higher at £1,621 million in 2006, compared to £1,605 million in 2005. This largely represents net fee and commission income; the moderate growth reflects the fact that good growth in current account fee income due to a change in mix towards the more comprehensive, and therefore higher fee-earning, added-value account packages has been partly offset by a reduction in card fee income following the sale of the Goldfish portfolio at the end of 2005. There has also been good growth in wealth management fee income.

Operating expenses were £221 million, or 8 per cent, lower at £2,476 million in 2006 compared to £2,697 million in 2005; this comparison includes, in 2005, a customer remediation provision of £150 million. Excluding this item, costs were £71 million, or 3 per cent, lower at £2,476 million. The reduction in underlying operating expenses reflects the sale of the Goldfish portfolio, efficiency savings, reduced levels of fraud and other operational losses and a lower level of marketing and brand spend.

The impairment charge on loans and advances at £1,238 million was £127 million, or 11 per cent, higher than £1,111 million in 2005. The impairment charge in 2005 included £46 million in respect of the Goldfish portfolio, which was sold at the end of that year. Adjusting for this the charge in 2006 was £173 million, or 16 per cent, higher at £1,238 million compared to £1,065 million in 2005. The charge in respect of personal loans and overdrafts was £84 million, or 13 per cent, higher at £740 million compared to £656 million in 2005 and represented 5.85 per cent of average lending (2005: 5.33 per cent); whilst the charge in respect of card balances was £94 million, or 24 per cent, higher at £490 million in 2006 compared to £396 million in 2005 (excluding charges in respect of the Goldfish portfolio). This reflects the impact of more customers with higher levels of indebtedness facing repayment difficulties, higher levels of bankruptcies and Individual Voluntary Arrangements, and deterioration in debt recovery experience. Mortgage quality remains good and there was an impairment charge of £8 million in 2006 compared to £13 million in 2005.

2005 compared to 2004

Profit before tax from UK Retail Banking decreased by £245 million, or 15 per cent, to £1,394 million, compared to £1,639 million in 2004. However, comparisons of performance were affected by the impact of the accounting standards implemented with effect from 1 January 2005, which reduced the profit of UK Retail Banking in 2005 by £213 million; excluding this profit before tax was £1,607 million in 2005 which was £32 million, or 2 per cent, lower than 2004.

Net interest income was £293 million, or 9 per cent, higher at £3,521 million compared to £3,228 million; excluding the impact of IAS 39 which was implemented with effect from 1 January 2005, net interest income was £79 million, or 2 per cent, higher at £3,307 million. During 2005, good levels of growth were achieved in all key product areas. Gross new mortgage lending for the Group totalled £25,979 million; net new lending totalled £8,311 million resulting in a market share of net new lending of 9.1 per cent, and mortgage balances outstanding increased by 10 per cent to £88,376 million. Personal loan balances outstanding at the year-end were £11,023 million, an increase of 3 per cent and credit card balances totalled £7,209 million, an increase of 9 per cent, after adjusting to exclude the effect of the Goldfish disposal. Credit balances on current accounts and savings and investment accounts increased by 7 per cent. The benefit of this volume growth was, however, partly offset by reduced margins on mortgages and personal loans, as a result of competitive pressures.

Other income was £91 million, or 5 per cent, lower at £1,605 million compared to £1,696 million in 2004; however, excluding the effect of those accounting standards applied with effect from 1 January 2005 other income was £115 million, or 7 per cent, higher at £1,811 million. This increase in underlying other income reflected growth in current account fees, due to the continuing success of added-value accounts and the benefit of tariff reviews; increased card fee income, particularly in relation to overseas-use charges; and income from the successful new wealth management products.

Operating expenses were £88 million, or 3 per cent, higher at £2,697 million. Of this increase, £50 million was as a result of an increased charge in respect of customer redress, mainly relating to past sales of endowment products through the branch network, following a review by the Lloyds TSB Group of the expected total cost, in the light of the introduction of time-barring and a consequent increase in claims. Underlying operating expenses remained well controlled with the residual increase being largely attributable to higher levels of restructuring costs as back office operations continued to be rationalised.

Impairment losses on loans and advances, at £1,111 million, were £435 million or 64 per cent higher than 2004. The impact of the accounting standards applied with effect from 1 January 2005 accounted for £206 million of this increase; excluding this underlying impairment losses were £229 million, or 34 per cent, higher at £905 million in 2005. The charge in respect of personal loans, overdrafts and credit cards increased as a result of volume growth over recent years as well as some deterioration in credit quality. Within the mortgage business there continued to be a low level of losses and as a result the impairment charge was £13 million, compared to a release of £39 million in 2004. C&G continued to focus on prime lending market segments during 2005. The average indexed loan-to-value ratio for C&G new mortgages and further advances written during 2005 was 64 per cent. At 31 December 2005, 95 per cent of C&G mortgage balances had an indexed loan-to-value ratio of less than 85 per cent and only 0.6 per cent of balances had an indexed loan-to-value ratio in excess of 95 per cent.

A profit of £76 million arose in 2005 on the disposal of the Goldfish credit card business.

Operating and financial review and prospects

Insurance and Investments

Lloyds TSB Group s Insurance and Investments activities comprise the life, pensions and OEICs businesses of Scottish Widows and Abbey Life, general insurance underwriting and broking, and Scottish Widows Investment Partnership.

In addition to presenting Insurance and Investments results prepared in accordance with applicable accounting standards, all monthly financial reporting to the group executive committee and board separately presents the results of the businesses before volatility. The information set out below, therefore, presents the information both in accordance with applicable accounting standards (statutory) and on a basis which excludes volatility (excluding volatility). Further discussion on Lloyds TSB Group s use of volatility is provided in Operating and financial review and prospects Line of business information Volatility .

	Statutory			Excluding volatility		
	2006 £m	2005 £m	2004 £m	**2006 £m**	2005 £m	2004 £m
Net interest income	**103**	395	283	**134**	389	283
Other income	**10,487**	13,859	10,874	**10,046**	13,116	10,736
Total income	**10,590**	14,254	11,157	**10,180**	13,505	11,019
Insurance claims	**(8,569)**	(12,186)	(9,622)	**(8,569)**	(12,186)	(9,622)
Total income, net of insurance claims	**2,021**	2,068	1,535	**1,611**	1,319	1,397
Operating expenses	**(638)**	(594)	(622)	**(638)**	(594)	(622)
Trading surplus	**1,383**	1,474	913	**973**	725	775
Impairment losses on loans and advances credit			3			3
Profit before tax, excluding volatility				**973**	725	778
Volatility				**410**	749	138
Profit before tax	**1,383**	1,474	916	**1,383**	1,474	916
Further analysis of other income:						
Net fee and commission expense	**(125)**	(112)	(164)	**(125)**	(112)	(164)
Net trading income	**5,668**	8,859	4,798	**5,308**	8,375	4,651
Insurance premium income	**4,719**	4,469	6,070	**4,719**	4,469	6,070
Other operating income	**225**	643	170	**144**	384	179
Other income, excluding volatility				**10,046**	13,116	10,736
Volatility				**441**	743	138
Other income	**10,487**	13,859	10,874	**10,487**	13,859	10,874
Analysis by area of business of profit before tax						
Life, pensions and OEICs	**1,093**	1,221	728	**701**	500	598
General insurance	**261**	237	180	**243**	209	172
Scottish Widows Investment Partnership	**29**	16	8	**29**	16	8
Profit before tax, excluding volatility				**973**	725	778
Volatility				**410**	749	138

Profit before tax	**1,383**	1,474	916	**1,383**	1,474	916

Operating and financial review and prospects

2006 compared to 2005

Profit before tax from the Lloyds TSB Group s Insurance and Investments businesses was £91 million, or 6 per cent, lower at £1,383 million compared to £1,474 million in 2005. This comparison is distorted by volatility arising from market movements (see Operating and financial review and prospects Line of business information Volatility); profit before tax excluding volatility was £248 million, or 34 per cent, higher at £973 million in 2006 compared to £725 million in 2005. However, results for the comparative year ended 31 December 2005 were also impacted by the £155 million provision for the strengthening of reserves in respect of annuitant mortality; if this item is also excluded, the profit before tax excluding volatility and strengthening of mortality reserves was £93 million, or 11 per cent, higher at £973 million in 2006 compared to £880 million in 2005.

Net interest income was £292 million, or 74 per cent, lower at £103 million in 2006 compared to £395 million in 2005. This decrease reflects a reduction in the level of interest income on cash deposit investments held in the long-term business and policyholder funds and, more significantly, an increase in the amounts payable to unitholders in those OEICs included in the consolidated results of the Lloyds TSB Group.

Other income was £3,372 million, or 24 per cent, lower at £10,487 million in 2006 compared to £13,859 million in 2005; excluding volatility, other income was £3,070 million, or 23 per cent, lower at £10,046 million in 2006 compared to £13,116 million in 2005. Net fee and commission expense was £13 million, or 12 per cent, higher at £125 million in 2006 compared to £112 million in 2005; the impact of good growth in OEIC management fee income and the benefit of reduced fees payable to UK Retail Banking were offset by a reduction in general insurance broking income and an increase in other fees payable. Net trading income was £3,191 million, or 36 per cent, lower at £5,668 million in 2006 compared to £8,859 million in 2005; this reflects fluctuations in the level of investment returns within the long-term business funds, with an offsetting reduction within the insurance claims figure and within interest expense in respect of the OEICs. Insurance premium income was £250 million, or 6 per cent, higher at £4,719 million in 2006 compared to £4,469 million in 2005. Life and pensions premiums were £212 million higher and general insurance premiums were £38 million higher, reflecting the commencement of underwriting of card and commercial loan protection products during 2006. Other operating income was £418 million, or 65 per cent, lower at £225 million in 2006 compared to £643 million in 2005; this reduction reflects a £429 million year-on-year decrease in the movement of value of in-force business as a result of the application of the new valuation rules in the FSA s Policy Statement 06/14; this reduction is, however, largely offset by a similar reduction within insurance claims expense.

Operating expenses were £44 million, or 7 per cent, higher at £638 million in 2006 compared to £594 million in 2005. The impact of a decrease in staff numbers was largely offset by annual pay awards and there were increased advertising and promotion costs in respect of the Scottish Widows brand together with a lower net credit in respect of the amortisation of deferred acquisition costs (due to new business fluctuations and actuarial model changes).

The performance of the life, pensions and OEICs business and the general insurance business is discussed further below.

2005 compared to 2004

Profit before tax from the Lloyds TSB Group s Insurance and Investments businesses was £1,474 million which was £558 million, or 61 per cent, higher than £916 million in 2004. However, much of this increase was due to volatility arising from market movements (see Operating and financial review and prospects Line of business information Volatility) and profit before tax excluding volatility was £53 million, or 7 per cent, lower at £725 million compared to £778 million in 2004. The 2005 results were reduced by a provision of £155 million for the strengthening of mortality reserves. The impact of the new accounting standards applied with effect from 1 January 2005 was to reduce profit before tax, excluding volatility, by £73 million; excluding this effect profit before tax was £20 million, or 3 per cent, higher at £798 million compared to £778 million in 2004.

Net interest income was £112 million, or 40 per cent, higher at £395 million compared to £283 million in 2004. This increase reflected higher average levels of cash deposit investments in long-term business and policyholder funds.

Other income, excluding volatility, was £2,380 million, or 22 per cent, higher at £13,116 million compared to £10,736 million in 2004. One of the impacts of the application of IFRS 4 with effect from 1 January 2005 was the need to reclassify as investment contracts certain transactions that were previously treated as insurance contracts. This resulted in a decrease in other income largely offset by a decrease in insurance claims. Adjusting for this effect, underlying other income in 2005 was £15,820 million which was £5,084 million, or 47 per cent, higher than £10,736 million in 2004. This increase in underlying other income was principally due to a £1,131 million increase in insurance premium income, reflecting improved sales and increased policyholder activity, together with a £3,724 million increase in net trading income. Net trading income represents the realised and unrealised gains on investments held in the long-term funds, together with the interest and dividend income on those investments, and the significant increase in 2005 reflected improved market returns.

The increases in premium income and trading income were largely offset by a matching increase in insurance claims, reflecting the fact that the majority of the premium inflows and investment gains are for the benefit of policyholders. Insurance claims were £2,564 million, or 27 per cent, higher at £12,186 million in 2005 compared to £9,622 million in 2004. If the 1 January 2005 reclassifications to investment contracts, described above, are excluded underlying insurance claims were £5,172 million, or 54 per cent, higher at £14,794 million in 2005, compared to £9,622 million in 2004.

Operating expenses reduced by £28 million, or 5 per cent, from £622 million in 2004 to £594 million in 2005. This decrease reflected the absence of a charge in respect of customer redress (£12 million in 2004) and a net credit in respect of deferred acquisition costs of £45 million in 2005, following the adoption of IFRS 4 with effect from 1 January 2005. Adjusting for these items, underlying operating expenses were £639 million in 2005, £29 million or 5 per cent higher than £610 million in 2004. This underlying increase in operating expenses reflected increased business volumes and some targeted project expenditure.

Operating and financial review and prospects

Life, pensions and OEICs

The tables below show measures of new business premiums for the life and pensions business and OEIC sales, which management monitor because they provide an indication of both the performance and the profitability of the business.

Weighted sales has historically been the UK insurance industry standard for measuring new business volumes; the weighting being made towards regular premium policies to reflect the long-term nature of these contracts. However, industry practice is now moving towards an alternative basis of calculation Present Value of New Business Premiums (PVNBP); this is calculated as the value of single premiums plus the discounted present value of future expected regular premiums. An analysis of new business sales on a PVNBP basis is set out below for 2006 and 2005 together with analyses on a weighted sales basis for 2006, 2005 and 2004. There are three main distribution channels for the sale of Lloyds TSB Group s life, pension and OEIC products and the tables below show the relative importance of each.

Present value of new business premiums (PVNBP)	**2006 £m**	2005 £m
Life and pensions:		
Savings and investments	**1,300**	1,465
Protection	**232**	255
Individual pensions	**2,219**	2,197
Corporate and other pensions	**1,961**	1,517
Retirement income	**960**	658
Managed fund business	**348**	535
Life and pensions	**7,020**	6,627
OEICs	**2,720**	1,215
Life, pensions and OEICs	**9,740**	7,842
Single premium business	**7,321**	5,636
Regular premium business	**2,419**	2,206
Life, pensions and OEICs	**9,740**	7,842
Bancassurance	**3,421**	2,114
Independent financial advisers	**5,358**	4,698
Direct	**613**	495
Managed fund business	**348**	535
Life, pensions and OEICs	**9,740**	7,842

Weighted sales (regular + 1/10 single)	**2006 £m**	2005 £m	2004 £m
Life and pensions (including Managed Fund business)	**902**	804	676
OEICs	**290**	148	86
Life, pensions and OEICs	**1,192**	952	762
Weighted sales by distribution channel:			
Bancassurance	**403**	274	242
Independent financial advisers	**679**	562	432
Direct	**75**	66	69

	1,157	902	743
Managed Fund business	**35**	50	19
Life, pensions and OEICs	**1,192**	952	762

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2006 compared to 2005

Overall life, pensions and OEICs sales, measured on a PVNBP basis, were £1,898 million, or 24 per cent, higher at £9,740 million in 2006 compared to £7,842 million in 2005. The majority of the growth was in OEICs sales, which were £1,505 million, or 124 per cent, higher at £2,720 million in 2006 compared to £1,215 million in 2005. The growth in OEICs sales reflects an improved sales process through the branch network, a very successful tax year end campaign, and increasing success in selling to Wealth Management customers. OEICs sales have also benefited from the development of the Financial Planning Service sales force in the branch network and development of the relationships with the Community Banking and Wealth Management businesses within UK Retail Banking in order to gain better access to the targeted Mass Affluent market.

Life and pensions sales (including managed fund business), on a PVNBP basis, were £393 million, or 6 per cent, higher at £7,020 million in 2006 compared to £6,627 million in 2005. Corporate and other pension sales were £444 million, or 29 per cent, higher as a result of continuing strong sales following improvements in the product in 2005. Retirement income sales were £302 million, or 46 per cent, higher as a result of improvements in the Income Drawdown product and increased market activity following A-day (6 April 2006, when new legislation simplifying the pensions market came into force in the UK). These increases were, however, in part offset by a decrease of £165 million in Savings and investments sales and a reduction of £187 million in Managed fund business. The decrease in Savings and investments sales reflects competitive pressures and the limiting of investments into the SWIP Property Fund; Managed fund business is lower as 2005 included some exceptional benefits from mandate gains.

By distribution channel, Bancassurance sales were £1,307 million, or 62 per cent, higher at £3,421 million in 2006 compared to £2,114 million in 2005, as a result of the success of the developing Financial Planning Service sales force and the strong OEICs sales. Sales via independent financial advisers were £660 million, or 14 per cent, higher at £5,358 million in 2006 compared to £4,698 million in 2005; this reflects the strong Corporate pensions, Retirement income and OEIC sales via the dedicated Scottish Widows Investment Partnership sales force, partly offset by the decrease in Savings and investments sales.

On an annual premium equivalent basis, overall sales of life, pensions and OEIC products were £240 million, or 25 per cent, higher at £1,192 million in 2006 compared to £952 million in 2005. OEICs sales were £142 million, or 96 per cent, higher at £290 million in 2006 compared to £148 million in 2005; this reflects the successful tax year end campaign and developing sales through to the Mass Affluent market. Life and pensions sales were £98 million, or 12 per cent, higher at £902 million in 2006 compared to £804 million in 2005 as a result of the strong Corporate and other pensions and Retirement income sales, in part offset by the reduction in Savings and investments.

Profit before tax, on a statutory basis, from life, pensions and OEICs was £128 million, or 10 per cent, lower at £1,093 million in 2006 compared to £1,221 million in 2005. Excluding volatility, profit before tax was £201 million, or 40 per cent, higher at £701 million in 2006 compared to £500 million in 2005. However, the 2005 results were also impacted by the £155 million provision for the strengthening of reserves for annuitant mortality (£nil in 2006); also excluding this item, profit before tax was £46 million, or 7 per cent, higher at £701 million in 2006 compared to £655 million in 2005. New business profits improved as a result of the strong sales of Corporate and other pensions and this was coupled with a higher level of profits from existing business; these increases were only partly offset by reduced returns on shareholder net assets as a result of a lower economic basis in 2006 and lower free asset balances.

2005 compared to 2004

Overall, weighted sales in 2005 increased by £190 million, or 25 per cent, to £952 million in 2005 compared to £762 million in 2004 and as a result the Lloyds TSB Group s life, pensions and investments market share increased significantly to 6.0 per cent, compared with 5.7 per cent in 2004. Strong growth in sales of pension products, as a result of more focused marketing, more than offset lower life protection sales, resulting from the slow down in the housing market. Single premium life sales increased, particularly the Unit Linked Flexible Options Bond product, and single premium pension sales were higher, again as a result of the specific marketing focus.

Total OEICs sales increased significantly compared to 2004. Regular premium sales were little changed with the increase being in single premium sales, primarily through Bancassurance; this reflected a successful campaign in relation to the April 2005 tax year end and built on the launch of the simplified product suite that was introduced at the end of 2004.

By distribution channel, Bancassurance weighted sales were £32 million, or 13 per cent, higher at £274 million compared to £242 million in 2004; this reflected, in particular, the successful OEIC sales. Weighted sales via independent financial advisers were £130 million, or 30 per cent, higher at £562 million in 2005 compared to £432 million in 2004 supported by significant product and service enhancements; as a result the Lloyds TSB Group s market share of the IFA market improved to 6.5 per cent, compared with 5.9 per cent in 2004.

Profit before tax, on a statutory basis, from life, pensions and OEICs was £493 million, or 68 per cent, higher at £1,221 million in 2005 compared to £728 million in 2004. Profit before tax, excluding volatility, was £98 million, or 16 per cent, lower at £500 million compared to £598 million in 2004. Profitability in 2005 benefited from the absence of a provision for customer redress (2004: £12 million) but the results in 2005 were reduced by a provision of £155 million for the strengthening of mortality reserves. Adjusting for these items, profit before tax, excluding volatility, in 2005 was £655 million compared to £610 million in 2004, an increase of £45 million or 7 per cent. The strong sales led to an increased contribution from new business, partly offset by a commensurate increase in distribution costs. Improved investment earnings resulted from higher cash balances held for the account of the shareholder. OEICs profitability rose following improved markets and sales volumes.

Operating and financial review and prospects

General insurance

The results of the general insurance business are set out below.

	Statutory			Excluding volatility		
	2006 £m	2005 £m	2004 £m	**2006 £m**	2005 £m	2004 £m
Net interest income	**24**	23	44	**24**	23	44
Other income	**594**	571	504	**576**	543	496
Total income	**618**	594	548	**600**	566	540
Insurance claims	**(200)**	(197)	(214)	**(200)**	(197)	(214)
Total income, net of insurance claims	**418**	397	334	**400**	369	326
Operating expenses	**(157)**	(160)	(154)	**(157)**	(160)	(154)
Profit before tax, excluding volatility				**243**	209	172
Volatility				**18**	28	8
Profit before tax	**261**	237	180	**261**	237	180

	2006 £m	2005 £m	2004 £m
Premium income from underwriting:			
Creditor	**180**	127	114
Home	**424**	441	442
Health	**13**	16	27
Reinsurance premiums	**(17)**	(22)	(29)
	600	562	554
Commissions from insurance broking:			
Creditor	**377**	396	442
Home	**47**	49	45
Health	**13**	15	20
Other	**192**	221	165
	629	681	672

2006 compared to 2005

Profit before tax, on a statutory basis, from the Lloyds TSB Group s general insurance operations was £24 million, or 10 per cent, higher at £261 million in 2006 compared to £237 million in 2005. Excluding volatility, profit before tax was £34 million, or 16 per cent, higher at £243 million in 2006 compared to £209 million in 2005.

Net interest income was £1 million, or 4 per cent, higher at £24 million in 2006 compared to £23 million in 2005.

Other income, on a statutory basis, was £23 million, or 4 per cent, higher at £594 million in 2006 compared to £571 million in 2005. Insurance broking commissions receivable were £52 million, or 8 per cent, lower at £629 million in 2006 compared to £681 million in 2005; this reflects lower loan protection product sales in the first half of 2006, reduced card protection income due to lower average balances outstanding and fluctuations in the level of retrospective commissions. Premium income, net of reinsurance, was

£38 million, or 7 per cent, higher at £600 million in 2006 compared to £562 million in 2005; this reflects the commencement, during 2006, of underwriting of card and commercial loan protection products, partly offset by a fall in home insurance income. Fees and commissions payable were £31 million, or 4 per cent, lower at £664 million in 2006 compared to £695 million in 2005; this largely reflects fluctuations in branch network sales volumes.

Insurance claims expense was £3 million, or 2 per cent, higher at £200 million in 2006 compared to £197 million in 2005 as the impact of the new creditor protection underwriting in 2006 has been partly offset by a lower charge in respect of home insurance.

Operating expenses were £3 million, or 2 per cent, lower at £157 million in 2006 compared to £160 million in 2005. Staff costs have increased due to the use of agency staff on project work, but this has been more than offset by lower marketing expenditure and other cost-saving initiatives.

Operating and financial review and prospects

2005 compared to 2004

Profit before tax, on a statutory basis, from the general insurance business was £57 million, or 32 per cent, higher at £237 million in 2005 compared to £180 million in 2004. Profit before tax, excluding volatility, was £209 million in 2005, which was £37 million, or 22 per cent, higher than £172 million in 2004. Net interest income was £21 million lower at £23 million, compared to £44 million in 2004, principally reflecting the adoption of IFRS 4 and IAS 39 from 1 January 2005.

Other income, excluding volatility, was £47 million, or 9 per cent, higher at £543 million compared to £496 million in 2004; £18 million of this reflected the impact of the accounting standards applied with effect from 1 January 2005 giving an underlying increase of £29 million, or 6 per cent. Premium income from underwriting, net of reinsurance, was £8 million, or 1 per cent, higher at £562 million; creditor insurance income was higher as a result of the business written in conjunction with the Lloyds TSB Group s asset finance businesses but health premium income declined as a result of the transfer of part of this business to BUPA in 2004. Insurance broking commissions were £9 million, or 1 per cent, higher at £681 million compared to £672 million in 2004; creditor commissions were £46 million lower, as a result of a slowdown in unsecured lending growth during 2005. Other commissions, however, were £56 million higher due largely to higher levels of retrospective income on existing business.

Insurance claims, at £197 million, were £17 million, or 8 per cent, lower than £214 million in 2004. Creditor insurance payouts were lower due to a lower level of unemployment claims and home insurance claims were lower due to the relatively benign weather conditions. Health claims also fell, following the transfer of part of this business in 2004. The general insurance underwriting ratio improved to 34 per cent compared to 37 per cent in 2004.

Operating expenses, at £160 million, were £6 million, or 4 per cent, higher than £154 million in 2004; this increase reflected higher marketing spend together with some specific project costs.

Wholesale and International Banking

	2006 **£m**	2005 £m	2004 £m
Net interest income	**2,385**	2,265	2,006
Other income	**1,827**	1,628	1,558
Total income	**4,212**	3,893	3,564
Operating expenses	**(2,264)**	(2,181)	(2,078)
Trading surplus	**1,948**	1,712	1,486
Impairment losses on loans and advances	**(308)**	(188)	(193)
Loss on sale of businesses		(6)	(21)
Profit before tax	**1,640**	1,518	1,272
Cost:income ratio	**53.8%**	56.0%	58.3%
Total assets (year-end)*	**£ 147,836m**	£124,044m	£123,826m
Total risk-weighted assets (year-end)*	**£91,843m**	£80,154m	£71,013m

No volatility arises within Wholesale and International Banking and so these results are both statutory and excluding volatility.

* To ensure comparability, 2004 asset and risk-weighted asset figures are shown as at 1 January 2005, following implementation of those international accounting standards for which restated comparatives were not required.

2006 compared to 2005

Profit before tax from Wholesale and International Banking was £122 million, or 8 per cent, higher at £1,640 million in 2006 compared to £1,518 million in 2005.

Net interest income was £120 million, or 5 per cent, higher at £2,385 million compared to £2,265 million in 2005. Average interest-earning assets were £18,823 million, or 18 per cent, higher at £122,575 million in 2006 compared to £103,752 million in 2005. Excluding the fine margin reverse repurchase agreement balances from both years, the increase was £17,782 million. Strong growth in corporate lending, as well as in lower-margin treasury and structured finance balances, led to an increase of £16,398 million in average balances within Corporate Markets. Continued lending growth led to a £994 million increase in average balances within Business Banking and average interest-earning assets in Asset Finance were £415 million higher, largely due to lending growth over 2005. The significant growth in average balances, however, was partly offset by a 31 basis point decrease in the net interest margin (excluding fine margin reverse repurchase agreement balances) as a result of a change in mix since the growth in assets has been predominately in corporate lending and in the finer margin treasury and structured finance balances.

Other income was £199 million, or 12 per cent, higher at £1,827 million compared to £1,628 million in 2005. Other income largely comprises net fee and commission income, trading profits and operating lease rental income. Net fee and commission income was higher from mid-corporate lending and new product revenue streams in structured products and debt capital markets, as well as good growth in asset backed lending and decreased dealer commissions payable within the asset finance business. There was a slight fall in operating lease rental income offset by increased gains on sale of available-for-sale investments.

Operating and financial review and prospects

Operating expenses were £83 million, or 4 per cent, higher at £2,264 million in 2006 compared to £2,181 million in 2005. Staff costs were higher as a result of annual pay awards and staff taken on to support the expansion of the business; business success also led to increasing levels of bonus payments. These increases were, in part, offset by efficiency savings.

Impairment losses on loans and advances and other credit risk provisions totalled £308 million in 2006 compared to £188 million in 2005. Impairment losses on loans and advances were £122 million, or 64 per cent, higher at £313 million in 2006 compared to £191 million in 2005. Within Corporate Markets, net releases of £13 million in 2006 were £44 million lower than in 2005, as some significant one-off releases were not repeated. The charge within Asset Finance was £40 million, or 20 per cent, higher at £245 million in 2006 compared to £205 million in 2005; this reflected rising levels of consumer arrears and voluntary terminations. Within Business Banking, the charge was £11 million, or 14 per cent, higher at £87 million in 2006 compared to £76 million in 2005 with the increase reflecting lending growth. Overall, the Wholesale and International Banking impairment charge in respect of loans and advances expressed as a percentage of average lending increased to 0.39 per cent in 2006 compared to 0.28 per cent in 2005.

2005 compared to 2004

Profit before tax from Wholesale and International Banking in 2005 was £246 million, or 19 per cent, higher at £1,518 million compared to £1,272 million in 2004. The overall impact of the accounting standards implemented with effect from 1 January 2005 was limited and accounted for £20 million of the increase in profits.

Net interest income was £259 million, or 13 per cent, higher at £2,265 million compared to £2,006 million in 2004. Of this increase, £100 million reflected the impact of implementation of IAS 39 from 1 January 2005 which caused certain income previously classified as fees to be included in the effective interest rate calculation. Excluding this impact, net interest income was £159 million, or 8 per cent, higher at £2,165 million compared to £2,006 million in 2004. This underlying growth in net interest income reflected good growth in average lending balances in Corporate Banking, Structured Finance, Asset Finance and Business Banking; net interest margins were higher within Financial Markets, as a result of a change in mix of balances held, and within Structured Finance, as a result of the terms of new transactions taken on, although Corporate Banking margins reduced as a result of competitive pressures.

Other income was £70 million, or 4 per cent, higher at £1,628 million compared to £1,558 million in 2004. However, excluding the impact of the accounting standards implemented with effect from 1 January 2005, other income was £152 million, or 10 per cent, higher. This growth in underlying other income reflected increases in customer volumes within Corporate Banking, Structured Finance and Business Banking which resulted in higher lending and other fees. Business Banking also benefited from tariff reviews and from a lower level of commission clawback in respect of insurance sales; Asset Finance income increased as a result of organic growth and the impact of the motor dealerships acquired by the Lloyds TSB Group s Dutton Forshaw subsidiary during 2005.

Operating expenses were £103 million, or 5 per cent, higher at £2,181 million compared to £2,078 million in 2004. This largely reflected higher staff costs in support of the substantial business growth within Wholesale and International Banking over 2005, together with the impact of the motor dealership acquisitions.

Impairment losses on loans and advances were £5 million, or 3 per cent, lower at £188 million compared to £193 million in 2004. Charges within Corporate Banking and Structured Finance reduced by £94 million as a result of lower new provisions and a good level of recoveries in 2005, in part reflecting the benign economic environment. The impairment charge within Asset Finance was £66 million higher than in 2004 as a result of the substantial lending growth in recent years, particularly in respect of personal finance. There was also a lower level of releases within the International Banking businesses, which in 2004 had benefited from a release of £30 million from the Lloyds TSB Group s centrally held provision in respect of exposures in Argentina.

Wholesale and International Banking profit in 2005 was also reduced by a charge of £6 million in respect of the sale of businesses; 2004 included a loss of £21 million which principally related to the sale of the Lloyds TSB Group s businesses in Argentina and Colombia.

Central group items

	Statutory	Excluding volatility

	2006 £m	2005 £m	2004 £m	2006 £m	2005 £m	2004 £m
Lloyds TSB Foundations	**(37)**	(34)	(31)	**(37)**	(34)	(31)
Funding cost of acquisitions less earnings on capital	**(378)**	(378)	(317)	**(378)**	(378)	(317)
Central costs and other unallocated items	**(37)**	(134)	(2)	**(34)**	(10)	(2)
Pension schemes related credit	**128**			**128**		
Loss on sale and closure of businesses		(20)			(20)	
Profit before tax, excluding volatility				**(321)**	(442)	(350)
Volatility				**(3)**	(124)	
Profit before tax	**(324)**	(566)	(350)	**(324)**	(566)	(350)

Operating and financial review and prospects

2006 compared to 2005

On a statutory basis, the loss before tax from Central group items was £242 million, or 43 per cent, lower at £324 million in 2006 compared to £566 million in 2005. Excluding volatility, the loss before tax was £121 million, or 27 per cent, lower at £321 million compared to £442 million in 2005.

The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly the disabled and disadvantaged, to play a fuller role in society. The Foundations receive 1 per cent of the Lloyds TSB Group s pre-tax profit after adjusting for gains and losses on the disposal of businesses and pre-tax minority interests, averaged over three years, instead of a dividend on their shareholdings. In 2006, the Lloyds TSB Group accrued £37 million for payment to registered charities. See note 39 to the Consolidated Financial Statements.

The charge in respect of the funding cost of acquisitions, less earnings on capital, was unchanged at £378 million and a £24 million increase in the charge in respect of central costs and other unallocated items, excluding volatility, was largely offset by the non-repetition of the loss on sale and closure of businesses. The main reason for the overall reduction in the loss before tax, excluding volatility, however, was a pension schemes related credit of £128 million in 2006; following recent changes in age discrimination legislation in the United Kingdom, the Lloyds TSB Group has taken the decision to cease to augment the pension entitlement of employees taking early retirement, leading to a credit to the income statement.

2005 compared to 2004

On a statutory basis, the loss before tax from Central group items was £216 million, or 62 per cent, higher at £566 million in 2005 compared to £350 million in 2004. Excluding volatility, the loss before tax was £92 million, or 26 per cent, higher at £442 million in 2005 compared to £350 million in 2004. The accrual for payments to the four Lloyds TSB Foundations was £3 million higher in 2005 at £34 million. The funding cost of acquisitions, less earnings on capital, was £61 million higher in 2005 at £378 million; this increase principally reflected the reclassification, as a result of the implementation of IAS 39 with effect from 1 January 2005, of certain capital instruments from minority interests to loan capital. As a result, the funding cost is now reported within interest expense.

Volatility

	2006 £m	2005 £m	2004 £m
Banking volatility*	**(3)**	(124)	
Insurance volatility	**84**	438	168
Policyholder interests volatility	**326**	311	(30)
Total volatility	**407**	625	138

* Included within Central group items on a statutory basis.

Included within Insurance and Investments on a statutory basis.

In addition to presenting the Lloyds TSB Group s results prepared in accordance with applicable accounting standards, all monthly financial reporting to the Lloyds TSB Group Executive Committee and Board separately presents the results of the businesses before volatility. It is one of the key measures used to evaluate the performance of each of the businesses and is the basis upon which annual incentive scheme awards are made to management.

Management believes that the use of profit before tax excluding volatility provides an additional measure of the performance of the business as it excludes amounts included within profit before tax which do not accrue to the Lloyds TSB Group s equity holders and excludes the impact of changes in market variables which are beyond the control of management.

The most significant limitations associated with profit before tax excluding volatility are:

(i) Insurance volatility requires an assumption to be made for the normalised return on equities and other investments; and

(ii) Banking and insurance volatility impact on the Lloyds TSB Group s regulatory capital position, even though they are not included within profit before tax excluding volatility.

Management compensates for the limitations above by:

(i) Monitoring closely the assumptions used to calculate the normalised return used within the calculation of insurance volatility; these assumptions are disclosed below; and

(ii) Producing separate reports on the Lloyds TSB Group s current and forecast capital ratios.

Operating and financial review and prospects

Banking volatility

In accordance with IFRS, it is the Lloyds TSB Group s policy to recognise all derivatives at fair value. The banking businesses manage their interest rate and other market risks primarily through the use of intra-Group derivatives, with the resulting net positions managed centrally using external derivatives. IFRS does not, however, permit the intra-Group derivatives to be used in a hedge relationship for reporting purposes. Although fair value accounting can have a significant impact on reported earnings, it does not impact on the business fundamentals or cash flows of the businesses. The Lloyds TSB Group has, therefore, implemented an internal pricing arrangement whereby divisions transfer to Central group items the volatility associated with marking-to-market derivatives held for risk management purposes where, as far as possible, the effect is minimised by establishing IAS 39 compliant hedge accounting relationships. Banking volatility is principally comprised of the difference between the result that would be recognised on an accrual accounting basis for derivatives held for risk management purposes and their mark-to-market value.

During 2006, profit before tax included banking volatility of £(3) million, being a charge of £136 million to net interest income and a credit of £133 million to other income, (2005: £(124) million, being a charge of £79 million to net interest income and a charge of £45 million to other income; 2004: £nil). The significant reduction in this source of volatility reflects the beneficial effect of rising interest rates which has had the result of changing the way in which the gradual unwind of the Lloyds TSB Group s fair value hedging relationships has impacted the income statement.

Insurance volatility

The Lloyds TSB Group s insurance businesses have liability products that are supported by substantial holdings of investments, including equities, property and fixed interest investments, all of which have a volatile fair value. The value of the liabilities does not move exactly in line with changes in the fair value of the investments, yet IFRS requires that the changes in both the value of the liabilities and investments be reflected within the income statement. As these investments are substantial and movements in their fair value can have a significant impact on the profitability of the Insurance and Investments division, management believes that it is appropriate to disclose the division s results on the basis of an expected return in addition to the actual return. The difference between the actual return on these investments and the expected return based upon economic assumptions made at the beginning of the period is included within insurance volatility.

Changes in market variables also affect the realistic valuation of the guarantees and options embedded within products written in the Scottish Widows With Profit Fund, the value of the in-force business and the value of shareholders funds. Fluctuations in these values caused by changes in market variables are also included within insurance volatility.

The expected investment returns used to determine the normalised profit of the business, which are based on prevailing market rates and published research into historic investment return differentials, are set out below:

	2007	2006	2005	2004
	%	%	%	%
Gilt yields (gross)	**4.62**	4.12	4.57	4.85
Equity returns (gross)	**7.62**	6.72	7.17	7.45
Dividend yield	**3.00**	3.00	3.00	3.00
Property return (gross)	**7.62**	6.72	7.17	7.45
Corporate bonds (gross)	**5.22**	4.72	5.17	5.45

During 2006, profit before tax included positive insurance volatility of £84 million, being a credit of £2 million to net interest income and a credit of £82 million to other income (2005: £438 million, being a credit of £6 million to net interest income and a credit of £432 million to other income; 2004: £168 million, being a credit to other income). Returns in 2005 benefited from rising stock markets and rising gilt values. Although equity values continued to rise in 2006, this was less marked than in 2005 and the effect was partly offset by falling gilt values and a charge following the change in the economic assumptions used to calculate the value of in-force business at 31 December 2006.

Policyholder interests volatility

As a result of the requirement contained in IFRS to consolidate life and pensions businesses on a line-by-line basis, the Lloyds TSB Group s income statement includes amounts attributable to policyholders which affect profit before tax; the most significant of these items is policyholder tax.

Under IFRS, tax on policyholder investment returns is required to be included in the tax charge rather than being offset against the related income, as it is in actual distributions made to policyholders. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge. Other items classified within policyholder interests volatility include the effects of investment vehicles which are only majority owned by the long-term assurance funds. In the case of these vehicles, the Lloyds TSB Group s profit for the year includes the minorities share of the profits earned. As these amounts do not accrue to the equity holders, management believes a clearer representation of the underlying performance of the Lloyds TSB Group s life and pensions businesses is presented by excluding policyholder interests volatility.

During 2006, profit before tax included positive policyholder interests volatility of £326 million, being a charge of £33 million to net interest income and a credit of £359 million to other income (2005: £311 million, being a credit to other income; 2004: £(30) million, being a charge to other income). The increase reflects an improved return from a property partnership majority owned by the policyholders, which more than offset a reduction in the policyholder tax charge as a result of a fall in the capital values of gilts and bonds and a smaller rise in equity markets.

Operating and financial review and prospects

Future accounting developments

Future developments in relation to the Lloyds TSB Group s IFRS reporting are discussed in note 51 to the Consolidated Financial Statements and future developments in relation to US GAAP are discussed in note 52 to the Consolidated Financial Statements.

IFRS compared with US GAAP

Under US GAAP, Lloyds TSB Group s net income for the year ended 31 December 2006 was £1,815 million (2005: £1,351 million; 2004: £1,508 million) compared to £2,803 million (2005: £2,493 million; 2004: £2,392 million) under IFRS. Reconciliations between IFRS and US GAAP figures, together with detailed explanations of the accounting differences, are included in note 52 to the Consolidated Financial Statements.

The Lloyds TSB Group s IFRS net income increased by £310 million, or 12 per cent, in 2006 compared with 2005, whereas its US GAAP net income increased by £464 million, or 34 per cent. The US GAAP results have been significantly affected by the Lloyds TSB Group s decision not to hedge any of its financial instruments for US GAAP accounting purposes, the requirement to consolidate certain variable interest entities under US GAAP and the increased US GAAP net pension charge.

Hedging and financial instruments. Under IFRS, changes in the fair value of derivatives that are designated as hedges are either offset against the change in fair value of the hedged asset or liability through earnings or recognised directly in equity until the hedged item is recognised in earnings, depending on the nature of the hedge. Under US GAAP, because Lloyds TSB Group has elected not to satisfy the onerous hedging criteria of SFAS No. 133 Accounting for Derivative Instruments and for Hedging Activities in respect of derivative contracts, these instruments are treated as being held for trading purposes, with the unrealised mark-to-market gains and losses taken to income as they arise and the resulting assets or liabilities recorded on the balance sheet. As Lloyds TSB Group continues to hold a significant number of derivatives which are hedge accounted under IFRS this means that net income and shareholders equity under US GAAP are subject to greater volatility. In addition there is an IFRS/US GAAP difference in the accounting for unrealised foreign exchange gains and losses on available-for-sale securities; and the Lloyds TSB Group has elected, under IFRS, to classify certain of its financial instruments at fair value through profit or loss (this classification is not available under US GAAP and these financial instruments are, generally, classified as available-for-sale securities). These differences result in the gains or losses, which are recognised through the income statement under IFRS, being recognised in other comprehensive income under US GAAP.

Pensions. IFRS requires that the pension costs in the income statement reflect the cost of accruing benefits for active employees, the unwind of the interest cost of the scheme liabilities and the cost of severances borne by the schemes net of the expected return on scheme assets. The Lloyds TSB Group has elected to apply the corridor approach in respect of actuarial gains and losses and so, to the extent that the cumulative gains or losses remain within a corridor defined as the greater of 10 per cent of the scheme assets or liabilities, they are not reflected in the accounts. A similar method is used to recognise pension costs under US GAAP, although amounts that remain within the corridor are recognised within other comprehensive income.

Although the methodologies used to recognise the pension expense are similar, the respective standards were adopted on different dates and, as a result, the cumulative unrecognised actuarial losses at the beginning of the year exceeded the corridor limits on a US GAAP basis, but did not on an IFRS basis (as the only cumulative losses relevant for IFRS are those arising since the adoption of IAS 19, Employee Benefits, on 1 January 2004). Consequently, the 2006 US GAAP pension charge includes the amortisation of actuarial losses which is not recognised under IFRS.

Other areas where differences in accounting have had a significant effect upon the Lloyds TSB Group s US GAAP results are as follows:

Insurance accounting. Under IFRS, for insurance contracts (and, in 2004, investment contracts within life assurance operations) the discounted value of the projected future cash flows attributable to the shareholder is recognised at the point of sale. IFRS therefore results in a proportion of the profit expected to accrue over the life of various products being recognised at their inception. Under US GAAP, income is recognised in the income statement in the period in which it is earned and expenses in the period in which they are incurred. This results, under US GAAP, in a more even recognition of profit over the life of the related policies.

Intangible assets. Under US GAAP, the Lloyds TSB Group has recognised intangible assets reflecting the value of the customer relationships associated with acquisitions made in prior periods. These intangible assets are amortised through the income statement reducing US GAAP net income. The reconciling item still exists, despite the convergence of IFRS and US GAAP in this area, as, on transition, the Lloyds TSB Group chose not to apply IFRS to business combinations that occurred before 1 January

2004.

Variable interest entities. US GAAP requires the consolidation of variable interest entities for which Lloyds TSB Group is deemed to be the primary beneficiary. The Lloyds TSB Group has a number of venture capital investments which do not require consolidation under IFRS, but for which Lloyds TSB Group is deemed to be the primary beneficiary. Consequently, the results of these entities are consolidated into the Lloyds TSB Group s results for US GAAP purposes, rather than the Lloyds TSB Group recording the investments at fair value through profit or loss.

Operating and financial review and prospects

Average balance sheet and net interest income

	2006 Average balance £m	**2006 Interest income £m**	**2006 Yield %**	2005 Average balance £m	2005 Interest income £m	2005 Yield %	2004 Average balance £m	2004 Interest income £m	2004 Yield %
Assets									
Treasury bills and other eligible bills:									
Domestic offices							41	2	4.88
Foreign offices							161	4	2.48
Loans and advances to banks:									
Domestic offices	**35,842**	**1,664**	**4.64**	31,198	1,111	3.56	26,731	917	3.43
Foreign offices	**2,854**	**162**	**5.68**	2,224	88	3.96	2,071	62	2.99
Loans and advances to customers:									
Domestic offices	**168,922**	**10,621**	**6.29**	152,469	9,859	6.47	127,646	8,221	6.44
Foreign offices	**5,948**	**288**	**4.84**	4,948	236	4.77	5,514	219	3.97
Available-for-sale financial assets:									
Domestic offices	**13,334**	**600**	**4.50**	9,623	349	3.63			
Foreign offices	**5,046**	**207**	**4.10**	4,554	159	3.49			
Debt securities:									
Domestic offices							9,989	300	3.00
Foreign offices							4,372	118	2.70
Lease and hire purchase receivables:									
Domestic offices	**10,425**	**774**	**7.42**	11,137	787	7.07	11,118	864	7.77
Foreign offices									
Total interest-earning assets of banking book	**242,371**	**14,316**	**5.91**	216,153	12,589	5.82	187,643	10,707	5.71
Total interest-earning trading securities and other financial assets at fair value through profit or loss (2004: trading assets)	**27,584**	**1,831**	**6.64**	31,185	1,563	5.01	34,037	1,536	4.51
Total interest-earning assets	**269,955**	**16,147**	**5.98**	247,338	14,152	5.72	221,680	12,243	5.52
Allowance for impairment losses on loans and advances	**(2,171)**			(2,058)			(1,729)		
Non-interest earning assets:									
Domestic offices	**63,175**			58,916			47,510		
Foreign offices	**471**			919			902		
Total average assets and interest income	**331,430**	**16,147**	**4.87**	305,115	14,152	4.64	268,363	12,243	4.56
Percentage of assets applicable to foreign activities (%)	**4.5**			4.2			4.8		

	2006 Average interest earning assets £m	**2006 Net interest income £m**	**2006 Net interest margin %**	2005 Average interest earning assets £m	2005 Net interest income £m	2005 Net interest margin %	2004 Average interest earning assets £m	2004 Net interest income £m	2004 Net interest margin %
Average interest-earning assets and net interest income:									
Banking business	**242,371**	**5,537**	**2.28**	216,153	5,671	2.62	187,643	5,110	2.72
Trading securities and other financial assets at fair value through profit or loss (2004: trading assets)	**27,584**	**1,551**	**5.62**	31,185	1,114	3.57	34,037	947	2.78

Net yield on interest-earning assets	**269,955**	**7,088**	**2.63**	247,338	6,785	2.74	221,680	6,057	2.73

Operating and financial review and prospects

	2006 Average balance £m	**2006 Interest expense £m**	**2006 Cost %**	2005 Average balance £m	2005 Interest expense £m	2005 Cost %	2004 Average balance £m	2004 Interest expense £m	2004 Cost %
Liabilities and shareholders funds									
Deposits by banks:									
Domestic offices	**33,861**	**1,550**	**4.58**	23,645	854	3.61	20,199	456	2.26
Foreign offices	**2,143**	**130**	**6.07**	4,075	99	2.43	4,227	102	2.41
Liabilities to banks under sale and repurchase agreements:									
Domestic offices	**3,907**	**230**	**5.89**	4,419	258	5.84	4,200	192	4.57
Foreign offices				3		1.56	4		2.41
Customer accounts:									
Domestic offices	**125,309**	**3,621**	**2.89**	117,622	3,329	2.83	105,400	2,963	2.81
Foreign offices	**3,242**	**117**	**3.61**	2,194	72	3.28	2,303	40	1.74
Liabilities to customers under sale and repurchase agreements:									
Domestic offices	**1,969**	**28**	**1.42**	4,179	134	3.21	2,787	125	4.49
Foreign offices	**106**	**2**	**1.89**	106	2	1.89	121	2	1.65
Debt securities in issue:									
Domestic offices	**39,795**	**1,862**	**4.68**	27,895	1,199	4.30	19,837	924	4.66
Foreign offices	**2,677**	**121**	**4.52**	3,026	108	3.57	2,685	48	1.79
Other interest-bearing liabilities:									
Domestic offices	**4,382**	**424**	**9.68**	3,618	262	7.24	2,635	144	5.46
Foreign offices									
Subordinated liabilities:									
Domestic offices	**12,129**	**694**	**5.72**	11,515	601	5.22	10,175	601	5.91
Foreign offices									
Total interest-bearing liabilities of banking book	**229,520**	**8,779**	**3.82**	202,297	6,918	3.42	174,573	5,597	3.21
Total interest-bearing trading liabilities and other liabilities at fair value through profit or loss (2005 and 2004: trading liabilities)	**6,349**	**280**	**4.41**	11,245	449	3.99	14,992	589	3.93
Total interest-bearing liabilities	**235,869**	**9,059**	**3.84**	213,542	7,367	3.45	189,565	6,186	3.26
Interest-free liabilities									
Non-interest bearing customer accounts:									
Domestic offices	**3,862**			3,636			3,134		
Foreign offices	**250**			267			372		
Other interest-free liabilities:									
Domestic offices	**78,712**			77,177			63,364		
Foreign offices	**1,804**			447			751		
Minority interests and shareholders funds	**10,933**			10,046			11,177		
Total average liabilities and interest expense	**331,430**	**9,059**	**2.73**	305,115	7,367	2.41	268,363	6,186	2.31
Percentage of liabilities applicable to foreign activities (%)	**3.2**			3.4			4.1		

Net interest margin for the banking book

	2006 %	2005 %	2004 %

Domestic offices	**2.30**	2.68	2.79
Foreign offices	**2.07**	1.72	1.74
Group margin	**2.28**	2.62	2.72

Loans and advances to banks and customers include impaired lending. In 2004, interest receivable on such loans was only included to the extent to which cash payments had been received, in accordance with Lloyds TSB Group s policy on income recognition. In 2005 and 2006, interest has been recognised using the effective interest rate method, as required by IAS 39.

Average balances are based on daily averages for the principal areas of the Lloyds TSB Group s banking activities with monthly or less frequent averages used elsewhere. Management believes that the interest rate trends are substantially the same as they would be if all balances were averaged on the same basis.

Operating and financial review and prospects

Changes in net interest income volume and rate analysis

The following table allocates changes in net interest income between volume and rate for 2006 compared with 2005 and for 2005 compared with 2004. Where variances have arisen from both changes in volume and rate these are allocated to volume.

	2006 compared with 2005 Increase/(decrease)			2005 compared with 2004 Increase/(decrease)		
	Total change £m	**Volume £m**	**Rate £m**	Total change £m	Volume £m	Rate £m
Interest receivable and similar income						
Loans and advances to banks:						
Domestic offices	**553**	**216**	**337**	194	159	35
Foreign offices	**74**	**36**	**38**	26	6	20
Loans and advances to customers:						
Domestic offices	**762**	**1,034**	**(272)**	1,638	1,605	33
Foreign offices	**52**	**48**	**4**	17	(27)	44
Available-for-sale financial assets (2004: Treasury and other eligible bills and Debt securities):						
Domestic offices	**251**	**167**	**84**	47	(15)	62
Foreign offices	**48**	**20**	**28**	37	1	36
Lease and hire purchase receivables:						
Domestic offices	**(13)**	**(53)**	**40**	(77)	1	(78)
Foreign offices						
Total banking book interest receivable and similar income	**1,727**	**1,468**	**259**	1,882	1,730	152
Total interest receivable and similar income on trading securities and other financial assets at fair value through profit or loss (2004: trading assets)	**268**	**(239)**	**507**	27	(143)	170
Total interest receivable and similar income	**1,995**	**1,229**	**766**	1,909	1,587	322
Interest payable						
Deposits by banks:						
Domestic offices	**696**	**468**	**228**	398	124	274
Foreign offices	**31**	**(117)**	**148**	(3)	(4)	1
Liabilities to banks under sale and repurchase agreements:						
Domestic offices	**(28)**	**(30)**	**2**	66	13	53
Foreign offices						
Customer accounts:						
Domestic offices	**292**	**222**	**70**	366	346	20
Foreign offices	**45**	**38**	**7**	32	(4)	36
Liabilities to customers under sale and repurchase agreements:						
Domestic offices	**(106)**	**(31)**	**(75)**	9	45	(36)
Foreign offices						
Debt securities in issue:						
Domestic offices	**663**	**557**	**106**	275	346	(71)
Foreign offices	**13**	**(16)**	**29**	60	12	48
Other interest bearing liabilities:						
Domestic offices	**162**	**74**	**88**	118	71	47
Foreign offices						
Subordinated liabilities:						

Domestic offices	**93**	**35**	**58**		70	(70)
Foreign offices						
Total banking book interest payable	**1,861**	**1,200**	**661**	1,321	1,019	302
Total interest payable on trading and other liabilities at fair value through profit or loss (2005 and 2004: trading liabilities)	**(169)**	**(216)**	**47**	(140)	(150)	10
Total interest payable	**1,692**	**984**	**708**	1,181	869	312

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Risk management

Risk as a strategic differentiator

Lloyds TSB Group continues with the development of the risk framework through close alignment of risk capabilities to objectives. Substantial progress has been made in 2006 in embedding our approach across the business. This has included a focus on enhancing our capabilities in providing both qualitative and quantitative data to the board on risks associated with strategic objectives and facilitating more informed and effective decision making. The Group s ability to take risks which are well understood, consistent with its strategy and plans and appropriately remunerated, is a key driver of shareholder return.

The maintenance of a strong control framework remains a priority and is the foundation for the delivery of effective risk management. Risk analysis and reporting capabilities continue to evolve to identify opportunities as well as risks, to improve the Group s ability to take an aggregate view of the overall risk portfolio and assign clear responsibilities and timescales at group and divisional level for risk mitigation strategies. Risk continues to be a key component of routine management information reporting and is embedded within staff objectives via balanced scorecards.

The objective remains to go beyond risk mitigation and control to developing risk capabilities as a key strategic differentiator for Lloyds TSB.

Risk governance structures

Lloyds TSB Group maintains a risk governance structure that strengthens risk evaluation and management, whilst also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.

The board, assisted by its sub-committees, the risk oversight committee, the group executive committee and the audit committee, approves the Group s overall risk management framework. The board also reviews the Group s aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board s appetite for risk. The risk oversight responsibilities of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 87 to 89, and further key risk oversight roles are described on the next page.

The group executive committee, assisted by its sub-committees, the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the development, implementation and effectiveness of the Group s risk management framework and the clear articulation of the Group s risk policies, and reviews the Group s aggregate risk exposures and concentrations of risk. The group executive committee s duties are described more fully on page 87.

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

The chief risk director, a member of the group executive committee and reporting directly to the group chief executive, oversees and promotes the development and implementation of a consistent group wide risk management framework. The chief risk director, supported by group risk, provides objective challenge to the Group s senior management.

Divisional risk officers provide oversight of risk management activity within each of the Group s operating divisions. Reporting directly to the group executive directors responsible for the divisions and the chief risk director, their day-to-day contact with business management, business operations and risk initiatives seeks to provide an effective risk oversight mechanism. The direct reporting line to the chief risk director enables the Group to maintain a wide ranging and current perspective on material risks facing the Group and provides a mechanism to share best risk management practice.

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

Accountability of line management has been further reinforced in relation to the management of risks arising from the Group s business and in developing the risk awareness and risk management capability of the Group s staff. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group s risk appetite. The senior executive team and Board received regular briefings and guidance from the chief risk director to ensure awareness of the overarching risk model and a clear understanding of their accountabilities for risk and internal control.

During the year an enhanced Control Self-Assessment process has increased the focus of management at all levels on risk management and reinforced accountabilities. All business units, divisional risk offices and group functions have completed a Control Self-Assessment, reviewing the effectiveness of their internal controls and putting in place enhancements where appropriate. Managing directors and group executive directors have certified the accuracy of their assessment.

Business management forms part of a tiered risk management model, as shown on page 39, with the divisional risk officers providing oversight and challenge, as described above, and the chief risk director and group committees establishing the group wide perspective.

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

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

Risk management framework

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

Principal risks

The Group s risk language is designed to capture the Group s principal risks referred to as the primary risk drivers . A description of each risk, including definition, appetite, control and exposures is included in the detail to this report. These are further broken down into 13 more granular risk types to enable more detailed review and facilitate appropriate reporting and analysis of root causes, as set out below.

Through Lloyds TSB s risk management processes these risks are assessed on an ongoing basis to ensure optimisation of risk and reward and that, where required, appropriate mitigation is in place. Both quantitative and qualitative factors are considered in assessing Lloyds TSB s current and potential future risks. At present the two most significant risks for the Group are:

Legal and regulatory risk, reflecting the volume and pace of change from within the UK and Europe. This impacts Lloyds TSB both operationally in terms of cost of compliance and uncertainty about regulatory expectations, and strategically through pressure on key earnings streams. The latter could potentially result in major changes to business and pricing models, particularly in the UK retail market. Our business planning processes continue to reflect change to the regulatory environment. Major current regulatory reviews are described on pages 11 and 12.

Credit risk, reflecting the risk inherent in our lending businesses. Whilst credit quality remains satisfactory this will always be a significant risk for Lloyds TSB. The current focus is on unsecured retail credit, where lending criteria and limits have been tightened over the last two years and collections and recoveries processes enhanced.

Risk appetite

In enhancing the Lloyds TSB Group risk framework in 2005, the Group s strategic vision and the desired outcomes for its key stakeholders were articulated. The risk implications are expressed in high level risk principles and risk appetite measures and metrics for the primary risk types. These are then translated into more detailed policies and measures which are applied to the businesses. A key focus in 2006 has been the enhancement of policy and development of risk appetite across our business and this work will continue throughout 2007.

The more detailed articulation of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses is subsequently agreed by the group chief executive, through consultation with the group executive committee and on the advice of the group business risk committee and the group asset and liability committee.

Policy

A key component of the risk management framework is the policy framework. The Group has continued to embed this further during 2006.

The main policy levels are identified below:

Principles high level principles for the six primary risk drivers

High level group policy policy for the main risk types aligned to the risk drivers

Detailed group policy detailed policy that applies across the Group

Divisional policy local policy that specifically applies to a division

Business unit policy local policy that specifically applies to a business unit

Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy and the associated accountabilities are clearly outlined. All staff are expected to be aware of the policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all staff within that area.

Group and divisional risk functions have responsibility for overseeing effective implementation of policy. Group audit provides independent assurance to the board about the effectiveness of the Group s control framework and adherence to policy.

Policies are reviewed annually to seek to ensure they remain fit for purpose.

Risk reporting

Divisional risk functions use the standard language when reporting risks centrally, to enable risk aggregation, and when assessing risk levels of new products, change initiatives or business plans. Divisions monitor their risk levels against their risk appetite seeking to ensure effective mitigating action is being taken where appropriate. Divisional risk reports are reviewed by divisional executive committees to ensure divisional senior management are satisfied with the overall risk profile, risk accountabilities and progress on any necessary mitigating actions.

At group level a consolidated risk report is produced which is reviewed and debated by group business risk committee, group executive committee, risk oversight committee and board to ensure senior management and the board are satisfied with the overall risk profile, risk accountabilities and any necessary mitigating actions. During the year the Group s consolidated risk report was further enhanced to support the identification, control and effective management of risk.

Strategy risk

The Group includes product and service risk within the wider definition of strategy risk and the two categories are described in further detail below.

Definition

Strategy risk is the risk arising from developing a strategy that does not maximise franchise value and/or fails to achieve the initiatives in the agreed strategic plan due to changing or flawed assumptions. In assessing strategic risk consideration is given to both:

- external factors (i.e. economic, technological, political, social and ethical, environmental, legal and regulatory, market expectations, reputation and competitive behaviour), and
- internal factors (i.e. resource capability and availability, customer treatment, service level agreements, products and funding and the risk appetite of other risk categories).

Risk appetite

Strategy risk is encapsulated as the budget and medium-term plan sanctioned by the board on an annual basis. Divisions and business units subsequently align their plans to the Group s overall strategic risk appetite.

Exposures

The market for UK financial services and the other markets within which the Group operates are highly competitive, and management expects such competition to intensify in response to consumer demand, technological changes, the impact of consolidation, regulatory actions and other factors, which could result in a reduction in profit margins. The Group s ability to generate an appropriate return for its shareholders depends significantly upon the competitive environment and management s response to it.

The Group seeks to achieve further organic growth by securing new customers and developing more business from existing customers. Lloyds TSB is currently expending significant resources and effort to bring about this growth, particularly with respect to its UK retail financial services business. If these expenditures and efforts did not meet with success, its operating results would grow more slowly or decline.

As well as the Group s organic growth plans, management and planning resources are also devoted to identifying possible acquisitions which would provide further opportunities for growth. If these strategic plans do not meet with success, the Group s earnings could grow more slowly or decline.

The Group s businesses are conducted in a market place that is consolidating and significant cross-border mergers and acquisitions may happen in the coming years. Lloyds TSB s ability to generate an appropriate return for its shareholders over the long term may depend upon whether management is able to achieve value creating acquisitions and/or mergers at the appropriate times and prices. Lloyds TSB cannot be sure that it will ultimately be able to make such mergers or acquisitions or that, if it does, such mergers or acquisitions will be integrated successfully or realise anticipated benefits.

Control

An annual strategic planning process is conducted at group and business level which includes a quantitative and qualitative assessment of the risks in the Group s plan. Within the planning round, the Group conducts both scenario analysis and stress tests to assess risks to future earning streams.

The Group s strategy is reviewed and approved by the board. Regular reports are provided to the group executive committee and the board on the progress of the Group s key strategies and plans. Group risk conducts oversight to seek to ensure the business plans remain consistent with the Group s strategy. Revenue and capital investment decisions require additional formal assessment and approval. Formal risk assessment is conducted as part of the financial approval process. Significant company mergers and acquisitions require specific approval by the board. In addition to the standard due diligence conducted during a merger or acquisition, group risk conducts, where appropriate, an independent risk assessment of the target company and its proposed integration into Lloyds TSB Group.

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

Product and service risk

Definition

The risk of loss, both financial and reputational, from the inherent design, management or distribution of products, or from the failure to meet or exceed customer expectations, competitor offerings or regulatory requirements.

Control

The Group is strongly committed to the fair treatment of its customers. This is embedded into the processes and risk assessment which takes place to seek to ensure businesses have developed customer centric strategies for product and business development, marketing, selling and after sales service. Businesses maintain a range of products to meet customers needs and the business strategy and are responsible for managing and controlling product risks and complying with applicable regulations.

Businesses have formal processes for reviewing the range of their product portfolios and subject all product development to rigorous assessment. The assessment includes seeking to ensure that the product meets clearly defined customer needs. Businesses have a defined channel distribution strategy for products, consistent with the Group s distribution strategy. Businesses launching new products are responsible for ensuring compliance with all applicable regulations and that the proposed sales activity is appropriate for the type of customer and their attitude to risk.

A product is defined as a solution that can be offered to a customer or counterparty that might satisfy a want or a need in order to generate revenue streams or gains (not necessarily financial) for the Group. In line with defined policy, businesses provide divisional risk management with details of new products at an early stage of product or service development to seek to ensure compliance with the Group s risk appetite and strategy. Businesses are required to demonstrate that new products meet clearly defined customer needs and that the sales process mitigates the risks of unsuitable sales. Where appropriate, technical advice and approval is sought from specialist functions.

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

Credit risk

Definition

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).

Risk appetite

Credit risk appetite is defined as the quantum and quality of the desired credit portfolio and the direction in which the Group wants to manage it, in order to achieve its short and long-term strategic goals.

Credit risk appetite is described and reported through a suite of metrics derived from a combination of accounting and economic equity model parameters which in turn uses the various credit risk rating systems as inputs. These metrics are supplemented by a variety of policies, sector caps and limits to manage concentration risk at an acceptable level.

Exposures

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. The credit risk exposures of the Group are set out in note 47 to the Consolidated Financial Statements.

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.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers.

Credit risk also arises from the use of derivatives. Note 16 to the Consolidated Financial Statements 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.

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.

Control

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.

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 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.

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.

The following are the principal control mechanisms through which the Group manages credit risk:

- Credit rating systems. All business units operate appropriate rating system(s) for their portfolio(s). All rating systems, which are authorised by executive management, comply with the Group s standard methodology. The Group uses a Master Scale rating structure with ratings corresponding to a range of probabilities of future default. The Group uses rating systems as an integral part of the credit process deployed within the credit life cycle. Whilst divisional risk teams have responsibility for monitoring rating model performance, group risk reviews new models and material changes to existing models, seeking executive management approval as necessary.

- Portfolio monitoring and reporting. With group risk, businesses and divisions identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by group risk. Group risk in turn produces an aggregated review of credit risk throughout the Group, which is presented to the group business risk committee.

Credit principles and policy. Group risk sets out the group credit principles according to which credit risk is managed. These form the basis of the group credit policy, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process. Business unit policy includes lending guidelines which define the responsibilities of lending officers and seek to provide a disciplined and focused benchmark for credit decisions.

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

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

Concentration risk. Credit risk management sets portfolio controls on certain industries, sectors and product lines that reflect risk appetite, and monitors exposures to prevent excessive concentration of risk. These concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. Amongst these controls is a series of sector caps to manage residual value risk exposure, seeking to ensure an acceptable distribution of risk. The Group s large exposures are managed in accordance with regulatory reporting requirements.

Impairment process. The maintenance of adequate impairment allowances is considered a key issue from a credit control perspective. Impairment methodology is set out in credit policy and is subject to a rigorous governance process, including the preparation of a regular impairment review paper to executive management, consideration by dedicated business unit and divisional impairment review committees and the reporting to the group executive committee of material individual counterparty impairment charges.

Facilities database. A database is maintained of all non-retail customer relationships to assist in the identification and aggregation of cross-business unit commitments. The Group uses a system known as parent company executives, under which there is a central person responsible for each non-retail customer relationship, to whom other business units wishing to do business with the same customer must apply for credit limits.

Credit portfolio model. The Group models portfolio credit risk based on defaults, using a statistically-based model which calculates the economic equity employed and credit value at risk for each portfolio.

Stress testing and scenario analysis. The credit portfolio model is also used in stress-testing, to simulate a scenario and calculate its impact. Our modelling capabilities are currently subject to further development. Events are modelled both at a group wide level, at divisional and business unit level and by portfolio, for example, for a specific industry sector.

Risk assurance and oversight. Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams and group audit are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.

Lloyds TSB Group also uses a range of approaches to mitigate credit risk. In the case of individual exposures, the Group makes use of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure. The Group also undertakes asset sales, securitisations and credit derivative-based approaches as appropriate for the nature of the assets and market conditions.

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.

Loan portfolio (unaudited)

The tables below have been prepared in accordance with IFRS (for 2004, 2005 and 2006) and with UK Generally Accepted Accounting Principles (for 2002 and 2003) and, as a result, the information included in the tables for 2004, 2005 and 2006 is not directly comparable with that for 2002 and 2003.

Analysis of loans and advances to banks and customers

The following tables analyse loans to banks and customers by geographical area and type of loan at 31 December for each of the five years listed.

IFRS	**2006 £m**	2005 £m	2004 £m
Domestic			
Loans and advances to banks	**37,014**	28,859	29,052
Loans and advances to customers:			
Mortgages	**95,167**	88,528	80,065
Other personal lending	**22,782**	23,020	22,934
Agriculture, forestry and fishing	**2,862**	2,405	2,076
Energy and water supply	**1,493**	971	420
Manufacturing	**6,816**	7,128	3,980
Construction	**2,236**	2,092	1,903
Transport, distribution and hotels	**9,784**	8,735	7,669
Postal and telecommunications	**504**	404	296
Financial, business and other services	**20,745**	19,675	15,976
Property companies	**12,638**	8,571	6,014
Lease financing	**4,802**	5,815	6,227
Hire purchase	**5,060**	4,853	4,828
Total domestic loans	**221,903**	201,056	181,440
Foreign			
Loans and advances to banks	**3,625**	2,797	2,797
Loans and advances to customers:			

Mortgages	**434**	367	277
Other personal lending	**243**	260	256
Agriculture, forestry and fishing	**43**	46	31
Energy and water supply	**531**	621	533
Manufacturing	**697**	795	511
Construction	**96**	130	87
Transport, distribution and hotels	**706**	730	1,041
Postal and telecommunications	**327**	142	50
Financial, business and other services	**2,254**	1,586	1,763
Property companies	**258**	142	64
Total foreign loans	**9,214**	7,616	7,410
Total loans	**231,117**	208,672	188,850
Allowance for impairment losses	**(2,194)**	(2,073)	(1,663)
Interest held in suspense			(21)
Total loans and advances net of allowance for impairment losses	**228,923**	206,599	187,166

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UK GAAP	2003 £m	2002 £m
Domestic		
Loans and advances to banks	13,671	15,291
Loans and advances to customers:		
Mortgages	70,750	62,467
Other personal lending	20,280	16,698
Agriculture, forestry and fishing	2,025	2,076
Energy and water supply	425	568
Manufacturing	3,771	3,972
Construction	1,516	1,491
Transport, distribution and hotels	5,446	5,382
Postal and telecommunications	273	371
Financial, business and other services	10,635	9,129
Property companies	4,822	4,276
Lease financing	6,470	7,285
Hire purchase	4,701	4,342
Total domestic loans	144,785	133,348
Foreign		
Loans and advances to banks	1,894	2,239
Loans and advances to customers:		
Mortgages	331	4,763
Other personal lending	263	1,098
Agriculture, forestry and fishing	40	2,220
Energy and water supply	711	1,051
Manufacturing	926	1,608
Construction	124	328
Transport, distribution and hotels	1,423	2,459
Postal and telecommunications	84	385
Financial, business and other services	1,866	3,196
Property companies	74	1,117
Lease financing		15
Total foreign loans	7,736	20,479
Total loans	152,521	153,827
Provisions for loan losses	(1,695)	(1,767)
Interest held in suspense	(28)	(57)
Total loans and advances net of provisions and interest held in suspense	150,798	152,003

IFRS	**2006 £m**	2005 £m	2004 £m
Analysis of foreign loans by region			
Loans and advances to customers:			
Latin America	**169**	173	125
USA	**2,253**	1,984	2,385
Europe	**2,417**	1,927	1,587
Rest of the world	**750**	735	516
	5,589	4,819	4,613
Loans and advances to banks:			
Latin America	**55**	76	72

USA	**2,235**	315	69
Europe	**1,037**	1,470	1,853
Rest of the world	**298**	936	803
	3,625	2,797	2,797
Total foreign loans	**9,214**	7,616	7,410

Operating and financial review and prospects

UK GAAP	2003 £m	2002 £m
Analysis of foreign loans by region		
Loans and advances to customers:		
New Zealand		10,447
Latin America	557	1,591
USA	2,681	3,412
Europe	1,981	2,142
Rest of the world	623	648
	5,842	18,240
Loans and advances to banks:		
New Zealand		622
Latin America	143	52
USA	95	227
Europe	1,408	1,164
Rest of the world	248	174
	1,894	2,239
Total foreign loans	7,736	20,479

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

Operating and financial review and prospects

Summary of loan loss experience

The following tables analyse the movements in the allowance for impairment losses for each of the five years listed.

IFRS	**2006 £m**	2005 £m	2004 £m
Balance at beginning of year			
Domestic	**2,037**	1,562	1,468
Foreign	**36**	101	227
Total balance at beginning of year before transition to IAS 39		1,663	1,695
Adjustment to reflect transition to IAS 39 on 1 January 2005		256	
Balance at beginning of year after transition to IAS 39	**2,073**	1,919	
Exchange and other adjustments	**(13)**	1	(11)
Reclassifications		43	
Acquisition and disposal of businesses and portfolios	**(27)**	(27)	(33)
Advances written off:			
Domestic			
Loans and advances to customers:			
Mortgages	**(9)**	(6)	(2)
Other personal lending	**(1,188)**	(900)	(760)
Agriculture, forestry and fishing	**(1)**	(1)	(4)
Energy and water supply	**(17)**	(20)	(18)
Manufacturing	**(21)**	(26)	(39)
Construction	**(7)**	(8)	(3)
Transport, distribution and hotels	**(50)**	(37)	(33)
Financial, business and other services	**(137)**	(151)	(35)
Property companies	**(1)**		(15)
Lease financing	**(1)**	(5)	(3)
Hire purchase	**(39)**	(77)	(49)
Loans and advances to banks			(15)
Total domestic	**(1,471)**	(1,231)	(976)
Foreign	**(18)**	(5)	(52)
Total advances written off	**(1,489)**	(1,236)	(1,028)
Recoveries of advances written off:			
Domestic			
Loans and advances to customers:			
Mortgages	**2**	2	2
Other personal lending	**158**	124	119
Agriculture, forestry and fishing			1
Energy and water supply	**1**	2	
Manufacturing	**3**	2	7
Construction	**1**	1	7
Transport, distribution and hotels	**4**	5	14
Financial, business and other services	**12**	14	15
Hire purchase	**9**	5	6
Total domestic	**190**	155	171

Foreign		3	3
Total recoveries of advances written off	**190**	158	174
Net advances written off:			
Domestic	**(1,281)**	(1,076)	(805)
Foreign	**(18)**	(2)	(49)
Total net advances written off	**(1,299)**	(1,078)	(854)

Operating and financial review and prospects

IFRS	**2006 £m**	2005 £m	2004 £m
Effect of unwinding of discount recognised through interest income	**(100)**	(87)	
Allowances for impairment losses charged against income for the year:			
Domestic			
Loans and advances to customers:			
Mortgages	**12**	18	4
Other personal lending	**1,345**	1,193	807
Agriculture, forestry and fishing	**1**		(3)
Energy and water supply	**4**	2	37
Manufacturing	**11**	1	(1)
Construction	**5**	(3)	4
Transport, distribution and hotels	**29**	20	43
Postal and telecommunications			
Financial, business and other services	**54**	8	(15)
Property companies			15
Lease financing	**4**	(3)	7
Hire purchase	**91**	70	57
General provisions			(57)
Total domestic	**1,556**	1,306	898
Foreign	**4**	(4)	(32)
Total allowances for impairment losses charged against income for the year	**1,560**	1,302	866
Balance at end of year			
Domestic	**2,174**	2,037	1,562
Foreign	**20**	36	101
Total balance at end of year	**2,194**	2,073	1,663
Ratio of net write-offs during the year to average loans outstanding during the year	**0.7%**	0.6%	0.6%

Operating and financial review and prospects

UK GAAP	2003 £m	2002 £m
Balance at beginning of year		
Domestic	1,344	1,162
Foreign	423	306
Total balance at beginning of year	1,767	1,468
Exchange and other adjustments	(1)	(58)
Acquisition and disposal of businesses	(54)	3
Advances written off:		
Domestic		
Loans and advances to customers:		
Mortgages	(1)	(21)
Other personal lending	(691)	(554)
Agriculture, forestry and fishing	(11)	(2)
Manufacturing	(30)	(25)
Construction	(11)	(17)
Transport, distribution and hotels	(40)	(27)
Postal and telecommunications	(8)	(1)
Financial, business and other services	(50)	(54)
Property companies	(36)	(19)
Lease financing	(4)	(17)
Hire purchase	(44)	(50)
Total domestic	(926)	(787)
Foreign	(219)	(91)
Total advances written off	(1,145)	(878)
Recoveries of advances written off:		
Domestic		
Loans and advances to customers:		
Mortgages	2	5
Other personal lending	103	83
Agriculture, forestry and fishing	2	3
Energy and water supply		1
Manufacturing	6	17
Construction	2	3
Transport, distribution and hotels	7	12
Financial, business and other services	7	13
Property companies	6	10
Lease financing	1	3
Hire purchase	6	15
Total domestic	142	165
Foreign	36	38
Total recoveries of advances written off	178	203
Net advances written off:		
Domestic	(784)	(622)
Foreign	(183)	(53)

Total net advances written off	(967)	(675)

Operating and financial review and prospects

UK GAAP	2003 £m	2002 £m
Provision for loan losses charged against income for the year:		
Domestic		
Loans and advances to customers:		
Mortgages	(19)	(5)
Other personal lending	679	514
Agriculture, forestry and fishing	8	
Energy and water supply	(9)	40
Manufacturing		31
Construction	11	14
Transport, distribution and hotels	26	28
Postal and telecommunications		2
Financial, business and other services	90	103
Property companies	22	(1)
Lease financing	2	3
Hire purchase	40	57
General provisions	9	14
Loans and advances to banks	16	
Total domestic	875	800
Foreign	75	229
Total provision for loan losses charged against income for the year	950	1,029
Balance at end of year		
Domestic	1,468	1,344
Foreign	227	423
Total balance at end of year	1,695	1,767
Ratio of net write-offs during the year to average loans outstanding during the year	0.7%	0.5%

Operating and financial review and prospects

The following tables analyse the coverage of the allowance for loan losses by category of loans.

IFRS	**2006 Allowance £m**	**2006 Percentage of loans in each category to total loans %**	2005 Allowance £m	2005 Percentage of loans in each category to total loans %	2004 Allowance £m	2004 Percentage of loans in each category to total loans %
Balance at year end applicable to:						
Domestic:						
Loans and advances to banks	**1**	**16.0**	1	13.8	1	15.4
Loans and advances to customers:						
Mortgages	**42**	**41.2**	36	42.4	11	42.3
Other personal lending	**1,719**	**9.9**	1,530	11.0	788	12.1
Agriculture, forestry and fishing	**1**	**1.2**	2	1.2	3	1.1
Energy and water supply	**14**	**0.6**	32	0.5	55	0.2
Manufacturing	**23**	**2.9**	29	3.4	64	2.1
Construction	**6**	**1.0**	8	1.0	17	1.0
Transport, distribution and hotels	**40**	**4.2**	58	4.2	84	4.1
Postal and telecommunications		**0.2**		0.2		0.2
Financial, business and other services	**157**	**9.0**	234	9.5	158	8.5
Property companies	**3**	**5.5**	4	4.1		3.2
Lease financing	**7**	**2.1**	4	2.8	10	3.3
Hire purchase	**161**	**2.2**	99	2.3	91	2.6
Total domestic	**2,174**	**96.0**	2,037	96.4	1,282	96.1
Foreign	**20**	**4.0**	36	3.6	101	3.9
General provision					280	
Total balance at year end	**2,194**	**100.0**	2,073	100.0	1,663	100.0

UK GAAP	2003 Allowance £m	2003 Percentage of loans in each category to total loans %	2002 Allowance £m	2002 Percentage of loans in each category to total loans %
Balance at year end applicable to:				
Domestic:				
Loans and advances to banks	16	9.0		9.9
Loans and advances to customers:				
Mortgages	7	46.4	25	40.7
Other personal lending	622	13.2	495	10.9
Agriculture, forestry and fishing	9	1.3	10	1.3
Energy and water supply	31	0.3	25	0.4
Manufacturing	97	2.5	121	2.6
Construction	9	1.0	7	1.0
Transport, distribution and hotels	60	3.6	67	3.5
Postal and telecommunications		0.2		0.2
Financial, business and other services	198	6.9	176	5.9

Property companies		3.2	8	2.8
Lease financing	6	4.2	7	4.7
Hire purchase	77	3.1	75	2.8
Total domestic	1,132	94.9	1,016	86.7
Foreign	181	5.1	318	13.3
General provision	382		433	
Total balance at year end	1,695	100.0	1,767	100.0

Risk elements in the loan portfolio

The following discussion consists of an analysis of credit risk elements by categories which reflect US lending and accounting practices. These differ from those employed in the UK. In particular:

Non-performing lending

2004

In the US, it is the normal practice to stop accruing interest when payments are 90 days or more past due or when recovery of both principal and interest is doubtful. When the loans are transferred to non accrual status, accrued interest is reversed from income and no further interest is recognised until it becomes probable that the principal and interest will be repaid in full. Loans on which interest has been accrued but suspended would be included in risk elements as loans accounted for on a non-accrual basis.

In addition, in the US non-performing loans and advances are typically written off more quickly than in the UK. Consequently a UK bank may appear to have a higher level of non-performing loans and advances than a comparable US bank although the reported income is likely to be similar in both the US and the UK.

In accordance with IFRS, Lloyds TSB Group continued to accrue interest, where appropriate, on doubtful debts when there was a realistic prospect of recovery. This interest was charged to the customer s account but it was not credited to income; it was placed on a suspense account and only taken to income if there ceased to be significant doubt about its being paid. Loans were transferred to non-accrual status where the operation of the customer s account had ceased. This lending was managed by specialist recovery departments and written down to its estimated realisable value. Interest was not added to the lending or placed on a suspense account as its recovery was considered unlikely; it was only taken to income if it was received.

2005 and 2006

In accordance with IFRS, Lloyds TSB Group continues to accrue and recognise interest on loans that have been written down as a result of an impairment loss. The interest recognised is based on the net carrying value of the loan and is less than that that would be recognised on a similar performing loan. Accordingly, no amounts are disclosed as non-accrual in 2005 and 2006. If there is objective evidence that impairment has occurred and the carrying value of the loan exceeds the present value of its estimated future cash flows discounted at the loan s original effective interest rate then a provision is made.

Lloyds TSB Group now analyses its non-performing lending between impaired loans with a provision and impaired loans contractually past due 90 days or more without a provision.

Troubled debt restructurings

In the US, loans whose terms have been modified due to problems with the borrower are required to be separately disclosed. If the new terms were in line with market conditions at the time of the restructuring and the restructured loan remains current as to repayment of principal and interest then the disclosure can be discontinued at the end of the first year.

There are no similar disclosure requirements in the UK.

Potential problem loans

Potential problem loans are loans where known information about possible credit problems causes management to have concern as to the borrower s ability to comply with the present loan repayment terms.

There are no similar disclosure requirements in the UK.

Assets acquired in exchange for advances

In most circumstances in the US, title to property securing residential real estate transfers to the lender upon foreclosure. The loan is written off and the property acquired in this way is reported in a separate balance sheet category with any recoveries recorded as an offset to the provision for loan losses recorded in the year. Upon sale of the acquired property, gains or losses are recorded in the income statement as a gain or loss on acquired property.

In the UK, although a bank is entitled to enforce a first charge on a property held as security, it typically does so only to the extent of enforcing its power of sale. In accordance with IFRS and industry practice, Lloyds TSB Group takes control of a property held as collateral on a loan at repossession but title does not transfer to it. Loans subject to repossession continue to be reported as loans in the balance sheet. Any gains or losses on sale of the acquired property are recorded within the allowance for impairment losses during the reporting period.

The difference in practices has no effect on net income reported in the UK compared to that reported in the US but it does result in a difference in classification of losses and recoveries in the income statement. It also has the effect of causing UK banks to report an increased level of non performing loans compared with US banks.

Operating and financial review and prospects

The following tables analyse risk elements in the loan portfolio as at 31 December for the last five years.

IFRS	**2006 £m**	2005 £m	2004 £m
Loans accounted for on a non-accrual basis			
Domestic offices			617
Foreign offices			56
Total non-accrual loans			673
Accruing loans on which interest is being placed in suspense			
Domestic offices			527
Foreign offices			40
Total suspended interest loans			567
Accruing loans on which interest is still being accrued and taken to profit, and against which specific provisions have been made*			
Domestic offices			1,363
Foreign offices			2
Total accruing loans against which specific provisions have been made			1,365
Impaired lending against which provisions are held			
Domestic offices	**3,984**	4,064	
Foreign offices	**22**	58	
Total impaired lending against which provisions are held	**4,006**	4,122	
Loans contractually past due 90 days or more as to principal or interest, but against which no provisions have been made			
Domestic offices	**1,252**	1,210	1,040
Foreign offices			
Total accruing loans	**1,252**	1,210	1,040
Total non-performing lending	**5,258**	5,332	3,645
Domestic offices	**5,236**	5,274	3,547
Foreign offices	**22**	58	98
Total non-performing lending	**5,258**	5,332	3,645

Following the adoption of IAS 39 with effect from 1 January 2005, interest is accrued on all outstanding loans, including those treated as impaired; accordingly, it is no longer possible to classify non-performing lending as being accounted for on either a non-accrual basis or a suspended interest basis. As a result, the Lloyds TSB Group analyses its non-performing lending between impaired loans with a provision and impaired loans contractually past due 90 days or more without a provision. This figure is not directly comparable to the amounts disclosed in 2004, because prior to the adoption of IAS 39 provisions were only established in the event that the recovery of the principal balance was in serious doubt.

* Included within accruing loans on which interest is still being accrued and taken to profit, and against which specific provisions have been made, in 2004 was £1 million in respect of troubled debt restructurings. There were no troubled debt restructurings in 2005 or 2006.

UK GAAP	2003 £m	2002 £m
Loans accounted for on a non-accrual basis		
Domestic offices	480	421
Foreign offices	105	241
Total non-accrual loans	585	662
Accruing loans on which interest is being placed in suspense		
Domestic offices	545	553
Foreign offices	88	199
Total suspended interest loans	633	752
Accruing loans on which interest is still being accrued and taken to profit, and against which specific provisions have been made		
Domestic offices	1,199	1,217
Foreign offices	23	66
Total accruing loans against which specific provisions have been made	1,222	1,283
Accruing loans on which interest is still being accrued and taken to profit, the lending is contractually past due 90 days or more as to principal or interest, but against which no provisions have been made		
Domestic offices	875	776
Foreign offices		34
Total accruing loans against which no provisions have been made	875	810
Troubled debt restructurings		
Domestic offices	1	1
Foreign offices		2
Total troubled debt restructurings	1	3
Total non-performing lending		
Domestic offices	3,100	2,968
Foreign offices	216	542
Total non-performing lending	3,316	3,510

Interest foregone on non-performing lending

The table below summarises the interest foregone on impaired lending.

	2006 £m
Interest income that would have been recognised under original contract terms	**431**
Interest income included in profit	**(297)**
Interest foregone	**134**

Potential problem loans

In addition to the non-performing lending disclosed above, lendings which were current as to payment of interest and principal but where concerns existed about the ability of the borrowers to comply with loan repayment terms in the near future were as follows:

IFRS	**2006 £m**	2005 £m	2004 £m
Potential problem lending	**1,764**	1,800	1,450

UK GAAP	2003 £m		2002 £m
Potential problem lending	1,696		1,734

The figures shown for potential problem lending are not indicative of the losses that might arise should the credit quality of this lending deteriorate since they do not take into account security held.

Operating and financial review and prospects

Cross border outstandings

The business of Lloyds TSB Group involves significant exposures in non-local currencies. These cross border outstandings comprise loans (including accrued interest), acceptances, interest-bearing deposits with other banks, other interest-bearing investments and any other monetary assets which are denominated in non-local currency. The following tables analyse, by type of borrower, foreign outstandings which individually represented in excess of 1 per cent of Lloyds TSB Group s total assets.

IFRS	% of assets	Total £m	Governments and official institutions £m	Banks and other financial institutions £m	Commercial, industrial and other £m
As at 31 December 2006:					
Belgium	**1.5**	**5,081**	**3**	**4,607**	**471**
France	**1.3**	**4,389**	**40**	**3,224**	**1,125**
United States of America	**1.2**	**4,255**	**218**	**1,478**	**2,559**
Netherlands	**1.2**	**4,018**	**6**	**1,595**	**2,417**
Germany	**1.1**	**3,655**	**12**	**3,274**	**369**
As at 31 December 2005:					
Germany	2.6	8,142	217	7,562	363
Netherlands	1.4	4,335		2,704	1,631
Belgium	1.3	4,133	12	4,006	115
United States of America	1.3	3,974	312	899	2,763
As at 31 December 2004:					
Belgium	2.5	7,033	796	6,161	76
Germany	2.1	5,872	331	5,118	423
Netherlands	1.2	3,480	415	2,173	892
Japan	1.1	3,235	550	1,037	1,648

As at 31 December 2006, Belgium had commitments of £33 million, Germany had commitments of £673 million, Netherlands had commitments of £1,322 million, United States of America had commitments of £551 million and France had commitments of £923 million.

As at 31 December 2006, there was no country with cross border outstandings of between 0.75 per cent and 1 per cent of assets.

As at 31 December 2005, the country with cross border outstandings of between 0.75 per cent and 1 per cent of assets, amounting to £2,448 million in total, was France.

As at 31 December 2004, the countries with cross border outstandings of between 0.75 per cent and 1 per cent of assets, amounting to £4,767 million in total, were France and United States of America.

Market risk

(audited information)

Definition

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. It arises in all areas of Lloyds TSB Group s activities and is managed by a variety of different techniques.

Risk appetite

Market risk appetite is defined as the quantum and composition of market risk that exists currently in the Group and the direction in which the Group wishes to manage this.

This statement of the Group s overall appetite for market risk is reviewed and approved annually by the board. The group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

Exposures

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.

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 objective of earning a profit from favourable movements in market rates

Market risk in the Group s retail portfolios and in the Group s capital funds arises from the different repricing characteristics of the Group s banking assets and liabilities. Interest rate risk arises from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets

Foreign currency risk also arises from the Group s investment in its overseas operations

The Group s insurance activities also expose it to market risk, encompassing interest rate, exchange rate, property and equity risk.

The management of with-profits funds leads to assets and liabilities that are mismatched with the aim of generating a higher rate of return to meet policyholders expectations

Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of those assets

For other insurance liabilities the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch

Surplus assets are held primarily in three portfolios: the surplus in the non-profit fund within the Long Term Fund of Scottish Widows plc, assets in shareholder funds of life assurance companies and an investment portfolio within the general insurance business

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.

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 table below (the table also aggregates potential loss measures from options portfolios).

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

Non-trading:

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

It is estimated that a hypothetical immediate and sustained 100 basis point 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.

	UK £m	North America £m	Asia & Australasia £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 businesses, the composition and value of surplus assets held in excess of liabilities are reported to 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 table below shows closing, average, maximum and minimum VaR for surplus assets held in excess of liabilities in the Group s insurance businesses for the years ended 31 December 2006 and 2005 on a 99 per cent confidence ten day basis.

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

The Group s structural foreign exchange position at 31 December 2006 is set out in note 47 to the Consolidated Financial Statements. 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 Lloyds TSB Group s risk asset ratios.

Control

The group asset and liability committee regularly reviews market risk exposure and makes recommendations to the group chief executive concerning overall market risk appetite and market risk policy.

Banking activity:

- 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

- 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 by the 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 activity:

- 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 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 the 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 discusses strategies for the overall mix of pension assets with the pension scheme trustees.

Insurance risk

Definition

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.

Risk appetite

Insurance risk appetite is defined as the quantum and composition of insurance risk that exists currently in the Group and the direction in which the Group wishes to manage this.

Exposures

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.

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

Control

A key element of the control framework is the consideration of insurance risk by 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 the Lloyds TSB Insurance executive committee with the more significant risks again being subject to Lloyds TSB group executive committee and/or Lloyds TSB Group board approval. All group pension scheme issues are covered by the group asset and liability committee.

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.

Operational risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people related or external events.

Risk appetite

Operational risk appetite is defined as the quantum and composition of operational risk that exists in the Group and the direction in which the Group wishes to manage it.

The Group has developed an impact on earnings approach to operational risk appetite. This involves looking at how much the Group could lose due to operational risk losses at various levels of severity. In setting operational risk appetite, the Group looks at both impact on solvency and the Group s reputation, including customer service requirements.

Exposures

The main sources of operational risk within Lloyds TSB Group relate to uncertainties created by the changing business environment in which we operate and how this is managed across the Group. Throughout 2006 there has been ongoing development of operational risk metrics to ensure both current and potential future operational risk exposures are understood in terms of both risk and reward potential.

Control

The Group continues to develop and refine its approach to managing operational risk. A consistent operational risk management framework for the timely identification, measurement, monitoring and control of operational risk has been introduced across the Group. Further development of operational risk metrics is taking place to seek to ensure that current and potential future operational risk exposures are understood in terms of both risk and reward potential.

The Group has seven sub operational risk types: governance risk, legal and regulatory risk, customer treatment risk, process and resource risk, theft, fraud and other criminal acts risk, people risk and change-related risk each of which is described in further detail below.

Governance risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from poor corporate governance at group, divisional and business unit level. Corporate governance in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise.

Control

The Group s governance arrangements are based upon the following core principles:

- the interests of shareholders and other stakeholders are protected by ensuring that excessive powers are not delegated to individuals;
- decisions taken by management are consistent with the Group s strategic objectives and risk appetite, which are approved by the board;
- managers are accountable for the management of risk, including internal controls, in their business;

- risk management arrangements and risk exposures (including material transactions, financial positions or portfolios) are subject to independent oversight;
- business is conducted in line with authorities and accountabilities ultimately delegated by the board; these are described within specific policies;
- clear accountabilities are delegated by management to people who have the right level of skills, competencies and experience;
- managers are required to safeguard against conflicts of interest;
- every member of staff is responsible for understanding and managing the risk they take on behalf of the Group and for ensuring that they act within the authorities and accountabilities delegated to them; and
- all staff are required to comply with group policies.

The Group s policy is to maintain strong corporate governance arrangements, as it believes this is consistent with the Group s objective of maximising shareholder value over time. This includes the means by which risks are effectively managed in order to enable successful implementation of the Group s strategy. The Group s high level governance arrangements are described on pages 87 to 89. These arrangements reflect the Group s policy which is that the board adheres to the principles contained in the Combined Code on corporate governance, issued by the Financial Reporting Council, when determining and reviewing its governance arrangements. The directors review the application of the principles and provisions of the Code annually.

The policy regarding organisational structure is that the Group seeks to optimise performance by allowing divisions, subsidiaries and business units to operate within established capital and risk parameters and the Group s policy framework. Group policy requires that they must do so in a way which is consistent with realising the Group s strategy and meets agreed business performance targets.

Group functions (e.g. group human resources, group risk, group finance, group strategy, group audit) are established to provide functional leadership (e.g. policy, strategy and standards), challenge and support across the Group and ensure information is consolidated at group level.

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

The Group s whistleblowing arrangements, reviewed and supported by the independent charity Public Concern at Work, encourage staff to speak up if they have concerns about any possible wrongdoing.

Legal and regulatory risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable.

Control

The Group s business is regulated primarily by the UK Financial Services Authority (FSA), the Banking Code Standards Board (BCSB) and the Office of Fair Trading (OFT) and additionally by local regulators in offshore and overseas jurisdictions. Each business has a nominated individual with compliance oversight responsibility under FSA rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

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

Group compliance also provides leadership on compliance with money laundering and terrorist financing legislation and regulation across the Group. It sets group policy and standards on the topic and undertakes high level oversight of anti-money laundering risks. A specialist team within Group compliance provides a centre of excellence on the relevant legislation and regulation as well as interfacing with external public and private bodies in order to evolve the Group s approach and seek to ensure greater effectiveness and focus on key risk areas. Its remit also includes compliance with financial sanctions.

Each business unit is responsible for complying with relevant laws and legal principles. Business units have access to legal advice both internal and external. The group chief legal adviser provides policies to assist business units identify areas where legal risk management procedures are necessary. Reports to the group chief legal adviser are required in relation to both significant litigation and also material legal issues.

The group compliance director and the group chief legal adviser have access to the chairman and group chief executive.

Customer treatment risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate or poor customer treatment.

Control

The Group is committed to the fair treatment of its customers. It is an essential part of the way the Group conducts its business and develops deep long-lasting relationships with its customers. A range of management information measures is in place across the Group to support the tracking of key customer treatment indicators. Group risk and group audit are required to report regularly on customer treatment risk, management information trends and on compliance with the Group s standards.

Service improvements are monitored by customer satisfaction surveys, as well as internal process evaluations. The results of the research are fed into the Group s CARE Index, which measures ongoing performance against five principal objectives: customer understanding; accessibility; responsibility; expertise; and overall service quality improvement. This is tracked monthly and is a key indicator for the Group.

A framework is in place to guide the consideration and documentation of customer treatment risk when developing policies and procedures. The Group has defined customer treatment principles and benchmark standards in all the key areas and enhanced its processes and procedures for a number of individual initiatives including the governance of responsible lending and complaints handling. The divisions are required to meet or exceed these standards, tailoring customer treatment to the needs of each customer segment. The revised detailed group product governance policy also requires customer treatment standards to be tailored.

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

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

Process and resource risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems, people-related events, damage to resources (excluding human resources), and deficiencies in the performance of external suppliers/service providers.

Control

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

The Group has defined high-level process and resource risk policies to seek to ensure a wide-ranging and consistent approach to the identification and management of process and resource risk. These include policies covering physical and information security, business continuity, outsourcing, procurement and incident management when policy implementation and oversight is led by specialist teams with a group wide remit.

Theft, fraud and other criminal acts risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from frauds carried out against the Group, and/or theft of the Group s assets, and other criminal acts.

Control

The Group has in place appropriate policies, procedures and tools for the management of theft, fraud and other criminal acts risks, which fall under the remit of the Chief Security Office.

Business units and group functions have primary responsibility for identifying and managing fraud risk at a local level in consultation with the Group Financial Crime Unit. Additionally the group fraud strategy and policy committee is responsible for monitoring fraud risk as well as ensuring that fraud risks are effectively identified and assessed and that strategies for fraud prevention are effectively coordinated. This includes external scanning of the threat environment across all service delivery channels and translation mechanisms with particular focus on card payment and internet transactions.

The Chief Security Office establishes policy for the security of the people, premises and assets, including identifying and developing countermeasures to minimise the impact of physical threats to the Group. Business unit management seek to ensure that the level of security risk applicable to each site they occupy is assessed, and that the appropriate security countermeasures are determined in order to protect people, premises and assets.

People risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate staff behaviour, industrial action or health and safety issues. Loss can also be incurred through failure to recruit, retain, train, reward and incentivise appropriately skilled staff to achieve business objectives and through failure to take appropriate action as a result of staff underperformance.

Control

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

Standards of behaviour. The Group has a code of business conduct which applies to all employees. It seeks to ensure that employees act with integrity and endeavour to deliver high levels of customer service. It promotes a working environment free from discrimination, harassment, bullying or victimisation of any kind. Employees are encouraged and expected to alert management to suspected misconduct, fraud or other serious malpractice. We provide mechanisms to facilitate disclosure if an employee is unable to inform their direct line management and will thoroughly investigate any reports made in good faith. The code as amended from time to time is available to the public on the Company s website at www.lloydstsb.com.

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

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

Change risk

Definition

Change-related risk is the risk of reductions in earnings and/or value, through financial or reputational loss, from change initiatives failing to deliver to requirements, budget or timescale or failing to implement change effectively or realise the desired benefits.

Control

To deliver the Group s strategic aims, change must be managed in an effective, risk-aware and appropriately controlled manner throughout the organisation. The Group s change management standards seek to ensure appropriate control across the project portfolio and the approach is regularly benchmarked against other leading institutions and practices. The Group s change management committee reviews the overall change portfolio monthly, with particular focus on initiatives having a high impact on customers and staff. The committee ensures that the aggregate impact of the implementation of change on customers, staff and systems is understood, managed and controlled.

Financial soundness

Definition

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

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

The international standard for measuring capital adequacy is the risk asset ratio, which relates to on- and off-balance sheet exposures weighted according to broad categories of risk. The Group s capital ratios, calculated in line with the requirements of the FSA, are set out in detail on page 63.

Risk appetite

Financial soundness risk appetite is set and reported through various metrics that enable the Group to manage liquidity and capital constraints and shareholder expectations.

Exposures

The principal financial soundness risk uncertainties relate to liquidity and capital adequacy and each of these sources of risk is described in more detail below.

Operating and financial review and prospects Audited information

Liquidity and capital resources

Liquidity sources

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

Lloyds TSB Group plc is also able to raise funds by issuing loan capital or equity, although in practice the majority of Lloyds TSB Group s loan capital has been issued by Lloyds TSB Bank. As at 31 December 2006, Lloyds TSB Group plc had £2,297 million of subordinated debt in issuance compared with £12,072 million for the consolidated Lloyds TSB Group. The cost and availability of subordinated debt finance are influenced by credit ratings. A reduction in these ratings could increase the cost and could reduce market access. At 31 December 2006, the credit ratings of Lloyds TSB Bank were as follows:

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

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

A significant part of the liquidity of the Lloyds TSB Group s banking businesses arises from their ability to generate customer deposits. A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally provided a stable source of funding. During 2006, amounts deposited by customers increased by £8,272 million from £131,070 million at 31 December 2005 to £139,342 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, of which £6,806 million had been utilised for senior funding at 31 December 2006, and commercial paper programmes, under which £2,343 million had been utilised at 31 December 2006. 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 Lloyds TSB Group s banking businesses. The Lloyds TSB Group holds sizeable balances of marketable debt securities which could be disposed of to provide additional funding should the need arise.

The following table sets out the amounts and maturities of Lloyds TSB Group s contractual cash obligations at 31 December 2006 (unaudited)

	Within one year £m	**One to three years £m**	**Three to five years £m**	**Over five years £m**	**Total £m**
Long-term debt dated	**300**	**459**	**1,094**	**2,399**	**4,252**
Euro Medium-Term Note programme	**417**	**799**	**978**	**4,612**	**6,806**
Commercial paper programme	**2,343**				**2,343**
Securitisation vehicles	**11,578**	**3,767**	**3,505**	**1,923**	**20,773**

Finance leases	**1**			**15**	**16**
Operating leases	**212**	**398**	**335**	**835**	**1,780**
Capital commitments	**129**	**31**			**160**
Other purchase obligations	**532**	**687**	**295**	**64**	**1,578**
	15,512	**6,141**	**6,207**	**9,848**	**37,708**

Other purchase obligations include amounts expected to be payable in respect of material contracts entered into by the Lloyds TSB Group, in the ordinary course of business, for the provision of outsourced and other services. The cost of these services will be charged to the income statement as it is incurred. The Lloyds TSB Group also has a constructive obligation to ensure that its defined post-retirement benefit schemes remain adequately funded. The amount and timing of the Lloyds TSB Group s cash contributions to these schemes is uncertain and will be affected by factors such as future investment returns and demographic changes. Lloyds TSB Group expects to make cash contributions of approximately £530 million to these schemes in 2007.

At 31 December 2006, Lloyds TSB Group also had £7,820 million of preferred securities and undated subordinated liabilities outstanding.

Off balance sheet arrangements (unaudited)

The following table sets out the amounts and maturities of Lloyds TSB Group s other commercial commitments at 31 December 2006. These commitments are not included in Lloyds TSB Group s consolidated balance sheet.

	Within one year £m	**One to three years £m**	**Three to five years £m**	**Over five years £m**	**Total £m**
Acceptances	**62**	**1**			**63**
Other contingent liabilities	**953**	**976**	**263**	**522**	**2,714**
Total contingent liabilities	**1,015**	**977**	**263**	**522**	**2,777**
Lending commitments	**56,019**	**11,310**	**11,050**	**3,900**	**82,279**
Other commitments	**5,945**	**109**	**23**	**61**	**6,138**
Total commitments	**61,964**	**11,419**	**11,073**	**3,961**	**88,417**
Total contingents and commitments	**62,979**	**12,396**	**11,336**	**4,483**	**91,194**

Lending commitments are agreements to lend to customers in accordance with contractual provisions; these are either for a specified period or, as in the case of credit cards and overdrafts, represent a revolving credit facility which can be drawn down at any time, provided that the agreement has not been terminated. The total amounts of unused commitments do not necessarily represent future cash requirements, in that commitments often expire without being drawn upon.

As explained in note 46 to the Consolidated Financial Statements, since 1 January 2006 all of the Lloyds TSB Group s financial guarantee contracts have been accounted for as financial instruments and measured at fair value on the balance sheet. The contractual nominal amounts of these guarantees totalled £8,139 million at 31 December 2006 (with £4,679 million expiring within one year; £802 million between one and three years; £1,499 million between three and five years; and £1,159 million over five years).

Lloyds TSB Group s banking businesses are also exposed to liquidity risk through the provision of securitisation facilities to certain corporate customers. Lloyds TSB Group currently offers securitisation facilities to its corporate and financial institution client base through two conduit securitisation vehicles, Cancara Asset Securitisation Limited (Cancara) and Obelisk Funding (No.2) Limited (Obelisk). These are funded in the global asset-backed commercial paper market. The assets and obligations of Cancara and Obelisk are included in Lloyds TSB Group s consolidated balance sheet. Lloyds TSB Group provides short-term asset-backed commercial paper liquidity support facilities on commercial terms to the issuers of the commercial paper, for use in the event of a market disturbance should they be unable to roll over maturing commercial paper or obtain alternative sources of funding.

As at 31 December 2006 Cancara and Obelisk held assets of £10,913 million, primarily loans and investments. Lloyds TSB Bank provided asset-backed commercial paper liquidity support facilities of £12,412 million.

During 2006 the Lloyds TSB Group securitised part of its residential mortgage portfolio by transferring beneficial interests in those mortgages to special purpose entities which issued floating rate debt securities. At 31 December 2006 the total amount of residential mortgages subject to securitisation was £14,927 million in respect of which external funding at the year end amounted to £10,048 million. The successful development of the Lloyds TSB Group s ability to securitise its own assets has provided a mechanism to tap a well established market, thereby diversifying the Lloyds TSB Group s funding base. For further details, see note 18 to the Consolidated Financial Statements.

Within Lloyds TSB Group s insurance and investments businesses, the principal sources of liquidity are premiums received from policyholders, charges levied upon policyholders, investment income and the proceeds from the sale and maturity of investments. The investment policies followed by Lloyds TSB Group s life assurance companies take account of anticipated cash flow requirements including by matching the cash inflows with projected liabilities where appropriate. Cash deposits and highly liquid government securities are available to provide liquidity to cover any higher than expected cash outflows.

Based upon the levels of resources within the banking and insurance and investments businesses and the ability of Lloyds TSB Group to access the wholesale money markets or issue debt securities should the need arise, Lloyds TSB Group believes that its overall liquidity is sufficient to meet current obligations to customers, policyholders and debt holders, support expectations for future changes in asset and liability levels and carry on normal operations.

Capital resources

The total capital resources of Lloyds TSB Group are set out below:

	31 December 2006 £m	31 December 2005 £m	31 December 2004 £m
Called-up share capital	**1,429**	1,420	1,419
Share premium account	**1,266**	1,170	1,145
Other reserves	**355**	383	343
Retained profits	**8,105**	7,222	8,140
Shareholders equity	**11,155**	10,195	11,047
Minority interests	**352**	435	631

	11,507	10,630	11,678
Preferred securities	**2,957**	2,549	1,388
Undated subordinated liabilities	**4,863**	5,184	4,464
Dated subordinated liabilities	**4,252**	4,669	4,400
	23,579	23,032	21,930

Lloyds TSB Group s total capital resources increased by £547 million during 2006. Shareholders equity increased by £960 million as a result of the profit for the year, after dividends. Minority interests were £83 million lower as a result of the wind-down of property investment vehicles in Scottish Widows. Overall, preferred securities and other subordinated liabilities were £330 million lower, as the two issues of preference shares by Lloyds TSB Group plc have been more than offset by the repayment of other issues and the negative impact of exchange and other market movements.

Group regulatory capital ratios

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

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

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

The risk asset ratios as at 31 December 2006 and 31 December 2005 are shown below and, in order to provide a meaningful comparison, a risk asset ratio as at 1 January 2005 is also shown, since this is the date from which IAS 39 and IFRS 4 were applied. A risk asset ratio on a UK GAAP basis is also shown as at 31 December 2004.

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IFRS	**31 December 2006 £m**	31 December 2005 £m	1 January 2005 £m
Capital:			
Tier 1	**12,828**	11,478	10,753
Tier 2	**9,965**	10,447	8,767
	22,793	21,925	19,520
Supervisory deductions	**(6,158)**	(6,160)	(6,219)
Total regulatory capital	**16,635**	15,765	13,301
Total risk-weighted assets	**156,043**	144,921	131,830
Risk asset ratios:			
Total capital	**10.7%**	10.9%	10.1%
Tier 1	**8.2%**	7.9%	8.2%

UK GAAP	31 December 2004 £m
Capital:	
Tier 1	11,725
Tier 2	8,800
	20,525
Supervisory deductions	(7,252)
Total regulatory capital	13,273
Total risk-weighted assets	132,173
Risk asset ratios:	
Total capital	10.0%
Tier 1	8.9%

At 31 December 2006, the risk asset ratios were 10.7 per cent for total capital and 8.2 per cent for tier 1 capital.

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

The Group is making good progress in its preparations for the introduction of Basel II, and our credit risk waiver application was submitted in December 2006. Whilst our work is well advanced, some uncertainty remains with regard to the regulatory treatment of certain issues for capital purposes. The Group expects to maintain satisfactory capital ratios throughout the transition to Basel II in 2008, and continues to expect no deduction of investments in existing insurance subsidiaries from tier 1 capital until at least 2012.

There are strict limits imposed by the regulatory authorities as to the proportion of the Lloyds TSB Group s regulatory capital base that can be made up of subordinated debt and preferred securities. The unpredictable nature of movements in the value of the investments supporting the long-term assurance funds could cause the amount of qualifying tier 2 capital to be restricted because of falling tier 1 resources. The Lloyds TSB Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

During 2006, total capital for regulatory purposes increased by £870 million to £16,635 million. Tier 1 capital increased by £1,350 million, as a result of profit retentions and issuance of capital instruments, in part offset by cash contributions into the defined benefit pension schemes. Tier 2 capital decreased by £482 million following loan capital redemptions and the negative impact of exchange movements. There was a decrease in supervisory deductions of £2 million, as profits for the year within the insurance and investment businesses were offset by dividends paid out.

Control (Audited information)

In addition to complying with the FSA s regulatory reporting framework, and similar regulatory/statutory requirements in other jurisdictions, the Group uses a number of internal tools to measure and control liquidity risk, detailed in the liquidity policy. These range from shorter term tactical measures (which include net cash flow profiles and various liquidity ratios) to longer term, more strategic analyses of the overall liquidity of the balance sheet. The reporting framework ensures that the relevant risk control functions have appropriate oversight, and the group asset and liability committee provides strategic direction for liquidity risk management.

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

Lloyds TSB Group and its regulated subsidiary banks have been allocated an Individual Capital Ratio by the FSA, and the board has agreed a formal buffer to be maintained in addition to the Individual Capital Ratio. Any breaches of the formal buffer must be notified to the FSA, together with proposed remedial action. No such notifications have been made during 2006.

Capital ratios are a key factor in the Lloyds TSB Group s budgeting and planning processes and updates of expected ratios are prepared regularly during the year. Capital raised takes account of expected growth and currency of risk assets.

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

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

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 .

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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Capital statement

The following table provides more detail regarding the sources of capital in the life assurance business. The figures that follow on pages 65 to 67 below are those quoted in the Lloyds TSB Group s Annual Report and Accounts and were based on management s expectation at that time, pending completion of the annual financial return to the FSA. The annual return has subsequently been submitted to the FSA and the figures therein were not materially different.

	With Profit Fund £m	**Non-Participating Fund £m**	**Total Long Term Fund £m**	**Shareholder Fund £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)**
Adjustment 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	**3,627**	**2,208**	**5,835**	**1,617**	**7,452**

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-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £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	2,302	2,663	4,965	1,307	6,272

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).

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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.

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	Shareholder Fund £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.

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[1]		31 December 2005[2]	
	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%

1 Subsequent to completion of Lloyds TSB Group s Annual Report and Accounts, final revisions to the Scottish Widows admissable asset values led to changes in the working capital ratio for the Long Term Fund. The actual year end working capital ratio for the Long Term Fund was 17.9 per cent with the ratio for the With Profits Fund unchanged at 5.8 per cent.

2 Subsequent 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.

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

	31 December 2006		31 December 2005	
	With Profit Fund £m	**Long Term Fund £m**	With Profit Fund £m	Long Term Fund £m
Available regulatory capital	**3,627**	**5,835**	2,302	4,965
Support arrangement assets	**1,174**		1,115	
Adjustments to replace statutory liabilities with realistic liabilities	**(3,721)**	**(3,544)**	(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	**32**	**32**	43	43
Removal of future profits allowable for regulatory capital purposes				(500)
Recognition of future profits allowable for realistic capital purposes		**1,896**		1,923
	1,112	**4,219**	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**
As at 31 December 2006			
With Profit Fund liabilities	**17,827**	**116**	**17,943**
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	**17,827**	**23,031**	**40,858**
Non-participating investment contract liabilities		**24,370**	**24,370**
Total policyholder liabilities	**17,827**	**47,401**	**65,228**

	Scottish Widows plc With Profit Fund (in accordance with FRS 27) £m	Other long-term funds £m	Total life business £m
As at 31 December 2005			
With Profit Fund liabilities	18,720	133	18,853
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	18,720	21,236	39,956
Non-participating investment contract liabilities		21,839	21,839
Total policyholder liabilities	18,720	43,075	61,795

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.

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.

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 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. 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.

Operating and financial review and prospects

Investment portfolio, maturities, deposits, short-term borrowings

The tables below have been prepared in accordance with IFRS.

Available-for-sale financial assets and trading securities and other financial assets at fair value through profit or loss (2004: investment securities and other securities)

The following table sets out the book values and valuations of Lloyds TSB Group s debt securities, treasury and other eligible bills and equity shares at 31 December for each of the three years indicated.

IFRS	**2006 Book value £m**	**2006 Valuation £m**	2005 Book value £m	2005 Valuation £m	2004 Book value £m	2004 Valuation £m
Available-for-sale financial assets (2004: investment securities)						
Bank and building society certificates of deposit	**1,615**	**1,615**	1,470	1,470	1,901	1,902
Corporate and other debt securities	**4,817**	**4,817**	3,065	3,065	3,721	3,728
Mortgage backed securities	**5,662**	**5,662**	4,161	4,161	2,774	2,781
Other asset backed securities	**4,721**	**4,721**	4,981	4,981	3,761	3,756
Securities of the US treasury and US government agencies	**387**	**387**	672	672	1,665	1,666
Other government securities	**6**	**6**	411	411	546	547
Other public sector securities	**189**	**189**	47	47		
Treasury bills and other eligible bills	**1,766**	**1,766**	87	87	88	90
Equity shares	**15**	**15**	46	46	41	65
	19,178	**19,178**	14,940	14,940	14,497	14,535
Trading securities and other financial assets at fair value through profit or loss (2004: other securities)						
Securities of the US treasury and US government agencies	**138**	**138**	186	186	164	164
Other government securities	**8,668**	**8,668**	10,987	10,987	13,854	13,854
Other public sector securities	**44**	**44**	119	119	321	321
Bank and building society certificates of deposit	**573**	**573**	898	898	488	488
Corporate and other debt securities	**17,316**	**17,316**	13,136	13,136	13,445	13,445
Mortgage backed securities	**538**	**538**	236	236	533	533
Other asset backed securities	**1,456**	**1,456**	691	691	312	312
Treasury bills and other eligible bills					4	4
Equity shares	**38,127**	**38,127**	33,505	33,505	27,269	27,269
	66,860	**66,860**	59,758	59,758	56,390	56,390

Operating and financial review and prospects

Maturities and weighted average yields of interest-bearing securities

The weighted average yield for each range of maturities is calculated by dividing the annualised interest income prevailing at 31 December 2006 by the book value of securities held at that date.

	Maturing within one year		Maturing after one but within five years		Maturing after five but within ten years		Maturing after ten years	
	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %	Amount £m	Yield %
Available-for-sale financial assets								
Bank and building society certificates of deposit	**1,615**	**5.1**						
Corporate and other debt securities	**634**	**5.4**	**2,795**	**5.1**	**1,252**	**5.0**	**136**	**3.4**
Mortgage backed securities	**288**	**5.1**	**2,584**	**5.2**	**2,601**	**4.9**	**189**	**4.3**
Other asset backed securities	**861**	**4.5**	**1,483**	**5.3**	**2,199**	**5.4**	**178**	**5.4**
US treasury and US government agencies	**46**	**5.5**	**51**	**5.8**	**191**	**5.5**	**99**	**5.5**
Other government securities			**6**	**0.0**				
Other public sector securities	**189**	**5.4**						
Treasury bills	**1,766**	**0.1**						
	5,399		**6,919**		**6,243**		**602**	
Trading securities and other financial assets at fair value through profit or loss								
Bank and building society certificates of deposit	**573**	**5.0**						
Corporate and other debt securities	**896**	**4.4**	**3,950**	**4.5**	**3,001**	**5.2**	**9,469**	**4.7**
Mortgage backed securities			**77**	**4.3**	**208**	**4.8**	**253**	**4.9**
Other asset backed securities			**148**	**5.2**	**267**	**5.2**	**1,041**	**5.2**
US treasury and US government agencies	**1**	**3.5**	**64**	**4.2**	**40**	**4.4**	**33**	**5.2**
Other government securities	**670**	**3.5**	**1,075**	**4.5**	**2,628**	**4.7**	**4,295**	**4.6**
Other public sector securities	**2**	**12.2**	**11**	**8.2**			**31**	**5.9**
	2,142		**5,325**		**6,144**		**15,122**	

Maturity analysis and interest rate sensitivity of loans and advances to customers and banks as at 31 December 2006

The following table analyses the maturity profile and interest rate sensitivity of loans by type on a contractual repayment basis as at 31 December 2006.

All amounts are before deduction of impairment allowances. Demand loans are included in the maturing in one year or less category.

	Maturing in one year or less £m	Maturing after one but within five years £m	Maturing after five years £m	Total £m
Domestic				
Loans and advances to banks	**24,225**	**7,442**	**5,347**	**37,014**
Loans and advances to customers:				
Mortgages	**2,372**	**12,218**	**80,577**	**95,167**

Other personal lending	**9,978**	**11,056**	**1,748**	**22,782**
Financial, business and other services	**12,059**	**4,721**	**3,965**	**20,745**
Lease financing	**234**	**1,232**	**3,336**	**4,802**
Hire purchase	**1,744**	**3,188**	**128**	**5,060**
Other	**18,808**	**7,615**	**9,910**	**36,333**
Total domestic loans	**69,420**	**47,472**	**105,011**	**221,903**
Total foreign loans	**4,177**	**3,640**	**1,397**	**9,214**
Total loans	**73,597**	**51,112**	**106,408**	**231,117**
Of which:				
Fixed interest rate	**39,290**	**24,890**	**54,457**	**118,637**
Variable interest rate	**34,307**	**26,222**	**51,951**	**112,480**

Operating and financial review and prospects

Deposits

The following tables show the details of Lloyds TSB Group s average customer deposits in each of the past three years.

IFRS	**2006 Average balance £m**	**2006 Average rate %**	2005 Average balance £m	2005 Average rate %	2004 Average balance £m	2004 Average rate %
Deposits in domestic offices						
Non-interest bearing demand deposits	**3,862**		3,636		3,134	
Interest-bearing demand deposits	**42,643**	**1.26**	35,848	0.52	29,200	0.21
Savings deposits	**68,686**	**3.39**	66,558	3.65	62,085	3.83
Time deposits	**13,980**	**5.38**	15,216	4.69	14,115	3.71
Total domestic office deposits	**129,171**	**2.80**	121,258	2.75	108,534	2.73
Deposits in foreign offices						
Non-interest bearing demand deposits	**250**		267		372	
Interest-bearing demand deposits	**593**	**2.02**	809	1.11	673	0.89
Savings deposits	**256**	**2.73**	239	0.84	285	1.05
Time deposits	**2,393**	**4.10**	1,146	5.32	1,345	2.30
Total foreign office deposits	**3,492**	**3.35**	2,461	2.93	2,675	1.50
Total average deposits	**132,663**	**2.82**	123,719	2.75	111,209	2.70

Certificates of deposit and other time deposits

The following table gives details of Lloyds TSB Group s certificates of deposit issued and other time deposits as at 31 December 2006 individually in excess of US$100,000 (or equivalent in another currency) by time remaining to maturity.

	3 months or less £m	Over 3 months but within 6 months £m	Over 6 months but within 12 months £m	Over 12 months £m	Total £m
Domestic					
Certificates of deposit	**14,087**	**3,306**	**4,026**	**27**	**21,446**
Time deposits	**32,010**	**1,811**	**1,484**	**1,819**	**37,124**
	46,097	**5,117**	**5,510**	**1,846**	**58,570**
Foreign					
Certificates of deposit and other time deposits	**12,030**	**1,128**	**285**	**6**	**13,449**
Total	**58,127**	**6,245**	**5,795**	**1,852**	**72,019**

Operating and financial review and prospects

Short-term borrowings

Short-term borrowings are included within the balance sheet captions Deposits by banks , Customer accounts and Debt securities in issue and are not identified separately on the balance sheet. The short-term borrowings of Lloyds TSB Group consist of overdrafts from banks, securities sold under agreements to repurchase, notes issued as part of the residential mortgage securitisation, certificates of deposit issued, commercial paper and promissory notes issued and other marketable paper. Securities sold under agreements to repurchase, certificates of deposit issued, commercial paper and promissory notes and securitisation notes are the only significant short-term borrowings of Lloyds TSB Group.

The following tables give details of these significant short term borrowings of Lloyds TSB Group for each of the past three years.

IFRS	**2006 £m**	2005 £m	2004 £m
Liabilities in respect of securities sold under repurchase agreements			
Balance at the year end	**2,521**	9,434	10,571
Average balance for the year	**5,982**	8,707	7,112
Maximum balance during the year	**10,119**	14,251	13,096
Average interest rate during the year	**4.4%**	4.5%	4.5%
Interest rate at the year end	**4.6%**	4.6%	4.6%
Certificates of deposit issued			
Balance at the year end	**25,244**	22,101	15,226
Average balance for the year	**23,289**	22,017	17,470
Maximum balance during the year	**27,510**	27,376	19,287
Average interest rate during the year	**4.7%**	4.4%	3.6%
Interest rate at the year end	**5.2%**	4.5%	4.1%
Commercial paper and promissory notes			
Balance at the year end	**13,067**	10,421	8,026
Average balance for the year	**12,004**	8,270	6,134
Maximum balance during the year	**13,458**	10,421	8,026
Average interest rate during the year	**4.6%**	3.4%	2.2%
Interest rate at the year end	**4.0%**	2.9%	3.8%
Securitisation notes			
Balance at the year end	**10,048**		
Average balance for the year	**1,009**		
Maximum balance during the year	**10,048**		
Average interest rate during the year	**6.0%**		
Interest rate at the year end	**5.0%**		

Corporate responsibility

Supporting business strategy

In an increasingly competitive market where customers are able to exercise choice among providers, Lloyds TSB Group believes that shareholder value creation is closely linked to customer value creation. It is only by meeting its customers needs that Lloyds TSB Group will win the right to a bigger share of their total financial services spend.

Lloyds TSB Group believes that corporate responsibility, built around the creation of employee motivation, customer satisfaction and brand loyalty, has a major part to play in supporting its business strategy. Lloyds TSB Group s commitment to corporate responsibility helps promote trust in the Lloyds TSB brand and reinforces customer loyalty and advocacy. Lloyds TSB is rooted in local communities throughout the UK and it takes its responsibilities to those communities seriously. By investing in the communities where it operates Lloyds TSB Group believes it not only creates economic value but also makes a positive social contribution. Through the Lloyds TSB Foundations, one per cent of the Lloyds TSB Group s pre-tax profits, averaged over three years, is distributed to local charities.

The Lloyds TSB Group s approach to corporate responsibility focuses on five areas: its people, its customers, its suppliers, its community and the environment.

People

Achieving the Lloyds TSB Group s vision of being the best financial services company in the UK depends on its ability to create a high performance culture. Lloyds TSB Group knows that every high performance company needs committed and motivated staff.

Employee engagement

Recent internal research has shown that it is not just employee satisfaction but employee engagement which is critical to high performance and that it is directly related to key business outcomes such as customer satisfaction, improved business performance and lower staff turnover. So, it is essential that Lloyds TSB Group understands not only how engaged employees are but what the business and managers can do to both encourage and support high levels of engagement throughout the organisation.

Lloyds TSB Group tracks employee engagement using a quarterly engagement index survey, which attracts a consistently high response rate (see page 75).

Equality and diversity

Equality and diversity is not just a legal issue or something which is socially desirable, it is key for competitive advantage. In an ever-tightening employment market, Lloyds TSB Group needs to differentiate itself as an employer of choice to ensure that it attracts and retains the best cross section of talent. The Lloyds TSB Group also needs to be close to its customers, to understand their needs and provide them with the right products and services. By attracting and retaining a diverse workforce, the Lloyds TSB Group will better understand the needs of all its customers and be able to explore the immense opportunities available across communities.

Over the last few years Lloyds TSB Group has been working to increase the number of women and ethnic minority employees in management and senior management positions across the organisation. At the end of 2006, twenty-one per cent of Lloyds TSB Group s senior managers are women, including three female board directors. Lloyds TSB Group is included in the Times top 50 places for women to work and is the top FTSE 100 company in terms of the number of female executive directors. During the year the Group won several diversity awards in the UK including first in the Race for Opportunity Benchmarking and fourth in the Employers Forum on Disability Benchmarking.

Training and development

To create a high performance company, Lloyds TSB Group recognises that it needs to provide all employees with the opportunity to learn, develop and to fulfil their potential. The University for Lloyds TSB is the Lloyds TSB Group s centre of excellence for learning, providing an accessible, high quality service structured around the needs of both the business and the individual. In 2006, the University provided over 33,250 training days and over 17,000 delegate places in addition to online learning through a group wide network of 2,029 multimedia personal computers and 20 dedicated cyber-cafés.

Customers

Lloyds TSB Group wants to continue to build a great organisation, which is recognised for operating to high standards and is built on strong customer franchises. Treating its customers fairly is essential to helping Lloyds TSB Group achieve that goal and is one of the ways in which the Group can develop competitive advantage. Lloyds TSB Group aims to be fair, clear and straightforward in all its dealings with its customers. Lloyds TSB Group has simplified the number and range of products it has and the Lloyds TSB Group is continuing its drive to make its terms and conditions simpler to understand and ensure its charges are absolutely clear.

Responsible lending

Lloyds TSB Group is committed to being a responsible lender. It is in its interest to help customers borrow only those amounts they can repay. Lloyds TSB Group has a responsible lending programme with internal management reporting and accountability. Lloyds TSB Group s employees are trained to offer the necessary advice and support to help customers manage their borrowing. Lloyds TSB Group s Customer Support Unit provides help for customers who are in financial difficulties to find an appropriate solution through effective budgeting or rescheduling their borrowing. We also support independent money advice networks including the Money Advice Trust and the Consumer Credit Counselling Service. Payments totalling more than £2.5 million were made in 2006.

Financial inclusion

Lloyds TSB Group continues to develop financial services especially tailored to tackle the problem of financial exclusion. These include basic bank accounts, support for community credit unions and other community finance initiatives and loan and venture capital funds. The Lloyds TSB Group s partnership with the Post Office allows its customers access to the UK network of post offices as well as over 2,000 of its own branches and 4,100 ATMs. At the end of 2006, Lloyds TSB Group had over 400,000 basic bank accounts.

Lloyds TSB Group also believes in the importance of financial education. The Lloyds TSB Group has collaborated with the Financial Services Authority to help lead the development and delivery of their Financial Capability in the Workplace programme.

Customer satisfaction

Lloyds TSB Group measures its customers satisfaction with the service they receive via monthly surveys and uses the results to calculate its CARE Index which is based on customer understanding, accessibility, responsibility and expertise. The Lloyds TSB Group seeks to address customer complaints as quickly as prudent whilst ensuring appropriate standards of investigation and communication are maintained (see page 75).

In 2006, in a poll of Finance Directors across the UK, Lloyds TSB Corporate was voted Bank of the Year for the second year running at the Real Finance/CBI FD s Excellence Awards, in recognition of its quality of service and understanding of its customers businesses. In 2006 Lloyds TSB Corporate was also voted Adviser of the Year in the UK; in this category it was not only competing against other banks but also leading accountants and lawyers.

Corporate responsibility

Suppliers

Each year Lloyds TSB Group buys around £2 billion worth of goods and services. Lloyds TSB Group s suppliers are important to it and the Lloyds TSB Group wants to ensure that it treats them fairly and pays them on time. Lloyds TSB Group s supplier relationships are governed by a strict Code of Purchasing Ethics that defines the way it does business. The Lloyds TSB Group also has an established supplier review process that allows it to assess its suppliers social, ethical and environmental performance as part of the tendering process (see page 75).

Community

Continuing to grow a successful business is the best way for Lloyds TSB to create value for all its stakeholders and contribute to the wider economy. Lloyds TSB Group is a major employer with some 63,000 employees. In 2006, salaries, national insurance, pension contributions and other staff costs totalled over £2.7 billion. Over £1.3 billion was paid to governments in tax and £1.9 billion was distributed to shareholders in the form of dividends. When dividends are added to share price appreciation, Lloyds TSB Group delivered a total return to its shareholders of 24.8 per cent in 2006 (10.9 per cent in 2005).

In addition to its financial contribution Lloyds TSB Group recognises that it is in its long-term interest to help improve the social and commercial fabric of local communities where it operates. That is why the Lloyds TSB Group has one of the largest community investment programmes in the UK.

Lloyds TSB Foundations

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

Through their shares in the Lloyds TSB Group, the Lloyds TSB Foundations together receive one per cent of the Group s pre-tax profits, averaged over three years, in lieu of their shareholder dividend. Over the last 10 years, Lloyds TSB Group has given a total of over £300 million to the Foundations, making Lloyds TSB one of the largest corporate charitable donors in the United Kingdom.

The Foundations recognise that their success as community and local funders depends on maintaining a presence in and actively engaging with communities. The England and Wales Foundation, for example, remains one of the few grant-makers with a significant regional presence and its regional structure enables the Foundation to respond directly and effectively to local needs.

Foundation funding supports charities working to meet social and community needs. The main grant programmes are designed to address essential community needs and, in particular, to support small under funded charities. 38 per cent of the charities supported by the England and Wales Foundation in 2006 had a total income of £100,000 or less and 70 per cent had an income of £500,000 or less.

Employee volunteering and fundraising

In addition to the Foundations support for local community causes, thousands of Lloyds TSB Group s employees volunteer to help in their communities, raise funds for the Group s Charity of the Year or make direct donations to charity using the UK s Give As You Earn system. In 2006, the Foundations provided matched funding for over 40,000 hours of time volunteered by Lloyds TSB employees in the community.

The Charity of the Year is chosen in an open ballot of staff. A team of Charity Champions across all parts of the Group leads the fundraising, inspiring and motivating their colleagues to organise and take part in events, sell pin badges and find new and innovative ways of raising money. In 2006 Lloyds TSB Group s staff raised over £1.8 million for Breast Cancer Care, the third year in a row that over £1 million has been raised for the Group s chosen charity. Lloyds TSB Group s staff have chosen Barnardo s as the charity of the year for 2007.

The environment

Lloyds TSB first introduced a formal environmental policy in 1996 and was also one of the first UK banks to develop an environmental risk assessment system for all of its business lending.

Climate change

The UK Government has stated its belief that climate change is the greatest long-term challenge facing the world today. Measures to tackle climate change will have potential implications for regulation, taxation and public policy and will carry both risks and opportunities for companies and the public.

In respect of Lloyds TSB Group s direct environmental impacts the Group s immediate priority is to reduce its carbon emissions. The Lloyds TSB Group has introduced a five-year carbon management programme which, through a series of energy saving projects and other initiatives, will not only reduce the Lloyds TSB Group s carbon footprint but also deliver cost savings. In 2005 the Lloyds TSB Group set a target to reduce property related emissions by 30 per cent from 2004 levels by 2010. Lloyds TSB Group is exploring other opportunities in relation to waste reduction and business travel (see page 75).

While the Lloyds TSB Group s direct carbon intensity is relatively low compared to other industry sectors, it still needs to fully understand the potential financial impact of climate change on others that it may lend to or invest in, so that the Lloyds TSB Group can manage the risks and identify business opportunities.

Lloyds TSB Group is in the process of establishing a group wide Climate Forum, led by the deputy group chief executive, to develop a holistic approach to managing climate related risks and opportunities.

Corporate responsibility management

The board reviews overall corporate responsibility performance annually and individual issues are subject to board discussion throughout the year. Lloyds TSB Group s corporate responsibility steering group is chaired by the deputy group chief executive and comprises senior executives from all business divisions and relevant group functions. The steering group meets quarterly to recommend strategy and provide direction.

Lloyds TSB Group has adopted the European Foundation of Quality Management s Corporate Responsibility Framework to help it align corporate responsibility with business strategy and also with individual balanced scorecard priorities. As part of the process Lloyds TSB Group has a network of almost 40 representatives across all business divisions, through whom it conducts an annual self-assessment of its performance with independent oversight and assurance. This allows the Lloyds TSB Group to identify strengths and areas for improvement and to prioritise actions and objectives. It also provides a benchmark against which the Lloyds TSB Group can compare its performance both internally and externally.

The board is satisfied that the systems in place to manage corporate responsibility risks are effective and that the relevant risks have been assessed during 2006 and managed in compliance with relevant policies and procedures.

Corporate responsibility

Corporate responsibility key performance indicators

People			2005	**2006**
Employee engagement index*			73.0%	**74.5%**

	2003	2004	2005	**2006**
Women in management positions	36%	37%	38%	**38%**
Women in senior management positions	17%	19%	20%	**21%**

	2003	2004	2005	**2006**
Ethnic minority managers	2.9%	3.5%	4.1%	**4.3%**
Ethnic minority senior managers	1.1%	1.2%	1.8%	**1.9%**

Customers	2005	**2006**
Customer service index**	68.0%	**69.7%**
Complaints resolved within 8 weeks	86.0%	**94.8%**
Service quality index	4.02	**4.30**

Suppliers	2004	2005	**2006**
Payment of suppliers			
Number of supplier payments	360,257	379,613	**344,422**
Value	£2.20 billion	£2.16 billion	**£2.29 billion**
Average time to pay	28.02 days	27.01 days	**29.72 days**
Number/amount of compensation payments for late settlement	1 payment totalling £25	None	**None**

The environment

		Tonnes CO_2		
	2003	2004	2005	**2006**
Greenhouse gas emissions				
Property	195,175	188,624	177,047	**181,086**
Property renewable	(730)	(4,438)	(14,606)	**(18,944)**
Travel	26,998	29,499	29,540	**27,231**
Total	221,443	213,685	191,981	**189,373**

* The employee engagement index is based on the results of a survey conducted quarterly, asking Lloyds TSB employees a series of questions which reflect both the drivers and outcomes of engagement. The data captures the percentage of total responses received which were favourable for each question, combined into a simple average overall score.

** The customer service index is computed based on the results of a customer satisfaction survey performed monthly for Lloyds TSB by an external agency. Customers in each of six business units are asked to rate the service they receive on fives bases overall satisfaction, understanding of the customer s needs, accessibility of the service, and the responsiveness and expertise of the service provider. These scores are weighted to produce a group score based on the proportion of total group income each business unit represents.

The service quality index is based on SIGMA, deriving its provenance from the manufacturing world, where it measures Defects per Million Opportunities (DPMO). For the Lloyds TSB Group s purposes, a defect is registered whenever there is a failure to deliver a process or product within a certain time period or to the required standard. The Lloyds TSB DPMO score is measured for over 150 end-to-end processes across eight business units, covering in excess of eighty per cent of transactions by volume.

Lloyds TSB Group has reported its greenhouse gas emissions arising from its operations since 1999 using the DEFRA Guideline for Reporting Greenhouse Gas Emissions. The key activities which contribute to the Lloyds TSB Group s Global Warming Impact are energy used in managing our buildings lighting, building controls and IT; and in business travel road, rail and air.

Management and employees

Directors and senior management

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

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

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

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

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

During the year, the board conducted a formal evaluation of its performance and that of its committees and individual directors, with advice and assistance from Dr Tracy Long, of Boardroom Review. Directors were invited to comment, through questionnaires and interviews, and responses were reviewed and discussed by the board. Where areas for improvement were identified, action has been agreed.

The chairman s performance was evaluated by the non-executive directors, taking account of the views of executive directors. This appraisal was discussed at a meeting of the non-executive directors, led by the senior independent director, without the chairman being present.

The remuneration committee reviewed the performance of the chairman, the group chief executive and the other group executive directors, when considering their remuneration arrangements. The nomination committee reviewed the performance of all the directors. The nomination committee and remuneration committee report to the board on their recommendations and decisions, including the results of these performance evaluations.

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

There is an induction programme for all new directors, which is tailored to their specific requirements and includes visits to individual businesses and meetings with senior management. Major shareholders are also offered the opportunity to meet new non-executive directors. Additional training and updates on particular issues are arranged as appropriate.

Meetings with shareholders

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

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

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

Board of directors

The board of directors as of the date of filing of this annual report on Form 20-F are listed below. Directors who served during 2006 are indicated on page 88.

Sir Victor Blank uu ++

Chairman

Joined the board in March 2006 as deputy chairman and became chairman in May 2006. Former partner in Clifford-Turner (now Clifford Chance) from 1969 to 1981 and chairman and chief executive of Charterhouse until 1997. Director of The Royal Bank of Scotland from 1985 to 1993 and of GUS from 1993 to 2006 (chairman from 2000). Chairman of Trinity Mirror from 1999 to 2006. A member of the Financial Reporting Council and of the Council of Oxford University. Chairs two charities, WellBeing of Women and UJS Hillel, as well as the Council of University College School. Aged 64.

Wolfgang C G Berndt u

Joined the board in 2003. Joined Procter and Gamble in 1967 and held a number of senior and general management appointments in Europe, South America and North America, before retiring in 2001. A non-executive director of Cadbury Schweppes, GfK AG and Telekom Austria. Board member of the Institute for the Future. Aged 64.

Ewan Brown CBE FRSE *+*

Chairman of Lloyds TSB Scotland

Joined the board in 1999. A non-executive director of Lloyds TSB Scotland since 1997. Joined Noble Grossart in 1969 and was an executive director of that company until December 2003. A non-executive director of Noble Grossart and Stagecoach Group and senior governor of the Court of the University of St Andrews. A former chairman of tie and non-executive director of John Wood Group. Aged 65.

Jan P du Plessis *u

Joined the board in 2005. Chairman of British American Tobacco. Held a number of senior and general management appointments in Rembrandt Group from 1981, before joining Compagnie Financière Richemont as group finance director in 1988, a position he held until 2004. A former chairman of RHM from 2005 to 2007 and group finance director of Rothmans International from 1990 to 1995. Aged 53.

Gavin J N Gemmell CBE *

Chairman of Scottish Widows

Joined the board in 2002. A non-executive director of Scottish Widows, having been appointed to the board of that company before it became a member of the Lloyds TSB Group. Retired as senior partner of Baillie Gifford in 2001, after 37 years with that firm. A non-executive director of Archangel Informal Investment. Chairman of the Court of Heriot-Watt University. Aged 65.

Philip N Green

Joined the board in May 2007. Appointed chief executive of United Utilities in 2006. Formerly chief executive of Royal P&O Nedlloyd from 2003 to 2006, chief operating officer of Reuters Group from 2001 to 2003 and held senior and general management appointments in Reuters Group from 1999, DHL from 1990 to 1999 and Coloroll Group from 1980 to 1990. Aged 53.

Sir Julian Horn-Smith u +

Joined the board in 2005. Held a number of senior and general management appointments in Vodafone from 1984 to 2006 including a directorship of that company from 1996 and of deputy chief executive officer from 2005. Previously held positions in Rediffusion from 1972 to 1978, Philips from 1978 to 1982 and Mars GB from 1982 to 1984. A non-executive director of Digicel Group, a member of the Altimo International advisory board and a senior adviser to UBS in relation to the global telecommunications sector. A former chairman of The Sage Group. Aged 58.

Lord Leitch *u+

Joined the board in 2005. Held a number of senior and general management appointments in Allied Dunbar, Eagle Star and Threadneedle Asset Management before the merger of Zurich Group and British American Tobacco s financial services businesses in 1998. Subsequently served as chairman and chief executive officer of Zurich Financial Services (UK & Asia Pacific) until his retirement in 2004. Chairman of the government s Review of Skills and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster and United Business Media. Former chairman of the National Employment Panel. Aged 59.

J Eric Daniels

Group Chief Executive

Joined the board in 2001 as group executive director, UK retail banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. Aged 55.

Michael E Fairey

Deputy Group Chief Executive

Joined TSB Group in 1991 and held a number of senior and general management appointments before being appointed to the board in 1997 and deputy group chief executive in 1998. Joined Barclays Bank in 1967 and held a number of senior and general management appointments, including managing director of Barclays Direct Lending Services from 1990 to 1991. President of The British Quality Foundation and chairman of Race for Opportunity. Aged 58.

Terri A Dial

Group Executive Director, UK Retail Banking

Joined the board in 2005. Served with Wells Fargo in the USA from 1973 to 2001 where she held a number of senior and general management appointments before becoming president and chief executive officer of Wells Fargo Bank in 1998. A non-executive director of the LookSmart Corporation and a member of the London Skills and Employment Board. Aged 57.

Archie G Kane

Group Executive Director, Insurance and Investments

Joined TSB Commercial Holdings in 1986 and held a number of senior and general management appointments in the Lloyds TSB Group before being appointed to the board in 2000, as group executive director, IT and operations. Appointed group executive director, insurance and investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. A member of the board of the Association of British Insurers. Aged 54.

G Truett Tate

Group Executive Director, Wholesale and International Banking

Joined the group in 2003 as managing director, corporate banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. Aged 57.

Helen A Weir

Group Finance Director

Joined the board in 2004. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q from 1997, having joined that company in 1995, and held a senior position at McKinsey & Co from 1990 to 1995. Began her career at Unilever in 1983. A non-executive director of Royal Mail Holdings and a member of the Accounting Standards Board. Aged 44.

* Member of the audit committee ** Chairman of the audit committee u Member of the nomination committee uu Chairman of the nomination committee Member of the remuneration committee Chairman of the remuneration committee + Member of the risk oversight committee ++ Chairman of the risk oversight committee Independent director Senior independent director

Compensation

Role of remuneration committee

The committee reviews the remuneration policy for the top management group, to ensure that members of the executive management are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation. It advises on major changes of employee benefits schemes and it also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount.

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

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

Remuneration committee membership

The remuneration committee is comprised of the following independent non-executive directors:

Dr Berndt (chairman)

Mr Green (appointed on 10 May 2007)

Sir Julian Horn-Smith

Sir Victor Blank, a non-executive director, joined the committee in August 2006 as permitted by the combined code on corporate governance issued by the Financial Reporting Council in June 2006.

Directors remuneration policy

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

FTSE 20 adopted as the comparator group used to benchmark overall competitiveness of the remuneration package whilst taking particular account of the remuneration practice of our direct competitors, namely the major UK banks. The FTSE 20 is regarded as providing a realistic and relevant comparison in terms of company size and sector, as well as being a key market for talent.

Basic salaries positioned to reflect the relevant market median and total direct compensation (basic salary, annual incentives and the value of long-term incentives) designed to enable upper quartile performance to be rewarded with upper quartile remuneration levels.

The majority of total compensation is linked to the achievement of stretching performance targets.

The long-term rewards are aligned to shareholder interests, which is achieved by taking account of measures that reflect shareholder interests, and by expecting executive directors to build a shareholding in the Group equivalent to 1.5 times (2 times for the group chief executive) the directors base pay. Executives are expected to retain at least 50 per cent of all net vested equity until the guideline is met.

The overall package reflects market practice and takes account of the terms and conditions applying to other employees of the Group.

In 2007, approximately 69 per cent (72 per cent for the group chief executive) of an executive director s potential direct remuneration (salary, annual bonus, long-term incentives and pension) will be performance related, based upon maximum opportunity. The value of long-term incentives is the expected value calculated by using a binomial model, which is a widely accepted methodology for this purpose.

Chairman s remuneration

The chairman s remuneration comprises salary and benefits which are broadly similar to those extended to the executive directors. However, he does not participate in the annual bonus and long-term incentive arrangements, nor is he entitled to pension benefits.

The chairman s salary is reviewed annually, usually in December, taking into account performance and market information and then adjusted from 1 January of the following year. His salary from 1 January 2007 is £600,000.

Independent non-executive directors fees

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. Directors may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the various responsibilities of a non-executive director s role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees from 1 January 2007 are listed below with the figures applicable since the previous review in April 2005 in brackets.

Board	£60,000	(£50,000)
Audit committee chairmanship	£50,000	(£40,000)
Audit committee membership	£15,000	(£15,000)
Nomination committee membership	£5,000	(£5,000)
Remuneration committee chairmanship	£25,000	(£20,000)
Remuneration committee membership	£15,000	(£15,000)
Risk oversight committee membership	£15,000	(£15,000)

Independent non-executive directors who serve on the boards of subsidiary companies may also receive fees from the subsidiaries. These are included in the table shown on page 81.

Compensation

Executive director basic salaries

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by Towers Perrin) and then adjusted from 1 January of the following year. Basic salary increases for other employees across the Group will be generally in the range of 0-10 per cent. Whilst the salary increases awarded to executive directors are normally consistent with this policy, any variation will be supported by robust and independent competitive market analysis. Salaries payable from 1 January 2007 are as follows:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
Amount	£960,000	£600,000	£625,000	£550,000	£600,000	£575,000

Annual incentive scheme

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

Incentive awards for executive directors are based upon individual contribution and overall corporate results. Half of the bonus opportunity is driven by corporate performance based on the stretching budget relating to profit before tax and economic profit. The lower of profit before tax and economic profit will determine the extent to which the target has been met. The other half of the bonus opportunity is determined by divisional achievement driven through individual performance. Individual targets are contained in a balanced scorecard and include profitability, franchise growth, risk, service and other specific goals that are relevant to improving overall business performance. These targets are weighted differently for each of the executive directors, reflecting differing strategic priorities. The maximum bonus opportunity is 150 per cent (200 per cent from 2007) of basic salary for the achievement of exceptional performance targets; an amount equal to 75 per cent (100 per cent from 2007) of basic salary is available on the achievement of stretching budget and individual targets. Failure to achieve at least 90 per cent of the stretching budget target would result in no payment under the corporate half of the bonus.

Regarding Mr Daniels incentive award, and in line with the arrangements for the executive directors, half of his bonus is driven by corporate results and the other half by individual performance. His maximum bonus opportunity is 175 per cent (225 per cent from 2007) of basic salary for the achievement of exceptional performance targets. An amount equal to 112.5 per cent of basic salary is available on the achievement of a range of financial and non-financial measures contained in a balanced scorecard. The non-financial measures include key performance indicators relating to customer service, process efficiency, service quality, risk and employees (e.g. employee engagement). Failure to achieve at least 90 per cent of the stretching budget target would result in no payment under the corporate half of the bonus.

Following the adoption of the new long-term incentive plan, and the discontinuation of the performance share plan, awards under the annual incentive scheme are made in cash only.

PricewaterhouseCoopers LLP check the calculation of the annual incentive payments for executive directors based on the achievement of performance against targets set. In respect of performance in 2006, the bonus percentages awarded to the directors are shown in the table below:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
Opportunity	175%	150%	150%	150%	150%	150%
% awarded	162.5%	140%	150%	140%	140%	140%

These payments reflect the significant progress made by the Group against its key performance indicators. Both the profit before tax and economic profit exceeded the amounts required for payment of the maximum award relating to corporate performance.

Long-term incentive plan

The aim of the new long-term incentive plan, approved by shareholders in 2006, is to deliver shareholder value through linking the receipt of shares to an improvement in the performance of the Group over a three year period. Under the plan, awards of shares may be made, with the number of shares received subject to the satisfaction of two distinct pre-determined performance conditions, measuring performance of the Group.

50 per cent of the award (the TSR Award) will be based on a condition measuring the Group s TSR against the comparator group listed below. In order for the TSR Award to vest in full, it will be necessary for the Group s TSR to exceed the median of the TSR of the comparator group by an average of 7.5 per cent per annum. 17.5 per cent of the TSR Award (8.75 per cent of the total award) will vest where the Group s TSR is equal to median and vesting will occur on a straight line basis in between these points. Where the Group s TSR is below the median of the comparator group, the TSR Award will lapse.

From 2007, and to align performance and vesting periods, the TSR performance period will start on the date awards are granted, and average the share price over three months before the grant date. This replaces the current approach of calculating the TSR in line with the financial year, taking an average share price over the preceding three months.

Other companies in the comparator group:

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

The other 50 per cent of the award (the EPS Award) will be based on earnings per share (EPS) growth calculated on a compound annualised basis. In order for the EPS Award to vest in full, the EPS growth over the performance period must be at least equivalent to an average of the Retail Price Index (RPI) plus 6 per cent per annum. 17.5 per cent of the EPS Award (8.75 per cent of the total award) will vest where EPS growth is an average of the RPI plus 3 per cent per annum and vesting will occur on a straight line basis in between these points. Where the EPS growth is less than an average of the RPI plus 3 per cent per annum, the EPS Award will lapse.

Awards in any one financial year will not normally exceed three times basic salary at the time of award. In exceptional circumstances this may be increased up to four times basic salary. Awards will lapse at the end of the performance period to the extent that the performance conditions have not been satisfied. There will be no retesting.

EPS is the Group s normalised earnings per ordinary share as shown in the Group s report and accounts, adjusted if necessary for consistency.

Details of previous long-term incentive plans are shown on pages 85 and 86.

Other share plans

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

Compensation

Dilution limits

The following charts illustrate the shares available for the Group s share schemes.

Pensions

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

Service agreements

The Group s policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months notice from the Group, but would be required to give 6 months notice if they wished to leave. Executive directors normally retire at age 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65.

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

It is the Group s policy that where compensation on early termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured, and that bonus payments should relate to the period of actual service, rather than the full notice period and will be determined on the basis of performance.

Any entitlements under the pension scheme or equity plans will be in accordance with the scheme rules on leaving.

	Notice to be given by the Company	Date of service agreement/letter of appointment
Sir Victor Blank	6 months	25 January 2006
J E Daniels	12 months	19 October 2001
M E Fairey	12 months	28 August 1991
T A Dial	12 months	23 May 2005
A G Kane	12 months	9 February 2000
G T Tate	12 months	29 July 2004
H A Weir	12 months	4 March 2004

External appointments

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

During 2006, Ms Dial and Mrs Weir received fees of $159,475 and £36,000 respectively, which were retained by them, for serving as non-executive directors of other companies. In addition Mrs Weir received and retained £15,000 for serving as a member of the Accounting Standards Board in 2006.

Performance graph

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

Compensation

Audited information

Directors emoluments for 2006

	Salaries/ fees £000	Other benefits Cash £000	Other benefits Non cash £000	Performance related payments £000	Compensation for loss of office £000	2006 Total £000	2005 Total £000
Current directors who served during 2006							
Executive directors							
J E Daniels	**880**	**103**	**5**	**1,456**		**2,444**	1,930
M E Fairey	**570**	**493**	**7**	**815**		**1,885**	1,462
T A Dial	**570**	**273**	**4**	**872**		**1,719**	877
A G Kane	**500**	**19**	**18**	**715**		**1,252**	919
G T Tate	**515**	**42**	**10**	**736**		**1,303**	1,075
H A Weir	**500**	**77**	**18**	**715**		**1,310**	963
Non-executive directors							
Sir Victor Blank	**405**					**405**	
W C G Berndt	**72**					**72**	67
Ewan Brown	**134**					**134**	122
J P du Plessis	**67**					**67**	16
G J N Gemmell	**121**					**121**	121
Sir Julian Horn-Smith	**82**					**82**	74
D S Julius	**68**					**68**	66
Lord Leitch	**80**					**80**	16
Former directors who served during 2006							
M A van den Bergh	**183**	**4**				**187**	487
A A Knight	**92**					**92**	105
Former directors who served during 2005							
P G Ayliffe					**36**	**36**	401
Others							125
	4,839	**1,011**	**62**	**5,309**	**36**	**11,257**	8,826

Mr Fairey waived fees payable to him as a director of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £10,000 in 2006 (2005: £10,000 waived).

Mr Brown waived fees payable to him as a director and chairman of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £14,750 in 2006 (2005: £14,000 waived).

The cash column under other benefits includes flexible benefits payments (4 per cent of basic salary), the tax planning allowances for Mr Daniels and Ms Dial, the housing allowance and pension scheme allowance for Ms Dial, payments to certain directors who elect to take cash rather than a company car under the car scheme, cash balance of pension allowance for Mr Tate and Mrs Weir and an additional payment in respect of the contribution to the separate fund relating to Mr Fairey s pension. The separate fund, which was mentioned in previous annual reports, was established to cover pension obligations of those who joined the Group after 1 June 1989 and who are subject to the earnings cap relating to pensions, introduced by the Finance Act 1989.

The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance. It also includes the value of any matching shares which are received under the terms of shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.

Performance-related payments relate to cash bonuses based on group performance and the attainment of pre-determined targets relating to profit before tax and economic profit. These payments also include the value of any award made under shareplan, the first £3,000 of which is made in the form of shares in Lloyds TSB Group plc.

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

Compensation Audited information

Directors pensions

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

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

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

Ms Dial elected to become a member of a pension scheme for life cover only. She joined the Lloyds TSB Group on 1 June 2005. She receives a salary supplement of 20 per cent of basic pay as an alternative to an employer contribution to a pension scheme.

Defined contribution scheme members

Mr Tate is a member of a defined contribution scheme. During the year to 31 December 2006, the employer has made contributions to the defined contribution scheme in respect of him totalling £79,825.

Mrs Weir is a member of a defined contribution scheme. During the year to 31 December 2006, the employer has made contributions to the defined contribution scheme in respect of her totalling £42,500.

Defined benefit scheme members

	Accrued pension at 31 December 2006 £000 (a)	Accrued pension at 31 December 2005 £000 (b)	**Change in accrued pension £000 (a)-(b)**	**Transfer value at 31 December 2006 £000 (c)**	Transfer value at 31 December 2005 £000 (d)	**Change in transfer value £000 (c)-(d)**	**Additional pension earned to 31 December 2006 £000 (e)**	**Transfer value of the increase £000 (f)**
J E Daniels	**120**	99	**21**	**2,100**	1,599	**501**	**19**	**326**
M E Fairey	**287**	256	**31**	**6,024**	5,003	**1,021**	**24**	**501**
A G Kane	**265**	240	**25**	**4,415**	3,700	**715**	**19**	**310**
In addition, the following unfunded benefits have accrued for Mr van den Bergh instead of a salary increase in 2002:								
M A van den Bergh	**13**	13	**0**	**196**	190	**6**		

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

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2006 and 2005, respectively (ignoring the two-year requirement to qualify for a deferred pension).

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2006 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme in accordance with actuarial guidance note GN11. The underlying bases used to arrive at the factors have not changed during the year.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2005 on the assumption that the director left service at that date.

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

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

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

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

Major changes to the legislation governing the provision of pensions in the UK (known as pension simplification) came into effect in April 2006. Benefits from an approved pension scheme will be limited to the Lifetime Allowance, currently £1.5 million which is equivalent to an annual pension of £75,000. Any benefit in excess of this amount will incur a tax charge for the individual. The Group has agreed that if an executive director has benefits in excess of the Lifetime Allowance they may cease to accrue benefits in the Scheme and receive a salary supplement as an alternative. This will not cost the Group more than the current arrangements. The Group will not compensate any individual in respect of any increased tax liability arising from pension simplification. To date, the executive directors affected have elected to continue to accrue benefits in the approved scheme.

Compensation

Directors interests

As detailed on page 85, the executive directors beneficially owned in aggregate 309,410 bonus shares under the Lloyds TSB Performance Share Plan at 31 December 2006 (151,147 shares at 1 January 2006).

Other interests, all beneficial, of those who were directors at 31 December 2006 in shares in Lloyds TSB Group were:

Shares	At 1 January 2006 (or later date of appointment)	**At 31 December 2006**
Executive directors		
J E Daniels	160,942	**165,174**
M E Fairey	79,104	**82,864**
T A Dial		**577**
A G Kane	100,101	**136,078**
G T Tate	1,356	**4,139**
H A Weir	3,992	**6,255**
Non-executive directors		
Sir Victor Blank	100,000	**100,000**
W C G Berndt	61,000	**96,000**
Ewan Brown	4,260	**4,469**
J P du Plessis	10,000	**10,000**
G J N Gemmell	70,000	**70,000**
Sir Julian Horn-Smith	5,000	**5,000**
D S Julius	2,000	**2,000**
Lord Leitch		**10,000**

The directors interests detailed above, in aggregate, represent 0.02% of the issued ordinary share capital of Lloyds TSB Group plc.

In addition, those who were directors at 31 December 2006 held, as at that date, options to acquire 8,410,807 shares, all of which were granted pursuant to the executive share option schemes, sharesave share option schemes and share retention plan; conditional awards of 1,048,858 performance shares under the Lloyds TSB Performance Share Plan; and conditional awards of 2,039,418 shares under the Lloyds TSB Long-Term Incentive Plan.

Non-beneficial interests

Directors had non-beneficial interests as follows:

Sir Victor Blank, Mr Daniels, Mr Fairey, Ms Dial, Mr Kane, Mr Tate and Mrs Weir, together with some 70,000 other employees, were potential beneficiaries in the 1,364 and 1,138,311 shares held at the end of the year by the Lloyds TSB qualifying employee share ownership trust and the Lloyds TSB Group employee share ownership trust respectively. 1,364 and 1,237,191 shares, respectively, were held by these trusts at the beginning of the year. In addition, the above directors, together with some 70,000 other employees, were potential participants in shareplan and were, therefore, treated as interested in the 898,320 shares held at the end of the year by the trustee of the shareplan. 582,462 shares were held by the trustee at the beginning of the year.

Compensation

Audited information

Interests in share options

	At 1 January 2006	**Granted during the year**	**Exercised/ lapsed during the year**	**At 31 December 2006**	Exercise price	Exercise periods From	To	Notes
J E Daniels	330,419		**330,419**		715p	6/3/2005	5/3/2012	d, j
	3,327		**3,327**		284p	1/6/2006	30/11/2006	a, i
	599,239			**599,239**	394.25p	21/2/2006	20/2/2013	d, g
	305,232			**305,232**	430p	14/8/2006	13/8/2013	d, g
	939,177			**939,177**	419.25p	18/3/2007	17/3/2014	d, h
	521,876			**521,876**	474.25p	17/3/2008	16/3/2015	e, h
		2,236		**2,236**	418p	1/6/2009	30/11/2009	a, h
M E Fairey	797		**797**		474p	1/11/2005	30/4/2006	a, i
	54,000		**54,000**		510p	26/3/2000	25/3/2007	b, i
	48,000			**48,000**	859.5p	15/5/2001	14/5/2008	b, f
	57,000			**57,000**	817p	2/8/2002	1/8/2009	b, g
	85,896			**85,896**	549.5p	6/3/2003	5/3/2010	c, g
	10,931			**10,931**	615.5p	8/8/2003	7/8/2010	c, g
	42,884			**42,884**	655p	6/3/2004	5/3/2011	c, g
	345,104		**345,104**		715p	6/3/2005	5/3/2012	d, j
	1,330		**1,330**		284p	1/6/2006	30/11/2006	a, i
	531		**531**		348p	1/11/2006	30/4/2007	a, i
	663,157			**663,157**	394.25p	21/2/2006	20/2/2013	d, g
	555,992			**555,992**	419.25p	18/3/2007	17/3/2014	d, h
	344,754			**344,754**	474.25p	17/3/2008	16/3/2015	e, h
		1,789		**1,789**	418p	1/6/2009	30/11/2009	a, h
T A Dial	464,134			**464,134**	474p	11/8/2008	10/8/2015	e, h
A G Kane	25,000		**25,000**		321p	28/3/1999	27/3/2006	b, i
	40,000		**40,000**		510p	26/3/2000	25/3/2007	b, i
	50,000			**50,000**	880p	4/3/2001	3/3/2008	b, f
	27,000			**27,000**	887.5p	4/3/2002	3/3/2009	b, g
	64,786			**64,786**	549.5p	6/3/2003	5/3/2010	c, g
	11,841			**11,841**	615.5p	8/8/2003	7/8/2010	c, g
	34,759			**34,759**	655p	6/3/2004	5/3/2011	c, g
	275,349		**275,349**		715p	6/3/2005	5/3/2012	d, j
	5,783	&n						