LLOYDS TSB GROUP PLC
Form 20-F
June 05, 2008

As filed with the Securities and Exchange Commission on 5 June 2008

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 2007

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 2007 was:

Ordinary shares, nominal value 25 pence each, as of 31 December 2007	5,647,703,945
Limited voting shares, nominal value 25 pence each, as of 31 December 2007	78,947,368
Preference shares, nominal value 25 pence each, as of 31 December 2007	600,400
Preference shares, nominal value 25 cents each, as of 31 December 2007	1,000,000
Preference shares, nominal value 25 euro cents each, as of 31 December 2007	0
Preference shares, nominal value Japanese ¥25 each, as of 31 December 2007	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 basis of accounting the registrant has used to prepare the financial statements including in this filing:

U.S. GAAP o International Financial Reporting Standards as issued by the International Accounting Standards Board x Other o

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 o Item 18 o

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

Table of contents

Presentation of information

In this annual report, references to Company are to Lloyds TSB Group plc; references to Lloyds TSB Group , Lloyds TSB 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 or FSA 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 (IFRS) as issued by the International Accounting Standards Board (IASB).

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 or c are to one-hundredth US 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 2007, which was $1.9843 = £1.00. The Noon Buying Rate on 31 December 2007 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 2007 total Lloyds TSB Group assets were £353,346 million and Lloyds TSB Group had some 58,000 employees (on a full-time equivalent basis). Lloyds TSB Group plc s market capitalisation at that date was some £26,700 million. The profit before tax for the 12 months to 31 December 2007 was £4,000 million and the risk asset ratios as at that date were 11.0 per cent for total capital and 8.1 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 2007. As described on page 8, Cheltenham & Gloucester plc (C&G) is the Group s specialist mortgage arranger. Following the transfer of its mortgage lending and deposits to Lloyds TSB Bank during 2007, C&G now arranges mortgages for Lloyds TSB Bank rather than for its own account. 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 corporates and financial institutions, and small and medium-sized UK businesses. It also provides asset finance 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. In order to provide a more comparable representation of business performance volatility (see Operating and financial review and prospects Line of business information Volatility , for a description of volatility, its significant limitations and the processes put in place by management to compensate for these limitations) 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).

	Profit before tax (statutory)			**Profit before tax (excluding volatility)**		
	2007 £m	2006 £m	2005 £m	**2007 £m**	2006 £m	2005 £m
UK Retail Banking	**1,732**	1,549	1,394	**1,732**	1,549	1,394
Insurance and Investments	**828**	1,383	1,474	**1,328**	973	725
Wholesale and International Banking	**1,822**	1,640	1,518	**1,822**	1,640	1,518
Central group items	**(382)**	(324)	(566)	**(382)**	(324)	(566)
Profit before tax, excluding volatility				**4,500**	3,838	3,071
Volatility*				**(500)**	410	749
Profit before tax	**4,000**	4,248	3,820	**4,000**	4,248	3,820

* Volatility relates to Insurance and Investments.

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. These tables have been prepared in accordance with IFRS (for 2004 and later years) and with UK Generally Accepted Accounting Principles (for 2003) and, as a result, the information included for 2004 and later years is not directly comparable with that for 2003. The financial statements for each of the years 2003 to 2007 have been audited by PricewaterhouseCoopers LLP, independent accountants.

IFRS	**2007**	2006	2005	2004[1]
Income statement data for the year ended 31 December (£m)				
Total income, net of insurance claims	**10,706**	11,104	10,540	9,661
Operating expenses	**(5,567)**	(5,301)	(5,471)	(5,297)
Trading surplus	**5,139**	5,803	5,069	4,364
Impairment losses on loans and advances	**(1,796)**	(1,555)	(1,299)	(866)
Profit before tax	**4,000**	4,248	3,820	3,477
Profit for the year	**3,321**	2,907	2,555	2,459
Profit for the year attributable to equity shareholders	**3,289**	2,803	2,493	2,392
Total dividend for the year[2]	**2,026**	1,928	1,915	1,914
Balance sheet data at 31 December (£m)				
Share capital	**1,432**	1,429	1,420	1,419
Shareholders equity	**12,141**	11,155	10,195	11,047
Customer accounts	**156,555**	139,342	131,070	119,811
Preferred securities	**3,031**	2,957	2,549	1,388
Undated subordinated liabilities	**4,869**	4,863	5,184	4,464
Dated subordinated liabilities	**4,058**	4,252	4,669	4,400
Loans and advances to customers	**209,814**	188,285	174,944	155,318
Total assets	**353,346**	343,598	309,754	284,422
Share information				
Basic earnings per ordinary share	**58.3p**	49.9p	44.6p	42.8p
Diluted earnings per ordinary share	**57.9p**	49.5p	44.2p	42.5p
Net asset value per ordinary share	**212p**	195p	180p	195p
Total dividend per ordinary share[2]	**35.9p**	34.2p	34.2p	34.2p
Equivalent cents per share[2,3]	**71.0c**	67.0c	62.2c	63.7c
Market price (year end)	**472p**	571.5p	488.5p	473p
Number of shareholders (thousands)	**814**	870	920	953
Number of ordinary shares in issue (millions)[4]	**5,648**	5,638	5,603	5,596
Financial ratios (%)[5]				
Dividend payout ratio	**61.6**	68.8	76.8	80.0
Post-tax return on average shareholders equity	**28.2**	26.6	25.6	22.8
Post-tax return on average assets	**0.94**	0.88	0.84	0.92
Post-tax return on average risk-weighted assets	**2.03**	1.89	1.81	1.99
Average shareholders equity to average assets	**3.3**	3.2	3.2	3.9
Cost:income ratio[6]	**52.0**	47.7	51.9	54.8
Capital ratios (%)[7]				
Total capital	**11.0**	10.7	10.9	10.1
Tier 1 capital	**8.1**	8.2	7.9	8.2

Selected consolidated financial data

UK GAAP	2003
Profit and loss account data for the year ended 31 December (£m)	
Net interest income	5,255
Other finance income	34
Other income	4,619
Operating expenses	(5,173)
Trading surplus	4,735
Provisions for bad and doubtful debts	(950)
Profit on ordinary activities before tax	4,348
Profit on ordinary activities after tax	3,323
Profit for the year attributable to equity shareholders	3,254
Dividends[8]	1,911
Balance sheet data at 31 December (£m)	
Called-up share capital	1,418
Shareholders funds (equity and non-equity)	9,624
Customer accounts	116,496
Undated subordinated loan capital	5,959
Dated subordinated loan capital	4,495
Loans and advances to customers	135,251
Assets[9]	201,934
Total assets	252,012
Share information	
Basic earnings per ordinary share	58.3p
Diluted earnings per ordinary share	58.1p
Net asset value per ordinary share	170p
Dividends per ordinary share[8]	34.2p
Equivalent cents per share[3, 8]	59.9c
Market price (year end)	448p
Number of shareholders (thousands)	974
Number of ordinary shares in issue (millions)[4]	5,594
Financial ratios (%)[5]	
Dividend payout ratio	58.7
Post-tax return on average shareholders equity	38.5
Post-tax return on average assets	1.57
Post-tax return on average risk-weighted assets	2.63
Average shareholders equity to average assets	4.0
Cost:income ratio[10]	52.2
Capital ratios (%)	
Total capital	11.3
Tier 1 capital	9.5

1 Except for capital ratios (see 7 below), 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 under IFRS 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.

8 Annual dividends comprise both interim and final dividend payments. Under UK GAAP, final dividends are included in the year to which they relate rather than in the year in which they are paid.

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

10 The cost:income ratio under UK GAAP is calculated as total operating expenses as a percentage of total income.

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:

	2008 April	2008 March	2008 February	2008 January	2007 December	2007 November
US dollars per pound sterling:						
High	2.00	2.03	1.99	1.99	2.07	2.11
Low	1.96	1.98	1.94	1.95	1.98	2.05

For each of the years shown, the average of the US dollar Noon Buying Rates per pound sterling on the last day of each month was:

	2007	2006	2005	2004	2003
US dollars per pound sterling:					
Average	2.01	1.86	1.81	1.84	1.64

On 8 May 2008, the latest practicable date, the US dollar Noon Buying Rate was $1.9543 = £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 Taylors and Lloyds was established in Birmingham, England. 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 1995, it continued to expand with the acquisition of the 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, and a motor vehicle hire purchase and leasing operation 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, and in 2000, Lloyds TSB Group acquired Scottish Widows. In addition to already 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 non-core 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 .

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. Lloyds TSB Group believes that this has already resulted in improved earnings growth in its core markets.

The 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 phase 3, the Lloyds TSB Group expects to leverage its financial strength and enhanced capabilities in new markets.

Relationships are critical to the Lloyds TSB Group s strategy. The Lloyds TSB Group has chosen to focus on building deep, long-lasting relationships with the Group s customers in order to deliver high quality, sustainable results over time. By building deep relationships, the Lloyds TSB Group aims to maintain stable revenues and thus achieve a lower risk profile.

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. In 2007, the Lloyds TSB Group continued to move out of non-core markets with the sale of Lloyds TSB Registrars and Abbey Life Assurance Company Limited (Abbey Life).

There remains significant growth potential for the Lloyds TSB Group within the UK. The UK remains an attractive market and the Lloyds TSB Group believes that it has good potential within its existing franchise to grow by meeting more of the Group s customers needs as well as through adding new customers to the franchise.

Strategy

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

(i) Strong customer relationships

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, based on building strong customer relationships. 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. Towers Perrin ISR research shows that high employee engagement scores are positively correlated with business performance.

Business

Motivated employees, combined with investments in improving service, help to build customer advocacy. The Lloyds TSB Group s customer satisfaction and advocacy scores have also improved in recent periods. The Lloyds TSB Group will continue to invest in the drivers of customer advocacy. Against this background, the Lloyds TSB Group has continued to achieve 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.

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 as these capabilities and disciplines are extended further.

(iii) Capital management

Lloyds TSB Group measures value internally by economic profit growth, a measure of financial performance which signals unambiguously where value is created or destroyed. It has developed a framework 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.

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 a 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 whilst remaining strongly capitalised.

It is the Lloyds TSB Group s belief that the relationship focused strategy has demonstrated its effectiveness in generating sustainable, high quality results through the cycle. The prudent approach to risk means that the Lloyds TSB Group believes that it has relatively limited exposure to assets affected by capital market uncertainties and continues to retain a strong liquidity position. In the future, the continued successful execution of the strategy should enable the Lloyds TSB Group to achieve its goal of double digit economic profit growth over time and 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, through over 2,000 branches of Lloyds TSB Bank, Lloyds TSB Scotland plc (Lloyds TSB Scotland) and Cheltenham & Gloucester plc (Cheltenham & Gloucester).

Internet banking. Internet banking provides online banking facilities for personal customers. Some 4.5 million customers have registered to use Lloyds TSB Group s internet banking services. At the end of 2007, these customers were conducting more than 71 million actions per month online, a 25 per cent increase on 2006.

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 2007, some 5.4 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 70 million calls during 2007.

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 2007, personal customers of Lloyds TSB Bank and Lloyds TSB Scotland were able to withdraw cash and check balances through over 4,100 ATMs at branches and external locations around the country. In addition, UK Retail Banking s personal customers have access to over 64,000 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 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.

Mortgages. Cheltenham & Gloucester is Lloyds TSB Group s specialist residential mortgage arranger, 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 2007 of £101,980 million.

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 advisors who can be accessed via the retail branch network and Private Banking offices throughout the United Kingdom. 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.

During 2007, Lloyds TSB Group sold Abbey Life, the UK life operation which was closed to new business in 2000.

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

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

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 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.

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

During 2007, Lloyds TSB Group completed the sale of Lloyds TSB Registrars and The Dutton-Forshaw Group, two of Wholesale and International Banking s businesses.

Corporate Markets. Combining the respective strengths of some 3,000 people in Corporate Banking and Products and Markets, Corporate Markets plays an integral role in leveraging and expanding the customer franchise and building deep, long-lasting relationships with around 17,000 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.

Products and Markets is where the specialist product capability resides for transactions undertaken by the corporate relationship customers of the Lloyds TSB Group. It offers customers a comprehensive range of finance and capital solutions, and also provides tailored risk management solutions and structured solutions across all areas of risk, including foreign exchange, interest rates, credit, inflation and commodities on behalf of Lloyds TSB Group. Additionally, Products and Markets fulfils the treasury role for Lloyds TSB Group, managing balance sheet liquidity.

Commercial Banking. Commercial Banking serves nearly one million customers across the UK from one-person start-ups to large, established enterprises. The expanded business focuses on providing banking facilities and solutions to customers with business turnover up to £15 million per annum, and incorporates the invoice discounting and factoring subsidiary, Lloyds TSB Commercial Finance, through which Lloyds TSB Group provides specialised working capital finance for its customers. Lloyds TSB Group has a leading share of the new business start-up market, with some 120,000 new businesses opening an account with Lloyds TSB Group in 2007. The main activity of The Agricultural Mortgage Corporation is to provide long-term finance to the agricultural sector.

Asset Finance. Lloyds TSB Group s asset finance businesses provide individuals and companies with specialist personal lending, store credit and finance through leasing, hire purchase and contract hire packages. Hire purchase 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. Altogether, Asset Finance has over 1.7 million individual customers and relationships with some 16,800 companies and small businesses.

International Banking. The Lloyds TSB Group has continued to shape its international network to support its UK operations. Its overseas banking operations include offices in the UK, the Channel Islands, the Isle of Man, Dubai, Hong Kong, Spain, France, Switzerland, Luxembourg, Belgium, Netherlands, Monaco, Gibraltar, Cyprus, South Africa, Japan, Singapore, Malaysia, China and the US. The business provides a wide range of private and retail banking, wealth management and expatriate services to local island residents, UK expatriates, foreign nationals and to other customers and also serves the corporate and institutional market in a number of these locations.

Material contracts

Lloyds TSB Group and its subsidiaries are party to various contracts in the ordinary course of business. In 2007, there have been no material contracts entered into outside the ordinary course of business.

Properties

As at 31 December 2007, Lloyds TSB Group occupied 3,422 properties in the UK. Of these, 500 were held as freeholds, 57 as long-term leaseholds and 2,865 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. For further information, see Legal proceedings in note 46 on page F-59. As referred to in note 46, the Group has provided information relating to certain historic US dollar payments to a number of authorities including the Office of Foreign Assets Control, the US Department of Justice and the New York County District Attorney s office. The Group is involved in ongoing discussions with these and other authorities with respect to agreeing a resolution of their investigations. Whilst the Group does not expect the final outcome to have a material adverse effect on its financial position, discussions have advanced towards resolution since the year end and accordingly Lloyds TSB Group has provided £180 million in respect of this matter in the first half of 2008.

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, but there is now evidence of divergent trends between unsecured and secured consumer borrowing, with unsecured lending expected to continue to grow whilst new secured lending is expected to fall in the short term. At the same time, the markets for life, pensions and insurance products are expected to grow over time in a number of key areas. The fragmented nature of the life, pensions and insurance market in the UK has resulted in some consolidation within certain product sectors, although the overall share of new business of the top ten providers has fallen slightly in 2007. 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. Wholesale markets have also shown strong growth until mid-2007, since when the ongoing dislocation of global capital markets has had a severe impact. Slower growth is now evident and this trend is likely to intensify going forward, together with a return to more normal levels of bad debt from recent cyclical lows.

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 specialist providers. In the wholesale banking market, 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; and in the insurance market, competitors include bancassurance, life assurance and general insurance companies operating in the UK.

The current dislocation in global capital markets has been the most severe examination of the banking system s capacity to absorb sudden significant changes in the funding and liquidity environment for many years and individual institutions have faced varying degrees of stress. Should the Group be unable to continue to source a sustainable funding profile which can absorb these sudden shocks, this could impact its ability to compete in the mortgage market and in other markets. Many competitors have reacted to short-term funding concerns by withdrawing products and/or tightening lending criteria. Lloyds TSB Group expects these conditions to continue throughout 2008.

Business

In the UK and elsewhere, there is continuing political and regulatory scrutiny of financial services (see also Operating and financial review and prospects Risk management Operational risk Exposures):

UK Competition Commission

The UK's Competition Commission (the Commission) is formally investigating the supply of payment protection insurance (PPI) services (except store card PPI) to non-business customers in the UK.

On 5 June 2008, the Commission issued its provisional findings, to the effect that there are market features which prevent, restrict or distort competition in the supply of PPI to non-business customers, with an adverse effect on competition and with resulting detriments to consumers.

The Commission has therefore also considered what remedies should be adopted to regulate the future supply of PPI. A remedies notice issued with the provisional findings sets out a range of possible remedies under consideration at this stage which contemplate (1) measures requiring greater disclosure of information about PPI policies prior to, or at, the point of sale of the policy; (2) a prohibition on the sale of PPI at the point of sale of any credit product and within a fixed time period after the credit sale; (3) a requirement that all PPI policies be subject to annual renewal, with renewal occurring only if the customer “opted in” (and, for single premium policies, a right for a customer who did not “opt in” to receive a rebate in cash); (4) a requirement that distributors of PPI should provide an annual statement to each customer, containing a reminder of certain key facts about the policy, including the customer s right to cancel the policy; (5) a prohibition on the sale of single premium PPI policies, or other restrictions on the sale and/or terms of such policies; (6) a requirement that PPI policies embody certain minimum standards of cover; (7) a range of measures requiring disclosure of customer-related information, or other forms of co-operation, between market participants, to facilitate the sale and administration of policies by stand alone and other providers of PPI; and (8) the imposition of a regulatory cap on the price of some or all kinds of PPI policy.

If the Commission decides to confirm its provisional findings to the effect that market features restrict competition in the supply of PPI with resulting adverse effects, it is expected to issue its provisional decision as to what remedies to adopt in September 2008. The Commission will issue its final report by February 2009.

UK Office of Fair Trading

The following reviews and inquiries are being carried out:

In April 2007, the UK Office of Fair Trading (OFT) commenced an investigation into the fairness of current account overdraft charges. At the same time it commenced a market study into wider questions about competition and price transparency in the provision of personal current accounts.

On 27 July 2007, following agreement between the OFT and eight UK financial institutions, the OFT issued High Court legal proceedings against those institutions, including Lloyds TSB Bank, to determine the legal status and enforceability of certain of the charges applied to their personal customers in relation to requests for unplanned overdrafts. On 24 April 2008, the High Court ruled on the preliminary issues of whether eight UK financial institutions terms and conditions in relation to unplanned overdraft charges are capable of being assessed for fairness under the Unfair Terms in Consumer Contracts Regulations 1999 (Regulations) or are capable of amounting to penalties at common law. The High Court determined, in relation to Lloyds TSB Bank s current terms and conditions, that the relevant charges are not capable of amounting to penalties but that they are assessable for fairness under the Regulations. On 22 May 2008 Lloyds TSB Bank, along with the other seven UK financial institutions, was given permission to appeal the finding that unplanned overdraft charges are assessable for fairness under the Regulations and expects this appeal to be heard later this year. A further hearing will consider whether Lloyds TSB Bank s historic terms and conditions are similarly not capable of being penalties. That hearing is expected to occur in early July 2008. Subject to the outcome of any appeal, it is expected that there will be a further substantive hearing to establish whether the charges are fair. If various appeals are pursued, the proceedings may take a number of years to conclude. Pending resolution, the Financial Services Authority has agreed for the time being, subject to certain conditions, that the handling of customer complaints on this issue can be suspended until the proceedings are concluded unless in the light of prevailing circumstances this would be inappropriate. Similarly cases before the Financial Ombudsman Service and the County Courts are also currently stayed pending the outcome of the legal proceedings initiated by the OFT. The Group intends to continue to defend its position strongly. Accordingly, no provision in relation to the outcome of this litigation has been made. Depending on the Court s determinations, a range of outcomes is possible, some of which could have a significant financial impact on the Lloyds TSB Group. The ultimate impact of the litigation on the Group can only be known at its conclusion.

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 also investigating interchange fees charged by some card networks in parallel with the European Commission s own investigation into cross-border interchange fees.

The European Commission

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

In addition, a number of EU directives, including the Unfair Commercial Practices Directive, Acquisitions Directive and the Payment Services Directive are currently being implemented in the UK. The EU is also considering regulatory proposals for, inter alia, Consumer Credit, Mortgage Credit, Single European Payments Area, Retail Financial Services Review and capital adequacy requirements for insurance companies (Solvency II).

UK regulators are also currently considering feedback from the market in connection with their review of the distribution of retail investment products and responses to a consultation on the UK financial stability and depositor protection regime.

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 matters.

Business

Recent developments

Board changes

On 28 March 2008, it was announced that Terri Dial, Group Executive Director, UK Retail Banking, had decided to leave the Lloyds TSB Group; Ms Dial resigned from the board of Lloyds TSB Group plc on 18 April 2008.

Also on 18 April 2008, the board announced the appointment of Helen Weir as Group Executive Director, UK Retail Banking, with immediate effect; Ms Weir was previously Group Finance Director of Lloyds TSB having joined the Group in 2004. In addition, the board announced that Tim Tookey, previously Deputy Group Finance Director, would assume the position of Acting Group Finance Director.

Interim management statement

Lloyds TSB Group issued the following interim management statement on 6 May 2008:

Interim management statement key highlights*

- The Group continues to deliver good growth in its relationship banking businesses in a difficult period for financial services companies.
- Excluding the impact of market dislocation and insurance related volatility, each division and the Group achieved revenue growth in excess of cost growth, and a double-digit percentage increase in profit before tax in the first quarter of 2008.
- The Group has continued to capture market share in a number of key areas, whilst improving product margins.
- The impact of market dislocation on profit before tax in Wholesale and International Banking was £387 million in the first quarter of 2008.
- The Group has maintained its strong liquidity and funding position.
- We remain firmly on track to deliver a good performance in the first half of 2008.

*Unless otherwise stated, first quarter 2008 performance comparisons relate to the equivalent period in 2007 for the Group s continuing businesses.

The Group s core banking businesses have continued their growth momentum during the first quarter of 2008, notwithstanding the continuing difficulties in financial markets. This serves to demonstrate both the prudence of our business model and the high quality, sustainable nature of our earnings. Whilst no bank has been immune from the recent market turbulence, the impact on the Group continues to be relatively limited.

Continuing to build our strong customer franchises: We have continued to extend our strong, relationship focused, customer franchises by acquiring new customers, deepening relationships with existing customers, and achieving good sales growth, whilst also improving productivity and efficiency. The underlying performance of the business remains strong with revenue growth remaining well ahead of cost growth. Like many other financial institutions, the Group has been affected by the recent market dislocation. However, due to our lower risk strategy, the impact on profit before tax in our Wholesale and International Banking division has been limited to £387 million in the first quarter of 2008.

In UK Retail Banking we have continued recent performance trends, with strong revenue momentum and excellent cost management. Insurance and Investments has delivered a solid performance against the backdrop of a slowdown in the sale of equity based savings and investment products. In Wholesale and International Banking our strong liquidity position has led to further progress in building our corporate and commercial relationship banking businesses. However, the division s overall performance has been affected by the impact of the widespread turbulence in global financial markets.

Despite the significant disruption in financial markets, Lloyds TSB maintains a strong liquidity and funding position, building on our triple A long-term debt rating and robust capital ratios.

Continued strong revenue momentum in UK Retail Banking: The Retail Bank has continued to make excellent progress, with further growth in product sales supporting strong revenue momentum. We continue to make progress in the acquisition of new current accounts and have also achieved good growth in customer deposits, especially in bank savings and cash Individual Savings Accounts. Our Wealth Management business delivered a particularly strong first quarter with a significant increase in new business flows.

In our mortgage business, we significantly improved our market share of net new mortgage lending in the first quarter of 2008, whilst maintaining prudent new business loan-to-value ratios. Recent levels of mortgage allocations continue to be strong. New business net interest margins have improved considerably as we benefit from both a market-wide increase in interest spreads and our relative funding advantage. The Group has continued to maintain high levels of asset quality by focusing on the prime UK mortgage market.

We have maintained our leadership position in personal loans and credit card issuance, and have continued to build our transaction focused credit card business with strong growth in new customers choosing the Lloyds TSB Airmiles Duo account. The quality of our new unsecured personal lending has remained strong, reflecting lower levels of arrears and the Group s focus on lending to existing current account customers where we better understand our customers financial position.

Continued progress in Insurance and Investments: In Insurance and Investments, we have continued to achieve growth in the bancassurance channel, although the level of growth slowed during the first quarter of 2008 as a result of a switch away from equity based products towards cash based products, and lower mortgage-related protection sales. Stand-alone sales of protection products have remained robust. In the IFA channel, sales of pensions were good. However a significant reduction in the sale of savings and investment products, largely as a result of the uncertainty caused by proposed changes to Capital Gains Tax, led to an overall reduction in new business sales. Scottish Widows continues to make improvements in service and operational efficiencies and this has led to another excellent cost performance. The capital position of Scottish Widows remains strong.

In General Insurance, we have delivered improved home insurance sales through the branch network and strong sales through our increasing corporate partnering arrangements. Cost control has been good and we expect to achieve notable profit growth in the business in the first half of 2008, largely reflecting the expected absence of last year s unusually high weather-related claims.

Strong relationship banking growth in Wholesale and International Banking: The division has continued to make substantial progress in its relationship banking businesses. Our Corporate and Commercial Banking businesses are in a strong competitive position and continue to expand their share of our customers business. In Commercial Banking, strong growth in business volumes and good progress in improving operational efficiency have resulted in continued strong profit growth. In Corporate Markets, further progress has been made in developing our relationship banking franchise supported by a

Business

significant increase in the demand for corporate lending and a strong cross-selling performance. Reflecting this, in April 2008, our corporate relationship banking businesses were awarded the CBI Corporate Bank of the Year Award for the fourth consecutive year.

The division has limited exposure to assets affected by current market uncertainties. However, in Wholesale and International Banking profit before tax was reduced by £387 million during the first quarter of 2008 as a result of the impact of market dislocation. This principally reflects mark-to-market adjustments on assets in our trading portfolio.

US sub-prime mortgage Asset Backed Securities (ABS) and ABS Collateralised Debt Obligations (CDOs)

Lloyds TSB continues to have no direct exposure to US sub-prime mortgage Asset Backed Securities and limited indirect exposure through ABS CDOs. During the first quarter of 2008, the market value of our holdings in ABS CDOs was written down by £5 million, leaving a residual investment of £125 million net of hedges.

The Group s residual investment of £125 million is stated net of credit default swap (CDS) protection totalling £406 million purchased from a triple A rated monoline Financial Guarantor. At 31 March 2008, the underlying assets supported by this protection had fallen in value, leaving a reliance on the CDS protection totalling £187 million. During the quarter, the Group has written down the value of this protection by £58 million. In addition, at 31 March 2008, the Group had £1,972 million of ABS CDO s which are fully cash collaterised by major global financial institutions. During April 2008, this exposure reduced by £566 million, or 29 per cent, following the sale, at cost, of an ABS CDO.

Structured Investment Vehicle (SIV) Capital Notes

During the first quarter of 2008, the Group wrote down the value of its SIV assets by a total of £46 million, leaving a residual exposure to SIV Capital Notes at 31 March 2008 totalling £35 million. Additionally, at 31 March 2008 the Group had commercial paper back-up liquidity facilities totalling £182 million, of which £115 million had been drawn. All of these liquidity lines are senior facilities.

Trading portfolio

In the first quarter of 2008, Corporate Markets saw a reduction in profit before tax of approximately £278 million as a result of the impact of mark-to-market adjustments in the Group s trading portfolio, reflecting the market-wide repricing of liquidity and, to a lesser extent, credit. At 31 March 2008, the trading portfolio contained £200 million of indirect exposure to US sub-prime mortgages and ABS CDOs.

Available-for-sale assets

At 31 March 2008, the Group s portfolio of available-for-sale assets totalled £23.2 billion. A significant proportion of these assets (£7.9 billion) related to the ABS in Cancara, our hybrid Asset Backed Commercial Paper conduit. Over 99 per cent of these ABS remain triple A rated by both Moody s and Standard & Poor s. Cancara, which is fully consolidated in the Group s accounts, comprises £7.9 billion ABS and £3.9 billion client receivables transactions and is managed in a very conservative manner, which is demonstrated by the quality and ratings stability of its underlying asset portfolio. Cancara has continued to fund itself satisfactorily without having to utilise the Group s liquidity backstop facility.

The balance of the Group s available-for-sale assets includes £3.1 billion Student Loan ABS, predominantly guaranteed by the US Government, £7.4 billion Government bond and short-dated bank commercial paper and certificates of deposit and £4.8 billion major bank senior paper and high quality ABS. These available-for-sale assets are intended to be held to maturity and as a result, under IFRS, they are marked-to-market through reserves. During the first quarter of 2008, a net £740 million reserves adjustment has been made to reflect the fact that, whilst not currently impaired, there has been a reduction in the value of these assets. This adjustment has no impact on the Group s capital ratios.

Credit Market Positions

Lloyds TSB s high quality business model means that the Group has relatively limited exposure to assets affected by current financial market turbulence. The following table shows credit market positions in Corporate Markets, on both a gross and net basis.

	31 December 2007		**31 March 2008**		**Write-down First quarter of 2008**
	Net Exposure £m	Gross Exposure £m	**Net Exposure £m**	**Gross Exposure £m**	**£m**
US sub-prime ABS-direct					
ABS CDOs					
unhedged	130	130	**125**	**125**	**5**
monoline hedged		470		**406**	**58**
major global bank cash collateralised		1,861		**1,972**	
Structured investment vehicles					
capital notes	78	78	**35**	**35**	**43**
liquidity backup facilities	370	370	**182**	**182**	**3**
Trading portfolio					
ABS trading book	474	474	**399**	**399**	**75**
secondary loan trading	665	863	**594**	**933**	**47**
other assets	3,895	3,895	**3,715**	**3,715**	**156**
					387

13

Business

Available-for-sale assets

	31 December 2007 £bn	**31 March 2008 £bn**	**Reserves adjustment First quarter of 2008 £m**
Cancara (over 99% AAA/Aaa)	8.3	**7.9**	**423**
US sub-prime nil			
Alt-A £456 million (100% AAA/Aaa)			
CMBS £1,256 million (100% AAA/Aaa)			
Student Loan ABS	3.2	**3.1**	**214**
US Government guaranteed			
Treasury assets	4.6	**7.4**	
Government bond and short-dated bank commercial paper			
Other assets	4.1	4.8	103
Major bank senior paper and high quality ABS			
Total Group	20.2	**23.2**	**740**

Valuation of financial instruments

Trading securities, other financial assets and liabilities at fair value through profit or loss, derivatives and available-for-sale financial assets are stated at fair value. The fair value of these financial instruments is the amount for which an asset could be exchanged or a liability settled between willing parties in arm s length transactions. The fair values of financial instruments are determined by reference to observable market prices where these are available and the market is active. Where market prices are not available or are unreliable because of poor liquidity, fair values are determined using valuation techniques including cash flow models which, to the extent possible, use observable market parameters. Within our Wholesale and International Banking business, exposure to assets held at fair value through profit or loss using unobservable market inputs totalled £1.3 billion, at 31 March 2008, of which £0.7 billion related to the Lloyds TSB Development Capital portfolio of investments.

Strong Group cost performance: The Group s strong cost performance has continued, resulting in a further improvement in the Group s underlying cost:income ratio. The Group s programme of efficiency improvements is progressing well and we remain on track to deliver net benefits of circa £250 million in 2008.

Overall credit quality remains satisfactory: Overall Group asset quality remains satisfactory. In the Retail Bank, arrears and delinquency trends in both the secured and unsecured lending portfolios have remained satisfactory. As we have previously indicated, the retail impairment charge in the first half of 2008 is not expected to be significantly different from that in the first half of 2007.

In Wholesale and International Banking, corporate and small business asset quality has also remained strong. The underlying level of new corporate provisions, excluding the impact of market dislocation, is expected to remain at a relatively low level during the first half of 2008, albeit higher than in the first half of last year.

Insurance volatility: In the first quarter of 2008, high levels of volatility in fixed income markets and lower equity markets contributed to adverse volatility of £474 million relating to the insurance business, excluding policyholder interests volatility. This reflects a reduction in the market consistent valuation of the annuity portfolio, driven by the continued widening of corporate bond spreads, and lower expected future shareholder income from contracts where the underlying policyholder investments are in equities.

Robust capital ratios and strong liquidity and funding position: The Group s capital ratios remain robust and the rate of risk-weighted asset growth in 2008 is expected to be consistent with our previously indicated high single-digit, low double-digit range. Throughout the ongoing market turbulence, Lloyds TSB has maintained a strong liquidity position for both the Group s funding requirements, which are supported by the Group s strong and stable retail and corporate deposit base, and those of its conduit, Cancara. In addition, retail and corporate deposit inflows remain strong and the Group continues to benefit from its strong credit ratings and diversity of funding sources.

Eric Daniels, Group Chief Executive, commented:

Despite the more challenging market conditions, the Group remains firmly on track to deliver a good performance for the first half of 2008, excluding the impact of market dislocation and insurance related volatility. Our strong liquidity and funding capability have ensured that the Group has continued to raise wholesale funding at market leading rates. This gives the Group a competitive advantage and has enabled our corporate and retail relationship banking businesses to achieve strong levels of business growth in the first quarter of the year, capturing market share in a number of key areas whilst improving product margins. Our strategy and focus remains on continuing to build strong customer relationships, whilst improving the efficiency and effectiveness of our operations.

Excluding the impact of market dislocation and insurance related volatility, each division and the Group delivered double-digit profit before tax growth in the first quarter of 2008. By focusing on our core strengths and continuing to capture the growth opportunities within our relationship businesses, we expect to continue to deliver good levels of growth with high returns.

Other than the recent developments described in this section there has been no significant change since the date of the consolidated financial statements.

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. Certain information for years prior to 2004 has been prepared under UK GAAP, which is not comparable with IFRS.

Table of Contents

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 2007 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 for its performance.

The UK economy has expanded strongly in the last two years, and in 2007 Gross Domestic Product grew by an above-trend rate of 3.0 per cent the fastest rate of growth amongst the G7 economies. The Group s loans and advances to customers have increased from £174,944 million to £209,814 million over this period and its profit before tax has increased from £3,820 million in 2005 to £4,000 million in 2007.

However, in 2008 growth is expected to slow, partly in response to rising interest rates during 2007, and partly in response to the effects of credit market problems on consumer and business confidence and on the availability and pricing of loans. The Group s current expectations are for growth in the UK s Gross Domestic Product of around 1.5 per cent, which will still make the UK one of the fastest growing G7 economies in what is likely to be a year of slower growth across the industrialised world. Unemployment is likely to rise as a result, but will remain low by international standards. The Monetary Policy Committee has already reduced interest rates in response to projections for a weaker outlook. With the economy slowing during 2008, and as inflation declines, interest rates are projected by markets to fall further, albeit not as sharply as recent US rate movements. A slower economy will mean slower rates of growth of consumer and business borrowing, and a weaker housing market will depress mortgage lending in particular, although household savings are expected to grow at a faster pace. Whilst the uncertain UK macroeconomic environment and customer insolvency trends remain key factors in the outlook for retail impairment, current lead indicators are good, the Group continues to enhance its underwriting and collections procedures and the quality of new business remains strong. As a result, based on current trends, the Group does not expect a significant change in the retail impairment charge.

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.

Future accounting developments

Future developments in relation to the Lloyds TSB Group s IFRS reporting are discussed in note 50 to the consolidated financial statements.

Results of operations 2007, 2006 and 2005

Summary

	2007 £m	2006 £m	2005 £m
Net interest income	**6,099**	5,329	5,443
Other income	**12,129**	14,344	17,283
Total income	**18,228**	19,673	22,726
Insurance claims	**(7,522)**	(8,569)	(12,186)
Total income, net of insurance claims	**10,706**	11,104	10,540
Operating expenses	**(5,567)**	(5,301)	(5,471)

Trading surplus	**5,139**	5,803	5,069
Impairment	**(1,796)**	(1,555)	(1,299)
Profit on sale and closure of businesses	**657**		50
Profit before tax	**4,000**	4,248	3,820
Taxation	**(679)**	(1,341)	(1,265)
Profit for the year	**3,321**	2,907	2,555
Profit attributable to minority interests	**32**	104	62
Profit attributable to equity shareholders	**3,289**	2,803	2,493
Profit for the year	**3,321**	2,907	2,555
Economic profit[1]	**2,238**	1,855	1,616

[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 .

16

Operating and financial review and prospects

2007 compared with 2006

The Lloyds TSB Group s profit before tax in 2007 was £248 million, or 6 per cent, lower at £4,000 million compared to £4,248 million in 2006. Profit attributable to equity shareholders was £486 million, or 17 per cent, higher at £3,289 million compared to £2,803 million in 2006. Earnings per share were 8.4p, or 17 per cent, higher at 58.3p compared to 49.9p in 2006.

Net interest income was £770 million, or 14 per cent, higher at £6,099 million compared to £5,329 million in 2006, in part reflecting higher levels of policyholder related net interest income within the insurance businesses. Average interest-earning assets were £19,773 million higher, or £21,243 million higher excluding the fine margin reverse repurchase agreement assets (instruments held for funding and liquidity purposes which are very efficient in terms of regulatory capital requirements and on which, as a consequence, very small interest margins are earned); this reflects continued growth in mortgage lending and in corporate, treasury and structured finance balances. The net interest margin was 13 basis points higher at 2.33 per cent, or 11 basis points higher at 2.46 per cent excluding the fine margin reverse repurchase agreement assets. The increase in net interest margin largely reflects the higher level of policyholder related net interest income; the margin within UK Retail Banking fell by 6 basis points, as a result of the continuing change in mix towards finer margin mortgage balances, but the margin within Wholesale and International Banking, excluding the fine margin reverse repurchase agreement balances, was 4 basis points higher.

Other income was £2,215 million, or 15 per cent, lower at £12,129 million compared to £14,344 million in 2006. Fees and commissions receivable were £108 million, or 3 per cent, higher at £3,224 million compared to £3,116 million in 2006, mainly due to growth in UK current account fees and card fees. Fees and commissions payable were £38 million, or 6 per cent, lower at £600 million compared to £638 million in 2006, with the reduction arising in the insurance businesses. Net trading income was £3,218 million, or 51 per cent, lower at £3,123 million compared to £6,341 million in 2006, this movement is largely due to reductions in the gains on policyholder investments in the insurance businesses, which is broadly matched by reductions in the claims expense and on other lines within the income statement, together with the impact of the market turmoil in the second half of the year. Insurance premium income was £711 million, or 15 per cent, higher at £5,430 million compared to £4,719 million in 2006, reflecting growth in the life and pensions business, in part due to the success of a new corporate pensions product. Other operating income was £146 million, or 18 per cent, higher at £952 million compared to £806 million in 2006.

The insurance claims expense of £7,522 million was £1,047 million, or 12 per cent, lower than £8,569 million in 2006. The charge in respect of the life and pensions business was £1,149 million, or 14 per cent, lower at £7,220 million in 2007 compared to £8,369 million in 2006. The reduced returns in 2007 on policyholder investments in the long-term insurance business have led to a related reduction in amounts allocated to policyholders via the claims expense. The impact of these lower allocations was partly offset by the releases from actuarial reserves in 2006 following FSA rule changes in that year. The charge in respect of general insurance was £102 million, or 51 per cent, higher at £302 million in 2007 compared to £200 million in 2006 as a result of increased weather related claims following severe flooding in the UK in June and July of 2007.

Operating expenses were £266 million, or 5 per cent, higher at £5,567 million compared to £5,301 million in 2006. However, if both the settlement of overdraft claims in 2007 and the pension credit in 2006 are excluded (see Operating expenses for more detail on both items), operating expenses were £62 million, or 1 per cent, higher at £5,491 million in 2007 compared to £5,429 million in 2006. Staff costs, excluding the £128 million pension schemes related credit from 2006, were £35 million, or 1 per cent, higher. Salaries were £10 million higher at £2,127 million as the decrease in costs resulting from the sale of businesses during 2007 and ongoing reductions in staff numbers was more than offset by annual pay awards and increased bonus and incentive costs. Excluding the one-off credit of £128 million from 2006, pension costs in 2007 were £55 million, or 19 per cent, lower than the underlying charge in 2006 following a reduction in the IAS 19 regular cost resulting from improved asset values at the end of 2006 and increased rates of return in 2007. Other staff costs were £74 million, or 25 per cent, higher at £372 million compared to £298 million in 2006 as a result of increased agency staff costs and general increases in other staff related expenditure. Premises and equipment costs were £20 million, or 3 per cent, lower at £619 million in 2007 compared to £639 million in 2006. Other costs, excluding the charge of £76 million in respect of the settlement of overdraft claims, were £36 million, or 3 per cent, higher at £1,338 million. Communications and external data processing costs were £37 million, or 7 per cent, lower at £462 million in 2007, compared to £499 million in 2006, as a result of efficiency initiatives; professional fees were £48 million, or 21 per cent, higher at £279 million compared to £231 million in 2006 due to significant expenditure on a number of projects and other costs were £17 million, or 4 per cent, higher at £405 million. Depreciation and amortisation was £11 million, or 2 per cent, higher at £630 million compared to £619 million in 2006.

The impairment charge in the income statement was £241 million, or 15 per cent, higher at £1,796 million in 2007 compared to £1,555 million in 2006; this comprised a charge of £1,721 million (2006: £1,560 million) in respect of impairment losses on loans and advances, a charge of £70 million (2006: £nil) in respect of the impairment of available-for-sale financial assets and a charge of £5 million (2006: a credit of £5 million) in respect of other credit risk provisions. In UK Retail Banking the charge reduced by £14 million, or 1 per cent, to £1,224 million from £1,238 million in 2006; for personal loans and overdrafts the charge reduced by £61 million following favourable collections experience and improved quality in new business, however the charge for the credit card portfolio increased by £37 million following a higher level of write-offs and lower recoveries. In Wholesale and International Banking the charge in respect of impairment losses on loans and advances increased by £184 million as a result of, in 2007, significant new charges for certain Corporate customers and a charge of £28 million in the leasing business resulting from the change in the UK corporation tax rate, and, in 2006, a greater level of releases and recoveries. 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 0.84 per cent compared to 0.83 per cent in 2006. In addition, a charge of £70 million in 2007 (2006: £nil) arose in respect of the impairment of available-for-sale financial assets.

In 2007, a profit of £657 million arose on the sale of businesses, principally Abbey Life, a life assurance company, and Lloyds TSB Registrars, the company registration business of Lloyds TSB Bank plc.

The tax charge, at £679 million, was £662 million lower than £1,341 million in 2006; this particularly reflects fluctuations in the level of tax attributable to UK life insurance policyholder earnings and the Lloyds TSB Group s interests in OEICs, which is required to be included within the income tax expense, the fact that no tax charge has arisen on the substantial profits on disposal of businesses in 2007 and the impact of the 2007 Finance Act reduction in the corporation tax rate which has led to a credit to the Group s tax charge in 2007 of £110 million.

At the end of 2007, the total capital ratio was 11.0 per cent. Risk-weighted assets increased by £15,928 million, or 10 per cent, from £156,043 million at 31 December 2006 to £171,971 million at the end of 2007, reflecting growth in mortgage balances and within the Corporate Markets business. Total assets increased by £9,748 million, or 3 per cent, to £353,346 million at 31 December 2007 from £343,598 million at the end of 2006 as growth in lending was, in part, offset by reductions in investment balances following the disposal of Abbey Life. Customer deposits increased by £17,213 million, or 12 per cent, to £156,555 million at the end of 2007 compared to £139,342 million at the end of 2006; this follows growth in current account credit balances and savings balances as well as in corporate deposits.

Operating and financial review and prospects

At 31 December 2007, Lloyds TSB Group s exposure to certain categories of assets the values of which have been affected by ongoing capital markets uncertainties was as described below:

US sub-prime Asset Backed Securities (ABS) and ABS Collateralised Debt Obligations (CDOs): Lloyds TSB Group had no direct exposure to US Sub-prime ABS and limited indirect exposure through ABS CDOs. The Group s residual investment in ABS CDOs at 31 December 2007 was £130 million, net of hedges and it had no exposure to mezzanine ABS CDOs. The Group s residual investment of £130 million was net of credit default swap (CDS) protection totalling £470 million purchased from a triple A rated monoline Financial Guarantor. At 31 December 2007, the underlying assets supported by this protection had fallen in value, leaving a reliance on the CDS protection totalling £155 million. In addition, the Group had £1,861 million of ABS CDOs which are fully cash collateralised by major global financial institutions.

Structured Investment Vehicle (SIV) Capital Notes: At 31 December 2007, the Group s residual exposure to SIV Capital Notes totalled £78 million. Additionally, at 31 December 2007 the Group had commercial paper back up liquidity facilities totalling £370 million, of which £98 million had been drawn. All of these liquidity lines are senior facilities. The Group had no SIV-Lite exposure at 31 December 2007.

Trading portfolio: At 31 December 2007 the trading portfolio contained £181 million of indirect super senior exposure, protected by note subordination, to US sub-prime mortgages and ABS CDOs.

Available-for-sale-assets: At 31 December 2007, the Group s portfolio of available-for-sale assets totalled £20,196 million. A significant proportion of these assets (£8,268 million) related to the ABS in Cancara Asset Securitisation Limited (Cancara). The residual assets included £3,164 million Student Loan ABS, predominantly guaranteed by the US Government, £4,676 million Government bond and short-dated bank commercial paper certificates of deposit and £4,088 million major bank senior paper and high quality ABS.

The Group s investment in Cancara, its hybrid Asset Backed Commercial Paper conduit, was £11,991 million at 31 December 2007, comprising £8,268 million ABS and £3,723 million client receivables transactions. At 31 December 2007, the ABS bonds in Cancara were 100 per cent Aaa/AAA rated by Moody s and Standard & Poor s respectively, and there was no exposure either directly or indirectly to sub-prime US mortgages within the ABS portfolio. At 31 December 2007 the client receivables portfolio included £115 million of US sub-prime mortgage exposure. Cancara is fully consolidated in the Group s financial statements.

Scottish Widows had no exposure to US sub-prime ABS either directly or indirectly through CDOs. At 31 December 2007 the Group held £25 million of short-dated SIV commercial paper through Scottish Widows.

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 £114 million, or 2 per cent, to £5,329 million compared to £5,443 million in 2005. Average interest-earning assets increased by £26,218 million, or £25,177 million excluding fine margin reverse repurchase agreement balances. This reflected growth in mortgage lending, in Corporate and Commercial Banking lending and in relatively low margin treasury and structured finance balances. The net interest margin was 32 basis points lower at 2.20 per cent, or 35 basis points lower at 2.35 per cent when the fine margin reverse repurchase agreement balances are excluded. This overall margin decline reflected a decrease in policyholder-related net interest income in the Insurance and Investments business together with a change in portfolio mix.

Other income was £2,939 million, or 17 per cent, lower at £14,344 million compared to £17,283 million in 2005. Fee 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 credit card business at the end of 2005. Fee and commission expense was £24 million, or 4 per cent, higher as decreases in card fees payable were more than offset by activity-related increases in the insurance businesses. Net trading income was £2,957 million lower; this largely reflected lower policyholder gains within the insurance and investment businesses for which there was 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 reflected the impact of the FSA s valuation rule changes in 2006 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 was principally attributable to lower returns on policyholder investments and the consequential reduction in amounts credited to policyholders. Claims expense was also 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 within Commercial 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.

Operating and financial review and prospects

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 Commercial 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.

Net interest income

	2007	2006	2005
Net interest income £m	**6,099**	5,329	5,443
Average interest-earning assets £m	**262,144**	242,371	216,153
Average rates:			
Gross yield on interest-earning assets[1] %	**6.44**	5.82	5.72
Interest spread[2] %	**2.20**	2.00	2.30
Net interest margin[3] %	**2.33**	2.20	2.52
Margin excluding average balances held under reverse repurchase agreements[4]:			
Net interest income £m	**6,099**	5,329	5,443
Average interest-earning assets £m	**248,233**	226,990	201,813
Net interest margin %	**2.46**	2.35	2.70

Certain fees payable by the Lloyds TSB Group s asset finance business have been reclassified from other income to interest income as part of the effective yield of the related lending; there is no impact upon profit before tax. Comparative figures have been restated accordingly.

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 (2007: £13,911 million; 2006: £15,381 million; 2005: £14,340 million).

2007 compared to 2006

Net interest income increased by £770 million, or 14 per cent, to £6,099 million in 2007 compared to £5,329 million in 2006. Within the insurance and investment businesses, net interest income was higher as a result of a decrease 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. For the rest of the Lloyds TSB Group, net interest income increased by £337 million, or 6 per cent, to £5,563 million in 2007 compared to £5,226 million in 2006. This increase arose principally as a result of asset growth, partially offset by lower margins as a result of tighter underwriting criteria, competitive pressures and an increase in funding costs.

Average interest-earning assets were £19,773 million, or 8 per cent, higher at £262,144 million in 2007 compared to £242,371 million in 2006. Excluding the fine margin reverse repurchase agreement assets held for liquidity purposes, average interest-earning assets were £21,243 million, or 9 per cent, higher at £248,233 million in 2007 compared to £226,990 million in 2006. Average interest-earning assets in UK Retail Banking were £5,959 million higher; average mortgage balances were £6,462 million higher, reflecting the benefit of continued net new lending over 2006 and 2007, but average balances in other personal lending have fallen as a result of the contraction in credit card outstandings. Average interest-earning assets within the insurance and investments businesses, which include the mortgage book within Scottish Widows Bank, were £697 million higher. Within Wholesale and International Banking, average interest-earning assets increased by £13,132 million, or £14,602 million excluding the fine margin reverse repurchase agreement balances. Average balances within Corporate Markets, excluding the reverse repurchase agreement balances, were £11,698 million higher as a result of continued growth in corporate lending and in the lower margin balances within the treasury and structured finance areas. Continued growth in lending also led to a £2,343 million increase in average balances in Commercial Banking, although average balances within Asset Finance fell slightly.

The Lloyds TSB Group s net interest margin increased by 13 basis points to 2.33 per cent in 2007, compared to 2.20 per cent in 2006; if the average balances held under reverse repurchase agreements are excluded from both years, the margin in 2007 was 11 basis points higher at 2.46 per cent compared to 2.35 per cent in 2006. Within Insurance and Investments, the net interest income consolidated in respect of policyholder items was £383 million higher in 2007, in part due to a £229 million reduction in the amounts payable to unitholders in those OEICs included in the Lloyds TSB Group s results; this increase contributed some 15 basis points to the increase in Lloyds TSB Group s net interest margin. The net interest margin in UK Retail Banking was 6 basis points lower as a result the adverse mix effect of growth in finer margin mortgages whilst the wider margin unsecured personal lending has been largely flat; product margins on a year-on-year basis fell slightly reflecting competitive pressures in the mortgage business which more than offset an increase in retail savings margins. The margin within Wholesale and International Banking, excluding the fine margin reverse repurchase agreement balances, was 4 basis points higher. Margins fell within Commercial Banking, as a result of growth being experienced in the more competitive, lower margin lending products, and in Asset Finance, as tightened underwriting criteria have led to better quality but lower margin lending; however margins within Corporate Markets improved, in part as a result of changes in funding arrangements.

Operating and financial review and prospects

2006 compared to 2005

Net interest income decreased by £114 million, or 2 per cent, to £5,329 million in 2006 compared to £5,443 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 banking and other operations increased by £178 million, or 4 per cent, to £5,226 million in 2006 compared to £5,048 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, 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 investment 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 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 an increase in average balances in Commercial Banking.

The Lloyds TSB Group s net interest margin fell by 32 basis points to 2.20 per cent in 2006, compared to 2.52 per cent in 2005; if the average balances held under reverse repurchase agreements are excluded from both years, the margin in 2006 was 35 basis points lower at 2.35 per cent compared to 2.70 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 reflected competitive pressures and the fact that growth in average interest-earning assets was within the mortgage portfolio. The margin within Wholesale and International Banking, excluding the fine margin reverse repurchase agreement balances, was 25 basis points lower; this again reflected competitive pressures and the fact that growth was 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.

Other income

	2007 £m	2006 £m	2005 £m
Fee and commission income:			
UK current account fees	**693**	652	593
Other UK fees and commissions	**1,215**	1,210	1,041
Insurance broking	**648**	629	681
Card services	**536**	493	545
International fees and commissions	**132**	132	130
	3,224	3,116	2,990
Fee and commission expense	**(600)**	(638)	(614)
Net fee and commission income	**2,624**	2,478	2,376
Net trading income	**3,123**	6,341	9,298
Insurance premium income	**5,430**	4,719	4,469
Other operating income	**952**	806	1,140
Total other income	**12,129**	14,344	17,283

Certain fees payable by the Lloyds TSB Group s asset finance business have been reclassified from other income to interest income as part of the effective yield of the related lending; there is no impact upon profit before tax. Comparative figures have been restated accordingly.

Operating and financial review and prospects

2007 compared to 2006

Other income was £2,215 million, or 15 per cent, lower at £12,129 million compared to £14,344 million in 2006.

Fee and commission income was £108 million (3 per cent) higher at £3,224 million compared to £3,116 million in 2006. UK current account fees were £41 million higher reflecting growth in added-value account fees partly offset by a reduction in returned cheque fees. Insurance broking income was £19 million higher, driven by improved creditor performance as a result of higher loan protection volumes across the branch network. Card fees were £43 million higher; merchant service charges were higher as a result of growth in the merchant base and interchange income was £20 million higher, in part due to the success of the new Airmiles Duo card. Other UK fees and commissions were £5 million higher at £1,215 million; increases in unit trust and asset management fees, factoring fees and corporate banking fees being largely offset by reduced levels of company registration fees (following the sale of Lloyds TSB Registrars) and other fees. International fees and commissions were unchanged at £132 million.

Fee and commission expense was £38 million, or 6 per cent, lower at £600 million. Increases in account fees and card fees (as a result of business volumes) have been more than offset by reductions in fees payable within the insurance businesses.

Net trading income was £3,218 million lower at £3,123 million; £2,411 million lower at £3,570 million excluding volatility. The majority of this decrease arises in the insurance businesses and represents reductions in the gains on policyholder investments that are required to be reported gross in the income statement; the period-on-period decrease is largely matched by a compensating movement within the claims figure. Trading income within the banking businesses was also impacted by the turmoil in global financial markets in the second half of 2007 which led to a reduction of £188 million, this reflected the market wide repricing of instruments for credit and liquidity risks, including those asset-backed securities carried in the Lloyds TSB Group s trading portfolio.

Insurance premium income was £711 million, or 15 per cent, higher at £5,430 million compared to £4,719 million in 2006, with life and pensions premiums being £720 million higher and general insurance premiums £9 million lower at £591 million. The increase in life and pensions premiums reflects higher single and regular premiums for the pensions business (including the new corporate pension product) plus the launch of a new protection product.

Other operating income was £146 million, or 18 per cent, higher at £952 million compared to £806 million in 2006. The movement in value of in-force business improved to a reduction of £93 million compared to a reduction of £199 million in 2006, in part due to the non-repetition of the charge arising from the introduction of new FSA valuation rules in 2006. Reductions in operating lease rental income and in income from investment property were more than offset by increases in other non-fee income.

2006 compared to 2005

Other income was £2,939 million, or 17 per cent, lower at £14,344 million in 2006 compared to £17,283 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 reflected a change in mix of added-value accounts, as customers increasingly opened 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 reflected 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 reflected 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 reflected 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 £24 million, or 4 per cent, higher at £638 million in 2006, compared to £614 million in 2005. 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 but this decrease, however, was 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 related 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 reflected 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.

Operating and financial review and prospects

Operating expenses

	2007 £m	2006 £m	2005 £m
Administrative expenses:			
Staff:			
Salaries	**2,127**	2,117	2,068
National insurance	**167**	161	154
Pensions, net of pension schemes related credit	**238**	165	308
Other staff costs	**372**	298	325
	2,904	2,741	2,855
Premises and equipment:			
Rent and rates	**304**	310	305
Hire of equipment	**16**	15	13
Repairs and maintenance	**154**	165	136
Other	**145**	149	152
	619	639	606
Other expenses:			
Communications and external data processing	**462**	499	467
Advertising and promotion	**192**	184	207
Professional fees	**279**	231	216
Provisions for customer redress			150
Settlement of overdraft claims	**76**		
Other	**405**	388	325
	1,414	1,302	1,365
Administrative expenses	**4,937**	4,682	4,826
Depreciation of tangible fixed assets	**594**	602	621
Amortisation of intangible assets	**36**	17	18
Impairment of goodwill			6
Total operating expenses	**5,567**	5,301	5,471
Cost: income ratio (%)*	**52.0**	47.7	51.9

Following changes in age discrimination legislation in the United Kingdom in 2006, the Lloyds TSB Group ceased to augment the pension entitlement of employees taking early retirement. This change resulted in a credit to the income statement in 2006 of £128 million (2007: £nil; 2005: £nil).

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

2007 compared to 2006

Operating expenses were £266 million, or 5 per cent, higher at £5,567 million compared to £5,301 million in 2006. Operating expenses in 2007 and 2006 were, however, particularly impacted by two items. The 2007 results include a charge of £76 million relating to the settlement of overdraft claims during the year, together with related costs. In 2006, there was a credit to pension costs of £128 million because, following changes in age discrimination legislation, the Lloyds TSB Group took the decision to cease to augment the pension entitlement of employees taking early retirement. If both the settlement of overdraft claims in 2007 and the pension credit in 2006 are excluded, operating expenses were £62 million, or 1 per cent, higher at £5,491 million in 2007 compared to £5,429 million in 2006.

Staff costs were £163 million, or 6 per cent, higher at £2,904 million. However, excluding the £128 million pension schemes related credit from 2006, staff costs were £35 million, or 1 per cent, higher. Salaries were £10 million higher at £2,127 million; the decrease in costs resulting from the sale of businesses during 2007 and ongoing reductions in staff numbers has been more than offset by annual pay awards and increased bonus and incentive costs. National insurance costs were £6 million, or 4 per cent, higher at £167 million compared to £161 million in 2006. Pension costs were £73 million, or 44 per cent, higher at £238 million compared to £165 million in 2006. Excluding the one-off credit of £128 million from 2006, pension costs in 2007 were £55 million, or 19 per cent, lower than the underlying charge in 2006; this reduction reflects a £55 million reduction in the IAS 19 regular cost resulting from improved asset values at the end of 2006 and increased rates of return in 2007. A small reduction in past service costs has been offset by a £7 million increase in defined contribution costs. Other staff costs were £74 million, or 25 per cent, higher at £372 million compared to £298 million in 2006; an increase in agency staff costs (used to cover specific project work), has been combined with a small increase in training costs, an increase in redundancy costs (due to various restructuring initiatives) and general increases in other staff related expenditure.

Premises and equipment costs were £20 million, or 3 per cent, lower at £619 million in 2007 compared to £639 million in 2006. Repairs and maintenance expenditure was £11 million lower in 2007, due to savings on renegotiation of various contracts; other premises and equipment costs were £4 million lower and there was a small reduction in rental costs.

Other costs were £112 million, or 9 per cent, higher at £1,414 million, although excluding the charge of £76 million in respect of the settlement of overdraft claims other costs in 2007 were £36 million, or 3 per cent, higher at £1,338 million. Communications and external data processing costs were £37 million, or 7 per cent, lower at £462 million compared to £499 million in 2006 as a result of efficiency initiatives, successful contract renegotiation and supplier rationalisation. Advertising and promotion costs were £8 million, or 4 per cent, higher at £192 million compared to £184 million in 2006, in part due to increased expenditure relating to the Lloyds TSB Group s sponsorship of the London 2012 Olympics. Professional fees were £48 million, or 21 per cent, higher at £279 million compared to £231 million in 2006 due to significant expenditure on a number of projects including the transfer of the mortgage lending and deposits of Lloyds TSB Bank plc s subsidiary, Cheltenham & Gloucester plc, into Lloyds TSB Bank plc, and further mortgage securitisations. Other costs were £17 million, or 4 per cent, higher at £405 million compared to £388 million in 2006 as an increase in the charge in respect of deferred acquisition costs in the insurance businesses, reflecting a change in mix of new business and the impact of changes in assumptions, was only partly offset by reductions in stationery and other costs.

Depreciation and amortisation was £11 million, or 2 per cent, higher at £630 million compared to £619 million in 2006. There was a small decrease in the charge in respect of operating lease assets, following a restructuring of the Group s lease arrangements, and a reduction in the charge relating to other premises and equipment; but these decreases were more than offset by an increase of £19 million in the charge in respect of software and other intangible assets, in part reflecting the customer list acquired at the end of 2006.

The cost: income ratio was 52.0 per cent in 2007 compared to 47.7 per cent in 2006.

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 impacted the comparison of operating expenses in 2006 to 2005. In 2006, following changes in age discrimination legislation in the United Kingdom, the Lloyds TSB Group ceased 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 reflected 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 redress 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 moved 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 reflected 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.

Operating and financial review and prospects

Impairment

	2007 **£m**	2006 £m	2005 £m
Impairment losses on loans and advances	**1,721**	1,560	1,302
Other credit risk provisions	**5**	(5)	(3)
	1,726	1,555	1,299
Impairment of available-for-sale financial assets	**70**		
Total impairment charged to income statement	**1,796**	1,555	1,299

Impairment losses on loans and advances	**2007** **£m**	2006 £m	2005 £m
UK Retail Banking	**1,224**	1,238	1,111
Wholesale and International Banking	**497**	313	191
Central group items		9	
Total charge for impairment losses on loans and advances	**1,721**	1,560	1,302
	%	%	%
Charge for impairment losses on loans and advances as a percentage of average lending	**0.84**	0.83	0.76

2007 compared to 2006

The impairment charge in the income statement was £241 million, or 15 per cent, higher at £1,796 million in 2007 compared to £1,555 million in 2006. This comprised a charge of £1,721 million (2006: £1,560 million) in respect of impairment losses on loans and advances, a charge of £70 million (2006: £nil) in respect of the impairment of available-for-sale financial assets and a charge of £5 million (2006: a credit of £5 million) in respect of other credit risk provisions.

The impairment charge in respect of loans and advances was £161 million, or 10 per cent, higher at £1,721 million compared to £1,560 million in 2006.

In UK Retail Banking the charge reduced by £14 million, or 1 per cent, to £1,224 million from £1,238 million in 2006, resulting in a charge as a percentage of average lending of 1.10 per cent compared to 1.18 per cent in 2006. For personal loans and overdrafts the charge reduced by £61 million, or 8 per cent, reflecting favourable collections experience and improved quality in new business. The charge for the credit card portfolio increased by £37 million, or 8 per cent, from £490 million in 2006 to £527 million in 2007 following a higher level of write-offs and lower recoveries. There has been a charge of £18 million in the mortgage book, compared to £8 million in 2006, reflecting the impact of changes in house price indices and higher write-offs.

In Wholesale and International Banking the charge increased by £184 million, or 59 per cent, from £313 million in 2006 to £497 million in 2007 and the charge as a percentage of average lending was 0.57 per cent compared to 0.39 per cent in 2006. In Corporate Markets the charge was £179 million higher, at £165 million compared to a release of £14 million in 2006; 2006 saw a number of releases, whereas in 2007 there were significant new charges for certain Corporate customers as well as a charge of £28 million in the leasing business resulting from the change in the UK Corporation tax rate from 30 per cent to 28 per cent. In Asset Finance the charge was £11 million lower, at £228 million, following a tightening of underwriting criteria. In Commercial Banking the charge was £5 million higher, at £99 million, and in International Banking and other businesses there was a charge of £5 million compared with a release of £6 million in 2006.

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 0.84 per cent compared to 0.83 per cent in 2006.

A charge of £70 million in 2007 (2006: £nil) arose in respect of the impairment of certain asset-backed security collateralised debt obligations held as available-for-sale financial assets.

Operating and financial review and prospects

2006 compared to 2005

The impairment charge was £256 million, or 20 per cent, higher at £1,555 million in 2006 compared to £1,299 million in 2005. This represented 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 reflected 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 remained 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 represented 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, as some significant one-off releases in 2005 were not repeated. The charge within Commercial Banking was higher, reflecting business growth; and in Asset Finance rising levels of consumer arrears and voluntary terminations led to an increase in the impairment charge.

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.

Taxation

	2007 £m	2006 £m	2005 £m
UK corporation tax:			
Current tax on profits for the year	**763**	1,024	862
Adjustments in respect of prior years	**(30)**	(137)	(20)
	733	887	842
Double taxation relief	**(60)**	(195)	(138)
	673	692	704
Foreign tax:			
Current tax on profits for the year	**98**	83	78
Adjustments in respect of prior years	**(3)**	(8)	(8)
	95	75	70
Current tax charge	**768**	767	774
Deferred tax	**(89)**	574	491
Total charge	**679**	1,341	1,265

2007 compared to 2006

The rate of tax is influenced by the geographic and business mix of profits. The effective rate of tax in 2007 was 17.0 per cent, compared to an effective rate of tax in 2006 of 31.6 per cent and the corporation tax rate in 2007 of 30 per cent (2006: 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. The effective rate in 2007 is also particularly distorted by substantial profits on disposal of businesses, on which no tax charge has arisen, and the impact on the tax charge of the 2007 Finance Act reduction in the corporation tax rate from 30 per cent to 28 per cent, as a result of which the Lloyds TSB Group s deferred tax liabilities have been remeasured leading to a credit to the Group s tax charge of £110 million. Excluding these items the effective tax rate in 2007 was 28.3 per cent compared to 28.0 per cent in 2006. The increased effective tax rate in 2007 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.

2006 compared to 2005

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). Excluding the tax attributable to UK life insurance policyholder earnings and the Lloyds TSB Group s interests in OEICs, 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 reflected normal fluctuations in disallowed and non-taxable items.

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 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.

	2007 £m	2006 £m	2005 £m
Average shareholders equity	**11,681**	10,531	9,747

Profit before tax	**4,000**	4,248	3,820
Taxation	**(679)**	(1,341)	(1,265)
Profit attributable to minority interests	**(32)**	(104)	(62)
Profit attributable to equity shareholders	**3,289**	2,803	2,493
Less: notional charge for the cost of equity	**(1,051)**	(948)	(877)
Economic profit	**2,238**	1,855	1,616

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

2007 compared to 2006

Economic profit increased to £2,238 million in 2007 compared to £1,855 million in 2006. Profit attributable to equity shareholders increased by £486 million, or 17 per cent, to £3,289 million; the notional charge on average equity was £103 million higher, as a result of an 11 per cent increase in average equity to £11,681 million compared to £10,531 million in 2006. The increase in average equity primarily reflects profit retentions, after dividends, over 2006 and 2007.

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.

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, which arises solely within the Insurance and Investments business. See page 36 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)**		
	2007 £m	2006 £m	2005 £m	**2007 £m**	2006 £m	2005 £m
UK Retail Banking	**1,732**	1,549	1,394	**1,732**	1,549	1,394
Insurance and Investments	**828**	1,383	1,474	**1,328**	973	725
Wholesale and International Banking	**1,822**	1,640	1,518	**1,822**	1,640	1,518
Central group items	**(382)**	(324)	(566)	**(382)**	(324)	(566)
Profit before tax, excluding volatility				**4,500**	3,838	3,071
Volatility				**(500)**	410	749
Profit before tax	**4,000**	4,248	3,820	**4,000**	4,248	3,820

UK Retail Banking

	2007 £m	2006 £m	2005 £m
Net interest income	**3,783**	3,642	3,521
Other income	**1,797**	1,621	1,605
Total income	**5,580**	5,263	5,126
Operating expenses	**(2,624)**	(2,476)	(2,697)
Trading surplus	**2,956**	2,787	2,429
Impairment	**(1,224)**	(1,238)	(1,111)
Profit on sale of businesses			76

Profit before tax	**1,732**	1,549	1,394
Cost:income ratio	**47.0%**	47.0%	52.6%
Total assets (year end)	**£115,012m**	£108,381m	£103,930m
Total risk-weighted assets (year end)	**£61,713m**	£59,101m	£60,582m

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

Operating and financial review and prospects

2007 compared to 2006

Profit before tax from UK Retail Banking increased by £183 million, or 12 per cent, to £1,732 million in 2007 compared to £1,549 million in 2006. Profit before tax included the cost of the settlement of overdraft claims (2007: £76 million; 2006: £nil); excluding this item, profit before tax in 2007 of £1,808 million was £259 million, or 17 per cent, higher than £1,549 million in 2006.

Net interest income was £141 million, or 4 per cent, higher at £3,783 million in 2007 compared with £3,642 million in 2006. Average interest-earning assets were £5,959 million, or 6 per cent higher at £110,894 million in 2007 compared to £104,935 million in 2006. Average mortgage balances were £6,462 million higher in 2007. Gross new mortgage lending for the Lloyds TSB Group totalled £29,431 million (2006: £27,599 million); net new lending totalled £6,647 million (2006: £6,957 million) resulting in a market share of net new mortgage lending of 6.2 per cent (2006: 6.3 per cent). Average balances in respect of other personal lending were £266 million lower reflecting a slow down in consumer demand, particularly with regard to credit cards. Credit card balances at 31 December 2007 were 4 per cent lower at £6,584 million compared to £6,877 million at 31 December 2006, whilst period end balances on personal loans were 1 per cent higher at £11,238 million at the end of 2007. Credit balances on savings and investment accounts at 31 December 2007 were 8 per cent higher at £82,081 million compared to £75,661 million at 31 December 2006. The effect of volume growth was, however, partly offset by a 6 basis point decrease in the net interest margin as a result of competitive pressures and an adverse mix effect, as most of the asset growth has been in the relatively lower margin mortgage sector.

Other income was £176 million, or 11 per cent, higher at £1,797 million compared to £1,621 million in 2006. The increase arises from growth in fee-earning added-value current accounts and income from debit cards as well as higher insurance commissions, partially offset by lower income from mortgages following changes in the structure of fees charged on closing a mortgage account and lower late payment charges in credit cards. There has also been an increase in wealth management fee income.

Operating expenses were £148 million higher at £2,624 million in 2007 compared with £2,476 million in 2006; this comparison includes the cost of the settlement of overdraft claims (2007: £76 million; 2006: £nil). Excluding this item, operating expenses were £72 million, or 3 per cent, higher at £2,548 million. Improvements have been made in the rationalisation of back office operations to improve efficiency and the Group continues to increase the proportion of front office to back office staff in the branch network. The cost:income ratio was 47.0 per cent (2006: 47.0 per cent), or 45.7 per cent excluding the cost of the settlement of overdraft claims.

The impairment charge on loans and advances of £1,224 million was £14 million, or 1 per cent, lower than the £1,238 million in 2006. The charge in respect of personal loans and overdrafts was £61 million, or 8 per cent, lower at £679 million compared to £740 million in 2006 and represented 5.32 per cent of average lending (2006: 5.85 per cent); and the charge in respect of card balances was £37 million, or 8 per cent, higher at £527 million compared with £490 million in 2006. The impairment charge in Mortgages was £18 million (2006: £8 million), or 2 basis points of average mortgage lending.

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 included, 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.

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 were £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 reflected 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 represented net fee and commission income; the moderate growth reflected 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 had been partly offset by a reduction in card fee income following the sale of the Goldfish portfolio at the end of 2005. There was also 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 included, 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 reflected 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 reflected 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 remained good and there was an impairment charge of £8 million in 2006 compared to £13 million in 2005.

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, general insurance underwriting and broking, and Scottish Widows Investment Partnership. The Group sold Abbey Life in the second half of 2007.

In addition to presenting Insurance and Investments results prepared in accordance with IFRS, all monthly financial reporting to the group executive committee and board presents separately the results of these 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 the Group s use of volatility is provided in Operating and financial review and prospects Line of business information Volatility .

	Statutory			**Excluding volatility**		
	2007 £m	2006 £m	2005 £m	**2007 £m**	2006 £m	2005 £m
Net interest income	**536**	103	395	**529**	134	389
Other income	**8,197**	10,487	13,859	**8,704**	10,046	13,116
Total income	**8,733**	10,590	14,254	**9,233**	10,180	13,505
Insurance claims	**(7,522)**	(8,569)	(12,186)	**(7,522)**	(8,569)	(12,186)
Total income, net of insurance claims	**1,211**	2,021	2,068	**1,711**	1,611	1,319
Operating expenses	**(655)**	(638)	(594)	**(655)**	(638)	(594)
Trading surplus	**556**	1,383	1,474	**1,056**	973	725
Profit on sale of businesses	**272**			**272**		
Profit before tax, excluding volatility				**1,328**	973	725
Volatility				**(500)**	410	749
Profit before tax	**828**	1,383	1,474	**828**	1,383	1,474
Further analysis of other income:						
Net fee and commission expense	**(94)**	(125)	(112)	**(94)**	(125)	(112)
Net trading income	**2,603**	5,668	8,859	**3,050**	5,308	8,375
Insurance premium income	**5,430**	4,719	4,469	**5,430**	4,719	4,469
Other operating income	**258**	225	643	**318**	144	384
Other income, excluding volatility				**8,704**	10,046	13,116
Volatility				**(507)**	441	743
Other income	**8,197**	10,487	13,859	**8,197**	10,487	13,859
Analysis by area of business of profit before tax						
Life, pensions and OEICs	**663**	1,093	1,221	**1,156**	701	500
General insurance	**121**	261	237	**128**	243	209
Scottish Widows Investment Partnership	**44**	29	16	**44**	29	16
Profit before tax, excluding volatility				**1,328**	973	725

Volatility				**(500)**	410	749
Profit before tax	**828**	1,383	1,474	**828**	1,383	1,474

Operating and financial review and prospects

2007 compared to 2006

Profit before tax from the Lloyds TSB Group s Insurance and Investments business was £555 million, or 40 per cent, lower at £828 million compared to £1,383 million in 2006. 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 £355 million, or 36 per cent, higher at £1,328 million in 2007 compared to £973 million in 2006. Profit before tax in 2007 includes £272 million profit on the disposal of Abbey Life at the end of September 2007.

Net interest income was £433 million higher at £536 million in 2007 compared to £103 million in 2006. This increase is primarily as a result of a decrease in the amounts payable to unitholders in those OEICs included in the consolidated results of the Group together with an increase in the level of interest income on cash deposit investments held in the long-term business and policyholder funds.

Other income was £2,290 million, or 22 per cent, lower at £8,197 million in 2007 compared to £10,487 million in 2006; excluding volatility, other income was £1,342 million, or 13 per cent, lower at £8,704 million in 2007 compared to £10,046 million in 2006. Net fee and commission expense was £31 million, or 25 per cent, lower at £94 million in 2007 compared to £125 million in 2006 partly reflecting an increase in general insurance broking income. Net trading income was £3,065 million, or 54 per cent, lower at £2,603 million in 2007 compared to £5,668 million in 2006, reflecting fluctuations in the level of investment returns within the long-term business funds. Insurance premium income was £711 million, or 15 per cent, higher at £5,430 million in 2007 compared to £4,719 million in 2006, of which, life and pensions premiums were £720 million higher as a result of the increased level of business written under contracts categorised as insurance. Other operating income was £33 million, or 15 per cent, higher at £258 million in 2007 compared to £225 million in 2006.

Operating expenses were £17 million, or 3 per cent, higher at £655 million in 2007 compared to £638 million in 2006. The reduction in staff costs resulting from a year-on-year reduction in staff numbers has been offset by the impact of annual salary increases, a higher net charge in respect of amortisation of deferred acquisition costs and an increased charge for depreciation and amortisation.

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

2006 compared to 2005

Profit before tax from the Lloyds TSB Group s Insurance and Investments business 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 reflected 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 reflected 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 reflected 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 was, 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).

Operating and financial review and prospects

Life, pensions and OEICs

The table below shows the measure of new business premiums for the life and pensions business and OEIC sales which management monitor because it provides an indication of both the performance and the profitability of the business 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. 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)	**2007 £m**	2006 £m	2005 £m
Life and pensions:			
Protection	**960**	232	255
Savings and investments	**913**	1,300	1,465
Individual pensions	**2,073**	2,219	2,197
Corporate and other pensions	**2,141**	1,961	1,517
Retirement income	**1,044**	960	658
Managed fund business	**486**	348	535
Life and pensions	**7,617**	7,020	6,627
OEICs	**2,807**	2,720	1,215
Life, pensions and OEICs	**10,424**	9,740	7,842
Single premium business	**8,375**	7,321	5,636
Regular premium business	**2,049**	2,419	2,206
Life, pensions and OEICs	**10,424**	9,740	7,842
Bancassurance	**4,096**	3,421	2,114
Independent financial advisers	**5,817**	5,706	5,233
Direct	**511**	613	495
Life, pensions and OEICs	**10,424**	9,740	7,842

2007 compared to 2006

Overall life, pensions and OEICs sales were £684 million, or 7 per cent, higher at £10,424 million in 2007 compared to £9,740 million in 2006.

The majority of the growth was in life and pension sales (including Managed fund business) which were £597 million, or 9 per cent, higher at £7,617 million in 2007 compared with £7,020 million in 2006. A key growth area in 2007 was Protection where sales increased by £728 million reflecting the launch of the Protection for Life proposition in all sales channels and the introduction, in 2007, of underwriting the life element of the creditor insurance and protection product, within Bancassurance. Additionally, corporate pension sales were £180 million, or 9 per cent, higher reflecting increased incremental premiums in 2007. These increases were, however, in part offset by a decrease of £387 million in Savings and investments sales largely due to a sharp decline in IFA Flexible Option Bond sales following property fund restrictions and increasing competition in the marketplace.

OEICs sales increased £87 million, or 3 per cent, in 2007 to £2,807 million compared to £2,720 million in 2006. The growth in OEICs sales reflects increased sales capabilities within the Bancassurance channel and, in particular, continued development of the relationships with the Community Banking and Wealth Management businesses within UK Retail Banking.

By distribution channel, Bancassurance sales were £675 million, or 20 per cent, higher at £4,096 million in 2007 compared to £3,421 million in 2006, as a result of continuing development of the relationships with the Community Banking and Wealth Management businesses. Sales via independent financial advisers were £111 million, or 2 per cent, higher at £5,817 million in

2007 compared to £5,706 million in 2006.

Profit before tax, on a statutory basis, from life, pensions and OEICs was £430 million, or 39 per cent, lower at £663 million in 2007 compared to £1,093 million in 2006. Excluding volatility, profit before tax was £455 million, or 65 per cent, higher at £1,156 million in 2007 compared to £701 million in 2006. Profit before tax in 2007 includes £272 million profit on disposal of Abbey Life. A slight reduction in new business profit resulted from a change in the mix of investment products sold through Bancassurance towards non-embedded value accounted products; however this was offset by increased existing business profit, partly reflecting a reduction in adverse assumption changes compared to 2006, and an improved expected return on shareholders net assets.

Operating and financial review and prospects

2006 compared to 2005

Overall life, pensions and OEICs sales 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 reflected 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 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) 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 reflected competitive pressures and the limiting of investments into the SWIP Property Fund; Managed fund business was 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 £473 million, or 9 per cent, higher at £5,706 million in 2006 compared to £5,233 million in 2005; this reflected 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 and in managed fund business.

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.

General insurance

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

	Statutory			Excluding volatility		
	2007 £m	2006 £m	2005 £m	**2007 £m**	2006 £m	2005 £m
Net interest income	**23**	24	23	**23**	24	23
Other income	**554**	594	571	**561**	576	543
Total income	**577**	618	594	**584**	600	566
Insurance claims	**(302)**	(200)	(197)	**(302)**	(200)	(197)
Total income, net of insurance claims	**275**	418	397	**282**	400	369
Operating expenses	**(154)**	(157)	(160)	**(154)**	(157)	(160)
Profit before tax, excluding volatility				**128**	243	209
Volatility				**(7)**	18	28

Profit before tax	**121**	261	237	**121**	261	237

	2007 £m	2006 £m	2005 £m
Premium income from underwriting:			
Creditor	**164**	180	127
Home	**441**	424	441
Health	**9**	13	16
Reinsurance premiums	**(23)**	(17)	(22)
	591	600	562
Commissions from insurance broking:			
Creditor	**394**	377	396
Home	**49**	47	49
Health	**12**	13	15
Other	**193**	192	221
	648	629	681

Operating and financial review and prospects

2007 compared to 2006

Profit before tax, on a statutory basis, from the Lloyds TSB Group s general insurance operations was £140 million, or 54 per cent, lower at £121 million in 2007 compared to £261 million in 2006. Excluding volatility, profit before tax was £115 million, or 47 per cent, lower at £128 million in 2007 compared to £243 million in 2006.

Net interest income was £1 million, or 4 per cent, lower at £23 million in 2007 compared to £24 million in 2006.

Other income, on a statutory basis, was £40 million, or 7 per cent, lower at £554 million in 2007 compared to £594 million in 2006. Insurance broking commissions receivable were £19 million, or 3 per cent, higher at £648 million in 2007 compared to £629 million in 2006; this is driven primarily by improved Creditor performance (up £17 million in 2007) and reflects higher loan protection sales volumes across the UK Retail Banking branch network. Underwriting income, net of reinsurance, was £9 million, or 2 per cent, lower at £591 million in 2007 compared to £600 million in 2006; increased income in respect of home insurance policies has been more than offset by reductions in respect of creditor protection products, partly due to lower average card balances, and an increased reinsurance cost. Fees and commissions payable were £28 million, or 4 per cent, higher at £692 million in 2007 compared to £664 million in 2006; this largely reflects fluctuations in branch network sales volumes.

Insurance claims expense was £102 million, or 51 per cent, higher at £302 million in 2007 compared to £200 million in 2006 largely as a result of a £113 million increase in weather related claims, resulting from storms in January 2007 and severe flooding in June and July 2007 in the UK.

Operating expenses were £3 million, or 2 per cent, lower at £154 million in 2007 compared to £157 million in 2006 reflecting continued focus on improving operational costs and processing efficiency.

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 reflected 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 reflected 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 reflected 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 was 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 increased due to the use of agency staff on project work, but this was more than offset by lower marketing expenditure and other cost-saving initiatives.

Wholesale and International Banking

	2007 £m	2006 £m	2005 £m
Net interest income	**2,518**	2,177	2,037
Other income	**1,773**	2,035	1,856

Total income	**4,291**	4,212	3,893
Operating expenses	**(2,282)**	(2,264)	(2,181)
Trading surplus	**2,009**	1,948	1,712
Impairment	**(572)**	(308)	(188)
Profit (loss) on sale of businesses	**385**		(6)
Profit before tax	**1,822**	1,640	1,518
Cost:income ratio	**53.2%**	53.8%	56.0%
Total assets (year end)	**£163,294m**	£147,836m	£124,044m
Total risk-weighted assets (year end)	**£105,145m**	£91,843m	£80,154m

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

33

Operating and financial review and prospects

2007 compared to 2006

Profit before tax from Wholesale and International Banking was £182 million, or 11 per cent, higher at £1,822 million in 2007 compared to £1,640 million in 2006. However, in 2007 profit before tax was particularly impacted by the profit on sale of businesses of £385 million (principally relating to Lloyds TSB Registrars) and by turbulence in global financial markets which reduced profit before tax by £280 million. Excluding both of these items, profit before tax in 2007 was £1,717 million which was £77 million, or 5 per cent, higher than 2006.

Net interest income was £341 million, or 16 per cent, higher at £2,518 million compared to £2,177 million in 2006. This increase reflected growth in customer lending and customer deposits in Corporate Markets and Commercial Banking. Average interest-earning assets were £13,132 million, or 11 per cent, higher at £135,707 million. Excluding the fine margin reverse repurchase agreement balances from both years, the increase was £14,602 million. The net interest margin, again excluding the fine margin reverse repurchase agreement balances, increased by 4 basis points, as a widening of margins within Corporate Markets, in part as a result of changes in funding arrangements, was partly offset by decreased margins in Commercial Banking, where growth has been in the most competitive products, and in Asset Finance.

Other income was £262 million, or 13 per cent, lower at £1,773 million compared to £2,035 million in 2006; of this movement a decrease of £188 million is attributable to the impact of the market turbulence, excluding which, other income decreased by £74 million, or 4 per cent. Increases in banking and transactional income were offset by a reduced level of company registration fees (following the sale of Lloyds TSB Registrars at the end of September 2007) and the impact of changes in funding arrangements.

Operating expenses were £18 million, or 1 per cent, higher at £2,282 million in 2007 compared to £2,264 million in 2006. The increase reflected continued staff investment particularly in the Corporate Markets and Commercial Banking businesses, offset by improvements in the management of day-to-day operating costs.

The impairment charge in 2007 totalled £572 million, of which £92 million is attributable to the impact of market turbulence, compared to £308 million in 2006, an increase of £264 million, or 86 per cent. The charge in respect of loans and advances increased by £184 million, or 59 per cent, from £313 million in 2006 to £497 million in 2007 and the charge as a percentage of average lending was 0.57 per cent compared to 0.39 per cent in 2006. In Corporate Markets the charge was £179 million higher, at £165 million compared to a release of £14 million in 2006; there were significant new charges for certain Corporate customers as well as a charge of £28 million in the leasing business resulting from the change in the UK Corporation tax rate from 30 per cent to 28 per cent in 2007, whereas there were net releases in 2006. In Commercial Banking the charge was £5 million higher, at £99 million, and in Asset Finance the charge was £11 million lower, at £228 million, following a tightening of underwriting criteria. In International Banking and other businesses there was a charge of £5 million compared with a release of £6 million in 2006. In addition, a charge of £70 million in 2007 (2006: £nil) arose in respect of the impairment of available-for-sale financial assets.

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 £140 million, or 7 per cent, higher at £2,177 million compared to £2,037 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 in average balances within Corporate Markets. Continued lending growth led to an increase in average balances within Commercial Banking and average interest-earning assets in Asset Finance were also higher, largely due to lending growth over 2005. The significant growth in average balances, however, was partly offset by a 25 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 predominantly in corporate lending and in the finer margin treasury and structured finance balances.

Other income was £179 million, or 10 per cent, higher at £2,035 million compared to £1,856 million in 2005. Other income largely comprised 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. There was a slight fall in operating lease rental income offset by increased gains on sale of available-for-sale investments.

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 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 were lower than in 2005, as some significant one-off releases were not repeated. Within Commercial Banking, the charge was higher, as a result of lending growth. The charge within Asset Finance also increased reflecting rising levels of consumer arrears and voluntary terminations. 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.

Operating and financial review and prospects

Central group items

	2007 £m	2006 £m	2005 £m
Lloyds TSB Foundations	**(37)**	(37)	(34)
Funding cost of acquisitions less earnings on capital[1]	**(378)**	(378)	(378)
Central costs and other unallocated items[2]	**33**	(37)	(134)
Pension schemes related credit		128	
Loss on sale and closure of businesses			(20)
Loss before tax	**(382)**	(324)	(566)

No volatility arises within Central group items and so these results are both statutory and excluding volatility.

1 These comprise:

- interest costs on central balances, which principally arise from the cost of centrally funded acquisitions net of the proceeds of any subsequent disposals, together with the funding cost of dividend flows;
- net interest margin cost resulting from central capital activities, primarily arising on the management of subordinated debt and preference shares; and
- earnings allocated to the UK banking businesses on equity required to support their current activities offset by the income on actual equity held in those businesses.

2 These relate to the on-going costs of central group activities including those of group corporate treasury (including the central hedge function), internal group audit, group risk, group compliance, group finance and group IT and operations.

2007 compared to 2006

The loss before tax from Central group items was £58 million, or 18 per cent, higher at £382 million in 2007 compared to £324 million in 2006.

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 2007, 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 there was a £33 million credit in respect of central costs and other unallocated items compared to a charge of £37 million in 2006. The increase in loss before tax, however, arises from the non-repetition of the pension schemes related credit of £128 million in 2006; following changes in age discrimination legislation in the United Kingdom that year, the Lloyds TSB Group ceased to augment the pension entitlement of employees taking early retirement, leading to a credit to the income statement.

2006 compared to 2005

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. In 2006, the Lloyds TSB Group accrued £37 million for payment to registered charities. The charge in respect of the funding cost of acquisitions, less earnings on capital, was unchanged at £378 million and a £97 million decrease in the charge in respect of central costs and other unallocated items was coupled with the non-repetition of the loss on sale and closure of businesses. The main reason for the overall reduction in the loss before tax, however, was the pension schemes related credit of £128 million in 2006.

Operating and financial review and prospects

Volatility

	2007 £m	2006 £m	2005 £m
Insurance volatility	**(267)**	84	438
Policyholder interests volatility	**(233)**	326	311
Total volatility	**(500)**	410	749

All volatility is 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) Insurance volatility impacts on the Lloyds TSB Group s regulatory capital position, even though it is 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.

Banking volatility

Since the introduction of IFRS in 2005, in order to provide a clearer view of the underlying performance of the business, the Lloyds TSB Group has separately disclosed within Central group items the effects of marking-to-market derivatives held for risk management purposes. This amount, net of the effect of the Lloyds TSB Group s IAS 39 compliant hedge accounting relationships, was previously disclosed as banking volatility.

The use of fair values in financial reporting is now more widespread and there is a better understanding of their effects; consequently, in line with evolving best practice, the Lloyds TSB Group no longer considers it appropriate to disclose banking volatility separately. Divisions will continue to transfer, through the Lloyds TSB Group s internal transfer pricing arrangements, to Group Corporate Treasury (included in Central group items) the movements in the market value of hedging derivatives where the impact is not locally managed.

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, including market spreads reflecting credit risk premia, are also included within insurance volatility. These market credit spreads represent the gap between the yield on corporate bonds and the yield on government bonds, and reflect the market s assessment of credit risk. Changes in the credit spreads affect the value of the in-force business asset in respect of the annuity portfolio.

Operating and financial review and prospects

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:

	2008	2007	2006	2005
	%	%	%	%
Gilt yields (gross)	**4.55**	4.62	4.12	4.57
Equity returns (gross)	**7.55**	7.62	6.72	7.17
Dividend yield	**3.00**	3.00	3.00	3.00
Property return (gross)	**7.55**	7.62	6.72	7.17
Corporate bonds (gross)	**5.15**	5.22	4.72	5.17

During 2007, profit before tax included negative insurance volatility of £267 million, being a credit of £7 million to net interest income and a charge of £274 million to other income (2006: positive volatility of £84 million, being a credit of £2 million to net interest income and a credit of £82 million to other income; 2005: positive volatility of £438 million, being a credit of £6 million to net interest income and a credit of £432 million to other income). During 2007, the effect of widening credit risk spreads and falling gilt values more than offset the favourable impact of a modest increase in equity values and changes in market consistent assumptions. During 2006 increases in equity values were partly offset by lower gilt values.

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 2007, profit before tax included negative policyholder interests volatility of £233 million, being a charge to other income (2006: positive volatility of £326 million, being a charge of £33 million to net interest income and a credit of £359 million to other income; 2005: positive volatility of £311 million, being a credit to other income). In 2007, substantial policyholder tax losses have been generated as a result of a fall in property, gilt and bond values. These losses reduce future policyholder tax liabilities and have led to a policyholder tax credit during the year. Profits were recognised in 2006 as a result of positive market movements combined with realised gains in the holdings in property investment vehicles majority owned by the long-term assurance funds.

Operating and financial review and prospects

Average balance sheet and net interest income

	2007 Average balance £m	2007 Interest income £m	2007 Yield %	2006 Average balance £m	2006 Interest income £m	2006 Yield %	2005 Average balance £m	2005 Interest income £m	2005 Yield %
Assets									
Loans and advances to banks	39,381	2,025	5.14	38,696	1,826	4.72	33,422	1,199	3.59
Loans and advances to customers	191,802	13,209	6.89	174,870	10,853	6.21	157,417	10,028	6.37
Available-for-sale financial assets	21,473	1,038	4.83	18,380	807	4.39	14,177	508	3.58
Lease and hire purchase receivables	9,488	602	6.34	10,425	622	5.97	11,137	626	5.62
Total interest-earning assets of banking book	262,144	16,874	6.44	242,371	14,108	5.82	216,153	12,361	5.72
Total interest-earning trading securities and other financial assets at fair value through profit or loss	28,524	1,542	5.41	27,584	1,831	6.64	31,185	1,563	5.01
Total interest-earning assets	290,668	18,416	6.34	269,955	15,939	5.90	247,338	13,924	5.63
Allowance for impairment losses on loans and advances	(2,268)			(2,171)			(2,058)		
Non-interest earning assets	66,202			63,646			59,835		
Total average assets and interest income	354,602	18,416	5.19	331,430	15,939	4.81	305,115	13,924	4.56

	2007 Average interest earning assets £m	2007 Net interest income £m	2007 Net interest margin %	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 %
Average interest-earning assets and net interest income:									
Banking business	262,144	6,099	2.33	242,371	5,329	2.20	216,153	5,443	2.52
Trading securities and other financial assets at fair value through profit or loss	28,524	1,179	4.13	27,584	1,551	5.62	31,185	1,114	3.57
Net yield on interest-earning assets	290,668	7,278	2.50	269,955	6,880	2.55	247,338	6,557	2.65

Operating and financial review and prospects

	2007 Average balance £m	**2007 Interest expense £m**	**2007 Cost %**	2006 Average balance £m	2006 Interest expense £m	2006 Cost %	2005 Average balance £m	2005 Interest expense £m	2005 Cost %
Liabilities and shareholders funds									
Deposits by banks	**38,406**	**1,919**	**5.00**	36,004	1,680	4.67	27,720	953	3.44
Liabilities to banks under sale and repurchase agreements	**3,127**	**153**	**4.89**	3,907	230	5.89	4,422	258	5.83
Customer accounts	**142,048**	**5,085**	**3.58**	128,551	3,738	2.91	119,816	3,401	2.84
Liabilities to customers under sale and repurchase agreements	**95**	**2**	**2.11**	2,075	30	1.45	4,285	136	3.17
Debt securities in issue	**52,743**	**2,680**	**5.08**	42,472	1,983	4.67	30,921	1,307	4.23
Other interest-bearing liabilities	**4,551**	**195**	**4.28**	4,382	424	9.68	3,618	262	7.24
Subordinated liabilities	**13,126**	**741**	**5.65**	12,129	694	5.72	11,515	601	5.22
Total interest-bearing liabilities of banking book	**254,096**	**10,775**	**4.24**	229,520	8,779	3.82	202,927	6,918	3.42
Total interest-bearing liabilities of trading book	**9,971**	**363**	**3.64**	6,349	280	4.41	11,245	449	3.99
Total interest-bearing liabilities	**264,067**	**11,138**	**4.22**	235,869	9,059	3.84	213,542	7,367	3.45
Interest-free liabilities									
Non-interest bearing customer accounts	**3,899**			4,112			3,903		
Other interest-free liabilities	**74,628**			80,516			77,624		
Minority interests and shareholders funds	**12,008**			10,933			10,046		
Total average liabilities and interest expense	**354,602**	**11,138**	**3.14**	331,430	9,059	2.73	305,115	7,367	2.41

Loans and advances to banks and customers include impaired lending; interest on this lending 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 2007 compared with 2006 and for 2006 compared with 2005. Where variances have arisen from both changes in volume and rate these are allocated to volume.

	2007 compared with 2006 Increase/(decrease)			2006 compared with 2005 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	**199**	**35**	**164**	627	249	378
Loans and advances to customers	**2,356**	**1,166**	**1,190**	825	1,083	(258)
Available-for-sale financial assets	**231**	**150**	**81**	299	185	114
Lease and hire purchase receivables	**(20)**	**(59)**	**39**	(4)	(42)	38
Total banking book interest receivable and similar income	**2,766**	**1,292**	**1,474**	1,747	1,475	272
Total interest receivable and similar income on trading securities and other financial assets at fair value through profit or loss	**(289)**	**51**	**(340)**	268	(239)	507
Total interest receivable and similar income	**2,477**	**1,343**	**1,134**	2,015	1,236	779
Interest payable						
Deposits by banks	**239**	**120**	**119**	727	387	340
Liabilities to banks under sale and repurchase agreements	**(77)**	**(38)**	**(39)**	(28)	(30)	2
Customer accounts	**1,347**	**483**	**864**	337	254	83
Liabilities to customers under sale and repurchase agreements	**(28)**	**(42)**	**14**	(106)	(32)	(74)
Debt securities in issue	**697**	**522**	**175**	676	539	137
Other interest bearing liabilities	**(229)**	**7**	**(236)**	162	74	88
Subordinated liabilities	**47**	**56**	**(9)**	93	35	58
Total banking book interest payable	**1,996**	**1,108**	**888**	1,861	1,227	634
Total interest payable on trading and other liabilities at fair value through profit or loss	**83**	**132**	**(49)**	(169)	(216)	47
Total interest payable	**2,079**	**1,240**	**839**	1,692	1,011	681

Risk management

Risk as a strategic differentiator

The Group seeks to optimise performance by allowing divisions and business units to operate within capital and risk parameters and the Group s policy framework. They must do so in a way which is consistent with realising the Group s strategy and meets agreed business performance targets. The Group s approach to risk management seeks to ensure the business remains accountable for risk whilst also ensuring there is effective independent oversight.

During 2007, the Group has continued to focus on enhancing its 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 support the identification of opportunities as well as risks and it provides an aggregate view of the overall risk portfolio. Responsibilities and timescales at group and divisional level are clearly assigned 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.

Risk governance structures

The 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.

Board and committees

The board, assisted by its committees, the risk oversight committee, the group executive committee, and the group 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 role of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 94 and 95, and further key risk oversight roles are described on the next page.

The group executive committee, assisted by the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the effectiveness of the Group s risk management framework and the clear articulation of the Group s risk policies, whilst also reviewing the Group s aggregate risk exposures and concentrations of risk. The group executive committee s duties are described in greater detail on page 94. The group executive committee members are also members of the group business risk committee which is chaired by the group chief executive. The group asset and liability committee, which is chaired by the deputy group chief executive, includes members of the group executive committee as well as the heads of products and markets and group market risk. The group business risk committee is supported by the following:

Compliance and Operational Risk Committee

Group Credit Risk Committee

Group Change Management Committee

These committees are further supported by a number of specialist risk committees covering the Group s risk types in detail.

Group executive directors 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.

Reflecting the importance the Group places on risk management, risk is one of the five principal criteria that it includes within 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 oversight

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 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 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.

Business risk management

Line management are directly accountable for the management of risks arising from the Group s business. 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 receive regular briefings and guidance from the chief risk director to ensure awareness of the overarching risk management framework and a clear understanding of their accountabilities for risk and internal control.

All business units, divisions and group functions complete a control self-assessment annually (described on page 95), reviewing the effectiveness of their internal controls and putting in place enhancements where appropriate. Managing directors and group executive directors certify the accuracy of their assessment.

Business risk management forms part of a tiered risk management model, as shown on page 41 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.

This approach 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.

Risk management framework

The Group uses an enterprise-wide risk management framework for the identification, assessment, measurement and management of risk, designed to meet its customers needs. It seeks to maximise value for shareholders over time by aligning risk management with the corporate strategy, assess