

Cheltenham & Gloucester plc
Annual Report and Accounts 2008

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Member of Lloyds Banking Group
(Formerly Lloyds TSB Group)

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DIRECTORS' REPORT

The Directors have pleasure in presenting their report for Cheltenham & Gloucester plc for the year ended 31 December 2008.

Principal activities

The principal activities of Cheltenham & Gloucester plc (the "Company") are the arranging and administering of mortgage and savings accounts on behalf of Lloyds TSB Bank plc (the "Bank"), the immediate parent company. The Company is the Bank's mortgage expert, designing, marketing and administering mortgages for the Bank, in addition to providing mortgages and savings products with C&G branding.

The Company's subsidiaries are dormant with the exception of C&G Property Holdings Limited whose principal activity is that of property leasing to the Company.

The Company and its subsidiaries are referred to in these financial statements as "C&G" or the "Group".

Results and dividends

The consolidated profit on ordinary activities before tax for the year ended 31 December 2008 is £98 million (2007: £346 million, of which £293 million related to the banking business transferred to the Bank in the year).

Dividends of £50 million (2007: £108 million) were paid during the year. The Directors propose payment of a dividend of £65 million for the year ended 31 December 2008.

Business review and future developments

The Company's primary objectives are to ensure that mortgages and savings accounts are sold and maintained properly and efficiently and the Company continues to focus on providing quality service to these account holders of the Bank.

The Company operates to service standards that have been agreed with the Bank, and is reimbursed for these services by the Bank. The Company remains well placed to continue to sell and administer mortgage and savings accounts for the Bank at the current high quality levels.

The Company's performance is measured by the Bank using a number of key performance indicators which are monitored and reviewed by the Bank on an on-going basis and are disclosed in the financial statements of Lloyds Banking Group (note 25).

Directors

The Directors of the Company at the end of the year were as follows:

JA Griffiths	
DS Pope	
SE Harris	(Appointed 7 January 2008)
JN Maltby	(Appointed 14 August 2008)
PW Baker	(Appointed 14 August 2008)
MF Mitchell	(Resigned 24 April 2008)

DIRECTORS' REPORT (Continued)

Policy and practice on payment of creditors

The Company follows "The Better Payment Practice Code" published by the Department of Business, Enterprise and Regulatory Reform (BERR), regarding the making of payments to suppliers. The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract.

The creditor days for 2008 are 16 (2007: 32).

Financial risk management

The consideration of risks and uncertainties of the business such as interest rate risk, foreign currency risk, credit risk and liquidity risk are set out in note 21 to the financial statements. There are no areas of concern that carry significant risks of causing material adjustments to the carrying value of the Company's assets and liabilities.

Auditors and audit information

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

PricewaterhouseCoopers LLP have indicated their willingness to continue in office and a resolution re-appointing them as auditors and authorising the Directors to set their remuneration will be proposed at the annual general meeting.

Employees

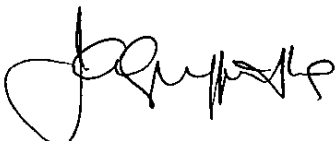
It is C&G's policy to recruit the best people and to encourage them to develop their skills and fulfil their career potential. It is also C&G's policy to provide equality of opportunity for any disabled employee or applicant.

C&G and the Lloyds Banking Group are committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality for employees regardless of sex, race, disability, age, sexual orientation or religious belief.

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

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

On behalf of the Board



J A Griffiths
Director
26 March 2009

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the consolidated and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required to give a true and fair view of the state of the affairs of the Company and the Group and of the profit or loss of the Group for that period. The Directors consider that in preparing the financial statements the Company and Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgments and estimates, and that all accounting standards which they consider applicable have been followed.

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

STATEMENT OF GOING CONCERN

The Company is reliant on fee income received from Lloyds TSB Bank plc. Owing to uncertainty in financial markets, Lloyds Banking Group plc and Lloyds TSB Bank plc participate in government sponsored measures to improve funding and liquidity. The directors are satisfied that it is the intention of Lloyds TSB Bank plc that the Company will continue to receive fee income in the future and, accordingly, the financial statements have been prepared on a going concern basis.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CHELTENHAM & GLOUCESTER PLC

We have audited the Group and parent Company financial statements (the "financial statements") of Cheltenham & Gloucester plc for the year ended 31 December 2008 which comprise the Consolidated Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Statement of Changes in Equity, the Group and Parent Company Cash Flow Statements and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements.

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report, the Statement of Director's Responsibilities and the Statement of Going Concern. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of the Group's profit and cash flows for the year then ended;
- the parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent Company's affairs as at 31 December 2008 and cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Bristol

26 March 2009

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	2008 £m	2007 £m
Interest income		0.5	-
Interest expense		(0.4)	-
Net interest income		<u>0.1</u>	<u>-</u>
Fee and commission income		440.2	13.2
Fee and commission expense		(0.1)	-
Net fee and commission income		440.1	13.2
Other operating income		0.6	106.5
Other income		<u>440.7</u>	<u>119.7</u>
Total income		<u>440.8</u>	<u>119.7</u>
Operating expenses	2	(342.8)	(67.0)
Profit before tax	3	<u>98.0</u>	<u>52.7</u>
Taxation	4	(31.3)	(10.9)
Profit for the financial year from continuing operations		<u>66.7</u>	<u>41.8</u>
Profit for the financial year from discontinued operations	22	-	214.1
Profit for the financial year attributable to shareholders	5	<u>66.7</u>	<u>255.9</u>

All of 2008 is classified as continuing operations.

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

BALANCE SHEETS
AT 31 DECEMBER 2008

	Note	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Assets					
Loans and advances to banks	6	14.0	15.8	14.0	15.8
Intercompany debtors	7	408.4	310.3	414.1	310.3
Other assets		1.2	5.6	1.2	5.6
Tangible fixed assets	8	51.2	55.9	41.7	46.3
Deferred tax asset	11	20.6	27.7	21.1	29.2
Shares in subsidiaries	12	-	-	1.3	1.3
Total assets		<u>495.4</u>	<u>415.3</u>	<u>493.4</u>	<u>408.5</u>
Equity and liabilities					
Liabilities					
Current tax liabilities		12.7	38.0	12.4	37.9
Other liabilities	13	234.0	124.0	234.0	117.8
Retirement benefit obligations	14	105.3	126.6	105.3	126.6
Other borrowed funds	15	5.0	5.0	5.0	5.0
Total liabilities		<u>357.0</u>	<u>293.6</u>	<u>356.7</u>	<u>287.3</u>
Equity					
Share capital	16	70.0	70.0	70.0	70.0
Retained profits		68.4	51.7	66.7	51.2
Shareholder's equity		<u>138.4</u>	<u>121.7</u>	<u>136.7</u>	<u>121.2</u>
Total equity and liabilities		<u>495.4</u>	<u>415.3</u>	<u>493.4</u>	<u>408.5</u>

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

The Directors approved the financial statements on 26 March 2009.



S E Harris
Director

STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	Share capital and premium £m	Retained profits £m	Total £m
Group				
Balance sheet at 1 January 2008		70.0	51.7	121.7
Profit for the year		-	66.7	66.7
Dividends	17	-	(50.0)	(50.0)
Balance at 31 December 2008		<u>70.0</u>	<u>68.4</u>	<u>138.4</u>
Company				
Balance sheet at 1 January 2008		70.0	51.2	121.2
Profit for the year		-	65.5	65.5
Dividends	17	-	(50.0)	(50.0)
Balance at 31 December 2008		<u>70.0</u>	<u>66.7</u>	<u>136.7</u>
Group				
Balance sheet at 1 January 2007		1,592.9	998.1	2,591.0
Profit for the year		-	255.9	255.9
Part VII transfer	22	-	(2,617.3)	(2,617.3)
Capital reduction – share premium	22	(1,084.6)	1,084.6	-
Capital reduction – share capital	22	(438.3)	438.3	-
Dividends	17	-	(107.9)	(107.9)
Balance at 31 December 2007		<u>70.0</u>	<u>51.7</u>	<u>121.7</u>
Company				
Balance sheet at 1 January 2007		1,592.9	970.6	2,563.5
Profit for the year		-	282.9	282.9
Part VII transfer	22	-	(2,617.3)	(2,617.3)
Capital reduction – share premium	22	(1,084.6)	1,084.6	-
Capital reduction – share capital	22	(438.3)	438.3	-
Dividends	17	-	(107.9)	(107.9)
Balance at 31 December 2007		<u>70.0</u>	<u>51.2</u>	<u>121.2</u>

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

CASH FLOW STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008

	Note	Group 2008 £m	Group 2007 £m	Company 2008 £m	Company 2007 £m
Profit before tax		98.0	52.7	97.7	52.5
Adjusted for:					
Depreciation		5.1	1.6	5.0	1.4
Profit on disposal of fixed assets		(0.3)	(10.4)	(0.3)	(10.4)
Income tax paid		(49.5)	(89.0)	(49.6)	(14.7)
		<u>53.3</u>	<u>(45.1)</u>	<u>52.8</u>	<u>28.8</u>
Changes in operating assets and liabilities					
Increase in debtors		(93.7)	(125.1)	(99.4)	(125.4)
Increase in creditors		110.0	45.9	116.2	46.6
Reduction in retirement obligations		(21.3)	(17.1)	(21.3)	(17.1)
Net cash provided by/(used in) operating activities		<u>48.3</u>	<u>(141.4)</u>	<u>48.3</u>	<u>(67.1)</u>
Cash flows from investing activities					
Purchase of fixed assets		(1.5)	(0.8)	(1.5)	(0.8)
Proceeds from sale of fixed assets		1.4	21.1	1.4	21.3
Net cash (used in)/provided by investing activities		<u>(0.1)</u>	<u>20.3</u>	<u>(0.1)</u>	<u>20.5</u>
Cash flows from financing activities					
Dividends paid		(50.0)	(107.9)	(50.0)	(107.9)
Net cash used in financing activities		<u>(50.0)</u>	<u>(107.9)</u>	<u>(50.0)</u>	<u>(107.9)</u>
Change in cash and cash equivalents from continuing operations		(1.8)	(229.0)	(1.8)	(154.5)
Change in cash and cash equivalents from discontinued operations	22	-	(563.0)	-	(592.0)
Cash and cash equivalents at beginning of year		15.8	807.8	15.8	762.3
Cash and cash equivalents at end of year	6	<u>14.0</u>	<u>15.8</u>	<u>14.0</u>	<u>15.8</u>

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

NOTES TO THE FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements; this is not relevant to the Group and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention as modified by the revaluation of land and buildings.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2008 and which have not been applied in preparing these financial statements are given in note 23.

The Group's accounting policies are set out below.

Consolidation

The assets, liabilities and results of Group undertakings are included in the financial statements on the basis of accounts made up to the reporting date. Group undertakings include all entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Group undertakings are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Intra-Group transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

Revenue recognition

Fees and commissions are generally recognised when the service has been provided.

Taxation

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

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax is determined using tax rates that have been enacted or announced by the balance sheet date that are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which those profits arise. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

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

Tangible fixed assets

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

Premises (excluding land):

- Freehold/long and short leasehold premises: shorter of 50 years or the remaining period of the lease.
- Leasehold improvements: shorter of 10 years or, if the lease renewal is not likely, the remaining period of the lease.

Equipment:

- Fixtures and furnishings: 10-20 years.
- Other equipment and motor vehicles: 3-8 years.

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

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

Leases

Operating lease rentals are charged to the income statement on a straight-line basis over the period of the lease.

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

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and on demand deposits.

Pensions and other post-retirement benefits

The Company's ultimate parent company operates a number of group-wide defined benefit and defined contribution schemes for employees including those employees of the Company.

For defined benefit schemes, full actuarial valuations of these group-wide schemes are carried out every three years with interim reviews in the intervening years which are updated by qualified independent actuaries. Scheme assets are included at their fair value. Scheme liabilities are measured on an actuarial basis using the projected unit credit method, adjusted for unrecognised actuarial gains and losses, and are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that have terms to maturity approximating to the terms of the related pension liability. The Company's share of the resulting net surplus or deficit, determined on the basis of the Company's cash contributions into the schemes for employee members (calculated in accordance with the scheme rules) is included in the Company's balance sheet. The Company's income statement includes the Company's share of current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities which is again determined on the basis of the Company's cash contributions into the schemes for employee members. The Company's share of actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds the greater of 10% of the scheme assets or liabilities. In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives. Past-service costs are charged immediately to the income statement, unless the changes are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The costs of the Company's contributions towards the Group's defined contribution plans for employee members are charged to the income statement in the period in which they fall due.

Share-based compensation

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

Share based compensation provided by the ultimate parent company is recharged to C&G at the fair value of the shares issued. There is no adjustment through the equity of C&G.

Dividends

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

Shares in subsidiaries

Shares in subsidiaries are stated in the balance sheet of the Company at cost less any provision for impairment in value.

Borrowings

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

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

Provisions

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

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

Critical accounting estimates and judgments

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

The Group makes judgments and estimates in the preparation of the results and financial position however none of these are deemed to be critical.

Additional accounting policies which applied in the prior year

The following accounting policies are no longer relevant due to the transfer of the banking business to the Bank, but are used for transactions and balances prior to the transfer in the prior year comparatives:

Loans and advances to banks and customers

Loans and advances to banks and customers are recognised at fair value when disbursed and subsequently measured at amortised cost using the effective interest rate method.

Impairment of financial assets

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

If there is objective evidence that an impairment loss has been incurred, a provision is established which is calculated as the difference between the balance sheet carrying value of the asset and the estimated discounted future cash flows. For the portfolio of homogenous residential mortgages, provisions are calculated for groups of assets taking into account historic cash flow experience. The calculation of the present value of the estimated discounted future cash flows of a collateralised asset or group of assets reflects the cash flows that may result from foreclosure less the costs of obtaining and selling the collateral.

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

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

When a loan or advance is uncollectible, it is written off against the related provision once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement. Interest is recognised on an impaired asset using its original effective interest rate.

Revenue recognition

Interest income and expense are recognised in the income statement for all interest bearing financial instruments, including loans and advances, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the future cash flows are estimated after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Group including expected early redemptions and related penalties and premiums and discounts that are an integral part of the overall return as well as direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

2. OPERATING EXPENSES

	Note	2008 £m	2007 £m
Salaries and profit sharing		72.1	23.2
Social security costs		4.2	1.2
Pension costs:	14		
Defined benefit scheme		4.9	1.3
Defined contribution scheme		1.8	0.4
Staff costs		<u>83.0</u>	<u>26.1</u>
Other administrative expenses		259.8	40.9
		<u>342.8</u>	<u>67.0</u>

The average number of persons employed by the Group and the Company during the year was as follows:

	Group		Company	
	2008	2007	2008	2007
UK	2,324	2,844	2,324	2,844
Non-UK	-	3	-	-
	<u>2,324</u>	<u>2,847</u>	<u>2,324</u>	<u>2,844</u>

Auditors' remuneration:

	2008 £'000	2007 £'000
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	20	228
Fees payable to the Company's Auditor and its associates for other services		
- The audit of the Company's subsidiaries, pursuant to legislation	2	29
- All other services	-	24

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

The Group has procedures to ensure that fees for audit and non-audit services are approved in advance.

3. PROFIT BEFORE TAX

Profit before tax is stated after taking account of:

	2008 £m	2007 £m
Profit on disposal of premises	0.4	10.4
Loss on disposal of equipment	0.1	-
Depreciation	5.1	1.6
Operating lease rental charges paid	13.0	11.8

4. TAXATION

(a) Analysis of charge in period:

	Note	2008 £m	2007 £m
UK corporation tax			
Current tax on profits for the year		21.5	6.6
Adjustments in respect of prior years		2.7	(4.5)
Corporation tax charge		<u>24.2</u>	<u>2.1</u>
Deferred tax			
	11		
Current year		6.8	6.2
Prior year		<u>0.3</u>	<u>2.6</u>
Total tax charge		<u>31.3</u>	<u>10.9</u>

The standard corporation tax rate changed from 30% to 28% effective 1 April 2008. The implication for the Company is that corporation tax has been charged at 30% for 3 months to 1 April 2008 and at 28% for 9 months to 31 December 2008. This has given rise to an average (blended) corporation tax rate of 28.5%.

(b) Factors affecting tax charge for the period

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

	2008 £m	2007 £m
Tax charge at UK corporation tax rate of 28.5% (2007: 30%)	27.9	15.8
Overseas tax rate differences	-	(0.1)
Non-allowable items	(0.3)	1.7
Non chargeable gains	(0.1)	(3.9)
Effect of reduction in deferred tax rate to 28%	(0.1)	2.1
Deferred tax on business combination	(0.2)	(2.4)
IFRS 2 Deferred tax release	1.1	-
Adjustment to tax credit in respect of prior years	3.0	(2.3)
Total tax charge	<u>31.3</u>	<u>10.9</u>

5. PROFIT FOR THE FINANCIAL YEAR ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders includes a profit of £65.5 million (2007: £282.9 million) dealt with in the financial statements of the parent Company, for which no income statement is presented as permitted by section 230 of the Companies Act 1985.

6. LOANS AND ADVANCES TO BANKS

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Loans and advances to banks	<u>14.0</u>	<u>15.8</u>	<u>14.0</u>	<u>15.8</u>
Included above:				
Due from Lloyds Banking Group subsidiary undertakings				
All unsubordinated	<u>14.0</u>	<u>15.8</u>	<u>14.0</u>	<u>15.8</u>

At 31 December 2008, £nil (2007: £nil) of loans and advances to banks of the Group and Company had a contractual residual maturity of greater than one year.

7. INTERCOMPANY DEBTORS

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Due from Lloyds Banking Group subsidiary undertakings				
All unsubordinated	<u>408.4</u>	<u>310.3</u>	<u>414.1</u>	<u>310.3</u>

At 31 December 2008, £nil (2007: £nil) of intercompany debtors had a contractual residual maturity of greater than one year.

8. TANGIBLE FIXED ASSETS

	Group Premises £m	Group Equipment £m	Group Total £m	Company Premises £m	Company Equipment £m	Company Total £m
Cost:						
At 1 January 2007	68.7	87.0	155.7	56.8	87.0	143.8
Additions	-	0.8	0.8	-	0.8	0.8
Disposals	(8.9)	(8.2)	(17.1)	(8.9)	(8.2)	(17.1)
At 31 December 2007	59.8	79.6	139.4	47.9	79.6	127.5
Additions	0.3	1.2	1.5	0.3	1.2	1.5
Disposals	(0.5)	(32.3)	(32.8)	(0.5)	(32.3)	(32.8)
At 31 December 2008	59.6	48.5	108.1	47.7	48.5	96.2
Depreciation:						
At 1 January 2007	17.2	68.9	86.1	15.3	68.8	84.1
Charge for the year	2.1	4.3	6.4	1.8	4.3	6.1
Disposals	(2.3)	(6.7)	(9.0)	(2.3)	(6.7)	(9.0)
At 31 December 2007	17.0	66.5	83.5	14.8	66.4	81.2
Charge for the year	1.8	3.3	5.1	1.7	3.3	5.0
Disposals	(0.2)	(31.5)	(31.7)	(0.2)	(31.5)	(31.7)
At 31 December 2008	18.6	38.3	56.9	16.3	38.2	54.5
Net book value:						
31 December 2008	41.0	10.2	51.2	31.4	10.3	41.7
31 December 2007	42.8	13.1	55.9	33.1	13.2	46.3

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Net book value of premises comprises:				
Freeholds	27.9	28.7	18.3	19.0
Leaseholds 50 years and over unexpired	7.4	7.6	7.4	7.6
Leaseholds less than 50 years unexpired	1.1	1.2	1.1	1.2
Adaptation costs	4.6	5.3	4.6	5.3
	41.0	42.8	31.4	33.1

9. OPERATING LEASE COMMITMENTS

At 31 December, the future minimum lease payments under non-cancellable building operating leases are as follows:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Not later than 1 year	11.9	12.2	12.0	12.3
Later than 1 year and not later than 5 years	40.8	42.6	41.1	42.9
Later than 5 years	56.3	63.9	58.7	66.3
	109.0	118.7	111.8	121.5

10. CAPITAL COMMITMENTS

Capital expenditure contracted, but not provided for, at 31 December 2008 amounted to nil for the Group and the Company (2007: Group and Company £0.5 million).

11. DEFERRED TAX ASSET

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
At 1 January	27.7	26.1	29.2	27.7
Income statement (debit)/credit	(7.1)	1.6	(8.1)	1.5
At 31 December	<u>20.6</u>	<u>27.7</u>	<u>21.1</u>	<u>29.2</u>

The deferred tax charge in the income statement comprised the following temporary differences:

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Accelerated depreciation allowances	1.0	0.5	-	0.4
Retirement benefit obligations	(5.9)	(10.3)	(5.9)	(10.3)
Allowance for impairment losses	-	(2.1)	-	(2.1)
Other temporary differences	(2.2)	13.5	(2.2)	13.5
Total movement in deferred tax	<u>(7.1)</u>	<u>1.6</u>	<u>(8.1)</u>	<u>1.5</u>
Movement in relation to continuing operations	(7.1)	(8.8)	(8.1)	(8.9)
Movement in relation to discontinued operations	-	10.4	-	10.4
	<u>(7.1)</u>	<u>1.6</u>	<u>(8.1)</u>	<u>1.5</u>

The net deferred tax asset is comprised as follows:

Deferred tax assets:				
Retirement benefit obligations	29.5	35.4	29.5	35.4
Deferred tax liabilities:				
Accelerated capital allowances	3.5	4.5	3.0	3.0
Other temporary differences	5.4	3.2	5.4	3.2
	8.9	7.7	8.4	6.2
	<u>20.6</u>	<u>27.7</u>	<u>21.1</u>	<u>29.2</u>

12. SHARES IN SUBSIDIARIES

	Company	
	2008 £m	2007 £m
Cost		
At 1 January	1.3	18.8
Disposals	-	(17.5)
At 31 December	<u>1.3</u>	<u>1.3</u>

The principal Group undertakings, all of which prepare financial statements to 31 December and whose results are included in the consolidated financial statements of Cheltenham & Gloucester plc, are:

	Country of registration / incorporation	Nature of business	Ownership
C&G Property Holdings Limited	England and Wales	Property holding and leasing	100%
C&G Estate Agents Limited	England and Wales	Dormant	100%
C&G Financial Services Limited	England and Wales	Dormant	100%
C&G Homes Limited	England and Wales	Dormant	100%
Central Mortgage Finance Limited	England and Wales	Dormant	100%
Lloyds TSB Homeloans Limited	England and Wales	Dormant	100%
Lloyds TSB Mortgages Limited	England and Wales	Dormant	100%

13. OTHER LIABILITIES

	Group		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Other creditors and accruals	<u>234.0</u>	<u>124.0</u>	<u>234.0</u>	<u>117.8</u>
Included above:				
Due to Lloyds Banking Group undertakings	<u>209.6</u>	<u>109.8</u>	<u>209.6</u>	<u>109.8</u>

At 31 December 2008, £nil (2007: £nil) of other liabilities of the Group and Company had a contractual residual maturity of greater than one year.

14. RETIREMENT BENEFIT OBLIGATIONS

Defined contribution schemes

The Company's ultimate parent company operates a number of defined contribution pension schemes, principally the defined contribution sections of the Lloyds TSB Group Pension Schemes No's 1 and 2; new employees are offered membership of the defined contribution section of the Lloyds TSB Group Pension Scheme No. 1.

During the year ended 31 December 2008, the charge to the income statement in respect of these schemes was £1.8 million (2007: £0.4m related to continuing operations and £1.3m related to discontinued operations) representing the contributions payable by the Company in accordance with each scheme's rules. There are no outstanding or prepaid contributions at 31 December 2008.

Defined benefits schemes

The Company's ultimate parent company has established a number of defined benefit pension schemes in the UK and overseas. The majority of the Company's employees are members of the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2.

14. RETIREMENT BENEFIT OBLIGATIONS (Continued)

These are funded schemes providing retirement benefits calculated as a percentage of final salary depending upon the length of service; the minimum retirement age under the rules of the schemes is 50.

The latest full valuations of the two main schemes were carried out as at 30 June 2008; these have been updated to 31 December 2008 by qualified independent actuaries.

The amounts shown below relate to the Company's share of obligations arising from membership by the Company's employees of the defined benefit schemes operated by the Company's ultimate parent company.

Amount included in the balance sheet:

	2008 £m	2007 £m
Group and Company's share of present value of funded obligations	923.0	993.3
Group and Company's share of fair value of scheme assets	(800.8)	(931.4)
	122.2	61.9
Group and Company's share of unrecognised actuarial gains	(16.9)	64.7
Liability in the balance sheet	105.3	126.6

The movements in the liability recognised in the balance sheet are as follows:

	2008 £m	2007 £m
At 1 January	126.6	143.7
Net charge to the income statement	4.9	5.4
Contributions paid	(26.2)	(22.5)
At 31 December	105.3	126.6

The expense recognised in the income statement comprises:

	2008 £m	2007 £m
Current service cost	11.6	14.5
Interest cost	49.3	46.1
Expected return on scheme assets	(56.0)	(55.2)
	4.9	5.4
Expense relating to continuing operations	4.9	1.3
Expense related to discontinued operations	-	4.1
	4.9	5.4

The following information relates to Lloyds TSB Group Pension Schemes No's 1 and 2 as at 31 December 2008.

In accordance with IAS 19, the remaining information below relates to the No's 1 and 2 schemes operated by the Company's ultimate parent company and amounts are shown in £ millions unless otherwise stated.

The Company's ultimate parent company expects to pay contributions of approximately £442 million in respect of the No's 1 and 2 schemes in 2009.

Movements in the defined benefit obligation:

	2008 £m	2007 £m
At 1 January	15,303	15,637
Current service cost	213	251
Interest cost	872	785
Actuarial gains	(1,776)	(887)
Benefits paid	(545)	(509)
Past service cost	22	26
At 31 December	14,089	15,303

14. RETIREMENT BENEFIT OBLIGATIONS (Continued)

Changes in the fair value of scheme assets:

	2008	2007
	£m	£m
At 1 January	14,746	13,768
Expected return	993	943
Employer contributions	466	397
Actuarial (losses)/gains	(3,227)	147
Benefits paid	(545)	(509)
At 31 December	<u>12,433</u>	<u>14,746</u>
Actual return on scheme assets	<u>(2,234)</u>	<u>1,090</u>

The principal actuarial and financial assumptions used in valuations of all of Lloyds Banking Group's defined benefit pension schemes including the No's 1 and 2 schemes were as follows:

	2008	2007
	%	%
Discount rate	6.30	5.80
Rate of inflation	3.00	3.30
Rate of salary increases	3.75	4.00
Rate of increase for pensions in payment and deferred pensions	2.80	3.10
	Years	Years
Life expectancy for member aged 60, on the valuation date:		
- Men	26.4	25.9
- Women	27.2	27.9
Life expectancy for member aged 60, 15 years after the valuation date:		
- Men	27.3	27.1
- Women	28.1	29.0

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes.

An analysis of the impact of a reasonable change in these assumptions is provided in the 2008 annual report and financial statements of the Company's ultimate parent company. Copies of the ultimate parent company's 2008 annual report and financial statements may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN.

The expected return on scheme assets for all of the Lloyds Banking Group's schemes including the No's 1 and 2 schemes is based on the following assumptions:

	2008	2007
	%	%
Equities	8.2	8.0
Fixed interest gilts	4.5	4.6
Index linked gilts	4.4	4.2
Non-government bonds	6.0	5.1
Property	6.7	6.5
Cash	4.8	3.9

14. RETIREMENT BENEFIT OBLIGATIONS (Continued)

The expected return on scheme assets in 2008 for all of the Lloyds Banking Group's schemes including the No's 1 and 2 schemes will be calculated using the following assumptions:

	2009
	%
Equities	8.4
Fixed interest gilts	3.7
Index linked gilts	4.0
Non-government bonds	6.7
Property	6.4
Cash	3.8

Composition of scheme assets:

	2008	2007
	£m	£m
Equities	6,517	7,821
UK fixed interest gilts	1,387	1,953
UK index linked gilts	1,073	1,316
Sterling non-government bonds	1,536	1,816
Property	1,421	1,604
Derivative assets	623	226
Cash	(124)	10
At 31 December	<u>12,433</u>	<u>14,746</u>

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

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

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

	2008	2007	2006	2005	2004
	£m	£m	£m	£m	£m
Present value of defined benefit obligation	14,089	15,303	15,637	15,610	13,427
Fair value of scheme assets	<u>(12,433)</u>	<u>(14,746)</u>	<u>(13,768)</u>	<u>(12,634)</u>	<u>(10,537)</u>
	1,656	557	1,869	2,976	2,890
Unrecognised actuarial gains/(losses)	<u>(217)</u>	<u>1,234</u>	<u>200</u>	<u>(478)</u>	<u>(234)</u>
Liability in the balance sheet	<u>1,439</u>	<u>1,791</u>	<u>2,069</u>	<u>2,498</u>	<u>2,656</u>
Experience losses on scheme liabilities	<u>(29)</u>	<u>(180)</u>	<u>(50)</u>	<u>(65)</u>	<u>(145)</u>
Experience (losses)/gains on scheme assets	<u>(3,227)</u>	<u>147</u>	<u>297</u>	<u>1,400</u>	<u>341</u>

The expense recognised in the income statement comprises:

	2008	2007
	£m	£m
Current service cost	213	251
Interest cost	872	785
Expected return on scheme assets	(993)	(943)
Past service cost	22	26
Total pension expense	<u>114</u>	<u>119</u>

15. OTHER BORROWED FUNDS

	2008 £m	2007 £m
Preference shares	<u>5.0</u>	<u>5.0</u>
	2008 Number (m) and £m	2007 Number (m) and £m
Authorised		
Preference shares of £1 each	10	10
'B' preference shares of £1 each	10	10
Issued and fully paid:		
Preference shares of £1 each	3.8	3.8
'B' preference shares of £1 each	1.2	1.2

The terms of the preference shares require the Company to pay a non-cumulative dividend at the rate of LIBOR plus 75 basis points per cent per annum on the amount for the time being paid up on each preference share. This is paid annually on 30 June.

16. CALLED UP SHARE CAPITAL

	2008 Number in millions	2007 Number in millions	2008 £m	2007 £m
Authorised: ordinary shares of £1 each				
At 1 January	311.7	750.0	311.7	750.0
Reduction in year (note 23)	-	(438.3)	-	(438.3)
At 31 December	<u>311.7</u>	<u>311.7</u>	<u>311.7</u>	<u>311.7</u>
Issued and fully paid: ordinary shares of £1 each				
At 1 January	70.0	508.3	70.0	508.3
Reduction in year (note 23)	-	(438.3)	-	(438.3)
At 31 December	<u>70.0</u>	<u>70.0</u>	<u>70.0</u>	<u>70.0</u>

The company has one class of ordinary voting shares which carry no right to fixed income.

17. ORDINARY DIVIDENDS

The dividends paid in the year were as follows:

	2008 £m	2007 £m
Final dividend in respect of preceding year	50.0	107.9
At 31 December	<u>50.0</u>	<u>107.9</u>
Dividend per share	<u>71.4p</u>	<u>21.2p</u>

18. SHARE BASED PAYMENTS

Share based payments

During the year ended 31 December 2008, the Company's ultimate parent company operated the following share based payment schemes, all of which are equity settled.

Executive schemes

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

Performance conditions for executive options

For options granted up to March 2001

Options granted	Performance conditions
March 1998 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period together with a further condition that Lloyds Banking Group plc's ranking based on shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1998 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period.

In respect of options granted between March 1998 and March 2001, the relevant period for the performance conditions begins at the end of the financial year preceding the date of grant and will continue until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions are met. Once the conditions have been satisfied the options will remain exercisable without further conditions. If they are not satisfied by the tenth anniversary of the grant the option will lapse.

For options granted from August 2001 to August 2004

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

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

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

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

18. SHARE BASED PAYMENTS (Continued)

For options granted in 2005

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

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

Save-As-You-Earn schemes

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

Other share option plans

Long-Term Incentive Plan

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

The performance conditions for awards made in May and August 2006 are as follows:

- (i) For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Lloyds Banking Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Price Index over the same period. If it is less than 3 per cent per annum the EPS Award will lapse. If the increase is more than 3 per cent but less than 6 per cent per annum then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ends on 31 December 2008.
- (ii) For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for the Group's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where the Group's total shareholder return is equal to median and vesting will occur on a straight line basis in between these points. Where the Lloyds Banking Group's total shareholder return is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ends on 31 December 2008.

The performance conditions for awards made in March and August 2007 are as follows:

- (i) For 50 per cent of the award (the 'EPS Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2007 and ending on 31 December 2009.
- (ii) For the other 50 per cent of the award (the 'TSR Award') – the performance condition is as described for May 2006 with the relevant performance period commencing on 8 March 2007 (the date of award) and ending on 7 March 2010.

18. SHARE BASED PAYMENTS (Continued)

The performance conditions for awards made in March, April, August and September 2008 are as follows:

- (i) For 50 per cent of the award (the EPS Award) – the performance condition is as described for May 2006 with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010.
- (ii) For the other 50 per cent of the award (the TSR Award) – the performance condition is as described for May 2006, except that the comparator group comprises of 13 companies, with the relevant performance period commencing on 6 March 2008 (the date of the first award) and ending on 5 March 2011.

Performance share plan

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

Share incentive plans

Free shares

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

The number of shares awarded relating to free shares in 2008 had an average fair value of £4.38 (2007: £5.82), based on the market price at the date of award.

Matching shares

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

The number of shares awarded relating to matching shares in 2008 had an average fair value of £2.56 (2007: £5.49), based on market prices at the date of award.

Other information

The charge made to the income statement represents the Company's share of the cost of the above schemes. This charge has been allocated to the Company based on the number of the Company's employees who participate in the above schemes. It is not practicable for the Company to provide information regarding the ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life information and the number of options outstanding that is specific to the Company's employees without incurring significant additional cost.

18. SHARE BASED PAYMENTS (Continued)

Full details of the ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life information and number of options outstanding for the above schemes overall can be found in the 2008 annual report and accounts of the Company's ultimate parent company. Copies of the ultimate parent company's 2008 annual report and accounts may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN.

19. DIRECTORS' EMOLUMENTS

The aggregate of the emoluments of the Directors for their services to the Company were £1,304,638 (2007: £1,597,011) which comprises:

	2008 £	2007 £
Short-term employee benefits	1,083,409	1,160,720
Post-employment benefits	50,450	46,374
Termination benefits	165,959	383,264
Share-based payments	4,820	6,653
	<u>1,304,638</u>	<u>1,597,011</u>

No gains were made on the exercise of Lloyds Banking Group plc share options by Directors during the course of the year. A gain of £3,650 was made by a Director (JC Pain) on the exercise of Lloyds Banking Group plc share options in 2007.

The number of Directors to whom retirement benefits are accruing under defined benefit pension schemes is nil (2007: 2). The number of Directors to whom retirement benefits are accruing under defined contribution pension schemes is 2 (2007: 2).

The total emoluments for the highest paid Director (JA Griffiths) were £529,639 all of which arose from her services to the Company and the contributions paid to a defined contribution scheme on her behalf were £36,719. The total for the highest paid Director in 2007 (JC Pain) was £370,783, all of which arose from his services to the Company. JC Pain also received a severance payment of £383,264 in 2007.

In 2007, the amount of the highest paid Director's accrued pension from the Company at the year-end was £167,898. In 2008, the highest paid Director is not a member of a defined benefit scheme.

JN Maltby and PW Baker are employed by other companies in the Lloyds Banking Group and consider that their services to the company are incidental to their other activities within the Group and therefore their emoluments have not been disclosed.

20. RELATED PARTY TRANSACTIONS

There are a number of transactions with Lloyds Banking Group plc and its subsidiary companies. Where applicable the transactions have been disclosed in the notes to the financial statements.

The following table details the impact of intra group transactions through the income statement.

	2008 £m	2007 £m
Interest income	0.5	56.7
Interest expense	-	2,134.9
Preference share interest expense	0.4	0.3
Commission receivable	436.2	158.1
Fees payable	0.1	-
Administrative expenses	222.9	198.1

20. RELATED PARTY TRANSACTIONS (Continued)

The Company leases a property from its subsidiary C&G Property Holdings Limited for which it paid rental charges of £0.8m during the year (2007: £0.8m). In addition, the Company receives interest on a loan outstanding from the subsidiary which was £0.3m for the year (2007: £0.4m). The principal amount of the loan outstanding at 31 December 2008 was £5.9m (2007: £6.4m).

In addition, there are amounts due to the Company at 31 December 2008 from C&G's dormant subsidiary companies which have been written off in these consolidated financial statements as the amounts are not deemed to be recoverable, given the dormant nature of the entities. The amounts which have been included in the subsidiary company financial statements but have previously been written off by C&G are C&G Estate Agents Limited £1.9m (2007: £1.9m), C&G Homes Limited £13.6m (2007: £13.6m) and Central Mortgage Finance Limited £4.3m (2007: £4.3m).

The Group's related parties also include key management personnel. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, which for the Group is the board of Directors of C&G. The total compensation paid to key management personnel is disclosed in note 19.

A number of banking transactions were entered into with key management in the normal course of business. These included loans and deposits. The Directors of C&G who hold C&G products ceased to have a related party relationship in relation to these mortgages and savings balances on transfer of the balances to the Bank. The transactions included in the comparatives were carried out on commercial terms and at market rates.

	2008 £m	2007 £m
Loans		
At 1 January	-	2.7
Adjustment for changes in key management personnel	-	0.4
Advanced during the year	-	0.9
Interest charged during the year	-	0.1
Repaid during the year	-	(1.2)
Mortgages and savings accounts transferred to Lloyds TSB Bank plc	-	(2.9)
Outstanding at 31 December	-	-
Deposits		
At 1 January	-	0.1
Withdrawn during the year	-	(0.1)
Outstanding at 31 December	-	-

21. FINANCIAL RISK MANAGEMENT POLICIES

The Directors are responsible for establishing a framework for evaluating, measuring, monitoring and controlling risk. They are responsible for ensuring that the risks within the business are identified, assessed, monitored and controlled. These controls and procedures where relevant comply with Lloyds Banking Group policies and standards.

Interest Rate Risk

The Company has no interest-bearing assets from third parties and no deposits are placed outside of the Lloyds Banking Group. Interest is received on a loan from a subsidiary Company at the Bank of England base rate. As such, this represents exposure to fluctuations in interest rates. If interest rates for the year ended 31 December 2008 had been 100 basis points higher or lower with all other variables held constant, post-tax profits for the year would have been £44k (2007: £47k) higher or lower respectively, as a result of reduced or increased interest income on the Company's loan from the subsidiary Company.

Currency Risk

The Company holds no foreign currency assets or liabilities and transacts all business in GBP and therefore has no significant exposure to currency risks.

21. FINANCIAL RISK MANAGEMENT POLICIES (Continued)

Credit Risk

All income received by the Company is from entities that are part of the Lloyds Banking Group. Hence, as there is no direct third party income, credit risk is capable of close monitoring and control. All loans and advances are neither past due nor impaired.

Liquidity risk

The table below analyses liabilities of the Group on an undiscounted future cash flows basis according to contractual maturity into relevant maturity groupings based on the remaining period at the balance sheet date. Balances with no fixed maturity are included in the over 5 years category.

As at 31 December 2008	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Liabilities						
Other liabilities	234.0	-	17.7	-	105.3	357.0

As at 31 December 2007	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Liabilities						
Other liabilities	124.0	-	43.0	-	126.6	293.6

Capital

The managed capital of the Company constitutes total shareholder's funds. These consist entirely of issued ordinary share capital and retained profit and loss.

The Company is authorised and regulated by the Financial Services Authority ('FSA') and is subject to the FSA's capital resource requirements per the FSA IPRU(Inv) and MIPRU Rulebooks. Capital is actively managed at an appropriate level of frequency and regulatory capital levels are a key factor in the Group's budgeting and planning processes. All FSA capital requirements imposed on the Company during the year were met.

22. PRIOR YEAR RESTRUCTURE OF CHELTENHAM & GLOUCESTER PLC

In the prior year, C&G transferred its banking business to the Bank by way of:

- a sale of C&G Channel Islands, which was C&G's Offshore deposit taker, to the Bank;
- a transfer of banking assets and liabilities to the Bank under a court approved scheme pursuant to Part VII of the Financial Services and Markets Act 2000; and
- a court approved capital restructure to redeem surplus share capital and share premium accounts against reserves.

In addition, during the prior year C&G sold its in house valuation business unit for a net consideration of £28.8 million.

22. PRIOR YEAR RESTRUCTURE OF CHELTENHAM & GLOUCESTER PLC (Continued)

The transfer of banking assets and liabilities to the Bank occurred on 1 October 2007 under a court approved scheme pursuant to Part VII of the Financial Services and Markets Act 2000 and these operations were classified as discontinuing. The following is a summary of the assets and liabilities transferred:

	2007 £m
Assets and liabilities transferred:	
Loans and advances to customers (net of impairment allowances of £23m)	87,142
Goodwill	299
Customer Accounts	(14,480)
Deposits from C&G Channel Islands	(346)
Debt securities in issue	(13,255)
Subordinated Liabilities	(700)
Net funding from Lloyds TSB Bank no longer required	(55,374)
Other net liabilities	(669)
Transfer reserve created	<u>2,617</u>

The cash and cash equivalents transferred were £2,241.9 million, included above in 'Net funding from Lloyds TSB Bank no longer required'. There was no cash consideration received by C&G for this transaction.

The transfer reserve represented a reduction in C&G's equity reserves reflecting its lower capital requirement for its new operations.

On 21 November 2007, the Court approved a scheme to reduce C&G's issued ordinary share capital from £508 million to £70 million, and the authorised ordinary share capital from £750 million to £312 million. The share premium account, which totalled £1,085 million, was also cancelled against reserves.

The net effect of this capital restructure was to reduce ordinary issued share capital to £70 million and clear the transfer reserve created by the Part VII transfer by setting this off against P&L reserves and the share premium cancellation.

The banking business was classified as discontinuing operations in 2007 and was disclosed in the 2007 financial statements as follows:

Consolidated Income Statement – Discontinued Operations

	Note	2007 £m
Interest income		3,648.3
Interest expense		(3,206.4)
Net interest income		<u>441.9</u>
Fee and commission income		62.3
Fee and commission expense		(0.8)
Net fee and commission income		61.5
Other operating income		67.1
Other income		<u>128.6</u>
Total income		<u>570.5</u>
Operating expenses	(i)	(274.9)
Impairment losses on loans and advances		(2.3)
Profit before tax	(ii)	<u>293.3</u>
Taxation	(iii)	(79.2)
Profit for the financial year attributable to equity shareholders		<u>214.1</u>

22. PRIOR YEAR RESTRUCTURE OF CHELTENHAM & GLOUCESTER PLC (Continued)

(i) Operating expenses – Discontinued Operations

	2007 £m
Salaries and profit sharing	69.7
Social security costs	3.7
Defined benefit scheme costs	4.1
Defined contribution scheme costs	1.3
Staff costs	78.8
Other administrative expenses	196.1
	<u>274.9</u>

(ii) Profit before tax – Discontinued Operations

The profit before tax on discontinued operations is stated after taking account of:

	2007 £m
Profit on disposal of premises	2.6
Depreciation	4.8
Loss on disposal of C&G Channel Islands Ltd	29.0
Profit on sale of valuers business unit	28.8

(iii) Taxation – Discontinued operations

Analysis of tax charge resulting from discontinued operations:

	2007 £m
UK corporation tax on profits for the year	89.4
Overseas tax on profits for the year	0.2
Corporation tax charge	89.6
Current year deferred tax	(10.4)
Total tax charge	<u>79.2</u>

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

	2007 £m
Tax charge at UK corporation tax rate of 30%	88.3
Profit on the sale of valuers business unit	(8.6)
Loss on sale of investment in C&G Channel Islands Limited	8.7
Provision relating to loan balance transferred to the Bank	(9.2)
Total tax charge	<u>79.2</u>

Cash flow statement – Discontinued Operations

	Group 2007 £m	Company 2007 £m
Net cash used in operating activities	(1,369.2)	(1,443.6)
Net cash used in investing activities	(2,258.5)	(2,213.1)
Net cash generated by financing activities	3,064.7	3,064.7
Change in cash and cash equivalents	<u>(563.0)</u>	<u>(592.0)</u>

23. FUTURE ACCOUNTING DEVELOPMENTS

The following pronouncements will be relevant to the Group but were not effective at 31 December 2008 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group, however, the initial view is that none of these pronouncements are expected to cause any material adjustments to reported numbers in the financial statements.

Pronouncement	Nature of Change	Effective Date
IAS 1 Presentation of Financial Statements	Revises the overall requirements for the presentation of financial statements, guidance for their structure and minimum content requirements. The revised standard requires the presentation of all non-owner changes in equity within a statement of comprehensive income.	Annual periods beginning on or after 1 January 2009.
IFRS 2 Share-based Payment – Vesting Conditions and Cancellations	The amendment restricts the definition of vesting conditions to include only service conditions and performance conditions and deals with the accounting consequences of a failure to meet a condition other than a vesting condition including how to deal with cancellations by the counterparty and circumstances where neither the entity nor the counterparty is in a position to choose whether or not to meet a vesting condition.	Annual periods beginning on or after 1 January 2009.
Improvements to IFRSs	Sets out minor amendments to IFRS standards as part of annual improvements process.	Dealt with on a standard by standard basis but not earlier than annual periods beginning on or after 1 January 2009.
Amendment to IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate	Removes the definition of the cost method and requires the presentation of dividends as income in the separate financial statements of the investor.	Annual periods beginning on or after 1 January 2009.
IAS 27 Consolidated and Separate Financial Statements ^{1,2}	Requires the effects of all transactions with non controlling interests to be recorded in equity if there is no change in control; any remaining interest in an investee is remeasured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.	Annual periods beginning on or after 1 July 2009.

¹ At the date of this report, these pronouncements are awaiting EU endorsement.

² Subject to any EU endorsement, the Group has not yet made a final decision as to whether it will apply these pronouncements in the 2009 financial statements.

24. GUARANTEES

Under the Building Societies Act 1986, Cheltenham & Gloucester Building Society had an obligation to discharge the liabilities of its subsidiary companies in so far as they were unable to discharge the liabilities out of their own assets. Under the Building Societies (Transfer of Business) Regulations 1988, any obligations which existed at 31 July 1995 remain as obligations of Cheltenham & Gloucester plc.

25. PARENT COMPANIES

The immediate parent company is Lloyds TSB Bank plc. The company regarded by the Directors as the ultimate parent company is Lloyds Banking Group plc (formerly Lloyds TSB Group plc), which is also the parent undertaking of the largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. The Bank is the parent undertaking of the smallest such group of undertakings. Lloyds Banking Group plc is registered in Scotland and the Bank is registered in England and Wales. Copies of the group financial statements of both may be obtained from the Company Secretary's Office, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN.

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