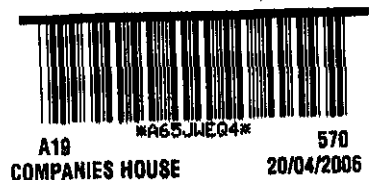


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Lloyds TSB Bank plc

Report and Accounts

2005



Member of Lloyds TSB Group

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Directors' report

Results and dividends

The consolidated income statement on page 5 shows a profit attributable to equity shareholders for the year ended 31 December 2005 of £2,504 million. An interim dividend of £599 million for the year ended 31 December 2005 was paid on 5 October 2005. A second interim dividend of £1,316 million will be paid on 3 May 2006.

Principal activities

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

Financial risk management objectives and policies

Information regarding the financial risk management objectives and policies of the Bank and its subsidiary undertakings, in relation to the use of financial instruments, is given in note 51 on pages 55 to 65.

Business review

Profit before tax for the Lloyds TSB Bank Group was £3,854 million, an increase of £353 million, or 10 per cent, compared with £3,501 million in 2004.

In 2005 the Lloyds TSB Bank Group continued to deliver good levels of earnings momentum. The Group's strategy to deepen customer relationships has led to an increase in retail lending, particularly in mortgages, credit cards and personal loans, and is reflected in a 12 per cent increase in loans and advances to customers to £177 billion. Customer deposits increased by £11 billion, or 9 per cent, to £131 billion, largely as a result of strong growth in current account credit balances.

Group net interest income increased by £578 million or 11 per cent, compared with 2004. Good levels of consumer lending growth increased average personal lending and credit card balances by £1.7 billion and average mortgage balances by £7.8 billion. Customer lending growth in our Business Banking and Corporate Markets businesses increased average interest earning assets by £4.4 billion.

Operating expenses continued to be tightly controlled and increased by only 3 per cent. Significant improvements continued to be made in processing and operational efficiency and we have continued to expand our programme of offshoring a number of our processing and back-office operations. During the year staff numbers reduced by over 3,000 to 66,797. As a result of this constant focus on day-to-day operating cost control, the cost:income ratio improved to 51.6 per cent, from 54.5 per cent in 2004.

Overall asset quality remained satisfactory. A substantial reduction in impairment losses in the

corporate franchise was offset by a 64 per cent rise in the retail banking business, resulting from a combination of volume related asset growth in personal loan and credit card lending, the absence of a provision release in the mortgage business which totalled £39 million in 2004, and an increase in the number of personal customers experiencing repayment difficulties. Overall impairment losses on loans and advances increased by 50 per cent to £1,299 million.

Profit before tax from UK Retail Banking, excluding customer redress provisions (2005: £150 million; 2004: £100 million), decreased by 11 per cent to £1,544 million. Continued growth in the division's consumer lending and customer deposit portfolios and improved current account fee income were offset by a higher level of impairment losses in the unsecured lending portfolios.

Profit before tax from Insurance and Investments, excluding volatility (2005: £749 million; 2004: £138 million), customer redress provisions (2005: £nil; 2004: £12 million) and strengthening of reserves for mortality (2005: £155 million; 2004: £nil), increased by 11 per cent to £880 million. New business weighted sales increased by 21 per cent and the Group's market share of life, pensions and long-term savings increased to 6.2 per cent, from 5.7 per cent in 2004. IFA sales grew 30 per cent to £562 million, supported by significant product and service enhancements in pensions and investments, and our estimated market share of the IFA market improved to 6.8 per cent, from 5.9 per cent in 2004. Bancassurance sales were 13 per cent higher at £274 million. Weighted sales of OEICs were 72 per cent higher, largely through the branch network and to Lloyds TSB private banking clients. As a result of improved capital efficiency and strong sales of pensions and single premium investments, the life and pensions new business margin increased to 29.7 per cent, from 28.6 per cent in 2004.

In General Insurance, profit before tax increased by 32 per cent reflecting the growth in income from home and motor business partly offset by reduced broking commission from loan protection insurance as well as further investment in our service performance, direct channel business and claims processing.

In Wholesale and International Banking, pre-tax profits increased by £246 million, or 19 per cent, to £1,518 million. Income growth of 9 per cent exceeded cost growth of 5 per cent, leading to a reduction in the cost:income ratio to 56.0 per cent. There was strong profit growth in Corporate Markets, Business Banking and

Directors' report

International Banking, while Asset Finance saw good trading surplus growth before higher impairment losses. Overall growth in profit was substantially ahead of growth in risk-weighted assets and has led to an increase in the post-tax return on average risk-weighted assets to 1.50 per cent, compared with 1.41 per cent in 2004. Good progress has continued to be made in delivering the strategy to build an integrated wholesale bank for corporate markets, with a 27 per cent increase in income from cross selling in the Corporate Markets business.

Shareholders' equity decreased by £967 million to £11,185 million reflecting a negative restatement on implementation of IAS 32, IAS 39 and IFRS 4 of £1,586 million. Excluding this restatement, shareholders' equity increased by £619 million, largely as a result of retained earnings.

Risk-weighted assets increased by 10 per cent to £144.9 billion reflecting strong growth in mortgages and corporate lending. At the end of 2005, the risk asset ratios were 10.8 per cent for total capital and 8.7 per cent for tier 1 capital.

Directors

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

Mr Ayliffe left the board on 31 January 2005 and Dr Gibson-Smith and Mr Pritchard left the board on 5 May 2005.

Sir Julian Horn-Smith and Ms Dial joined the board on 1 January 2005 and 1 June 2005 respectively, Mr du Plessis and Lord Leitch joined the board on 1 October 2005 and Sir Victor Blank joins the board on 1 March 2006.

Directors' interests

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

Employees

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

In the UK, the Bank supports Opportunity Now and is represented on the board of Race for Opportunity, campaigns to improve opportunities for women and ethnic minorities in the work place. The Bank is a gold card member of the Employers' Forum on Disability, in support of employment of people with disabilities. This recognises the need for

ensuring fair employment practices in recruitment and selection, and the retention, training and career development of disabled staff.

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

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

Policy and practice on payment of creditors

The Bank follows 'The Better Payment Practice Code' published by the Department of Trade and Industry (DTI) regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from The DTI Publications Orderline 0845 0150010, quoting ref URN 04/606.

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

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is 27. This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2005 bears to the aggregate of the amounts invoiced by suppliers during the year.

On behalf of the board

A J Michie
Secretary

23 February 2006



Directors

M A van den Bergh
Chairman
(retiring on 11 May 2006)

Sir Victor Blank
Deputy Chairman
(from 1 March 2006)
(succeeding M A van den Bergh as Chairman)

J E Daniels
Chief Executive

M E Fairey
Deputy Chief Executive

H A Weir
Finance Director

W C G Berndt

Ewan Brown CBE

T A Dial

J P du Plessis

G J N Gemmell CBE

Sir Julian Horn-Smith

D S Julius CBE

A G Kane

A A Knight

Lord Leitch

G T Tate

Independent auditors' report

To the members of Lloyds TSB Bank plc

We have audited the consolidated and parent company financial statements (the 'financial statements') for the year ended 31 December 2005 which comprise the consolidated income statement, the consolidated and parent company balance sheets, the consolidated and parent company cash flow statements, the consolidated and parent company statement of changes in equity 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. 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 whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the annual report and consider whether it is consistent with the audited financial statements. The other information comprises only the directors' report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

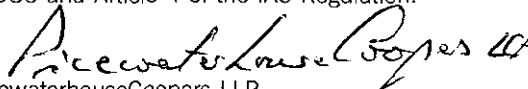
We conducted our audit in accordance with International Standards on Auditing issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates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

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

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2005 and of its profit and cash flows for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2005 and cash flows for the year then ended; and
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.



PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

Southampton

23 February 2006

Consolidated income statement
for the year ended 31 December 2005

	Note	2005 £ million	2004 £ million
Interest and similar income		12,592	10,652
Interest and similar expense		(6,920)	(5,558)
Net interest income	4	5,672	5,094
Fees and commission income		2,993	3,057
Fees and commission expense		(842)	(844)
Net fees and commission income	5	2,151	2,213
Net trading income	6	9,293	5,036
Insurance premium income	7	4,469	6,070
Other operating income	8	1,140	857
Other income		17,053	14,176
Total income		22,725	19,270
Insurance claims	9	(12,186)	(9,622)
Total income, net of insurance claims		10,539	9,648
Operating expenses	10	(5,436)	(5,260)
Trading surplus		5,103	4,388
Impairment losses on loans and advances	11	(1,299)	(866)
Profit (loss) on sale and closure of businesses	12	50	(21)
Profit before tax		3,854	3,501
Taxation	13	(1,288)	(1,063)
Profit for the year		2,566	2,438
Profit attributable to minority interests		62	67
Profit attributable to equity shareholders		2,504	2,371
Profit for the year		2,566	2,438

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

Balance sheets
at 31 December 2005

		The Group		The Bank	
	Note	2005 £ million	2004 £ million	2005 £ million	2004 £ million
Assets					
Cash and balances at central banks		1,156	1,078	966	998
Items in the course of collection from banks		1,310	1,462	1,256	1,416
Treasury bills and other eligible bills	14	██████████	92	██████████	88
Trading securities and other financial assets at fair value through profit or loss	15	60,567	██████████	5,924	██████████
Derivative financial instruments	16	5,878	██████████	6,050	██████████
Loans and advances to banks	17	31,655	31,848	86,090	79,819
Loans and advances to customers	18	176,635	157,059	91,759	76,855
Debt securities	20	██████████	43,485	██████████	16,531
Equity shares	21	██████████	27,518	██████████	17
Available-for-sale financial assets	22	14,940	██████████	4,503	██████████
Investment property	23	4,260	3,776	—	—
Goodwill	24	2,373	2,469	8	118
Value of in-force business	25	2,922	4,363	—	—
Other intangible assets	26	50	28	23	21
Deferred tax asset	39	—	—	984	788
Tangible fixed assets	27	4,291	4,180	1,243	1,266
Investment in subsidiary undertakings	29	—	—	16,078	17,596
Other assets	30	5,584	9,005	2,887	4,870
Total assets		311,621	286,363	217,771	200,383

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

The directors approved the financial statements on 23 February 2006.

Maarten A van den Bergh
Chairman

J Eric Daniels
Group Chief Executive

Helen A Weir
Group Finance Director

Maarten A van den Bergh *J Eric Daniels*

Helen A Weir

Balance sheets
at 31 December 2005

		The Group		The Bank	
	Note	2005 £ million	2004 £ million	2005 £ million	2004 £ million
Equity and liabilities					
Liabilities					
Deposits from banks	31	31,527	39,723	37,973	47,544
Customer accounts	32	131,350	120,103	115,505	100,687
Items in course of transmission to banks		658	631	533	527
Derivative financial instruments and other trading liabilities	16	6,584		7,212	
Debt securities in issue	33	39,346	28,770	31,316	23,407
Liabilities arising from insurance contracts and participating investment contracts	34	40,684	52,419	–	–
Liabilities arising from non-participating investment contracts	35	21,839		–	
Unallocated surplus within insurance businesses	36	518	1,362	–	–
Other liabilities	37	9,876	14,504	2,990	7,097
Retirement benefit obligations	38	2,910	3,075	2,206	2,330
Current tax liabilities		536	434	73	136
Deferred tax liabilities	39	1,170	1,719	–	–
Other provisions	40	368	211	298	160
Subordinated liabilities	41	12,635	10,629	11,382	10,479
Total liabilities		300,001	273,580	209,488	192,367
Equity					
Share capital	42	1,542	1,542	1,542	1,542
Share premium account	43	2,960	2,960	2,960	2,960
Other reserves	44	40	–	37	–
Retained profits	45	6,643	7,650	3,744	3,514
Shareholders' equity		11,185	12,152	8,283	8,016
Minority interests	48	435	631	–	–
Total equity		11,620	12,783	8,283	8,016
Total equity and liabilities		311,621	286,363	217,771	200,383

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

Statements of changes in equity

The Group

	Attributable to equity shareholders				
	Share capital and premium £m	Other reserves £m	Retained profits £m	Total £m	Minority interests £m
Balance at 1 January 2004 (note 54)	4,502	–	7,204	11,706	782
Currency translation differences	–	–	(12)	(12)	1
Profit for the year	–	–	2,371	2,371	67
Total recognised income for 2004	–	–	2,359	2,359	68
Dividends	–	–	(1,913)	(1,913)	(68)
Change in minority interests	–	–	–	–	(151)
Balance at 31 December 2004 (note 54)	4,502	–	7,650	12,152	631
Adjustments on transition to IAS 32, IAS 39 and IFRS 4 (note 54)	–	28	(1,614)	(1,586)	(550)
Restated balance at 1 January 2005 (note 54)	4,502	28	6,036	10,566	81
Movement in available-for-sale financial assets, net of tax	–	8	–	8	–
Movement in cash flow hedges, net of tax	–	11	–	11	–
Currency translation differences	–	(7)	16	9	–
Net income recognised directly in equity	–	12	16	28	–
Profit for the year	–	–	2,504	2,504	62
Total recognised income for 2005	–	12	2,520	2,532	62
Dividends	–	–	(1,913)	(1,913)	(37)
Change in minority interests	–	–	–	–	329
Balance at 31 December 2005	4,502	40	6,643	11,185	435

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

Statements of changes in equity

The Bank

Attributable to equity shareholders

	Share capital and premium £m	Other reserves £m	Retained profits £m	Total £m
Balance at 1 January 2004 (note 54)	4,502	—	2,754	7,256
Currency translation differences	—	—	(7)	(7)
Profit for the year	—	—	2,680	2,680
Total recognised income for 2004	—	—	2,673	2,673
Dividends	—	—	(1,913)	(1,913)
Balance at 31 December 2004 (note 54)	4,502	—	3,514	8,016
Adjustments on transition to IAS 32 and IAS 39 (note 54)	—	22	(618)	(596)
Restated balance at 1 January 2005 (note 54)	4,502	22	2,896	7,420
Movement in available-for-sale financial assets, net of tax	—	11	—	11
Movement in cash flow hedges, net of tax	—	11	—	11
Currency translation differences	—	(7)	25	18
Net income recognised directly in equity	—	15	25	40
Profit for the year	—	—	2,736	2,736
Total recognised income for 2005	—	15	2,761	2,776
Dividends	—	—	(1,913)	(1,913)
Balance at 31 December 2005	4,502	37	3,744	8,283

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

Cash flow statements
for the year ended 31 December 2005

	Note	The Group		The Bank	
		2005 £ million	2004 £ million	2005 £ million	2004 £ million
Net cash (used in) provided by operating activities	53a	(306)	12,226	(4,914)	12,225
Cash flows from investing activities:					
Purchase of fixed asset investments			(10,088)		(9,407)
Proceeds from sale and maturity of fixed asset investments			9,732		8,705
Purchase of available-for-sale financial assets		(10,108)		(8,210)	
Proceeds from sale and maturity of available-for-sale financial assets		10,266		9,958	
Purchase of fixed assets		(1,843)	(1,565)	(318)	(314)
Proceeds from sale of fixed assets		1,073	698	46	27
Additional capital injections to subsidiaries		–	–	(250)	(1,371)
Capital repayments by subsidiaries		–	–	350	–
Acquisition of businesses, net of cash acquired	53e	(27)	(17)	(4)	(2)
Disposal of businesses, net of cash disposed	53f	(4)	(25)	–	(11)
Net cash (used in) generated by investing activities		(643)	(1,265)	1,572	(2,373)
Cash flows from financing activities:					
Dividends paid to equity shareholders		(1,913)	(1,913)	(1,913)	(1,913)
Dividends paid to minority interests	53d	(37)	(68)	–	–
Proceeds from issue of subordinated liabilities	53d	1,361	699	810	699
Repayment of subordinated liabilities (loan capital)	53d	(232)	(764)	(232)	(759)
Capital element of finance lease rental payments	53d	(2)	(1)	(2)	(1)
Change in minority investment in subsidiaries	53d	329	(151)	–	–
Net cash used in financing activities		(494)	(2,198)	(1,337)	(1,974)
Change in cash and cash equivalents		(1,443)	8,763	(4,679)	7,878
Cash and cash equivalents at beginning of year		28,196	19,433	21,986	14,108
Cash and cash equivalents at end of year	53b	26,753	28,196	17,307	21,986

Cash and cash equivalents comprise cash and balances at central banks (excluding mandatory deposits) and amounts due from banks with a maturity of less than three months.

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

Notes to the accounts

1 Accounting policies

In accordance with the requirements of Regulation (EC) No 1606/2002 of the European Parliament, the Group has applied International Financial Reporting Standards ('IFRS') as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2005. The rules for first time adoption of IFRS are set out in IFRS 1 'First-time Adoption of International Financial Reporting Standards'. On 1 January 2004, the date of transition, the opening IFRS balance sheet position has been determined in accordance with IFRS 1 which requires IFRS accounting policies to be applied on a retrospective basis with certain exceptions and exemptions detailed below.

Mandatory exception Impact

Estimates	The Group's estimates at the date of transition are consistent with those under UK GAAP.
Assets held for sale and discontinued operations	The Group has no transactions prior to 1 January 2005 that are affected by the transitional requirements of IFRS 5.
Derecognition of financial instruments	Financial instruments derecognised before 1 January 2004 have not been re-recognised by the Group under IFRS.
Hedge accounting	IFRS compliant hedge accounting is applied by the Group from 1 January 2005.

Voluntary exemption Impact

Business combinations	By electing to apply IFRS 3 on a prospective basis from 1 January 2004, the Group has not restated past acquisitions and mergers. Goodwill previously written off to reserves has not been reinstated and no additional intangible assets have been recognised in this regard.
Retirement benefits	Under UK GAAP, the Group has recognised all cumulative actuarial gains and losses and elects to apply this treatment at the date of transition to IFRS.
Cumulative translation adjustment	The Group has opted to reset the cumulative translation difference on adoption of IFRS to zero.
Comparatives for financial instruments and designation of financial assets	The Group has chosen not to restate comparatives for IAS 32 and IAS 39, but to reflect the impact of these standards through adjustments to shareholders' equity as at 1 January 2005. At this date the Group has designated various financial assets as at fair value through profit or loss or as available-for-sale. The Group has applied UK GAAP to financial instruments and hedging transactions for its 2004 comparatives.
Share-based payments	The Group has elected to apply IFRS 2 to equity instruments that were granted before 7 November 2002.
Insurance contracts	The Group has chosen not to restate its comparatives for IFRS 4 but to reflect the impact of this standard through adjustments to shareholders' equity at 1 January 2005. The Group has applied UK GAAP for its 2004 comparatives.

The Group has also adopted the requirements of Financial Reporting Standard ('FRS') 27 'Life Assurance' issued by the UK Accounting Standards Board. FRS 27 has been applied from 1 January 2005; comparative figures have not been restated.

1 Accounting policies (continued)

The financial information has been prepared under the historical cost convention, as modified by the revaluation of investment properties, available-for-sale financial assets, trading securities and other financial assets at fair value through profit or loss and all derivative contracts, on the basis of IFRS as adopted by the 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 which is operative for years commencing 1 January 2005 relaxes some of the hedge accounting requirements; the Group has not taken advantage of this relaxation.

Further information on the principal differences between IFRS and FRS 27 and the Group's previous accounting policies and the effect of their adoption on the Group's previously published information is given in note 54.

The accounting policies are set out below:

a Consolidation

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

b Goodwill

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

Goodwill arising on acquisitions prior to 1 January 2004, the date of transition to IFRS, has been retained at the balance sheet amount at that date and has been tested for impairment at that date. Goodwill previously written off directly to reserves under UK GAAP has not been reinstated and will not be included in calculating any subsequent profit or loss on disposal.

Notes to the accounts

1 Accounting policies (continued)**c 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. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see i).

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

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

Revenue recognition policies specific to life assurance and general insurance business, except for investment management fees as noted above, are detailed below (see r).

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

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

Other financial assets at fair value through profit or loss are designated as such by management upon initial recognition. Such assets are carried in the balance sheet at their fair value and gains and losses recognised in the income statement in the period in which they occur. Financial assets are only designated as at fair value through profit or loss when doing so results in more relevant information because it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis. No use is currently made of the option to designate financial liabilities at fair value through profit or loss.

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

1 Accounting policies (continued)

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

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

e Loans and advances to banks and customers

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

f Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as assets pledged when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in deposits from banks or customer accounts, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

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

g Derivative financial instruments and hedge accounting

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

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

Notes to the accounts

1 Accounting policies (continued)

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

(1) Fair value hedges

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

(2) Cash flow hedges

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

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

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

h Offset

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

i Impairment**(1) Assets accounted for at amortised cost**

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

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

1 Accounting policies (continued)

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

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

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

(2) Available-for-sale assets

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

j Investment property

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

k 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:

Notes to the accounts

1 Accounting policies (continued)

Premises (excluding land):

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

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.

l Leases**(1) As lessee**

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

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

(2) As lessor

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

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

m Investment in subsidiary undertakings

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

n Borrowings

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

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

o Pensions and other post-retirement benefits

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

1 Accounting policies (continued)

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

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

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

p Share-based compensation

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

q Income taxes, including deferred income taxes

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

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

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

Notes to the accounts

1 Accounting policies (continued)

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

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

r Insurance

The Group undertakes both life assurance and general insurance business. The general insurance business issues insurance contracts only. The life assurance business issues insurance contracts and investment contracts. Insurance contracts are those contracts which transfer significant insurance risk. As a general guideline, the Group defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event which are more than the benefits payable if the insured event were not to occur. Investment contracts are those contracts which carry no significant insurance risk.

A number of insurance and investment contracts contain a discretionary participation feature which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses that are likely to be a significant portion of the total contractual benefits and whose amount or timing is contractually at the discretion of the Group and based on the performance of specified assets. Contracts containing a discretionary participation feature are referred to as participating contracts.

IFRS 4 allows entities to continue with existing accounting policies for insurance and participating investment contracts, subject to certain criteria; the Group continues to apply UK GAAP for such contracts. For insurance and participating contracts issued by the life assurance business, this includes continued application of the embedded value basis of accounting although, as described below, the underlying contracts are presented separately from the value of in-force life assurance business in respect of those contracts. Investment contracts that are non-participating are accounted for as financial instruments.

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

The majority of the life insurance contracts issued by the Group are long-term life assurance contracts. The Group also issues life insurance contracts to protect customers from the consequences of events (such as death, critical illness or disability) that would affect the ability of the customer or their dependants to maintain their current level of income. Guaranteed claims paid on occurrence of the specified insurance event are either fixed or linked to the extent of the economic loss suffered by the policyholder.

Premiums and claims

Premiums received in respect of life insurance contracts and participating investment contracts are recognised as revenue when due and are shown before deduction of commission.

Claims are recorded as an expense when they are incurred.

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

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

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

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

– life insurance contracts or participating investment contracts which are unit-linked

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

Unallocated surplus

The Group has an obligation to pay policyholders a specified portion of all interest and realised gains and losses arising from the assets backing participating contracts. Any amounts not yet determined as being due to policyholders are recognised as an unallocated surplus which is shown separately from other liabilities.

Value of in-force life assurance business

The Group recognises as an asset the value of in-force life assurance business in respect of life insurance contracts and participating investment contracts. The asset, which represents the present value of future profits expected to arise from these contracts, is determined by projecting the future surpluses and other cash flows arising from life insurance contract and participating investment contract business written by the balance sheet date but excluding any future investment margins, using appropriate economic and actuarial assumptions; the value of future cash flows on with-profits policies has been reduced, where necessary, to allow for the realistic value of options and guarantees. The result is discounted at a rate which removes investment margins and reflects the Group's overall risk premium attributable to this business. The asset in the consolidated balance sheet is shown gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

Receivables and payables

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

Notes to the accounts

1 Accounting policies (continued)**(ii) Accounting for non-participating investment contracts**

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

The element of premiums and claims in respect of non-participating investment contracts which is invested on behalf of the contract holder is excluded from the income statement, with all movements in the contract holder liability and related assets recorded in the balance sheet. Details of the basis of revenue recognition for the related investment management fees are set out above (see c).

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

(2) General insurance business

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

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

(3) Liability adequacy test

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

(4) Reinsurance

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

1 Accounting policies (continued)

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

s Foreign currency translation**(1) Functional and presentation currency**

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

(2) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

(3) Group companies

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

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

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

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

t Provisions

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

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

Notes to the accounts

1 Accounting policies (continued)

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.

u Dividends

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

2 Critical accounting estimates and judgements

The Group makes assumptions and estimates that affect the reported amounts of assets and liabilities. Estimates and judgments 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. The accounting policies deemed critical to the Group's results and financial position, based upon materiality and significant judgments and estimates, are discussed below.

Impairment on assets accounted for at amortised cost

The Group regularly reviews its loan portfolios to assess for impairment. In determining whether an impairment has occurred the Group considers whether there is any observable data indicating that there has been a measurable decrease in the estimated future cash flows and their timings; such observable data includes whether there has been an adverse change in the payment status of borrowers or changes in economic conditions that correlate with defaults on assets in the Group.

The methodology used to calculate the required provision varies according to the type of lending portfolio. For portfolios of smaller balance homogenous loans, such as residential mortgages, personal loans and credit card balances, impairment provisions are calculated collectively using formulae which take into account factors such as the length of time that the customer's account has been delinquent, historical loss rates and the value of any collateral held in order to determine expected future cash flows. The variables used in the formulae are kept under regular review to ensure that as far as possible they reflect the current economic circumstances, although actual experience may differ from that assumed.

For other lending portfolios, provisions are calculated on an individual basis with reference to expected future cash flows including those arising from the realisation of collateral. The determination of these provisions often requires the exercise of considerable judgement by management involving matters such as future economic conditions and the resulting trading performance of the customer and the value of collateral, for which there may not be a readily accessible market. As a result these provisions can be subject to significant variation as time progresses and the circumstances of the customer become clearer.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Pensions

The net liability recognised in the balance sheet in respect of the Group's retirement benefit obligations represents the liabilities of the Group's defined benefit pension schemes after deduction of the fair value of the related assets. The schemes' liabilities are derived by estimating the ultimate cost of benefits payable by the schemes and reflecting the discounted value of the proportion accrued by the year-end in the balance sheet. In order to arrive at this estimate a number of key financial and non-financial assumptions are made by management, changes to which could have a material impact upon the net deficit and also the net cost recognised in the income statement.

The principal assumptions relate to the rate of inflation, mortality and the discount rate. The assumed rate of inflation is important because this affects the rate at which salaries grow and therefore the size of the pension that employees receive upon retirement. Over the longer term rates of inflation can vary significantly; at 31 December 2005 it was assumed that the longer term rate of inflation would be 2.7 per cent on average, although if this was increased by 0.2 per cent the net deficit would increase by approximately £600 million and the net cost by approximately £15 million. A reduction of 0.2 per cent would reduce the net deficit by approximately £575 million and the net cost by approximately £20 million.

Notes to the accounts

2 Critical accounting estimates and judgements (continued)

The overall cost of the benefits payable by the schemes will also depend upon the length of time that members of the schemes live for; the longer they remain alive the higher the cost of the pension benefits to be met by the schemes. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rates of advance in medical science it is uncertain whether these assumptions will prove to be accurate in practice. An increase of one year in the expected lifetime of scheme members would increase the net deficit by approximately £450 million and the net cost by approximately £30 million; a reduction of one year reduces the net deficit and the net cost by similar amounts.

The rate used to discount the resulting cash flows is equivalent to the market yield at the balance sheet date on high quality bonds with a similar duration to the schemes' liabilities. This rate is potentially subject to significant variation. At 31 December 2005 the discount rate used was 4.8 per cent; a reduction of 0.2 per cent would result in an increase in the net deficit of approximately £650 million and in the net cost of approximately £15 million while an increase of 0.2 per cent would reduce the net deficit by approximately £600 million and the net cost by approximately £15 million.

The net cost recognised in the income statement is also affected by the expected return on the schemes' assets. This is determined on the basis of the asset mix within the schemes at the beginning of the year and market expectations for the return on each asset type. During 2005 the assumed return on equities was 8.2 per cent; a 0.25 per cent increase or decrease in the assumed return on equities increases or decreases the expected return reflected in the income statement by approximately £20 million.

Goodwill

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

Customer remediation provisions

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes are found to have been deficient. The ultimate cost is inherently uncertain and in determining the level of provisions required it is necessary for management to exercise significant judgement. The principal assumptions underlying the provisions relate to the number of cases requiring redress and the estimated average cost of redress per case; these will be affected by external factors beyond the control of management, such as regulatory actions and the performance of the financial markets. Therefore over time it is possible that adjustments will be necessary to the level of provisions held.

Insurance**Life assurance business**

Calculation of the value of in-force life assurance business assets and life assurance business policy liabilities are dependent on assumptions made regarding future experience. If actual experience differs from that assumed, this could significantly affect the value attributed to those items. Any profit or loss arising from such changes would be recognised in the income statement in that period. The key assumptions upon which these items are dependent are described in notes 25 and 34, along with the impact on profit before tax which would occur if they were to change.

2 Critical accounting estimates and judgements (continued)**General insurance business**

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

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

Income taxes

Significant judgement is required in determining the Group's income tax liabilities. There are many transactions and calculations for which the ultimate tax determination is uncertain and where calculations have been based on management's assessment of legal and professional advice, case law and other relevant guidance. In these situations, the various risks are categorised and approximate weightings applied in arriving at the assessment of the expected liability. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax amounts in the period in which such determination is made.

Notes to the accounts

3 Segmental analysis

Lloyds TSB Group is a leading UK-based financial services group, whose businesses provide a wide range of banking and financial services in the UK and in certain locations overseas.

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

Under the Group's transfer pricing arrangements, inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds. In addition, with effect from 1 January 2005, for those derivative contracts entered into by business units for risk management purposes, the difference between the result that would have been recognised on an accruals accounting basis and the actual result calculated using fair values is charged or credited to the central segment where the resulting volatility is managed.

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

Notes to the accounts

3 Segmental analysis (continued)

Year ended 31 December 2004	UK Retail Banking £m	General insurance £m	Life, pensions and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Inter-segment eliminations £m	Total £m
Interest and similar income	5,825	56	537	593	5,954	828	(2,548)	10,652
Interest and similar expense	(2,597)	(12)	(298)	(310)	(3,948)	(1,251)	2,548	(5,558)
Net interest income	3,228	44	239	283	2,006	(423)	–	5,094
Other income (net of fee and commission expense)	1,696	504	10,370	10,874	1,558	48	–	14,176
Total income	4,924	548	10,609	11,157	3,564	(375)	–	19,270
Insurance claims	–	(214)	(9,408)	(9,622)	–	–	–	(9,622)
Total income, net of insurance claims	4,924	334	1,201	1,535	3,564	(375)	–	9,648
Operating expenses	(2,609)	(154)	(468)	(622)	(2,078)	49	–	(5,260)
Trading surplus	2,315	180	733	913	1,486	(326)	–	4,388
Impairment losses on loans and advances	(676)	–	3	3	(193)	–	–	(866)
Loss on sale of businesses	–	–	–	–	(21)	–	–	(21)
Profit (loss) before tax	1,639	180	736	916	1,272	(326)	–	3,501
External revenue	7,089	1,288	11,121	12,409	6,135	39	–	25,672
Inter-segment revenue	791	48	19	67	1,716	851	(3,425)	–
Segment revenue	7,880	1,336	11,140	12,476	7,851	890	(3,425)	25,672
External assets	96,763	1,058	70,874	71,932	114,086	3,582	–	286,363
Inter-segment assets	1,340	526	2,644	3,170	70,947	39,503	(114,960)	–
Total assets	98,103	1,584	73,518	75,102	185,033	43,085	(114,960)	286,363
External liabilities	68,149	931	62,305	63,236	130,171	12,024	–	273,580
Inter-segment liabilities	27,035	75	4,105	4,180	50,643	33,102	(114,960)	–
Total liabilities	95,184	1,006	66,410	67,416	180,814	45,126	(114,960)	273,580
Other segment items:								
Capital expenditure	103	–	386	386	907	169	–	1,565
Depreciation	217	11	25	36	385	–	–	638
Customer remediation provision	100	12	–	12	–	–	–	112
Retirement benefit scheme charges	142	3	24	27	90	16	–	275

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

Notes to the accounts

4 Net interest income

	2005 Average effective interest rate %	2005 £m	2004 £m
Interest receivable:			
Treasury bills and other eligible bills			6
Investment securities			418
Available-for-sale financial assets	3.58	508	
Loans and advances to customers	6.40	10,098	8,385
Loans and advances to banks	3.59	1,199	979
Lease and hire purchase receivables	7.07	787	864
	5.82	12,592	10,652
Interest payable:			
Deposits from banks	3.44	(953)	(558)
Customer accounts	2.81	(3,389)	(2,963)
Debt securities in issue	4.23	(1,307)	(972)
Subordinated liabilities	5.29	(615)	(602)
Liabilities under sale and repurchase agreements	4.53	(394)	(319)
Other	7.24	(262)	(144)
	3.41	(6,920)	(5,558)
Net interest income		5,672	5,094

Included within interest income of the Group in 2005 is £209 million in respect of impaired financial assets.

5 Net fees and commission income

	2005 £m	2004 £m
Fees and commission income:		
Current accounts	593	637
Insurance broking	681	672
Credit and debit card services	545	520
Other	1,174	1,228
	2,993	3,057
Fees and commission expense:		
Credit and debit card services	(182)	(176)
Dealer commissions	(247)	(272)
Other	(413)	(396)
	(842)	(844)
Net fees and commission income	2,151	2,213

6 Net trading income

	2005 £m	2004 £m
Foreign exchange translation gains	16	22
Gains on foreign exchange trading transactions	150	152
Total foreign exchange	166	174
Investment property gains	430	329
Securities and other gains	8,697	4,533
	9,293	5,036

7 Insurance premium income

The table below reflects the insurance premiums, substantially all of which relate to business written in the United Kingdom, broken down into life insurance and non-life insurance:

	2005 £m	2004 £m
<i>Life insurance</i>		
Gross premiums	3,996	5,581
Ceded reinsurance premiums	(89)	(65)
Net premiums earned	3,907	5,516
<i>Non-life insurance</i>		
Gross premiums written	575	635
Ceded reinsurance premiums	(22)	(29)
Net premiums	553	606
Change in provision for unearned premiums	9	(52)
Net premiums earned	562	554
Total net premiums earned	4,469	6,070

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

	2005 £m	2004 £m
Life	1,286	2,100
Pensions	2,136	2,826
Annuities	547	626
Other	27	29
Gross premiums	3,996	5,581

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

	2005 £m	2004 £m
Credit protection	173	224
Home	390	396
Health	12	15
	575	635

8 Other operating income

	2005 £m	2004 £m
Operating lease rental income	433	422
Income from investment property	272	158
Other rents receivable	30	32
Gains less losses on disposal of available-for-sale financial assets, net of allowances for impairment	5	
Gains less losses on disposal of investment securities, net of amounts written off		74
Movement in value of in-force insurance business (note 25)	162	16
Other income	238	155
	1,140	857

Notes to the accounts

9 Insurance claims

Insurance claims comprise:

	2005 £m	2004 £m
<i>Life insurance</i>		
Claims and surrenders:		
– Gross	4,279	5,242
– Reinsurers' share	(56)	(62)
	4,223	5,180
Changes in life insurance policyholder liabilities:		
– Gross	7,641	3,206
– Reinsurers' share	33	(1)
	7,674	3,205
Change in unallocated surplus	92	1,023
Total life insurance	11,989	9,408
<i>Non-life insurance</i>		
Claims and claims paid:		
– Gross	195	204
– Reinsurers' share	(1)	(1)
	194	203
Changes in non-life insurance policyholder liabilities:		
– Gross	3	11
– Reinsurers' share	–	–
	3	11
Total non-life insurance	197	214
Total insurance claims	12,186	9,622

Life insurance gross claims can also be analysed as follows:

	2005 £m	2004 £m
Death	298	354
Maturities	1,197	1,617
Surrenders	2,204	2,700
Annuities	528	528
Other	52	43
	4,279	5,242

A non-life insurance claims development table is included in note 34.

10 Operating expenses

	2005 £m	2004 £m
Salaries	2,068	1,969
Pensions	308	307
Other staff costs	479	427
Staff costs	2,855	2,703
Other administrative expenses:		
Operating lease rentals	252	249
Repairs and maintenance	136	129
Communications and data processing	467	449
Advertising	207	205
Professional fees	216	218
Provisions for customer remediation (note 40)	150	112
Other	508	557
	1,936	1,919
Depreciation	639	638
Impairment charges:		
Goodwill (note 24)	6	–
Total operating expenses	5,436	5,260

The average number of persons on a headcount basis employed by the Group during the year was 79,594 (2004: 82,953) of which 77,620 (2004: 79,581) were employed in the UK and 1,974 (2004: 3,372) overseas.

The auditors' remuneration was £8.0 million (2004: £5.2 million), of which £2.9 million (2004: £1.6 million) related to the Bank. Fees paid to the auditors in respect of non-audit services were £3.7 million (2004: £9.3 million). Non-audit fees relate to regulatory and other advisory work.

The aggregate of the emoluments of the directors was £8,826,000 (2004: £8,478,000).

The aggregate of the amount of the gains made by directors on the exercise of Lloyds TSB Group plc share options was £1,077,312 (2004: £492).

The number of directors to whom retirement benefits were accruing under defined contribution and defined benefit pension schemes were two and five respectively (2004: two and six).

The total for the highest paid director (Mr Daniels), was £1,930,000. The amount of his accrued pension at the year end was £99,000, being his pension entitlement based on pensionable service with the Group to 31 December 2005 but payable at normal retirement age. (The total for the highest paid director in 2004 (Mr Daniels), was £1,903,000).

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

11 Impairment losses on loans and advances

	2005 £m	2004 £m
Specific bad debt provisions	953	953
General bad debt provisions	(87)	(87)
Impairment losses on loans and advances (note 19)	1,302	866
Other credit risk provisions (note 40)	(3)	–
	1,299	866

Notes to the accounts

12 Profit (loss) on sale and closure of businesses

	2005 £m	2004 £m
Net profit (loss) on disposal of businesses	74	(21)
Adjustment to consideration received in respect of prior period disposals	(4)	–
Provision for costs in respect of the closure of businesses	(20)	–
	50	(21)

The net profit (loss) on the disposal of businesses in 2005 principally relates to the sale of the Goldfish credit card business. During the year ended 31 December 2004 the Group completed the sales of its principal businesses in Colombia and substantially all of the businesses of the branches of Lloyds TSB Bank plc in Argentina, Panama, Guatemala and Honduras.

The businesses sold in 2004 and 2005 were not material to the Group, and consequently they have not been treated as discontinued operations.

13 Taxation

	2005 £m	2004 £m
a Analysis of charge for the year		
UK corporation tax:		
– Current tax on profits for the year	868	788
– Adjustments in respect of prior years	(4)	(51)
	864	737
Double taxation relief	(138)	(57)
	726	680
Foreign tax:		
– Current tax on profit for the year	78	118
– Adjustments in respect of prior years	(8)	(2)
	70	116
Current tax charge	796	796
Deferred tax (note 39)	492	267
	1,288	1,063

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2004: 30 per cent).

The Group, as a proxy for policyholders in the UK, is required to record taxes on investment income and gains each year. Accordingly, the tax benefit or expense attributable to UK life insurance policyholder earnings is included in income tax expense. The tax expense attributable to policyholder earnings was £298 million (2004: £36 million), including a prior year tax credit of £25 million (2004: £6 million).

b Factors affecting the tax charge for the year

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

	2005 £m	2004 £m
Profit before tax	3,854	3,501
Tax charge thereon at UK corporation tax rate of 30%	1,156	1,050
Factors affecting charge:		
Disallowed and non-taxable items	(31)	(34)
Overseas tax rate differences	(1)	(14)
Net tax effect of disposals and unrealised gains	(59)	(2)
Tax deductible coupons on non-equity minority interests	–	(12)
Policyholder tax and Open Ended Investment Companies	223	33
Other items	–	42
Tax on profit on ordinary activities	1,288	1,063
Effective rate	33.4%	30.4%

The effective tax rate of the Group excluding the gross policyholder tax charge and Open Ended Investment Company interests from profit before tax and the tax charge was 27.4 per cent (2004: 29.4 per cent).

Notes to the accounts

14 Treasury bills and other eligible bills

Up to 31 December 2004 (prior to the implementation of IAS 32 and IAS 39 on 1 January 2005) treasury bills and other eligible bills were shown separately on the balance sheet. This balance sheet caption comprised both investment securities and other securities. Investment securities were those intended for use on a continuing basis in the activities of the Group and not for dealing purposes. At 31 December 2005, treasury bills and other eligible bills are categorised as either trading securities and other financial assets at fair value through profit or loss (note 15) or available-for-sale financial assets (note 22).

Details of the balance sheet carrying value of the treasury bills and other eligible bills held at 31 December 2004 were as follows:

	The Group £m	The Bank £m
Investment securities:		
Treasury bills and similar securities	75	75
Other eligible bills	13	13
	<u>88</u>	<u>88</u>
Other securities:		
Treasury bills and similar securities	4	–
Balance sheet carrying value – treasury bills and other eligible bills	<u>92</u>	<u>88</u>
Geographical analysis by issuer:		
Latin America	18	18
Other	<u>74</u>	<u>70</u>
	<u>92</u>	<u>88</u>

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

From 1 January 2005 (upon the implementation of IAS 32 and IAS 39), the Group is required to disclose its trading securities and other financial assets at fair value through profit or loss separately on the face of the balance sheet.

Details of the balance sheet carrying value of these assets held at 31 December 2005 are:

	The Group £m	The Bank £m
Trading securities	<u>5,442</u>	<u>5,442</u>
Other financial assets at fair value through profit or loss	<u>55,125</u>	<u>482</u>
	<u>60,567</u>	<u>5,924</u>

These assets are comprised as follows:

	Trading securities		Other financial assets at fair value through profit or loss	
	The Group £m	The Bank £m	The Group £m	The Bank £m
Loans and advances to banks	5	5	5	5
Loans and advances to customers	161	161	445	445
Debt securities				
Government securities	535	535	10,638	–
Other public sector securities	35	35	84	–
Bank and building society certificates of deposit	–	–	898	–
Corporate debt securities	4,667	4,667	4,214	–
Mortgage backed securities	39	39	197	–
Other asset backed securities	–	–	691	32
Other debt securities	–	–	4,255	–
	<u>5,276</u>	<u>5,276</u>	<u>20,977</u>	<u>32</u>
Equity shares				
Listed	–	–	27,690	–
Unlisted	–	–	6,008	–
	<u>–</u>	<u>–</u>	<u>33,698</u>	<u>–</u>
	<u>5,442</u>	<u>5,442</u>	<u>55,125</u>	<u>482</u>

See notes 14, 20 and 21 for details of investments held at 31 December 2004.

Notes to the accounts

16 Derivative financial instruments and other trading liabilities

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

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

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

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

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

16 Derivative financial instruments and other trading liabilities (continued)

The Group	Contract/ notional amount £m	Fair values	
		Assets £m	Liabilities £m
31 December 2005			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	145,591	1,515	1,345
Currency swaps	12,770	267	237
Options purchased	3,623	58	–
Options written	3,892	–	45
	165,876	1,840	1,627
Interest rate contracts:			
Interest rate swaps	289,640	2,814	4,015
Forward rate agreements	50,006	16	20
Options purchased	12,679	108	–
Options written	8,812	–	85
Futures	29,358	–	–
	390,495	2,938	4,120
Equity and other contracts	5,349	610	84
Total derivative assets/liabilities held for trading		5,388	5,831
Hedging			
<i>Derivatives designated as fair value hedges:</i>			
Cross currency interest rate swaps	69	12	–
Interest rate swaps (including swap options)	39,499	473	730
	39,568	485	730
<i>Derivatives designated as cash flow hedges:</i>			
Interest rate swaps	648	5	23
Total derivative assets/liabilities held for hedging		490	753
Total recognised derivative assets/liabilities		5,878	6,584

Notes to the accounts

16 Derivative financial instruments and other trading liabilities (continued)

The Group	Contract/ notional amount £m	Fair values	
		Assets £m	Liabilities £m
31 December 2004			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	117,532	4,593	5,237
Currency swaps	11,850	426	635
Options purchased	2,059	44	-
Options written	1,922	-	41
	<u>133,363</u>	<u>5,063</u>	<u>5,913</u>
Interest rate contracts:			
Interest rate swaps	276,476	3,118	3,792
Forward rate agreements	62,797	28	24
Options purchased	9,679	78	-
Options written	7,430	-	163
Futures	48,278	-	-
	<u>404,660</u>	<u>3,224</u>	<u>3,979</u>
Equity and other contracts	<u>4,294</u>	<u>538</u>	<u>215</u>
Effect of netting		(3,956)	(3,956)
Total derivative assets/liabilities held for trading		<u>4,869</u>	<u>6,151</u>

At 31 December 2004, the fair value amounts shown above were included on the balance sheet within other assets and other liabilities (see notes 30 and 37).

The maturity of the notional principal amounts and replacement cost of trading instruments entered into with third parties was:

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
<i>Exchange rate contracts:</i>				
Notional principal amount	120,794	8,093	4,476	133,363
Replacement cost	4,610	177	276	5,063
<i>Interest rate contracts:</i>				
Notional principal amount	203,851	153,672	47,137	404,660
Replacement cost	458	1,353	1,413	3,224
<i>Equity and other contracts:</i>				
Notional principal amount	638	3,358	298	4,294
Replacement cost	262	258	18	538
<i>Total:</i>				
Notional principal amount	325,283	165,123	51,911	542,317
Replacement cost	5,330	1,788	1,707	8,825

16 Derivative financial instruments and other trading liabilities (continued)

The Bank	Contract/ notional amount £m	Fair values	
		Assets £m	Liabilities £m
31 December 2005			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	133,585	1,490	1,328
Currency swaps	13,799	356	244
Options purchased	3,949	58	-
Options written	3,898	-	45
	<u>155,231</u>	<u>1,904</u>	<u>1,617</u>
Interest rate contracts:			
Interest rate swaps	300,842	3,103	4,260
Forward rate agreements	50,041	16	20
Options purchased	12,769	108	-
Options written	9,260	-	92
Futures	29,358	-	-
	<u>402,270</u>	<u>3,227</u>	<u>4,372</u>
Equity and other contracts	<u>7,733</u>	<u>499</u>	<u>496</u>
Total derivative assets/liabilities held for trading		<u>5,630</u>	<u>6,485</u>
<i>Hedging</i>			
<i>Derivatives designated as fair value hedges:</i>			
Cross currency interest rate swaps	69	12	-
Interest rate swaps (including swap options)	36,251	403	704
	<u>36,320</u>	<u>415</u>	<u>704</u>
<i>Derivatives designated as cash flow hedges:</i>			
Interest rate swaps	648	5	23
Total derivative assets/liabilities held for hedging		<u>420</u>	<u>727</u>
Total recognised derivative assets/liabilities		<u>6,050</u>	<u>7,212</u>

Notes to the accounts

16 Derivative financial instruments and other trading liabilities (continued)

	Contract/ notional amount £m	Fair values	
		Assets £m	Liabilities £m
The Bank			
31 December 2004			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	115,594	2,036	2,662
Currency swaps	12,693	601	633
Options purchased	2,290	45	-
Options written	1,938	-	44
	<u>132,515</u>	<u>2,682</u>	<u>3,339</u>
Interest rate contracts:			
Interest rate swaps	283,534	3,328	3,859
Forward rate agreements	62,797	28	24
Options purchased	9,783	79	-
Options written	7,484	-	163
Futures	48,278	-	-
	<u>411,876</u>	<u>3,435</u>	<u>4,046</u>
Equity and other contracts	<u>7,098</u>	<u>282</u>	<u>263</u>
Effect of netting		<u>(3,956)</u>	<u>(3,956)</u>
Total derivative assets/liabilities held for trading		<u>2,443</u>	<u>3,692</u>

At 31 December 2004, the fair value amounts shown above were included on the balance sheet within other assets and other liabilities (see notes 30 and 37).

The maturity of the notional principal amounts and replacement cost of trading instruments entered into with third parties was:

	Under 1 year £m	1 to 5 years £m	Over 5 years £m	Total £m
<i>Exchange rate contracts:</i>				
Notional principal amount	119,089	8,950	4,476	132,515
Replacement cost	2,054	352	276	2,682
<i>Interest rate contracts:</i>				
Notional principal amount	205,509	157,877	48,490	411,876
Replacement cost	464	1,426	1,545	3,435
<i>Equity contracts:</i>				
Notional principal amount	946	5,556	596	7,098
Replacement cost	6	258	18	282
<i>Total:</i>				
Notional principal amount	325,544	172,383	53,562	551,489
Replacement cost	2,524	2,036	1,839	6,399

17 Loans and advances to banks

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Lending to banks	2,510	2,483	66,954	59,300
Money market placements with banks	29,146	29,366	19,137	20,520
Total loans and advances to banks	31,656	31,849	86,091	79,820
Allowance for impairment losses (note 19)	(1)	(1)	(1)	(1)
	<u>31,655</u>	<u>31,848</u>	<u>86,090</u>	<u>79,819</u>

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

18 Loans and advances to customers

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
<i>Domestic</i>				
Agriculture, forestry and fishing	2,299	2,076	873	720
Manufacturing	5,983	3,292	4,684	2,611
Construction	2,059	1,877	1,738	1,658
Transport, distribution and hotels	7,649	6,753	6,569	5,815
Property companies	8,267	5,775	7,494	5,122
Financial, business and other services	16,272	13,442	12,418	10,108
Personal:				
- Mortgages	88,528	80,065	385	338
- Other	22,776	22,830	18,894	19,056
Lease financing	5,815	6,227	-	-
Hire purchase	4,853	4,828	273	176
Due from fellow Group undertakings	1,692	1,741	29,645	24,979
Other	7,695	5,223	5,744	3,492
	<u>173,888</u>	<u>154,129</u>	<u>88,717</u>	<u>74,075</u>
<i>International</i>				
Latin America	173	125	173	125
USA	1,984	2,385	1,946	1,985
Europe	1,927	1,587	1,927	1,587
Rest of the world	735	516	714	500
Total international	4,819	4,613	4,760	4,197
	<u>178,707</u>	<u>158,742</u>	<u>93,477</u>	<u>78,272</u>
Allowance for impairment losses (note 19)	(2,072)	(1,662)	(1,718)	(1,408)
Interest held in suspense	████████	(21)	████████	(9)
	<u>176,635</u>	<u>157,059</u>	<u>91,759</u>	<u>76,855</u>

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

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18 Loans and advances to customers (continued)

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

	The Group	
	2005 £m	2004 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	673	603
Later than 1 year and not later than 5 years	2,388	2,698
Later than 5 years	6,025	7,481
	9,086	10,782
Unearned future finance income on finance leases	(2,954)	(4,021)
Rentals received in advance	(200)	(338)
Commitments for expenditure in respect of equipment to be leased	(117)	(196)
Net investment in finance leases	5,815	6,227

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

	The Group	
	2005 £m	2004 £m
Not later than 1 year	648	446
Later than 1 year and not later than 5 years	1,610	844
Later than 5 years	3,557	4,937
	5,815	6,227

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other 'big ticket' items. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £4 million (2004: £10 million).

19 Allowance for impairment losses on loans and advances

The Group	2005 £m	Specific £m	2004 General £m	Total £m
At 1 January	1,663	1,313	382	1,695
Adjustment on transition to IAS 39	256			
Restated balance at 1 January	1,919			
Exchange and other adjustments	1	(8)	(3)	(11)
Reclassifications	43	-	-	-
Adjustments on acquisitions and disposals	(27)	(21)	(12)	(33)
Advances written off	(1,236)	(1,028)	-	(1,028)
Recoveries of advances written off in previous years	158	174	-	174
Effect of unwinding of discount recognised through interest income	(87)			
Charge (release) to the income statement	1,302	953	(87)	866
At 31 December	2,073	1,383	280	1,663
In respect of:				
Loans and advances to banks (note 17)	1			1
Loans and advances to customers (note 18)	2,072			1,662
	2,073			1,663

19 Allowance for impairment losses on loans and advances (continued)

The Bank	2005 £m	Specific £m	2004 General £m	Total £m
At 1 January	1,409	1,119	318	1,437
Adjustment on transition to IAS 39	236			
Restated balance at 1 January	1,645			
Exchange and other adjustments	(1)	(9)	(3)	(12)
Reclassifications	43	-	-	-
Adjustments on acquisitions and disposals	(27)	(13)	(12)	(25)
Advances written off	(1,054)	(887)	-	(887)
Recoveries of advances written off in previous years	138	154	-	154
Effect of unwinding of discount recognised through interest income	(87)			
Charge (release) to the income statement	1,062	788	(46)	742
At 31 December	1,719	1,152	257	1,409
In respect of:				
Loans and advances to banks (note 17)	1			1
Loans and advances to customers (note 18)	1,718			1,408
	1,719			1,409

20 Debt securities

As at 31 December 2004 (prior to the implementation of IAS 32 and IAS 39 on 1 January 2005) debt securities were shown separately on the balance sheet. This balance sheet caption comprised both investment securities and other securities. Investment securities were those intended for use on a continuing basis in the activities of the Group and the Bank and not for dealing purposes. At 31 December 2005, debt securities are categorised as either trading securities and other financial assets at fair value through profit or loss (note 15) or available-for-sale financial assets (note 22).

Details of the balance sheet carrying value of the debt securities held at 31 December 2004 were as follows:

	The Group £m	The Bank £m
Investment securities		
Government securities	2,211	1,680
Bank and building society certificates of deposit	1,901	1,547
Corporate debt securities	2,581	172
Mortgage backed securities	2,774	927
Other asset backed securities	3,761	880
Other debt securities	1,140	499
	14,368	5,705
Other securities		
Government securities	14,018	4,524
Other public sector securities	321	51
Bank and building society certificates of deposit	488	-
Corporate debt securities	13,445	5,733
Mortgage backed securities	533	504
Other asset backed securities	312	14
	29,117	10,826
Balance sheet carrying value – debt securities	43,485	16,531

Notes to the accounts

20 Debt securities (continued)

	The Group £m	The Bank £m
Investment securities		
Listed	8,925	2,600
Unlisted	5,443	3,105
	<u>14,368</u>	<u>5,705</u>
Other securities		
Listed	28,400	10,378
Unlisted	717	448
	<u>29,117</u>	<u>10,826</u>
Geographical analysis by issuer:		
United Kingdom	21,288	3,046
Other European	13,464	8,930
North America and Caribbean	5,264	3,270
Latin America	76	74
Asia Pacific	2,866	873
Other	527	338
	<u>43,485</u>	<u>16,531</u>

21 Equity shares

As at 31 December 2004 (prior to the implementation of IAS 32 and IAS 39 on 1 January 2005) equity shares were shown separately on the balance sheet. This balance sheet caption comprised both investment securities and other securities. Investment securities were those intended for use on a continuing basis in the activities of the Group and the Bank and not for dealing purposes. At 31 December 2005, equity shares are categorised as either trading securities and other financial assets at fair value through profit or loss (note 15) or available-for-sale financial assets (note 22).

Details of the balance sheet carrying value of the equity shares held at 31 December 2004 were as follows:

	The Group £m	The Bank £m
Investment securities		
Listed	5	–
Unlisted	36	17
	<u>41</u>	<u>17</u>
Other securities		
Listed	24,705	–
Unlisted	2,772	–
	<u>27,477</u>	<u>–</u>
Balance sheet carrying value – equity shares	<u>27,518</u>	<u>17</u>
Geographical analysis by issuer:		
United Kingdom	18,168	10
Other European	3,921	–
North America and Caribbean	2,302	–
Latin America	384	–
Asia Pacific	1,470	–
Other	1,273	7
	<u>27,518</u>	<u>17</u>

22 Available-for-sale financial assets

From 1 January 2005 (upon the implementation of IAS 32 and IAS 39), the Group is required to disclose its available-for-sale financial assets separately on the face of the balance sheet. Details of the balance sheet carrying value of these assets held at 31 December 2005 are:

	The Group £m	The Bank £m
Debt securities		
Government securities	1,083	348
Other public sector securities	47	47
Bank and building society certificates of deposit	1,470	1,470
Corporate debt securities	3,036	167
Mortgage backed securities	4,161	1,610
Other asset backed securities	4,981	705
Other debt securities	29	27
	<u>14,807</u>	<u>4,374</u>
Equity shares		
Listed	34	34
Unlisted	12	12
	<u>46</u>	<u>46</u>
Treasury bills and other eligible bills		
Treasury bills and similar securities	70	66
Other eligible bills	17	17
	<u>87</u>	<u>83</u>
	<u>14,940</u>	<u>4,503</u>

See notes 14, 20 and 21 for details of investments held at 31 December 2004.

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

	Carrying value before provisions £m	Provisions £m	Balance sheet value £m
The Group			
At 1 January 2005 (following implementation of IAS 32 and IAS 39)	14,624	(31)	14,593
Exchange and other adjustments	559	–	559
Additions	10,108	–	10,108
Disposals	(10,266)	–	(10,266)
Reclassifications	(31)	31	–
Amortisation of premiums and discounts	(65)	–	(65)
Changes in fair value	11	–	11
At 31 December 2005	<u>14,940</u>	<u>–</u>	<u>14,940</u>
The Bank			
At 1 January 2005 (following implementation of IAS 32 and IAS 39)	6,136	(31)	6,105
Exchange and other adjustments	134	–	134
Additions	8,210	–	8,210
Disposals	(9,958)	–	(9,958)
Reclassifications	(31)	31	–
Amortisation of premiums and discounts	(1)	–	(1)
Changes in fair value	13	–	13
At 31 December 2005	<u>4,503</u>	<u>–</u>	<u>4,503</u>

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23 Investment property of the Group	2005 £m	2004 £m
At 1 January	3,776	3,551
Fair value movements	430	329
Additions to investment properties	807	351
Disposals of investment properties	(753)	(455)
At 31 December	4,260	3,776

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

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

	2005 £m	2004 £m
Rental income	272	158
Direct operating expenses arising from investment properties that generate rental income	24	17

Capital expenditure in respect of investment properties:

	2005 £m	2004 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	31	66

24 Goodwill	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
At 1 January	2,469	2,507	118	118
Acquisition adjustment	–	(34)	–	–
Acquisitions of businesses (note 53)	3	6	–	–
Adjustments on disposal of businesses	(93)	(10)	(110)	–
Impairment charge	(6)	–	–	–
At 31 December	2,373	2,469	8	118
Cost*	2,379	2,469	8	118
Accumulated impairment losses	(6)	–	–	–
	2,373	2,469	8	118

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

An impairment charge of £6 million (2004: nil) was made during 2005 following a strategic review of a business acquired in previous years.

Goodwill assumptions of the Group

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,373 million (2004: £2,469 million), £1,836 million (or 77 per cent of the total) has been allocated to Scottish Widows and £517 million (or 22 per cent of the total) to Asset Finance.

24 Goodwill (continued)

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

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 9 per cent. Due to similarities in the risk profile and the funding model management believes that Asset Finance is closely aligned to Lloyds TSB Group; the discount rate represents the Lloyds TSB Group's cost of equity. The cash flows for each of the businesses of Asset Finance beyond the five-year period are extrapolated using steady growth rates, in each case not exceeding 3 per cent nor the long-term average growth rates for markets in which the respective businesses of Asset Finance participate. Management also believes that any reasonably possible change in the key assumptions on which the recoverable amount of Asset Finance is based would not cause the carrying amount of Asset Finance to exceed its recoverable amount.

25 Long-term assurance business of the Group

Life assurance businesses

The principal subsidiaries involved in the Group's life assurance operations during 2004 and 2005 were Scottish Widows plc ('Scottish Widows', the Group's principal provider of life assurance, pensions and investment products, which holds the only large With-Profits Fund managed by the Lloyds TSB Group), Scottish Widows Annuities Limited (a subsidiary of Scottish Widows that accepts the reinsurance of annuity business from its parent), Scottish Widows Unit Funds Limited (a subsidiary of Scottish Widows that accepts the reinsurance of unit-linked business from its parent), Abbey Life Assurance Company Limited ('Abbey Life') and Lloyds TSB Life Assurance Company Limited ('Lloyds TSB Life'). Since March 2000 both Abbey Life and Lloyds TSB Life have continued to administer existing policies and have undertaken only limited new business. No change in this activity is anticipated in respect of Abbey Life. On 31 December 2004, Lloyds TSB Life ceased trading and transferred most of its assets and insurance business to Scottish Widows.

Value of in-force business

The Group recognises as an asset the value of in-force life assurance business in respect of life insurance contracts and participating investment contracts. The asset, which represents the present value of future profits expected to arise from these contracts, is determined by projecting future surpluses and other cash flows arising from life insurance contract and participating investment contract business written by the balance sheet date. This asset does not recognise any investment risk margins and is reduced by the value of any with-profits options and guarantees; it is presented gross of attributable tax. The asset in the consolidated balance sheet and movement recognised in the income statement are as follows:

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25 Long-term assurance business of the Group (continued)

	£m
At 1 January 2004	4,347
Movement in value of in-force business (gross of tax)	16
At 31 December 2004	4,363
Adjustments on the adoption of FRS27	(386)
Adjustments on the adoption of IFRS4 and IAS39	(1,217)
At 1 January 2005	2,760
Movement in value of in-force business (gross of tax)	162
At 31 December 2005	2,922

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

	2005 %	2004 %
Risk adjusted discount rate (net of tax)	7.02	7.40
Return on equities (gross of tax)	6.72	7.17
Return on fixed interest securities (gross of tax)	4.12	4.57
Expenses inflation	3.79	3.76

The process for determining the key assumptions used in the calculations of the value of in-force business is set out below.

- **Investment returns.** The assumption for future investment returns for fixed (or index linked) investments reflects the actual portfolio. Projected returns from fixed and index linked investments are based on risk-free (gilt-edged) returns and are reduced for the risk of default but not adjusted for liquidity. Where an assumption on future equity or property returns is required, this is based on such returns having an equity or property yield margin over the corresponding risk-free (gilt-edged) return assumed.
- **Risk Discount Rate (RDR).** The RDR is set to remove investment risk margins, including those assumed to be generated by equities, whilst retaining a margin for other, non-investment, risks.
- **Mortality and morbidity.** The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this is significant, and relevant industry data otherwise.
- **Persistency rates.** Persistency rates refer to the rate of policy termination and the rate at which policies cease to pay regular premiums. These rates are based on a combination of historical experience and management's views on future experience.
- **Maintenance expenses.** Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs. Explicit allowance is made for future expense inflation.

The sensitivity of the value of in-force business to changes in these assumptions is included within the disclosures in note 34.

Regulatory capital position of the Group's life assurance businesses

Basis of determining regulatory capital of the life assurance business

Available capital resources

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

25 Long-term assurance business of the Group (continued)

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

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

The valuation of with-profits assets in the With-Profits Fund on a realistic basis differs from the valuation on a statutory basis as, in respect of non-profits business written in the With-Profits Fund, it includes the present value of the anticipated future release of the prudent margins for adverse deviation. The realistic valuation uses the market value of assets without the limit affecting the statutory basis noted above.

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

Regulatory capital requirements

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

For Scottish Widows, a further test is required in respect of the With-Profits Fund which compares the level of 'realistic excess capital' to the 'statutory excess capital' of the With-Profits Fund and, in circumstances where the 'realistic excess capital' position is less, the Company is required to hold additional capital to cover the shortfall. The 'realistic excess capital' is calculated as the difference between realistic assets and realistic liabilities of the With-Profits Fund with a further deduction to cover various stress tests. Any additional capital requirement under this test is referred to as the With-Profits Insurance Capital Component.

The determination of realistic liabilities of the With-Profits Fund in respect of Scottish Widows includes the value of internal transfers expected to be made from the With-Profits Fund to the Non-Profit Fund of Scottish Widows. These internal transfers include charges on policies where the associated costs are borne by the Non-Profit Fund. The value of the transfers exceeds the value of the costs which, in the case of Scottish Widows, results in the somewhat artificial increase in the With-Profits Insurance Capital Component of over £500 million.

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25 Long-term assurance business of the Group (continued)*Capital Statement*

The following table provides more detail regarding the sources of capital in the life assurance business and reconciles those amounts to the Group's balance sheet.

The figures quoted are based on management's current expectations regarding completion of the annual financial return to the FSA.

	Scottish Widows plc									
	With- Profits Fund £m	Non- Profit Fund £m	Total Long- Term Fund £m	Share- holder's funds £m	Statutory basis £m	Consoli- dation adjust- ments £m	Total life business on a Group basis £m	Other sources of capital £m	Consoli- dation adjust- ments £m	Group total £m
Assets attributable to the shareholder held outside the long-term funds	-	-	-	1,513	1,513					
Assets attributable to the shareholder held within the long-term funds	-	2,619	2,619	-	2,619					
Total shareholders' funds	-	2,619	2,619	1,513	4,132	1,346	5,478	10,899	(5,192)	11,185
Adjustments onto a regulatory basis:										
Life assurance business										
Unallocated surplus within insurance business	494	-	494	-	494					
Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities	-	(456)	(456)	(767)	(1,223)					
Adjustments to include estimated 'realistic' liabilities payable to the shareholder	(729)	-	(729)	-	(729)					
Adjustment to replace 'realistic' liabilities with statutory liabilities	2,580	-	2,580	-	2,580					
Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With-Profits Fund	(43)	-	(43)	-	(43)					
Recognition of future profits for regulatory capital purposes	-	500	500	-	500					
Banking business										
Collective impairment provisions								1,782		1,782
Goodwill								(2,373)		(2,373)
Pensions deficit adjustment								1,372		1,372
Other								15		15
Qualifying loan capital	-	-	-	561	561	(561)	-	11,513		11,513
Available capital resources – insurance business	2,302	2,663	4,965	1,307	6,272					
Supervisory deductions										
Net investment in life assurance business										(5,478)
Other										(2,374)
Available capital resources – Group										15,642

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

Notes to the accounts

25 Long-term assurance business of the Group (continued)*Formal intra-group capital arrangements*

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

Constraints over available capital resources

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

Requirement to maintain a Support Account. The Scheme requires the maintenance of a 'Support Account' within the Non-Profit Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Profit Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account in assessing the realistic value of assets available to the With-Profits Fund. At 31 December 2005, the estimated value of surplus admissible assets in the Non-Profit Fund was £2,163 million (31 December 2004: £2,222 million) and the value of the Support Account was £1,115 million (31 December 2004: £1,265 million).

Further Support Account. The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Profit Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Profit Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2005, the net economic value of the Non-Profit Fund and its subsidiaries for the purposes of this test was £4,140 million (31 December 2004: £4,185 million) and the combined value of the Support Account and Further Support Account was £2,836 million (31 December 2004: £2,704 million).

25 Long-term assurance business of the Group (continued)

Other restrictions in the Non-Profit Fund. In addition to the policies which existed at the date of demutualisation, the With-Profits Fund includes policies which have been written since that date. As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2005 is £267 million (31 December 2004: £300 million). There is a further test requiring that no amounts can be transferred from the Non-Profit Fund of Scottish Widows unless there are sufficient assets within the Long-Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

Movements in regulatory capital

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

With-Profits Fund

Available capital in the With-Profits Fund has increased from £1,351 million at 31 December 2004 to an estimated £2,302 million at 31 December 2005 primarily as a result of strong investment market performance.

Non-Profit Fund

Available capital in the Non-Profit Fund has decreased from £2,222 million at 31 December 2004 to an estimated £2,163 million (excluding the recognition of future profits) at 31 December 2005. This is primarily as a result of proposed transfers from the Non-Profit Fund to the Shareholder Fund at the year end of £559 million. One of those proposed transfers relates to an investment in Abbey Life which, following a transfer of capital amounting to £560 million from the Shareholder Fund, was acquired by the Non-Profit Fund during the year at market value and then written down to its regulatory value in accordance with FSA asset valuation rules. The effect of these transactions has to a degree been offset by strong investment return and the emergence of surplus.

Shareholder Fund

Available capital in the Shareholder Fund has increased from £770 million at 31 December 2004 to an estimated £1,307 million at 31 December 2005. During the year the Shareholder Fund issued £560 million of subordinated debt and, as noted above, transferred this amount into the Non-Profit Fund. This transaction has had no effect on the available capital of the Shareholder Fund. The reason for the increase in available capital is primarily a result of the proposed transfers from the Non-Profit Fund noted above.

Financial information calculated on a 'realistic' basis

The estimated financial position of the With-Profits Fund of Scottish Widows at 31 December 2005, calculated on a 'realistic' basis, is given in the following table, in the form that the information will be reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the 'realistic' financial position of the Long-Term Fund of Scottish Widows as a whole, which consists of both the With-Profits Fund and the Non-Profit Fund.

Notes to the accounts

25 Long-term assurance business of the Group (continued)

	31 December 2005		31 December 2004	
	With-Profits Fund £m	Long-Term Fund £m	With-Profits Fund £m	Long-Term Fund £m
Realistic value of assets of fund	19,018	23,242	17,814	22,012
Support arrangement assets (value of 'Support Account')	1,115	—	1,265	—
Realistic value of assets available to the fund	20,133	23,242	19,079	22,012
Realistic value of liabilities of fund	(19,253)	(19,102)	(18,108)	(17,827)
Working capital for fund	880	4,140	971	4,185
Working capital ratio for fund	4.4%	17.8%	5.1%	19.0%

Scottish Widows continues to be well capitalised with the working capital ratios for the With-Profits Fund and the Long-Term Fund being an estimated 4.4 per cent (31 December 2004: 5.1 per cent) and 17.8 per cent (31 December 2004: 19.0 per cent) respectively. The decrease in the Long-Term Fund ratio is a result of the proposed transfers to the Shareholder Fund noted above.

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

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

25 Long-term assurance business of the Group (continued)

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

	Scottish Widows plc				
	With-Profits Fund (in accordance with FRS27) £m	Non-Profit fund £m	Total Long-term fund £m	Other long-term funds £m	Total life business £m
With-Profits Fund liabilities	18,854	—	18,854	133	18,987
Unit-linked business (excluding those accounted for as investment contracts)	—	8,041	8,041	2,738	10,779
Other life assurance business	—	8,671	8,671	1,653	10,324
Insurance and participating investment contract liabilities	18,854	16,712	35,566	4,524	40,090
Non-participating liabilities	—	14,624	14,624	7,215	21,839
Total policyholder liabilities	18,854	31,336	50,190	11,739	61,929

Capital sensitivities

Shareholders' funds

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

With-Profits Fund

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

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

Other long-term funds

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

Notes to the accounts

25 Long-term assurance business of the Group (continued)

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

Options and guarantees

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

Options and guarantees within the With-Profits Fund

The most significant options and guarantees provided from within the With-Profits Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies.

For those policies written pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With-Profits Fund of Scottish Widows called the Additional Account, which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2005 of £1.7 billion (2004: £1.4 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as persistency and mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

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

The most significant economic assumptions included in the model are:

- **Risk-free yield curve.** This is derived from the yield on UK gilts, with an additional 0.1 per cent yield assumed to be risk-free;
- **Investment volatility.** This is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example as at 31 December 2005, the 10 year equity-implied at-the-money assumption was set at 20.0 per cent (31 December 2004: 18.0 per cent). The long-term at-the-money assumption for property and fixed interest stocks was 15.0 per cent (31 December 2004: 15.0 per cent) and 13.5 per cent (31 December 2004: 13.0 per cent) respectively.

The model includes a matrix of the correlations between each of the underlying modelled asset types. The correlations used are consistent with long-term historical returns. The most significant non-economic assumptions included in the model are management actions (in respect of investment policy and bonus rates), guaranteed annuity option take up rates and assumptions regarding persistency (both of which are based on recent actual experience), and assumptions regarding mortality (which are based on recent actual experience and industry tables).

25 Long-term assurance business of the Group (continued)**Options and guarantees outside the With-Profits Fund of Scottish Widows**

Abbey Life currently has a number of policies in-force which have a guaranteed annuity option. In total it holds traditional regulatory reserves of £332 million to cover this liability at 31 December 2005 (£288 million at 31 December 2004). These reserves have been determined using prudent future interest rate, mortality rate and rate of annuity option take-up assumptions and exceed the value that would be placed on them using a market-consistent stochastic model. It is estimated that a 0.5 per cent reduction in future interest rates would increase the liability by some £54 million.

Under some of Abbey Life's older contracts, the maturity value or the surrender value at the end of the selected period is guaranteed to be not less than total premiums paid or sums assured. The total provision for these options was £5 million at 31 December 2005 (£11 million at 31 December 2004) and was established using stochastic techniques after making prudent assumptions.

In both Abbey Life and Scottish Widows, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £108 million (31 December 2004: £89 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £8 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £19 million.

26 Other intangible assets

These comprise capitalised software enhancements. Amounts are amortised over periods of up to five years, being their estimated useful lives, using the straight-line method. Other intangible assets are reviewed for impairment whenever events or any changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, it is written down immediately.

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Cost:				
At 1 January	107	103	90	98
Additions	40	18	13	5
Disposals	—	(14)	—	(13)
At 31 December	147	107	103	90
Accumulated depreciation:				
At 1 January	79	62	69	57
Charge for the year	18	22	11	17
Disposals	—	(5)	—	(5)
At 31 December	97	79	80	69
Balance sheet amount at 31 December	50	28	23	21

Notes to the accounts

27 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m	Total fixed assets £m
The Group				
Cost:				
At 1 January 2004	1,312	2,376	2,488	6,176
Exchange and other adjustments	3	1	(46)	(42)
Adjustments on acquisition and disposal of businesses	(10)	(13)	-	(23)
Additions	73	283	801	1,157
Disposals	(18)	(121)	(476)	(615)
At 31 December 2004	1,360	2,526	2,767	6,653
Exchange and other adjustments	1	(3)	63	61
Adjustments on acquisition and disposal of businesses	8	-	-	8
Additions	89	280	615	984
Disposals	(37)	(136)	(484)	(657)
At 31 December 2005	1,421	2,667	2,961	7,049
Accumulated depreciation and impairment:				
At 1 January 2004	475	1,438	321	2,234
Exchange and other adjustments	-	3	(3)	-
Adjustments on acquisition and disposal of businesses	(4)	(8)	-	(12)
Charge for the year	68	267	281	616
Disposals	(6)	(73)	(286)	(365)
At 31 December 2004	533	1,627	313	2,473
Exchange and other adjustments	3	(1)	9	11
Charge for the year	76	267	278	621
Disposals	(11)	(97)	(239)	(347)
At 31 December 2005	601	1,796	361	2,758
Balance sheet amount at 31 December 2005	820	871	2,600	4,291
Balance sheet amount at 31 December 2004	827	899	2,454	4,180

27 Tangible fixed assets (continued)

	Premises £m	Equipment £m	Total fixed assets £m
The Bank			
Cost:			
At 1 January 2004	903	1,806	2,709
Exchange and other adjustments	-	(1)	(1)
Adjustments on acquisition and disposal of businesses	(7)	(3)	(10)
Additions	62	232	294
Disposals	(12)	(74)	(86)
At 31 December 2004	946	1,960	2,906
Exchange and other adjustments	(6)	1	(5)
Additions	78	246	324
Disposals	(13)	(95)	(108)
At 31 December 2005	1,005	2,112	3,117
Accumulated depreciation and impairment:			
At 1 January 2004	421	1,016	1,437
Exchange and other adjustments	(1)	-	(1)
Adjustments on acquisition and disposal of businesses	(3)	-	(3)
Charge for the year	57	217	274
Disposals	(5)	(62)	(67)
At 31 December 2004	469	1,171	1,640
Exchange and other adjustments	2	-	2
Charge for the year	64	234	298
Disposals	(6)	(60)	(66)
At 31 December 2005	529	1,345	1,874
Balance sheet amount at 31 December 2005	476	767	1,243
Balance sheet amount at 31 December 2004	477	789	1,266
At 31 December the future minimum rentals receivable by the Group under non-cancellable operating leases were as follows:			
	2005 £m	2004 £m	
Receivable within 1 year	393	326	
1 to 5 years	695	601	
Over 5 years	165	258	
	1,253	1,185	

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2004 and 2005 no contingent rentals in respect of operating leases were recognised in the income statement.

Notes to the accounts

28 Capital commitments

Excluding commitments of the Group in respect of investment property (see note 23), capital expenditure contracted but not provided for at 31 December 2005 amounted to £223 million for the Group and £8 million for the Bank (2004: £150 million for the Group and £4 million for the Bank). Of the capital commitments of the Group, £215 million (2004: £146 million) relates to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

29 Investment in subsidiary undertakings

	£m
At 31 December 2004	17,596
Adjustments to reflect the implementation of IAS 32	(1,422)
At 1 January 2005	16,174
Additions	4
Additional capital injections	250
Capital repayments	(350)
At 31 December 2005	16,078

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

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

*Indirect interest

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

30 Other assets

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Assets arising from reinsurance contracts held	548	581	—	—
Deferred acquisition costs	429	2	—	—
Settlement balances	336	79	156	1
Derivative financial instruments (see note 16)	—	4,869	—	2,443
Other assets and prepayments	4,271	3,474	2,731	2,426
	5,584	9,005	2,887	4,870

31 Deposits from banks

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

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Domestic:				
Non-interest bearing	105	172	577	640
Interest bearing	24,707	33,022	30,659	40,354
	24,812	33,194	31,236	40,994
International:				
Non-interest bearing	24	30	24	31
Interest bearing	6,691	6,499	6,713	6,519
	6,715	6,529	6,737	6,550
	31,527	39,723	37,973	47,544

32 Customer accounts

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Non-interest bearing current accounts	4,203	3,807	3,942	3,608
Interest bearing current accounts	40,365	32,157	37,907	29,950
Savings and investment accounts	62,206	58,773	39,752	36,273
Other customer deposits	24,576	25,366	33,904	30,856
	131,350	120,103	115,505	100,687

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

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Domestic:				
Non-interest bearing	3,868	3,511	3,607	3,312
Interest bearing	123,802	113,757	107,822	94,362
	127,670	117,268	111,429	97,674
International:				
Non-interest bearing	335	296	335	296
Interest bearing	3,345	2,539	3,741	2,717
	3,680	2,835	4,076	3,013
	131,350	120,103	115,505	100,687

Notes to the accounts

33 Debt securities in issue

	2005 £m	2004 £m
The Group		
Euro medium-term note programme	6,683	5,097
Other bonds and medium-term notes	141	266
Certificates of deposit issued	22,101	15,226
Commercial paper	10,421	8,026
Other marketable paper	-	155
Total debt securities in issue	39,346	28,770
The Bank		
Euro medium-term note programme	6,683	5,097
Certificates of deposit issued	21,629	15,029
Commercial paper	3,004	3,281
Total debt securities in issue	31,316	23,407

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

	2005 £m	2004 £m
Insurance contract liabilities	26,616	52,419
Participating investment contract liabilities	14,068	-
	40,684	52,419

Insurance contract liabilities

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

	2005			2004		
	Gross £m	Rein- surance £m	Net £m	Gross £m	Rein- surance £m	Net £m
Life insurance	26,022	(511)	25,511	51,822	(577)	51,245
Non-life insurance:						
Unearned premiums	447	-	447	456	-	456
Claims outstanding	147	(4)	143	141	(4)	137
	594	(4)	590	597	(4)	593
	26,616	(515)	26,101	52,419	(581)	51,838

Life insurance

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

	£m
At 31 December 2004	51,822
Adjustments to reflect the implementation of IAS 32, IAS 39, IFRS 4 and FRS 27	(28,033)
At 1 January 2005	23,789
New business	1,381
Changes in existing business	852
At 31 December 2005	26,022

34 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)

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

	£m
At 31 December 2004	-
Adjustments to reflect the implementation of IAS 32, IAS 39, IFRS 4 and FRS 27	12,469
At 1 January 2005	12,469
New business	1,181
Changes in existing business	418
At 31 December 2005	14,068

Process for determining key assumptions

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

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

With-Profits Fund Realistic Liabilities

The Group's With-Profits Fund contains life insurance contracts and participating investment contracts. The calculation of With-Profits realistic liabilities uses best estimate assumptions for mortality and morbidity, persistency rates and expenses. These are calculated in a similar manner to those used for the value of the in-force business as discussed in note 25.

Other key assumptions are:

- **Investment returns and discount rates.** The realistic capital regime dictates that With-Profits Fund liabilities are valued on a market consistent basis. This is achieved by setting assumed investment returns and discount rates equal to a risk-free yield, defined as 0.1 per cent higher than the yield on UK gilts.
- **Guaranteed annuity option take up rates.** The guaranteed annuity option take up rates are set with regard to the Group's actual experience.
- **Investment volatility.** Investment volatility is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2005, the 10 year equity-implied at-the-money assumption was set at 20.0 per cent (31 December 2004: 18.0 per cent). The long-term at-the-money assumptions for property and fixed interest stocks were 15.0 per cent (31 December 2004: 15.0 per cent) and 13.5 per cent (31 December 2004: 13.0 per cent) respectively.

Non-Profit Fund liabilities

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

- **Interest rates.** The rates used are derived in accordance with the FSA Rules. These limit the rates of interest that can be used by reference to a number of factors including the redemption yields on fixed interest assets at the valuation date.

Margins for risk are allowed for in the assumed interest rates. These are derived from the limits in the FSA Rules, including reductions made to the available yields to allow for default risk based upon the credit rating of each stock.

Notes to the accounts

34 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)

- *Mortality and morbidity.* The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation.
- *Maintenance expenses.* Allowance is made for future policy costs explicitly. Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviations. Explicit allowance is made for future expense inflation.

Key changes in assumptions

Changes in certain key assumptions were made during 2005 with the following impacts on profit before tax. These amounts include movements in liabilities and value of the in-force business in respect of insurance contracts and participating investment contracts:

	Reduction in profit before tax £m
Annuitant mortality ⁽¹⁾	155
Modelling of options and guarantees in the With-Profits Fund ⁽²⁾	60
Lapse rates ⁽³⁾	58

- (1) The charge in respect of annuitant mortality reflects the introduction of an assumed minimum annual improvement in mortality.
- (2) Changes to the valuation of options and guarantees primarily reflects emerging best practice in this area.
- (3) Lapse rates have been set following a detailed review of the Group's current and expected experience.

Sensitivity analysis

The following table demonstrates the effect of changes in key assumptions on profit before tax assuming that the other assumptions remain unchanged. In practice this is unlikely to occur, and changes in some assumptions may be correlated. These amounts include movements in liabilities and the value of the in-force business in respect of insurance contracts and participating investment contracts:

	Change in variable	Reduction in profit before tax (Insurance) £m	Reduction (increase) in profit before tax (Participating Investment) £m	Total reduction in profit before tax £m
Mortality ⁽¹⁾	10% adverse	414	11	425
Lapse rates	20% increase	21	32	53
Maintenance expenses	10% increase	40	29	69
Interest rates ⁽²⁾	1% addition	242	(18)	224
Guaranteed annuity option take up	5% increase	81	–	81
Equity investment volatility	1% addition	12	17	29

- (1) Adverse mortality means that mortality rates are either reduced or increased depending on the class of business – i.e. reduced for annuities and increased for protection business.
- (2) The interest rate sensitivity shows the impact of a 1 per cent movement in gilt yields and all of the consequential impacts on key economic assumptions including the RDR, investment returns, valuation rates of interest and values of assets backing the business in question.

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

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

	2005 £m	2004 £m
Credit protection	284	290
Home	304	299
Health	6	8
	594	597

For non-life insurance contracts, the methodology and assumptions used in relation to determining the bases of the earned premium and claims provisioning levels are derived for each individual underwritten product. Assumptions are intended to be neutral estimates of the most likely or expected outcome. A margin is placed on these best estimate claims reserves to provide confidence in being able to achieve this objective and varies according to product class. A relatively small margin was used for most products where sufficient past experience has been accumulated. An additional margin was used to allow for reserve uncertainty of claims where there is less experience and the introduction of claims re-engineering processes, which will affect how claims are being reported for household and domestic all risks products.

The reserving methodology and associated assumptions are set out below:

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

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

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

	Gross £m	Rein- surance £m	Net £m
At 1 January 2005	456	–	456
Increase in the year	575	–	575
Release in the year	(584)	–	(584)
At 31 December 2005	447	–	447

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

Notes to the accounts

34 Liabilities of the Group arising from insurance contracts and participating investment contracts (continued)

Claims and loss adjustment expenses	Gross £m	Rein- surance £m	Net £m
Notified claims	117	(4)	113
Incurred but not reported	24	–	24
At 1 January 2005	141	(4)	137
Cash paid for claims settled in the year	(221)	–	(221)
Increase in liabilities			
– arising from current year claims	239	–	239
– arising from prior year claims	(12)	–	(12)
At 31 December 2005	147	(4)	143
Notified claims	120	(4)	116
Incurred but not reported	27	–	27
At 31 December 2005	147	(4)	143

Non-life insurance claims development table

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

Non-life insurance all risks – gross

Accident year	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m	Total £m
Estimate of ultimate claims costs:						
– at end of accident year	195	242	234	227	211	1,109
– one year later	177	230	220	209	–	
– two years later	184	228	223	–	–	
– three years later	181	224	–	–	–	
– four years later	179	–	–	–	–	
Current estimate of cumulative claims	179	224	223	209	211	1,046
Cumulative payments to date	(172)	(221)	(206)	(192)	(123)	(914)
Liability recognised in the balance sheet	7	3	17	17	88	132
Liability in respect of prior years						6
Total liability included in the balance sheet						138

The liability of £138 million shown in the above table excludes £9 million of unallocated claims handling expenses.

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

	2005 £m	2004 £m
Gross unit-linked investment contracts (non-participating)	21,839	–
Reinsurance (included in other assets)	(33)	–
	21,806	–

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

	£m
At 31 December 2004	–
Adjustments to reflect the implementation of IAS 32, IAS 39 and IFRS 4	16,361
At 1 January 2005	16,361
New business	3,413
Changes in existing business	2,065
At 31 December 2005	21,839

36 Unallocated surplus within insurance businesses for the Group

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

	£m
At 31 December 2004	1,362
Adjustments to reflect the implementation of IAS 39 and IFRS 27	(936)
At 1 January 2005	426
Change in unallocated surplus recognised in the income statement	92
At 31 December 2005	518

37 Other liabilities

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Settlement balances	779	134	5	3
Unitholders' interest in OEICs	3,296	2,680	–	–
Derivative financial instruments (see note 16)	–	6,151	–	3,692
Other creditors and accruals	5,801	5,539	2,985	3,402
	9,876	14,504	2,990	7,097

Notes to the accounts

38 Retirement benefit obligations

Amounts recognised in the balance sheet:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Pension schemes	2,809	2,981	2,105	2,236
Other post-retirement benefit schemes	101	94	101	94
	2,910	3,075	2,206	2,330

Pension schemes*Defined benefit schemes*

The Group has established a number of defined benefit pension schemes in the UK and overseas. The majority of the Group's and the Bank's employees are members of the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2. These 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 schemes were carried out as at 30 June 2005; these have been updated to 31 December 2005 by qualified independent actuaries. The last full valuations of other group schemes were carried out on a number of different dates; these have been updated to 31 December 2005 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The principal financial assumptions used in the scheme valuations were as follows:

	2005 %	2004 %
Rate of inflation	2.70	2.60
Rate of salary increases	3.98	4.14
Rate of increase for pensions in payment and deferred pensions	2.50	2.60
Discount rate	4.80	5.30

The mortality assumptions used in the scheme valuations were based on the experience of the relevant schemes. The mortality assumptions used in the valuations of the Group's principal schemes are illustrated by the following years of life expectancy in retirement:

	31 December 2005 Years	31 December 2004 Years
Life expectancy for member aged 60, on the valuation date		
- Men	25.6	24.7
- Women	27.6	26.8
Life expectancy for member aged 60, 15 years after the valuation date		
- Men	26.8	25.7
- Women	28.7	27.8

The amounts recognised in the balance sheet are as follows:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Present value of scheme liabilities	17,320	14,866	13,134	11,282
Fair value of scheme assets	(14,026)	(11,648)	(10,619)	(8,839)
	3,294	3,218	2,515	2,443
Unrecognised actuarial losses	(485)	(237)	(410)	(207)
	2,809	2,981	2,105	2,236

38 Retirement benefit obligations (continued)

The allocation of the assets of the Group's defined benefit schemes was as follows:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Market values of scheme assets:				
Equities	9,021	8,032	6,830	6,095
UK fixed interest gilts	946	550	716	417
UK index linked gilts	920	561	697	426
Sterling non-government bonds	1,415	938	1,071	712
Property	1,185	959	897	728
Cash	539	608	408	461
Total fair value of scheme assets	14,026	11,648	10,619	8,839

The movements in the net amount recognised in the balance sheet are as follows:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
At 1 January	2,981	3,080	2,236	2,311
Exchange and other adjustments	4	2	4	3
Net charge to the income statement	243	268	175	195
Contributions paid	(419)	(369)	(310)	(273)
At 31 December	2,809	2,981	2,105	2,236

The amounts recognised in the consolidated income statement are as follows:

	2005 £m	2004 £m
Current service cost	292	280
Interest cost	775	728
Expected return on scheme assets	(839)	(757)
Past service cost	15	17
	243	268

The actual return on scheme assets was £2,377 million for the Group and £1,804 million for the Bank (2004: £1,119 million for the Group and £848 million for the Bank).

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

	2005 %	2004 %
Equities	8.2	8.1
UK fixed interest gilts	4.6	4.8
UK index linked gilts	4.3	4.4
Sterling non-government bonds	5.3	5.4
Property	6.9	7.1
Cash	3.6	3.5

Notes to the accounts

38 Retirement benefit obligations (continued)

The expected return on scheme assets in 2006 will be calculated using the following assumptions:

	2006 %
Equities	8.0
UK fixed interest gilts	4.1
UK index linked gilts	3.9
Sterling non-government bonds	4.8
Property	6.4
Cash	3.7

Defined contribution schemes

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

During the year ended 31 December 2005 the charge to the income statement in respect of these schemes was £49 million for the Group and £31 million for the Bank (2004: £32 million for the Group and £20 million for the Bank), representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

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

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000; this valuation has been updated to 31 December 2005 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 6.81 per cent (2004: 6.70 per cent).

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

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
At 1 January	94	92	94	92
Exchange and other adjustments	(3)	-	(3)	-
Insurance premiums paid	(6)	(5)	(6)	(5)
Charge for the year	16	7	16	7
	101	94	101	94

39 Deferred tax balances

The movement in the net deferred tax balance is as follows:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Liability (asset) at 1 January	1,719	1,468	(788)	(850)
Restatement on implementation of IAS 32, IAS 39 and IFRS 4	(791)	-	(265)	-
At 1 January 2005 – restated	928	-	(1,053)	-
Exchange and other adjustments	3	7	-	(1)
Disposals	(256)	(23)	-	-
Income statement charge (note 13)	492	267	65	63
Amount charged (credited) to equity				
Available-for-sale financial assets	(2)	-	(1)	-
Cash flow hedges	1	-	1	-
	(1)	-	-	-
Amounts transferred to the income statement				
Available-for-sale financial assets	-	-	-	-
Cash flow hedges	4	-	4	-
	4	-	4	-
Liability (asset) at 31 December	1,170	1,719	(984)	(788)

With effect from 1 January 2005 the Group implemented the requirements of IAS 39 'Financial Instruments: Recognition and Measurement'. As a result, certain financial assets and liabilities previously valued at amortised cost are now carried at fair value with a consequential adjustment being made to the deferred tax balance. Comparative figures have not been restated.

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

	2005 £m	2004 £m
Accelerated capital allowances	59	80
Pensions and other post-retirement benefits	44	37
Investment reserve	-	96
Allowances for impairment losses (provisions for bad and doubtful debts in 2004)	23	48
Unrealised gains	279	40
Tax on value of in-force business	64	(18)
Other temporary differences	23	(16)
	492	267

Notes to the accounts

39 Deferred tax balances (continued)

Deferred tax assets and liabilities are comprised as follows:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Deferred tax assets				
Pensions and other post-retirement benefits	(893)	(917)	(646)	(647)
Allowances for impairment losses (provisions for bad and doubtful debts in 2004)	(165)	(95)	(157)	(84)
Other provisions	(36)	(53)	(31)	(49)
Derivatives	(172)	—	(157)	—
Tax losses carried forward	(323)	(372)	—	—
Other temporary differences	(205)	(183)	(100)	(74)
	(1,794)	(1,620)	(1,091)	(854)
	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Deferred tax liabilities				
Accelerated capital allowances	1,358	1,555	42	44
Investment reserve	90	90	—	—
Unrealised gains	338	59	—	—
Tax on value of in-force business	934	1,450	—	—
Other temporary differences	244	185	65	22
	2,964	3,339	107	66

Deferred tax assets

Deferred tax assets are recognised for tax losses and tax credit carry forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable.

Deferred tax assets of £526 million for the Group and £305 million for the Bank (2004: £527 million for the Group and £305 million for the Bank) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of Eligible Unrelieved Foreign Tax ('EUFT') and other foreign tax credits carried forward as at 31 December 2005 of £88 million for the Group and £43 million for the Bank (2004: £32 million for the Group and £27 million for the Bank), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. EUFT can be carried forward indefinitely.

Deferred tax liabilities

Deferred tax liabilities have not been recognised for tax that may be payable if earnings of certain subsidiaries were remitted to the UK. Such amounts are either permanently reinvested or can be remitted free of tax. Unremitted earnings totalled £609 million for the Group and £24 million for the Bank (2004: £639 million for the Group and £24 million for the Bank).

Future transfers from Scottish Widows plc's long-term business fund to its Shareholder Fund will be subject to a shareholder tax charge. Under IAS 12, no provision is required to be made to the extent that the timing of such transfers is under Scottish Widows plc's control. Accordingly, deferred tax liabilities of £110 million (2004: £230 million) have not been recognised.

40 Other provisions

	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
The Group				
At 31 December 2004	—	121	90	211
Adjustments to reflect the implementation of IAS 32, IAS 39 and IFRS 4	49	—	10	59
At 1 January 2005	49	121	100	270
Exchange and other adjustments	—	—	24	24
Reclassifications	(12)	—	—	(12)
Provisions applied	(1)	(77)	(16)	(94)
Charge (credit) for the year	(3)	150	33	180
At 31 December 2005	33	194	141	368
	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
The Bank				
At 31 December 2004	—	80	80	160
Adjustments to reflect the implementation of IAS 32, IAS 39 and IFRS 4	49	—	10	59
At 1 January 2005	49	80	90	219
Exchange and other adjustments	—	—	11	11
Reclassifications	(12)	—	—	(12)
Provisions applied	(1)	(62)	(13)	(76)
Charge (credit) for the year	(3)	147	12	156
At 31 December 2005	33	165	100	298

Provisions for contingent liabilities and commitments

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

Customer remediation provisions

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes are found to be deficient. During 2005 management have reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and as a result an additional charge of £150 million for the Group and £147 million for the Bank (2004: £112 million for the Group and £100 million for the Bank) has been made.

At 31 December 2005 the provisions held mainly related to past sales of mortgage endowment policies. Mortgage endowments were sold to customers through the branch network of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester, and underwritten by life assurance companies within the Group and also by third parties. The principal assumptions that have been made in the calculation of the provision relate to the number of cases that are likely to require redress and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the expenditure will be incurred over the next two years.

Notes to the accounts

40 Other provisions (continued)

Vacant leasehold property and other

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

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

Notes to the accounts

41 Subordinated liabilities

The Group	Notes	2005 £m	2004 £m
Undated subordinated loan capital*			
Primary Capital Undated Floating Rate Notes:	a		
Series 1 (US\$750 million)		436	389
Series 2 (US\$500 million)		291	259
Series 3 (US\$600 million)		349	311
11 ³ / ₄ % Perpetual Subordinated Bonds (£100 million)		100	100
6.625% Perpetual Capital Securities (€750 million) callable 2006	b	518	526
6.90% Perpetual Capital Securities callable 2007 (US\$1,000 million)	c	553	512
5 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	g	892	877
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a	103	105
6 ⁵ / ₈ % Undated Subordinated Step-up Notes callable 2010 (£410 million)	f	407	407
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (£430 million)	i,k	337	—
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	b,g	371	350
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million)	d,l	553	—
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	h	127	101
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	j,k	248	—
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		501	497
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	b,g,l	522	—
6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2019 (£270 million)	f	269	267
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	f	202	199
6 ¹ / ₂ % Undated Subordinated Step-up Notes callable 2029 (£450 million)	f	457	455
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	f	500	500
		7,736	5,855
Dated subordinated loan capital			
7 ³ / ₄ % Subordinated Bonds 2007 (£300 million)		300	299
5 ¹ / ₄ % Subordinated Notes 2008 (DM 750 million)		274	270
10 ³ / ₈ % Guaranteed Subordinated Loan Stock 2008 (£100 million)	e	106	107
9 ¹ / ₂ % Subordinated Bonds 2009 (£100 million)		99	100
6 ¹ / ₄ % Subordinated Notes 2010 (£400 million)		303	281
Subordinated Floating Rate Notes 2010 (US\$400 million)	a	—	207
12% Guaranteed Subordinated Bonds 2011 (£100 million)	e	115	114
4 ³ / ₄ % Subordinated Notes 2011 (£850 million)		597	582
Subordinated Floating Rate Notes 2011 (£150 million)		150	150
Subordinated Floating Rate Notes 2011 (£100 million)		100	100
Subordinated Floating Rate Notes 2012 (£200 million)		200	200
Subordinated Floating Rate Notes 2013 (£150 million)		150	150
Subordinated Floating Rate Notes 2014 (£464 million)		464	464
5 ⁷ / ₈ % Subordinated Notes 2014 (£150 million)		148	148
6 ⁵ / ₈ % Subordinated Notes 2015 (£350 million)		345	345
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	a,l	300	—
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	a	343	353
Subordinated Floating Rate Notes 2020 (£100 million)	a	68	70
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		346	346
9 ⁵ / ₈ % Subordinated Bonds 2023 (£300 million)		341	338
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		150	150
		4,899	4,774
Total subordinated loan capital		12,635	10,629

Notes to the accounts

41 Subordinated liabilities (continued)

The Bank	Notes	2005 £m	2004 £m
Undated subordinated loan capital*			
Primary Capital Undated Floating Rate Notes:	a		
Series 1 (US\$750 million)		436	389
Series 2 (US\$500 million)		291	259
Series 3 (US\$600 million)		349	311
6.625% Perpetual Capital Securities (£750 million) callable 2006	b	518	526
6.90% Perpetual Capital Securities callable 2007 (US\$1,000 million)	c	553	512
5 $\frac{7}{8}$ % Undated Subordinated Step-up Notes callable 2009 (£1,250 million)	g	892	877
Undated Step-up Floating Rate Notes callable 2009 (£150 million)	a	103	105
6 $\frac{7}{8}$ % Undated Subordinated Step-up Notes callable 2010 (£410 million)	f	407	407
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (£430 million)	i	337	302
6.35% Step-up Perpetual Capital Securities callable 2013 (£500 million)	b,g	371	350
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	h	127	101
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	j	248	248
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		501	497
4.385% Step-up Perpetual Capital Securities callable 2017 (£750 million)	b,g,l	522	-
6 $\frac{1}{2}$ % Undated Subordinated Step-up Notes callable 2019 (£270 million)	f	269	267
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	f	202	199
6 $\frac{1}{2}$ % Undated Subordinated Step-up Notes callable 2029 (£450 million)	f	457	455
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	f	500	500
		7,083	6,305
Dated subordinated loan capital			
7 $\frac{3}{4}$ % Subordinated Bonds 2007 (£300 million)		300	299
5 $\frac{1}{4}$ % Subordinated Notes 2008 (DM 750 million)		274	270
10 $\frac{5}{8}$ % Guaranteed Subordinated Loan Stock 2008 (£100 million)	e	106	107
9 $\frac{1}{2}$ % Subordinated Bonds 2009 (£100 million)		99	100
6 $\frac{1}{4}$ % Subordinated Notes 2010 (£400 million)		303	281
Subordinated Floating Rate Notes 2010 (US\$400 million)	a	-	207
12% Guaranteed Subordinated Bonds 2011 (£100 million)	e	115	114
4 $\frac{3}{4}$ % Subordinated Notes 2011 (£850 million)		597	582
Subordinated Floating Rate Notes 2014 (£464 million)		464	464
5 $\frac{7}{8}$ % Subordinated Notes 2014 (£150 million)		148	148
6 $\frac{5}{8}$ % Subordinated Notes 2015 (£350 million)		345	345
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	a,l	300	-
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£500 million)	a	343	353
Subordinated Floating Rate Notes 2020 (£100 million)	a	68	70
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		346	346
9 $\frac{5}{8}$ % Subordinated Bonds 2023 (£300 million)		341	338
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		150	150
		4,299	4,174
Total subordinated loan capital		11,382	10,479

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

* In certain circumstances, these notes, bonds and securities would acquire the characteristics of preference share capital. Any repayments of undated loan capital would require the prior consent of the Financial Services Authority. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of certain preference shares.

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

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

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

d) In certain circumstances the interest payments on these securities can be deferred although in this case Scottish Widows plc cannot declare or pay a dividend until any deferred payments have been made.

e) Issued by a group undertaking under the Company's subordinated guarantee.

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

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

Notes to the accounts

41 Subordinated liabilities (continued)

- h) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a fixed margin over the then five year Yen swap rate.
- i) These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 2.33 per cent above EURIBOR, to be set annually. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.
- j) These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 3.50 per cent above a rate based on the yield of specified UK government stock. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.
- k) At 31 December 2004, prior to the implementation of the prospective standards IAS 32 and IAS 39 from 1 January 2005, these instruments were classified by the Group as minority interests (see note 48).
- l) Issued during 2005 primarily to finance the general business of the Group.

Notes to the accounts

42 Share capital

	Group and Bank	
	2005 £m	2004 £m
Authorised: 1,650 million ordinary shares of £1 each	1,650	1,650
: 1 cumulative floating rate preference share of £1	—	—
: 100 6% Non-Cumulative Redeemable Preference shares of £1 each	—	—
Issued and fully paid:		
: ordinary shares of £1 each		
: At 1 January and 31 December	1,542	1,542
: Cumulative floating rate preference share of £1		
: At 1 January and 31 December	—	—

During 2004 the directors approved the creation and allotment at par of 100 6 per cent non-cumulative redeemable preference shares of £1 each. The shares, which are redeemable at the option of the Bank at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Bank. With effect from 1 January 2005, following the implementation of IAS 39, these instruments have been reclassified as debt.

43 Share premium account

	Group and Bank	
	2005 £m	2004 £m
At 1 January and 31 December	2,960	2,960

44 Other reserves

Other reserves comprise:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Revaluation reserve in respect of available-for-sale financial assets	29	—	26	—
Cash flow hedging reserve	11	—	11	—
	40	—	37	—

Movements in other reserves were as follows:

	The Group £m	The Bank £m
Revaluation reserve in respect of available-for-sale financial assets:		
At 1 January 2005 (following implementation of IAS 32 and IAS 39)	28	22
Exchange and other adjustments	(7)	(7)
Change in fair value of available-for-sale financial assets	11	13
Deferred tax thereon	2	1
	13	14
Transfer to income statement		
Disposal	(5)	(3)
Deferred tax thereon	—	—
	(5)	(3)
At 31 December 2005	29	26

44 Other reserves (continued)

	The Group £m	The Bank £m
Cash flow hedging reserve:		
At 1 January 2005 (following implementation of IAS 32 and IAS 39)	—	—
Change in fair value of hedging derivatives	4	4
Deferred tax thereon	(1)	(1)
	3	3
Transfer to income statement	12	12
Deferred tax thereon	(4)	(4)
	8	8
At 31 December 2005	11	11

45 Retained profits

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
At 1 January	7,650	7,204	3,514	2,754
Restatement on implementation of IAS 32, IAS 39 and IFRS 4	(1,614)	—	(618)	—
At 1 January – restated	6,036	—	2,896	—
Currency translation differences	16	(12)	25	(7)
Profit for the year*	2,504	2,371	2,736	2,680
Dividends	(1,913)	(1,913)	(1,913)	(1,913)
At 31 December	6,643	7,650	3,744	3,514

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

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

	The Group £m	The Bank £m
At 1 January 2005	(12)	(7)
Currency translation differences arising in the year	16	25
At 31 December 2005	4	18

46 Ordinary dividends

The dividends paid in the year were as follows:

	2005 £m	2004 £m
Second interim dividend in respect of preceding year	1,314	1,314
First interim dividend in respect of current year	599	599
	1,913	1,913

The directors have proposed a second interim dividend of £1,316 million (2004: £1,314 million) which will be paid on 3 May 2006.

Notes to the accounts

47 Share based payments

During the year ended 31 December 2005 Lloyds TSB Group plc operated the following share based payment schemes, all of which are equity settled.

Executive schemes

The Executive share option schemes are long-term incentive schemes and are available to certain senior executives of the Group, with grants usually made annually. Options are granted within limits set by the rules of the schemes. These limits relate to the number of shares under option and the price payable on the exercise of options. In 2005, 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**

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

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

For options granted from August 2001 to August 2004

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

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

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

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

For options granted in 2005

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

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

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

	2005 Number of options	2005 Weighted average exercise price (pence)	2004 Number of options	2004 Weighted average exercise price (pence)
Outstanding at 1 January	39,289,430	515.95	33,141,522	557.80
Granted	10,869,357	474.23	12,998,345	418.67
Exercised	(202,708)	273.37	(474,028)	218.95
Forfeited	(5,978,668)	673.41	(6,376,409)	557.24
Outstanding at 31 December	43,977,411	485.35	39,289,430	515.95
Exercisable at 31 December	1,430,218	685.23	1,949,426	650.12

The weighted average share price at the time that the options were exercised during 2005 was 490.15 pence (2004: 423.80 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 7.4 years (2004: 7.7 years).

Notes to the accounts

47 Share based payments (continued)**Save-As-You-Earn schemes**

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

Movements in the number of share options outstanding under the Save-As-You-Earn schemes are set out below:

	2005 Number of options	2005 Weighted average exercise price (pence)	2004 Number of options	2004 Weighted average exercise price (pence)
Outstanding at 1 January	122,115,907	321.71	124,683,429	335.85
Granted	9,610,466	380.00	16,225,108	322.90
Exercised	(6,086,150)	418.80	(1,280,773)	354.59
Forfeited	(4,404,042)	315.36	(2,993,735)	332.84
Cancelled	(3,722,135)	415.76	(7,640,996)	383.71
Expired	(3,054,572)	488.49	(6,877,126)	501.03
Outstanding at 31 December	114,459,474	314.17	122,115,907	321.71
Exercisable at 31 December	2,153,227	497.86	1,308,580	620.34

The weighted average share price at the time that the options were exercised during 2005 was 465.51 pence (2004: 427.55 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 2.2 years (2004: 2.9 years).

Other share option plans**Lloyds TSB Group plc Share Retention Plan**

In 2001, the Group adopted the Lloyds TSB Group plc Share Retention Plan. Options granted under this scheme are not subject to any conditions other than to remain employed by the Group for three years.

	2005 Number of options
Outstanding at 1 January	216,763
Exercised	(216,763)
Outstanding at 31 December	—

The weighted average remaining vesting period as at 31 December 2005 was nil (2004: nil). No options were exercisable at 31 December 2005.

Lloyds TSB Group plc Share Plan 2003

In 2003, the Group adopted the Lloyds TSB Group plc Share Plan 2003. Options granted under this scheme were not subject to any performance conditions. An option was granted in 2003 specifically to facilitate the recruitment of one executive director, this option had a total exercise price of £1, and would have been exercisable in the six month period beginning 31 December 2005; however this option lapsed during 2004 following the executive director's resignation.

	2004 Number of options
Outstanding at 1 January	331,125
Lapsed during the year	(331,125)
Outstanding at 31 December	—

Lloyds TSB Group Executive Share Plan 2003

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

	2005 Number of options	2005 Weighted average exercise price (pence)	2004 Number of options	2004 Weighted average exercise price (pence)
Outstanding at 1 January	206,647	Nil	—	—
Granted during the year	62,271	Nil	206,647	Nil
Outstanding at 31 December	268,918	Nil	206,647	Nil

The weighted average fair value of options granted in the year was £4.18 (2004: £3.69). No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 1.9 years (2004: 3.0 years).

Notes to the accounts

47 Share based payments (continued)

Lloyds TSB Group executive share plan 2005

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

	2005 Number of options	2005 Weighted average exercise price (pence)
Outstanding at 1 January	–	–
Granted during the year	242,825	Nil
Outstanding at 31 December	242,825	Nil

The weighted average fair value of options granted in the year was £3.63. No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 2.4 years.

Performance share plan

Under the performance share plan, introduced during 2005, executive directors will be eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 bonus. The maximum match will be two performance shares for each bonus share, awarded at the end of a three year period. The actual number of Lloyds TSB Group plc's shares awarded will depend on Lloyd TSB Group's TSR 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 TSR performance places it first in the comparator group; one performance share for each bonus share will be granted if the Group is placed fifth; and one performance share for every two bonus shares if the Group is placed eighth (median). Between first and fifth and fifth and eighth sliding scales will apply. If the TSR 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.

	2005 Number of Shares
Outstanding at 1 January	–
Granted during the year	854,116
Forfeited	(27,678)
Outstanding at 31 December	826,438

The fair value of the matching element of the performance shares awarded during 2005 was £1.78.

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

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

Notes to the accounts

47 Share based payments (continued)

31 December 2004	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	2.5	206,647
£2 to £3	245.01	0.2	127,058	284.00	3.0	83,117,427	–	–	–
£3 to £4	392.82	8.0	10,386,979	330.51	3.7	21,992,866	–	–	–
£4 to £5	419.89	9.2	13,813,324	452.21	1.4	10,674,528	–	–	–
£5 to £6	541.65	4.6	2,767,256	554.84	1.6	5,849,754	–	–	–
£6 to £7	665.06	6.3	3,063,872	632.00	1.2	105,995	–	–	–
£7 to £8	717.64	7.1	7,392,741	723.79	0.5	375,337	–	–	–
£8 to £9	873.34	3.7	1,738,200	–	–	–	–	–	–

The weighted average fair value of options granted during the year was £0.67 (2004: £0.47) for executive options and £0.98 (2004: £0.92) for Save-As-You-Earn options. The values for executive options have been determined using a binomial model that uses a stochastic projection model to determine the effect of the market based conditions. The values for the SAYE options have been determined using a standard Black-Scholes model. The fair value calculations are based on the following assumptions:

	Executive	SAYE	Other share option plans
Risk-free interest rate	4.73%	4.61%	4.41%
Expected life	4.8 years	4.1 years	2.8 years
Expected volatility	33%	30%	28%
Expected dividend yield	7.0%	7.4%	7.3%
Weighted average share price	£4.74	£4.76	£4.59
Weighted average exercise price	£4.74	£3.80	Nil
Expected forfeitures	5%	9%	5%

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

Share incentive plan

Free shares

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

Matching shares

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

The number of shares awarded relating to free shares in 2005 was 8,748,521 (2004: 8,903,125), with an average fair value of £4.57 (2004: £4.27), based on the market price at the date of award. The number of shares awarded relating to matching shares in 2005 was 2,296,575 (2004: 2,431,305), with an average fair value of £4.73 (2004: £4.28), based on market prices at the date of award.

The charge to the income statement is set out below:

	2005 £m	2004 £m
Options granted in the year	4	3
Options granted in prior years	27	27
Shares granted in the year	24	19
Shares granted in prior years	21	16
	76	65

Notes to the accounts

48 Minority interests

Minority interests comprise:

	The Group	
	2005 £m	2004 £m
Euro Step-up Non-voting Non-cumulative Preferred Securities callable 2012 (€430 million)*	302	
Sterling Step-up Non-voting Non-cumulative Preferred Securities callable 2015**	248	
Capital instruments†	550	
Other minority interests (note 53d)	435	81
	435	631

*These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a rate of 233 basis points above EURIBOR, to be set annually.

**These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a rate of 350 basis points above a rate based on the yield of specified UK government stock.

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

†Following the implementation of IAS 32 and IAS 39 on 1 January 2005, these securities are now classified as subordinated loan capital (see note 41).

49 Related party transactions**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 group executive committee of Lloyds TSB Group plc together with its non-executive directors.

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

	2005 £m	2004 £m
<i>Compensation</i>		
Salaries and other short-term benefits	11	10
Post-employment benefits	3	3
Termination benefits	–	1
Share based payments	2	2
Total	16	16

49 Related party transactions (continued)

	2005 millions	2004 millions
<i>Share options over Lloyds TSB Group plc shares</i>		
At 1 January	12	10
Granted (includes options of appointed directors)	3	5
Exercised/lapsed (includes options of retired directors)	(3)	(3)
At 31 December	12	12

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

	2005 £m	2004 £m
<i>Loans</i>		
At 1 January	3	3
Advanced	1	1
Interest	–	–
Repayments	(1)	(1)
At 31 December	3	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 4.6 per cent and 17.9 per cent in 2005 (2004: 5.4 per cent and 17.9 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2004: nil).

	2005 £m	2004 £m
<i>Deposits</i>		
At 1 January	2	2
Placed	22	5
Interest	–	–
Withdrawn	(19)	(5)
At 31 December	5	2

Deposits placed by key management personnel attracted interest rates of up to 4.5 per cent (2004: 4.8 per cent.)

At 31 December 2005, the Group provided guarantees totalling £19,744 in respect of one director (2004: £nil).

At 31 December 2005, transactions, arrangements and agreements entered into by the Group and its banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £3 million with seven directors and their connected persons (2004: £3 million with four directors and their connected persons).

Notes to the accounts

49 Related party transactions (continued)

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

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

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

	2005 £m	2004 £m
<i>Assets, included within:</i>		
Derivative financial instruments	323	████████
Loans and advances to banks	64,728	56,520
Loans and advances to customers	28,990	24,979
Other assets	445	367
	94,486	81,866
<i>Liabilities, included within:</i>		
Deposits from banks	8,407	8,738
Customer accounts	15,318	10,142
Derivative financial instruments	702	████████
Subordinated liabilities	585	550
Other liabilities	376	346
	25,388	19,776

Due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2005 the Bank earned interest income on the above asset balances of £4,128 million (2004: £3,232 million) and incurred interest expense on the above liability balances of £921 million (2004: £713 million).

In addition, the Bank raised recharges of £531 million (2004: £353 million) on its subsidiaries in respect of costs incurred and also received fees of £625 million (2004: £783 million), and paid fees of £61 million (2004: £76 million), for various services provided between the Bank and its subsidiaries.

Balances and transactions with Lloyds TSB Group plc

The Bank and its subsidiaries have balances due to and from the Bank's parent company, Lloyds TSB Group plc, which are included on the balance sheet as follows:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
<i>Assets, included within:</i>				
Derivative financial instruments	—	—	—	—
Loans and advances to customers	1,692	1,741	655	649
	1,692	1,741	655	649
<i>Liabilities, included within:</i>				
Customer accounts	280	293	205	218
Derivative financial instruments	188	████████	188	████████
Subordinated liabilities	1,714	1,714	1,114	1,114
	2,182	2,007	1,507	1,332

49 Related party transactions (continued)

These balances include Lloyds TSB Group plc's banking arrangements and, due to the size and volume of transactions passing through these accounts, it is neither practical nor meaningful to disclose information on gross inflows and outflows. During 2005 the Group earned interest income on the above asset balances of £5 million and the Bank earned interest income of nil (2004: Group £46 million; Bank £38 million); the Group incurred an interest expense on the above liability balances of £102 million and the Bank incurred an interest expense of £70 million (2004: Group £161 million; Bank £131 million).

Other related party disclosures

At 31 December 2005, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £14 million (2004: £14 million).

The Group manages 86 (2004: 76) Open Ended Investment Companies ('OEICs'), and of these 36 (2004: 47) are consolidated. The Group invested £345 million (2004: £131 million) and redeemed £265 million (2004: £164 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £2,074 million (2004: £1,415 million) at 31 December. The Group earned fees of £85 million from the unconsolidated OEICs (2004: £78 million). The Company held no investments in OEICs at any time during 2004 or 2005.

The Group has a number of venture capital associates that it accounts for at fair value through profit or loss. At 31 December 2005, these companies had total assets of approximately £1,194 million (2004: £1,095 million), liabilities of approximately £1,072 million (2004: £968 million) and for the year ended 31 December 2005 had turnover of approximately £1,782 million (2004: £1,551 million) and made a net profit of approximately £36 million (2004: £42 million). In addition the Group has provided £363 million (2004: £335 million) of financing to these companies on which it received £19 million (2004: £13 million) of interest income in the year.

50 Contingent liabilities and commitments

Legal proceedings

During the ordinary course of business the Group and the Bank are subject to threatened or actual legal proceedings. All material cases are periodically reassessed, with the assistance of external professional advisors where appropriate, to determine the likelihood of the Group or the Bank incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the balance sheet date.

In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed to properly assess the merits of the case. No provisions are held against such cases, however the Group and the Bank do not currently expect the final outcome to have a material effect upon the Group's or the Bank's financial position.

Contingent liabilities and commitments arising from the banking business

Acceptances and endorsements arise where the Group or the Bank agrees to guarantee payment on a negotiable instrument drawn up by a customer.

Guarantees include those given on behalf of a customer to stand behind the current obligations of the customer and to carry out those obligations should the customer fail to do so.

Other items serving as direct credit substitutes include standby letters of credit, or other irrevocable obligations, serving as financial guarantees where the Group or the Bank has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment; they also include acceptances drawn under letters of credit or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods.

Notes to the accounts

50 Contingent liabilities and commitments (continued)

Performance bonds and other transaction related contingencies (which include bid or tender bonds, advance payment guarantees, VAT Customs & Excise bonds and standby letters of credit relating to a particular contract or non-financial transaction) are undertakings where the requirement to make payment under the guarantee depends on the outcome of a future event.

Where the guarantees are issued on behalf of customers, the Group or the Bank usually holds collateral against the exposure or has a right of recourse to the customer.

The Group's and the Bank's maximum exposure to loss is represented by the contractual nominal amount detailed in the table below. Consideration has not been taken of any possible recoveries from customers for payments made in respect of such guarantees under recourse provisions or from collateral held.

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Contingent liabilities				
Acceptances and endorsements	35	71	35	37
Guarantees	9,373	6,786	9,911	6,899
Other:				
Other items serving as direct credit substitutes	550	345	552	347
Performance bonds and other transaction-related contingencies	1,737	1,324	1,753	1,339
	2,287	1,669	2,305	1,686
	11,695	8,526	12,251	8,622

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

Commitments

Documentary credits and other short-term trade-related transactions	283	431	191	406
Forward asset purchases and forward deposits placed	277	1,654	377	1,654
Undrawn formal standby facilities, credit lines and other commitments to lend:				
Less than 1 year maturity	55,310	59,085	60,016	60,922
1 year or over maturity	24,123	20,009	22,512	18,810
	79,993	81,179	83,096	81,792

Of the amounts shown in respect of undrawn formal standby facilities and other commitments to lend £43,094 million (2004: £42,376 million) for the Group, and £46,189 million (2004: £38,902 million) for the Bank were irrevocable.

Operating lease commitments

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

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Not later than 1 year	216	211	187	190
Later than 1 year and not later than 5 years	784	783	694	711
Later than 5 years	1,016	980	863	861
	2,016	1,974	1,744	1,762

50 Contingent liabilities and commitments (continued)

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

Finance lease commitments

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

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Not later than 1 year	1	2	–	1
Later than 1 year and not later than 5 years	–	4	–	4
Later than 5 years	15	15	15	15
	16	21	15	20

Finance lease payments relate to leases of certain premises and equipment. No arrangements have been entered into for contingent rental payments. The fair value of these finance lease obligations approximates their carrying amount at 31 December 2005 and 2004.

Capital commitments

Details of capital commitments are given in note 28.

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

The Group uses financial instruments (including derivatives) to meet the financial needs of its customers, as part of its trading activities and to reduce its own exposure to fluctuations in interest and exchange rates.

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

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

Credit risk

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

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

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

Notes to the accounts

51 Financial risk management (continued)

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

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

Credit risk also arises from the use of derivatives. Note 16 shows the total notional principal amount of interest rate, exchange rate and equity and other contracts outstanding at 31 December 2005. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. To reduce credit risk the Group uses a variety of credit enhancement techniques such as netting and collateralisation, where security is provided against the exposure.

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

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

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

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

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

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

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

51 Financial risk management (continued)

At 31 December 2005, the maximum credit risk exposure of the Group in the event of other parties failing to perform their obligations is detailed below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instruments' balance sheet carrying amounts or, for non-derivative off-balance sheet transactions, their contractual nominal amounts.

	The Group £m	The Bank £m
Loans and advances to banks	31,656	86,091
Loans and advances to customers	178,707	93,477
Deposit amounts available for offset ¹	(6,414)	(6,073)
Impairment losses	(2,073)	(1,719)
	201,876	171,776
Available for sale debt securities and treasury bills	14,894	4,457
Contingent liabilities	11,695	12,251
Undrawn irrevocable formal standby facilities, credit lines and other commitments to lend ²	43,094	46,189
Derivative assets, before netting	5,878	6,050
Amounts available for offset under master netting arrangements ¹	(3,235)	(3,235)
	2,643	2,815
Trading securities and other financial assets at fair value through profit and loss	26,869	5,923
	301,071	243,411

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

² See Note 50 – Contingent liabilities and commitments for further information.

Market risk

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

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

Market risk in the Group's retail portfolios and in the Group's capital funds is managed within limits set out in the policy for group balance sheet management, which is reviewed annually and approved by the group asset and liability committee. The structural foreign exchange position is managed having regard to the currency composition of the Group's risk-weighted assets and reported to the group asset and liability committee on a monthly basis. The objective is to limit the effect of exchange rate movements on the published risk asset ratio.

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

Notes to the accounts

51 Financial risk management (continued)

- With-profits funds are managed in accordance with the relevant funds' Principles and Practices of Financial Management.
- The investment strategy for other insurance liabilities is determined by the term and nature of the underlying liabilities and asset/liability matching positions are actively monitored. Actuarial tools are used to project and match cash flows.
- Investment strategy for surplus assets held in excess of liabilities takes account of the regulatory and internal business requirements for capital to be held to support the business now and in the future.

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

The primary measure within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. The use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. VaR is also not well suited to options positions. The Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity and include interest rate re-pricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at Group level to simulate extreme conditions to supplement these core measures. The risk of loss measured by the VaR model is the potential loss in earnings. The total and average trading VaR does not assume any diversification benefit across the three risk types. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole. Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding three years, the VaR for the years ended 31 December 2005 and 2004 based on the Group's global trading positions was as detailed in the following table (the table also aggregates potential loss measures from options portfolios).

	31 December 2005			
	Closing £m	Average £m	Maximum £m	Minimum £m
The Group				
Interest rate risk	0.9	1.8	4.5	0.5
Foreign exchange risk	0.2	0.3	0.4	0.2
Equity risk	0.0	0.0	0.0	0.0
Total VaR (no diversification)	1.1	2.1	4.7	0.8
	31 December 2004			
	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	0.7	0.9	1.7	0.5
Foreign exchange risk	0.2	0.3	0.6	0.2
Equity risk	0.0	0.0	0.0	0.0
Total VaR (no diversification)	0.9	1.3	2.0	0.8

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

51 Financial risk management (continued)

The Group's banking non-trading exposure is summarised in the form of an interest rate repricing table, as set out on page 59. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date. However, the table does not take into account the effect of interest rate options used by the Group to hedge its exposure.

It is estimated that a hypothetical immediate and sustained 100 basis points increase in interest rates on 1 January 2006 would decrease net interest income by £112.5 million for the 12 months to 31 December 2006, while a hypothetical immediate and sustained 100 basis point decrease in interest rates would increase net interest income by £104.7 million. An analysis by currency is shown below.

	UK £m	North America £m	Asia & Austra- lasia £m	Europe & Middle East £m	Total 2006 £m	Total 2005 £m
Change in net interest income from a +100 basis point shift in yield curves	(76.4)	(25.7)	0.1	(10.5)	(112.5)	(80.7)
Change in net interest income from a -100 basis point shift in yield curves	68.6	25.7	(0.1)	10.5	104.7	76.3

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

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

The composition, and value, of both the Scottish Widows plc Non-Profit Fund and the General Insurance portfolio are reported to Group Risk on a monthly basis and a VaR is calculated which is presented to the Lloyds TSB Group asset and liability committee. The VaR methodology used is the same in all respects to that used for the traded risk in banking activities, except that in the case of equity risk, the model maps the portfolio composition onto a series of appropriate indices by region and sector. In addition the risks are calculated based on a 99 per cent confidence level and a ten day holding period. The figures quoted below are the sum of the two portfolios with no allowance for diversification between portfolios or asset classes and represents the potential loss in earnings.

Notes to the accounts

51 Financial risk management (continued)

The following table shows closing, average, maximum and minimum VaR for the years ended 31 December 2005 and 2004 on a 99 per cent confidence ten day basis.

	31 December 2005			
	Closing £m	Average £m	Maximum £m	Minimum £m
The Group				
Interest rate risk	19.8	17.9	20.0	15.8
Foreign exchange risk	3.3	2.8	3.5	2.3
Equity risk	41.7	47.7	57.3	39.4
Total VaR	64.8	68.4	77.8	59.1
	31 December 2004			
	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	15.5	16.1	17.9	11.2
Foreign exchange risk	2.4	2.7	3.4	2.2
Equity risk	55.2	54.2	56.4	51.6
Total VaR	73.1	73.0	75.9	67.1

The Group's structural foreign exchange position at 31 December 2005 is set out on page 61. The position implies that at 31 December 2005 a hypothetical increase of 10 per cent in the value of sterling against all other currencies would have led to a £42 million reduction in reserves, and vice versa. On this basis, there would have been no material impact on the Group's risk asset ratios.

Interest rate risk

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

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

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

51 Financial risk management (continued)

The Group establishes two types of hedge accounting relationships: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio. At 31 December 2005 the aggregate notional principal of interest rate swaps designated as fair value hedges was £39,568 million with a net fair value (liability) of £245 million (see note 16). In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next seven years and will be reported in the income statement as they take place. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2005 was £648 million with a fair value (liability) of £18 million (see note 16).

Notes to the accounts

51 Financial risk management (continued)

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

The Group

As at 31 December 2005

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
Assets:							
Trading securities and other financial assets at fair value through profit or loss	1,734	2,418	1,035	3,796	17,886	33,698	60,567
Derivative financial instruments*	-	-	-	-	-	5,878	5,878
Loans and advances to banks	25,107	2,483	2,923	370	57	715	31,655
Loans and advances to customers	72,997	17,048	20,327	51,044	13,594	1,625	176,635
Available-for-sale financial assets	1,695	8,674	1,221	1,497	1,678	175	14,940
Other assets	195	50	-	-	-	21,701	21,946
Total assets	101,728	30,673	25,506	56,707	33,215	63,792	311,621
Liabilities:							
Deposits from banks	23,859	4,866	1,472	131	1,070	129	31,527
Customer accounts	112,831	4,901	3,941	4,061	1,413	4,203	131,350
Derivative financial instruments*	-	-	-	-	-	6,584	6,584
Debt securities in issue	13,167	15,640	3,905	1,709	4,925	-	39,346
Liabilities arising from insurance and investment contracts	-	-	-	-	-	63,041	63,041
Other liabilities	50	23	65	1	3,296	12,083	15,518
Subordinated liabilities	1,797	1,389	504	2,302	6,493	150	12,635
Total liabilities	151,704	26,819	9,887	8,204	17,197	86,190	300,001
Net repricing gap	(49,976)	3,854	15,619	48,503	16,018	(22,398)	11,620

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

As at 31 December 2004

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
Assets:							
Treasury bills and other eligible bills	21	25	41	5	-	-	92
Loans and advances to banks	21,979	5,561	2,984	629	81	614	31,848
Loans and advances to customers	82,392	18,302	13,565	36,681	6,198	(79)	157,059
Debt securities and equity shares	1,967	10,788	2,724	6,444	21,670	27,410	71,003
Other assets	234	60	1	3	-	26,063	26,361
Total assets	106,593	34,736	19,315	43,762	27,949	54,008	286,363
Equity and liabilities:							
Deposits from banks	31,646	5,142	2,521	122	90	202	39,723
Customer accounts	104,318	5,579	2,034	3,676	689	3,807	120,103
Debt securities in issue	10,624	9,484	3,227	1,436	3,999	-	28,770
Liabilities arising from insurance contracts	-	-	-	-	-	53,781	53,781
Other liabilities	180	-	19	1	2,680	17,694	20,574
Subordinated liabilities	922	1,377	459	1,652	6,069	150	10,629
Equity	-	-	-	-	-	12,783	12,783
Total equity and liabilities	147,690	21,582	8,260	6,887	13,527	88,417	286,363
Off-balance sheet items	-	(13,254)	6,327	9,467	(2,540)	-	-
Interest rate repricing gap	(41,097)	(100)	17,382	46,342	11,882	(34,409)	-
Cumulative interest rate repricing gap	(41,097)	(41,197)	(23,815)	22,527	34,409	-	-

Notes to the accounts

51 Financial risk management (continued)

The Bank

As at 31 December 2005

Assets:

Trading securities and other financial assets at fair value through profit of loss

Derivative financial instruments*

Loans and advances to banks

Loans and advances to customers

Available-for-sale financial assets

Other assets

Total assets

Liabilities:

Deposits from banks

Customer accounts

Derivative financial instruments*

Debt securities in issue

Other liabilities

Subordinated liabilities

Total liabilities

Net repricing gap

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
Trading securities and other financial assets at fair value through profit of loss	1,207	2,059	530	1,762	366	-	5,924
Derivative financial instruments*	-	-	-	-	-	6,050	6,050
Loans and advances to banks	39,465	4,926	12,778	25,466	2,496	959	86,090
Loans and advances to customers	41,991	10,350	8,031	14,235	11,301	5,851	91,759
Available-for-sale financial assets	828	2,391	923	161	26	174	4,503
Other assets	185	46	-	-	-	23,214	23,445
Total assets	83,676	19,772	22,262	41,624	14,189	36,248	217,771
Deposits from banks	29,972	5,103	1,751	546	-	601	37,973
Customer accounts	94,395	9,719	3,420	3,143	886	3,942	115,505
Derivative financial instruments*	-	-	-	-	-	7,212	7,212
Debt securities in issue	13,122	7,878	3,682	1,709	4,925	-	31,316
Other liabilities	3	26	1	-	-	6,070	6,100
Subordinated liabilities	1,211	639	504	2,302	6,580	146	11,382
Total liabilities	138,703	23,365	9,358	7,700	12,391	17,971	209,488
Net repricing gap	(55,027)	(3,593)	12,904	33,924	1,798	18,277	8,283

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

As at 31 December 2004

Assets:

Treasury bills and other eligible bills

Loans and advances to banks

Loans and advances to customers

Debt securities and equity shares

Other assets

Total assets

Equity and liabilities:

Deposits from banks

Customer accounts

Debt securities in issue

Other liabilities

Subordinated liabilities

Equity

Total equity and liabilities

Off-balance sheet items

Interest rate repricing gap

Cumulative interest rate repricing gap

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
Treasury bills and other eligible bills	17	25	41	5	-	-	88
Loans and advances to banks	33,442	10,591	10,507	22,301	2,197	781	79,819
Loans and advances to customers	54,915	7,835	5,173	3,523	2,232	3,177	76,855
Debt securities and equity shares	1,623	4,651	1,684	3,153	5,449	(12)	16,548
Other assets	96	35	-	-	-	26,942	27,073
Total assets	90,093	23,137	17,405	28,982	9,878	30,888	200,383
Deposits from banks	36,775	5,375	3,838	884	1	671	47,544
Customer accounts	86,944	4,072	1,175	3,031	1,857	3,608	100,687
Debt securities in issue	10,543	4,659	3,006	1,200	3,999	-	23,407
Other liabilities	25	-	-	1	-	10,224	10,250
Subordinated liabilities	922	777	459	1,652	6,523	146	10,479
Equity	-	-	-	-	-	8,016	8,016
Total equity and liabilities	135,209	14,883	8,478	6,768	12,380	22,665	200,383
Off-balance sheet items	-	(15,726)	6,926	11,113	(2,313)	-	-
Interest rate repricing gap	(45,116)	(7,472)	15,853	33,327	(4,815)	8,223	-
Cumulative interest rate repricing gap	(45,116)	(52,588)	(36,735)	(3,408)	(8,223)	-	-

Notes to the accounts

51 Financial risk management (continued)*Foreign exchange risk*

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

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to Group Treasury. Group Treasury calculates the associated VaR and the closing, average, maximum and minimum for 2004 and 2005 are disclosed on page 57.

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

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

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Functional currency of Group operations				
Euro	80	82	49	57
US dollar	102	114	37	42
Swiss franc	56	58	44	46
Other non-sterling	183	189	149	161
	421	443	279	306

Insurance risk

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

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

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

Insurance risks are measured through deterministic studies of the impact of different insurance market scenarios on the future free assets of the business together with relevant stochastic modelling.

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

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

51 Financial risk management (continued)

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

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

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

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

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

Liquidity risk

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

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

A substantial proportion of the customer deposit base is made up of current and savings accounts which, although repayable on demand, have traditionally provided a stable source of funding. During 2005, amounts deposited by customers increased by £11,247 million from £120,103 million at 31 December 2004. These customer deposits are supplemented by the issue of subordinated loan capital and wholesale funding sources in the capital markets, including deposits taken on the inter-bank market, certificates of deposit, sale and repurchase agreements, a Euro Medium-Term Note programme and a commercial paper programme.

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

Notes to the accounts

51 Financial risk management (continued)

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

Maturities of assets and liabilities

The Group

As at 31 December 2005

Assets

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

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Trading securities and other financial assets at fair value through profit or loss	520	818	1,051	6,271	51,907	60,567
Derivative financial instruments	848	618	603	1,906	1,903	5,878
Loans and advances to banks	24,372	1,513	3,955	1,357	458	31,655
Loans and advances to customers	24,560	7,696	10,944	39,132	94,303	176,635
Available-for-sale financial assets	130	1,092	1,839	6,638	5,241	14,940
Other assets	6,256	246	68	154	15,222	21,946
Total assets	56,686	11,983	18,460	55,458	169,034	311,621

Liabilities

Deposits from banks
Customer accounts
Derivative financial instruments
Debt securities in issue
Liabilities arising from insurance and investment contracts
Other liabilities
Subordinated liabilities

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	23,839	4,778	1,710	141	1,059	31,527
Customer accounts	117,624	5,065	3,317	3,773	1,571	131,350
Derivative financial instruments	690	657	799	1,893	2,545	6,584
Debt securities in issue	20,629	8,395	3,887	1,586	4,849	39,346
Liabilities arising from insurance and investment contracts	1,030	359	1,263	9,502	50,887	63,041
Other liabilities	5,561	306	602	265	8,784	15,518
Subordinated liabilities	-	-	-	1,082	11,553	12,635
Total liabilities	169,373	19,560	11,578	18,242	81,248	300,001

Net liquidity gap

	(112,687)	(7,577)	6,882	37,216	87,786	11,620
As at 31 December 2004						
Total assets	55,528	14,808	15,231	51,495	149,301	286,363
Total liabilities	165,201	16,338	9,654	13,974	68,413	273,580
Net liquidity gap	(109,673)	(1,530)	5,577	37,521	80,888	12,783

Notes to the accounts

51 Financial risk management (continued)

The Bank

As at 31 December 2005

Assets

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

Derivative financial instruments

Loans and advances to banks

Loans and advances to customers

Available-for-sale financial assets

Other assets

Total assets

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Trading securities and other financial assets at fair value through profit or loss	219	456	540	4,104	605	5,924
Derivative financial instruments	825	506	652	2,021	2,046	6,050
Loans and advances to banks	40,701	3,371	6,214	33,688	2,116	86,090
Loans and advances to customers	42,889	6,606	7,162	18,519	16,583	91,759
Available-for-sale financial assets	126	1,085	757	1,161	1,374	4,503
Other assets	4,456	151	100	249	18,489	23,445
Total assets	89,216	12,175	15,425	59,742	41,213	217,771

Liabilities

Deposits from banks

Customer accounts

Derivative financial instruments

Debt securities in issue

Other liabilities

Subordinated liabilities

Total liabilities

Net liquidity gap

As at 31 December 2004

Total assets

Total liabilities

Net liquidity gap

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Deposits from banks	29,955	4,920	2,105	993	–	37,973
Customer accounts	95,589	4,952	4,990	5,986	3,988	115,505
Derivative financial instruments	688	600	800	2,372	2,752	7,212
Debt securities in issue	13,338	7,879	3,664	1,586	4,849	31,316
Other liabilities	3,487	109	243	63	2,198	6,100
Subordinated liabilities	–	–	–	1,082	10,300	11,382
Total liabilities	143,057	18,460	11,802	12,082	24,087	209,488
Net liquidity gap	(53,841)	(6,285)	3,623	47,660	17,126	8,283
As at 31 December 2004						
Total assets	84,341	10,920	20,249	46,911	37,962	200,383
Total liabilities	140,800	13,309	9,525	9,502	19,231	192,367
Net liquidity gap	(56,459)	(2,389)	10,724	37,409	18,731	8,016

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

Notes to the accounts

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

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

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

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

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

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

The valuation technique and fair values for derivative financial instruments are disclosed in note 16; the valuation technique for each other major category of financial instrument is discussed below.

Treasury bills and other eligible bills

Fair value is estimated using market prices, where available.

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

Fair value is determined using market prices.

Derivative financial instruments

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

Loans and advances to banks and customers

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

51 Financial risk management (continued)***Debt securities and equity shares***

Listed investment securities are valued at quoted market prices. Unlisted investment securities are valued based on discounted cash flows, market prices of similar securities and other appropriate valuation techniques. Trading securities are valued using market prices.

Available-for-sale financial assets

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

Investment properties

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

Deposits from banks and customer accounts

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

Debt securities in issue and subordinated liabilities

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

Liabilities arising from non-participating investment contracts

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

Financial commitments and contingent liabilities

The Group considers that, given the lack of an established market, the diversity of fee structures and the difficulty of separating the value of the instruments from the value of the overall transaction, it is not meaningful to provide an estimate of the fair value of financial commitments and contingent liabilities. These are therefore excluded from the following table.

Notes to the accounts

51 Financial risk management (continued)

The Group	Carrying value		Fair value	
	2005 £m	2004 £m	2005 £m	2004 £m
Financial assets				
Treasury bills and other eligible bills				
– investment securities		88		90
– other securities		4		4
Trading securities and other financial assets at fair value through profit or loss	60,567		60,567	
Derivative financial instruments	5,878		5,878	
Loans and advances to banks	31,655	31,848	31,691	31,800
Loans and advances to customers	176,635	157,059	177,245	157,570
Debt securities				
– investment securities		14,368		14,380
– other securities		29,117		29,117
Equity shares				
– investment securities		41		65
– other securities		27,477		27,477
Available-for-sale financial assets	14,940		14,940	
Investment properties	4,260	3,776	4,260	3,776
Financial liabilities				
Deposits from banks	31,527	39,723	31,508	39,725
Customer accounts	131,350	120,103	131,332	120,065
Derivative financial instruments and other trading liabilities	6,584		6,584	
Debt securities in issue	39,346	28,770	39,352	28,477
Liabilities arising from non-participating investment contracts	21,839		21,839	
Subordinated liabilities	12,635	10,629	13,436	11,920
The Bank	Carrying value		Fair value	
	2005 £m	2004 £m	2005 £m	2004 £m
Financial assets				
Treasury bills and other eligible bills – investment securities		88		90
Trading securities and other financial assets at fair value through profit or loss	5,924		5,924	
Derivative financial instruments	6,050		6,050	
Loans and advances to banks	86,090	79,819	86,126	79,772
Loans and advances to customers	91,759	76,855	92,275	77,412
Debt securities				
– investment securities		5,705		5,707
– other securities		10,826		10,826
Equity shares				
– investment securities		17		37
Available-for-sale financial assets	4,503		4,503	
Financial liabilities				
Deposits from banks	37,973	47,544	37,961	47,545
Customer accounts	115,505	100,687	115,523	100,650
Derivative financial instruments and other trading liabilities	7,212		7,212	
Debt securities in issue	31,316	23,407	31,323	23,113
Subordinated liabilities	11,382	10,479	12,034	11,730

52 Acquisitions

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

53 Cash flow statements

a Reconciliation of profit before tax to net cash (used in) provided by operating activities

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Profit before tax	3,854	3,501	3,042	3,013
(Profit) loss on disposal of businesses	(50)	21	(57)	(7)
Depreciation of fixed assets	639	638	309	291
Allowance for loan losses	1,302	866	1,062	742
Write-off of allowance for loan losses	(1,078)	(854)	(916)	(733)
Insurance claims	12,186	9,622	–	–
Insurance claims paid	(8,265)	(5,330)	–	–
Movement in value of in-force business	(162)	(16)	–	–
Customer remediation provision	150	112	147	100
Customer remediation paid	(77)	(245)	(62)	(87)
Net charge in respect of retirement benefit schemes	259	275	191	202
Contributions to retirement benefit schemes	(425)	(374)	(316)	(278)
Net gain on sale of investment securities	(5)	(126)	(3)	(1)
Revaluation of investment property	(430)	(329)	–	–
Change in loans and advances to banks	(1,277)	(964)	(10,926)	(8,953)
Change in loans and advances to customers	(14,475)	(19,656)	(8,851)	(6,424)
Change in deposits from banks	(8,168)	16,046	(9,418)	17,412
Change in customer accounts	4,607	5,520	8,616	939
Change in debt securities in issue	10,280	1,876	7,652	1,476
Change in trading assets	(88)	834	5,837	4,217
Change in trading liabilities	(3,957)	–	(1,149)	–
Change in investment contract liabilities	6,094	–	–	–
Change in other assets	(1,040)	(1,536)	(55)	263
Change in other liabilities	1,205	2,871	213	119
Tax paid	(723)	(641)	(301)	(63)
Other non-cash movements	(662)	115	71	(3)
Total adjustments	(4,160)	8,725	(7,956)	9,212
Net cash (used in) provided by operating activities	(306)	12,226	(4,914)	12,225

b Analysis of cash and cash equivalents as shown in the balance sheet

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Cash and balances with central banks (excluding mandatory deposits)	868	833	797	857
Loans and advances to banks with a maturity of less than three months	25,885	27,363	16,510	21,129
	26,753	28,196	17,307	21,986

Included within cash and cash equivalents at 31 December 2005 is £8,860 million (2004: £7,920 million) held within the Group's life funds, which is not immediately available for use in the business. In addition, mandatory reserve deposits of £288 million (2004: £245 million) are also held with local central banks in accordance with statutory requirements; these deposits are not available to finance the Group's day-to-day operations.

Notes to the accounts

53 Cash flow statements (continued)

c Analysis of changes in cash and cash equivalents during the year

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
At 1 January	28,196	19,433	21,986	14,108
Net cash (outflow) inflow before adjustments for the effect of foreign exchange movements	(1,423)	8,777	(4,659)	7,892
Effect of foreign exchange movements	(20)	(14)	(20)	(14)
	(1,443)	8,763	(4,679)	7,878
At 31 December	26,753	28,196	17,307	21,986

d Analysis of changes in financing during the year

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Share capital (including premium):				
At 1 January and 31 December	4,502	4,502	4,502	4,502

Minority interests:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
At 1 January			631	782
Adjustments on adoption of IAS 32, IAS 39 and IFRS 4			(550)	
At 1 January – restated			81	
Exchange and other adjustments			–	1
Capital invested by minority shareholders			329	–
Repayment of capital to minority shareholders			–	(151)
Minority share of profit after tax			62	67
Payments to minority shareholders			(37)	(68)
At 31 December			435	631

Subordinated liabilities and finance leases:

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
At 1 January	10,650	10,850	10,499	10,695
Adjustments on adoption of IAS 32, IAS 39 and IFRS 4	804		254	
At 1 January – restated	11,454		10,753	
Exchange and other adjustments	70	(140)	68	(140)
Issue of subordinated liabilities	1,361	699	810	699
Repayments of subordinated liabilities	(232)	(764)	(232)	(759)
Lease financing	–	6	–	5
Finance lease capital repayments	(2)	(1)	(2)	(1)
At 31 December	12,651	10,650	11,397	10,499

53 Cash flow statements (continued)

e Acquisition of group undertakings and businesses

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Investment in subsidiary	–	–	4	2
Net assets acquired:				
Other assets	8	–	–	–
Tangible fixed assets	8	2	–	–
Other liabilities	(3)	(7)	–	–
Goodwill arising on consolidation	3	6	–	–
Net cash outflow from acquisitions in the year*	16	1	4	2
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	11	15	–	–
Deferred consideration in respect of acquisition in 2002	–	1	–	–
Net cash outflow from acquisitions	27	17	4	2

*The consideration in respect of these acquisitions was settled in cash in the year concerned (see note 52).

f Disposal and closure of group undertakings and businesses

	The Group		The Bank	
	2005 £m	2004 £m	2005 £m	2004 £m
Cash and cash equivalents	–	46	–	41
Loans and advances to banks	–	132	–	95
Loans and advances to customers	803	257	803	107
Debt securities and treasury bills	–	59	–	44
Goodwill	93	10	110	–
Other intangible assets	–	9	–	9
Deposits by banks	–	(42)	–	(20)
Customer accounts	–	(327)	–	(274)
Debt securities in issue	–	(111)	–	–
Other net assets and liabilities	(946)	9	(970)	21
	(50)	42	(57)	23
Profit (loss) on sale and closure of businesses	50	(21)	57	7
Cash and cash equivalent consideration received	–	21	–	30
Cash and cash equivalents disposed of	–	(46)	–	(41)
Net cash outflow from disposals in the year	–	(25)	–	(11)
Adjustment to consideration received in respect of prior period disposals	(4)	–	–	–
Net cash outflow from disposals	(4)	(25)	–	(11)

Notes to the accounts

54 Adoption of International Financial Reporting Standards

IFRS differs in certain respects from the Group's previous accounting policies, which complied with UK Generally Accepted Accounting Principles ('UK GAAP'). Set out below are explanations and reconciliations showing the effect of the adoption of IFRS and FRS 27 upon the Group's previously published financial information.

Accounting changes effective from 1 January 2004 and which impact 2004 comparatives:*Consolidation (IAS 27 and SIC-12)*

IFRS requires line-by-line consolidation for all items of income and expenditure; consequently, the Group no longer reports the results and balances of the life assurance business as one line items.

IFRS also requires consolidation of several entities that the Group was not required to consolidate under UK GAAP including companies supporting the Group's securitisation conduits, which facilitate customers' own securitisations, and Open Ended Investment Companies (OEICs) and unit trusts where the Group, through the Group's life funds, has a controlling interest.

Leasing (IAS 17)

IFRS requires income from finance leases to be credited to the income statement to give a constant pre-tax rate of return on the net investment in the lease; UK GAAP required a constant post-tax rate of return. In addition, IFRS requires depreciation on operating lease assets to be charged on the same basis as for other tangible fixed assets, which for the Group is a straight-line basis. Under UK GAAP depreciation was charged so as to give a constant rate of return on the leased asset.

Employee benefits (IFRS 2, IAS 19)

IFRS 2 requires that a cost is recognised in the financial statements for all options granted under executive and employee Save-As-You-Earn ('SAYE') share option schemes; no costs were recognised under UK GAAP in respect of these schemes.

The Group has elected to apply the corridor approach to determine the treatment of actuarial gains and losses arising during the year as permitted under IAS 19. The effect of this has been to derecognise the actuarial losses charged to reserves in 2004 under UK GAAP in the restated figures.

Capitalisation of software (IAS 38)

Under UK GAAP the Group's accounting policy was to capitalise, within tangible fixed assets, only software costs relating to separable new systems. Under IFRS, both external and directly related internal costs relating to enhancements that lead to additional system functionality are also now capitalised and included in other intangible assets.

Investment management fees (IAS 18)

Under IFRS the Group moved from immediate recognition of up-front fees received for investment management services to recognising them on a straight-line basis over the estimated lives of the investment contracts.

Goodwill (IFRS 3 and IAS 36)

Under UK GAAP the Group's accounting policy was to amortise goodwill arising on acquisitions after 1 January 1998, with the exception of goodwill which arose on the acquisition of Scottish Widows. Under IFRS all goodwill recognised in the UK GAAP balance sheet at 1 January 2004 is carried forward without adjustment in the balance sheet and is now subject to impairment testing annually, or more frequently if events or circumstances indicate that it might be impaired.

Dividends (IAS 10)

Under IFRS equity dividends declared after the balance sheet date may not be included as a liability at the balance sheet date.

54 Adoption of International Financial Reporting Standards (continued)*Depreciation (IAS 16)*

IFRS requires property, plant and equipment to be depreciated from the date of acquisition. Under UK GAAP, long leasehold and freehold properties have been depreciated only since 1 January 2000 and therefore it is necessary to adjust their carrying values to reflect the depreciation that would have been charged from the date of acquisition to 1 January 2000.

Claims equalisation provision (IAS 37)

The claims equalisation provision in respect of the Group's general insurance business, established under law to minimise volatility in incurred claims, is not permitted under IFRS.

Cash flow statement (IAS 7)

Whilst the requirements under IFRS are similar to those under UK GAAP, two principal differences arise between UK GAAP and IFRS with regard to the definition of cash and cash equivalents and the classification of items within the cash flow statement. Cash and cash equivalents comprise cash and balances at central banks and amounts due from banks with a maturity of less than three months (under UK GAAP only amounts due from banks repayable on demand were included in cash and cash equivalents), excluding mandatory deposits. In terms of classification, UK GAAP requires a more detailed classification of cash flows which includes separate classifications of cash flows arising from dividends and taxation.

Accounting changes effective from 1 January 2005 and which do not affect 2004 comparatives:*Fees integral to effective yield (IAS 18, IAS 39)*

Fees and commissions that are an integral part of the effective yield on a financial instrument, and direct incremental costs associated with its origination, are included in the calculation of the effective interest rate and recognised over the expected life of the instrument, or a shorter period if appropriate. As a result the recognition of up-front fees and costs that were recognised when received, or incurred, under UK GAAP, for example those related to loan origination, are now deferred and the recognition of fee income typically charged at the end of an agreement, for example early redemption charges on mortgages, brought forward.

Loan impairment (IAS 39)

IFRS adopts an incurred loss model for impairment losses on loans and provides guidance on the measurement of impairment. Any provision required is calculated by comparing the book value of the loans with the net present value of the expected future cash flows from the loans discounted at their effective interest rates or, as a practical expedient for variable rate loans, using observable market prices. The impairment principles under IFRS are similar to those followed by the Group under UK GAAP, with the exception of the requirements to discount the expected cash flows at the original effective interest rate when determining the provisioning requirement.

Netting (IAS 32)

IFRS prohibits financial assets and financial liabilities from being offset unless there is a legal right of set-off and the asset and liability are in practice normally settled, or there is an intention to settle, on a net basis. In the banking business, this has resulted in the grossing-up on the balance sheet of certain assets and liabilities subject to set-off arrangements that were presented net under UK GAAP.

Derivative financial instruments and hedging (IAS 39)

The Group enters into derivative contracts for both trading purposes and to hedge exposures arising from within the banking book. Under UK GAAP trading derivatives were carried at fair value but hedging derivatives were accounted for on the same basis as the underlying hedged item, mainly on an accruals basis. IAS 39 requires that all derivative contracts are carried at fair value on the Group's balance sheet and movements in their fair value are reflected in the income statement except where cash flow hedging is applied; this results in a mismatch between the accounting and the underlying economics where the Group has hedged its economic risk resulting from the different treatment of the derivative and the underlying hedged position.

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

The Group has not changed the way it hedges its economic exposures as a result of the implementation of IFRS, but the Group seeks to mitigate the resulting income statement volatility by the application of hedge accounting. Although the Group intends to mitigate the volatility arising from the requirement to fair value all derivatives as far as possible, this will be a source of increased volatility in the income statement in 2005 and beyond.

Other non-derivative financial assets (IAS 39)

IAS 39 permits financial assets to be designated at the time of initial recognition as being held at fair value, with unrecognised gains or losses reported in the income statement. Certain loans and advances and debt securities previously carried at amortised cost under UK GAAP have been designated as held at fair value through profit or loss on adoption of IAS 39 and have been valued at their fair value at 1 January 2005.

Under UK GAAP debt securities held for continuing use in the business were classified as investment securities and carried in the balance sheet at cost less any provisions for permanent diminution in value. IAS 39 introduces strict requirements to be met before debt securities can be carried at amortised cost and the Group has determined that it does not meet these. Accordingly debt securities previously classified as investment securities have been reclassified as available-for-sale and valued at their fair values at 1 January 2005. Equity investments may not be carried at cost under IAS 39 and these have also been reclassified as available-for-sale.

Insurance (IFRS 4, IAS 39, IAS 18)

IFRS 4 applies to contracts under which the insurer agrees to compensate the policyholder if a specified uncertain future event adversely affects the policyholder as well as to investment contracts which entitle the holder to receive additional discretionary benefits depending on performance. For contracts within the scope of IFRS 4, accounting practices are largely unchanged except for the modifications introduced by FRS 27 which is dealt with separately below.

Investment contracts that are not within the scope of IFRS 4 are accounted for as financial instruments under IAS 39. The principal effects of this change on the accounting for non-participating investment contracts are the removal of that portion of the embedded value which represents the value of in-force business relating to those contracts, the recognition of an asset for deferred acquisition costs, and the deferral of up-front fees received for investment management services; deferred acquisition costs and deferred up-front fees are amortised over the period of the provision of investment management services.

Life assurance (FRS 27)

Following the implementation of FRS 27, the Group excludes from the value of in-force business recognised in the balance sheet any amounts that reflect future investment margins and measures the liabilities of the Scottish Widows With-Profits Fund in accordance with the realistic capital regime of the Financial Services Authority. This basis includes a realistic valuation of guarantees and options embedded within products written by the With-Profits Fund. The principal effect of these new requirements is on the measurement of the in-force business, as the valuation of the With-Profits Fund on a realistic basis reduces the expected income to the shareholder from that fund. Changes in the valuation are reflected in the income statement and because this is market related it is inherently volatile.

54 Adoption of International Financial Reporting Standards (continued)**Equity to debt reclassification (IAS 32)**

The classification of the majority of the Group's capital and subordinated debt instruments continues to follow their UK GAAP treatment. However, the Group's preferred securities, which were treated as non-equity minority interests under UK GAAP, have been reclassified as debt because the coupon payment is not discretionary. Distributions on these securities are shown as interest expense rather than as minority interests.

Derecognition of financial liabilities (IAS 39)

Under IFRS a financial liability may only be removed from the balance sheet after it has been settled, it has expired or alternatively the debtor has been legally released from the liability, either by process of law or by the creditor. Upon adoption of IFRS, certain financial liabilities in respect of which amounts had been released to the income statement under UK GAAP on the basis that the likelihood of their settlement was remote have been remeasured as at 1 January 2005 to reflect the entire legal obligation.

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

Restated Group balance sheet (reconciliation of equity) at 1 January 2004 (excludes effects of IAS 32, IAS 39 and IFRS 4)

	UK GAAP £m	Consolidation		Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Dividend £m	Other £m	IFRS £m
		Insurance business £m	New entities £m								
Assets											
Cash and balances at central banks	1,195	-	-	-	-	-	-	-	-	-	1,195
Items in the course of collection from banks	1,447	-	-	-	-	-	-	-	-	-	1,447
Treasury bills and other eligible bills	539	-	-	-	-	-	-	-	-	-	539
Loans and advances to banks	15,547	4,948	1,649	-	-	-	-	-	-	(2)	22,142
Loans and advances to customers	137,017	(137)	1,178	(178)	-	-	-	-	-	(1)	137,879
Debt securities	28,669	16,896	318	-	-	-	-	-	-	2	45,885
Equity shares	458	25,109	244	-	-	-	-	-	-	2	25,813
Investment property	-	3,551	-	-	-	-	-	-	-	-	3,551
Goodwill	2,507	-	-	-	-	-	-	-	-	-	2,507
Value of in-force business	-	4,347	-	-	-	-	-	-	-	-	4,347
Intangible assets	-	-	-	-	-	41	-	-	-	-	41
Fixed assets	3,916	138	-	(85)	-	-	-	-	-	(27)	3,942
Other assets	3,979	1,203	416	15	-	-	3	-	-	1,914	7,530
Prepayments and accrued income	1,928	-	-	-	-	-	-	-	-	(1,928)	-
Long-term assurance business attributable to the shareholder	6,496	(6,496)	-	-	-	-	-	-	-	-	-
Long-term assurance assets attributable to the policyholders	50,200	(50,200)	-	-	-	-	-	-	-	-	-
Total assets	253,898	(641)	3,805	(248)	-	41	3	-	-	(40)	256,818
Equity and liabilities											
Liabilities											
Deposits from banks	23,955	-	-	-	-	-	-	-	-	(8)	23,947
Customer accounts	116,944	(1,995)	-	-	-	-	-	-	-	-	114,949
Items in course of transmission to banks	626	-	-	-	-	-	-	-	-	-	626
Debt securities in issue	25,922	217	1,319	-	-	-	-	-	-	-	27,458
Insurance contract liabilities	-	49,201	-	-	-	-	-	-	-	(51)	49,150
Unallocated surplus within insurance business	-	339	-	-	-	-	-	-	-	-	339
Other liabilities	6,789	734	2,484	150	-	-	87	-	(1,314)	3,239	12,169
Accruals and deferred income	3,242	-	-	-	-	-	-	-	-	(3,242)	-
Deferred tax liabilities	1,383	1,137	-	(155)	(35)	12	(25)	-	-	(849)	1,468
Other provisions	402	(186)	-	-	-	-	-	-	-	-	216
Retirement benefit obligations	2,139	-	-	-	117	-	-	-	-	916	3,172
Subordinated liabilities	10,836	-	-	-	-	-	-	-	-	-	10,836
Long-term assurance liabilities to policyholders	50,200	(50,200)	-	-	-	-	-	-	-	-	-
Total liabilities	242,438	(753)	3,803	(5)	82	12	62	-	(1,314)	5	244,330
Equity											
Share capital	1,542	-	-	-	-	-	-	-	-	-	1,542
Share premium account	2,960	-	-	-	-	-	-	-	-	-	2,960
Retained profits	6,231	57	-	(241)	(82)	29	(59)	-	1,314	(45)	7,204
Shareholders' equity	10,733	57	-	(241)	(82)	29	(59)	-	1,314	(45)	11,706
Minority interests	727	55	2	(2)	-	-	-	-	-	-	782
Total equity	11,460	112	2	(243)	(82)	29	(59)	-	1,314	(45)	12,488
Total equity and liabilities	253,898	(641)	3,805	(248)	-	41	3	-	-	(40)	256,818

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

Restated Group balance sheet (reconciliation of equity) at 31 December 2004 (excludes effects of IAS 32, IAS 39 and IFRS 4)

	UK GAAP £m	Consolidation									IFRS £m
		Insurance business £m	New entities £m	Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Dividend £m	Other £m	
Assets											
Cash and balances at central banks	1,078	-	-	-	-	-	-	-	-	-	1,078
Items in the course of collection from banks	1,462	-	-	-	-	-	-	-	-	-	1,462
Treasury bills and other eligible bills	92	-	-	-	-	-	-	-	-	-	92
Loans and advances to banks	23,565	5,836	2,447	-	-	-	-	-	-	-	31,848
Loans and advances to customers	155,981	(99)	1,339	(162)	-	-	-	-	-	-	157,059
Debt securities	25,194	17,794	498	-	-	-	-	-	-	(1)	43,485
Equity shares	215	28,217	(914)	-	-	-	-	-	-	-	27,518
Investment property	-	3,160	616	-	-	-	-	-	-	-	3,776
Goodwill	2,425	-	-	-	-	-	-	44	-	-	2,469
Value of in-force business	-	4,363	-	-	-	-	-	-	-	-	4,363
Intangible assets	-	-	-	-	-	28	-	-	-	-	28
Fixed assets	4,181	133	-	(100)	-	-	-	-	-	(34)	4,180
Other assets	3,254	2,435	717	14	-	-	3	-	-	2,582	9,005
Prepayments and accrued income	2,584	-	-	-	-	-	-	-	-	(2,584)	-
Long-term assurance business attributable to the shareholder	6,796	(6,796)	-	-	-	-	-	-	-	-	-
Long-term assurance assets attributable to the policyholders	54,894	(54,894)	-	-	-	-	-	-	-	-	-
Total assets	281,721	149	4,703	(248)	-	28	3	44	-	(37)	286,363
Equity and liabilities											
Liabilities											
Deposits from banks	39,738	-	-	-	-	-	-	-	-	(15)	39,723
Customer accounts	122,354	(2,254)	-	-	-	-	-	-	-	3	120,103
Items in course of transmission to banks	631	-	-	-	-	-	-	-	-	-	631
Debt securities in issue	27,217	208	1,345	-	-	-	-	-	-	-	28,770
Insurance contract liabilities	-	52,480	-	-	-	-	-	-	-	(61)	52,419
Unallocated surplus within insurance business	-	1,362	-	-	-	-	-	-	-	-	1,362
Accruals and deferred income	3,912	-	-	-	-	-	-	-	-	(3,912)	-
Other liabilities	6,570	2,127	3,356	183	25	-	56	-	(1,314)	3,935	14,938
Deferred tax liabilities	1,476	1,276	-	(159)	29	9	(16)	3	-	(899)	1,719
Other provisions	417	(206)	-	-	-	-	-	-	-	-	211
Retirement benefit obligations	2,231	-	-	-	(112)	-	-	-	-	956	3,075
Subordinated liabilities	10,629	-	-	-	-	-	-	-	-	-	10,629
Long-term assurance liabilities to policyholders	54,894	(54,894)	-	-	-	-	-	-	-	-	-
Total liabilities	270,069	99	4,701	24	(58)	9	40	3	(1,314)	7	273,580
Equity											
Share capital	1,542	-	-	-	-	-	-	-	-	-	1,542
Share premium account	2,960	-	-	-	-	-	-	-	-	-	2,960
Retained profits	6,554	13	-	(268)	58	19	(37)	41	1,314	(44)	7,650
Shareholders' equity	11,056	13	-	(268)	58	19	(37)	41	1,314	(44)	12,152
Minority interests	596	37	2	(4)	-	-	-	-	-	-	631
Total equity	11,652	50	2	(272)	58	19	(37)	41	1,314	(44)	12,783
Total equity and liabilities	281,721	149	4,703	(248)	-	28	3	44	-	(37)	286,363

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

Restated Group income statement (reconciliation of profit) for the year ended 31 December 2004 (excludes effects of IAS 32, IAS 39 and IFRS 4)

	Consolidation									
	UK GAAP £m	Insurance business £m	New entities £m	Leasing £m	Employee benefits £m	Software £m	Unit trusts £m	Goodwill £m	Other £m	IFRS £m
Interest income	10,340	170	125	(2)	–	–	–	–	19	10,652
Interest expense	(5,436)	55	(162)	–	–	–	–	–	(15)	(5,558)
Net interest income	4,904	225	(37)	(2)	–	–	–	–	4	5,094
Other finance income	39	–	–	–	(39)	–	–	–	–	–
Insurance premium income	554	5,516	–	–	–	–	–	–	–	6,070
Fees and commission income	3,127	(16)	(52)	(38)	–	–	31	–	5	3,057
Fees and commission expense	(744)	(95)	(10)	5	–	–	–	–	–	(844)
Net fees and commission income	2,383	(111)	(62)	(33)	–	–	31	–	5	2,213
Dealing profits	271	–	–	–	–	–	–	–	(271)	–
Net trading income	–	4,663	109	–	–	–	–	–	264	5,036
Increase in value of long-term assurance business	715	(715)	–	–	–	–	–	–	–	–
Other operating income	688	202	5	16	–	–	–	–	(54)	857
Total income	9,554	9,780	15	(19)	(39)	–	31	–	(52)	19,270
Insurance claims	(224)	(9,408)	–	–	–	–	–	–	10	(9,622)
Total income, net of insurance claims	9,330	372	15	(19)	(39)	–	31	–	(42)	9,648
Administrative expenses	(4,241)	(395)	(2)	2	8	10	–	–	(4)	(4,622)
Depreciation of property, plant and equipment	(589)	(12)	–	(15)	–	(22)	–	–	–	(638)
Amortisation of goodwill	(44)	–	–	–	–	–	–	44	–	–
Total operating expenses	(4,874)	(407)	(2)	(13)	8	(12)	–	44	(4)	(5,260)
Trading surplus	4,456	(35)	13	(32)	(31)	(12)	31	44	(46)	4,388
Impairment losses on loans and advances	(866)	–	–	–	–	–	–	–	–	(866)
Amounts written off fixed asset investments	(52)	–	–	–	–	–	–	–	52	–
Profit and loss on disposal of businesses	(15)	–	–	–	–	–	–	–	(6)	(21)
Profit before tax	3,523	(35)	13	(32)	(31)	(12)	31	44	–	3,501
Taxation	(1,045)	(8)	(12)	4	8	4	(9)	(3)	(2)	(1,063)
Profit for the year	2,478	(43)	1	(28)	(23)	(8)	22	41	(2)	2,438
Profit attributable to minority interests	68	–	1	(1)	–	–	–	–	(1)	67
Profit attributable to equity shareholders	2,410	(43)	–	(27)	(23)	(8)	22	41	(1)	2,371
	2,478	(43)	1	(28)	(23)	(8)	22	41	(2)	2,438

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

Restated Group balance sheet (reconciliation of equity) at 1 January 2005 (includes effects of IAS 32, IAS 39 and IFRS 4)

	Restated 31 December 2004 £m	Reclassifi- cations £m	Effective interest rates £m	Impairment £m	Offset £m	Derivatives £m	Available- for-sale £m	Insurance £m	Debt/ equity £m	Other £m	1 January 2005 £m
Assets											
Cash and balances at central banks	1,078	-	-	-	-	-	-	-	-	-	1,078
Items in the course of collection from banks	1,462	-	-	-	-	-	-	-	-	-	1,462
Treasury bills and other eligible bills	92	(92)	-	-	-	-	-	-	-	-	-
Trading securities and other financial assets at fair value through profit or loss	-	57,073	-	-	-	25	-	(45)	-	(5)	57,048
Derivative financial instruments	-	4,869	-	-	3,956	438	-	-	-	-	9,263
Loans and advances to banks	31,848	-	3	-	-	-	-	-	-	-	31,851
Loans and advances to customers	157,059	(337)	108	(314)	6,287	95	-	-	-	5	162,903
Debt securities	43,485	(43,485)	-	-	-	-	-	-	-	-	-
Equity shares	27,518	(27,518)	-	-	-	-	-	-	-	-	-
Available-for-sale financial assets	-	14,385	-	-	-	175	33	-	-	-	14,593
Investment property	3,776	-	-	-	-	-	-	-	-	-	3,776
Goodwill	2,469	-	-	-	-	-	-	-	-	-	2,469
Value of in-force business	4,363	-	-	-	-	-	-	(1,603)	-	-	2,760
Intangible assets	28	-	-	-	-	-	-	-	-	-	28
Fixed assets	4,180	-	-	-	-	-	-	-	-	-	4,180
Other assets	9,005	(4,869)	(137)	-	-	(910)	-	291	-	4	3,384
Total assets	286,363	26	(26)	(314)	10,243	(177)	33	(1,357)	-	4	294,795
Equity and liabilities											
Liabilities											
Deposits from banks	39,723	-	-	-	-	-	-	-	-	-	39,723
Customer accounts	120,103	(36)	(13)	-	6,287	127	-	-	-	173	126,641
Items in course of transmission to banks	631	-	-	-	-	-	-	-	-	-	631
Derivative financial instruments and other trading liabilities	-	6,151	-	-	3,956	435	-	-	-	-	10,542
Liabilities to customers under investment contracts	-	16,354	-	-	-	-	-	7	-	-	16,361
Debt securities in issue	28,770	-	-	-	-	(42)	-	-	-	-	28,728
Insurance contract liabilities	52,419	(16,354)	-	-	-	-	-	790	-	-	36,855
Unallocated surplus within insurance business	1,362	-	-	-	-	-	-	(936)	-	-	426
Other liabilities	14,938	(6,148)	(45)	-	-	(589)	-	416	-	(37)	8,535
Deferred tax liabilities	1,719	-	10	(93)	-	(94)	5	(568)	-	(51)	928
Other provisions	211	59	-	-	-	-	-	-	-	-	270
Retirement benefit obligations	3,075	-	-	-	-	-	-	-	-	-	3,075
Subordinated liabilities	10,629	-	-	-	-	206	-	-	550	48	11,433
Total liabilities	273,580	26	(48)	(93)	10,243	43	5	(291)	550	133	284,148
Equity											
Share capital	1,542	-	-	-	-	-	-	-	-	-	1,542
Share premium account	2,960	-	-	-	-	-	-	-	-	-	2,960
Other reserves	-	-	-	-	-	-	28	-	-	-	28
Retained profits	7,650	-	22	(221)	-	(220)	-	(1,066)	-	(129)	6,036
Shareholders' equity	12,152	-	22	(221)	-	(220)	28	(1,066)	-	(129)	10,566
Minority interests	631	-	-	-	-	-	-	-	(550)	-	81
Total equity	12,783	-	22	(221)	-	(220)	28	(1,066)	(550)	(129)	10,647
Total equity and liabilities	286,363	26	(26)	(314)	10,243	(177)	33	(1,357)	-	4	294,795

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

Restated Bank balance sheet (reconciliation of equity) at 1 January 2004 (excludes the effects of IAS 32 and IAS 39)

	UK GAAP £m	Revaluation of investments £m	Employee benefits £m	Software £m	Goodwill £m	Dividend £m	Other £m	IFRS £m
Assets								
Cash and balances at central banks	1,106	-	-	-	-	-	-	1,106
Items in the course of collection from banks	1,396	-	-	-	-	-	-	1,396
Treasury bills and other eligible bills	525	-	-	-	-	-	-	525
Loans and advances to banks	62,981	-	-	-	-	-	-	62,981
Loans and advances to customers	72,428	-	-	-	-	(1,674)	-	70,754
Debt securities	19,558	-	-	-	-	-	2	19,560
Equity shares	264	-	-	-	-	-	-	264
Investment in subsidiary undertakings	19,805	(3,408)	-	-	-	-	-	16,397
Goodwill	118	-	-	-	-	-	-	118
Intangible assets	-	-	-	41	-	-	-	41
Deferred tax asset	188	-	694	(12)	-	-	(7)	863
Fixed assets	1,297	-	-	-	-	-	(25)	1,272
Other assets	3,491	42	-	-	-	-	1,577	5,110
Prepayments and accrued income	1,584	-	-	-	-	-	(1,584)	-
Total assets	184,741	(3,366)	694	29	-	(1,674)	(37)	180,387
Equity and liabilities								
Liabilities								
Deposits from banks	30,211	-	-	-	-	-	(19)	30,192
Customer accounts	100,141	-	-	-	-	-	-	100,141
Items in course of transmission to banks	552	-	-	-	-	-	-	552
Debt securities in issue	22,160	-	-	-	-	-	-	22,160
Other liabilities	6,051	-	(15)	-	-	(1,314)	2,139	6,861
Accruals and deferred income	2,135	-	-	-	-	-	(2,135)	-
Other provisions	142	-	-	-	-	-	-	142
Retirement benefit obligations	-	-	2,403	-	-	-	-	2,403
Subordinated liabilities	10,680	-	-	-	-	-	-	10,680
Total liabilities	172,072	-	2,388	-	-	(1,314)	(15)	173,131
Equity								
Share capital	1,542	-	-	-	-	-	-	1,542
Share premium account	2,960	-	-	-	-	-	-	2,960
Other reserves	3,374	(3,374)	-	-	-	-	-	-
Retained profits	4,793	8	(1,694)	29	-	(360)	(22)	2,754
Shareholders' equity	12,669	(3,366)	(1,694)	29	-	(360)	(22)	7,256
Total equity and liabilities	184,741	(3,366)	694	29	-	(1,674)	(37)	180,387

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

Restated Bank balance sheet (reconciliation of equity) at 31 December 2004 (excludes effects of IAS 32 and IAS 39)

	UK GAAP £m	Revaluation of investments £m	Employee benefits £m	Software £m	Goodwill £m	Dividend £m	Other £m	IFRS £m
Assets								
Cash and balances at central banks	998	-	-	-	-	-	-	998
Items in the course of collection from banks	1,416	-	-	-	-	-	-	1,416
Treasury bills and other eligible bills	88	-	-	-	-	-	-	88
Loans and advances to banks	79,880	-	-	-	-	(61)	-	79,819
Loans and advances to customers	77,709	-	-	-	-	(854)	-	76,855
Debt securities	16,531	-	-	-	-	-	-	16,531
Equity shares	17	-	-	-	-	-	-	17
Investment in subsidiary undertakings	21,434	(3,838)	-	-	-	-	-	17,596
Goodwill	107	-	-	-	11	-	-	118
Intangible assets	-	-	-	21	-	-	-	21
Deferred tax asset	131	-	673	(6)	(3)	-	(7)	788
Fixed assets	1,289	-	-	-	-	-	(23)	1,266
Other assets	2,983	19	-	-	-	-	1,868	4,870
Prepayments and accrued income	1,871	-	-	-	-	-	(1,871)	-
Total assets	204,454	(3,819)	673	15	8	(915)	(33)	200,383
Equity and liabilities								
Liabilities								
Deposits from banks	47,568	-	-	-	-	-	(24)	47,544
Customer accounts	100,708	-	(21)	-	-	-	-	100,687
Items in course of transmission to banks	527	-	-	-	-	-	-	527
Debt securities in issue	23,407	-	-	-	-	-	-	23,407
Accruals and deferred income	2,265	-	-	-	-	-	(2,265)	-
Other liabilities	6,250	-	11	-	-	(1,314)	2,286	7,233
Other provisions	160	-	-	-	-	-	-	160
Retirement benefit obligations	-	-	2,330	-	-	-	-	2,330
Subordinated liabilities	10,479	-	-	-	-	-	-	10,479
Total liabilities	191,364	-	2,320	-	-	(1,314)	(3)	192,367
Equity								
Share capital	1,542	-	-	-	-	-	-	1,542
Share premium account	2,960	-	-	-	-	-	-	2,960
Other reserves	3,827	(3,827)	-	-	-	-	-	-
Retained profits	4,761	8	(1,647)	15	8	399	(30)	3,514
Shareholders' equity	13,090	(3,819)	(1,647)	15	8	399	(30)	8,016
Total equity and liabilities	204,454	(3,819)	673	15	8	(915)	(33)	200,383

Notes to the accounts

54 Adoption of International Financial Reporting Standards (continued)

Restated Bank balance sheet (reconciliation of equity) at 1 January 2005 (includes effects of IAS 32 and IAS 39)

	Restated 31 December 2004 £m	Reclassifi- cations £m	Effective interest rates £m	Impairment £m	Offset £m	Derivatives £m	Available- for-sale £m	Debt/ equity £m	Other £m	1 January 2005 £m
Assets										
Cash and balances at central banks	998	-	-	-	-	-	-	-	-	998
Items in the course of collection from banks	1,416	-	-	-	-	-	-	-	-	1,416
Treasury bills and other eligible bills	88	(88)	-	-	-	-	-	-	-	-
Trading securities and other financial assets at fair value through profit or loss	-	10,919	-	-	-	25	-	-	-	10,944
Derivative financial instruments	-	2,641	-	-	3,956	230	-	-	-	6,827
Loans and advances to banks	79,819	-	-	-	-	-	-	-	(16)	79,803
Loans and advances to customers	76,855	(303)	(58)	(305)	5,965	-	-	1,422	-	83,576
Debt securities	16,531	(16,531)	-	-	-	-	-	-	-	-
Equity shares	17	(17)	-	-	-	-	-	-	-	-
Available-for-sale financial assets	-	6,080	-	-	-	-	25	-	-	6,105
Investment in subsidiary undertakings	17,596	-	-	-	-	-	-	(1,422)	-	16,174
Goodwill	118	-	-	-	-	-	-	-	-	118
Intangible assets	21	-	-	-	-	-	-	-	-	21
Deferred tax asset	788	-	13	93	-	110	(2)	-	51	1,053
Fixed assets	1,266	-	-	-	-	-	-	-	-	1,266
Other assets	4,870	(2,641)	2	-	-	(559)	-	-	-	1,672
Total assets	200,383	60	(43)	(212)	9,921	(194)	23	-	35	209,973
Equity and liabilities										
Liabilities										
Deposits from banks	47,544	-	-	-	-	(156)	-	-	-	47,388
Customer accounts	100,687	-	(13)	-	5,965	(10)	-	-	143	106,772
Items in course of transmission to banks	527	-	-	-	-	-	-	-	-	527
Derivative financial instruments and other trading liabilities	-	4,032	-	-	3,956	374	-	-	-	8,362
Debt securities in issue	23,407	-	-	-	-	(13)	-	-	(48)	23,346
Other liabilities	7,233	(4,032)	-	-	-	(337)	1	-	11	2,876
Other provisions	160	59	-	-	-	-	-	-	-	219
Retirement benefit obligations	2,330	-	-	-	-	-	-	-	-	2,330
Subordinated liabilities	10,479	-	-	-	-	206	-	-	48	10,733
Total liabilities	192,367	59	(13)	-	9,921	64	1	-	154	202,553
Equity										
Share capital	1,542	-	-	-	-	-	-	-	-	1,542
Share premium account	2,960	-	-	-	-	-	-	-	-	2,960
Other reserves	-	-	-	-	-	-	22	-	-	22
Retained profits	3,514	1	(30)	(212)	-	(258)	-	-	(119)	2,896
Shareholders' equity	8,016	1	(30)	(212)	-	(258)	22	-	(119)	7,420
Total equity and liabilities	200,383	60	(43)	(212)	9,921	(194)	23	-	35	209,973

Notes to the accounts

55 Future developments

The following pronouncements will be relevant to the Group but were not effective at 31 December 2005 and have not been applied in preparing these financial statements.

Pronouncement	Nature of change	Effective date
*IFRS 7 <i>Financial Instruments: Disclosures</i>	Consolidates the current financial instruments disclosures into a single standard and requires more detailed qualitative and quantitative disclosures about exposure to risks arising from financial instruments.	Annual periods beginning on or after 1 January 2007
Amendment to IAS 39 <i>Financial Instruments: Recognition and Measurement</i> and IFRS 4 <i>Insurance Contracts – Financial Guarantee Contracts</i>	Requires issued financial guarantee contracts to be accounted for as financial instruments unless the issuer has previously asserted that the contracts are regarded as insurance contracts and has accounted for them as such.	Annual periods beginning on or after 1 January 2006
Amendments to IAS 39 <i>Financial Instruments: Recognition and Measurement – The Fair Value Option</i>	Restricts the fair value option for financial instruments to certain situations, including when doing so results in more relevant information because it eliminates or reduces a measurement or recognition inconsistency or where a group of financial instruments is managed and evaluated on a fair value basis in accordance with a documented strategy.	Annual periods beginning on or after 1 January 2006
Amendment to IAS 19 <i>Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures</i>	Permits actuarial gains and losses to be recognised outside profit and loss where those gains and losses are recognised in the period in which they occur, more clearly distinguishes between multi-employer plans and defined benefit plans between entities under common control, and requires additional disclosures about trends in the assets and liabilities in a defined benefit plan and the assumptions underlying the components of the defined benefit cost.	Annual periods beginning on or after 1 January 2006
*Amendments to IAS 1 <i>Presentation of Financial Statements – Capital Disclosures</i>	Introduces additional disclosures of the objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, and compliance with capital requirements.	Annual periods beginning on or after 1 January 2007
IFRIC Interpretation 4 <i>Determining whether an arrangement Contains a Lease</i>	Interpretation provides guidance for determining whether arrangements comprising transactions that do not take the legal form of lease but convey a right to use an asset contain leases that should be separately accounted for.	Annual periods beginning on or after 1 January 2006

The full impact of these accounting changes is being assessed by the Group; none of these pronouncements are expected to cause any material adjustments to the financial statements. The Group has not yet made a final decision as to whether it will apply in the 2006 financial statements those pronouncements marked (*) in the table above.

56 Approval of the financial statements and other information

The financial statements were approved by the directors of Lloyds TSB Bank plc on 23 February 2006.

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