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Lloyds TSB Bank plc

Report and Accounts

2006

Member of Lloyds TSB Group

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Registered office
25 Gresham Street, London EC2V 7HN
Registered in England no 2065

Directors' report

Results and dividends

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

Principal activities

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

Business review

Profit before tax for the Lloyds TSB Bank Group was £4,282 million, an increase of £428 million, or 11 per cent, compared with £3,854 million in 2005, profit attributable to equity shareholders was £412 million (or 16 per cent) higher at £2,916 million compared with £2,504 million in 2005, and the post-tax return on equity increased to 25 0 per cent compared with 23 0 per cent in 2005 The Lloyds TSB Bank Group's customer service index (which is based on the results of a customer satisfaction survey performed monthly for the Lloyds TSB Group by an external agency) improved to 69 7 per cent from 68 0 per cent in 2005, and the service quality index (a measure of 'defects per million opportunities', where a 'defect' is registered whenever there is a failure to deliver a process or product within a certain time or to the required standard) improved to 4 30 from 4 02 in 2005

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

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

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

Operating expenses, excluding the impact of a £128 million pension schemes related credit and, in 2005, a £150 million provision for customer redress, continued to be tightly controlled and increased by only 2 per cent Significant improvements continued to be made in processing and operational efficiency and, over the past 12 months, staff numbers on a full-time equivalent basis reduced by 4,167 to 62,630 As a result of this constant focus on day-to-day operating cost control, the cost income ratio, excluding the pension schemes related credit, provision for customer redress and insurance grossing adjustments, improved to 48 9 per cent, from 51 7 per cent in 2005

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

As expected, the Wholesale and International Banking charge for impairment losses on loans and advances increased by £120 million to £308 million, reflecting lower levels of releases and recoveries in Corporate Markets than in 2005, and a higher level of consumer finance lending impairment in the Asset Finance business Overall asset quality remains good and the level of new corporate provisions remained at a low level in 2006, although we expect a return to more normal levels of impairment over time

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

Profit before tax from Insurance and Investments, excluding volatility (2006 £410 million, 2005 £749 million), and strengthening of reserves for mortality in 2005 (£155 million), increased by 11 per cent to £973 million There was a 24 per cent increase in the present value of new business premiums reflecting, in particular, strong growth in the sales of Open Ended Investment Companies (OEICs) and corporate pension products Bancassurance sales improved significantly and were 62 per cent higher, including excellent growth in the sales of OEICs through the branch network and to Lloyds TSB private banking clients As a result of improved capital efficiency and strong sales of pensions and single premium investments, the life, pensions and OEICs new business margin increased to 3 6 per cent, from 3 2 per cent in 2005

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

In Wholesale and International Banking, pre-tax profits increased by £122 million, or 8 per cent, to £1,640 million Income growth of 8 per cent exceeded cost growth of 4 per cent, leading to a significant reduction in the cost income ratio to 53 8 per cent The trading surplus increased by 14 per cent There was strong profit growth in Corporate Markets and Business Banking, while Asset Finance profit decreased by 13 per cent, reflecting higher levels of consumer finance impairment losses Good progress has continued to be made in delivering the strategy to build an integrated wholesale bank for corporate markets, with a 46 per cent increase in income from cross-selling in the Corporate Markets business

Shareholders' equity increased by £939 million to £12,124 million, largely as a result of retained earnings Risk-weighted assets increased by 8 per cent to £156 billion reflecting strong growth in mortgages and corporate lending At the end of 2006, the risk asset ratios were 9 8 per cent for total capital and 8 1 per cent for tier 1 capital

Financial risk management objectives and policies

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

Directors

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

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

Directors' interests

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

Directors' indemnities

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

Statement of directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have prepared the consolidated and parent company financial statements in accordance with IFRS as adopted by the European Union The financial statements are required by law to give a true and fair view of the state of affairs of the parent company and the group and of the profit or loss of the group for that period The directors consider that, in preparing the financial statements on pages 7 to 73, the Bank and the Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed

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

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

Employees

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

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

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

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

Policy and practice on payment of creditors

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

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

The number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is 29 This bears the same proportion to the number of days in the year as the aggregate of the amounts owed to trade creditors at 31 December 2006 bears to the aggregate of the amounts invoiced by suppliers during the year

Auditors and audit information

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

On behalf of the board

AJMichie

A J Michie
Secretary
22 February 2007

Directors

Sir Victor Blank
Chairman

J E Daniels
Chief Executive

M E Fairey
Deputy Chief Executive

H A Weir
Finance Director

W C G Berndt

Ewan Brown CBE

T A Dial

J P du Plessis

G J N Gemmell CBE

Sir Julian Horn-Smith

D S Julius CBE
(retiring on 9 May 2007)

A G Kane

Lord Leitch

G T Tate

Independent auditors' report

To the members of Lloyds TSB Bank plc

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

Respective responsibilities of directors and auditors

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

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

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

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

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

Basis of audit opinion

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

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

Opinion

In our opinion

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit and cash flows for the year then ended,
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2006 and cash flows for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation, and
- the information given in the directors' report is consistent with the financial statements

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton
22 February 2007

Consolidated income statement

for the year ended 31 December 2006

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

The accompanying notes are an integral part of the financial statements

Balance sheets

at 31 December 2006

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

The accompanying notes are an integral part of the financial statements

The directors approved the financial statements on 22 February 2007

Sir Victor Blank
Chairman

J Eric Daniels
Chief Executive

Helen A Weir
Finance Director

Helen A Weir

Balance sheets

at 31 December 2006

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

The accompanying notes are an integral part of the financial statements

Statements of changes in equity

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

The accompanying notes are an integral part of the financial statements

Statements of changes in equity

The Bank

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

The accompanying notes are an integral part of the financial statements

Cash flow statements

for the year ended 31 December 2006

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

The accompanying notes are an integral part of the financial statements

Notes to the accounts

1 Accounting policies

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

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

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

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

(i) Amendment to IAS 19 *Actuarial Gains and Losses, Group Plans and Disclosures* The Group has not changed its accounting policy for the recognition of actuarial gains and losses as a result of this amendment, the additional disclosures required have been provided in note 35

(ii) Amendment to IAS 39 *Financial Instruments Recognition and Measurement – The Fair Value Option* This amendment, which was effective from 1 January 2006, changed the criteria for financial assets to be designated at fair value through profit or loss and permitted financial liabilities meeting certain criteria to be designated at fair value for the first time The adoption of these requirements had no effect upon the classification or valuation of those financial assets that were designated at fair value through profit or loss prior to 1 January 2006, at 31 December 2006, £1 2 billion of financial liabilities for the Group and the Bank had been designated at inception into this category during the year This change has had no material effect upon the Group's income statement

(iii) Amendment to IAS 39 *Financial Instruments Recognition and Measurement* and IFRS 4 *Insurance Contracts – Financial Guarantee Contracts* Since 1 January 2006, all of the Group's financial guarantee contracts have been accounted for as financial instruments This change has had no material effect upon the Group's financial statements

(iv) IFRIC Interpretation 4 *Determining Whether an Arrangement Contains a Lease* The Group has reviewed the terms of all contracts potentially affected by this interpretation, its adoption has had no material effect upon the Group's financial statements

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

The accounting policies are set out below

a Consolidation

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

1 Accounting policies (continued)

b Goodwill

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

c Other intangible assets

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

d Revenue recognition

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

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

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

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

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

1 Accounting policies (continued)

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

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

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

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

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

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

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

1 Accounting policies (continued)

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

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

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

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

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

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

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

1 Accounting policies (continued)

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

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

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

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

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

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

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

1 Accounting policies (continued)

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

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

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

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

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

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

Premises (excluding land)
- Freehold/long and short leasehold premises shorter of 50 years or the remaining period of the lease
- Leasehold improvements shorter of 10 years or the remaining period of the lease

1 Accounting policies (continued)

Equipment

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

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

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

m Leases

(1) *As lessee*

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

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

(2) *As lessor*

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

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

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

n Investment in subsidiary undertakings

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

o Borrowings

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

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

p Pensions and other post retirement benefits

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

1 Accounting policies (continued)

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

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

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

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

q Share-based compensation

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

r Taxation

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

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

1 Accounting policies (continued)

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

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

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

s Insurance

The Group undertakes both life assurance and general insurance business

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

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

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

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

For accounting purposes the general insurance business only issues insurance contracts

(1) *Life assurance business*

(i) ***Accounting for insurance and participating investment contracts***

Premiums and claims

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

Claims are recorded as an expense when they are incurred

1 Accounting policies (continued)

Liabilities

– insurance or participating investment contracts in the Group's With Profit Fund

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

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

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

– insurance or participating investment contracts which are unit-linked

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

Unallocated surplus

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

Value of in-force business

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

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

(ii) ***Accounting for non-participating investment contracts***

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

Notes to the accounts

1 Accounting policies (continued)

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

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

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

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

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

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

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

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

1 Accounting policies (continued)

t Foreign currency translation
(1) *Functional and presentation currency*
Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency') These financial statements are presented in sterling, which is the Bank's functional and presentation currency

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

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

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet,

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions), and

(iii) all resulting exchange differences are recognised as a separate component of equity

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

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

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

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

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

1 Accounting policies (continued)

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

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

2 Critical accounting estimates and judgements

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

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

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

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

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

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

2 Critical accounting estimates and judgements (continued)

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

Two important assumptions are the rate of inflation and the expected lifetime of the schemes' members The assumed rate of inflation affects the rate at which salaries are projected to grow and therefore the size of the pension that employees receive upon retirement and also the rate at which pensions in payment increase Over the longer term rates of inflation can vary significantly, at 31 December 2006 it was assumed that the rate of inflation would be 2 9 per cent per annum (2005 2 7 per cent), although if this was increased by 0 2 per cent the overall deficit would increase by approximately £559 million and the annual cost by approximately £20 million A reduction of 0 2 per cent would reduce the overall deficit by approximately £539 million and the annual cost by approximately £15 million

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

The size of the overall deficit is also sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variations At 31 December 2006 the discount rate used was 5 1 per cent (2005 4 8 per cent), a reduction of 0 2 per cent would increase the overall deficit by approximately £592 million and the annual cost by approximately £14 million, while an increase of 0 2 per cent would reduce the net deficit by approximately £570 million and the annual cost by approximately £13 million

Goodwill

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

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

2 Critical accounting estimates and judgements (continued)

Insurance

Life assurance business

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

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

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

General insurance business

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

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

Taxation

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

Notes to the accounts

3 Segmental analysis

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

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

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

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

3 Segmental analysis (continued)

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

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

Notes to the accounts

4 Net interest income

	Weighted average effective interest rate 2006 %	2005 %	2006 £m	2005 £m
Interest receivable				
Available-for-sale financial assets	4 39	3 58	807	508
Loans and advances to customers	6 24	6 40	10,912	10,098
Loans and advances to banks	4 72	3 59	1,826	1,199
Lease and hire purchase receivables	7 42	7 07	774	787
	5 91	5 82	14,319	12,592
Interest payable				
Deposits from banks	4 67	3 44	(1,680)	(953)
Customer accounts	2 91	2 81	(3,756)	(3,389)
Debt securities in issue	4 67	4 23	(1,983)	(1,307)
Subordinated liabilities	5 56	5 29	(677)	(615)
Liabilities under sale and repurchase agreements	4 35	4 53	(260)	(394)
Other	9 68	7 24	(424)	(262)
	3 82	3 41	(8,780)	(6,920)
Net interest income			5,539	5,672

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

5 Net fee and commission income

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

6 Net trading income

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

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

7 Insurance premium income

	2006 £m	2005 £m
Life insurance		
Gross premiums	4,308	3,996
Ceded reinsurance premiums	(189)	(89)
Net earned premiums	4,119	3,907
Non-life insurance		
Gross premiums written	608	575
Ceded reinsurance premiums	(17)	(22)
Net premiums	591	553
Change in provision for unearned premiums	9	9
Net earned premiums	600	562
Total net earned premiums	4,719	4,469

Life insurance gross written premiums can be further analysed as follows

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

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

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

Notes to the accounts

8 Other operating income

	2006 £m	2005 £m
Operating lease rental income	**422**	433
Rental income from investment property	**313**	272
Other rents receivable	**28**	30
Gains less losses on disposal of available-for-sale financial assets	**22**	5
Movement in value of in-force business (note 22)	**(199)**	162
Other income	**220**	238
	806	1,140

9 Insurance claims

Insurance claims comprise

	2006 £m	2005 £m
Life insurance and participating investment contracts		
Claims and surrenders		
Gross	**5,375**	4,279
Reinsurers' share	**(76)**	(56)
	5,299	4,223
Change in liabilities		
Gross	**2,923**	7,641
Reinsurers' share	**(18)**	33
	2,905	7,674
Change in unallocated surplus (note 33)	**165**	92
Total life insurance and investment contracts	**8,369**	11,989
Non-life insurance		
Claims and claims paid		
Gross	**198**	195
Reinsurers' share	**–**	(1)
	198	194
Changes in non-life insurance policyholder liabilities		
Gross	**2**	3
Reinsurers' share	**–**	–
	2	3
Total non-life insurance	**200**	197
Total insurance claims expense	**8,569**	12,186

	2006 £m	2005 £m
Life insurance gross claims can also be analysed as follows		
Deaths	**286**	298
Maturities	**1,385**	1,197
Surrenders	**3,081**	2,204
Annuities	**558**	528
Other	**65**	52
	5,375	4,279

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

10 Operating expenses

	2006 £m	2005 £m
Salaries	**2,117**	2,068
Social security costs	**161**	154
Pensions and other post-retirement benefit schemes (note 35)	**165**	308
Other staff costs	**298**	325
Staff costs	**2,741**	2,855
Other administrative expenses		
Operating lease rentals	**254**	252
Repairs and maintenance	**165**	136
Communications and data processing	**499**	467
Advertising	**184**	207
Professional fees	**230**	216
Provisions for customer remediation (note 37)	**–**	150
Other	**570**	508
	1,902	1,936
Depreciation of tangible fixed assets (note 24)	**602**	621
Amortisation of other intangible assets (note 23)	**17**	18
Impairment charges		
Goodwill (note 21)	**–**	6
Total operating expenses	**5,262**	5,436

The average number of persons on a headcount basis employed by the Group during the year was 76,092 (2005 79,594) of which 74,079 (2005 77,620) were employed in the UK and 2,013 (2005 1,974) overseas

Fees payable to the Bank's auditors

During the year the auditors earned the following fees

	2006 £m	2005 £m
Fees payable for the audit of the Bank's annual report	**5 9**	6 2
Fees payable for other services		
Audit of the Bank's subsidiaries pursuant to legislation	**2 3**	1 7
Additional fees in respect of the previous year's audit of subsidiaries	**0 6**	–
Other services supplied pursuant to legislation	**4 7**	0 8
Other services relating to taxation	**0 6**	0 6
Services relating to corporate finance transactions	**1 0**	0 3
All other services	**1 8**	2 1
Total fees payable to the Bank's auditors	**16 9**	11 7

During the year the auditors also earned fees payable by entities outside the consolidated Lloyds TSB Bank Group in respect of the following

	2006 £m	2005 £m
Audits of the Group pension schemes	**0 2**	0 1
Audits of unconsolidated Open Ended Investment Companies managed by the Group	**0 4**	0 2
Reviews of the financial position of corporate and other borrowers	**1 6**	1 2
Acquisition due diligence and other work performed in respect of potential venture capital investments	**1 0**	0 6

11 Impairment losses on loans and advances

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

12 Profit on sale and closure of businesses

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

13 Taxation

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

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

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

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

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

	2006 £m	2005 £m
Profit before tax	**4,282**	3,854
Tax charge thereon at UK corporation tax rate of 30%	**1,285**	1,156
Factors affecting charge		
Disallowed and non-taxable items	**(92)**	(31)
Overseas tax rate differences	**(2)**	(1)
Net tax effect of disposals and unrealised gains	**(78)**	(59)
Policyholder interests and Open Ended Investment Companies	**139**	223
Other items	**10**	–
Tax on profit on ordinary activities	**1,262**	1,288
Effective rate	**29 5%**	33 4%

The effective tax rate of the Group excluding gross policyholder and Open Ended Investment Company interests from profit before tax and the tax charge was 25 7 per cent (2005 27 4 per cent)

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

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

These assets are comprised as follows

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

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

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

These assets are comprised as follows

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

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

15 Derivative financial instruments

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

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

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

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

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

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

15 Derivative financial instruments (continued)

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

15 Derivative financial instruments (continued)

The Group	Contract/ notional amount £m	Fair values Assets £m	Fair values 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
Credit derivatives	562	3	–
Equity and other contracts	4,787	607	84
Total derivative assets/liabilities held for trading		5,388	5,831
Hedging			
Derivatives designated as fair value hedges			
Cross currency interest rate swaps	69	12	–
Interest rate swaps (including swap options)	39,499	473	730
	39,568	485	730
Derivatives designated as cash flow hedges			
Interest rate swaps	648	5	23
Total derivative assets/liabilities held for hedging		490	753
Total recognised derivative assets/liabilities		5,878	6,584

15 Derivative financial instruments (continued)

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

Notes to the accounts

15 Derivative financial instruments (continued)

The Bank	Contract/ notional amount £m	Fair values Assets £m	Fair values 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
	155,231	1,904	1,617
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	–	–
	402,270	3,227	4,372
Credit derivatives	562	3	–
Equity and other contracts	7,171	496	496
Total derivative assets/liabilities held for trading		5,630	6,485
Hedging			
Derivatives designated as fair value hedges			
Cross currency interest rate swaps	69	12	–
Interest rate swaps (including swap options)	36,251	403	704
	36,320	415	704
Derivatives designated as cash flow hedges			
Interest rate swaps	648	5	23
Total derivative assets/liabilities held for hedging		420	727
Total recognised derivative assets/liabilities		6,050	7,212

16 Loans and advances to banks

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

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

17 Loans and advances to customers

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

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

Of the Bank s amounts due from fellow Group undertakings at 31 December 2006, US$5 5 billion has been pledged as security against a demand loan made to the Bank by another of its fellow Group undertakings

17 Loans and advances to customers (continued)

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

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

The net investment in finance leases may be analysed as follows

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

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

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

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

Securitisations

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

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

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

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

17 Loans and advances to customers (continued)

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

18 Allowance for impairment losses on loans and advances

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

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

19 Available-for-sale financial assets

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

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

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

19 Available-for-sale financial assets (continued)

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

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

20 Investment property of the Group

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

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

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

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

Capital expenditure in respect of investment properties

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

21 Goodwill

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

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

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

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

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

22 Value of in-force business of the Group

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

Gross value of in-force insurance and participating investment business

	2006 £m	2005 £m
At 1 January	**2,922**	2,760
Movement in value of in-force business	**(199)**	162
At 31 December	**2,723**	2,922

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

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

	%
Risk discount rate	7 02
Return on equities	6 72
Return on fixed interest securities	4 12
Expense inflation	3 79

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

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

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

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

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

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

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

	%
Risk-free rate (value of in-force)	**4 72**
Risk-free rate (financial options and guarantees)	**3 91 to 5 41**
Retail Price inflation	**3 23**
Expense inflation	**4 13**

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

Regulatory capital position of the Group's life assurance businesses

Basis of determining regulatory capital of the life assurance businesses

Available capital resources

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

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

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

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

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

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

Regulatory capital requirements

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

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

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

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

Capital statement

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Financial information calculated on a 'realistic' basis

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

	31 December 2006		31 December 2005[1]	
	With Profit Fund £m	Long Term Fund £m	With Profit Fund £m	Long Term Fund £m
Realistic value of assets of fund	**18,121**	**22,330**	19,018	23,242
Support arrangement assets	**1,174**	**-**	1,115	-
Realistic value of assets available to the fund	**19,295**	**22,330**	20,133	23,242
Realistic value of liabilities of fund	**(18,183)**	**(18,111)**	(19,253)	(19,102)
Working capital for fund	**1,112**	**4,219**	880	4,140
Working capital ratio for fund	**5 8%**	**18 9%**	4 4%	17 8%

[1]Subsequent to publication of the 2005 results, Scottish Widows obtained from the FSA permission to include the value of additional support assets in respect of policies written since demutualisation in assessing the realistic value of assets available to the With Profit Fund The actual year end working capital ratios for the With Profit Fund and the Long Term Fund based on information from the final FSA returns were 5 5 per cent and 17 7 per cent respectively

Scottish Widows continues to be well capitalised with the working capital ratios for the With Profit Fund and the Long Term Fund being an estimated 5 8 per cent (31 December 2005 5 5 per cent in the final FSA returns) and 18 9 per cent (31 December 2005 17 7 per cent in the final FSA returns) respectively

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

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

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

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

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

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

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

Capital sensitivities

Shareholders' funds

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

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

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

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

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

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

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

Options and guarantees within the With Profit Fund
The most significant options and guarantees provided from within the With Profit Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies For those policies written pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With Profit Fund of Scottish Widows called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies The Additional Account had a value at 31 December 2006 of £1 8 billion (2005 £1 7 billion) The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as persistency and mortality, and the proportion of policyholders who seek to exercise their options The ultimate cost will therefore not be known for many years

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

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

The most significant economic assumptions included in the model are

- *Risk-free yield* The risk-free yield is defined as 0 1 per cent higher than spot yields derived from the UK gilt yield curve,
- *Investment volatility* This is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices For example as at 31 December 2006, the 10 year equity-implied at-the-money assumption was set at 20 per cent (31 December 2005 20 per cent) The long-term at the-money assumption for property was 15 per cent (31 December 2005 15 per cent) The equivalent assumption for fixed rate interest stocks was 13 per cent (31 December 2005 13 5 per cent)

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

Options and guarantees outside the With Profit Fund of Scottish Widows
Abbey Life currently has a number of policies in force which have a guaranteed annuity option In total it holds traditional regulatory reserves of £257 million to cover this liability at 31 December 2006 (£332 million at 31 December 2005) These reserves have been determined using prudent future interest rate, mortality rate and rate of annuity option take-up assumptions and exceed the value that would be placed on them using a market-consistent stochastic model It is estimated that a 0 5 per cent reduction in future interest rates would increase the liability by some £27 million

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

In both Abbey Life and Scottish Widows, certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns There is currently a provision, calculated on a deterministic basis, of £98 million (31 December 2005 £108 million) in respect of those guarantees If future salary growth were 0 5 per cent per annum greater than assumed, the liability would increase by some £6 million If yields were 0 5 per lower than assumed, the liability would increase by some £17 million

23 Other intangible assets

The Group	Customer lists £m	Software enhancements £m	Total £m
Cost			
At 1 January 2005	–	107	107
Additions	–	40	40
At 31 December 2005	–	147	147
Additions	**54**	**51**	**105**
At 31 December 2006	**54**	**198**	**252**
Accumulated amortisation			
At 1 January 2005	–	79	79
Charge for the year	–	18	18
At 31 December 2005	–	97	97
Charge for the year	**–**	**17**	**17**
At 31 December 2006	**–**	**114**	**114**
Balance sheet amount at 31 December 2006	**54**	**84**	**138**
Balance sheet amount at 31 December 2005	–	50	50

The Bank	2006 £m	2005 £m
Software enhancements		
Cost		
At 1 January	**103**	90
Additions	**24**	13
At 31 December	**127**	103
Accumulated amortisation		
At 1 January	**80**	69
Charge for the year	**10**	11
At 31 December	**90**	80
Balance sheet amount at 31 December	**37**	23

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

24 Tangible fixed assets

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

24 Tangible fixed assets (continued)

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

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

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

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

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

25 Investment in subsidiary undertakings

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

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

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

*Indirect interest

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

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

26 Other assets

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Assets arising from reinsurance contracts held	**451**	548	**–**	–
Deferred acquisition costs	**443**	429	**–**	–
Settlement balances	**285**	336	**55**	156
Other assets and prepayments	**3,483**	4,271	**1,911**	2,731
	4,662	5,584	**1,966**	2,887

	2006 £m	2005 £m
Deferred acquisition costs of the Group		
At 1 January	**429**	293
Acquisition costs deferred, net of amounts amortised to the income statement	**14**	136
At 31 December	**443**	429

27 Deposits from banks

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

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

28 Customer accounts

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

28 Customer accounts (continued)

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

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

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

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

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

30 Debt securities in issue

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

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

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

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

Insurance contract liabilities

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

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

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

Life insurance

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

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

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

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

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

Process for determining key assumptions

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

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

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

With Profit Fund realistic liabilities

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

Other key assumptions are

- *Investment returns and discount rates* The realistic capital regime dictates that With Profit Fund liabilities are valued on a market-consistent basis This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data The With Profit Fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield The risk-free yield is defined as 0 1 per cent higher than the spot yields derived from the UK gilt yield curve

- *Guaranteed annuity option take-up rates* The guaranteed annuity option take up rates are set with regard to the Group's actual experience and make allowance for potential increases in take-up rates when the Guaranteed Annuity Options become more valuable to the policyholder

- *Investment volatility* Investment volatility is derived from derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices For example, as at 31 December 2006, the 10 year equity-implied at-the-money assumption was set at 20 per cent (31 December 2005 20 per cent) The long-term at-the-money assumptions for property and fixed interest stocks were 15 per cent (31 December 2005 15 per cent) and 13 per cent (31 December 2005 13 5 per cent) respectively

Non-Profit Fund liabilities

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

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

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

- *Mortality and morbidity* The mortality and morbidity assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this provides a reliable basis, and relevant industry data otherwise, and includes a margin for adverse deviation

- *Lapse rates* Lapse rates, set with regard to the Group's actual experience and with a margin for adverse deviation, are allowed for on some Non-Profit Fund contracts

- *Maintenance expenses* Allowance is made for future policy costs explicitly Expenses are determined by reference to an internal analysis of current and expected future costs plus a margin for adverse deviation Explicit allowance is made for future expense inflation

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

Key changes in assumptions

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

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

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

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

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

Sensitivity analysis

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

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

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

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

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

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

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

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

Non-life insurance

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

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

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

The reserving methodology and associated assumptions are set out below

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

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

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

Provisions for unearned premiums	Gross £m	Reinsurance* £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
Increase in the year	**608**	**(17)**	**591**
Release in the year	**(617)**	**17**	**(600)**
At 31 December 2006	**438**	**–**	**438**

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

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

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

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

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

Non-life insurance claims development table

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

Non-life insurance all risks – gross

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

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

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

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

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

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

33 Unallocated surplus within insurance businesses for the Group

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

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

34 Other liabilities

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

35 Retirement benefit obligations

Charge to the Group income statement

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

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

35 Retirement benefit obligations (continued)

Amounts recognised in the balance sheet

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

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

Pension schemes

Defined benefit schemes

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

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

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

Amounts included in the balance sheet

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

Movements in the defined benefit obligation

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

35 Retirement benefit obligations (continued)

Changes in the fair value of scheme assets

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

Assumptions

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

	2006 %	2005 %
Discount rate	**5 10**	4 80
Rate of inflation	**2 90**	2 70
Rate of salary increases	**3 93**	3 98
Rate of increase for pensions in payment and deferred pensions	**2 70**	2 50
	Years	Years
Life expectancy for member aged 60, on the valuation date		
Men	**25 8**	25 6
Women	**27 8**	27 6
Life expectancy for member aged 60, 15 years after the valuation date		
Men	**27 0**	26 8
Women	**28 9**	28 7

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with both current industry experience and the actual experience of the relevant schemes The table shows that a member retiring at age 60 as at 31 December 2006 is assumed to live for, on average, 25 8 years for a male and 27 8 years for a female In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members It is assumed that younger members will live longer in retirement than those retiring now This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60

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

35 Retirement benefit obligations (continued)

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

	2006 %	2005 %
Equities	**8 0**	8 2
Fixed interest gilts	**4 1**	4 6
Index linked gilts	**3 9**	4 3
Non-government bonds	**4 8**	5 3
Property	**6 4**	6 9
Cash	**3 7**	3 6

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

	2007 %
Equities	**8 0**
Fixed interest gilts	**4 6**
Index linked gilts	**4 2**
Non-government bonds	**5 1**
Property	**6 5**
Cash	**3 9**

Composition of scheme assets

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

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

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

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

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

35 Retirement benefit obligations (continued)

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

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

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

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

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

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

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

For the principal post retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 31 December 2000, this valuation has been updated to 31 December 2006 by qualified independent actuaries The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 7 02 per cent (2005 6 81 per cent)

35 Retirement benefit obligations (continued)

Amount included in the balance sheet

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Present value of unfunded obligations	**110**	112	**110**	112
Unrecognised actuarial losses	**(10)**	(11)	**(10)**	(11)
Liability in the balance sheet	**100**	101	**100**	101

Movements in the other post-retirement benefits obligation

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
At 1 January	**112**	104	**112**	104
Exchange and other adjustments	**–**	(3)	**–**	(3)
Actuarial (gain) loss	**(1)**	1	**(1)**	1
Insurance premiums paid	**(6)**	(6)	**(6)**	(6)
Charge for the year	**5**	16	**5**	16
At 31 December	**110**	112	**110**	112

36 Deferred tax balances

The movement in the net deferred tax balance is as follows

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Liability (asset) at 1 January	**1,170**	928	**(984)**	(1,053)
Exchange and other adjustments	**(4)**	3	**–**	–
Disposals	**(281)**	(256)	**–**	–
Income statement charge (note 13)	**531**	492	**123**	65
Amount charged (credited) to equity				
Available-for-sale financial assets (note 41)	**–**	(2)	**–**	(1)
Cash flow hedges (note 41)	**–**	1	**–**	1
	–	(1)	**–**	–
Amounts transferred to the income statement in respect of cash flow hedges (note 41)	**–**	4	**–**	4
Liability (asset) at 31 December	**1,416**	1,170	**(861)**	(984)

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

	2006 £m	2005 £m
Accelerated capital allowances	**(106)**	59
Pensions and other post-retirement benefits	**157**	44
Investment reserve	**59**	–
Allowances for impairment losses	**22**	23
Unrealised gains	**162**	279
Tax on value of in-force business	**(59)**	64
Other temporary differences	**296**	23
	531	492

36 Deferred tax balances (continued)

Deferred tax assets and liabilities are comprised as follows

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Deferred tax assets				
Pensions and other post-retirement benefits	**(736)**	(893)	**(563)**	(646)
Allowances for impairment losses	**(143)**	(165)	**(136)**	(157)
Other provisions	**(39)**	(36)	**(27)**	(31)
Derivatives	**(168)**	(172)	**(132)**	(157)
Tax losses carried forward	**(326)**	(323)	**–**	–
Other temporary differences	**(247)**	(205)	**(107)**	(100)
	(1,659)	(1,794)	**(965)**	(1,091)

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Deferred tax liabilities				
Accelerated capital allowances	**1,252**	1,358	**58**	42
Investment reserve	**149**	90	**–**	–
Unrealised gains	**500**	338	**–**	–
Tax on value of in-force business	**875**	934	**–**	–
Other temporary differences	**299**	244	**46**	65
	3,075	2,964	**104**	107

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 £567 million for the Group and £305 million for the Bank (2005 £526 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 2006 of £138 million for the Group and £49 million for the Bank (2005 £88 million for the Group and £43 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 reinvested for the foreseeable future or can be remitted free of tax Unremitted earnings totalled £682 million for the Group and £27 million for the Bank (2005 £609 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 (2005 £110 million) have not been recognised

37 Other provisions

The Group	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2006	33	194	141	368
Exchange and other adjustments	–	–	3	3
Provisions applied	(1)	(93)	(22)	(116)
Amortisation of discount	–	–	4	4
Charge (release) for the year	(5)	–	5	–
At 31 December 2006	27	101	131	259

The Bank	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2006	33	165	100	298
Exchange and other adjustments	–	–	(2)	(2)
Provisions applied	(1)	(76)	(17)	(94)
Amortisation of discount	–	–	2	2
Charge (release) for the year	(5)	(8)	5	(8)
At 31 December 2006	27	81	88	196

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

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

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

37 Other provisions (continued)

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

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

38 Subordinated liabilities

The Group	Note	2006 £m	2005 £m
Preferred securities			
6 90% Perpetual Capital Securities callable 2007 (US$1,000 million)	a,d	483	553
6% Non-cumulative Redeemable Preference Shares	l	-	-
6 625% Perpetual Capital Securities callable 2006 (€750 million)	a,c	-	518
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	a,j	312	337
6 35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	a,c,h	345	371
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	a,k	248	248
4 385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	a,c,h	478	522
		1,866	2,549
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes	a,b		
Series 1 (US$750 million)		383	436
Series 2 (US$500 million)		255	291
Series 3 (US$600 million)		306	349
11¾% Perpetual Subordinated Bonds (£100 million)		100	100
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	a,h	845	892
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a,b	101	103
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)	a,g	408	407
5 125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million)	a,e	525	553
5 57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	a,i	107	127
5 125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		475	501
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	a,g	255	269
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	a,g	189	202
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	a,g	447	457
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	a,g	470	500
		4,866	5,187
Dated subordinated liabilities			
7¾% Subordinated Bonds 2007 (£300 million)		300	300
5¼% Subordinated Notes 2008 (DM 750 million)		260	274
10⅝% Guaranteed Subordinated Loan Stock 2008 (£100 million)	f	104	106
9½% Subordinated Bonds 2009 (£100 million)		99	99
6¼% Subordinated Notes 2010 (€400 million)		283	303
12% Guaranteed Subordinated Bonds 2011 (£100 million)	f	113	115
4¾% Subordinated Notes 2011 (€850 million)		562	597
Subordinated Floating Rate Notes 2011 (£150 million)		150	150
Subordinated Floating Rate Notes 2011 (£100 million)		100	100
Subordinated Floating Rate Notes 2012 (£200 million)		200	200
Subordinated Floating Rate Notes 2013 (£150 million)		150	150
Subordinated Floating Rate Notes 2014 (£464 million)		464	464
5⅞% Subordinated Notes 2014 (£150 million)		149	148
6⅝% Subordinated Notes 2015 (£350 million)		330	345
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	b	300	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	b	336	343
Subordinated Floating Rate Notes 2020 (€100 million)	b	67	68
5 75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		328	346
9⅝% Subordinated Bonds 2023 (£300 million)		329	341
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		150	150
		4,774	4,899
Total subordinated liabilities		11,506	12,635

38 Subordinated liabilities (continued)

The Bank	Note	2006 £m	2005 £m
Preferred securities			
6 90% Perpetual Capital Securities callable 2007 (US$1,000 million)	a,d	483	553
6% Non-cumulative Redeemable Preference Shares	l	–	–
6 625% Perpetual Capital Securities callable 2006 (€750 million)	a,c	–	518
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	a,j	312	337
6 35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	a,c,h	345	371
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	a,k	248	248
4 385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	a,c,h	478	522
		1,866	2,549
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes	a,b		
Series 1 (US$750 million)		383	436
Series 2 (US$500 million)		255	291
Series 3 (US$600 million)		306	349
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	a,h	845	892
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	a,b	101	103
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)	a,g	408	407
5 57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20 billion)	a,i	107	127
5 125% Undated Subordinated Step-up Notes callable 2016 (£500 million)		475	501
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	a,g	255	269
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	a,g	189	202
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	a,g	447	457
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	a,g	470	500
		4,241	4,534
Dated subordinated liabilities			
7¾% Subordinated Bonds 2007 (£300 million)		300	300
5¼% Subordinated Notes 2008 (DM 750 million)		260	274
10⅝% Guaranteed Subordinated Loan Stock 2008 (£100 million)	f	104	106
9½% Subordinated Bonds 2009 (£100 million)		99	99
6¼% Subordinated Notes 2010 (€400 million)		283	303
12% Guaranteed Subordinated Bonds 2011 (£100 million)	f	113	115
4¾% Subordinated Notes 2011 (€850 million)		562	597
Subordinated Floating Rate Notes 2014 (£464 million)		464	464
5⅞% Subordinated Notes 2014 (£150 million)		149	148
6⅝% Subordinated Notes 2015 (£350 million)		330	345
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	b	300	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	b	336	343
Subordinated Floating Rate Notes 2020 (€100 million)	b	67	68
5 75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		328	346
9⅝% Subordinated Bonds 2023 (£300 million)		329	341
Subordinated Non-Interest Bearing Loan on rolling 6 year notice (£150 million)		150	150
		4,174	4,299
Total subordinated liabilities		10,281	11,382

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

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

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

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

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

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

f) Guaranteed by Lloyds TSB Group plc on a subordinated basis

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

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

38 Subordinated liabilities (continued)

i) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a margin of 1 60 per cent over the five year Yen swap rate

j) These securities constitute limited partnership interests in Lloyds TSB Capital 1 L P , a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner Non-cumulative income distributions accrue at a fixed rate of 7 375 per cent per annum up to 7 February 2012, thereafter they will accrue at a rate of 2 33 per cent above EURIBOR, to be set annually This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities

k) These securities constitute limited partnership interests in Lloyds TSB Capital 2 L P , a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner Non-cumulative income distributions accrue at a fixed rate of 7 834 per cent per annum up to 7 February 2015, thereafter they will accrue at a rate of 3 50 per cent above a rate based on the yield of specified UK government stock This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities

l) Throughout 2005 and 2006, the Bank has had in issue 100 6 per cent non-cumulative redeemable preference shares of £1 each The shares, which are redeemable at the option of the Bank at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum, no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid Upon winding up, the shares rank equally with any other preference shares issued by the Bank

39 Share capital

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

Issued and fully paid preference shares

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

40 Share premium account

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

41 Other reserves

Other reserves comprise

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

41 Other reserves (continued)

Movements in other reserves were as follows

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

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

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

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

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

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

The directors have proposed a second interim dividend of £1,325 million (2005 £1,316 million) which will be paid on 2 May 2007, this is equivalent to 85 94 pence per ordinary share (2005 85 36 pence)

44 Share based payments

Charge to the income statement

The charge to the income statement is set out below	2006 £m	2005 £m
Executive and SAYE schemes		
Options granted in the year	6	4
Options granted in prior years	25	27
	31	31
Share incentive plan		
Shares granted in the year	12	24
Shares granted in prior years	15	21
	27	45
	58	76

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

Executive schemes

The Executive share option schemes are long-term incentive schemes available to certain senior executives of the Group, with grants usually made annually Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options The last grant of executive options was made in March 2005 These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1 5 times annual salary with a maximum performance multiplier of 3 5 Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied

Performance conditions for executive options

For options granted up to March 2001

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

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

For options granted from August 2001 to August 2004

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

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

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

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

44 Share based payments (continued)

For options granted in 2005

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

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

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

	2006 Number of options	**2006 Weighted average exercise price (pence)**	2005 Number of options	2005 Weighted average exercise price (pence)
Outstanding at 1 January	**43,977,411**	**485 35**	39,289,430	515 95
Granted	**–**	**–**	10,869,357	474 23
Exercised	**(328,218)**	**437 03**	(202,708)	273 37
Forfeited	**(11,189,600)**	**560 77**	(5,978,668)	673 41
Outstanding at 31 December	**32,459,593**	**459 84**	43,977,411	485 35
Exercisable at 31 December	**819,139**	**744 90**	1,430,218	685 23

The weighted average share price at the time that the options were exercised during 2006 was 552 29 pence (2005 490 15 pence) The weighted average remaining contractual life of options outstanding at the end of the year was 6 8 years (2005 7 4 years)

Save-As-You-Earn schemes

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

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

	2006 Number of options	**2006 Weighted average exercise price (pence)**	2005 Number of options	2005 Weighted average exercise price (pence)
Outstanding at 1 January	**114,459,474**	**314 17**	122,115,907	321 71
Granted	**19,301,716**	**418 00**	9,610,466	380 00
Exercised	**(35,148,982)**	**294 84**	(6,086,150)	418 80
Forfeited	**(3,440,257)**	**339 47**	(4,404,042)	315 36
Cancelled	**(3,984,599)**	**427 14**	(3,722,135)	415 76
Expired	**(967,208)**	**503 13**	(3,054,572)	488 49
Outstanding at 31 December	**90,220,144**	**335 94**	114,459,474	314 17
Exercisable at 31 December	**889,479**	**475 41**	2,153,227	497 86

The weighted average share price at the time that the options were exercised during 2006 was 524 36 pence (2005 465 51 pence) The weighted average remaining contractual life of options outstanding at the end of the year was 2 2 years (2005 2 2 years)

Other share option plans

Lloyds TSB Group Executive Share Plan 2003

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

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

44 Share based payments (continued)

The weighted average fair value of options granted in the year was £4 58 (2005 £4 18) The weighted average share price at the time that the options were exercised during 2006 was 557 25 pence No options outstanding at 31 December were exercisable The weighted average remaining contractual life of options outstanding at the end of the year was 2 0 years (2005 1 9 years)

Lloyds TSB Group executive share plan 2005

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

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

The weighted average fair value of options granted in 2005 was £3 63 No options outstanding at 31 December were exercisable The weighted average remaining contractual life of options outstanding at the end of the year was 1 9 years (2005 2 9 years)

Long-Term Incentive Plan

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

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

50 per cent of the award will be based on a condition measuring the Group's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds TSB Group plc To vest in full, the Group's total shareholder return must exceed the median of the total shareholder return of the comparator group by an average of 7 5 per cent per annum 8 75 per cent of the award will vest where the Group's total shareholder return is equal to the median and vesting will be on a straight-line basis between these points Where the Groups total shareholder return is below the median, this part of the award will lapse

The remaining 50 per cent of the award will be based on earnings per share growth calculated on a compound annualised basis For the award to vest in full, the earnings per share growth over the performance period must be at least equivalent to an average of the Retail Price Index plus 6 per cent per annum 8 75 per cent of the award will vest where earnings per share growth is an average of the Retail Price Index plus 3 per cent per annum and vesting will be on a straight-line basis between these points Where the earnings per share growth is less than an average of the Retail Price Index plus 3 per cent per annum this part of the award will lapse

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

The fair value of the share awards granted in 2006 was £2 96

Performance share plan

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

44 Share based payments (continued)

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

The fair value of the matching element of the performance shares awarded during 2006 was £1 92 (2005 £1 78)

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

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2006									
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	1 9	599,948
£2 to £3	–	–	–	284 00	1 8	45,234,578	–	–	–
£3 to £4	394 25	6 2	6,265,105	345 97	2 3	23,320,638	–	–	–
£4 to £5	444 24	7 7	22,497,465	422 94	3 1	20,125,284	–	–	–
£5 to £6	541 32	2 6	1,424,507	571 24	0 7	1,522,876	–	–	–
£6 to £7	652 98	4 2	1,332,177	–	–	–	–	–	–
£7 to £8	–	–	–	718 00	0 2	16,768	–	–	–
£8 to £9	873 12	1 7	940,339	–	–	–	–	–	–

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2005									
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	2 2	511,743
£2 to £3	–	–	–	284 00	2 0	78,553,860	–	–	–
£3 to £4	393 33	7 1	10,112,857	346 71	3 1	28,535,928	–	–	–
£4 to £5	444 04	8 6	24,177,788	469 50	1 4	3,415,737	–	–	–
£5 to £6	542 22	3 7	2,320,524	544 77	1 1	3,821,055	–	–	–
£6 to £7	652 79	5 1	1,823,756	632 00	0 2	95,572	–	–	–
£7 to £8	715 04	6 2	4,111,758	720 20	1 0	37,322	–	–	–
£8 to £9	868 08	2 8	1,430,728	–	–	–	–	–	–

The weighted average fair value of options granted during the year was £nil (2005 £0 67) for executive options and £1 00 (2005 £0 98) for SAYE options The values for executive options have been determined using a binomial model that uses a stochastic projection model to determine the effect of the market based conditions The values for the SAYE options have been determined using a standard Black-Scholes model The fair value calculations are based on the following assumptions

	SAYE	Other option schemes	Other share plans
Risk-free interest rate	4 44%	4 55%	4 79%
Expected life	3 5 years	2 9 years	3 0 years
Expected volatility	23%	21%	19%
Expected dividend yield	6 5%	6 2%	6 7%
Weighted average share price	£5 23	£5 50	£5 15
Weighted average exercise price	£4 18	–	–
Expected forfeitures	6%	5%	5%

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

44 Share based payments (continued)

Share incentive plan

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

The number of shares awarded relating to free shares in 2006 was 7,725,195 (2005 8,748,521), with an average fair value of £5 28 (2005 £4 57), based on the market price at the date of award

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

The number of shares awarded relating to matching shares in 2006 was 2,036,423 (2005 2,296,575), with an average fair value of £5 40 (2005 £4 73), based on market prices at the date of award

45 Related party transactions

Key management personnel

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

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

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

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

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

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

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

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

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

	2006 £m	2005 £m
Loans		
At 1 January	3	3
Advanced	–	1
Interest	–	–
Repayments	(1)	(1)
At 31 December	2	3

The loans are on both a secured and unsecured basis and are expected to be settled in cash The loans attracted interest rates of between 5 1 per cent and 19 9 per cent in 2006 (2005 4 6 per cent and 17 9 per cent)

45 Related party transactions (continued)

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

	2006 £m	2005 £m
Deposits		
At 1 January	5	2
Placed	12	22
Interest	–	–
Withdrawn	(12)	(19)
At 31 December	5	5

Deposits placed by key management personnel attracted interest rates of up to 5 2 per cent (2005 4 5 per cent)

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

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

Balances and transactions with fellow Lloyds TSB Group undertakings

Balances and transactions between members of the Lloyds TSB Bank group

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

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

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

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

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

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

45 Related party transactions (continued)

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	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Assets, included within				
Loans and advances to customers	**1,850**	1,692	**904**	655
Liabilities, included within				
Customer accounts	**1,425**	280	**1,349**	205
Derivative financial instruments	**114**	188	**114**	188
Subordinated liabilities	**1,714**	1,714	**1,114**	1,114
	3,253	2,182	**2,577**	1,507

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 2006 the Group earned interest income on the above asset balances of £3 million and the Bank earned interest income of nil (2005 Group £5 million, Bank nil), the Group incurred an interest expense on the above liability balances of £105 million and the Bank incurred an interest expense of £73 million (2005 Group £102 million, Bank £70 million)

Other related party disclosures
At 31 December 2006, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £19 million (2005 £14 million)

The Group manages 89 (2005 86) Open Ended Investment Companies ('OEICs'), and of these 38 (2005 36) are consolidated The Group invested £372 million (2005 £345 million) and redeemed £237 million (2005 £265 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £1,746 million (2005 £2,074 million) at 31 December The Group earned fees of £149 million from the unconsolidated OEICs (2005 £85 million) The Bank held no investments in OEICs at any time during 2005 or 2006

The Group has a number of venture capital associates that it accounts for at fair value through profit or loss At 31 December 2006, these companies had total assets of approximately £1,625 million (2005 £1,194 million), liabilities of approximately £1,609 million (2005 £1,072 million) and for the year ended 31 December 2006 had turnover of approximately £2,409 million (2005 £1,782 million) and made a net loss of approximately £5 million (2005 profit £36 million) In addition the Group has provided £460 million (2005 £363 million) of financing to these companies on which it received £20 million (2005 £19 million) of interest income in the year

46 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

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

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	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Contingent liabilities				
Acceptances and endorsements	**63**	35	**68**	35
Guarantees	**-***	9,373	**-***	9,911
Other				
Other items serving as direct credit substitutes	**618**	550	**654**	552
Performance bonds and other transaction related contingencies	**2,096**	1,737	**2,114**	1,753
	2,714	2,287	**2,768**	2,305
	2,777	11,695	**2,836**	12,251

	The Bank	
	2006 £m	2005 £m
Incurred on behalf of fellow Lloyds TSB Group undertakings	**62**	607

*As indicated in note 1, since 1 January 2006 all of the Group's financial guarantee contracts have been accounted for as financial instruments and measured at fair value on the Group's and the Bank's balance sheets

46 Contingent liabilities and commitments (continued)

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

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

	The Bank	
	2006 £m	2005 £m
Incurred on behalf of fellow Lloyds TSB Group undertakings	**12,589**	8,348

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

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

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

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

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

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

46 Contingent liabilities and commitments (continued)

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

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

47 Financial risk management

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

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

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

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

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

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

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

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

47 Financial risk management (continued)

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

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

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

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

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

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

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

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

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

47 Financial risk management (continued)

The Group	**2006 £m**	2005 £m
Loans and advances to banks	**40,639**	31,656
Loans and advances to customers	**192,328**	178,707
Deposit amounts available for offset[1]	**(6,392)**	(6,414)
Impairment losses	**(2,194)**	(2,073)
	224,381	201,876
Available-for-sale debt securities and treasury bills	**19,163**	14,894
Contingent liabilities	**2,777**	11,695
Financial guarantees[2]	**8,139**	-
Undrawn irrevocable formal standby facilities, credit lines and other commitments to lend[2]	**51,288**	43,094
Derivative assets, before netting	**5,565**	5,878
Amounts available for offset under master netting arrangements[1]	**(2,761)**	(3,235)
	2,804	2,643
Trading and other financial assets at fair value through profit or loss	**29,568**	26,869
	338,120	301,071

The Bank	**2006 £m**	2005 £m
Loans and advances to banks	**86,589**	86,091
Loans and advances to customers	**108,276**	93,477
Deposit amounts available for offset[1]	**(6,040)**	(6,073)
Impairment losses	**(1,701)**	(1,719)
	187,124	171,776
Available-for-sale debt securities and treasury bills	**3,958**	4,457
Contingent liabilities	**2,836**	12,251
Financial guarantees[2]	**8,633**	-
Undrawn irrevocable formal standby facilities, credit lines and other commitments to lend[2]	**52,419**	46,189
Derivative assets, before netting	**5,665**	6,050
Amounts available for offset under master netting arrangements[1]	**(2,761)**	(3,235)
	2,904	2,815
Trading and other financial assets at fair value through profit or loss	**8,810**	5,923
	266,684	243,411

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

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

Market risk

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

47 Financial risk management (continued)

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

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

The Group

	31 December 2006			
	Closing £m	**Average £m**	**Maximum £m**	**Minimum £m**
Interest rate risk	**3 3**	**2 3**	**4 6**	**0 6**
Foreign exchange risk	**0 3**	**0 3**	**0 7**	**0 0**
Equity risk	**0 0**	**0 0**	**0 0**	**0 0**
Total VaR (no diversification)	**3 6**	**2 6**	**5 0**	**0 9**

	31 December 2005			
	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	0 9	1 8	4 5	0 5
Foreign exchange risk	0 2	0 3	0 4	0 2
Equity risk	0 0	0 0	0 0	0 0
Total VaR (no diversification)	1 1	2 1	4 7	0 8

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

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

It is estimated that a hypothetical immediate and sustained 100 basis points increase in interest rates on 1 January 2007 would decrease net interest income by £237 8 million for the 12 months to 31 December 2007, while a hypothetical immediate and sustained 100 basis point decrease in interest rates would increase net interest income by £237 4 million An analysis by currency is shown below

47 Financial risk management (continued)

	UK £m	**North America £m**	**Asia & Australasia £m**	**Europe & Middle East £m**	**Total 2007 £m**	Total 2006 £m
Change in net interest income from a +100 basis point shift in yield curves	**(207 6)**	**(12 8)**	**0 3**	**(17 7)**	**(237 8)**	(112 5)
Change in net interest income from a -100 basis point shift in yield curves	**207 2**	**12 8**	**(0 3)**	**17 7**	**237 4**	104 7

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

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

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

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

The Group

	31 December 2006			
	Closing £m	**Average £m**	**Maximum £m**	**Minimum £m**
Interest rate risk	**17 9**	**19 1**	**20 5**	**16 9**
Foreign exchange risk	**2 6**	**3 2**	**3 5**	**2 6**
Equity risk	**43 1**	**40 9**	**43 1**	**39 4**
Total VaR	**63 6**	**63 2**	**65 9**	**59 7**

	31 December 2005			
	Closing £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	19 8	17 9	20 0	15 8
Foreign exchange risk	3 3	2 8	3 5	2 3
Equity risk	41 7	47 7	57 3	39 4
Total VaR	64 8	68 4	77 8	59 1

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

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

47 Financial risk management (continued)

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

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

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

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

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

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

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

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

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

47 Financial risk management (continued)

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

47 Financial risk management (continued)

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

The Group

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non interest bearing £m	Total £m
As at 31 December 2006							
Assets							
Trading and other financial assets at fair value through profit or loss	**1,455**	**867**	**1,012**	**5,177**	**21,057**	**38,360**	**67,928**
Derivative financial instruments*	**–**	**–**	**–**	**–**	**–**	**5,565**	**5,565**
Loans and advances to banks	**24,652**	**1,561**	**1,561**	**7,449**	**5,346**	**69**	**40,638**
Loans and advances to customers	**71,081**	**17,711**	**19,572**	**60,845**	**19,110**	**1,816**	**190,135**
Available-for-sale financial assets	**5,525**	**10,732**	**1,594**	**1,174**	**138**	**15**	**19,178**
Other assets	**828**	**48**	**–**	**–**	**–**	**21,344**	**22,220**
Total assets	**103,541**	**30,919**	**23,739**	**74,645**	**45,651**	**67,169**	**345,664**
Liabilities							
Deposits from banks	**28,157**	**3,654**	**1,716**	**827**	**1,920**	**120**	**36,394**
Customer accounts	**124,974**	**3,444**	**4,802**	**1,809**	**1,333**	**4,405**	**140,767**
Derivative financial instruments, trading and other liabilities at fair value through profit or loss*	**–**	**–**	**55**	**467**	**634**	**5,905**	**7,061**
Debt securities in issue	**29,672**	**13,562**	**5,059**	**1,339**	**4,486**	**–**	**54,118**
Liabilities arising from insurance and investment contracts	**–**	**–**	**–**	**–**	**–**	**66,655**	**66,655**
Other liabilities	**37**	**27**	**2**	**–**	**4,583**	**12,038**	**16,687**
Subordinated liabilities	**1,337**	**561**	**750**	**2,657**	**6,051**	**150**	**11,506**
Total liabilities	**184,177**	**21,248**	**12,384**	**7,099**	**19,007**	**89,273**	**333,188**
Net repricing gap	**(80,636)**	**9,671**	**11,355**	**67,546**	**26,644**	**(22,104)**	**12,476**

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
As at 31 December 2005							
Assets							
Trading and other financial assets at fair value through profit or loss	1,734	2,418	1,035	3,796	17,886	33,698	60,567
Derivative financial instruments*	–	–	–	–	–	5,878	5,878
Loans and advances to banks	25,107	2,483	2,923	370	57	715	31,655
Loans and advances to customers	72,997	17,048	20,327	51,044	13,594	1,625	176,635
Available-for-sale financial assets	1,695	8,674	1,221	1,497	1,678	175	14,940
Other assets	195	50	–	–	–	21,701	21,946
Total assets	101,728	30,673	25,506	56,707	33,215	63,792	311,621
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, trading and other liabilities at fair value through profit or loss*	–	–	–	–	–	6,584	6,584
Debt securities in issue	20,411	8,396	3,905	1,709	4,925	–	39,346
Liabilities arising from insurance and investment contracts	–	–	–	–	–	63,041	63,041
Other liabilities	50	23	65	1	3,296	12,083	15,518
Subordinated liabilities	1,346	640	504	2,381	7,614	150	12,635
Total liabilities	158,497	18,826	9,887	8,283	18,318	86,190	300,001
Net repricing gap	(56,769)	11,847	15,619	48,424	14,897	(22,398)	11,620

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

47 Financial risk management (continued)

The Bank

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non interest bearing £m	Total £m
As at 31 December 2006							
Assets							
Trading and other financial assets at fair value through profit or loss	491	465	676	3,496	3,682	9	8,819
Derivative financial instruments*	–	–	–	–	–	5,665	5,665
Loans and advances to banks	27,340	4,865	11,647	34,991	7,443	302	86,588
Loans and advances to customers	46,092	11,261	7,000	19,069	14,880	8,274	106,576
Available-for-sale financial assets	1,207	1,836	666	114	134	15	3,972
Other assets	824	48	–	–	–	24,849	25,721
Total assets	75,954	18,475	19,989	57,670	26,139	39,114	237,341
Liabilities							
Deposits from banks	35,622	3,948	2,090	1,388	902	120	44,070
Customer accounts	100,910	12,692	5,261	3,084	1,471	4,520	127,938
Derivative financial instruments, trading and other liabilities at fair value through profit or loss*	–	–	55	467	634	6,433	7,589
Debt securities in issue	17,361	4,689	4,844	1,339	4,486	–	32,719
Other liabilities	–	27	2	–	–	5,952	5,981
Subordinated liabilities	737	561	750	2,657	5,426	150	10,281
Total liabilities	154,630	21,917	13,002	8,935	12,919	17,175	228,578
Net repricing gap	(78,676)	(3,442)	6,987	48,735	13,220	21,939	8,763

	1 month or less £m	3 months or less but over 1 month £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-interest bearing £m	Total £m
As at 31 December 2005							
Assets							
Trading and other financial assets at fair value through profit or loss	1,207	2,059	530	1,762	366	–	5,924
Derivative financial instruments*	–	–	–	–	–	6,050	6,050
Loans and advances to banks	39,465	4,926	12,778	25,466	2,496	959	86,090
Loans and advances to customers	41,991	10,350	8,031	14,235	11,301	5,851	91,759
Available-for-sale financial assets	828	2,391	923	161	26	174	4,503
Other assets	185	46	–	–	–	23,214	23,445
Total assets	83,676	19,772	22,262	41,624	14,189	36,248	217,771
Liabilities							
Deposits from banks	29,972	5,103	1,751	546	–	601	37,973
Customer accounts	94,395	9,719	3,420	3,143	886	3,942	115,505
Derivative financial instruments, trading and other liabilities at fair value through profit or loss*	–	–	–	–	–	7,212	7,212
Debt securities in issue	13,122	7,878	3,682	1,709	4,925	–	31,316
Other liabilities	3	26	1	–	–	6,070	6,100
Subordinated liabilities	746	640	504	2,381	6,961	150	11,382
Total liabilities	138,238	23,366	9,358	7,779	12,772	17,975	209,488
Net repricing gap	(54,562)	(3,594)	12,904	33,845	1,417	18,273	8,283

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

47 Financial risk management (continued)

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

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

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

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

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

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

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

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

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

47 Financial risk management (continued)

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

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

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

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

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

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

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

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

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

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

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

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

47 Financial risk management (continued)

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

Maturities of assets and liabilities

The Group	**Up to 1 month £m**	**1 3 months £m**	**3 12 months £m**	**1 5 years £m**	**Over 5 years £m**	**Total £m**
As at 31 December 2006						
Assets						
Trading and other financial assets at fair value through profit or loss	**886**	**782**	**905**	**5,589**	**59,766**	**67,928**
Derivative financial instruments	**559**	**740**	**1,198**	**1,749**	**1,319**	**5,565**
Loans and advances to banks	**22,491**	**1,349**	**1,539**	**9,807**	**5,452**	**40,638**
Loans and advances to customers	**29,924**	**8,223**	**10,716**	**40,633**	**100,639**	**190,135**
Available-for-sale financial assets	**652**	**1,301**	**3,446**	**6,919**	**6,860**	**19,178**
Other assets	**6,200**	**191**	**71**	**175**	**15,583**	**22,220**
Total assets	**60,712**	**12,586**	**17,875**	**64,872**	**189,619**	**345,664**

	Up to 1 month £m	**1 3 months £m**	**3-12 months £m**	**1-5 years £m**	**Over 5 years £m**	**Total £m**
Liabilities						
Deposits from banks	**28,268**	**3,659**	**1,707**	**818**	**1,942**	**36,394**
Customer accounts	**129,158**	**3,394**	**4,960**	**1,854**	**1,401**	**140,767**
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	**932**	**709**	**751**	**1,991**	**2,678**	**7,061**
Debt securities in issue	**28,320**	**4,866**	**5,912**	**8,611**	**6,409**	**54,118**
Liabilities arising from insurance and investment contracts	**945**	**832**	**2,292**	**12,474**	**50,112**	**66,655**
Other liabilities	**5,586**	**325**	**437**	**274**	**10,065**	**16,687**
Subordinated liabilities	**–**	**–**	**300**	**1,673**	**9,533**	**11,506**
Total liabilities	**193,209**	**13,785**	**16,359**	**27,695**	**82,140**	**333,188**
Net liquidity gap	**(132,497)**	**(1,199)**	**1,516**	**37,177**	**107,479**	**12,476**

	Up to 1 month £m	1-3 months £m	3-12 months £m	1 5 years £m	Over 5 years £m	Total £m
As at 31 December 2005						
Assets						
Trading and other financial assets at fair value through profit or loss	520	818	1,051	6,271	51,907	60,567
Derivative financial instruments	848	618	603	1,906	1,903	5,878
Loans and advances to banks	24,372	1,513	3,955	1,357	458	31,655
Loans and advances to customers	24,560	7,696	10,944	39,132	94,303	176,635
Available-for-sale financial assets	130	1,092	1,839	6,638	5,241	14,940
Other assets	6,256	246	68	154	15,222	21,946
Total assets	56,686	11,983	18,460	55,458	169,034	311,621

	Up to 1 month £m	1-3 months £m	3-12 months £m	1 5 years £m	Over 5 years £m	Total £m
Liabilities						
Deposits from banks	23,839	4,778	1,710	141	1,059	31,527
Customer accounts	117,624	5,065	3,317	3,773	1,571	131,350
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	690	657	799	1,893	2,545	6,584
Debt securities in issue	20,629	8,395	3,887	1,586	4,849	39,346
Liabilities arising from insurance and investment contracts	1,030	359	1,263	9,502	50,887	63,041
Other liabilities	5,561	306	602	265	8,784	15,518
Subordinated liabilities	–	–	–	1,082	11,553	12,635
Total liabilities	169,373	19,560	11,578	18,242	81,248	300,001
Net liquidity gap	(112,687)	(7,577)	6,882	37,216	87,786	11,620

Notes to the accounts

47 Financial risk management (continued)

The Bank	**Up to 1 month £m**	**1 3 months £m**	**3 12 months £m**	**1 5 years £m**	**Over 5 years £m**	**Total £m**
As at 31 December 2006						
Assets						
Trading and other financial assets at fair value through profit or loss	**291**	**378**	**549**	**3,781**	**3,820**	**8,819**
Derivative financial instruments	**564**	**633**	**1,287**	**1,746**	**1,435**	**5,665**
Loans and advances to banks	**27,211**	**4,333**	**11,655**	**35,469**	**7,920**	**86,588**
Loans and advances to customers	**54,009**	**10,623**	**6,753**	**19,584**	**15,607**	**106,576**
Available-for-sale financial assets	**460**	**629**	**814**	**1,081**	**988**	**3,972**
Other assets	**4,318**	**152**	**111**	**245**	**20,895**	**25,721**
Total assets	**86,853**	**16,748**	**21,169**	**61,906**	**50,665**	**237,341**

	Up to 1 month £m	**1 3 months £m**	**3 12 months £m**	**1 5 years £m**	**Over 5 years £m**	**Total £m**
Liabilities						
Deposits from banks	**35,742**	**3,948**	**2,090**	**1,388**	**902**	**44,070**
Customer accounts	**104,564**	**5,301**	**11,423**	**4,502**	**2,148**	**127,938**
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	**796**	**744**	**802**	**2,495**	**2,752**	**7,589**
Debt securities in issue	**17,361**	**4,689**	**4,844**	**1,339**	**4,486**	**32,719**
Other liabilities	**3,579**	**125**	**86**	**127**	**2,064**	**5,981**
Subordinated liabilities	**–**	**–**	**300**	**1,423**	**8,558**	**10,281**
Total liabilities	**162,042**	**14,807**	**19,545**	**11,274**	**20,910**	**228,578**
Net liquidity gap	**(75,189)**	**1,941**	**1,624**	**50,632**	**29,755**	**8,763**

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2005						
Assets						
Trading and other financial assets at fair value through profit or loss	219	456	540	4,104	605	5,924
Derivative financial instruments	825	506	652	2,021	2,046	6,050
Loans and advances to banks	40,701	3,371	6,214	33,688	2,116	86,090
Loans and advances to customers	42,889	6,606	7,162	18,519	16,583	91,759
Available-for-sale financial assets	126	1,085	757	1,161	1,374	4,503
Other assets	4,456	151	100	249	18,489	23,445
Total assets	89,216	12,175	15,425	59,742	41,213	217,771

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Liabilities						
Deposits from banks	29,955	4,920	2,105	993	–	37,973
Customer accounts	95,589	4,952	4,990	5,986	3,988	115,505
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	688	600	800	2,372	2,752	7,212
Debt securities in issue	13,338	7,879	3,664	1,586	4,849	31,316
Other liabilities	3,487	109	243	63	2,198	6,100
Subordinated liabilities	–	–	–	1,082	10,300	11,382
Total liabilities	143,057	18,460	11,802	12,082	24,087	209,488
Net liquidity gap	(53,841)	(6,285)	3,623	47,660	17,126	8,283

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

47 Financial risk management (continued)

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

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

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

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

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

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

Trading and other financial assets at fair value through profit or loss
Fair value is determined using market prices

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

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

47 Financial risk management (continued)

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

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

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

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

Trading and other liabilities at fair value through profit or loss
Fair value is determined using valuation techniques based upon market prices

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

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

47 Financial risk management (continued)

The Group	Carrying value 2006 £m	Carrying value 2005 £m	Fair value 2006 £m	Fair value 2005 £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	**67,928**	60,567	**67,928**	60,567
Derivative financial instruments	**5,565**	5,878	**5,565**	5,878
Loans and advances to banks	**40,638**	31,655	**40,641**	31,691
Loans and advances to customers	**190,135**	176,635	**189,827**	177,245
Available-for-sale financial assets	**19,178**	14,940	**19,178**	14,940
Investment properties	**4,739**	4,260	**4,739**	4,260
Financial liabilities				
Deposits from banks	**36,394**	31,527	**36,383**	31,508
Customer accounts	**140,767**	131,350	**140,688**	131,332
Trading and other liabilities at fair value through profit or loss	**1,184**	–	**1,184**	–
Derivative financial instruments	**5,877**	6,584	**5,877**	6,584
Debt securities in issue	**54,118**	39,346	**54,070**	39,352
Liabilities arising from non-participating investment contracts	**24,370**	21,839	**24,370**	21,839
Financial guarantees	**49**	–	**49**	–
Subordinated liabilities	**11,506**	12,635	**12,250**	13,436

The Bank	Carrying value 2006 £m	Carrying value 2005 £m	Fair value 2006 £m	Fair value 2005 £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	**8,819**	5,924	**8,819**	5,924
Derivative financial instruments	**5,665**	6,050	**5,665**	6,050
Loans and advances to banks	**86,588**	86,090	**86,591**	86,126
Loans and advances to customers	**106,576**	91,759	**106,675**	92,275
Available-for-sale financial assets	**3,972**	4,503	**3,972**	4,503
Financial liabilities				
Deposits from banks	**44,070**	37,973	**44,059**	37,961
Customer accounts	**127,938**	115,505	**127,929**	115,523
Trading and other liabilities at fair value through profit or loss	**1,184**	–	**1,184**	–
Derivative financial instruments	**6,405**	7,212	**6,405**	7,212
Debt securities in issue	**32,719**	31,316	**32,671**	31,323
Financial guarantees	**49**	–	**49**	–
Subordinated liabilities	**10,281**	11,382	**10,921**	12,034

48 Acquisitions

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

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

49 Cash flow statements

a Change in operating assets	The Group 2006 £m	The Group 2005 £m	The Bank 2006 £m	The Bank 2005 £m
Change in loans and advances to banks	**(11,063)**	(1,319)	**(3,465)**	(10,953)
Change in loans and advances to customers	**(14,069)**	(14,475)	**(15,431)**	(8,851)
Change in trading assets	**(7,112)**	(88)	**(2,574)**	5,837
Change in other operating assets	**50**	(1,202)	**(131)**	(55)
Change in operating assets	**(32,194)**	(17,084)	**(21,601)**	(14,022)

b Change in operating liabilities	The Group 2006 £m	The Group 2005 £m	The Bank 2006 £m	The Bank 2005 £m
Change in deposits from banks	**5,222**	(8,168)	**6,750**	(9,418)
Change in customer accounts	**9,668**	4,607	**12,728**	8,616
Change in debt securities in issue	**15,068**	10,280	**1,699**	7,652
Change in trading liabilities	**482**	(3,957)	**382**	(1,149)
Change in investment contract liabilities	**3,795**	6,094	**–**	–
Change in other operating liabilities	**(71)**	1,179	**380**	195
Change in operating liabilities	**34,164**	10,035	**21,939**	5,896

49 Cash flow statements (continued)

c Non-cash and other items

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Depreciation of fixed assets	**619**	639	**295**	309
Revaluation of investment property	**(631)**	(430)	**-**	-
Allowance for loan losses	**1,560**	1,302	**1,268**	1,062
Write-off of allowance for loan losses	**(1,299)**	(1,078)	**(1,146)**	(916)
Impairment of goodwill	**-**	6	**-**	-
Insurance claims	**8,569**	12,186	**-**	-
Insurance claims paid	**(7,486)**	(8,265)	**-**	-
Customer remediation provision	**-**	150	**(8)**	147
Customer remediation paid	**(93)**	(77)	**(76)**	(62)
Other provision movements	**(19)**	(7)	**(16)**	(5)
Net charge in respect of defined benefit schemes	**109**	259	**73**	191
Contributions to defined benefit schemes	**(556)**	(425)	**(432)**	(316)
Other non-cash items	**175**	(589)	**(695)**	127
Total non-cash items	**948**	3,671	**(737)**	537
Interest expense on subordinated liabilities	**727**	684	**614**	591
Profit on disposal of businesses	**-**	(50)	**-**	(57)
Other	**(43)**	(15)	**(32)**	(7)
Total other items	**684**	619	**582**	527
Non-cash and other items	**1,632**	4,290	**(155)**	1,064

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

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Cash and balances with central banks	**1,898**	1,156	**1,678**	966
Less mandatory reserve deposits[1]	**(300)**	(288)	**(169)**	(169)
	1,598	868	**1,509**	797
Loans and advances to banks	**40,638**	31,655	**86,588**	86,090
Less amounts with a maturity of three months or more and balances due from subsidiary undertakings	**(16,798)**	(5,770)	**(72,662)**	(69,580)
	23,840	25,885	**13,926**	16,510
	25,438	26,753	**15,435**	17,307

[1]Mandatory reserve deposits are held with local central banks in accordance with statutory requirements, these deposits are not available to finance the Group's day-to-day operations

Included within cash and cash equivalents of the Group at 31 December 2006 is £9,054 million (2005 £8,860 million) held within the Group's life funds, which is not immediately available for use in the business

49 Cash flow statements (continued)

e Analysis of changes in financing during the year

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Share capital (including share premium account)				
At 1 January and 31 December	**4,502**	4,502	**4,502**	4,502

	The Group	
	2006 £m	2005 £m
Minority interests		
At 1 January	**435**	81
Exchange and other adjustments	**(4)**	-
Capital invested by minority shareholders	**-**	329
Repayment of capital to minority shareholders	**(151)**	-
Minority share of profit after tax	**104**	62
Payments to minority shareholders	**(32)**	(37)
At 31 December	**352**	435

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Subordinated liabilities and finance leases				
At 1 January	**12,651**	11,454	**11,397**	10,753
Exchange and other adjustments	**(620)**	70	**(592)**	68
Issue of subordinated liabilities	**-**	1,361	**-**	810
Repayments of subordinated liabilities	**(509)**	(232)	**(509)**	(232)
Finance lease capital repayments	**-**	(2)	**-**	(2)
At 31 December	**11,522**	12,651	**10,296**	11,397

f Acquisition of group undertakings and businesses

	The Group		The Bank	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Investment in subsidiary	**-**	-	**8**	4
Net assets acquired				
Loans and advances to customers	**11**	-	**-**	-
Other assets	**1**	8	**-**	-
Tangible fixed assets	**-**	8	**-**	-
Other liabilities	**-**	(3)	**-**	-
Goodwill arising on consolidation	**4**	3	**-**	-
Net cash outflow from acquisitions in the year*	**16**	16	**8**	4
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	**4**	11	**-**	-
Net cash outflow from acquisitions	**20**	27	**8**	4

*The consideration in respect of these acquisitions was settled in cash in the year concerned (see note 48)

49 Cash flow statements (continued)

g Disposal and closure of group undertakings and businesses

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

Notes to the accounts

50 Future developments

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

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

[1] Includes consequential changes to other pronouncements

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

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

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

51 Approval of the financial statements and other information

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

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