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

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

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

OR

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

OR

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

OR

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

Commission file number 001-15246

LLOYDS TSB GROUP plc

(Exact name of Registrant as Specified in Its Charter)

Scotland
(Jurisdiction of Incorporation or Organization)

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

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

Title of each class

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

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

None

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

None

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

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

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

Yes x No o

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

Yes o No x

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

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

Yes x No o

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

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

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

Item 17 o Item 18 x

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

Yes o No x

Table of contents

Presentation of information

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

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

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

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

Business overview

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

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

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

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

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

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

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

Selected consolidated financial data

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

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

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

1

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

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

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

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

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

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

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

3

Selected consolidated financial data

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

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

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

Exchange rates

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

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

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

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

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

Business

History and development of Lloyds TSB Group

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

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

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

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

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

Management and resources

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

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

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

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

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

Strategy of Lloyds TSB Group

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

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

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

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

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

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

Business

Markets

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

Strategy

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

(i) Strong customer franchises

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

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

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

(ii) Continuous productivity improvement

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

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

(iii) Capital efficiency

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

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

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

Business

Business and activities of Lloyds TSB Group

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

UK Retail Banking

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

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

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

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

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

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

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

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

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

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

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

Insurance and Investments

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

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

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

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

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

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

Business

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

Wholesale and International Banking

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

Wholesale

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

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

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

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

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

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

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

International Banking

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

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

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

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

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

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

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

Business

Material contracts

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

Recent developments

Sale of the business and assets of Lloyds TSB Registrars

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

Trading statement

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

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

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

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

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

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

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

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

Business

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

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

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

Properties

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

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

Legal actions

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

Competitive environment

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

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

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

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

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

Competition Commission

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

Office of Fair Trading (OFT)

The following reviews and inquiries are being carried out:

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

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

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

The European Commission

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

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

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

Operating and financial review and prospects

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

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

Table of Contents

Operating and financial review and prospects

Overview and trend information

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

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

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

Critical accounting policies

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

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

Results of operations   2006, 2005 and 2004

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

Summary

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

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

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

Operating and financial review and prospects

2006 compared with 2005

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

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

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

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

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

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

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

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

2005 compared with 2004

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

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

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

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

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

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

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

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

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

Net interest income

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

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

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

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

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

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

Operating and financial review and prospects

2006 compared to 2005

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

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

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

2005 compared to 2004

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

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

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

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

Operating and financial review and prospects

Other income

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

2006 compared to 2005

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

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

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

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

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

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

2005 compared to 2004

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

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

Operating and financial review and prospects

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

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

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

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

Operating expenses

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

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

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

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

Operating and financial review and prospects

2006 compared to 2005

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

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

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

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

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

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

2005 compared with 2004

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

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

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

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

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

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

Operating and financial review and prospects

Impairment losses on loans and advances

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

Impairment losses on loans and advances	2006 £m	2005 £m	2004 £m
UK Retail Banking	**1,238**	1,111	676
Insurance and Investments			(3)
Wholesale and International Banking	**313**	191	193
Central group items	**9**		
Total charge for impairment losses on loans and advances	**1,560**	1,302	866
	%	%	%
Charge as a percentage of average lending	**0.83**	0.76	0.59

2006 compared to 2005

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

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

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

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

21

Operating and financial review and prospects

2005 compared to 2004

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

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

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

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

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

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

Taxation

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

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

2006 compared to 2005

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

2005 compared to 2004

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

Operating and financial review and prospects

Economic profit

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Operating and financial review and prospects

2006 compared to 2005

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

2005 compared to 2004

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

Line of business information

Summary

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

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

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

UK Retail Banking

	2006 £m	2005 £m	2004 £m

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

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

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

2006 compared to 2005

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

Operating and financial review and prospects

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

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

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

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

2005 compared to 2004

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

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

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

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

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

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

Operating and financial review and prospects

Insurance and Investments

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

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

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

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

Operating and financial review and prospects

2006 compared to 2005

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

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

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

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

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

2005 compared to 2004

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

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

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

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

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

Operating and financial review and prospects

Life, pensions and OEICs

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

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

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

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

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

Operating and financial review and prospects

2006 compared to 2005

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

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

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

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

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

2005 compared to 2004

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

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

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

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

Operating and financial review and prospects

General insurance

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

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

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

2006 compared to 2005

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

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

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

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

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

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

Operating and financial review and prospects

2005 compared to 2004

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

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

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

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

Wholesale and International Banking

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

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