Annual Report and Accounts 2007

Building long-term relationships

Lloyds TSB | for the journey...

Our vision

To be the best financial services organisation in the UK

We will achieve this by:

Building strong customer franchises, that are based on deep customer relationships
- that give value to the customer
- that give sustainable earnings growth to the shareholder

Executing brilliantly
- flawlessly for the customer
- doing what we say we are going to do

Managing our most valuable resource, our people

Our strategy

Build customer franchises
- extending reach and depth of customer relationships
- enhancing product capabilities to build competitive advantage
- improving processing efficiency
- working capital harder

Expand from strength
- look to leverage our financial strength and enhanced capabilities
- new product, customer and geographical markets

Our business priorities

UK Retail Banking
- grow income from existing customer base
- grow income from new customers
- improve productivity

Insurance and Investments
- maximise bancassurance success
- profitably grow the IFA distribution channel
- continue to improve operational efficiency and cost management
- optimise capital management

Wholesale and International Banking
- grow the Corporate Markets business
- build on the growth momentum in Commercial Banking
- maintain strong asset quality

Group key performance indicators

2007 highlights

- **Strong financial performance** with statutory earnings per share increased by 17 per cent to 58.3p. Economic profit increased by 21 per cent. Statutory profit before tax was 6 per cent lower at £4,000 million, largely reflecting adverse policyholder interests volatility.
- **Strong underlying profit momentum.** Profit before tax up 6 per cent to £3,919 million notwithstanding impact of global financial markets turbulence. Excluding the impact of £280 million market dislocation, profit before tax increased by 13 per cent to £4,199 million.
- **High returns maintained,** with return on equity of 25.2 per cent. Improved return on risk-weighted assets, and return on Embedded Value increased to 9.9 per cent.
- **Good income growth.** Income growth of 5 per cent, reflecting the strength and resilience of the Group's revenue base. Excluding the impact of market dislocation and insurance grossing, income increased by 6 per cent.
- **Excellent cost management.** Cost growth of only 1 per cent, delivering wide positive jaws. Cost:income ratio improved by 1.8 percentage points to 49.0 per cent. Groupwide productivity programme exceeded 2007 expectations, and remains on track to deliver benefits of £250 million in 2008.
- **Satisfactory credit quality.** Retail impairment charge lower than in 2006. Based on current trends, we do not expect a significant change in the retail impairment charge in the first half of 2008, compared to the first half of 2007. Corporate asset quality remains good.
- **Strong liquidity and funding position maintained** throughout the recent global financial markets turbulence.
- **Excellent capital management.** Robust capital ratios maintained. Satisfactory transition to Basel II, with tier 1 capital ratio increasing to 9.5 per cent. Over £3.6 billion of capital repatriated from Scottish Widows over the last 3 years.

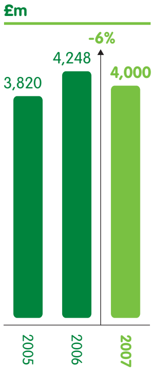
Profit analysis by division

	2007 £m	2006 £m
UK Retail Banking	**1,808**	1,549
Insurance and Investments	**1,056**	973
Wholesale and International Banking		
– Before impact of market dislocation	**1,717**	1,640
– Impact of market dislocation	**(280)**	–
	1,437	1,640
Central group items	**(382)**	(452)
Profit before tax*	**3,919**	3,710
Volatility		
– Insurance	**(267)**	84
– Policyholder interests	**(233)**	326
Profit on sale of businesses	**657**	–
Settlement of overdraft claims	**(76)**	–
Pension schemes related credit	**–**	128
Profit before tax	**4,000**	4,248
Earnings per share	**58.3p**	49.9p

* Excluding volatility, profit on sale of businesses, the settlement of overdraft claims in 2007 and the pension schemes related credit in 2006.

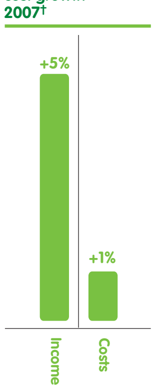
Group – financial

Statutory profit before tax £m



Profit before tax £m†

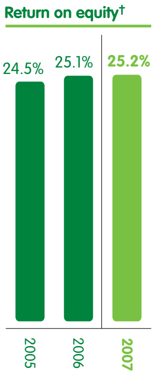
Income and cost growth 2007†



Economic profit £m†

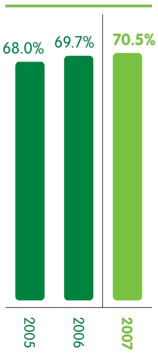
Earnings per share†

Return on equity†

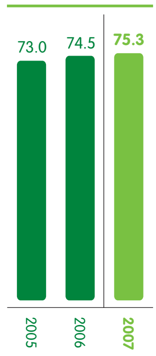


Group – non financial

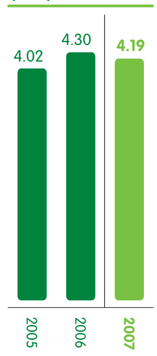
Customer service index††



Employee engagement index◆

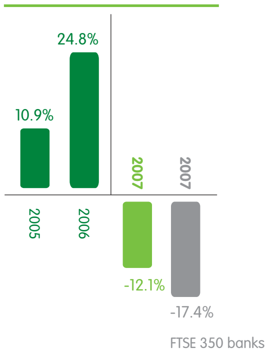


Service quality index



Total shareholder return

Total shareholder return



† Excluding volatility, profit on sale of businesses, the settlement of overdraft claims in 2007, the pension schemes related credit in 2006, and customer redress provisions and the strengthening of reserves for mortality in 2005.

†† See Corporate responsibility section (page 34).

◆ See Our people section (page 32).

The Group at a glance

Our group

Lloyds TSB is a leading UK based financial services group providing a wide range of banking and financial services, primarily in the UK, to personal and corporate customers. Our main business activities are retail, commercial and corporate banking, general insurance, and life, pensions and investment provision. The Group has a large and diversified customer base and services are offered through a number of well recognised brands (Lloyds TSB, Cheltenham & Gloucester, Scottish Widows), and via a unique distribution capability comprising one of the largest branch networks in the UK and intermediary channels.

Lloyds TSB Group was formed in 1995 following the merger of Lloyds Bank and TSB and now comprises the Lloyds TSB brand along with Cheltenham & Gloucester, one of the largest mortgage providers in the UK and Scottish Widows, one of the UK's largest providers of life, pensions and unit trust products.

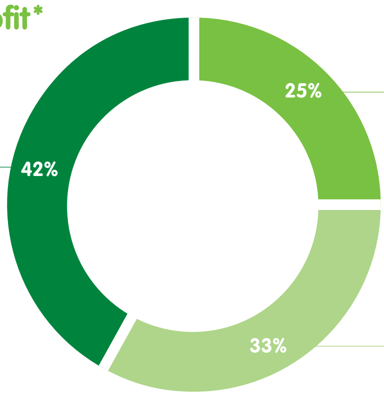
Lloyds TSB Group is quoted on the London Stock Exchange and is one of the largest companies within the FTSE 100, with a market capitalisation of £26.7 billion on 31 December 2007. At the end of 2007 total group assets were £353 billion and the Group has nearly 70,000 employees. Total income for the 12 months to 31 December 2007 was £18 billion with profit before tax totalling £4 billion.

Our activities are organised into three businesses: UK Retail Banking, Insurance and Investments and Wholesale and International Banking. Their respective contributions are outlined below.

Our divisions – contribution to profit*

UK Retail Banking
£1,808m

Secured lending – mortgages
Unsecured lending – credit cards, loans and overdrafts
Internet and telephone banking
Current accounts
Savings accounts
Wealth Management



Insurance and Investments
£1,056m

Life assurance, pensions and investments
General Insurance
Scottish Widows Investment Partnership

Wholesale and International Banking
£1,437m

Corporate Markets
Commercial Banking
Asset Finance
International Banking

* Excluding volatility, profit on sale of businesses and the settlement of overdraft claims. Also excludes Central Group Items.

Presentation of information and Forward looking statements

Presentation of information

In order to provide a more comparable representation of underlying business performance, insurance and policyholder interests volatility have been separately analysed for the Group's insurance businesses. Further information on these items is shown on pages 30 and 31. In addition, the profit on the sale of businesses and the settlement of overdraft claims in 2007 and the impact in 2006 of the one-off pension schemes related credit have been separately analysed in the Group's results. A reconciliation of this basis of presentation to the statutory profit is shown on page 10. Certain commentaries also separately analyse the impact in 2007 of market dislocation.

Forward looking statements

This annual report includes certain forward looking statements within the meaning of the US Private Securities Litigation Reform Act of 1995 with respect to the business, strategy and plans of Lloyds TSB Group and its current goals and expectations relating to its future financial condition and performance. Statements that are not historical facts, including statements about Lloyds TSB Group's or management's beliefs and expectations, are forward looking statements. Words such as 'believes', 'anticipates', 'estimates', 'expects', 'intends', 'aims', 'potential', 'will', 'would', 'could', 'considered', 'likely', 'estimate' and variations of these words and similar future or conditional expressions are intended to identify forward looking statements but are not the exclusive means of identifying such statements. By their nature, forward looking statements involve risk and uncertainty because they relate to events and depend upon circumstances that will occur in the future.

Examples of such forward looking statements include, but are not limited to, projections or expectations of profit attributable to shareholders, provisions, economic profit, dividends, capital structure or any other financial items or ratios; statements of plans, objectives or goals of Lloyds TSB Group or its management; statements about the future trends in interest rates, foreign exchange rates, stock market levels and demographic trends and any impact on Lloyds TSB Group; statements concerning any future UK or other economic environment or performance including in particular any such statements included in this annual report; statements about strategic goals, competition, regulation, dispositions and consolidation or technological developments in the financial services industry; and statements of assumptions underlying such statements.

Factors that could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward looking statements made by Lloyds TSB Group or on Lloyds TSB Group's behalf include, but are not limited to, general economic conditions in the UK and internationally; inflation, deflation, policies of the Bank of England and other G7 central banks, interest rate, exchange rate, market and monetary fluctuations; changing demographic developments including consumer spending, saving and borrowing habits, technological changes, natural and other disasters, adverse weather and similar contingencies outside the Lloyds TSB Group's control; inadequate or failed internal or external processes, people and systems; terrorist acts and other acts of war or hostility and responses to those acts; changes in laws, regulations, taxation, government policies or accounting standards or practices; exposure to regulatory scrutiny, legal proceedings or complaints; changes in competition and pricing environments; the inability to hedge certain risks economically; the adequacy of loss reserves; the ability to secure new customers and develop more business from existing customers; the ability to achieve value-creating mergers and/or acquisitions at the appropriate time and prices and the success of the Lloyds TSB Group in managing the risks of the foregoing.

Lloyds TSB Group plc may also make or disclose written and/or oral forward looking statements in reports filed with or furnished to the US Securities and Exchange Commission, Lloyds TSB Group plc's annual review, half-year announcement, proxy statements, offering circulars, prospectuses, press releases and other written materials and in oral statements made by the directors, officers or employees of Lloyds TSB Group plc to third parties, including financial analysts. The forward looking statements contained in this annual report are made as of the date hereof, and Lloyds TSB Group undertakes no obligation to update any of its forward looking statements.

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Shareholder Information

The most trusted bank in Britain for seven years running

Lloyds TSB has a very clear vision to be the best financial services organisation in the UK. In achieving this we aim to be a great place for our customers to do business; a great place for our people to work; and to generate good returns for our shareholders. Underlying these aims we also want to be valued by the communities where we operate through high ethical standards, respect for our stakeholders, community involvement and a commitment to corporate responsibility. I am very pleased to be able to report significant progress on our journey towards achieving this vision during 2007.

Achieving the vision

We have maintained strong business momentum through the year to deliver another good set of results with underlying profit before tax up 6 per cent in 2007 to £3,919 million. Against a turbulent backdrop, these results are achieved from a business that focuses tirelessly on the needs of customers and which, as a result, has a lower risk and a more predictable earnings stream. Our quality of earnings emerges from the strength of our three high quality businesses; our UK Retail Bank; our Wholesale and International Banking division; and our Insurance and Investments division which includes Scottish Widows.

Our confidence in our business model and its ability to increase earnings throughout the economic cycle led to our decision to increase the dividend by 5 per cent year on year. This is the first year in five that we have increased our dividend and supports our long term shareholder proposition; going forward, we expect to continue to grow our dividend whilst continuing to build dividend cover.

"We have maintained strong business momentum through the year."

Customer focus

Our customers are critical to our success. Retaining and broadening these relationships and adding new customers are a key part of our strategy. This will not be achieved unless we are providing a high quality service and products that our customers want to buy and which provide good value for money. Success has been measured through high levels of customer satisfaction and customer advocacy and a strong sales performance. It is also measured through external recognition and I am pleased to report that our businesses have won a number of awards throughout 2007.

In the UK Retail Bank we were the market leader in new current account recruitment at the same time as being voted the most trusted bank in Britain for the seventh year running. In Wholesale and International Banking we were voted by Finance Directors as Corporate Bank of the Year at the Real Finance/CBI FDs' Excellence Awards for the third year in succession. And in Insurance and Investments, Scottish Widows was voted Best Individual Pensions Provider by IFAs at the Financial Adviser Awards. All of these recognise our commitment to our customers and are the result of hard work and dedication from our employees who can justifiably be proud of what we have achieved.

Corporate responsibility

Lloyds TSB has a strong commitment to improving the quality of life of people in the communities where we work and I am proud of our achievements in this area.

Our major focus for support is through the four Lloyds TSB Foundations in England and Wales, Northern Ireland, Scotland and the Channel Islands. Our commitment is to provide 1 per cent of the Group's pre-tax profits to the Foundations and in 2007 we gave £37 million to support their work. A further £37 million will be donated in 2008 bringing our total contributions since the Lloyds TSB merger to over £360 million, making Lloyds TSB one of the largest charitable donors in the UK. I would strongly encourage you to visit the website for the Lloyds TSB Foundations at www.lloydstsbfoundations.org.uk to look at some of the programmes we support and to see the difference we can make in helping disadvantaged people to live a fuller life in communities across the UK.

Our employees also support a wide range of community programmes, volunteering their time and energy to local causes and initiatives. I am particularly proud of the work we have done to support the Group's 2007 charity partner, Barnardo's, where to date almost £1 million has been raised, with fund raising initiatives continuing into 2008.

Our journey in response to the global issue of climate change reached a new milestone this year with the introduction of a new stretching target to reduce our CO_2 emissions by 30 per cent by 2012, based on 2002 levels. We are focusing particularly on energy consumption and efficiency and we recognise that a real behavioural change is required by all of our people to achieve this target. To support this change we have introduced a sustainability network, drawing on champions from across the Group, to raise awareness and support the initiatives that are required. It is my firm view that companies that develop the skills, resources and relationships to manage these challenges will thrive and prosper in the years ahead.

We cannot eliminate all CO_2 emissions so in 2007 we committed to become carbon neutral by offsetting those emissions that we cannot reduce. I am pleased to confirm that in 2007 we purchased sufficient carbon credits to achieve carbon neutrality.

In March 2007 we were the first organisation to become a domestic partner of the 2012 Olympic and Paralympic Games. This places Lloyds TSB at the heart of the most exciting world event to take place in the UK for many decades. Our vision for our partnership with London 2012 is 'to inspire and support young people, communities and businesses all over Britain on their journey to the Olympic and Paralympic Games and beyond.'

The Games are much more than 16 days of competition. It is about the journey that young people take toward excellence and becoming the best and the legacy that we leave for them when the Games are over. These ideals very much resonate with our own vision and values and why we are proud to be involved.

Looking after our customers' money every day

Corporate governance

While the board of any company must ensure that a robust governance structure is in place, we are equally committed to fostering a culture throughout the organisation that values exemplary ethical standards, personal and corporate identity, teamwork, taking personal responsibility and respect for others. Our approach to governance is predicated on the belief that there is a link between high quality governance and the creation of shareholder value.

Our Group Chief Executive, Eric Daniels, has given real leadership to the Group. He and his executive have driven financial and operational success within a strong culture of teamwork and integrity. It is this work that has created the results that we have seen through 2007 and will ensure our continued success in future years.

The board's ongoing renewal process has continued throughout the year and we are delighted to have appointed two new independent non-executive directors since the last annual general meeting. Philip Green was welcomed to the board on 10 May 2007. He brings valuable experience to the Group through a very successful business career across a number of different business sectors including his current role as Chief Executive of United Utilities and as the former Chief Executive of Royal P&O Nedlloyd. Sir David Manning will join us on 1 May 2008. Sir David has a long and distinguished career in the Foreign and Commonwealth Office where he was most recently Her Majesty's Ambassador to the United States of America.

Gavin Gemmell left the board at the end of September, when he retired as chairman of Scottish Widows. I would like to thank Gavin for his significant contribution to the Group's affairs and wish him well for the future.

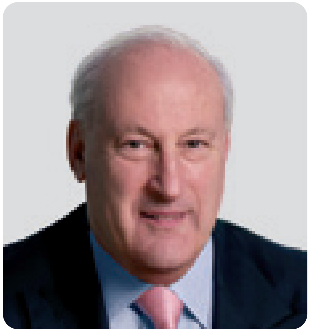
Mike Fairey, Deputy Group Chief Executive, will retire in June, following a wonderful career with the Group spanning 17 years. Mike joined the TSB group in 1991, became a director of Lloyds TSB in 1997 and became Deputy Group Chief Executive in 1998. He has given both loyal service and wise counsel during these years and I will personally miss his contribution. I would like to thank Mike for all of his input over the years and wish him well for the future.

Outlook

As we look forward to 2008, we face the prospect of slowing global economic activity and all the associated challenges that this brings. Despite this our strategy remains unchanged. The progress made over the last four years means that we have a strong capital position from which we can continue to grow the business. We believe that our excellent customer proposition, based on high levels of service quality and committed customer relationships, leaves us well positioned to continue to grow our returns to shareholders through 2008 and in future years.

"We have a strong capital position from which we can continue to grow the business."

I would like to thank all of our employees for their contribution to making 2007 such a successful year. It is the commitment, support and dedication of every one of our employees that makes so much difference. I look forward to continuing our journey together in the years ahead.



london
official banking and insurance partner

Sir Victor Blank
Chairman
21 February 2008

More Britons count on us for their current accounts

2007 was another good year for Lloyds TSB. We delivered strong results, despite the more challenging operating environment that we saw in the second half of the year. Our business performance, excluding the impact of the market dislocation, continued its strong momentum as our relationship-based strategy serves us well. We believe this momentum will carry through to 2008, given we have a high quality, sustainable earnings stream, driven by the deep relationships we have with our customers, coupled with the significant growth potential we have both within our own franchise and in the UK market as a whole. As a result, we remain confident as to the Group's future outlook.

Given this strong performance and confidence in our future earnings capacity, the board has decided to increase the final dividend by 5 per cent to 24.7 pence per share. This brings the full year dividend to 35.9 pence per share, an increase of 5 per cent over that paid for 2006. Going forward, the board expects to grow the dividend over time, whilst continuing to build dividend cover.

Strong momentum

On an underlying basis, the Group increased profit before tax by 6 per cent to £3,919 million. Excluding the £280 million charge arising from the market dislocation, the Group grew profits by 13 per cent from £3,710 million to £4,199 million. Whilst we cannot overlook the impact of the dislocation on our results, these numbers are more reflective of the ongoing performance of the Group.

Our lower risk strategy limited the impact of the abrupt change in the markets and, consequently, our charge was relatively modest in comparison to our balance sheet size, our earnings, and the charges taken by many other organisations. This is in large part due to the conscious choice to focus the Group's strategy on building deep, long-lasting relationships with our customers in order to deliver high quality, sustainable results over time.

> **"We have a high quality, sustainable earnings stream, driven by the deep relationships we have with our customers."**

Over the last few years, the successful execution of our strategy has delivered increasing levels of customer recruitment and enhanced sales volumes, and in 2007 we saw further progress on these leading indicators of future profit.

In the Retail Bank, we attracted over one million new current accounts and we delivered strong flows of new business, with sales volumes rising 17 per cent. We are now the number one provider of current accounts, cards and personal loans. In Insurance and Investments, we have seen good progress in the sale of bancassurance products to our franchise customers and sales volumes rose by 20 per cent, with particular success in the sale of protection products through the branch network.

> **"We are now number one in terms of the provision of current accounts, cards and personal loans."**

In Wholesale and International Banking, we saw similar strong progress. Our Corporate Markets business is attracting growing numbers of new customers and recorded a further 46 per cent improvement in cross-sales. Our Commercial Banking business attracted good levels of the more valuable switcher accounts and we remain the leader in terms of the share of the start-up market, at 21 per cent.

Key to supporting our relationship-focused strategy is the efficient management of costs and capital, allowing us to continue to invest in the franchise and drive future growth. Once again we have delivered a strong performance in these areas.

Costs rose by only 1 per cent, as we continue to embed our efficiency programmes, and our cost:income ratio improved to 49.0 per cent, from 50.8 per cent in 2006. The extension of our lean manufacturing and sigma efficiency programmes, the improvement of our procurement processes and the adoption of end-to-end processing led to improvements in efficiency as well as better levels of service quality.

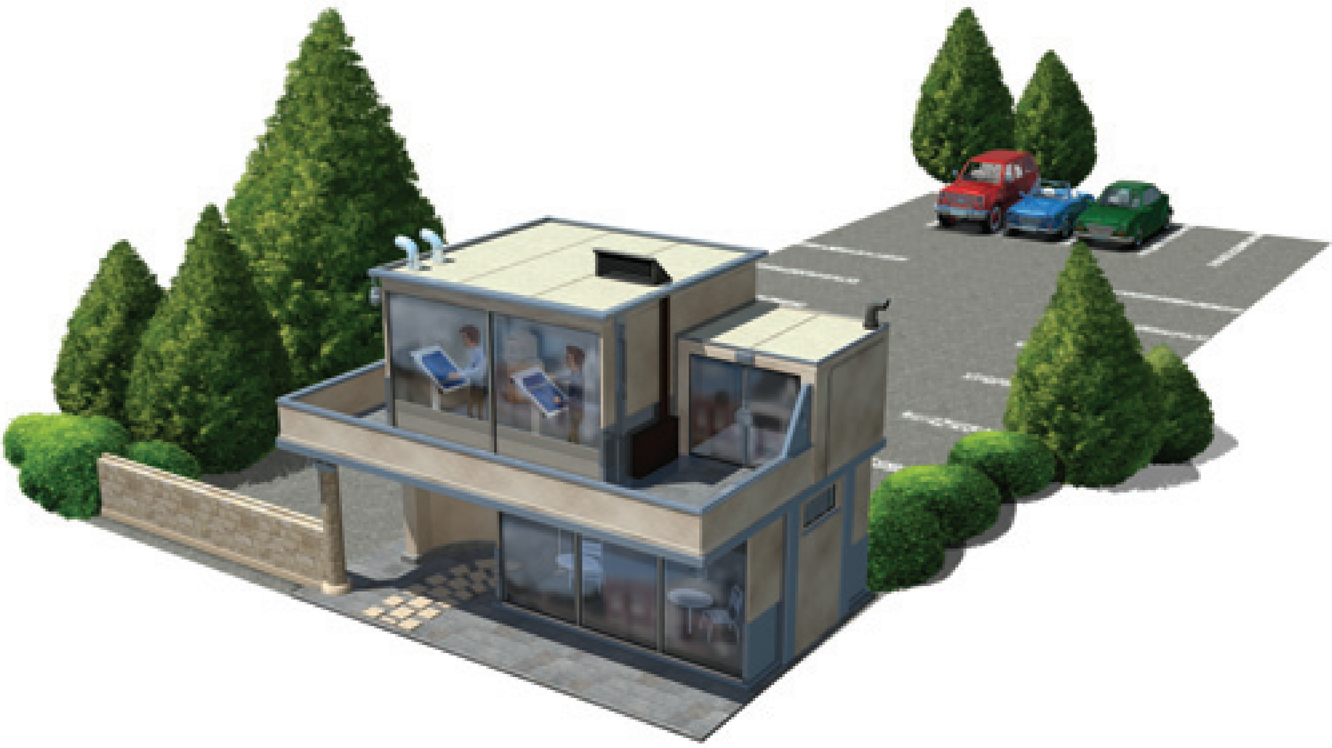
Our capital position is strong. We manage our capital to support efficient growth, directing capital to our higher growth and higher return business lines. We continued the capital efficiency programmes in Scottish Widows, with a further £1.9 billion repatriated to the Group during the year.

High quality sustainable business

Key to sustaining our strong momentum in future years are the relationships we are building with our customers, understanding their needs and developing the products and services to meet those needs.

As our results in recent periods show, this strategy has served us well and has a number of benefits. A high percentage of our income is recurring customer revenue, which is by nature more stable and sustainable. By building deep relationships, meeting more of our customers' needs, we also benefit in that we have a lower cost of acquiring new sales. Additionally, because we understand our customers well, we tend to have lower impairments and thus require less capital. Perhaps as important as the decision to pursue the relationship strategy, was the decision not to pursue a product-led strategy which, as we have seen of late, results in more volatile revenues and carries a significantly higher risk profile.

Giving businesses what they need to grow



Significant growth potential

The UK market represents the second largest economic profit pool for financial services, with high levels of household financial wealth. It enjoys the lowest level of unemployment in the G7 economies and despite a likely slow down in 2008, we are projecting good medium-term economic performance and strong long-term savings growth.

We estimate that we currently only have a 10 per cent share of the economic profit pool, and so we have significant potential within our existing franchise to grow by meeting more of our customers' needs as well as through adding new customers to our franchise.

"We have significant potential within our existing franchise to grow."

To support this growth potential we are investing in developing the supporting infrastructure in areas such as customer data management and account planning tools. We continue to enhance our risk and financial systems and, together, these areas will ensure we have the necessary platform to safely support our future growth.

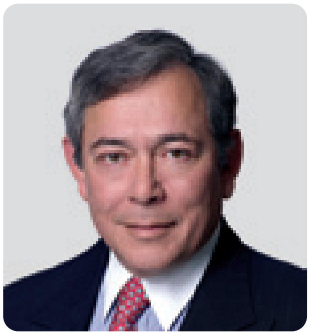
Outlook

As we look forward to 2008, we do so against a backdrop of turbulent markets and slowing global economic growth. Despite these challenges, we are well positioned to deliver further growth and to take advantage of the opportunities that the current environment offers.

"We are well positioned to deliver further growth and to take advantage of the opportunities that the current environment offers."

Our relationship-focused strategy is delivering good results for all our stakeholders. The events of the last year show that it is effective in generating sustainable, high quality results through the cycle. Our prudent approach to risk ensured we experienced minimal impact from the US sub-prime fall-out. We have a strong capital position and this will support the future growth of the business.

This has been a year of significant progress across the Group and let me express my thanks to all our staff for their wonderful contribution to our success. Relationship businesses thrive on great staff that understand customers and work towards meeting their needs. In this last year, the performance of our staff has been terrific.



J Eric Daniels
Group Chief Executive
21 February 2008

Summary of Group results

Our strategy

Our strategy remains to grow the business through developing long term customer relationships and building our customer franchise. All our businesses are focused on extending the reach and depth of our customer relationships, enhancing product capabilities to build competitive advantage, and improving processing efficiency whilst working capital harder. This will enable us to achieve our vision of being the best financial services organisation in the United Kingdom.

The focus on developing our relationships with personal, commercial and corporate customers, whilst developing innovative products that meet the needs of existing customers and attract new customers, is a key driver for income and business growth. Ensuring we become more efficient in everything we do will help ensure our costs are managed effectively whilst also enabling us to invest in the business to drive further growth. Resource allocation is also increasingly important and significant focus is given to allocating capital to where it will have the most positive impact on our businesses.

Our focus remains on the core business within the UK and in 2007 we continued to move out of non-core markets with the sale of Lloyds TSB Registrars and Abbey Life.

We are already making excellent progress in building the customer franchise and Lloyds TSB is the leading recruiter of new personal current accounts in the UK and has the leading share of new business start-ups. The 2007 results highlight we are on the right track, both in terms of our financial performance and in making further progress in the development of our organic growth strategy.

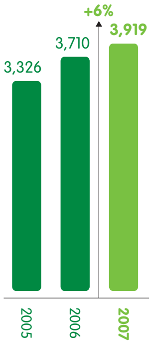
We believe there remains significant opportunity for organic growth and as we successfully grow the business and develop our skills and capabilities, we will look to expand from a solid foundation of strength. This is likely to be through leveraging our financial strength and enhanced capabilities in new product, customer and geographic markets.

Group results

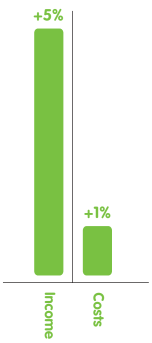
	2007 £m	2006 £m
Net interest income	6,092	5,360
Other income	12,636	13,903
Total income	18,728	19,263
Insurance claims	(7,522)	(8,569)
Total income, net of insurance claims	11,206	10,694
Operating expenses	(5,491)	(5,429)
Trading surplus	5,715	5,265
Impairment	(1,796)	(1,555)
Profit before tax*	3,919	3,710
Volatility		
– Insurance	(267)	84
– Policyholder interests	(233)	326
Profit on sale of businesses	657	–
Settlement of overdraft claims	(76)	–
Pension schemes related credit	–	128
Profit before tax	4,000	4,248

* Excluding volatility, profit on sale of businesses, the settlement of overdraft claims in 2007 and the pension schemes related credit in 2006.

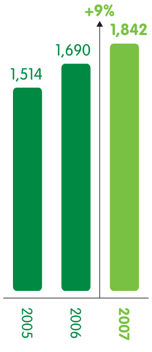
Profit before tax £m†



Income and cost growth 2007†



Economic profit £m†



† Excluding volatility, profit on sale of businesses, the settlement of overdraft claims in 2007, the pension schemes related credit in 2006, and customer redress provisions and the strengthening of reserves for mortality in 2005.

Summary of Group results

In 2007 the Group delivered a strong performance against the backdrop of significant turbulence in global financial markets. Statutory profit attributable to equity shareholders increased by £486 million, or 17 per cent, to £3,289 million and earnings per share increased by 17 per cent to 58.3p. Economic profit increased by 21 per cent to £2,238 million, and the post-tax return on equity improved from 26.6 per cent to 28.2 per cent. Profit before tax fell by 6 per cent to £4,000 million, largely as a result of significant adverse policyholder interests volatility.

To enable meaningful comparisons to be made with 2006, the income statement commentaries below exclude insurance related volatility, the profit on sale of businesses, settlement of overdraft claims in 2007 and the pension schemes related credit in 2006.

Building strong customer relationships

Lloyds TSB's strategy to build strong customer franchises and grow our business by realising the considerable potential within those franchises continues to deliver strong results. We have continued to extend the reach and depth of our customer relationships, achieving good sales growth, whilst also improving productivity and efficiency. The underlying performance of the business remains strong with revenue growth remaining well ahead of cost growth.

Like many other financial institutions, the Group has been affected by the recent market dislocation; however, the relationship focus of our strategy has meant that the impact on the Group's profit before tax was limited to £280 million in 2007 (£188 million reduction in income; £92 million increase in impairment).

Continued momentum throughout the business

Profit before tax increased by £209 million, or 6 per cent, to £3,919 million, underpinned by good relationship banking momentum, notwithstanding the impact of the £280 million market dislocation in Corporate Markets. Revenue growth of 5 per cent exceeded cost growth of 1 per cent, with each division delivering stronger revenue growth than cost growth. Earnings per share increased by 8 per cent to 50.8p and economic profit increased by 9 per cent to £1,842 million. Excluding the impact of market dislocation, Group profit before tax increased by 13 per cent to £4,199 million.

"Lloyds TSB's strategy to build strong customer franchises and grow our business by realising the considerable potential within those franchises continues to deliver strong results."

Good income growth

Overall, income growth of 5 per cent reflects good progress in delivering our divisional strategies. We have increased income from both new and existing customers, with strong growth in both assets and liabilities, as well as a significant increase in fee-related income. Excluding the impact of market dislocation and insurance grossing, income increased by 6 per cent.

Group net interest income, excluding insurance grossing, increased by £349 million, or 7 per cent, to £5,631 million. Customer deposits increased by 12 per cent to £157 billion, supported by strong growth in savings balances in the retail bank, where bank savings increased by 15 per cent and wealth management balances by 12 per cent. Customer deposits in our Corporate Markets, Commercial and International businesses increased by 18 per cent.

Strong levels of customer lending growth in Commercial Banking and Corporate Markets, and good growth in mortgages and retail deposits, more than offset the marketwide experience of lower unsecured personal lending balances. Total assets increased by 3 per cent to £353 billion, with an 11 per cent increase in loans and advances to customers.

The net interest margin from our banking businesses decreased by 9 basis points, to 2.79 per cent, with broadly stable product margins but an adverse mix effect. Stronger growth in finer margin mortgages and flat wider margin unsecured consumer lending contributed to the negative mix effect which accounted for 9 basis points of margin decline. Overall product margins were 2 basis points lower, reflecting competitive pressures in the mortgage and asset finance businesses and a move to finer margin secured lending in Commercial Banking. Funding costs improved the margin by 2 basis points. During the second half of 2007, product margins have started to show signs of improving, with increased new business margins becoming evident in mortgages and corporate lending reflecting a marketwide trend towards more appropriate pricing for risk.

Other income, net of insurance claims and excluding insurance grossing, increased by £133 million, or 2 per cent, to £5,530 million. This reflected higher fees and commissions receivable as a result of strong growth in added value current accounts and higher insurance commissions in the retail bank. In addition, good levels of growth were achieved in fee based product sales to corporate and commercial banking customers.

"Overall income growth of 5 per cent reflects good progress in delivering our divisional strategies."

Excellent cost management

The Group continues to invest in improving processing efficiency, resulting in continued tight control over costs. During 2007, operating expenses increased by only 1 per cent to £5,491 million. Over the last 12 months, staff numbers have fallen by 4,552 (7 per cent) to 58,078, largely as a result of the disposal of Lloyds TSB Registrars and Dutton-Forshaw and further efficiency improvements in back-office processing centres. These improvements in operational effectiveness have resulted in a further reduction in the Group cost:income ratio from 50.8 per cent to 49.0 per cent.

The Group's programme of productivity initiatives has continued to deliver significant benefits, improving underlying cost efficiency and creating greater headroom for further investment in the business. During 2007 the programme delivered net cost reductions of £145 million, exceeding the previously indicated net benefits of approximately £125 million, with gross benefits of £248 million and reinvestment in further programme initiatives of £103 million. The Group remains on track to deliver net benefits of approximately £250 million in 2008.

Along with a number of other UK banks, during the year the Group has received a number of customer claims for the repayment of overdraft fees. On 27 July 2007, several banks, together with the Office of Fair Trading, asked the High Court of England and Wales to clarify the legal position regarding personal current account fees. The 2007 results include a charge of £76 million relating to the settlement of claims during the year, together with related costs.

Overall credit quality remains satisfactory

Impairment losses increased by 15 per cent to £1,796 million. Our impairment charge on loans and advances expressed as a percentage of average lending was 0.82 per cent, excluding the impact of market dislocation and the 2007 Finance Act, compared to 0.83 per cent in 2006. Impaired assets increased by 8 per cent to £5,311 million, less than the rate of lending growth, and now represent 2.5 per cent of total lending, down from 2.6 per cent at 31 December 2006.

In UK Retail Banking, impairment losses decreased by £14 million, or 1 per cent, to £1,224 million. During 2007, we have seen a reduction in the level of customer insolvencies, improvements in the Group's collections procedures and better than assumed recoveries. The quality of new unsecured lending has continued to be strong and our arrears and delinquency trends have improved during the year. In addition, the asset quality of our mortgage portfolio has remained excellent. Whilst the uncertain UK macroeconomic environment and customer insolvency trends remain key factors in the outlook for retail impairment, our current lead indicators are good, we are continuing to enhance our underwriting and collections procedures and the quality of new business remains strong. As a result, based on current trends, we do not expect a significant change in the retail impairment charge in the first half of 2008, compared to the first half of 2007.

The Wholesale and International Banking charge for impairment losses increased by £264 million to £572 million, including a £92 million impairment charge relating to the impact of market dislocation in the second half of 2007, and a one-off charge of £28 million relating to the impact of the 2007 Finance Act on the Group's leasing business. The increase in the impairment charge also reflects a lower level of releases and recoveries in Corporate Markets and the impact of recent double-digit growth rates in Corporate lending.

> **"We do not expect a significant change in the retail impairment charge in the first half of 2008, compared to the first half of 2007."**

Limited exposure to assets affected by current capital markets uncertainties

Whilst no bank has been immune to the impact of the turbulence in global financial markets in the second half of 2007, Lloyds TSB's high quality business model means that the Group has relatively limited exposure to assets affected by current capital markets uncertainties.

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

Lloyds TSB has no direct exposure to US sub-prime ABS and limited indirect exposure through ABS CDOs. During the second half of 2007, the market value of our holdings in ABS CDOs reduced and, as a result, the Group has taken an income statement charge of £114 million, leaving a residual investment of £130 million, net of hedges. The write-down largely reflects junior tranches of CDOs which have been written down to the expected interest payments to be received within the next 12 months. The Group has no exposure to mezzanine ABS CDOs. The Group's residual investment of £130 million is stated net of credit default swap (CDS) protection totalling £470 million purchased from a 'triple A' rated monoline Financial Guarantor. At 31 December 2007, the underlying assets supported by this protection had fallen in value, leaving a reliance on the CDS protection totalling £155 million. In addition, we have £1,861 million of ABS CDOs which are fully cash collateralised by major global financial institutions.

Structured Investment Vehicle (SIV) Capital Notes

At 30 June 2007 the Group's exposure to SIV Capital Notes totalled £100 million. During the second half of 2007 the Group wrote down the value of these assets by £22 million, leaving a residual exposure at 31 December 2007 of £78 million. Additionally, at 31 December 2007 the Group had commercial paper back up liquidity facilities totalling £370 million, of which £98 million had been drawn. All of these liquidity lines are senior facilities. Since the year end, these facilities have been reduced to £208 million, of which £115 million has been drawn. The Group has no SIV-Lite exposure.

Trading portfolio

In the second half of 2007, Corporate Markets also saw a reduction in profit before tax of approximately £144 million as a result of the impact of mark-to-market adjustments in the Group's trading portfolio, to reflect the marketwide repricing of liquidity and credit. At 31 December 2007 the trading portfolio contained £181 million of indirect exposure to US sub-prime mortgages and ABS CDOs. This super senior exposure is protected by note subordination.

Available-for-sale assets

At 31 December 2007, the Group's portfolio of available-for-sale assets totalled £20,196 million (31 December 2006: £19,178 million). A significant proportion of these assets (£8.3 billion) related to the ABS in Cancara. The residual assets included £3.2 billion Student Loan ABS, predominantly guaranteed by the US Government, £4.6 billion Government bond and short-dated bank commercial paper and certificates of deposit and £4.1 billion major bank senior paper and high quality ABS. These available-for-sale assets are intended to be held to maturity however, under IFRS, they are marked-to-market through reserves. During 2007, a net £413 million reserves adjustment, which has no impact on the Group's capital ratios, has been made to reflect a reduction in the value of these assets. These assets are not impaired and we expect to obtain full value for them upon maturity.

The Group's investment in Cancara, our hybrid Asset Backed Commercial Paper conduit, was £12.0 billion at 31 December 2007, comprising £8.3 billion ABS and £3.7 billion client receivables transactions. Cancara, which is fully consolidated in the Group's accounts, is managed in a very conservative manner, which is demonstrated by the quality and ratings stability of its underlying asset portfolio. At 31 December 2007, the ABS bonds in Cancara were 100 per cent Aaa/AAA rated by Moody's and Standard & Poor's respectively, and there was no exposure either directly or indirectly to sub-prime US mortgages within the ABS portfolio. Since the year end, ABS totalling £67 million have been downgraded. At 31 December 2007 the client receivables portfolio included £115 million of US sub-prime mortgage exposure.

Scottish Widows has no exposure to US sub-prime ABS either directly or indirectly through CDOs. The Group holds £25 million of short-dated SIV commercial paper through Scottish Widows.

Strong capital management disciplines

Capital efficiency continued to improve throughout the Group, resulting in an increase in post-tax return on average shareholders' equity to 25.2 per cent, and in the post-tax return on average risk-weighted assets to 1.76 per cent, from 1.72 per cent. In our life assurance and investment businesses, the post-tax return on embedded value, on a European Embedded Value (EEV) basis, increased to 9.9 per cent, from 9.3 per cent.

At the end of December 2007, the total capital ratio on a Basel I basis was 11.0 per cent and the tier 1 ratio was 8.1 per cent. During the year, risk-weighted assets increased by 10 per cent to £172.0 billion, reflecting growth in our mortgage and Corporate Markets businesses. Going forward, we expect high single-digit or low double-digit annual growth in risk-weighted assets, reflecting increased opportunities to continue to grow our customer lending. The Group has successfully managed the transition to Basel II and the Group's opening capital ratios on a Basel II basis were 11.0 per cent for total capital and 9.5 per cent for tier 1 capital (page 51).

Scottish Widows remains strongly capitalised and, at the end of December 2007, the working capital ratio of the Scottish Widows Long Term Fund was an estimated 19.2 per cent (page 54). During 2007, further capital repatriation totalling £1.9 billion was made to the Group, bringing the total capital repatriation since the beginning of 2005 to over £3.6 billion. On 5 December 2007 Standard & Poor's announced that it had re-affirmed its Scottish Widows 'AA-' debt rating and placed it on positive outlook.

Maintaining a strong liquidity and funding position

Throughout the recent marketwide liquidity turbulence, Lloyds TSB has maintained a strong liquidity position for both the Group's funding requirements, which are supported by our strong and stable retail and corporate deposit base, and those of its sponsored conduit, Cancara. Retail and corporate deposit inflows have been strong and the Group continues to benefit from its strong credit ratings and diversity of funding sources. This has resulted in the Group continuing to fund well over the last few months. In January 2008, Moody's announced that it had re-affirmed its 'Aaa' long-term debt rating for Lloyds TSB Bank plc.

> **"Throughout the recent market-wide liquidity turmoil, Lloyds TSB has maintained a strong liquidity position."**

Significant reduction in the Group pension schemes' deficit

The Group's defined benefit pension schemes' gross deficit at 31 December 2007 improved by £1,416 million to £683 million, comprising net recognised liabilities of £2,033 million partly offset by unrecognised actuarial gains of £1,350 million. This improvement reflects an increase in the real discount rate used to value the schemes' liabilities and Group contributions to the schemes, which exceeded the cost of accruing benefits.

Substantial profit on sale of non-core businesses

During 2007 the Group sold a number of non-core businesses realising profits on the disposal totalling £657 million. This has further strengthened the Group's capital ratios and improved capital flexibility.

In May 2007, Lloyds TSB Group agreed the sale of the business and assets of Lloyds TSB Registrars to Advent International, subject to completion and other adjustments. The transaction was completed on 30 September 2007, following regulatory approval, and the Group has reported a profit before tax on the sale of this business of £407 million (tax: £nil).

In July 2007, the Group announced an agreement to sell Abbey Life Assurance Company Limited (Abbey Life) to Deutsche Bank AG. This transaction was also completed at the end of September 2007 and the Group has reported a profit before tax on the sale of this business of £272 million (tax: £nil). In addition, a pre-sale dividend of £175 million was paid to Group in June 2007.

Taxation charge

The Group's tax charge for 2007 was £679 million, which was an effective rate of 17.0 per cent (2006: 31.6 per cent). The effective tax rate is below the standard UK corporation tax rate as a result of the gains on disposals being either exempt from tax or covered by capital losses arising in earlier years, a deferred income tax credit following the reduction in the corporation tax rate announced in the 2007 Finance Act, and credits arising on policyholder interests. Under IFRS, the income statement includes a corresponding charge for policyholder interests within the Group's profit before tax. Excluding these items the Group's effective rate of tax was 28.3 per cent.

The 2007 Finance Act reduction in corporation tax rate from 30 per cent to 28 per cent resulted in a one-off impairment charge of £28 million before tax (£20 million after tax), relating to a reduction in future rental income within the Group's leasing business. In addition, the Group's deferred tax liabilities at 31 December 2007 were reduced, resulting in a credit to the Group's tax charge of £110 million. The net impact of these items has been to increase earnings attributable to shareholders by £90 million during the year.

Delivering accelerated earnings momentum, whilst improving profitability and returns

2007 has been a challenging year for all banks, however Lloyds TSB's high quality, more conservative business model has withstood the difficulties of global financial markets turbulence. Strong earnings momentum has continued in the UK retail banking and insurance businesses, and our relationship focused Corporate and Commercial businesses have also continued to perform well. These strong performances have resulted in a good level of income growth which, combined with excellent cost control, has resulted in strong underlying profit momentum. The Group has also continued to maintain satisfactory asset quality. Encouragingly, this performance has not come at the expense of returns, as the Group has continued to improve both its return on equity and return on risk-weighted assets. As a result, the Group is well placed to maintain the recent momentum established throughout the business, and we expect to continue to perform well in 2008.

> **"The Group is well placed to maintain the recent momentum established throughout the business, and we expect to continue to perform well in 2008."**

Summarised segmental analysis

2007	UK Retail Banking £m	Insurance and Investments** £m	Wholesale and International Banking £m	Central group items £m	Group excluding insurance gross up £m	Insurance gross up** £m	Group £m
Net interest income	3,783	68	2,518	(738)	5,631	461	6,092
Other income	1,797	1,900	1,773	362	5,832	6,804	12,636
Total income	5,580	1,968	4,291	(376)	11,463	7,265	18,728
Insurance claims	–	(302)	–	–	(302)	(7,220)	(7,522)
Total income, net of insurance claims	5,580	1,666	4,291	(376)	11,161	45	11,206
Operating expenses	(2,548)	(636)	(2,282)	(6)	(5,472)	(19)	(5,491)
Trading surplus (deficit)	3,032	1,030	2,009	(382)	5,689	26	5,715
Impairment	(1,224)	–	(572)	–	(1,796)	–	(1,796)
Profit (loss) before tax*	1,808	1,030	1,437	(382)	3,893	26	3,919
Volatility							
– Insurance	–	(267)	–	–	(267)	–	(267)
– Policyholder interests	–	–	–	–	–	(233)	(233)
Profit on sale of businesses	–	272	385	–	657	–	657
Settlement of overdraft claims	(76)	–	–	–	(76)	–	(76)
Profit (loss) before tax	1,732	1,035	1,822	(382)	4,207	(207)	4,000

2006	UK Retail Banking £m	Insurance and Investments** £m	Wholesale and International Banking £m	Central group items £m	Group excluding insurance gross up £m	Insurance gross up** £m	Group £m
Net interest income	3,642	56	2,177	(593)	5,282	78	5,360
Other income	1,621	1,740	2,035	201	5,597	8,306	13,903
Total income	5,263	1,796	4,212	(392)	10,879	8,384	19,263
Insurance claims	–	(200)	–	–	(200)	(8,369)	(8,569)
Total income, net of insurance claims	5,263	1,596	4,212	(392)	10,679	15	10,694
Operating expenses	(2,476)	(646)	(2,264)	(51)	(5,437)	8	(5,429)
Trading surplus (deficit)	2,787	950	1,948	(443)	5,242	23	5,265
Impairment	(1,238)	–	(308)	(9)	(1,555)	–	(1,555)
Profit (loss) before tax*	1,549	950	1,640	(452)	3,687	23	3,710
Volatility							
– Insurance	–	84	–	–	84	–	84
– Policyholder interests	–	–	–	–	–	326	326
Pension schemes related credit	–	–	–	128	128	–	128
Profit (loss) before tax	1,549	1,034	1,640	(324)	3,899	349	4,248

* Excluding volatility, profit on sale of businesses, the settlement of overdraft claims in 2007 and the pension schemes related credit in 2006.

** The Group's income statement includes income and expenditure which are attributable to the policyholders of the Group's long-term assurance funds. These items have no impact upon the profit attributable to equity shareholders. In order to provide a clearer representation of the underlying trends within the Insurance and Investments segment, these items are shown within a separate column in the segmental analysis above.

Divisional results

UK Retail Banking

Our business

UK Retail Banking provides a wide range of banking and financial services through our diversified, proprietary distribution network and highly recognised and well-regarded brands (Lloyds TSB, Cheltenham & Gloucester and Scottish Widows) to some 16 million personal customers through over 2,000 branches across the UK. We are the UK's largest personal current account bank with over 12 million current account customers, have the largest number of internet banking customers in the UK and operate 11 call centres, all in the UK, taking 70 million calls per year. Lloyds TSB has been voted the most trusted bank in Britain for seven years running.

Our strategy

UK Retail Banking's strategic priorities are to grow revenue from its existing customer base; expand its customer franchise; and continuously improve productivity and efficiency.

We believe Lloyds TSB can excel through focusing on the needs of our customers. UK Retail Banking's strategy is customer centric with our vision being to help our customers succeed financially so that they reward us with more of their business, stay with us longer and recommend us to others. To deliver this we aim to maximise our advantaged distribution position, our superior risk management skills and our customer understanding and analytical capability whilst developing superior customer focused products, creating a culture of needs based sales and building life long relationships with our customers. Our people remain a competitive advantage.

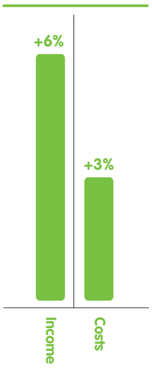
UK Retail Banking results

	2007 £m	2006 £m
Net interest income	3,783	3,642
Other income	1,797	1,621
Total income	5,580	5,263
Operating expenses*	(2,548)	(2,476)
Trading surplus	3,032	2,787
Impairment	(1,224)	(1,238)
Profit before tax*	1,808	1,549
Cost:income ratio*	45.7%	47.0%
Post-tax return on average risk-weighted assets*	2.13%	1.76%

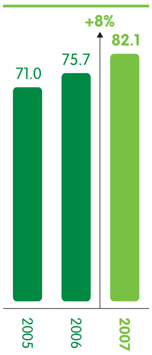
* Excluding the settlement of overdraft claims.

	31 December 2007 £bn	31 December 2006 £bn
Total assets	115.0	108.4
Risk-weighted assets	61.7	59.1
Customer deposits	82.1	75.7

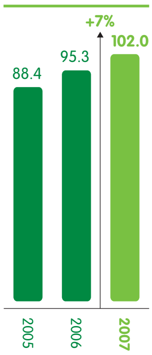
Income and cost growth 2007†



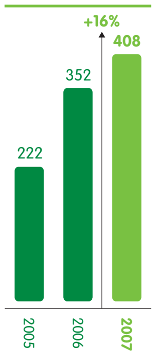
Customer deposits £bn



Group UK mortgage balances £bn



Target customer recruitment 000s



† Excluding the settlement of overdraft claims.

Divisional results

Key highlights

- **Excellent profit performance.** Profit before tax increased by 17 per cent to £1,808 million, excluding the settlement of overdraft claims.
- **Strong income momentum**, up 6 per cent, supported by overall sales growth of 17 per cent.
- **Excellent progress in growing the current account customer franchise**, with over 1 million new current accounts opened, an increase of 17 per cent. New Added Value Accounts increased by 79 per cent. Lloyds TSB is now the UK market leader in new current account customer recruitment.
- **Strong growth in savings deposits** resulted in an 11 per cent increase in savings balances, with 15 per cent growth in bank savings.
- **Stabilisation in net interest margin**, with net interest margin in the second half of 2007 1 basis point higher than in the first half of 2007.
- **Continued good cost management**, with a clear focus on investing to improve service quality and processing efficiency. Excluding the impact of the settlement of overdraft claims, operating expenses increased by 3 per cent and there was a substantial improvement in the cost:income ratio to 45.7 per cent.
- **The quality of new lending continues to be strong.** Arrears levels have continued to improve and the impairment charge in 2007 was lower than in 2006. Whilst the economic outlook for 2008 is uncertain, we do not expect to experience a significant change in the retail impairment charge in the first half of 2008, compared to the first half of 2007.
- **Improved return on risk-weighted assets**, reflecting the impact of double-digit profit growth exceeding the increase in risk-weighted assets.

During 2007, UK Retail Banking continued to make substantial progress in each of its key strategic priorities: growing income from its existing customer base; expanding its customer franchise; and improving productivity and efficiency. In each of these areas, a key focus has been on improving sales of recurring income products, such as current accounts and savings products which, combined with higher lending related income, has supported the accelerating rate of revenue growth.

Profit before tax from UK Retail Banking increased by £183 million, or 12 per cent, to £1,732 million, reflecting strong levels of franchise growth, excellent cost management and a slightly reduced impairment charge. Excluding the settlement of overdraft claims, profit before tax increased by 17 per cent to £1,808 million. Total income increased by £317 million, or 6 per cent, supported by higher income from current accounts, savings and personal lending.

The adverse mix effect of strong growth in finer margin mortgages and flat wider margin unsecured personal lending led to an overall reduction in the division's net interest margin. Product margins on a year-on-year basis fell slightly reflecting competitive pressures in the mortgage business in the first half of 2007 which more than offset an increase in retail savings margins. Towards the end of the year, new business margins in the mortgage business started to improve and this supported a stabilisation in the UK Retail Banking net interest margin in the second half of the year, compared to the first half.

Operating expenses remained well controlled, increasing by 3 per cent, excluding the settlement of overdraft claims. Significant improvements have been made in the rationalisation of back office operations to improve efficiency and we continue to increase the proportion of front office to back office staff in the branch network.

Growing income from the customer base

The Retail Bank has continued to make excellent progress, with further strong growth in product sales and continued good revenue growth. We continue to deliver a very strong performance in the growing savings and investment market, especially in bank savings where we have recently benefited from a significantly improved rate of deposit growth.

> **"Overall sales increased by 17 per cent, with improvements over a broad range of products, especially current accounts, credit cards and bank savings products."**

Overall sales increased by 17 per cent, with improvements over a broad range of products, especially current accounts, credit cards and bank savings products. Sales volumes were particularly strong in the branch network with an increase of 24 per cent. This continued strong sales growth has been driven from high levels of product innovation over the last twelve months with the successful launch of a number of enhanced savings products, an improved range of added value current accounts and the introduction of the innovative Lloyds TSB Duo Airmiles credit card offer. Customer deposits have increased strongly, by 8 per cent over the last twelve months, with particularly strong progress in growing our bank savings and wealth management deposit balances, with increases of 15 per cent and 12 per cent respectively.

Current account and savings balances	31 December 2007 £m	31 December 2006 £m
Bank savings	41,976	36,417
C&G deposits	14,861	14,621
Wealth management	4,939	4,402
UK Retail Banking savings	61,776	55,440
Current accounts	20,305	20,221
Total customer deposits	82,081	75,661

The Group has delivered good levels of mortgage growth, focusing on prime mortgage business and seeking to maintain economic returns. However, as we have previously indicated, our market share of net new mortgage lending in the second half of the year was below our outstanding stock position, reflecting our continued focus on writing value-creating business. The Group continues to focus on those segments of the mortgage market where value can be created while adopting a conservative approach to credit risk. As a result of our focus on managing for value and the recent marketwide increase in interest spreads, new business net interest margins have strengthened. Recent levels of mortgage allocations have been stronger and we expect this to translate into robust balance growth as we move into 2008.

Gross new mortgage lending for the Group totalled £29.4 billion (2006: £27.6 billion). Mortgage balances outstanding increased by 7 per cent to £102.7 billion and net new lending totalled £6.7 billion, resulting in a market share of net new lending of approximately 6.2 per cent.

We have maintained our market leadership position in personal loans, despite tightened credit criteria and a slowdown in consumer demand. Unsecured consumer credit balances were broadly flat with personal loan balances outstanding at 31 December 2007 marginally higher at £11.2 billion, and credit card balances slightly lower at £6.6 billion.

Expanding the customer franchise

In addition to the strong growth in product sales from existing customers, the Group has continued to make progress in expanding its customer franchise. Current account recruitment increased by 17 per cent, compared with last year, supported by the range of added value current accounts, in particular the Silver Account focusing on foreign nationals. During 2007, the Group opened more than 1 million new current accounts.

"During 2007, the Group opened more than 1 million new current accounts."

Wealth Management continues to make good progress with its expansion plans, and over 260 advisers have now been trained on an enhanced wealth management offer comprising private banking, open architecture portfolio management, retirement planning, insurance and estate planning services. As a result, new Investment Portfolio cases increased by 42 per cent and overall wealth management clients increased by 11 per cent. Total new assets under management increased by 42 per cent and wealth management banking deposits grew by 12 per cent.

In June 2007, the Group launched the Lloyds TSB Airmiles Duo account, a new, innovative and exclusive credit card that offers a 'two in one' easy to manage account, with one PIN, one statement and two cards, an American Express and a MasterCard on which customers can earn Airmiles. The demand for this new product has been extremely strong, and over 700,000 cards have been issued to a generally more transactional, high quality, customer segment. As a result, Lloyds TSB was the UK market leader in new credit card issuance during 2007, and now has the largest and fastest growing loyalty credit card programme in the UK.

Improving productivity and efficiency

We have continued to make significant progress in reducing levels of administration and processing work carried out in branches and, as a result, we have increased the number of dedicated customer facing branch network staff by some 4,000 over the last 2 years. Over the same period, branch network staff time spent on back office administration work has reduced from approximately 35 per cent to around 5 per cent. This has enabled us to increase our focus on meeting our customers' needs and has supported the substantially improved branch network sales productivity and service efforts. These improvements have led to the retail banking cost:income ratio, excluding the impact of the settlement of overdraft claims, improving to 45.7 per cent, from 47.0 per cent last year.

In Telephone Banking we have continued to invest in our market leading speech recognition technology which has supported significant growth in the number of customers using our automated service. This, combined with further improvements in the efficiency of our contact centre operations, has led to all customer service calls now being answered from UK based centres.

Impairment levels slightly decreased

Impairment losses on loans and advances decreased by £14 million, or 1 per cent, to £1,224 million, largely reflecting a reduction in the level of customer insolvencies and the quality of new lending. In addition, collections procedures continue to improve, a particularly important competitive advantage in a slowing consumer environment, and we achieved better than assumed recoveries. The impairment charge as a percentage of average lending improved to 1.10 per cent, compared to 1.18 per cent last year. Over 99 per cent of new personal loans and 89 per cent of new credit cards sold during 2007 were to existing customers, where the Group has a better understanding of an individual customer's total financial position. The level of arrears in the personal loan and credit card portfolios reduced during 2007, whilst overdraft arrears remained stable.

"We remain very confident in the quality of our mortgage portfolio."

Mortgage credit quality remains excellent with the impairment charge remaining at a low level of £18 million, or 2 basis points of average mortgage lending. Arrears in the mortgage business have also fallen. In Cheltenham & Gloucester, the average indexed loan-to-value ratio on the mortgage portfolio was 43 per cent, and the average loan-to-value ratio for new mortgages and further advances written during 2007 was 63 per cent. At 31 December 2007, only 1.7 per cent of balances had an indexed loan-to-value ratio in excess of 95 per cent. We extensively stress-test our lending to changes in macroeconomic conditions and we remain very confident in the quality of our mortgage portfolio.

Insurance and Investments

Our business

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

The Scottish Widows brand is the main brand for new sales of Lloyds TSB Group's life, pensions, Open Ended Investment Companies and other long-term savings products.

Lloyds TSB General Insurance is the leading distributor of home insurance in Britain, with products distributed through Lloyds TSB Group channels and strategic corporate partners.

Scottish Widows Investment Partnership (SWIP) manages funds for Lloyds TSB Group's retail life, pensions and investment products. Other key clients cover both the retail and institutional segments, with SWIP occupying a top 3 position in terms of retail funds under management. SWIP has close to £100 billion of funds under management.

Our strategy

Insurance and Investments' strategic priorities are maximising bancassurance success, profitably growing IFA sales, improving service and operational efficiency and optimising capital management.

Within Scottish Widows this will be achieved by developing strong and enduring relationships, developing market-led propositions and being easy to do business with. Scottish Widows products are distributed through Lloyds TSB Group channels, independent financial advisers and other intermediaries. Scottish Widows was voted Best Individual Pensions Provider by IFAs and is the most trusted choice for pensions amongst UK consumers.

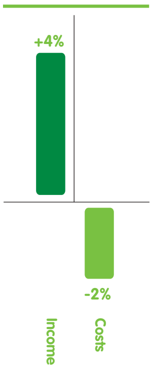
Lloyds TSB General Insurance is targeting growing share in chosen customer segments, developing key insurance partnerships, improving margins by better customer management and improving service and efficiency.

Insurance and Investments results

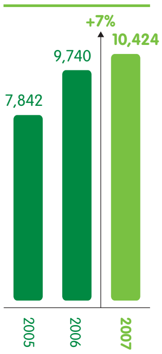
Excluding volatility and profit on disposal of businesses	2007 £m	2006 £m
Net interest income*	68	56
Other income*	1,900	1,740
Total income	1,968	1,796
Insurance claims*	(302)	(200)
Total income, net of insurance claims	1,666	1,596
Operating expenses*	(636)	(646)
Insurance grossing adjustment (page 14)	26	23
Profit before tax	1,056	973
Profit before tax analysis		
Life, pensions and OEICs	884	701
General insurance	128	243
Scottish Widows Investment Partnership	44	29
Profit before tax	1,056	973
Present value of new business premiums (PVNBP)	10,424	9,740
PVNBP new business margin (EEV basis)	3.1%	3.6%
Post-tax return on embedded value	9.9%	9.3%

* Excluding insurance grossing adjustment.

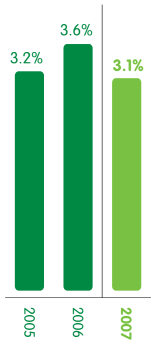
Income and cost growth* 2007



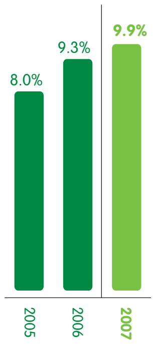
New business sales (PVNBP) £m



New business margin (PVNBP)†



Return on embedded value†



* Excluding volatility and insurance grossing.

† EEV basis.

Key highlights

- **Strong profit performance.** Profit before tax increased by 9 per cent to £1,056 million. Adjusting for the impact of surplus capital repatriation, profit before tax increased by 13 per cent.
- **Good income growth and excellent cost control.** Income, net of insurance claims and adjusting for the impact of surplus capital repatriation, increased by 7 per cent. Operating expenses decreased by 2 per cent.
- **Good sales performance.** 7 per cent increase in Scottish Widows' present value of new business premiums. Strong progress in increasing bancassurance sales, up 20 per cent. Good performance in the sale of protection products, corporate pensions and retirement income products.
- **Improved returns.** On an EEV basis, the post-tax return on embedded value increased to 9.9 per cent. New business margin was robust at 3.1 per cent.
- **Robust capital position.** Scottish Widows continues to deliver improving capital efficiency and self-financing growth, and a further £1.9 billion of capital was repatriated to the Group during 2007.
- **Increased weather related claims** of £113 million, largely relating to the severe flooding in the UK in June and July, contributed to a 47 per cent reduction in profit before tax in General Insurance.
- **Excellent performance in Scottish Widows Investment Partnership.** Profit before tax increased by 52 per cent reflecting higher margins and improved mix of external business.

Scottish Widows life, pensions and OEICs

Profit before tax increased by £183 million, or 26 per cent, to £884 million. The effect of surplus capital repatriation to the Group has been to reduce investment earnings by a total of £36 million in 2007. Adjusting 2006 for this, profit before tax increased by 33 per cent.

Life and pensions new business profit, on an IFRS basis and excluding volatility, reduced by 5 per cent to £163 million reflecting a change in the mix of investment products sold through the branch network towards non-embedded value accounted products. Total existing business profit grew by 43 per cent to £551 million, partly reflecting increased profits from the growing OEIC portfolio, improved cost management and a reduction in adverse assumption changes compared to 2006. The expected return on shareholders' net assets increased by 43 per cent to £192 million as a result of a higher volume of free assets, driven by strong equity markets and the impact of regulatory changes in 2006, and a higher expected rate of return.

During 2007, Scottish Widows has continued to make strong progress in each of its key business priorities: to maximise bancassurance success; to profitably grow IFA sales; to improve service and operational efficiency; and to optimise capital management.

> **"During 2007, Scottish Widows has continued to make strong progress in each of its key business priorities."**

Maximising bancassurance success

In 2007, the value of Scottish Widows' bancassurance new business premiums increased by 20 per cent, building on the success of the simplified product range for distribution through the Lloyds TSB branch network, Commercial Banking and Wealth Management channels. Sales of protection products were particularly strong. A new branch network creditor insurance and protection product, which replaced an externally provided creditor product, has led to the significant increase in protection sales during 2007. In addition, Scottish Widows launched a new protection product, 'Protection for Life' towards the end of 2006, which has performed very well. We have continued to deliver good sales of OEICs following the more than doubling of sales in 2006.

Profitably growing IFA sales

Sales through the IFA distribution channel increased by 2 per cent, following record A-day related sales levels in 2006. Scottish Widows has continued to focus on the more profitable business areas within the IFA market. Sales of savings and investment products were lower as we chose not to compete in areas which deliver unsatisfactory returns, although this was partly offset by good growth in OEIC sales. Corporate pensions volumes remained strong following excellent growth last year and our managed fund business also showed good improvement.

Improving service and operational efficiency

The business has made continued improvements in service and operational efficiencies, and the benefits can be seen in a reduction of expenses by 2 per cent compared to prior year, notwithstanding the introduction of a number of new products. In addition, customer satisfaction is at its highest ever level. Scottish Widows received a number of awards for service quality and product innovation, including 'Best Individual Pensions Provider' at the Financial Adviser awards whilst maintaining its top quartile position for lowest servicing and acquisition costs per policy.

Optimising capital management

Scottish Widows has maintained its strong focus on improving capital management. During 2007 Scottish Widows continued to deliver a more capital efficient product profile and improved internal rates of return. The post-tax return on embedded value, on an EEV basis, increased to 9.9 per cent, from 9.3 per cent last year. During 2007, £1.9 billion of capital was repatriated to the Group, giving a total capital repatriation of over £3.6 billion since the beginning of 2005.

Present value of new business premiums (PVNBP)	2007 £m	2006 £m
Life and pensions:		
Protection	960	232
Savings and investments	913	1,300
Individual pensions	2,073	2,219
Corporate and other pensions	2,141	1,961
Retirement income	1,044	960
Managed fund business	486	348
Life and pensions	7,617	7,020
OEICs	2,807	2,720
Life, pensions and OEICs	10,424	9,740
Single premium business	8,375	7,321
Regular premium business	2,049	2,419
Life, pensions and OEICs	10,424	9,740
Bancassurance	4,096	3,421
Independent financial advisers	5,817	5,706
Direct	511	613
Life, pensions and OEICs	10,424	9,740

Results on a European Embedded Value (EEV) basis

Lloyds TSB continues to report under IFRS, however, in line with industry best practice, the Group provides supplementary financial reporting for Scottish Widows on an EEV basis. The Group believes that EEV represents the most appropriate measure of long-term value creation in life assurance and investment businesses.

	2007 Life, pensions and OEICs £m	2006 Life, pensions and OEICs £m
New business profit	326	346
Existing business		
– Expected return	337	403
– Experience variances	78	69
– Assumption changes	(45)	(133)
	370	339
Expected return on shareholders' net assets	207	131
Profit before tax, adjusted for capital repatriation*	903	816
Impact of surplus capital repatriation to Group	–	36
Profit before tax*	903	852
New business margin (PVNBP)	3.1%	3.6%
Embedded value (year end)	£5,365m	£6,413m
Post-tax return on embedded value*	9.9%	9.3%

* Excluding volatility and other items.

Adjusting for the impact of capital repatriation, EEV profit before tax from the Group's life, pensions and OEICs business increased by 11 per cent to £903 million.

New business profit fell by £20 million, or 6 per cent, to £326 million, largely reflecting the impact of a higher risk-free discount rate and changes in other economic assumptions applied to new business. This was however offset by a corresponding credit to the expected return on shareholders' net assets.

Existing business profit increased by 9 per cent. Expected return decreased by 16 per cent to £337 million, primarily reflecting a lower shareholder benefit this year from the reduction in the value of realistic balance sheet liabilities and the impact of regulatory changes in 2006. Positive experience variances were driven by higher annuity profits from Abbey Life. Overall lapse experience was broadly in line with the Group's expectations, as higher lapse experience in the life and pensions business was broadly offset by a favourable experience in OEICs. Assumption changes primarily reflect changes to the longer term lapse assumptions for both life and pensions business and OEICs. The expected return on shareholders' net assets increased by £76 million, as a result of a higher volume of free assets, driven by strong equity markets and the impact of regulatory changes in 2006, and a higher expected rate of return.

Overall the post-tax return on embedded value increased to 9.9 per cent from 9.3 per cent. Scottish Widows maintained a strong new business margin of 3.1 per cent. Individual new business product margins remained broadly stable. The overall new business margin fell by 50 basis points however, as a result of an adverse impact from a higher risk-free discount rate and changes in other economic assumptions applied to new business and the shift in product mix resulting from the insourcing of a new branch network creditor insurance and protection product. This product generates a lower new business margin, but delivers good levels of value for the Group.

Scottish Widows Investment Partnership

Pre-tax profit from Scottish Widows Investment Partnership (SWIP) increased by 52 per cent to £44 million, reflecting increased profitability resulting from higher margins and an improved mix of external business, a key strategic priority for SWIP. Over the last 12 months, SWIP's assets under management decreased by £4.1 billion to £97.6 billion, reflecting the decision by the Trustees of the Lloyds TSB pension schemes to move £5.7 billion into external passive management. As a result, institutional funds under management reduced by £5.0 billion. The net movement in retail funds, net of expenses and commissions, was an increase of £2.9 billion.

Movements in funds under management

The following table highlights the movement in retail and institutional funds under management.

	2007 £bn	2006 £bn
Opening funds under management	105.7	97.5
Movement in Retail Funds		
Premiums	11.7	11.7
Claims	(4.8)	(3.6)
Surrenders	(6.4)	(5.4)
Net inflow of business	0.5	2.7
Investment return, expenses and commission	2.4	6.0
Net movement	2.9	8.7
Movement in Institutional Funds		
Lloyds TSB pension schemes	(5.7)	–
Other institutional funds	(0.6)	(1.3)
Investment return, expenses and commission	1.3	1.5
Net movement	(5.0)	0.2
Proceeds from sale of Abbey Life	1.0	–
Dividends and surplus capital repatriation	(1.9)	(0.7)
Closing funds under management	102.7	105.7
Managed by SWIP	97.6	101.7
Managed by third parties	5.1	4.0
Closing funds under management	102.7	105.7

Including assets under management within our UK Wealth Management and International Private Banking businesses, Groupwide funds under management decreased by 3 per cent to £122.8 billion.

European Embedded Value reporting - results for year ended 31 December 2007

This section provides further details of the Scottish Widows EEV financial information.

Composition of EEV balance sheet

	2007 £m	2006 £m
Value of in-force business (certainty equivalent)	2,779	3,220
Value of financial options and guarantees	(53)	(56)
Cost of capital	(178)	(248)
Non-market risk	(61)	(75)
Total value of in-force business	2,487	2,841
Shareholders' net assets	2,878	3,572
Total EEV of covered business	5,365	6,413

Reconciliation of opening EEV balance sheet to closing EEV balance sheet on covered business

	Shareholders' net assets £m	Value of in-force business £m	Total £m
As at 1 January 2006	3,445	2,941	6,386
Total profit after tax	873	(100)	773
Dividends	(746)	–	(746)
As at 31 December 2006	3,572	2,841	6,413
Total profit after tax	661	107	768
Profit on disposal of Abbey Life (EEV basis)			
– Sale proceeds	985	–	985
– Assets disposed	(474)	(461)	(935)
	511	(461)	50
Dividends	(1,866)	–	(1,866)
As at 31 December 2007	2,878	2,487	5,365

Analysis of shareholders' net assets on an EEV basis on covered business

	Required capital £m	Free surplus £m	Shareholders' net assets £m
As at 1 January 2006	2,393	1,052	3,445
Total profit after tax	(186)	1,059	873
Dividends	–	(746)	(746)
As at 31 December 2006	2,207	1,365	3,572
Total (loss) profit after tax	(238)	899	661
Disposal of Abbey Life (EEV basis)	(232)	743	511
Dividends	–	(1,866)	(1,866)
As at 31 December 2007	1,737	1,141	2,878

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Summary income statement on an EEV basis

	2007 £m	2006 £m
New business profit	326	346
Existing business profit		
– Expected return	337	403
– Experience variances	78	69
– Assumption changes	(45)	(133)
	370	339
Expected return on shareholders' net assets	207	167
Profit before tax, excluding volatility and other items*	903	852
Volatility	(271)	176
Other items*	58	76
Total profit before tax	690	1,104
Taxation	(59)	(331)
Impact of Corporation tax rate change	137	–
Total profit after tax, excluding profit on sale of Abbey Life	768	773
Profit on sale of Abbey Life (EEV basis)	50	–
Total profit after tax	818	773

* Other items represent amounts not considered attributable to the underlying performance of the business.

Breakdown of income statement between life and pensions, and OEICs

2007	Life and pensions £m	OEICS £m	Total £m
New business profit	270	56	326
Existing business			
– Expected return	286	51	337
– Experience variances	35	43	78
– Assumption changes	(105)	60	(45)
	216	154	370
Expected return on shareholders' net assets	199	8	207
Profit before tax*	685	218	903
New business margin (PVNBP)	3.5%	2.0%	3.1%
Post-tax return on embedded value*			9.9%

2006	Life and pensions £m	OEICS £m	Total £m
New business profit	287	59	346
Existing business			
– Expected return	361	42	403
– Experience variances	35	34	69
– Assumption changes	(129)	(4)	(133)
	267	72	339
Expected return on shareholders' net assets	160	7	167
Profit before tax*	714	138	852
New business margin (PVNBP)	4.1%	2.2%	3.6%
Post-tax return on embedded value*			9.3%

* Excluding volatility and other items.

Economic assumptions

A bottom up approach is used to determine the economic assumptions for valuing the business in order to determine a market consistent valuation.

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

	31 December 2007 %	31 December 2006 %
Risk-free rate (value of in-force)	**4.65**	4.72
Risk-free rate (financial options and guarantees)	**4.28 to 4.81**	3.91 to 5.41
Retail price inflation	**3.28**	3.23
Expense inflation	**4.18**	4.13

Non-market risk

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the With Profit Fund these are asymmetric in the range of potential outcomes for which an explicit allowance is made.

Non-economic assumptions

Future mortality, morbidity, lapse and paid-up rate assumptions are reviewed each year and are based on an analysis of past experience and on management's view of future experience. These assumptions are intended to represent a best estimate of future experience.

For OEIC business, the lapse assumption is based on recent experience which has been collected over a period that has coincided with favourable investment conditions. Management have used a best estimate of the long-term lapse assumption which is higher than indicated by this experience. In management's view, the approach and lapse assumption are both reasonable.

Sensitivity analysis

The table below shows the sensitivity of the EEV and the new business profit before tax to movements in some of the key assumptions. The impact of a change in the assumption has only been shown in one direction other than for risk free rate. Where the impact has been shown only in one direction it can be assumed to be reasonably symmetrical.

	Impact on EEV £m	Impact on new business profit before tax £m
2007 EEV/new business profit before tax	**5,365**	**326**
100 basis points reduction in risk-free rate[1]	161	7
100 basis points increase in risk-free rate[1]	(115)	(7)
10 per cent reduction in market values of equity assets[2]	(178)	n/a
10 per cent reduction in market values of property assets[3]	(32)	n/a
10 per cent reduction in expenses[4]	96	31
10 per cent reduction in lapses[5]	88	19
5 per cent reduction in annuitant mortality[6]	(64)	(5)
5 per cent reduction in mortality and morbidity (excluding annuitants)[7]	22	3
100 basis points increase in equity and property returns[8]	nil	nil
10 basis points increase in credit spreads[9]	(46)	(6)

1 In this sensitivity the impact takes into account the change in the value of in-force business, financial options and guarantee costs, statutory reserves and asset values.

2 The reduction in market values is assumed to have no corresponding impact on dividend yields.

3 The reduction in market values is assumed to have no corresponding impact on rental yields.

4 This sensitivity shows the impact of reducing new business maintenance expenses and investment expenses to 90 per cent of the expected rate.

5 This sensitivity shows the impact of reducing lapse and surrender rates to 90 per cent of the expected rate.

6 This sensitivity shows the impact on our annuity and deferred annuity business of reducing mortality rates to 95 per cent of the expected rate.

7 This sensitivity shows the impact of reducing mortality rates on non-annuity business to 95 per cent of the expected rate.

8 Under a market consistent valuation, changes in assumed equity and property returns have no impact on the EEV.

9 This sensitivity shows the impact of a 10 basis point increase in corporate bond yields and the corresponding reduction in market values. Government bond yields and the risk-free rate are assumed to be unchanged.

In sensitivities 4 to 7 assumptions have been flexed on the basis used to calculate the value of in-force business and the realistic and the statutory reserving bases. A change in risk discount rates is not relevant as the risk discount rate is not an input to a market consistent valuation.

General insurance

	2007 £m	2006 £m
Commission receivable	**648**	629
Commission payable	**(692)**	(664)
Underwriting income (net of reinsurance)	**591**	600
Other income	**37**	35
Net operating income	**584**	600
Claims paid on insurance contracts (net of reinsurance)	**(302)**	(200)
Operating income, net of claims	**282**	400
Operating expenses	**(154)**	(157)
Profit before tax	**128**	243
Claims ratio	**49%**	32%
Combined ratio	**93%**	80%

Profit before tax from our general insurance operations decreased by £115 million, to £128 million, largely as a result of a £113 million increase in weather related claims, primarily reflecting severe flooding in the UK in June and July. Net operating income decreased by 3 per cent whilst costs were reduced by 2 per cent.

Net operating income decreased by £16 million, or 3 per cent, as growth in home and loan protection income was more than offset by lower motor insurance income, increased reinsurance costs and the run-off from the legacy health portfolio. Our continued focus on improving operational efficiency and improving the effectiveness of our marketing spend has resulted in a £3 million, or 2 per cent, reduction in operating costs, whilst also continuing to improve processing efficiency.

Overall sales performance has been good with an 8 per cent increase in new business gross written premiums (GWP). Home insurance sales through the branch network continue to perform well with 14 per cent growth in new business GWP. We have, however, scaled back our participation in the distribution of home insurance through direct channels, as a result of the increasingly competitive pricing in that area of the market. During the year we continued to invest in product development, with loan protection and home insurance products both securing industry leading external quality ratings.

Income, net of claims, was £118 million lower, largely as a result of the increased extreme weather related claims, following a benign period in 2006. As a result, overall claims increased by £102 million, and key underwriting ratios were significantly affected with an increase in the claims ratio to 49 per cent, and an increase in the combined ratio to 93 per cent. Adjusting for the extreme weather related claims, the claims ratio improved, reflecting both a favourable claims experience in our home insurance underwriting and the impact of recent investment in improving the efficiency of our claims processing.

The business continues to invest in the development of its Corporate Partnership distribution arrangements and the performance of the Pearl business acquired in 2006 has exceeded our initial expectations.

Wholesale and International Banking

Our business

Our businesses within the Wholesale and International Banking arena cover a broad scope, serving thousands of customers, ranging from start-ups and small enterprises to large organisations and global corporations. Combining the respective strengths of some 3,000 people in Corporate Banking and Products & Markets, Corporate Markets plays an integral role in leveraging and expanding the customer franchise and building deep, long-lasting relationships with around 17,000 corporate customers and was awarded with 'Real Finance/CBI FDs' Excellence Awards – Corporate Bank of the Year' for the third year running. Commercial Banking is a growing business with some 5,500 people serving nearly one million customers across the UK from one-person start-ups to large, established enterprises. Lloyds TSB Group has a leading share of the new business start-up market, with some 120,000 new businesses opening an account in 2007. We also participate in specialist markets with a range of solutions including personal and international expatriate and private banking, motor and leisure finance and auto leasing.

Our strategy

The Wholesale and International Banking strategic vision is to be the best UK mid-market focused wholesale bank and to compete successfully in selected, relevant global markets. Our key strategic priorities are to grow the Corporate Markets business; build on the growth momentum in Commercial Banking; and maintain strong asset quality.

Making Wholesale and International Banking a great place for our customers to bank is our number one priority. As a relationship bank, we place our customers at the forefront of our vision and we strive, with passion, to meet their needs. The way by which we manage our customer relationships is the vital ingredient in what differentiates us from our competition.

We use our strong product capabilities to support our new and existing customer relationships, with primary current focus being placed on the UK corporate segment in which energies and resource are directed to achieve gains in profitable market share thereby creating long term, sustainable relationships with our customers.

Wholesale and International Banking results

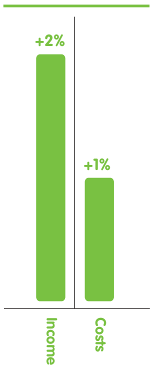
	2007 £m	2006 £m
Net interest income	2,518	2,177
Other income	1,773	2,035
Total income	4,291	4,212
Operating expenses	(2,282)	(2,264)
Trading surplus	2,009	1,948
Impairment	(572)	(308)
Profit before tax*	1,437	1,640
Cost:income ratio	53.2%	53.8%
Post-tax return on average risk-weighted assets*	1.13%	1.38%

	31 December 2007 £bn	31 December 2006 £bn
Total assets	163.3	147.8
Risk-weighted assets	105.1	91.8
Customer deposits	72.3	61.2

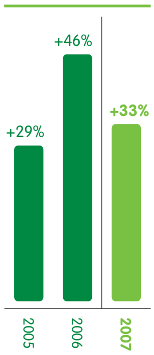
	2007 £m	2006 £m
Profit before tax by business unit*		
Corporate Markets		
– Before impact of market dislocation	1,132	1,030
– Impact of market dislocation	(280)	–
	852	1,030
Commercial Banking	451	398
Asset Finance	60	113
International Banking and other businesses	74	99
	1,437	1,640

* Excluding profit on sale of businesses.

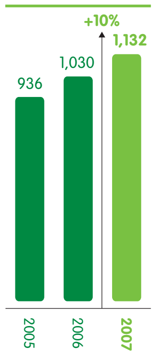
Income and cost growth 2007



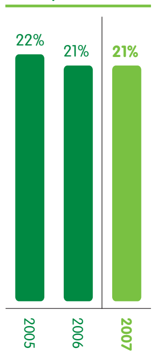
Growth in cross-selling income



Corporate Markets profit before tax £m†



Market share of Commercial Banking start-ups



† Before impact of market dislocation.

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Key highlights

- **Overall profits impacted by turbulence in global financial markets.** Whilst the division has limited exposure to assets affected by current capital market uncertainties, the impact of recent market dislocation has been to reduce profit before tax in 2007 by £280 million.
- **Continued relationship banking momentum.** Excluding the impact of market dislocation, profit before tax increased by 5 per cent.
- **Further good progress in expanding our Corporate Markets business**, with an 18 per cent increase in Corporate Markets income supporting a 10 per cent increase in profit before tax, excluding the impact of market dislocation.
- **Continued strong franchise growth in Commercial Banking**, with an 8 per cent growth in income and a 13 per cent growth in profit before tax. Lloyds TSB has retained its leading position as the bank of choice for start-up businesses.
- **Continued tight credit control in Asset Finance**, and a slowdown in demand in the consumer lending portfolio, led to a 47 per cent reduction in profit before tax.
- **Strong risk management and good asset quality**, despite a rise of £264 million in impairment losses, largely as a result of the £92 million impact of market dislocation, a £28 million provision reflecting the impact of the 2007 Finance Act on the division's leasing business, and a lower level of corporate releases and recoveries during the year.

In Wholesale and International Banking, the Group has continued to make significant progress in its strategy to develop the Group's strong corporate and small to medium business customer franchises and, in doing so, become the best UK mid-market focused wholesale bank. The division has continued to make substantial progress in its relationship banking businesses. In Commercial Banking, strong growth in business volumes, further customer franchise improvements and good progress in improving operational efficiency have resulted in continued strong profit growth. In Corporate Markets, further good progress has been made in developing our relationship banking franchise supported by a strong cross-selling performance.

Overall, the division's profit before tax decreased by 12 per cent, to £1,437 million, reflecting the £280 million reduction in profits as a result of market dislocation. Excluding this impact, profit before tax increased by 5 per cent, with a continued strong performance in our relationship banking businesses. This has generated overall income growth of 6 per cent, driven by strong Corporate Markets and Commercial Banking income growth of 18 per cent and 8 per cent respectively. This exceeded cost growth of 1 per cent, leading to a reduction in the cost:income ratio to 50.9 per cent, from 53.8 per cent last year. Trading surplus, excluding the impact of market dislocation, increased by £249 million, or 13 per cent, to £2,197 million.

"In Wholesale and International Banking, the Group has continued to make significant progress in its strategy to leverage the Group's strong corporate and small to medium business customer franchises."

The charge for impairment losses on loans and advances increased by £264 million to £572 million, largely as a result of the £92 million impact of market dislocation, a one-off £28 million impairment charge reflecting a reduction in rental income from operating lease activities following the corporation tax rate change included in the 2007 Finance Act, a lower level of releases and recoveries during the year and the impact of recent strong growth in the corporate lending portfolio. Overall corporate and SME asset quality remains good although we continue to expect some normalisation in the impairment charge over the next few years. We do believe, however, that we remain relatively well positioned as a result of our prudent credit management policy.

Divisional results

Corporate Markets	2007 £m	2006 £m
Net interest income	**1,104**	806
Other income		
– Before market dislocation	**808**	821
– Market dislocation	**(188)**	–
	620	821
Total income	**1,724**	1,627
Operating expenses	**(632)**	(615)
Trading surplus	**1,092**	1,012
Impairment		
– Before market dislocation	**(148)**	18
– Market dislocation	**(92)**	–
	(240)	18
Profit before tax	**852**	1,030

In Corporate Markets, profit before tax fell by 17 per cent, however, excluding the impact of market dislocation and the 2007 Finance Act, profit before tax increased by 13 per cent. On this basis, income increased by 18 per cent, supported by continued high levels of cross-selling income, strong growth in corporate lending and a higher level of income from venture capital investments. The strong growth in lending was supported by an increase of £4.7 billion in Group lending to property companies, to £17.6 billion. Two-thirds of this lending portfolio is commercial property lending supporting our existing customer franchise and reflects a well-spread nationwide portfolio. We adopt conservative credit criteria and the indexed loan-to-value of the portfolio is approximately 62 per cent. One third of the portfolio is residential lending, over half of which is to local authority backed public housing.

"Corporate Markets underlying income increased by 18 per cent, supported by continued high levels of cross-selling income."

Operating expenses increased by 3 per cent to £632 million, reflecting further investment in people to support ongoing business growth. The trading surplus, excluding market dislocation, increased by 26 per cent. The impairment charge of £240 million includes £92 million from the impact of market dislocation and the £28 million one-off charge relating to the impact of the 2007 Finance Act on the division's leasing business. Excluding these items, the underlying increase in the impairment charge reflects lower levels of releases and recoveries, recent strong growth in corporate customer lending and impairments relating to two special situations.

Commercial Banking	2007 £m	2006 £m
Net interest income	**890**	821
Other income	**429**	397
Total income	**1,319**	1,218
Operating expenses	**(769)**	(727)
Trading surplus	**550**	491
Impairment	**(99)**	(93)
Profit before tax	**451**	398

Profit before tax in Commercial Banking grew by £53 million, or 13 per cent, reflecting strong growth in business volumes, further improvements in growing the Commercial Banking customer franchise and progress in improving operational efficiency. Income increased by 8 per cent to £1,319 million, reflecting strong growth in lending and deposit balances, whilst costs were 6 per cent higher, as a result of increased investment to improve the operating platform. Commercial Banking continued to develop and grow its customer franchise strongly, with customer recruitment of 120,000 during 2007, reflecting its market-leading position in the start-up market with a market share of 21 per cent. We also made good progress in continuing to attract customers 'switching' from other financial services providers. Lloyds TSB Commercial Finance has continued to improve its strong market position, with a market share of approximately 20 per cent, measured by client numbers. Asset quality in the Commercial Banking portfolios remains good with impairment charges as a percentage of average lending reducing by 7 basis points to 0.60 per cent, partly reflecting our move to increase levels of secured lending.

"Income increased by 8 per cent to £1,319 million, reflecting strong growth in lending and deposit balances."

Asset Finance	2007 £m	2006 £m
Net interest income	299	331
Other income	472	529
Total income	771	860
Operating expenses	(483)	(508)
Trading surplus	288	352
Impairment	(228)	(239)
Profit before tax	60	113

Profit before tax in Asset Finance decreased by 47 per cent to £60 million, largely reflecting continued tight credit criteria and a slowdown in demand in the consumer lending portfolio which has led to a reduction in the level of new business underwritten. As a result, income decreased by £89 million, or 10 per cent. Costs were 5 per cent lower and the impairment charge decreased by £11 million to £228 million, reflecting the recent tightening of credit criteria, improved collections procedures and lower balances outstanding, which offset an increase in arrears. Conditions in the Motor Finance business remain challenging. New business volumes have reduced, reflecting the marketwide slowdown in consumer demand, and we have sought to avoid the structural contraction in interest margins. In Personal Finance, new business volumes have risen modestly in a fiercely competitive market. Our Contract Hire business, Autolease, has performed well by continuing to leverage its strong market position and efficient operation.

Central group items

	2007 £m	2006 £m
Lloyds TSB Foundations	(37)	(37)
Funding cost of acquisitions less earnings on capital	(378)	(378)
Central costs and other unallocated items	33	(37)
Pension schemes related credit	–	128
Loss before tax	**(382)**	(324)

The four independent Lloyds TSB Foundations support registered charities throughout the UK that enable people, particularly disabled and disadvantaged, to play a fuller role in society. The Foundations receive 1 per cent of the Lloyds TSB Group's pre-tax profit after adjusting for gains and losses on the disposal of businesses and pre-tax minority interests, averaged over three years, instead of a dividend on their shareholdings. In 2007, £37 million was accrued for payment to registered charities.

Following changes in age discrimination legislation in 2006, the Group ceased to augment the pension entitlement of employees taking early retirement; this change reduced the Group's defined benefit pension liability at 31 December 2006 by £129 million (£1 million of which was unrecognised) and resulted in a one-off credit to the 2006 income statement of £128 million.

Volatility

Banking volatility

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

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

Insurance volatility

The Group's insurance businesses have liability products that are supported by substantial holdings of investments, including equities, property and fixed interest investments, all of which have a volatile fair value. The value of the liabilities does not move exactly in line with changes in the fair value of the investments, yet IFRS requires that the changes in both the value of the liabilities and investments be reflected within the income statement. As these investments are substantial and movements in their fair value can have a significant impact on the profitability of the Insurance and Investments division, management believes that it is appropriate to disclose the division's results on the basis of an expected return in addition to the actual return. The difference between the actual return on these investments and the expected return based upon economic assumptions made at the beginning of the year is included within insurance volatility.

Changes in market variables also affect the realistic valuation of the guarantees and options embedded within products written in the Scottish Widows With Profit Fund, the value of the in-force business and the value of shareholders' funds. Fluctuations in these values caused by changes in market variables, including market spreads reflecting credit risk premia, are also included within insurance volatility. These market credit spreads represent the gap between the yield on corporate bonds and the yield on government bonds, and reflect the market's assessment of credit risk. Changes in the credit spreads affect the value of the in-force business asset in respect of the annuity portfolio.

The expected investment returns used to determine the normalised profit of the business, which are based on prevailing market rates and published research into historic investment return differentials, are set out below:

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

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

Policyholder interests volatility

As a result of the requirement under IFRS to consolidate the Group's life and pensions businesses on a line-by-line basis, the Group's income statement includes amounts attributable to policyholders which affect profit before tax; the most significant of these items is policyholder tax.

Under IFRS, tax on policyholder investment returns is required to be included in the Group's tax charge rather than being offset against the related income, as it is in actual distributions made to policyholders. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge. Other items classified within policyholder interests volatility include the effects of investment vehicles which are only majority owned by the long-term assurance funds. In the case of these vehicles, the Group's profit for the year includes the minorities' share of the profits earned. As set out below these amounts do not accrue to the equity holders, accordingly management believes a clearer representation of the underlying performance of the Group's life and pensions businesses is presented by excluding policyholder interests volatility.

	2007 £m	2006 £m
Net interest income	–	(33)
Other income	(233)	359
Profit before tax	(233)	326
Taxation – policyholder	243	(222)
Minority interests	(10)	(104)
Profit attributable to equity shareholders	–	–

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

Regulation

In the UK and elsewhere, there is continuing political and regulatory scrutiny of financial services. On 6 November 2007 the Competition Commission published its emerging thinking into the Payments Protection Inquiry and is expected to report by December 2008. The OFT is also carrying out a market study into personal current account pricing alongside its investigation into certain current account charges which are also subject to a legal test case. The OFT is also investigating interchange fees charged by some card networks in parallel with the European Commission's own investigation into cross-border interchange fees. At the same time regulators are considering the review of retail distribution and UK financial stability and depositor protection proposals. It is not presently possible to assess the cost or income impact of these inquiries or any connected matters on the Group until the outcome is known.

In addition, a number of EU directives, including the Unfair Commercial Practices Directive and Payment Services Directive are currently being implemented in the UK. The EU is also considering regulatory proposals for, inter alia, a Consumer Credit, Mortgage Credit, Single European Payments Area, Retail Financial Services Review and capital adequacy requirements for insurance companies (Solvency II). In the US, a major focus of governmental policy relating to financial institutions in recent years has been combating money laundering and terrorist financing and enforcing compliance with US economic sanctions, with serious legal and reputational consequences for any failures arising in these areas.

Our people

At Lloyds TSB, people are our most valuable resource. Managing our people effectively is fundamental to the success of the business and achieving our vision of being the best financial services organisation in the UK. Creating a great place to work is a core priority of the people strategy which seeks to enable Lloyds TSB to be recognised, both within the financial services sector, but also more generally in the UK employment market, as the best company to work for.

In creating a great place to work in this way, we believe we will attract the highest performing people to join us and secure the motivation and commitment of those who are the strongest performers and have the highest potential to stay.

To achieve these goals we aim to create a high commitment, high performance organisation. We are clear about what we expect from our people. Our values guide us in all our dealings with colleagues, customers and the wider community. We have nearly 70,000 people working for the Company and whilst business units across the Group have developed values specific to their business needs. They are based on the core Group values of:

- putting customers first;
- acting with integrity and respect;
- taking personal responsibility;
- working as a team.

Talent, recruitment and retention

One of the highest people priorities for our leaders is recruitment, retention and development of talented people. Top performers are attracted to join Lloyds TSB because of our reputation, strong brand and values; together with top class reward and development. Last year, we successfully recruited over 9,500 people from the external market.

It's not just about bringing in new people. Developing existing employees and succession planning are equally important to support our growth strategy. We have strong succession and development plans for all our senior leaders across the Group and we are retaining people for an average tenure across our business of 13 years.

Alongside this we run a wide range of generalist and specialist development programmes to support career progression into management. In 2007 we recruited 106 people into our business specialist programmes (A level entry), 88 people to graduate trainee programmes, offered 32 internships and 111 student placements. We are consistently identified in The Times Top 100 organisations for graduate recruitment. We also ran numerous programmes at more senior levels in management and leadership to develop our pipeline of leaders for the future.

We actively track and manage retention of our highest performers, retaining approximately 96 per cent of our top performers in 2007. In addition we have robust systems for differentiating performance and the management of under performance.

Performance management

The Group uses a balanced scorecard to measure and manage employee performance. The scorecard takes into account the needs of customers, employees and shareholders and measures individual performance against a range of factors, including financial success, contribution to the long term growth of the business, customer service, risk management and personal development.

Meeting our customers' needs is key to our business strategy. Our balanced scorecard aims to show employees how their actions impact their colleagues and customers and how this, in turn, translates into our overall performance. It ensures that people understand how their personal objectives relate to our strategy, and how their performance contributes to the Group's performance.

All employees receive formal reviews and feedback on performance at least twice a year.

Reward and recognition

We believe an individual's reward should reflect their whole contribution to the Company's achievements and take account of performance against individual objectives; contribution in terms of knowledge, competencies and skills and the level of stretch and challenge presented by objectives. In addition it will reflect their potential to develop into more senior roles.

Total reward

As well as our competitive salary packages we differentiate our reward through bonus schemes, and various reward and incentive programmes. This helps drive a high commitment, high performance culture where individuals strive for stretching goals.

We also offer an award winning flexible benefits package where eligible employees receive an additional 4 per cent of their salary each month to select from a range of benefits. Some 67 per cent of our employees currently participate in this scheme choosing from a range of non-cash alternatives including: medical and life assurance, dental plan, additional pension, holiday trading, education vouchers, childcare vouchers and matched learning.

In addition all eligible employees are entitled to participate in our various employee share plans and receive free shares which are awarded annually. For 2007 this award was 3 per cent of salary. 98 per cent of Lloyds TSB employees held free shares as at the end of 2007.

Recognition

Recognition and reward schemes are widely used throughout the organisation to celebrate team and individual achievement. While our emphasis is on providing recognition through line management, we also formally recognise those who have exceeded expectations and pushed boundaries in areas such as colleague support, customer service and building community profile.

Learning and development

We remain committed to investing in our people through providing efficient and effective learning and development that helps our people to deliver great service and achieve great results. Our focus remains on providing our people with the knowledge and skills they need for their jobs today while continuing to develop the capabilities we will need to be successful in the future.

Creating an enabling environment in which our people feel they have the right tools to develop their capabilities, perform effectively and drive business performance is key. Our learning framework enables employees to develop a clear learning plan that reflects their specific learning and future career needs.

University for Lloyds TSB

The University for Lloyds TSB, (UfLTSB), one of the largest corporate universities in Europe, delivers learning programmes through a range of media. This includes on-line knowledge modules and face to face workshops to support skills development. In 2007 the website, which acts as a primary portal for learning across the Group, received over 3 million visits and hosted almost 300,000 on line assessments.

Overall investment in people development has risen by 10 per cent in 2007, and we now deliver an average of 2.3 days formal learning per full time employee (FTE), an increase of 24 per cent on 2006. We continue to provide our people with a range of opportunities and have seen formal learning delivery increase during 2007 to 939,000 hours; an increase of 37 per cent over 2006.

In addition to developing programmes internally the UfLTSB works with external companies to develop and deliver learning. Some programmes may be certificated by external organisations providing employees with performance benchmarks and portable qualifications. We also support a range of business focused and developmental professional qualifications; for example over 1,800 people received financial study support during the year.

Lloyds TSB remains committed to the principles of Investors in People, a standard for ensuring employees have the opportunity to reach their full potential.

Training days

	2007	2006
Number of days formal learning per FTE	2.3	1.8

Employee engagement

Lloyds TSB has inspirational leaders who provide a clear direction for the organisation through our strategy and vision and values framework. The success of our vision is in its simplicity, clarity and re-enforcement in what our leaders do. We ensure our people are actively engaged through communication and participation in regular employee engagement surveys.

Communications

To support this, the Group invests in a range of internal media, ensuring our people are informed and involved. These include a company intranet, print publications and increasingly e-zines and social networking technology. The essential communication relationship between managers and their teams is also supported with bespoke communications training.

Employee engagement survey

Every quarter a comprehensive confidential employee survey is undertaken on-line to gauge employees viewpoints on key engagement issues. Our group chief executive personally agrees the content of our employee engagement survey, demonstrating our commitment and investment in understanding our employee's view. Over the last three years the overall employee engagement index has increased to 75.3 per cent and response rates have been consistently above 70 per cent.

Engagement index

	2007	2006	2005
Employee engagement index*	75.3	74.5	73.3

*The employee engagement index is based on the results of a survey conducted quarterly, asking Lloyds TSB employees a series of questions which reflect both the drivers and outcomes of engagement. The data captures the percentage of total responses received which were favourable for each question, combined into a simple average overall score.

Work environment

Lloyds TSB Group is committed to making sure the work place is maintained to the highest standards of health, safety and fire protection. Our objective is to provide great facilities and a safe environment for everyone, employees and customers alike, in all of our business locations.

Flexible working is increasingly important in the competitive workplace and we have created a balanced environment where we offer a multitude of flexible working practices including:

- reduced hours;
- variable hours;
- job sharing;
- compressed hours;
- term-time working;
- tele-working.

We believe that by treating our employees as adults and placing value on their contribution and delivery rather than working hours will create a high commitment high performance organisation.

Lloyds TSB also has a whistle blowing policy setting out the procedure by which people can raise, in confidence, any matters of concern. A whistle blowing line enables employees to raise any concerns and for such matters to be independently investigated.

Equality and diversity

Equality and diversity is not just about complying with equality legislation. We believe that it is vital for achieving competitive advantage and in a tight employment market, we need to attract and retain talented people from all the UK's diverse communities. We need to be close to our customers and provide them with the right products and services. By attracting and retaining a diverse workforce, we will better understand the needs of all our customers and be able to build lasting relationships.

Over the last few years we have been working to increase the number of women and ethnic minority employees in management and senior management positions across the organisation. At the end of 2007, there were four women on our group executive committee, one of the highest numbers for a FTSE 100 company, and 22 per cent of our senior managers were women.

We continue to make significant progress with our disability and sexual orientation programmes. In 2007 our disability programme was ranked first out of 116 organisations by the Employers' Forum on Disability and we maintained our sixth place ranking in Stonewall's† Index of the 100 best employers of lesbian, gay and bisexual people.

†Stonewall is a campaigning organisation that works to achieve equality and justice for lesbians, gay men and bisexual people.

Diversity

	2007	2006	2005
Women managers	40.1%	38.5%	38.4%
Women senior managers	21.7%	20.9%	20.3%
Ethnic minority managers††	4.9%	4.3%	4.1%
Ethnic minority senior managers††	2.5%	1.9%	1.8%
Disabled employees††	2%	1.5%	1.5%
Lesbian, gay and bisexual (LGB) employees††	0.8%	0.2%	0.2%

††Shows percentage of whole workforce although not all employees have supplied information on race, disability or sexual orientation.

Corporate responsibility

Supporting business strategy

In an increasingly competitive market where customers are able to exercise choice among providers, we believe that shareholder value creation is closely linked to customer value creation. It is only by meeting our customers' needs that we will win the right to a bigger share of their total financial services spend.

We believe that corporate responsibility, built around the creation of employee motivation, customer satisfaction and brand loyalty, has a major part to play in supporting our business strategy. Our commitment to corporate responsibility helps promote trust in the Lloyds TSB brand and reinforces customer loyalty and advocacy. This supports our customer-orientated strategy where we look to develop our business based on deep relationships, as opposed to a product-led approach favoured by others.

Lloyds TSB is rooted in local communities throughout the UK and we take our responsibilities to those communities very seriously. By investing in the communities where we operate we not only create economic value but also make a positive social contribution. Through the Lloyds TSB Foundations, one per cent of the Group's pre-tax profits, averaged over three years, is distributed to local charities.

Our corporate vision is to make Lloyds TSB the best financial services company in the UK. Our corporate responsibility strategy is to support our corporate vision by helping to build a great place for our people to work, a great place for our customers to do business, and generating great returns for our shareholders. In so-doing, we create value for all our stakeholders through:

- more effective risk management;
- increased employee engagement;
- increased customer satisfaction;
- delivering competitive advantage through better corporate responsibility management.

All employees have a balanced scorecard of objectives that takes account of the needs of customers, employees and shareholders, rather than pure financial measures.

Managing corporate responsibility

The board reviews overall corporate responsibility performance annually and the chairman receives a quarterly progress report. Individual issues are subject to board discussion throughout the year. Our corporate responsibility steering group is chaired by the deputy group chief executive and comprises senior executives from all business divisions and relevant group functions. The steering group meets quarterly to recommend strategy and provide direction.

We have adopted the European Foundation of Quality Management's Corporate Responsibility Framework to help us align corporate responsibility with business strategy and also with individual balanced scorecard priorities. As part of the process we have a network of approximately 60 representatives across all business divisions, through whom we conduct an annual self assessment of our performance with independent oversight and assurance. This allows us to identify strengths and areas for improvement and to prioritise actions and objectives. It also provides a benchmark against which we can compare our performance both internally and externally.

The board is satisfied that the systems in place to manage corporate responsibility risks are effective and that the relevant risks have been assessed during 2007 and managed in compliance with relevant policies and procedures.

Our approach to corporate responsibility focuses on five areas; our people (see pages 32-33), our customers, our suppliers, our community and the environment.

Our customers

We want to build a great organisation, which is recognised for operating to high standards and is built on strong customer franchises. Our ultimate goal is to become Britain's most recommended bank. We have put in place the essential building blocks; providing excellent customer service from well-trained staff; appropriate products that meet real needs; treating customers fairly at all times; and following ethical business practices to build a sustainable, profitable business.

Responsible lending

We are committed to being a responsible lender. It is in our interest to help customers borrow only those amounts they can manage to repay. We have a responsible lending programme with internal management reporting and accountability. Our employees are trained to offer the necessary advice and support to help customers manage their borrowing. Our Customer Support Unit provides help for customers who are in financial difficulties to find an appropriate solution through effective budgeting or rescheduling their borrowing. We also support independent money advice networks including the Money Advice Trust and the Consumer Credit Counselling Service. Payments totalling more than £3.4 million were made in 2007.

Complaints resolved within 8 Weeks

2007	2006	2005
97.0%	94.8%	86.0%

Combating financial crime

We take protecting our customers and their assets extremely seriously and continue to invest in systems and activities to deter, detect and prevent fraud. These include transaction monitoring tools to identify suspicious account activity and the introduction of verification technology on our counters to secure withdrawals. We also work to ensure customers are aware of how to protect themselves including dedicating a section of our website to information on common internet fraud types and an annual campaign to raise awareness of the threat of identity theft.

Financial inclusion

We continue to develop financial services especially tailored to tackle the problem of financial exclusion. These include basic bank accounts, support for community credit unions and other community finance initiatives and, loan and venture capital funds, which offer loans to individuals and businesses in some of the most deprived areas in the UK. Lloyds TSB currently has £14 million invested in the community finance sector in addition to its normal commercial lending to small businesses in these areas. Our alliance with the Post Office allows our customers access to the UK network of post offices as well as over 2,000 of our own branches and over 4,100 free ATMs. At the end of 2007 we had over 470,000 basic bank accounts.

Lloyds TSB welcomes and fully supports the Financial Services Authority's initiatives to increase Financial Capability in the UK. We have seconded a Senior Executive to develop, launch and manage the financial capability in the workplace workstream of the FSA Strategy. Since launching 18 months ago, the team have provided educational material and training to over 1.2 million employees throughout the UK, and are well on track to reach the target of 4 million, by 2011. Feedback from all parties has been very encouraging and is improving these employees' financial capability.

Customer satisfaction

We measure our customers' satisfaction with the service they receive via monthly surveys and use the results to calculate our CARE Index which is based on customer understanding, accessibility, responsibility and expertise. We seek to address customer complaints as quickly as prudent while ensuring appropriate standards of investigation and communication are maintained.

Customer service index

2007	2006	2005
70.5%	69.7%	68.0%

From 2008 we will be introducing a new measure of customer advocacy, the Net Promoter Score, which measures the likelihood of customers recommending Lloyds TSB to friends, family and colleagues.

In a poll of finance directors across the UK, Lloyds TSB Corporate was voted 'Bank of the Year' for the third year running at the Real Finance/CBI FDs' Excellence Awards, in recognition of our quality of service and understanding of our customers' businesses. Lloyds TSB was also voted the Reader's Digest most trusted bank or building society for the seventh successive year in 2007.

Our suppliers

Each year we buy around £2 billion worth of goods and services. Our suppliers are important to us and we want to ensure that we treat them fairly and pay them on time. Our supplier relationships are governed by a strict Code of Purchasing Ethics that defines the way we do business. We also have an established supplier review process that allows us to assess our suppliers' social, ethical and environmental performance as part of the tendering process.

We are currently working with a number of other financial services companies to develop an industry-wide corporate responsibility questionnaire, which will include new questions on carbon management and diversity. The new questionnaire will be available on-line in 2008 and will benefit suppliers who will only have to complete one questionnaire for all participating financial services companies, as well as benefiting Lloyds TSB by providing comparable information across different suppliers.

Payment of suppliers

	2007	2006	2005	2004
Number of supplier payments	320,579	344,422	379,613	360,257
Value	£2.20 billion	£2.29 billion	£2.16 billion	£2.20 billion
Average time to pay	28.78 days	29.72 days	27.01 days	28.02 days
Number/amount of compensation payments	No payments for late settlement	No payments for late settlement	No payments for late settlement	1 payment totalling £25 for late settlement

Our community

Continuing to grow a successful business is the best way for Lloyds TSB to create value for all its stakeholders and contribute to the wider economy. We are a major employer with nearly 70,000 employees. In 2007, salaries, national insurance, pension contributions and other staff costs totalled over £2.90 billion. £0.86 billion of corporation tax was paid to governments and £1.96 billion was distributed to shareholders in the form of dividends.

In addition to our financial contribution we recognise that it is in our long-term interest to help improve the social and commercial fabric of local communities where we operate. That is why we have one of the largest community investment programmes in the UK.

Lloyds TSB Foundations

The majority of Lloyds TSB's charitable giving is channelled through the four Lloyds TSB Foundations, which cover England and Wales, Scotland, Northern Ireland and the Channel Islands. Their mission is to improve the lives of people in local communities, especially those who are disadvantaged.

Through their shares in the Lloyds TSB Group, the Lloyds TSB Foundations together receive one per cent of the Group's pre-tax profits, averaged over three years, in lieu of their shareholder dividend. In 2007 we gave £37 million to support their work and a further £37 million will be donated in 2008 bringing our total contributions since the Lloyds TSB merger to over £360 million, making Lloyds TSB one of the largest charitable donors in the UK.

The Foundations recognise that their success as community and local funders depends on maintaining a presence in and actively engaging with communities. The England and Wales Foundation, for example, remains one of the few grant-makers with a significant regional presence and its regional structure enables the Foundation to respond directly and effectively to local needs.

Foundation funding supports charities working to meet social and community needs. The main grants programmes are designed to address essential community needs and in particular, to support small under-funded charities. 41 per cent of the charities supported by the England and Wales Foundation in 2007 had a total income of £100,000 or less and 88 per cent had an income of £500,000 or less.

Employee volunteering and fundraising

In addition to the Foundations' support for local community causes, thousands of our employees volunteer to help in their communities, raise funds for the Group's Charity of the Year or make direct donations to charity using the UK's Give As You Earn system. In 2007, the Foundations provided matched funding for over 33,000 hours of time volunteered by Lloyds TSB employees in the community and also matched over £768,000 funds raised by employees for charities.

The Charity of the Year is chosen in an open ballot of staff. A team of Charity Champions across all parts of the Group leads the fundraising, inspiring and motivating their colleagues to organise and take part in events, sell pin badges and find new and innovative ways of raising money. In 2006 our staff raised over £2 million for Breast Cancer Care. Barnardo's is our current charity partner and to date almost £1 million has been raised with fundraising initiatives continuing into 2008.

The environment

Lloyds TSB first introduced a formal environmental policy in 1996 and was also one of the first UK banks to develop an environmental risk assessment system for all of our business lending.

Climate change

The UK Government has stated its belief that climate change is the greatest long-term challenge facing the world today. Measures to tackle climate change will have potential implications for regulation, taxation and public policy and will carry both risks and opportunities for companies and the public.

While our direct carbon intensity is relatively low compared to other industry sectors, we still need to fully understand the potential financial impact of climate change on others that we may lend to or invest in, so that we can manage the risks and identify business opportunities.

During 2007 we consulted with senior management across all Lloyds TSB Group businesses to identify key climate-related risks and opportunities and to develop a programme to engage our employees and customers on the environment. Following the consultation, we published a target to reduce our CO_2 emissions by 30 per cent by 2012, based on 2002 levels. This is a stretching target and to achieve it we will need to manage our energy consumption and efficiency together with our business travel.

We have established a carbon reduction committee (reporting to the corporate responsibility steering group) to measure, monitor and manage progress against the target. Environmental impacts associated with major projects are calculated and that has helped us to identify a number of property and IT related projects that will begin to deliver significant CO_2 reductions from 2008. Over time, many of these will also deliver significant cost savings.

Of course, we cannot eliminate all CO_2 emissions so in 2007 we also committed to become carbon neutral by offsetting those emissions that we cannot reduce. We can confirm that in 2007 we purchased carbon credits through our carbon trading desk to achieve carbon neutrality.

Since 2006 we have purchased part of our electricity from combined heat and power (CHP) sources, which have a lower carbon footprint than standard grid electricity. Some contracts for green electricity and CHP will expire before 2012 so progress towards the long-term target may fluctuate. We will therefore continue to concentrate on reducing our energy consumption and unnecessary business travel. The CHP figures for 2006 were not included in our 2006 report as we were still awaiting confirmation of their treatment from DEFRA at the time of reporting.

Our staff have responded enthusiastically to the challenge and are keen to be involved in environmental initiatives. We are introducing a Group wide sustainability network in 2008 for employees at all levels to meet, share experiences and ideas, and to help fulfil our commitment to reducing our carbon footprint.

Greenhouse gas emissions

Tonnes CO_2	2007	2006*	2005	2002 Baseline
Property	180,526	181,086	177,047	198,950
Property renewable	(18,164)	(18,944)	(14,606)	n/a
Travel	30,474	29,705	29,540	26,333
Total	192,836	191,847	191,981	225,283
Combined heat and power	(31,635)	(30,945)	n/a	n/a
Net total	161,201	160,902	191,981	225,283

* 2006 travel figures have been restated to reflect the fact that C&G travel data is now included and to provide a more accurate comparison between 2006 and 2007.

More information on all the above issues is available in the Group's corporate responsibility report and there are details on how to obtain a copy on page 159.

Risk as a strategic differentiator

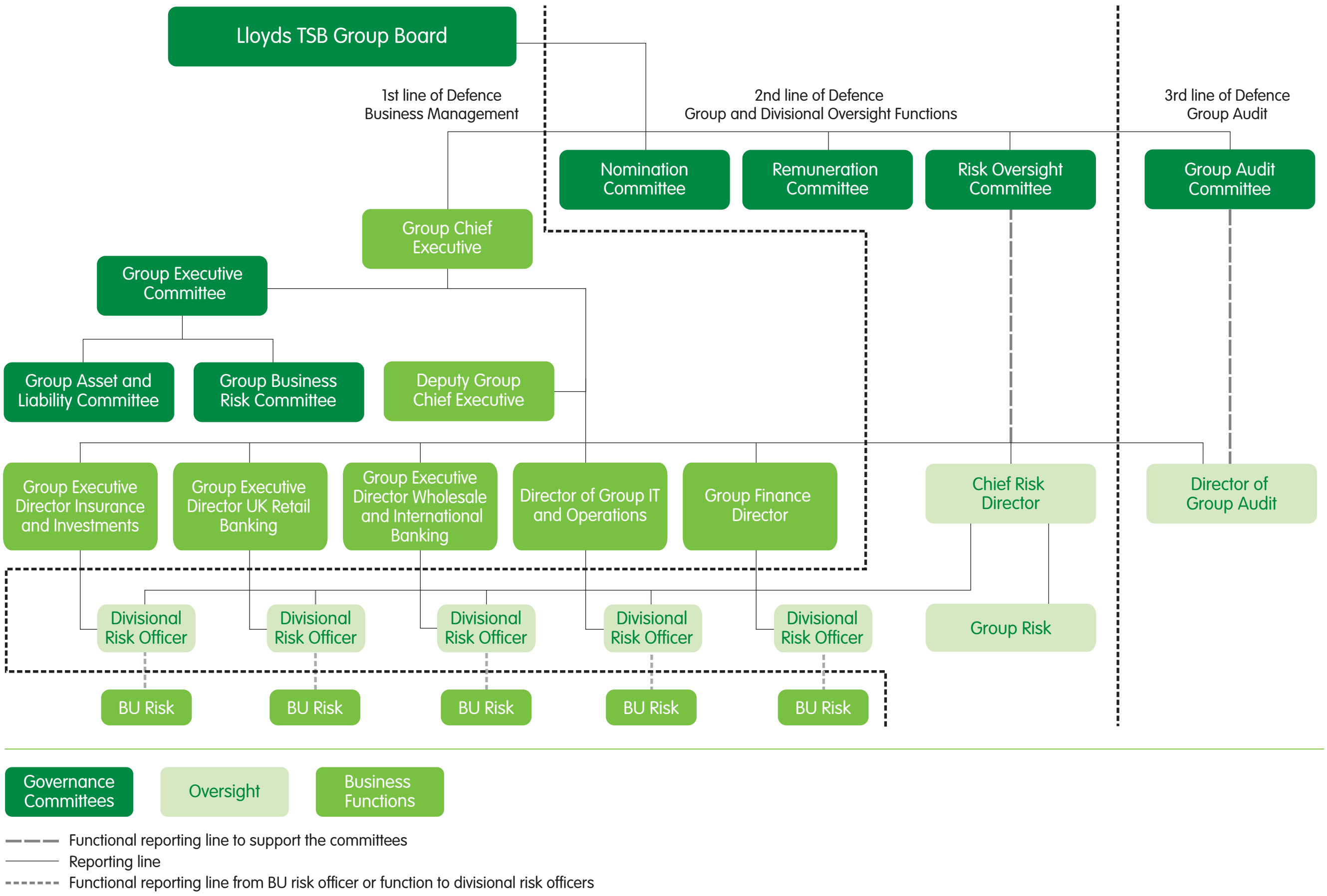
The Group seeks to optimise performance by allowing divisions and business units to operate within capital and risk parameters and the Group's policy framework. They must do so in a way which is consistent with realising the Group's strategy and meets agreed business performance targets. The Group's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

During 2007, we have continued to focus on enhancing our capabilities in providing both qualitative and quantitative data to the board on risks associated with strategic objectives and facilitating more informed and effective decision making. The Group's ability to take risks which are well understood, consistent with our strategy and plans and appropriately remunerated, is a key driver of shareholder return.

The maintenance of a strong control framework remains a priority and is the foundation for the delivery of effective risk management. Risk analysis and reporting capabilities support the identification of opportunities as well as risks and it provides an aggregate view of the overall risk portfolio. Responsibilities and timescales at group and divisional level are clearly assigned for risk mitigation strategies. Risk continues to be a key component of routine management information reporting and is embedded within staff objectives via balanced scorecards.

Risk governance structures

The Group maintains a risk governance structure that strengthens risk evaluation and management, whilst also positioning the Group to manage the changing regulatory environment in an efficient and effective manner.



Board and committees

The board, assisted by its committees, the risk oversight committee, the group executive committee, and the group audit committee, approves the Group's overall risk management framework. The board also reviews the Group's aggregate risk exposures and concentrations of risk to seek to ensure that these are consistent with the board's appetite for risk. The role of the board, audit committee and risk oversight committee are shown in the corporate governance section on pages 61 and 62, and further key risk oversight roles are described on the next page.

The group executive committee, assisted by the group business risk committee and the group asset and liability committee, supports the group chief executive in ensuring the effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, whilst also reviewing the Group's aggregate risk exposures and concentrations of risk. The group executive committee's duties are described in greater detail on page 62. The group executive committee members are also members of the group business risk committee which is chaired by the group chief executive. The group asset and liability committee, which is chaired by the deputy group chief executive, includes members of the group executive committee as well as the heads of products and markets and group market risk. The group business risk committee is supported by the following:

– Compliance and Operational Risk Committee

– Group Credit Risk Committee

– Group Change Management Committee

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

Group executive directors have primary responsibility for measuring, monitoring and controlling risks within their areas of accountability and are required to establish control frameworks for their businesses that are consistent with the Group's high level policies and within the parameters set by the board, group executive committee and group risk. Compliance with policies and parameters is overseen by the risk oversight committee, the group business risk committee, the group asset and liability committee, group risk and the divisional risk officers.

Reflecting the importance the Group places on risk management, risk is one of the five principal criteria that it includes within its balanced scorecard on which individual staff performance is judged. Business executives have specified risk management objectives, and incentive schemes take account of performance against these.

Risk management oversight

The chief risk director, a member of the group executive committee and reporting directly to the group chief executive, oversees and promotes the development and implementation of a consistent group wide risk management framework. The chief risk director, supported by group risk, provides objective challenge to the Group's senior management.

Divisional risk officers provide oversight of risk management activity within each of the Group's divisions. Reporting directly to the group executive directors responsible for the divisions and the chief risk director, their day-to-day contact with business management, business operations and risk initiatives seeks to provide an effective risk oversight mechanism.

The director of group audit provides the required independent assurance to the audit committee and the board that risks within the Group are recognised, monitored and managed within acceptable parameters. Group audit is fully independent of group risk, seeking to ensure objective challenge to the effectiveness of the risk governance framework.

Business risk management

Line management are directly accountable for the management of risks arising from the Group's business. A key objective is to ensure that business decisions strike an appropriate balance between risk and reward, consistent with the Group's risk appetite. The senior executive team and board receive regular briefings and guidance from the chief risk director to ensure awareness of the overarching risk management framework and a clear understanding of their accountabilities for risk and internal control.

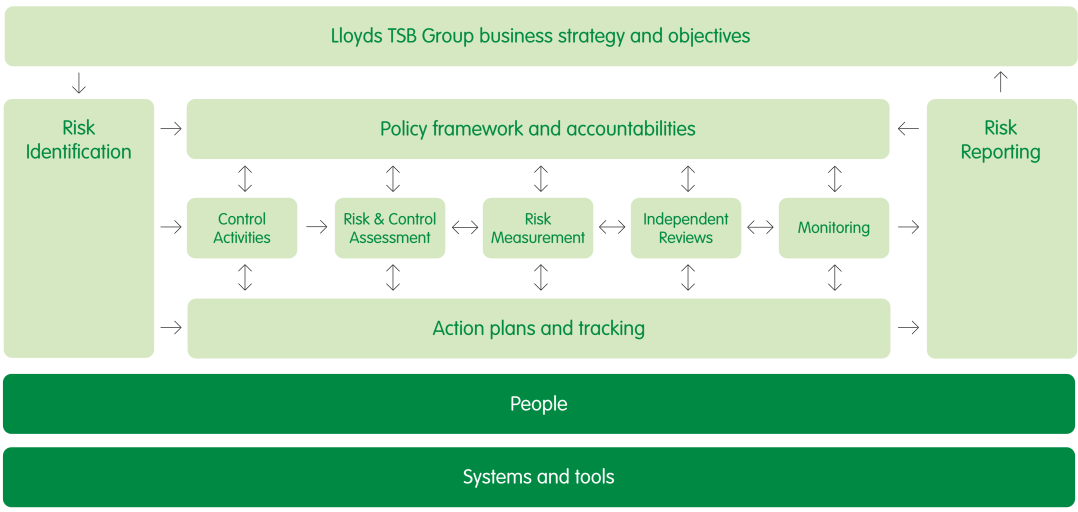
All business units, divisions and group functions complete a control self-assessment annually (described on page 63), reviewing the effectiveness of their internal controls and putting in place enhancements where appropriate. Managing directors and group executive directors certify the accuracy of their assessment.

Business risk management forms part of a tiered risk management model, as shown on page 36 with the divisional risk officers providing oversight and challenge, as described above, and the chief risk director and group committees establishing the group wide perspective.

This approach seeks to provide the Group with an effective mechanism for developing and embedding risk policies and risk management strategies which are aligned with the risks faced by its businesses. It also facilitates effective communication on these matters across the Group.

Risk management framework

The Group uses an enterprise-wide risk management framework for the identification, assessment, measurement and management of risk, designed to meet its customers' needs. It seeks to maximise value for shareholders over time by aligning risk management with the corporate strategy, assessing the impact of emerging risks from legislation, new technologies or the market, and developing risk tolerances and mitigating strategies. The framework strengthens the Group's ability to identify and assess risks; aggregate group wide risks and define the corporate risk appetite; develop solutions for reducing or transferring risk, where appropriate; and exploit risks to gain competitive advantage, thereby seeking to increase shareholder value. The principal elements of the risk management framework are shown below:



The risk management framework above comprises 10 interdependent activities which map to the components of the internal control-integrated framework issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO).

Lloyds TSB Group business strategy and the desired outcomes for our key stakeholders are used to determine the Group's high level risk principles and risk appetite measures and metrics for the primary risk types. A key focus in 2007 has been to develop earnings volatility measures to complement existing capital measures for risk appetite. Risk appetite is reviewed annually in line with the overall Group's appetite and the reward potential of the relevant exposures. Risk appetite is defined, cascaded and monitored.

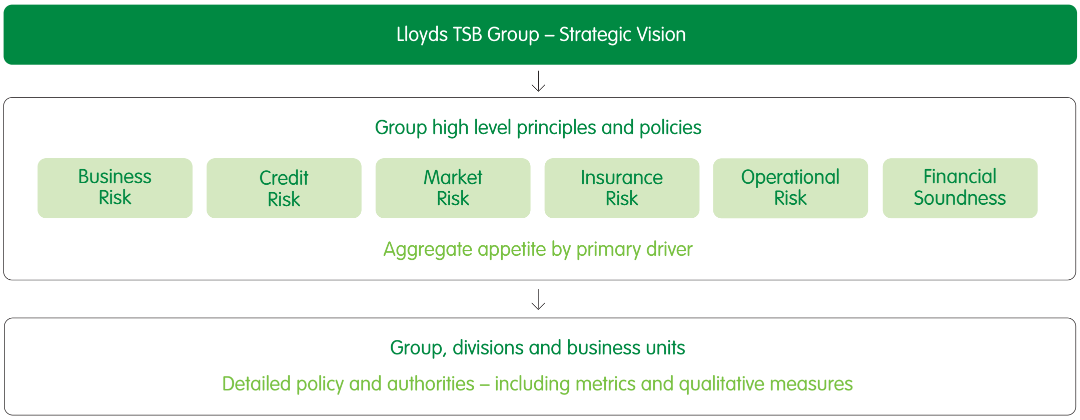
Group, divisions and business units ensure that there is a process for **risk identification** of the exposure to each risk type.

The risk appetite is proposed by the group chief executive and reviewed by various governance bodies including the group executive committee and the risk oversight committee. Responsibility for the approval of risk appetite rests with the board. The approved high level appetite and limits are delegated to individual group executive directors by the group chief executive.

The more detailed articulation of the risk principles and distribution of the risk appetite measures amongst the divisions and businesses are subsequently determined by the group chief executive, through consultation with the group business risk committee.

A key component of the risk management framework is the **policy framework and accountabilities**. The main policy levels are identified below:

- Principles – high level principles for the six primary risk drivers
- High level group policy – policy for the main risk types aligned to the risk drivers
- Detailed group policy – detailed policy that applies across the Group
- Divisional policy – local policy that specifically applies to a division
- Business unit policy – local policy that specifically applies to a business unit



Divisional and business unit policy is only produced by exception and is not necessary unless there is a specific area for which a particular division or business unit requires a greater level of detail than is appropriate for group level policy. The governance arrangements for development of, and compliance with, group, divisional and business unit policy and the associated accountabilities are clearly outlined. All staff are expected to be aware of the policies and procedures which apply to them and their work and to observe the relevant policies and procedures. Line management in each business area has primary responsibility for ensuring that group policies and the relevant local policies and procedures are known and observed by all staff within that area.

Group and divisional risk functions have responsibility for overseeing effective implementation of policy. Group audit provides independent assurance to the board about the effectiveness of the Group's control framework and adherence to policy. Policies are reviewed at least annually to seek to ensure they remain fit for purpose.

Proportionate **control activity** strategy is put in place to design mitigating controls, to transfer risk where appropriate and to ensure executives are content with the residual level of risk accepted.

Risk and control assessments are undertaken to assess the effectiveness of current mitigations and whether risks taken are consistent with the Group's risk appetite (this includes the annual control self assessment exercise).

The impact of risks and issues (including financial, reputational and regulatory capital) are determined through effective **risk measurement** including modelling and stress testing.

The outcomes of **independent reviews** (including internal and external audit and regulatory reviews) are integrated into risk management activities and action plans.

Risk reporting is standardised through the use of consistent definitions when reporting, to enable risk aggregation. Divisions monitor their risk levels against their risk appetite seeking to ensure effective mitigating action has been taken where appropriate. Divisional risk reports are reviewed by divisional executive committees to ensure that respective senior management are satisfied with the overall risk profile, risk accountabilities and progress on any necessary mitigating actions. Reporting, including that of performance against relevant limits or policies, is in place at a detailed level appropriate to the exposures concerned and regular information is provided to group risk for review and aggregate reporting. Any significant issues identified in the **monitoring** process are appropriately reported, and an escalation process is in place to report significant losses to appropriate levels of management. Group risk reports on risk exposures and material issues quarterly to the group asset and liability committee, group business risk committee, group executive committee, risk oversight committee and the board.

At group level a consolidated risk report is produced which is reviewed and debated by the group business risk committee, group executive committee, risk oversight committee and the board to ensure senior management and the board are satisfied with the overall risk profile, risk accountabilities and mitigating actions. During the year the Group's consolidated risk report was further enhanced to support the ongoing identification, control and effective management of risk.

Risk drivers

The Group's risk language is designed to capture the Group's principal risks referred to as the 'primary risk drivers'. A description of each risk, including definition, appetite, control and exposures is included in the detail to this report. These are further broken down into 25 more granular risk types to enable more detailed review and facilitate appropriate reporting and monitoring, as set out below.

Through the Group's risk management processes these risks are assessed on an ongoing basis to ensure optimisation of risk and reward and that, where required, appropriate mitigation is in place. Both quantitative and qualitative factors are considered in assessing the Group's current and potential future risks.

Primary risk drivers	Business Risk	Credit Risk	Market Risk	Insurance Risk	Operational Risk	Financial Soundness
Detailed risk types	Strategy setting Execution of strategy	Retail Wholesale	Interest rate Foreign exchange Equity Credit spread	Mortality Longevity Morbidity Persistency	Legal and regulatory Customer treatment Products and services Process and resource Theft, fraud and other criminal acts People Change Governance	Liquidity and funding Capital Financial and prudential regulatory reporting Disclosure Tax

Principal risks

At present the most significant risks faced by the Group are:

- Legal and regulatory risk, reflecting the legal and regulatory environment in which the Group operates and the volume and pace of change from within the UK and the rest of the world. This impacts the Group, both operationally in terms of cost of compliance with uncertainty about legal and regulatory expectations, and strategically through pressure on key earnings streams. The latter could potentially result in changes to business and pricing models, particularly in the UK retail market. Our business planning processes continue to reflect change to the legal and regulatory environment. Major current legal and regulatory reviews and proceedings are described on page 31. In addition, the Group faces risk where legal proceedings are brought against it. Regardless of whether such claims have merit, the outcome of legal proceedings is inherently uncertain and could result in financial loss.
- Credit risk, reflecting the risk inherent in our lending businesses. In unsecured retail credit, lending criteria and limits have been tightened further during the year and collections and recoveries processes enhanced. Wholesale credit markets remain volatile and dislocated. This market dislocation is beginning to impact the real economy, where fears of a credit crunch persist. This could result in a significant worsening of the business environment.
- Market risk arising in Insurance and Investments division and the Group's pension schemes, reflecting the exposure to a fall in equity markets and the consequent effect upon the value of assets held by either the insurance businesses or in the pension schemes. The value of the pension schemes liabilities is also exposed to changes in real interest rates. Both of these market risks could impact earnings adversely.
- Insurance risk arising in Insurance and Investments division and the Group's pension schemes reflecting the exposure to increasing longevity of annuitants and pensioners.

The current dislocation in global capital markets has been the most severe examination of the banking system's capacity to absorb sudden significant changes in the funding and liquidity environment in recent history and individual institutions have faced varying degrees of stress. Should the Group be unable to continue to source a sustainable funding profile which can absorb these sudden shocks, it could impact its ability to fund its financial obligations or could result in securing them at an excessive cost. Throughout the market dislocation, the Group has maintained a strong liquidity position based on its significant retail and corporate deposit base.

Business risk

Definition

Business risk is defined as the risk to economic profit in the Group's budget and over the medium term plan arising from a sub optimal business strategy, or the sub optimal implementation of the plan as agreed by the board of directors. In assessing business risk consideration is given to internal and external factors.

Risk appetite

Business risk appetite is encapsulated in the Group's budget and medium-term plan, which are sanctioned by the board on an annual basis. Divisions and business units subsequently align their plans to the Group's overall business risk appetite.

Exposures

The Group's portfolio of businesses exposes it to a number of internal and external factors:

- internal factors: resource capability and availability, customer treatment, service level agreements, products and funding and the risk appetite of other risk categories; and
- external factors: economic, technological, political, social and ethical, environmental, legal and regulatory, market expectations, reputation and competitive behaviour.

Measurement

An annual business planning process is conducted at group and business unit level which includes a quantitative and qualitative assessment of the risks that could impact the Group's plans. Within the planning round, the Group conducts both scenario analysis and stress tests to assess risks to future earning streams. Over the last few years, the Group has made significant progress with embedding stress testing and scenario analysis into its risk management practice with the dual objectives of adding value to the business whilst also meeting regulatory requirements. The Group assesses a wide array of scenarios including economic recessions, regulatory action scenarios, pandemics and scenarios specific to the operations of each part of the business.

A common approach is applied across the Group to assess the creation of shareholder value. This is measured by economic profit (the profit attributable to shareholders, less a notional charge for the equity invested in the business). The focus on economic profit allows the Group to compare the returns being made on capital employed in each business on a consistent basis.

Mitigation

As part of the annual business planning process, the Group develops a set of management actions to prevent or mitigate the impact on earnings in the event that business risks materialise. Additionally, business risk monitoring, through regular reports and oversight, results in corrective actions to plans and reductions in exposures where necessary.

Revenue and capital investment decisions require additional formal assessment and approval. Formal risk assessment is conducted as part of the financial approval process. Significant mergers and acquisitions by business units require specific approval by the board. In addition to the standard due diligence conducted during a merger or acquisition, group risk conducts, where appropriate, an independent risk assessment of the target company and its proposed integration into the Group.

Monitoring

The Group's strategy is reviewed and approved by the board. Regular reports are provided to the group executive committee and the board on the progress of the Group's key strategies and plans. Group risk conducts oversight to seek to ensure that business plans remain consistent with the Group's strategy.

Credit risk

Definition

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

Risk appetite

Credit risk appetite is expressed both in terms of credit risk economic equity and in terms of the impact of credit risk on earnings volatility.

Credit risk appetite is described and reported through a suite of metrics derived from a combination of accounting and credit portfolio model parameters which in turn use the various credit risk rating systems as inputs. These metrics are supplemented by a variety of policies, sector caps and limits to manage concentration risk at an acceptable level.

Exposures

The principal sources of credit risk within the Group arise from loans and advances to retail customers, financial institutions and corporate clients. The credit risk exposures of the Group are set out in note 47 to the financial statements.

In terms of loans and advances, credit risk arises both from amounts lent and commitments to extend credit to a customer as required. These commitments can take the form of loans and overdrafts, or credit instruments such as guarantees and standby, documentary and commercial letters of credit. With respect to commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most retail commitments to extend credit can be cancelled and the credit-worthiness of customers is monitored continually. In addition, most wholesale commitments to extend credit are contingent upon customers maintaining specific credit standards.

Credit risk can also arise from debt securities, derivatives and foreign exchange activities. Note 16 to the financial statements shows the total notional principal amount of interest rate, exchange rate, credit derivative and equity and other contracts outstanding at 31 December 2007. The notional principal amount does not, however, represent the Group's credit risk exposure, which is limited to the current cost of replacing contracts with a positive value to the Group. Such amounts are reflected in note 47 on page 136.

Credit risk exposures in the insurance businesses arise primarily from holding investments and from exposure to reinsurers.

Measurement

In measuring the credit risk of loans and advances to customers and to banks at a counterparty level, the Group reflects three components: (i) the 'probability of default' by the client or counterparty on its contractual obligations; (ii) current exposures to the counterparty and their likely future development, from which the Group derives the 'exposure at default'; and (iii) the likely recovery ratio on the defaulted obligations (the 'loss given default').

The Group assesses the probability of default of individual counterparties using internal rating models tailored to the various categories of counterparty. For its retail lending, exposure at default and loss given default models are also in use. All rating models, which are authorised by executive management, comply with the Group's standard methodology. They have been developed internally and use statistical analysis, combined, where appropriate, with external data and/or credit officer judgement. Each rating model is subject to a rigorous validation process, undertaken by independent risk teams, which includes benchmarking to externally available data, where possible.

Each probability of default rating model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. The outputs of different rating approaches are also mapped on to either a retail or a wholesale master scale (Note 47 to the financial statements provides an analysis of the portfolio). Exposures migrate between classifications if the assessment of the obligor probability of default changes, or, in the case of mortgages, if the obligor probability of default changes or the assessment of loan-to-value changes.

The rating systems described above assess probability of default, exposure at default and loss given default, in order to derive an expected loss. In contrast, impairment allowances are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment (see note 19 to the consolidated financial statements on page 104). Due to the different methodologies applied, the amount of incurred credit losses provided for in the financial statements differs from the amount determined from the expected loss model that is used for internal operational management and banking regulation purposes.

The Group's debt securities holdings, which are the subject of external agency ratings, are marked to market and independently checked by the middle office function within the products and markets business. Similarly, debt security investments within Scottish Widows are independently marked to market.

The Group also employs a statistically-based credit portfolio model, which models portfolio credit risk based on defaults and calculates the economic equity employed and credit value at risk for each portfolio.

Mitigation

The Group uses a range of approaches to mitigate credit risk.

Internal control

- Credit principles and policy: Group risk sets out the group credit principles and policy according to which credit risk is managed, which in turn is the basis for divisional and business unit credit policy. Principles and policy are reviewed regularly and any changes are subject to a review and approval process. Business unit policy includes lending guidelines, which define the responsibilities of lending officers and provide a disciplined and focused benchmark for credit decisions. Credit policy also specifies maximum holding period limits for the credit trading portfolios.
- Counterparty limits: Credit risk in wholesale portfolios is subject to individual credit assessments, which consider the strengths and weaknesses of individual transactions and the balance of risk and reward. Exposure to individual counterparties, groups of counterparties or customer risk segments is controlled through a tiered hierarchy of delegated sanctioning authorities. Approval requirements for each decision are based on the transaction amount, the customer's aggregate facilities, credit risk ratings and the nature and term of the risk. The Group's credit approval criteria for counterparty underwriting is the same as that for assets intended to be held over the period to maturity.
- Credit scoring: In its principal retail portfolios, the Group uses statistically-based decisioning techniques (primarily credit scoring). Divisional risk departments review scorecard effectiveness and approve changes, with material changes subject to group risk approval.
- Cross-border and cross-currency exposures: Country limits are authorised and managed by a dedicated unit taking into account economic and political factors.
- Concentration risk: Credit risk management includes portfolio controls on certain industries, sectors and product lines that reflect risk appetite. Credit policy is aligned to our risk appetite and restricts exposure to certain high risk and more vulnerable sectors. Note 18 to the accounts provides an analysis of loans and advances to customers by industry (for wholesale) and product (for retail). Exposures are monitored to prevent excessive concentration of risk. These

concentration risk controls are not necessarily in the form of a maximum limit on lending but may instead require new business in concentrated sectors to fulfil additional hurdle requirements. Amongst these controls is a series of sector caps to manage residual value risk exposure, seeking to ensure an acceptable distribution of risk. The Group's large exposures are managed in accordance with regulatory reporting requirements.

- Stress testing and scenario analysis: The credit portfolio is also subjected to stress-testing and scenario analysis, to simulate outcomes and calculate their associated impact. Events are modelled at a group wide level, at divisional and business unit level and by portfolio, for example, for a specific industry sector.
- Specialist units: Credit quality is maintained by specialist units providing, for example: intensive management and control; security perfection, maintenance and retention; expertise in documentation for lending and associated products; sector-specific expertise; and legal services applicable to the particular market place and product range offered by the business.
- Daily settlement limits: Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from the Group's market transactions on any single day.

Collateral

The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities;
- Guarantees received from third parties.

The Group has implemented guidelines on the acceptability of specific classes of collateral. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial instruments. Collateral is generally not held against loans and advances to financial institutions, except where securities are held as part of reverse repurchase or securities borrowing transactions or where a collateral agreement has been entered into under a master netting agreement.

It is Group policy that collateral should always be realistically valued by an appropriately qualified source, independent of the customer, at the time of borrowing. Collateral is reviewed on a regular basis in accordance with business unit credit policy, which will vary according to the type of lending and collateral involved. In order to minimise the credit loss, the Group may seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances.

Master netting agreements

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

Derivatives

Credit risk exposure on individual derivative transactions is managed as part of overall lending limits with customers, together with potential exposures from market movements. Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Group requires margin deposits from counterparties.

Other credit risk transfers

The Group also undertakes asset sales, securitisations and credit derivative-based transactions as a means of mitigating or reducing credit risk, taking into account the nature of assets and the prevailing market conditions.

Monitoring

- Portfolio monitoring and reporting: In conjunction with group risk, businesses and divisions identify and define portfolios of credit and related risk exposures and the key benchmarks, behaviours and characteristics by which those portfolios are managed in terms of credit risk exposure. This entails the production and analysis of regular portfolio monitoring reports for review by senior management. Group risk in turn produces an aggregated review of credit risk throughout the Group, including reports on significant credit exposures, which are presented to the group business risk committee.
- Risk assurance and oversight: Divisional and group level oversight teams monitor credit performance trends, review and challenge exceptions to planned outcomes and test the adequacy of credit risk infrastructure and governance processes throughout the Group. This includes tracking portfolio performance against an agreed set of key risk indicators. Risk assurance teams are engaged where appropriate to conduct further credit reviews if a need for closer scrutiny is identified.
- Term to maturity: The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Market risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, arising from unexpected changes in financial prices, including interest rates, exchange rates and prices for bonds, commodities, equities, property and other instruments. It arises in all areas of the Group's activities and is managed by a variety of different techniques.

Risk appetite

Market risk appetite is defined as the quantum and composition of market risk that exists currently in the Group and the direction in which the Group wishes to manage this.

This statement of the Group's overall appetite for market risk is reviewed and approved annually by the board. The group chief executive allocates this risk appetite across the Group. Individual members of the group executive committee ensure that market risk appetite is further delegated to an appropriate level within their areas of responsibility.

Exposures

The Group's banking activities expose it to the risk of adverse movements in interest rates, credit spreads, exchange rates and equity prices, with little or no exposure to commodity risk.

Most of the Group's trading activity is undertaken to meet the requirements of wholesale and retail customers for foreign exchange and interest rate products. However, some interest rate and exchange rate positions are taken using derivatives and other on-balance sheet instruments with the objective of earning a profit from favourable movements in market rates.

Market risk in the Group's retail portfolios and in the Group's capital and funding activities arises from the different repricing characteristics of the Group's non-trading assets and liabilities. Interest rate risk arises from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets.

Foreign currency risk also arises from the Group's investment in its overseas operations.

The Group's insurance activities also expose it to market risk, encompassing interest rate, exchange rate, property and equity risk:

- The management of with-profits funds leads to assets and liabilities that are mismatched with the aim of generating a higher rate of return on assets to meet policyholders' expectations.
- Unit-linked liabilities are matched with the same assets that are used to define the liability but future fee income is dependent upon the performance of those assets.
- For other insurance liabilities the aim is to invest in assets such that the cash flows on investments will match those on the projected future liabilities. It is not possible to eliminate risk completely as the timing of insured events is uncertain and bonds are not available at all of the required maturities. As a result the cash flows cannot be precisely matched and so sensitivity tests are used to test the extent of the mismatch.
- Surplus assets are held primarily in three portfolios: the surplus in the non-profit fund within the long term fund of Scottish Widows plc, assets in shareholder funds of life assurance companies and an investment portfolio within the general insurance business.

The Group's defined benefit pension schemes are exposed to significant risks from the constituent parts of their assets and from the present value of their liabilities, primarily equity and real interest rate risk. For further information on pension scheme assets and liabilities please refer to page 116.

Measurement

The primary market risk measure used within the Group is the Value at Risk (VaR) methodology, which incorporates the volatility of relevant market prices and the correlation of their movements. This is used for determining the Group's overall market risk appetite and for the high level allocation of risk appetite across the Group. Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. The use of confidence levels does not convey any information about potential loss when the confidence level is exceeded. VaR can also be less well suited to non-linear positions, for example options. The Group recognises these limitations and supplements its use with a variety of other techniques. These reflect the nature of the business activity, and include interest rate repricing gaps, open exchange positions and sensitivity analysis. Stress testing and scenario analysis are also used in certain portfolios and at group level, to simulate extreme conditions to supplement these core measures.

Banking – trading and other financial assets at fair value through profit or loss

Based on the commonly used 95 per cent confidence level, assuming positions are held overnight and using observation periods of the preceding 300 business days, the VaR for the years ended 31 December 2007 and 2006 based on the Group's global trading positions was as detailed in the table below (the table also aggregates potential loss measures from options portfolios). VaR is calculated daily for trading and other fair valued portfolios in the products and markets business.

The risk of loss measured by the VaR model is the potential loss in earnings. The total and average trading VaR does not assume any diversification benefit across the four risk types. The maximum and minimum VaR reported for each risk category did not necessarily occur on the same day as the maximum and minimum VaR reported as a whole.

	31 December 2007				31 December 2006			
	Close £m	Average £m	Maximum £m	Minimum £m	Close £m	Average £m	Maximum £m	Minimum £m
Interest rate risk	1.63	2.20	4.66	1.27	3.67	2.47	4.71	0.61
Foreign exchange risk	0.08	0.23	0.53	0.04	0.26	0.31	0.72	0.04
Equity risk	0.00	0.29	3.02	0.00	0.00	0.00	0.00	0.00
Credit spread risk	4.21	3.60	8.30	2.06	2.31	1.52	2.46	0.00
Total VaR	5.92	6.32	11.00	4.28	6.24	4.30	6.30	0.89

Banking – non-trading

The estimated impact of an immediate 200 basis point increase in interest rates on economic value for the years ended 31 December 2007 and 2006 is shown below. Economic value is defined as the present value of the non-trading portfolios concerned. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. No currency breakdown has been provided due to the relatively low overall sensitivity. These calculations are made monthly using assumptions regarding the maturity of interest rate insensitive assets and liabilities. The portfolio is updated monthly to reflect any changes in the relationship between customer behaviour and the level of interest rates. This non-trading disclosure is now value based rather than income based (as in 2006) in line with market risk reporting used internally.

Internal reporting shows this sensitivity as a percentage of the Group's regulatory capital base, and as at December 2007 the relevant percentage was 0.4 per cent (2006 2.9 per cent). The sensitivity has fallen as a result of changes to balance sheet management strategy. This is a risk based disclosure and the amounts below would be amortised in the income statement over the duration of the portfolio.

	31 December 2007 £m	31 December 2006 £m
Reduction in value	67	476

Insurance portfolios

The Group's market risk exposure in respect of insurance activities described above is measured using European Embedded Value (EEV) as a proxy for economic value. The pre-tax sensitivity of EEV to standardised market stresses is shown below for the years ended 31 December 2007 and 2006. Foreign exchange risk arises predominantly from overseas equity holdings. Impacts have only been shown in one direction but can be assumed to be reasonably symmetrical. Opening and closing numbers only have been provided as this data is not volatile or tracked on a daily basis. This disclosure has been amended to reflect internal reporting for market risk in the insurance portfolio, in accordance with IFRS7.

	31 December 2007 £m	31 December 2006 £m
Equity risk (impact of 10% fall pre-tax)	(248)	(277)
Interest rate risk (impact of 25bp reduction pre-tax)	58	85

Mitigation

Various mitigation activities are undertaken across the Group to manage portfolios and ensure they remain within approved limits.

Banking – non-trading activities

Interest rate risk arising from the different repricing characteristics of the Group's non-trading assets and liabilities, and from the mismatch between interest rate insensitive liabilities and interest rate sensitive assets, is managed centrally. Matching assets and liabilities are offset against each other and internal interest rate swaps are also used.

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled.

Insurance activities

Investment holdings are diversified across markets and, within markets, across sectors. Holdings are diversified to minimise specific risk and the relative size of large individual exposures is monitored closely. For assets held outside unit-linked funds, investments are only permitted in countries and markets which are sufficiently regulated and liquid.

Monitoring

The group asset and liability committee regularly reviews high level market risk exposure including, but not limited to, the data described above. It also makes recommendations to the group chief executive concerning overall market risk appetite and market risk policy. Exposures at lower levels of delegation are monitored at various intervals according to their volatility, from daily in the case of trading portfolios to monthly or quarterly in the case of less volatile portfolios. Levels of exposures compared to approved limits are monitored locally by independent risk functions and at a high level by group risk. Where appropriate, escalation procedures are in place.

Banking activities

Trading is restricted to a number of specialist centres, the most important centre being the products and markets business in London. These centres also manage market risk in the wholesale non-trading portfolios, both in the UK and internationally. The level of exposure is strictly controlled and monitored within approved limits. Active management of the wholesale portfolios is necessary to meet customer requirements and changing market circumstances.

Market risk in the Group's retail portfolios and in the Group's capital and funding activities is managed within limits defined in the detailed group policy for interest rate risk in the banking book, which is reviewed and approved annually.

Insurance activities

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

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

The Group also agrees strategies for the overall mix of pension assets with the pension scheme trustees.

Insurance risk

Definition

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

Risk appetite

Insurance risk appetite is defined as the quantum and composition of insurance risk that exists currently in the Group and the direction in which the Group wishes to manage this.

Exposures

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

Measurement

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

Current and potential future insurance risk exposures are assessed and aggregated using risk measures based on 1-in-20 year stresses and other supporting measures where appropriate.

Mitigation

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

The overall insurance risk is mitigated through pooling and through diversification across large numbers of uncorrelated individuals, geographical areas, and different types of risk exposure.

Insurance risk is primarily controlled via the following processes:

- Underwriting (the process to ensure that new insurance proposals are properly assessed)
- Pricing-to-risk (new insurance proposals would usually be priced in accordance with the underwriting assessment)
- Claims management
- Product management
- The use of reinsurance or other risk mitigation techniques.

In addition, limits are used as a control mechanism for insurance risk at policy level.

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

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

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

In respect of insurance risks in the staff pension schemes, the Group ensures that effective communication mechanisms are in place for consultation with the trustees and that risk management is in line with the Group's risk appetite.

Monitoring

Ongoing monitoring is in place to track the progression of insurance risks. This normally involves monitoring relevant experiences against expectations (for example claims experience, option take up rates, persistency experience, expenses, non-disclosure at the point of sale), as well as evaluating the effectiveness of controls put in place to manage insurance risk.

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

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

Operational risk

Definition

The risk of reductions in earnings and/or value, through financial or reputational loss, from inadequate or failed internal processes and systems, or from people related or external events. There are a number of categories of operational risk:

Legal and regulatory risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from failing to comply with the laws, regulations or codes applicable.

Customer treatment risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate or poor customer treatment.

Product and service risk

The risk of loss, both financial and reputational, from the inherent design, management or distribution of products, or from the failure to meet or exceed customer expectations, competitor offerings or regulatory requirements.

Process and resource risk

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from inadequate or failed internal processes and systems, people-related events, damage to resources (excluding human resources), and deficiencies in the performance of external suppliers/service providers.

Theft, fraud and other criminal acts risk

The risk of reductions in earnings and/or value, through financial or reputational loss, resulting from frauds carried out against the Group, and/or theft of the Group's assets, and other criminal acts.

People risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from inappropriate staff behaviour, industrial action or health and safety issues. Loss can also be incurred through failure to recruit, retain, train, reward and incentivise appropriately skilled staff to achieve business objectives and through failure to take appropriate action as a result of staff underperformance.

Change risk

The risk of reductions in earnings and/or value, through financial or reputational loss, from change initiatives failing to deliver to requirements, budget or timescale or failing to implement change effectively or realise the desired benefits.

Governance

The risk of reductions in earnings and/or value, through financial or reputational loss, from poor corporate governance at group, divisional and business unit level. Corporate governance in this context embraces the structures, systems and processes that provide direction, control and accountability for the enterprise.

Risk appetite

Operational risk appetite is defined as the quantum and composition of operational risk identified in the Group and the direction in which the Group wishes to manage it.

The Group has developed an impact on earnings approach to operational risk appetite. This involves looking at how much the Group could lose due to operational risk losses at various levels of certainty. In setting operational risk appetite, the Group looks at both impact on solvency and the Group's reputation, including customer service requirements.

For legal and regulatory risk the Group has minimal risk appetite and seeks to operate to high ethical standards. The Group encourages and maintains an appropriately balanced legal and regulatory compliance culture and promotes policies and procedures to enable businesses and their staff to operate in accordance with the laws, regulations and voluntary codes which impact on the Group and its activities.

Exposures

The main sources of operational risk within the Group relate to uncertainties created by the changing business, in particular the legal and regulatory environment in which financial firms operate both in the UK and overseas. As a result the most significant operational risk exposures are legal and regulatory.

Legal and regulatory exposure is driven by the significant volume of current legislation and regulation with which the Group has to comply, along with new legislation and regulation which needs to be reviewed, assessed and embedded into day to day operational and business practices across the Group as a whole. Further uncertainties arise where regulations are principles based without supporting minimum standards either for the benefit of the consumer or firms. This gives rise to both the risk of retrospection from any one regulator combined with the risk of differing interpretation by individual regulators.

For legal and regulatory risks there are significant reputational risks associated with potential censure which drive the Group's stance on appetites referred to above. There are clear accountabilities and processes in place for reviewing new and changing requirements. Each business has a nominated individual with 'compliance oversight' responsibility under FSA rules. The role of such individuals is to advise and assist management to ensure that each business has a control structure which creates awareness of the rules and regulations, to which the Group is subject, and to monitor and report on adherence to these rules and regulations.

Measurement

Throughout 2007 there has been ongoing development of operational risk appetites and metrics to ensure both current and potential future operational risk exposures are understood in terms of both risk and reward potential.

The Group has a comprehensive and consistent operational risk management framework for the timely identification, measurement, monitoring and control of operational risk.

Integral to this operational risk management framework is a hybrid approach to calculating capital to support unexpected losses. The capital model calculations are driven by internal data which captures past losses, and forward looking scenarios which value potential future risk events. External industry wide data is collected to help with validating scenarios.

The capital model outputs are used to determine the internal capital charge for the Group which is then allocated to the businesses within the Group. Following review and approval of the operational risk management framework and capital model the FSA has granted the banking businesses within the Group an Advanced Measurement Approach (AMA) Waiver which recognises the embedding of the operational risk framework across the Group. The waiver allows the Group to calculate its own regulatory capital charge for operational risk from its capital model with effect from 1 January 2008.

The intention is to extend the same methodology to the insurance businesses within the Group where regulatory capital is currently determined under the ICA requirements.

Mitigation

The Group's operational risk management framework consists of five key components:

- Identification of the key operational risks facing a business area.
- Evaluation of the effectiveness of the control framework covering each of the key risks to which the business area is exposed.
- Evaluation of the non-financial exposures (e.g. reputational risk) for each of the risks to which the business area is exposed.
- For each of the material risks identified, an estimate of the exposure to financial losses that could result within the coming financial year, together with a 'worst case' stressed estimate.
- For each of the material risks identified an estimate of exposure to high impact, low frequency events through a scenario.

The Group purchases insurance to mitigate certain operational risk events.

Monitoring

Business unit risk exposure is aggregated at divisional level and reported to Group risk where a group-wide report is prepared. The report is discussed at the monthly group compliance and operational risk committee, with an extended report being reviewed once a quarter. This committee can escalate matters to the chief risk director, or higher committees if appropriate.

The insurance programme is monitored and reviewed regularly, with recommendations being made to the Group's senior management annually prior to each renewal. Insurers are monitored on an ongoing basis, to ensure counterparty risk is minimised. A process is in place to manage any insurer rating changes or insolvencies.

The Group has adopted a formal approach to operational risk event escalation. This involves the identification of an event, an assessment of the materiality of the event in accordance with a risk event impact matrix and appropriate escalation.

Financial soundness

Definition

The risk of financial failure, reputational loss, loss of earnings and/or value arising from a lack of liquidity, funding or capital, and/or the inappropriate recording, reporting and disclosure of financial, taxation and regulatory information.

Liquidity and funding

Liquidity risk is defined as the risk that the Group does not have sufficient financial resources to meet its commitments when they fall due, or can secure them only at excessive cost. Funding risk is further defined as the risk that the Group does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient.

Capital

Capital risk is defined as the risk that the group has insufficient capital to provide a stable resource to absorb any losses or that the capital structure is inefficient.

Financial and prudential regulatory reporting, disclosure and tax

The risk of reputational damage, loss of investor confidence and/or financial loss arising from, the adoption of inappropriate accounting policies, ineffective controls over financial, prudential regulatory and tax reporting and the failure to disclose information on a timely basis about the legal constitution of the Group.

Risk appetite

Financial soundness risk appetite is set and reported through various metrics that enable the Group to manage liquidity and capital constraints and shareholder expectations. It also includes the avoidance of the need for restatement of published financial and prudential regulatory reporting, disclosure and tax.

Exposure

Liquidity and funding

Liquidity exposure represents the amount of potential outflows in any future period less committed inflows in that period such that the Group is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. Liquidity is considered from both an internal and regulatory perspective.

Capital

Capital exposure arises should the Group have insufficient regulatory capital resources to support its strategic objectives and plans, and meet external stakeholder requirements and expectations.

The Group's capital management policy is focused on optimising value for shareholders. There is a clear focus on delivering organic growth and expected capital retentions are sufficient to support planned levels of growth. However, management also wishes to maintain the flexibility to make value enhancing 'in market' acquisitions and therefore, at this stage, there are no plans to return capital to shareholders other than by way of dividend payments. Management will keep all options for the utilisation of capital under review.

Financial and prudential regulatory reporting, disclosure and tax

Exposure represents the sufficiency of our policies and procedures to maintain adequate books and records to support statutory, regulatory and tax reporting, to present and detect financial reporting fraud and to manage the Group's tax exposure.

Measurement

Liquidity and funding

A series of measures are used across the Group to monitor both short and long term liquidity including ratios, cash outflow triggers and stress test survival period triggers.

An analysis of financial instrument liabilities of the Group, excluding those arising from insurance contracts, on an undiscounted future cash flow basis according to contractual maturity into relevant maturity groupings based on the remaining period at the balance sheet date is shown in note 47 to the accounts. An analysis of insurance contracts on a behavioural basis is also shown in note 47 to the accounts.

Capital

For the banking businesses the international standard for measuring capital adequacy is the risk asset ratio, which relates regulatory capital to balance sheet assets and off-balance sheet exposures weighted according to broad categories of risk as defined by the Basel I framework.

The Group's regulatory capital is divided into tiers defined by the European Community Banking Consolidation Directive as implemented in the UK by the FSA's General Prudential Sourcebook. Tier 1 comprises mainly shareholders' equity, tier 1 capital instruments and minority interests, after deducting goodwill and other intangible assets. Tier 2 comprises collective impairment provisions, and qualifying subordinated loan capital, with restrictions on the amount of collective impairment provisions and loan capital which may be included. The amount of qualifying tier 2 capital cannot exceed that of tier 1 capital. Total capital is reduced by deducting investments in subsidiaries and associates which are not consolidated for regulatory purposes and investments in the capital of other credit/financial institutions. In the case of Lloyds TSB Group, this means that the net assets of its life assurance and general insurance businesses are deducted from its regulatory capital.

Risk-weighted assets are determined according to a broad categorisation of the nature of each asset or exposure and counterparty and, for the FSA defined trading book, by taking into account market-related risks.

	31 December 2007 £m	31 December 2006 £m
Capital:		
Core tier 1		
Share capital and reserves	12,141	11,155
Regulatory post-retirement benefit adjustments	704	1,041
Other items	–	39
Perpetual non-cumulative preference shares		
Preference share capital and preferred securities	1,589	1,610
Innovative tier 1		
Innovative tier 1 capital instruments*	1,474	1,372
Adjustments to tier 1		
Available-for-sale revaluation reserve and cash flow hedging reserve	402	(12)
Goodwill	(2,358)	(2,377)
Total tier 1 capital	13,952	12,828
Tier 2		
Undated loan capital	4,457	4,390
Dated loan capital	3,441	3,624
Collectively assessed provisions	2,150	1,951
Available-for-sale revaluation reserve in respect of equities	12	–
Total tier 2 capital	10,060	9,965
	24,012	22,793
Supervisory deductions		
Life and pensions businesses	(4,373)	(5,368)
Other deductions	(762)	(790)
Total supervisory deductions	(5,135)	(6,158)
Total capital	18,877	16,635

	31 December 2007 £bn	31 December 2006 £bn
Risk-weighted assets (unaudited)		
UK Retail Banking	61.7	59.1
Insurance and Investments	3.3	3.1
Wholesale and International Banking	105.1	91.8
Central group items	1.9	2.0
Total risk-weighted assets	172.0	156.0
Risk asset ratios (unaudited)		
Total tier 1	8.1%	8.2%
Total tier 1, excluding innovative capital instruments*	7.3%	7.3%
Total capital	11.0%	10.7%

*A firm is permitted to include innovative tier 1 capital in its tier 1 capital resources for the purposes of GENPRU1.2 (adequacy of financial resources) but is required to exclude these amounts from tier 1 for the purposes of meeting the main BIPRU firm Pillar 1 rules. Accordingly, the Group has provided its tier 1 capital ratio both including and excluding these amounts.

There are limits imposed by the FSA as to the proportion of the regulatory capital base that can be made up of subordinated debt and preferred securities. The unpredictable nature of movements in the value of the investments supporting the long-term assurance funds could cause the amount of qualifying tier 2 capital to be restricted because of falling tier 1 resources. The Group seeks to ensure that even in the event of such restrictions the total capital ratio will remain adequate.

Lloyds TSB Group and its regulated subsidiary banks have been allocated an Individual Capital Ratio by the FSA, and the board has agreed a formal buffer to be maintained in addition to this ratio. Any breaches of the formal buffer must be notified to the FSA, together with proposed remedial action. No such notifications have been made during 2007.

With effect from 1 January 2008 the Group moved onto the Basel II framework and maintained satisfactory capital ratios throughout the transition as set out in further detail on page 51.

The life assurance and general insurance businesses are subject to separate regulatory rules. Further disclosure relating to the life assurance business, as required by FRS 27, is set out in detail on pages 52 to 56.

Financial and prudential regulatory reporting, disclosure and tax

The Group has developed procedures to ensure that compliance with both current and potential future requirements are understood and that policies are aligned to its risk appetite.

Mitigation

Liquidity and funding

The Group mitigates the risk of a liquidity mismatch which is outside of its appetite by managing the liquidity profile of the balance sheet through both short-term liquidity management and long-term strategic funding.

Short-term liquidity management is considered from two perspectives; business as usual and crisis liquidity, both of which relate to funding in the less than one year time horizon.

Longer term funding is used to manage the Group's strategic liquidity profile which is determined by the Group's balance sheet structure. Longer term is defined as an original maturity of more than one year.

The Group's funding and liquidity management is fundamentally based on a significant retail deposit base, accompanied by appropriate funding from the wholesale markets. A substantial proportion of the retail deposit base is made up of customer's current and savings accounts which, although repayable on demand, have traditionally in aggregate provided a stable source of funding. Additionally, the Group accesses the short-term wholesale markets to provide inter-bank deposits and to issue certificates of deposit and commercial paper to meet short-term obligations. The Group's short-term money market funding is based on an analysis of the market's capacity for the Group's credit, based on quantitative data. The Group has developed strong relationships with certain wholesale market segments, for example central banks and corporate customers, to supplement its retail deposit base.

During 2007, amounts deposited by customers increased by £17,213 million from £139,342 million at 31 December 2006 to £156,555 million at 31 December 2007. These customer deposits were supplemented by short-term wholesale market operations, the use of sale and repurchase agreements and the issue of subordinated loan capital and wholesale funding sources in the capital markets; these comprised Euro Medium-Term Note programmes, of which £7,090 million had been utilised for senior funding at 31 December 2007, and commercial paper programmes, under which £5,051 million had been utilised at 31 December 2007. The Group also raised wholesale funding via the issuance of Residential Mortgage Backed Securities; £12,403 million was outstanding at 31 December 2007.

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

Within the insurance businesses, non-linked funds investments are arranged to minimise the possibility of being a distressed seller whilst at the same time investing to meet policyholder obligations. For unit-linked business, deferral provisions are designed to give time to realise linked assets without being a forced seller.

Capital

The Group is able to raise funds by issuing subordinated liabilities or equity. As at 31 December 2007, the Group had £11,958 million of subordinated debt in issuance. The cost and availability of subordinated liability finance are influenced by credit ratings. A reduction in these ratings could increase the cost and could reduce market access. At 31 December 2007, the credit ratings of Lloyds TSB Bank, the primary issuer in the Group, were as follows:

	Senior debt
Moody's	Aaa
Standard & Poor's	AA
Fitch	AA+

The ratings outlook from Moody's, Standard & Poor's and Fitch for Lloyds TSB Bank is stable. These credit ratings are not a recommendation to buy, hold or sell any security; and each rating should be evaluated independently of every other rating.

Financial and prudential regulatory reporting, disclosure and tax

The Group maintains a system of internal controls, consistently applied, providing reasonable assurance that transactions are recorded and undertaken in accordance with delegated authorities that permit the preparation and disclosure of financial statements, prudential regulatory reporting and tax returns in accordance with IFRS, statutory and regulatory requirements.

Monitoring

Liquidity and funding

Liquidity is actively monitored at business unit and group level at an appropriate frequency. Routine reporting is in place to senior management and through the Group's committee structure, in particular GALCO. In a stress situation the level of monitoring and reporting is increased commensurate with the nature of the event. Liquidity policies and procedures are subject to independent oversight.

Capital

Capital is actively managed at an appropriate level of frequency and regulatory ratios are a key factor in the Group's budgeting and planning processes with updates of expected ratios reviewed regularly during the year by GALCO. Capital raised takes account of expected growth and currency of risk assets. Capital policies and procedures are subject to independent oversight.

Financial and prudential regulatory reporting, disclosure and tax

The group undertakes a programme of work designed to support an annual assessment of the effectiveness of internal controls over financial reporting, in accordance with the requirements of s.404 of the US Sarbanes-Oxley Act of 2002; to identify and maintain tax liabilities and to assess emerging regulation and legislation.

Basel II (unaudited)

The Group has placed significant focus on the implementation of Basel II. During the year the Group was successful in obtaining the FSA's approval of both its credit risk waiver application to use an Internal Ratings Based (IRB) approach for the majority of its credit portfolios (Retail IRB for retail portfolios and Foundation IRB for non-retail portfolios) and of its application to use the Advanced Measurement Approach (AMA) for operational risk. It also submitted to the FSA its Internal Capital Adequacy Assessment Process document in April 2007.

For information, a comparison of Basel I to Basel II equivalents, on the Group's key ratios as at 31 December 2007 is shown below:

	Basel I 31 December 2007 £m	Basel II 31 December 2007 £m
Capital:		
Tier 1	13,952	13,545
Tier 2	10,060	6,994
	24,012	20,539
Supervisory deductions	(5,135)	(4,864)
Total regulatory capital	18,877	15,675

	31 December 2007 £bn	31 December 2007 £bn
Total risk-weighted assets equivalent	172.0	142.6
Risk asset ratios:		
Tier 1	8.1%	9.5%
Total capital	11.0%	11.0%

The principal movements are:

- a reduction of tier 1 capital resources primarily arising from a deduction of 50 per cent of the difference between expected loss and accounting impairment provisions partially offset by related notional tax relief.
- a reduction of tier 2 capital resources primarily arising from a deduction of 50 per cent of the difference between expected loss and accounting impairment provisions, together with the removal of collective impairment provisions which no longer qualify as tier 2 capital under the Basel II rules.
- a reduction in supervisory deduction reflecting derecognition for capital adequacy purposes of mortgage securitisation.
- a reduction in total risk-weighted assets, reflecting the application of the IRB approach to the majority of the Group's credit portfolios, offset, in part, by the introduction of a specific charge for operational risk.

The above comparison is set out using the risk asset ratio framework, which, as explained above, remains the international standard for measuring capital adequacy. The FSA's approach to such measurement under Basel II is now based primarily on monitoring the relationship of the Capital Resources Requirement (CRR – broadly equivalent to 8 per cent of risk-weighted assets and thus representing the capital required under Pillar 1 of Basel II) to available capital resources. Notwithstanding this new approach, the Group will continue to report ratios both internally and externally. The FSA is also setting Individual Capital Guidance (ICG) for each UK bank, calibrated by reference to its CRR. A key input to the FSA's ICG setting process (which addresses the requirements of Pillar 2 under Basel II) is each bank's Internal Capital Adequacy Assessment Process (ICAAP). The Group submitted its ICAAP document to the FSA in April 2007. The FSA has made it clear that each ICG remains a confidential matter between each bank and the FSA.

Future changes to regulatory capital rules

The regulatory capital regime is subject to ongoing review and development by the regulator. The Group continues to work with the regulator to assess the impact on the Group's regulatory capital requirements and resources.

Life assurance businesses

The principal subsidiary involved in the Group's life assurance operations is Scottish Widows plc ('Scottish Widows'), which holds the only large With Profit Fund managed by the Lloyds TSB Group. Throughout 2006 and up until the third quarter of 2007, the Group also owned Abbey Life Assurance Company Limited (which had been closed to new business since March 2000) but this business was sold at the end of September 2007.

Basis of determining regulatory capital of the life assurance businesses

Available capital resources

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

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

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

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

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

Regulatory capital requirements

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

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

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

Capital statement

The following table provides more detail regarding the sources of capital in the life assurance business. The figures quoted are based on management's current expectations pending completion of the annual financial return to the FSA. The figures allow for an anticipated transfer of £300 million from the Long Term Fund to the Shareholder Fund as at 31 December 2007.

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2007					
Assets attributable to the shareholder held outside the long-term funds	–	–	–	946	946
Assets attributable to the shareholder held within the long-term funds	–	2,346	2,346	–	2,346
Total shareholders' funds	–	2,346	2,346	946	3,292
Adjustments onto a regulatory basis:					
Life assurance business					
Unallocated surplus within insurance business	569	–	569	–	569
Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities	–	(431)	(431)	(600)	(1,031)
Adjustment to include estimated 'realistic' liabilities payable to the shareholder	(634)	–	(634)	–	(634)
Adjustment to replace 'realistic' liabilities with statutory liabilities	3,696	–	3,696	–	3,696
Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With Profit Fund	(23)	–	(23)	–	(23)
Qualifying loan capital	–	–	–	541	541
Available capital resources	3,608	1,915	5,523	887	6,410

The figures shown above for available capital resources within the insurance business relate to Scottish Widows plc only. The estimated total additional resources relating to the other life assurance subsidiaries within the Group are £330 million.

The comparative position as at 31 December 2006 was as follows (again, relating to Scottish Widows plc only):

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2006					
Assets attributable to the shareholder held outside the long-term funds	–	–	–	1,947	1,947
Assets attributable to the shareholder held within the long-term funds	–	2,225	2,225	–	2,225
Total shareholders' funds	–	2,225	2,225	1,947	4,172
Adjustments onto a regulatory basis:					
Life assurance business					
Unallocated surplus within insurance business	615	–	615	–	615
Adjustments to remove differences between IFRS and regulatory valuation of assets and liabilities	–	(263)	(263)	(810)	(1,073)
Adjustment to include estimated 'realistic' liabilities payable to the shareholder	(680)	–	(680)	–	(680)
Adjustment to replace 'realistic' liabilities with statutory liabilities	3,783	–	3,783	–	3,783
Adjustment to remove the value of future profits recognised in respect of non-participating contracts written in the With Profit Fund	(32)	–	(32)	–	(32)
Qualifying loan capital	–	–	–	533	533
Available capital resources	3,686	1,962	5,648	1,670	7,318

Formal intra-group capital arrangements

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

Constraints over available capital resources

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

Requirement to maintain a Support Account: The Scheme requires the maintenance of a 'Support Account' within the Non-Participating Fund. The quantum of the Support Account is calculated with reference to the value of assets backing current with-profits policies which also existed at the date of demutualisation and must be maintained until the value of these assets reaches a minimum level. Assets can only be transferred from the Non-Participating Fund if the value of the remaining assets in the fund exceeds the value of the Support Account. Scottish Widows has obtained from the FSA permission to include the value of the Support Account in assessing the realistic value of assets available to the With Profit Fund. At 31 December 2007, the estimated value of surplus admissible assets in the Non-Participating Fund was £1,915 million (31 December 2006: £1,962 million) and the estimated value of the Support Account was £827 million (31 December 2006: £974 million).

Further Support Account: The Further Support Account is an extra tier of capital support for the with-profits policies in existence at the date of demutualisation. The Scheme requires that assets can only be transferred from the Non-Participating Fund if the economic value of the remaining assets in the fund exceeds the aggregate of the Support Account and Further Support Account. Unlike the Support Account test, the economic value used for this test includes both admissible assets and the present value of future profits of business written in the Non-Participating Fund or by any subsidiaries of that fund. The balance of the Further Support Account is expected to reduce to nil by the year 2030. At 31 December 2007, the estimated net economic value of the Non-Participating Fund and its subsidiaries for the purposes of this test was £4,028 million (31 December 2006: £3,962 million) and the estimated combined value of the Support Account and Further Support Account was £2,834 million (31 December 2006: £2,873 million).

Other restrictions in the Non-Participating Fund: In addition to the policies which existed at the date of demutualisation, the With Profit Fund includes policies which have been written since that date. As a result of statements made to policyholders that investment policy will usually be the same for both types of business, there is an implicit requirement to hold additional regulatory assets in respect of the business written after demutualisation. The estimated amount required to provide such support at 31 December 2007 is £193 million (31 December 2006: £216 million). Scottish Widows has obtained from the FSA permission to include the value of this support in assessing the realistic value of assets available to the With Profit Fund. There is a further test requiring that no amounts can be transferred from the Non-Participating Fund of Scottish Widows unless there are sufficient assets within the Long Term Fund to meet both policyholders' reasonable expectations in light of liabilities in force at a year end and the new business expected to be written over the following year.

Movements in regulatory capital

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

	With Profit Fund £m	Non-Participating Fund £m	Total Long Term Fund £m	Shareholder Fund £m	Total £m
As at 31 December 2006	3,686	1,962	5,648	1,670	7,318
Changes in assumptions used to measure life assurance liabilities	(104)	(40)	(144)	–	(144)
Dividends and capital transfers	–	(300)	(300)	(1,560)	(1,860)
Changes in regulatory requirements	–	69	69	–	69
New business and other factors	26	224	250	777	1,027
As at 31 December 2007	**3,608**	**1,915**	**5,523**	**887**	**6,410**

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

With Profit Fund

Available capital in the With Profit Fund has decreased from £3,686 million at 31 December 2006 to an estimated £3,608 million at 31 December 2007. The key driver is investment market performance, which was broadly neutral over 2007.

Non-Participating Fund

Available capital in the Non-Participating Fund has decreased from £1,962 million at 31 December 2006 to an estimated £1,915 million at 31 December 2007. This is primarily a result of the anticipated transfer from the Non-Participating Fund to the Shareholder Fund at the year end of £300 million, offset by the return generated from the business.

Shareholder Fund

During 2007, dividends of £1,860 million were paid. These were partly financed by the sale of Abbey Life Assurance Company Limited.

Financial information calculated on a 'realistic' basis

The estimated financial position of the With Profit Fund of Scottish Widows at 31 December 2007, calculated on a 'realistic' basis, is given in the following table, in the form reported to the FSA. As a result of the capital support arrangements, it is considered appropriate to also disclose the estimated 'realistic' financial position of the Long Term Fund of Scottish Widows as a whole, which consists of both the With Profit Fund and the Non-Participating Fund.

	31 December 2007		31 December 2006	
	With Profit Fund £m	Long Term Fund £m	With Profit Fund £m	Long Term Fund £m
Realistic value of assets of fund	16,781	20,929	18,183	22,278
Support arrangement assets	1,020	–	1,190	–
Realistic value of assets available to the fund	17,801	20,929	19,373	22,278
Realistic value of liabilities of fund	(16,846)	(16,901)	(18,248)	(18,316)
Working capital for fund	955	4,028	1,125	3,962
Working capital ratio for fund	5.4%	19.2%	5.8%	17.9%

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

	31 December 2007		31 December 2006	
	With Profit Fund £m	Long Term Fund £m	With Profit Fund £m	Long Term Fund £m
Available regulatory capital	3,608	5,523	3,686	5,648
Support arrangement assets	1,020	–	1,190	–
Adjustments to replace statutory liabilities with 'realistic' liabilities	(3,696)	(3,582)	(3,783)	(3,614)
Adjustments to include the value of future profits recognised in respect of Non-Participating business written in the With Profit Fund	23	23	32	32
Recognition of future profits allowable for 'realistic' capital purposes	–	2,064	–	1,896
	955	4,028	1,125	3,962

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

	Scottish Widows plc With Profit Fund (in accordance with FRS 27) £m	Other long-term funds £m	Total life business £m
As at 31 December 2007			
With Profit Fund liabilities	16,404	–	16,404
Unit-linked business (excluding that accounted for as investment contracts)	–	14,282	14,282
Other life assurance business	–	6,714	6,714
Insurance and participating investment contract liabilities	16,404	20,996	37,400
Non-participating investment contract liabilities	–	18,197	18,197
Total policyholder liabilities	16,404	39,193	55,597

	Scottish Widows plc With Profit Fund (in accordance with FRS 27) £m	Other long-term funds £m	Total life business £m
As at 31 December 2006			
With Profit Fund liabilities	17,827	116	17,943
Unit-linked business (excluding that accounted for as investment contracts)	–	12,734	12,734
Other life assurance business	–	10,181	10,181
Insurance and participating investment contract liabilities	17,827	23,031	40,858
Non-participating investment contract liabilities	–	24,370	24,370
Total policyholder liabilities	17,827	47,401	65,228

The sale of Abbey Life Assurance Company Limited during 2007 reduced total policyholder liabilities by £11,632 million.

Capital sensitivities

Shareholders' funds

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

With Profit Fund

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

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

Other long-term funds

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

Assets held in excess of those backing actuarial reserves are invested across a range of investment categories including fixed interest securities, equities, properties and cash. The mix of investments is determined in line with the policy of Lloyds TSB Group to minimise the working capital (defined as available capital less minimum required capital) required to ensure all capital requirements continue to be met under a range of stress tests.

Options and guarantees

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

Options and guarantees within the With Profit Fund

The most significant options and guarantees provided from within the With Profit Fund are in respect of guaranteed minimum cash benefits on death, maturity, retirement or certain policy anniversaries, and guaranteed annuity options on retirement for certain pension policies. For those policies written pre-demutualisation containing potentially valuable options and guarantees, under the terms of the Scheme a separate memorandum account was set up within the With Profit Fund of Scottish Widows called the Additional Account which is available, inter alia, to meet any additional costs of providing guaranteed benefits in respect of those policies. The Additional Account had a value at 31 December 2007 of £1.7 billion (2006: £1.8 billion). The eventual cost of providing benefits on policies written both pre and post demutualisation is dependent upon a large number of variables, including future interest rates and equity values, demographic factors, such as mortality, and the proportion of policyholders who seek to exercise their options. The ultimate cost will therefore not be known for many years.

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

The most significant economic assumptions included in the model are:

- Risk-free yield. The risk-free yield is defined as 0.1 per cent higher than spot yields derived from the UK gilt yield curve.
- Investment volatility. The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical observed volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2007, the 10 year equity-implied at-the-money assumption was set at 25.5 per cent (31 December 2006: 20 per cent). The assumption for property volatility was 15 per cent (31 December 2006: 15 per cent). The volatility of interest rates has been calibrated to the implied volatility of swaptions which was broadly 11 per cent (31 December 2006: 13 per cent).

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

Options and guarantees outside the With Profit Fund of Scottish Widows

Certain personal pension policyholders, for whom reinstatement to their occupational pension scheme was not an option, have been given a guarantee that their pension and other benefits will correspond in value to the benefits of the relevant occupational pension scheme. The key assumptions affecting the ultimate value of the guarantee are future salary growth, gilt yields at retirement, annuitant mortality at retirement, marital status at retirement and future investment returns. There is currently a provision, calculated on a deterministic basis, of £65 million (31 December 2006: £98 million) in respect of those guarantees. If future salary growth were 0.5 per cent per annum greater than assumed, the liability would increase by some £3 million. If yields were 0.5 per cent lower than assumed, the liability would increase by some £12 million.

Five year financial summary

The financial information set out in the table below has been derived from the annual report and accounts of Lloyds TSB Group plc for each of the past five years. 2005 was the first year in which the annual report and accounts were prepared under International Financial Reporting Standards (IFRS). 2004 and earlier years had been prepared under UK Generally Accepted Accounting Principles (UK GAAP) and earlier years had been adjusted for subsequent changes in accounting policy and presentation. To bridge the change in framework, 2004 figures have been presented under both IFRS and UK GAAP. Under IFRS, accounting standards dealing with financial instruments (IAS 32 and IAS 39) and insurance (IFRS 4 and FRS 27) were applied only from 1 January 2005. To aid comparison, IFRS balance sheet data is presented as at 1 January 2005 rather than 31 December 2004; the 2004 IFRS income statement data is not comparable to the data for 2005 and 2006. The financial statements for each of the years presented have been audited by PricewaterhouseCoopers LLP, independent auditors.

	IFRS				UK GAAP	
	2007	2006	2005	2004	2004	2003
Income statement data for the year ended 31 December (£m)						
Total income, net of insurance claims	**10,706**	11,104	10,540	9,661	9,343	9,672
Operating expenses	**(5,567)**	(5,301)	(5,471)	(5,297)	(4,917)	(5,173)
Trading surplus	**5,139**	5,803	5,069	4,364	4,426	4,499
Impairment	**(1,796)**	(1,555)	(1,299)	(866)	(866)	(950)
Profit before tax	**4,000**	4,248	3,820	3,477	3,493	4,348
Profit for the year	**3,321**	2,907	2,555	2,459	2,489	3,323
Profit for the year attributable to equity shareholders	**3,289**	2,803	2,493	2,392	2,421	3,254
Total dividend for the year[1]	**2,026**	1,927	1,915	1,914	1,914	1,911
	31 December 2007	31 December 2006	31 December 2005	1 January 2005	31 December 2004	31 December 2003
Balance sheet data (£m)						
Share capital	**1,432**	1,429	1,420	1,419	1,419	1,418
Shareholders' equity	**12,141**	11,155	10,195	9,489	9,977	9,624
Net asset value per ordinary share	**212p**	195p	180p	167p	176p	170p
Customer accounts	**156,555**	139,342	131,070	126,349	122,062	116,496
Subordinated liabilities	**11,958**	12,072	12,402	11,211	10,252	10,454
Loans and advances to customers	**209,814**	188,285	174,944	161,162	154,240	135,251
Total assets	**353,346**	343,598	309,754	292,854	279,843	252,012
	2007	2006	2005	2004	2004	2003
Share information						
Basic earnings per ordinary share	**58.3p**	49.9p	44.6p	42.8p	43.3p	58.3p
Diluted earnings per ordinary share	**57.9p**	49.5p	44.2p	42.5p	43.0p	58.1p
Total dividend per ordinary share[1]	**35.9p**	34.2p	34.2p	34.2p	34.2p	34.2p
Market price (year end)	**472.0p**	571.5p	488.5p	473p	473p	448p
Number of shareholders (thousands)	**814**	870	920	953	953	974
Number of ordinary shares in issue (millions)[2]	**5,648**	5,638	5,603	5,596	5,596	5,594
	2007	2006	2005	2004	2004	2003
Financial ratios (%)[3]						
Dividend payout ratio	**61.6**	68.7	76.8	80.0	79.1	58.7
Post-tax return on average shareholders' equity	**28.2**	26.6	25.6	22.8	24.3	38.5
Post-tax return on average risk-weighted assets	**2.03**	1.89	1.81	1.99	2.01	2.63
Cost:income ratio[4]	**52.0**	47.7	51.9	54.8	51.4	52.2
	31 December 2007	31 December 2006	31 December 2005	1 January 2005	31 December 2004	31 December 2003
Capital ratios (%)						
Total capital	**11.0**	10.7	10.9	10.1	10.0	11.3
Tier 1 capital	**8.1**	8.2	7.9	8.2	8.9	9.5

[1] Annual dividends comprise both interim and estimated final dividend payments. Under IFRS, the total dividend for the year represents the interim dividend paid during the year and the final dividend which will be paid and accounted for during the following year. Under UK GAAP, final dividends are included in the year to which they relate rather than in the year in which they are paid.

[2] This figure excludes 79 million limited voting ordinary shares.

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

[4] The cost:income ratio is calculated as total operating expenses as a percentage of total income (net of insurance claims for the IFRS numbers in 2004 and later years).

The board

Non-executive directors

* Member of the audit committee
** Chairman of the audit committee
◆ Member of the nomination committee
◆◆ Chairman of the nomination committee
† Member of the remuneration committee
†† Chairman of the remuneration committee
\+ Member of the risk oversight committee
++ Chairman of the risk oversight committee
✠ Independent director
▲ Senior independent director

Sir Victor Blank◆◆†++
Chairman
Joined the board in 2006 as deputy chairman and became chairman in May 2006. Former partner in Clifford-Turner (now Clifford Chance) from 1969 to 1981 and chairman and chief executive of Charterhouse until 1997. Director of The Royal Bank of Scotland from 1985 to 1993 and of GUS from 1993 to 2006 (chairman from 2000). Chairman of Trinity Mirror from 1999 to 2006. A member of the Financial Reporting Council from 2002 to 2007 and a member of the Council of Oxford University from 2000 to 2007. A senior adviser to the Texas Pacific Group. Chairs two charities, WellBeing of Women and UJS Hillel, as well as the Council of University College School. Aged 65.

Wolfgang C G Berndt✠◆††
Joined the board in 2003. Joined Procter and Gamble in 1967 and held a number of senior and general management appointments in Europe, South America and North America, before retiring in 2001. A non-executive director of Cadbury Schweppes, GfK AG and Telekom Austria. Aged 65.

Ewan Brown CBE FRSE▲+**
Joined the board and became chairman of Lloyds TSB Scotland in 1999. Joined Noble Grossart in 1969 and was an executive director of that company until December 2003. A non-executive director of Noble Grossart and Stagecoach Group, senior governor of the Court of the University of St Andrews and vice chairman of the Edinburgh International Festival. A former chairman of tie and non-executive director of John Wood Group. Aged 65.

Jan P du Plessis✠*◆
Joined the board in 2005. Chairman of British American Tobacco. Held a number of senior and general management appointments in Rembrandt Group from 1981, before joining Compagnie Financière Richemont as group finance director in 1988, a position he held until 2004. A former chairman of RHM from 2005 to 2007 and group finance director of Rothmans International from 1990 to 1995. Aged 54.

Philip N Green✠†*
Joined the board in May 2007. Appointed chief executive of United Utilities in 2006. Former chief executive of Royal P&O Nedlloyd from 2003 to 2005. Previously held senior positions in DHL from 1990 to 1999, becoming chief operating officer for Europe and Africa in 1994, and the Reuters Group from 1999 to 2003, becoming chief operating officer in 2001. A director of Business in the Community, a member of the UK Commission for Employment and Skills and a trustee of the Philharmonia Orchestra. Aged 54.

Sir Julian Horn-Smith✠◆†+
Joined the board in 2005. Held a number of senior and general management appointments in Vodafone from 1984 to 2006 including a directorship of that company from 1996 and of deputy chief executive officer from 2005. Previously held positions in Rediffusion from 1972 to 1978, Philips from 1978 to 1982 and Mars GB from 1982 to 1984. A non-executive director of Digicel Group, a member of the Altimo International advisory board and a senior adviser to UBS in relation to the global telecommunications sector. A former chairman of The Sage Group. Aged 59.

Lord Leitch✠*◆+
Joined the board in 2005. Appointed chairman of Scottish Widows in 2007. Held a number of senior and general management appointments in Allied Dunbar, Eagle Star and Threadneedle Asset Management before the merger of Zurich Group and British American Tobacco's financial services businesses in 1998. Subsequently served as chairman and chief executive officer of Zurich Financial Services (UK & Asia Pacific) until his retirement in 2004. Chairman of the government's Review of Skills (published in December 2006) and deputy chairman of the Commonwealth Education Fund. Chairman of BUPA and Intrinsic Financial Services and a non-executive director of Paternoster and United Business Media. Former chairman of the National Employment Panel. Aged 60.

Sir David Manning GCMG CVO✠
Joins the board on 1 May 2008. Entered the Foreign and Commonwealth Office in 1972 and held senior appointments, including HM ambassador to Israel between 1995 and 1998, foreign policy adviser to the Prime Minister from 2001 to 2003 and HM ambassador to the USA from 2003 to 2007. Aged 58.

Executive directors

J Eric Daniels
Group Chief Executive
Joined the board in 2001 as group executive director, UK retail banking before his appointment as group chief executive in June 2003. Served with Citibank from 1975 and held a number of senior and general management appointments in the USA, South America and Europe before becoming chief operating officer of Citibank Consumer Bank in 1998. Following the Citibank/Travelers merger in 1998, he was chairman and chief executive officer of Travelers Life and Annuity until 2000. Chairman and chief executive officer of Zona Financiera from 2000 to 2001. Aged 56.

Michael E Fairey
Deputy Group Chief Executive
(retiring on 30 June 2008)
Joined TSB Group in 1991 and held a number of senior and general management appointments before being appointed to the board in 1997 and deputy group chief executive in 1998. Joined Barclays Bank in 1967 and held a number of senior and general management appointments, including managing director of Barclays Direct Lending Services from 1990 to 1991. A non-executive director of The Energy Saving Trust and VTX Bidco. President of The British Quality Foundation and chairman of Race for Opportunity. Aged 59.

Terri A Dial
Group Executive Director, UK Retail Banking
Joined the board in 2005. Served with Wells Fargo in the USA from 1973 to 2001 where she held a number of senior and general management appointments before becoming president and chief executive officer of Wells Fargo Bank in 1998. Chairs the retail committee of the British Bankers' Association. A non-executive director of the LookSmart Corporation and a member of the advisory board of the Judge Business School of Cambridge and the London Skills and Employment Board. Aged 58.

Archie G Kane
Group Executive Director, Insurance and Investments
Joined TSB Commercial Holdings in 1986 and held a number of senior and general management appointments in Lloyds TSB Group before being appointed to the board in 2000, as group executive director, IT and operations. Appointed group executive director, insurance and investments in October 2003. After some 10 years in the accountancy profession, joined General Telephone & Electronics Corporation in 1980, serving as finance director in the UK from 1983 to 1985. Chairman of the Association of British Insurers. Aged 55.

G Truett Tate
Group Executive Director, Wholesale and International Banking
Joined the group in 2003 as managing director, corporate banking before being appointed to the board in 2004. Served with Citigroup from 1972 to 1999, where he held a number of senior and general management appointments in the USA, South America, Asia and Europe. He was president and chief executive officer of eCharge Corporation from 1999 to 2001 and co-founder and vice chairman of the board of Chase Cost Management Inc from 1996 to 2003. A non-executive director of BritishAmerican Business Inc. A member of the fund-raising board of the National Society for the Prevention of Cruelty to Children. Aged 57.

Helen A Weir CBE
Group Finance Director
Joined the board in 2004. Group finance director of Kingfisher from 2000 to 2004. Previously finance director of B&Q from 1997, having joined that company in 1995, and held a senior position at McKinsey & Co from 1990 to 1995. Began her career at Unilever in 1983. A non-executive director of Royal Mail Holdings. A member of the Said Business School Advisory Board and a former member of the Accounting Standards Board. Aged 45.

Alastair J Michie FCIS FCIBS
Company Secretary

Directors' report

Results and dividends

The consolidated income statement on page 77 shows a profit attributable to equity shareholders for the year ended 31 December 2007 of £3,289 million.

An interim dividend of 11.2p per ordinary share was paid on 3 October 2007 and a final dividend of 24.7p per ordinary share will be paid on 7 May 2008. These dividends will absorb £2,026 million.

Principal activities, business review, future developments and financial risk management objectives and policies

The Company is a holding company and its subsidiary undertakings provide a wide range of banking and financial services through branches and offices in the UK and overseas. A review of the development and performance of the business during the financial year and an indication of the likely future developments are given on pages 2 to 56. Key performance indicators are shown on page i. Information regarding the financial risk management objectives and policies of the Company and its subsidiary undertakings, in relation to the use of financial instruments, is given on pages 36 to 56 and in note 47 on pages 134 to 142.

Directors

Biographical details of directors are shown on pages 58 and 59. Particulars of their emoluments and interests in shares in the Company are given on pages 64 to 75.

Dr DeAnne S Julius and Mr G J N Gemmell left the board on 9 May 2007 and 30 September 2007, respectively.

Mr P N Green joined the board on 10 May 2007 and Sir David Manning has been appointed a director from 1 May 2008. In accordance with the articles of association, they offer themselves for election at the annual general meeting.

Mr M E Fairey, Sir Julian Horn-Smith and Mr G T Tate retire at the annual general meeting and offer themselves for re-election. Mr Ewan Brown, whom the board has asked to remain as a director for a further year, also seeks re-election as stated in the corporate governance report on page 62.

Directors' indemnities

The directors, including two former directors who left during the year, entered into individual contracts of indemnity with the Company which constituted 'qualifying third party indemnity provisions' for the purposes of the Companies Act 1985. These contracts were in force during the whole of the financial year or from the date of appointment in respect of the director who joined the board on 10 May 2007. Since the end of the year following the introduction of relevant sections of the Companies Act 2006, revised contracts of indemnity were entered into with the directors which constitute 'qualifying third party indemnity provisions' and 'qualifying pension scheme indemnity provisions' and these remain in force and are available for inspection at the Company's registered office.

Share capital and control

Information about share capital and control is shown in note 39 on pages 122 to 124; in note 6 of the parent company accounts, included within this document, on page 153; in the corporate governance report on pages 61 to 63; and in the directors' remuneration report on pages 64 to 75.

Employees

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

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

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

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

Donations

The income statement includes a charge for charitable donations totalling £37,463,000 (2006: £37,335,000), including £37,183,000 (2006: £37,133,000) which will be paid under deeds of covenant to the four Lloyds TSB Foundations during 2008.

Policy and practice on payment of creditors

The Company follows 'The Better Payment Practice Code' published by the Department of Business, Enterprise and Regulatory Reform (BERR), regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the BERR as shown on page 159.

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

As the Company owed no amounts to trade creditors at 31 December 2007, the number of days required to be shown in this report, to comply with the provisions of the Companies Act 1985, is nil.

Auditors and audit information

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

Resolutions concerning the re-appointment of PricewaterhouseCoopers LLP as auditors and authorising the audit committee to set their remuneration will be proposed at the annual general meeting.

On behalf of the board

A J Michie
Company Secretary
21 February 2008

Corporate governance

Compliance with the combined code

The board considers that good governance is central to achieving the Group's governing objective of maximising shareholder value over time. That has been uppermost in directors' minds when applying the principles contained in the combined code on corporate governance issued by the Financial Reporting Council. The Group has complied with the provisions of the code and has done so throughout the year regarding the provisions where the requirements are of a continuing nature.

The board and its committees

The Group is led by a board comprising executive and non-executive directors with wide experience. The appointment of directors is considered by the board and, following the provisions in the articles of association, they must stand for election by the shareholders at the first annual general meeting following their appointment and must retire, and may stand for re-election by the shareholders, at least every three years. Independent non-executive directors are appointed for three-year renewable terms, which may, in accordance with the articles of association, be terminated without notice or payment of compensation.

The board meets at least nine times a year. It has a programme designed to enable the directors regularly to review corporate strategy and the operations and results of the businesses and discharge their duties within a framework of prudent and effective controls relating to the assessing and managing of risk.

The roles of the chairman, the group chief executive and the board and its governance arrangements, including the schedule of matters specifically reserved to the board for decision, are reviewed annually. The matters reserved to the board for decision include the approval of the annual report and accounts and any other financial statements; the payment of dividends; the long term objectives of the Group; the strategies necessary to achieve these objectives; the Group's budgets and plans; significant capital expenditure items; significant investments and disposals; the basis of allocation of capital within the Group; the organisation structure of the Group; the arrangements for ensuring that the Group manages risks effectively; any significant change in accounting policies or practices; the appointment of the Company's main professional advisers and their fees; and the appointment of senior executives within the organisation and related succession planning.

According to the articles of association, the business and affairs of the Company are managed by the directors, who have delegated to management the power to make decisions on operational matters, including those relating to credit, liquidity and market risk, within an agreed framework.

All directors have access to the services of the company secretary, and independent professional advice is available to the directors at the Group's expense, where they judge it necessary to discharge their duties as directors.

During the year, the board conducted a formal evaluation of its performance and that of its committees and individual directors, with advice and assistance from Dr Tracy Long, of Boardroom Review. Directors were invited to comment, through questionnaires and interviews, and the responses were reviewed and discussed by the board. Where areas for improvement were identified, action has been agreed.

The chairman's performance was evaluated by the non-executive directors, taking account of the views of executive directors. This appraisal was discussed at a meeting of the non-executive directors, led by the senior independent director, without the chairman being present.

The remuneration committee reviewed the performance of the chairman, the group chief executive and the other group executive directors, when considering their remuneration arrangements. The nomination committee reviewed the performance of all the directors and the independence of non-executive directors. Like all board committees, the nomination committee and remuneration committee report to the board on their recommendations and decisions, including the results of the performance and independence evaluations.

The chairman has a private discussion at least once a year with every director on a wide range of issues affecting the Group, including any matters which the directors, individually, wish to raise.

There is an induction programme for all new directors, which is tailored to their specific requirements and includes visits to individual businesses and meetings with senior management. Major shareholders are also offered the opportunity to meet new non-executive directors. Additional training and updates on particular issues are arranged as appropriate.

Meetings with shareholders

In order to develop an understanding of the views of major shareholders, the board receives regular reports from the group finance director and the director of investor relations.

The chairman, the group chief executive and the group finance director also have meetings with representatives of major shareholders and the senior independent director also attends some of these meetings. In addition, all directors are invited to attend investment analysts' and stockbrokers' briefings on the financial results.

All shareholders are encouraged to attend and participate in the Group's annual general meeting.

Each resolution considered at the annual general meeting in 2007 was decided on a poll. Votes representing some fifty per cent of the total number of shares in issue were cast and each resolution was passed by a substantial majority. Details of the poll results were announced following the meeting and displayed on our website, www.lloydstsb.com. They are available from the company secretary.

The resolutions to be considered at the annual general meeting in 2008 will also be decided on a poll. Details of the results will be announced following the meeting and will be displayed on our website, www.lloydstsb.com. They will also be available from the company secretary.

Audit committee

The audit committee comprises Mr Brown (chairman), Mr du Plessis (who will succeed Mr Brown as chairman after the annual general meeting), Mr Green and Lord Leitch. The committee's terms of reference are available from the company secretary and are displayed on our website www.lloydstsb.com.

During the year, the audit committee received reports from, and held discussions with, management and the auditors. In discharging its duties, the committee has approved the auditors' terms of engagement, including their remuneration and, in discussion with them, has assessed their independence and objectivity (more information about which is given in note 10 to the accounts, in relation to the procedure for approving fees for audit and non-audit work) and recommended their re-appointment at the annual general meeting. The committee also reviewed the financial statements published in the name of the board and the quality and acceptability of the related accounting policies, practices and financial reporting disclosures; the scope of the work of the group audit department, reports from that department and the adequacy of its resources; the effectiveness of the systems for internal control, risk management and compliance with financial services legislation and regulations (more information about which is given in the note about internal control on page 63); the results of the external audit and its cost effectiveness; and reports from the external auditors on audit planning and their findings on accounting and internal control systems. Procedures for handling complaints regarding accounting, internal accounting controls or auditing matters and for staff to raise concerns in confidence were established by the committee. The committee also had a meeting with the auditors, without executives present, and a meeting with the director of group audit alone.

Chairman's committee

The chairman's committee, comprising the chairman, the group chief executive and the deputy group chief executive, meets to assist the chairman in preparing for board meetings.

The committee exercises specific powers delegated to it by the board from time to time.

Group executive committee

The group executive committee, comprising the group chief executive, the deputy group chief executive, the group executive directors, the chief risk director, the group human resources director and the director of group IT and operations, meets to assist the group chief executive in performing his duties. Specifically, the committee considers the development and implementation of strategy, operational plans, policies and budgets; the monitoring of operating and financial performance; the assessment and control of risk; the prioritisation and allocation of resources; and the monitoring of competitive forces in each area of operation. The committee, assisted by its sub-committees, the group business risk and group asset and liability committees, also supports the group chief executive in endeavouring to ensure the development, implementation and effectiveness of the Group's risk management framework and the clear articulation of the Group's risk policies, and in reviewing the Group's aggregate risk exposures and concentrations of risk.

The committee exercises specific powers delegated to it by the board from time to time. To comply with the Group's articles of association, only committee members who are also directors of the company participate in the exercising of any powers delegated by the board.

Nomination committee

The nomination committee, comprising Sir Victor Blank (chairman), Dr Berndt, Mr du Plessis, Sir Julian Horn-Smith and Lord Leitch, reviews the structure, size and composition of the board, taking into account the skills, knowledge and experience of directors and considers and makes recommendations to the board on potential candidates for appointment as directors. The committee also makes recommendations to the board concerning the re-appointment of any independent non-executive director by the board at the conclusion of his or her specified term; the re-election of any director by the shareholders under the retirement provisions of the articles of association; any matters relating to the continuation in office of a director; and the appointment of any director to executive or other office in the company, although the chairman of the company would not chair the committee when it was dealing with the appointment of a successor to the chairmanship of the company.

During the year, in accordance with the plans for the orderly succession for appointments to the board, the committee recommended the appointment of two non-executive directors. In that regard, detailed role specifications were drawn up, external search consultants were engaged and candidates were interviewed by committee members and other directors.

In addition, the directors agreed with the committee's recommendation that Mr Brown be asked to remain on the board for a further year. This would enable the group to continue to benefit from his wide experience and maintain an appropriate balance of skills and experience on the board, as part of the plans for orderly succession for appointments. His continuing membership of the audit committee and understanding of the Group's activities will be particularly helpful to the new chairman of that committee. Mr Brown remains the senior independent director and both the nomination committee and the board considered the matter very carefully and concluded that Mr Brown was independent in character and there were no relationships or circumstances which were likely to affect, or could appear to affect, the director's judgement. As stated in the directors' report, Mr Brown will stand for re-election at the annual general meeting, in accordance with the provisions of the combined code on corporate governance issued by the Financial Reporting Council which apply to independent non-executive directors who have served on the board for more than nine years from the date of their first election.

The committee's terms of reference are available from the company secretary and are displayed on our website www.lloydstsb.com.

Remuneration committee

Information about the remuneration committee's membership and work is given in the directors' remuneration report on pages 64 to 75 and its terms of reference are available from the company secretary and are displayed on the Company's website www.lloydstsb.com.

Risk oversight committee

The risk oversight committee comprises Sir Victor Blank (chairman), Mr Brown, Sir Julian Horn-Smith and Lord Leitch. All non-executive directors are also invited to attend meetings if they wish. The risk oversight committee's duties include overseeing the development, implementation and maintenance of the Group's overall risk management framework, and its risk appetite, strategy, principles and policies, to ensure they are in line with emerging regulatory, corporate governance and industry best practice. The committee also oversees the Group's risk exposures; facilitates the involvement of non-executive directors in risk issues and aids their understanding of these issues; oversees adherence to Group risk policies and standards and considers any material amendments to them; and reviews the work of the Group Risk division.

Attendance at meetings

The attendance of directors at board meetings and at meetings of the audit, nomination, remuneration and risk oversight committees during 2007 was as follows:

	Board	Audit committee	Nomination committee	Remuneration committee	Risk oversight committee
Number of meetings during the year	14	6	4	4	4
Current directors who served during 2007					
W C G Berndt	14		4	4	
Sir Victor Blank	14		4	4	4
Ewan Brown	14	6			4
J E Daniels	14				
T A Dial	14				
J P du Plessis	13	6	4		
M E Fairey	14				
P N Green[1]	8			3	1
Sir Julian Horn-Smith	12		4	4	3
A G Kane	14				
Lord Leitch	13	6	3		4
G T Tate	14				
H A Weir	14				
Former directors who served during 2007					
G J N Gemmell[2]	10	3			
D S Julius[3]	1				

[1] Appointed to the board and remuneration committee from 10 May 2007 and the audit committee from 14 December 2007. A member of the risk oversight committee from 1 July 2007 to 14 December 2007.
[2] Left the board on 30 September 2007.
[3] Left the board on 9 May 2007.

Statement of directors' responsibilities

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the consolidated and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. The directors consider that in preparing the financial statements on pages 77 to 156 the Company and the Group have used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider applicable have been followed.

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

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

Internal control

The board of directors is responsible for the establishment and review of the Lloyds TSB Group's system of internal control, which is designed to ensure effective and efficient operations, quality of internal and external reporting, internal control, and compliance with laws and regulations. It should be noted, however, that such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. In establishing and reviewing the system of internal control the directors have regard to the nature and extent of relevant risks, the likelihood of a loss being incurred and the costs of control. It follows, therefore, that the system of internal control can only provide reasonable but not absolute assurance against the risk of material loss.

The directors and senior management are committed to maintaining a control-conscious culture across all areas of operation. This is communicated to all employees by way of published policies and procedures and regular management briefings. A requirement to comply with internal control risk policies is a key component of individual staff objectives expressed in the balanced scorecard. Key business risks are identified, and these are controlled by means of procedures such as physical controls, credit, trading and other authorisation limits and segregation of duties. In addition, there is an annual control self assessment exercise whereby the key businesses and head office functions review specific controls and attest to the accuracy of their assessments. The assessment covers all EWRM categories and is in accordance with the principles of the Combined Code. As in previous years, this exercise was completed for the year ended 31 December 2006. All returns have been satisfactorily completed and appropriately certified.

The effectiveness of the internal control system is reviewed regularly by the board and the audit committee, which also receives reports of reviews undertaken around the Lloyds TSB Group by its risk management function, including Group Compliance, and Group Audit. The audit committee receives reports from the Company's auditors, PricewaterhouseCoopers LLP, (which include details of significant internal control matters that they have identified) and has a discussion with the auditors at least once a year without executives present, to ensure that there are no unresolved issues of concern.

Going concern

The directors are satisfied that the Company and Lloyds TSB Group have adequate resources to continue to operate for the foreseeable future and are financially sound. For this reason they continue to adopt the going concern basis in preparing the accounts.

Directors' remuneration report

This is a report made by the board of Lloyds TSB Group plc, on the recommendation of the remuneration committee. It covers the current and proposed components of the remuneration policy and details the remuneration for each serving director during 2007.

Statement from Wolfgang Berndt

I am delighted to introduce the report of the board in relation to remuneration policy and practice.

In 2005, we conducted a comprehensive and independent review of remuneration policy for our most senior executives which led to a number of important policy changes, including the introduction of a new long-term incentive plan. This plan has been used for all long-term awards made since its introduction and we believe that this plan will continue to underpin our primary objective of attracting, retaining and motivating executives of the highest calibre.

As detailed in last year's report and given strong endorsement by shareholders who voted on the Directors' Remuneration Report at our 2006 AGM, we made some changes to the annual incentive scheme for 2007, with an increase in the maximum bonus opportunity for executive directors to 200 per cent of salary (225 per cent for Mr Daniels) to ensure that the individual elements and the totality of our reward offering is competitive. We believe that a policy of positioning basic salaries at the median of the market combined with the substantial proportion of total reward opportunity being at risk through our short and long-term incentive schemes, underpinned by demanding performance conditions, provides strong levels of alignment with shareholders' interests as well as engaging the executive directors in pursuing long-term shareholder value.

Looking forward, Lloyds TSB's remuneration policy remains unchanged and, following further independent review, we intend to maintain the short and long-term incentive schemes in their current form. We believe that it is essential for the positioning of our package to be highly competitive against the external market; and in setting appropriate pay levels we will continue to consider remuneration practice of FTSE 20, and at the same time take close account of our direct competitors, namely the major UK banks, with whom we typically compete for high calibre talent.

The committee met on four occasions during 2007 and, in addition to its regular business, attention was given to:

- reviewing the appropriateness of comparator groups used for the purpose of benchmarking overall levels of reward opportunity
- considering the level of Group performance and the correlation with outcomes under our previous long-term incentive awards
- examining the linkage between performance and remuneration elsewhere in the business, with a particular focus on annual bonus schemes which apply to areas of the Group operating in highly specialised pay markets
- monitoring the appropriateness of remuneration arrangements applicable to the wider executive management population across the Group.

In terms of changes to the committee's membership, Mr Green joined the committee in May, replacing Dr Julius. In addition to welcoming Mr Green, I am extremely grateful to Dr Julius for her contribution to the work of the committee.

We have made a number of changes to this year's report which are intended to demonstrate our commitment to the highest levels of clarity and comprehensive disclosure. Given our stated aim of ensuring a strong level of alignment between overall performance and reward outcomes, I believe that the actual levels of reward disclosed in the report which follows are entirely consistent with Lloyds TSB's performance in 2007.

The remuneration committee unanimously recommends that you vote to approve the remuneration report at the 2008 AGM.

Dr Wolfgang Berndt
Chairman, Remuneration Committee

Content of remuneration report

- Role of remuneration committee
- Remuneration committee membership
- Advisers to the committee
- Directors' remuneration policy
- Dilution limits
- Pensions
- Service agreements
- External appointments
- Performance graphs
- Audited information

Role of remuneration committee

The committee reviews the remuneration policy for the top management group, to ensure that members of the executive management are provided with appropriate incentives to encourage them to enhance the performance of the Group and that they are rewarded for their individual contribution to the success of the organisation. It advises on major changes of employee benefits schemes and it also agrees the policy for authorising claims for expenses from the group chief executive and the chairman. It has delegated power for settling remuneration for the chairman, the group executive directors, the company secretary and any group employee whose salary exceeds a specified amount.

All the independent non-executive directors are invited to attend meetings if they wish, and they receive the minutes and have the opportunity to comment and have their views taken into account before the committee's decisions are implemented.

The committee's terms of reference are available from the company secretary and are displayed on the Group's website www.lloydstsb.com.

Remuneration committee membership

- Dr Berndt (chairman)
- Sir Victor Blank
- Mr Green (from 10 May when he joined the board)
- Sir Julian Horn-Smith
- Dr Julius (until 9 May when she left the board)

Advisers to the committee

Towers Perrin, New Bridge Street Consultants and Kepler Associates were engaged by the committee to advise on matters relating to executive remuneration. Over the course of 2007 Towers Perrin also provided market remuneration data as well as other remuneration consulting services to the Group.

In addition, in 2007, Alithos Limited provided information on behalf of the committee for the testing of the total shareholder return (TSR) (calculated by reference to both dividends and growth in share price) performance conditions for the Group's long-term incentive schemes.

Mr Daniels, Mr Fairey, Mrs Risley (Group Human Resources Director from 23 May 2007) and Mr Farley (Reward & Employment Policy Director) provided guidance to the committee (other than for their own remuneration).

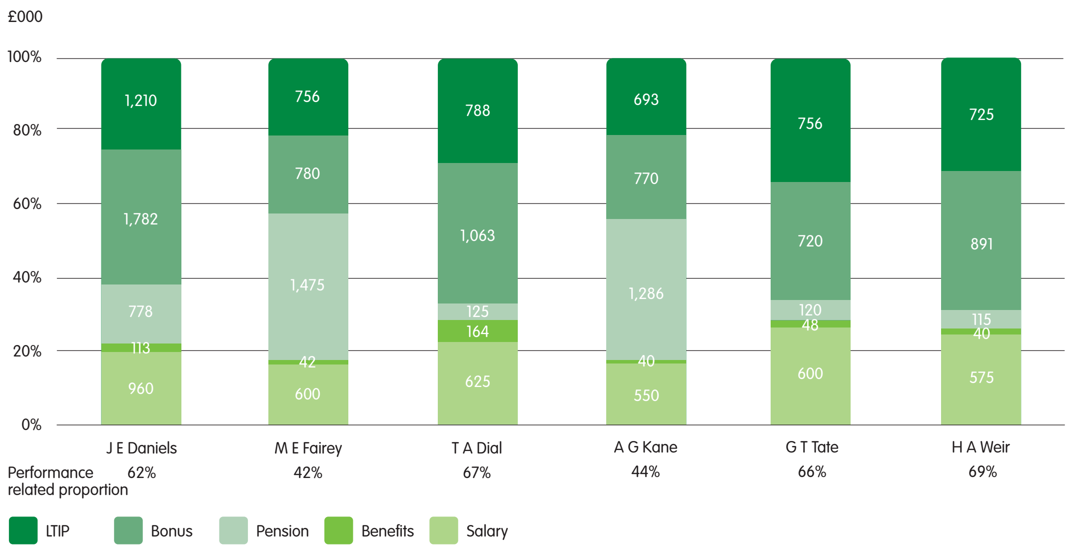
Directors' remuneration policy

The Group's remuneration policy is to ensure that individual rewards are aligned with the Group's performance and the interests of its shareholders, and that cost effective packages are provided which attract and retain executive directors and senior management of the highest calibre and motivate them to perform to the highest standards. The main principles, which remain unchanged from last year, are:

- FTSE 20 adopted as the comparator group used to benchmark overall competitiveness of the remuneration package whilst taking particular account of the remuneration practice of our direct competitors, namely the major UK banks. The FTSE 20 is regarded as providing a realistic and relevant comparison in terms of company size and sector, as well as being a key market for talent.
- Basic salaries positioned to reflect the relevant market median and total direct compensation (basic salary, annual incentives and the value of long-term incentives) designed to enable upper quartile performance to be rewarded with upper quartile remuneration levels.
- The majority of total compensation is linked to the achievement of stretching performance targets.
- The long-term rewards are aligned to shareholder interests, which is achieved by taking account of measures that reflect shareholder interests, and by expecting executive directors to build a shareholding in the Group equivalent to 1.5 times (2 times for the group chief executive) the directors' base pay. Executives are expected to retain at least 50 per cent of all net vested equity until the guideline is met.
- The overall package reflects market practice and takes account of the terms and conditions applying to other employees of the Group.

Composition of directors' remuneration

In 2007 the total compensation of the executive directors consisted of components in the following proportions:



Note: Salary and benefits are the actual amounts received during 2007; pension for those directors in the defined benefits scheme (Messrs Daniels, Fairey and Kane) is the increase in actual transfer value for 2007; pension for those in the defined contribution scheme (Mr Tate and Mrs Weir) is the sum of the employer's contribution and any cash pension supplement; pension for Ms Dial is the cash salary supplement she receives for choosing not to join the pension scheme; performance bonus is that payable in respect of 2007 and includes the value of any award made under the Group's 'shareplan'; and the value of the LTIP awarded in 2007 is the expected value calculated by using a 'binominal' model, which is a widely accepted methodology for this purpose.

Chairman's remuneration

The chairman's remuneration comprises salary and benefits which are broadly similar to those extended to the executive directors. However, he does not participate in the annual bonus and long-term incentive arrangements, nor is he entitled to pension benefits.

The chairman's salary is reviewed annually, usually in December, taking into account performance and market information and then adjusted from 1 January of the following year. His salary from 1 January 2008 is £640,000.

Independent non-executive directors' fees

The fees of the independent non-executive directors are agreed by the board within a total amount determined by the shareholders. Directors may also receive fees, agreed by the board, for membership of board committees. The fees are designed to recognise the various responsibilities of a non-executive director's role and to attract individuals with relevant skills, knowledge and experience. The fees are neither performance related nor pensionable and are comparable with those paid by other companies. The annual fees from 1 January 2008 are listed below with the figures applicable since the previous review in January 2007 in brackets.

Board	£65,000	(£60,000)
Audit committee chairmanship	£50,000	(£50,000)
Audit committee membership	£20,000	(£15,000)
Nomination committee membership	£5,000	(£5,000)
Remuneration committee chairmanship	£30,000	(£25,000)
Remuneration committee membership	£15,000	(£15,000)
Risk oversight committee membership	£15,000	(£15,000)

Independent non-executive directors who serve on the boards of subsidiary companies may also receive fees from the subsidiaries. The fees paid in 2007 to the current non-executive directors are shown in the table below:

2007 non-executive directors' fees	Lloyds TSB Group					Lloyds TSB Scotland	Scottish Widows	
	Board	Audit committee	Remuneration committee	Nomination committee	Risk oversight committee	Board	Board	2007 Total fees
W C G Berndt	60,000		25,000	5,000				90,000
Ewan Brown	60,000	50,000			15,000	26,000		151,000
J P du Plessis	60,000	15,000		5,000				80,000
P N Green	38,478	592	9,620		6,908			55,598
Sir Julian Horn-Smith	60,000		15,000	5,000	15,000			95,000
Lord Leitch	60,000	15,000		5,000	15,000		34,508	129,508

Executive director basic salaries

Basic salaries are reviewed annually, usually in December, taking into account individual performance and market information (which is provided by Towers Perrin) and then adjusted from 1 January of the following year. Basic salary increases for other employees across the Group will be generally in the range of 0-10 per cent. Whilst the salary increases awarded to executive directors are normally consistent with this policy, any variation will be supported by robust and independent competitive market analysis. The current and previous annual basic salaries for the executive directors are shown in the table below:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
As at 1 January 2008	£1,035,000	£630,000	£680,000	£590,000	£640,000	£625,000
As at 1 January 2007	£960,000	£600,000	£625,000	£550,000	£600,000	£575,000
% increase	7.8%	5.0%	8.8%	7.3%	6.7%	8.7%

Annual incentive scheme

The annual incentive scheme for executive directors is designed to reflect specific goals linked to the performance of the business.

Incentive awards for executive directors are based upon individual contribution and overall corporate results. Half of the bonus opportunity is driven by corporate performance based on the stretching budget relating to profit before tax and economic profit. The lower of profit before tax and economic profit will determine the extent to which the target has been met. The other half of the bonus opportunity is determined by divisional achievement driven through individual performance. Individual targets relevant to improving overall business performance are contained in a balanced scorecard and are grouped under the following headings:

Financial	Franchise Growth	Customer Service	Risk	People Development

These targets are weighted differently for each of the executive directors, reflecting differing strategic priorities. The non-financial measures include key performance indicators relating to process efficiency, service quality and employee engagement.

The maximum bonus opportunity is 200 per cent (225 per cent for Mr Daniels) of basic salary for the achievement of exceptional performance targets. The maximum payment under the corporate half of the bonus is only available if exceptional performance is achieved against the stretching corporate budget. An amount equal to 50 per cent of this element of the bonus is available on the achievement of the stretching corporate budget. Failure to achieve at least 90 per cent of the stretching budget would result in no payment under the corporate half of the bonus.

Awards under the annual incentive scheme are made in cash only.

PricewaterhouseCoopers LLP check the calculation of the annual incentive payments for executive directors based on the achievement of performance against targets set. In respect of performance in 2007, the bonuses awarded to the directors and the relevant percentages are shown in the table below:

Name	J E Daniels	M E Fairey	T A Dial	A G Kane	G T Tate	H A Weir
Opportunity	225%	200%	200%	200%	200%	200%
Bonus awarded	£1,782,000	£780,000	£1,062,500	£770,000	£720,000	£891,250
% awarded	185.6%	130.0%	170.0%	140.0%	120.0%	155.0%
Corporate performance	90.0%	80.0%	80.0%	80.0%	80.0%	80.0%
Individual performance	95.6%	50.0%	90.0%	60.0%	40.0%	75.0%

In 2007, the Group performed strongly against the backdrop of significant turbulence in global financial markets. The 80 per cent of opportunity awarded for the corporate half of the bonus plan was deemed by the remuneration committee to be the appropriate level to recognise this performance and the marked progress made by the Group against its key performance indicators. The profit before tax* increased by 6 per cent to £3,919 million and the economic profit increased by 9 per cent to £1,842 million. Excluding the £280 million charge arising from the market dislocation, the Group grew profits by 13 per cent from £3,710 million to £4,199 million. While we cannot overlook the impact of the dislocation on our results, these numbers are more reflective of the ongoing performance of the Group.

Excellent progress has also been made in cost management. Although costs grew by 1 per cent, there has been a significant cost:income ratio improvement to 49.0 per cent: the groupwide productivity improvement programme exceeded 2007 expectations and remains on track for benefits of approximately £250 million to be achieved in 2008.

Some of the key non-financial achievements include an increase in the Group customer CARE Index and we again won the award for Britain's most trusted bank (for the seventh year in succession) and the CBI Corporate Bank of the year award (for the third year running). We have seen a strengthening of our risk framework, which has served us well in the current environment. We have also seen a further improvement in our Employee Engagement Index, which on a comparative basis places us above the financial services norm and in line with the high performing company score. TSR performance, particularly when tracked against our comparator group, also continues to improve.

Other key achievements within the three commercial divisions of the Group, which impact on the individual balanced score card elements of bonus awards made to Ms Dial, Mr Tate and Mr Kane, were:

- Profit before tax from UK Retail Banking, excluding settlement of overdraft claims, increased by 17 per cent reflecting strong levels of franchise growth, excellent cost management and a slightly reduced impairment charge.
- Profit before tax from Wholesale and International Banking decreased by 12 per cent, reflecting the £280 million reduction in profits as a result of market dislocation. Excluding this impact, profit before tax increased by 5 per cent, and in the relationship banking businesses, good trading momentum has continued.
- Profit before tax from Insurance and Investments increased by 9 per cent. Strong progress was made in increasing bancassurance sales and the profit before tax from Scottish Widows Investment Partnership increased by 52 per cent, reflecting higher margins and an improved mix of business. The increased weather related claims, largely relating to the severe flooding in the UK, contributed to a 47 per cent reduction in profit before tax in the General Insurance business.

*To enable meaningful profit before tax comparisons to be made with 2006, the figures quoted above exclude insurance related volatility, the profit on sale of businesses, settlement of overdraft claims in 2007 and the pension schemes related credit in 2006.

Long-term incentive plan

The aim of the long-term incentive plan is to deliver shareholder value through linking the receipt of shares to an improvement in the performance of the Group over a three year period.

Awards in any one financial year will not normally exceed three times basic salary at the time of award. In exceptional circumstances this may be increased up to four times basic salary. Awards will lapse at the end of the performance period to the extent that the performance conditions have not been satisfied. There will be no retesting.

The award granted to each of the directors in 2007 was set at the maximum level of three times basic salary. This was to ensure that the total compensation package, including the value of long-term incentives, remains appropriately positioned against the market. Pending a wider review of executive remuneration and the need to ensure that we continue to provide a fully market competitive remuneration framework, following shareholder consultation the remuneration committee will be looking to exercise its discretion in 2008 to make enhanced long-term incentive awards for a number of directors. Any such awards will not exceed the overall limits of the plan as previously approved by shareholders.

Under the plan, awards of shares may be made, with the number of shares received subject to the satisfaction of two distinct pre-determined performance conditions, measuring performance of the Group.

50 per cent of any award granted (the 'TSR Award') will be based on a condition measuring the Company's TSR against the comparator group listed below. In order for the TSR Award to vest in full, it will be necessary for the Company's TSR to exceed the median of the TSR of the comparator group by an average of 7.5 per cent per annum.

17.5 per cent of the TSR Award (8.75 per cent of the total award) will vest where the Company's TSR is equal to median and vesting will occur on a straight line basis in between these points. Where the Company's TSR is below the median of the comparator group, the TSR Award will lapse.

The TSR performance period starts on the date awards are granted, and average the share price over three months before the grant date.

Other companies in the comparator group:

Alliance & Leicester	Aviva	Banco Santander	Barclays
Bradford & Bingley	Friends Provident	HBOS	HSBC Holdings
Legal & General	Northern Rock	Prudential	Royal Bank of Scotland
Royal & Sun Alliance	Standard Chartered		

From 2008 Northern Rock will be removed from this comparator group following the Government's decision to take this company into temporary public ownership.

The other 50 per cent of any award granted (the 'EPS Award') will be based on earnings per share (EPS) growth calculated on a compound annualised basis. In order for the EPS Award to vest in full, the EPS growth over the performance period must be at least equivalent to an average of the Retail Price Index (RPI) plus 6 per cent per annum. 17.5 per cent of the EPS Award (8.75 per cent of the total award) will vest where EPS growth is an average of the RPI plus 3 per cent per annum and vesting will occur on a straight line basis in between these points. Where the EPS growth is less than an average of the RPI plus 3 per cent per annum, the EPS Award will lapse.

EPS is the Group's normalised earnings per ordinary share as shown in the Group's report and accounts, adjusted if necessary for consistency. Details of the Group's basic earnings per share are shown in the consolidated income statement on page 77.

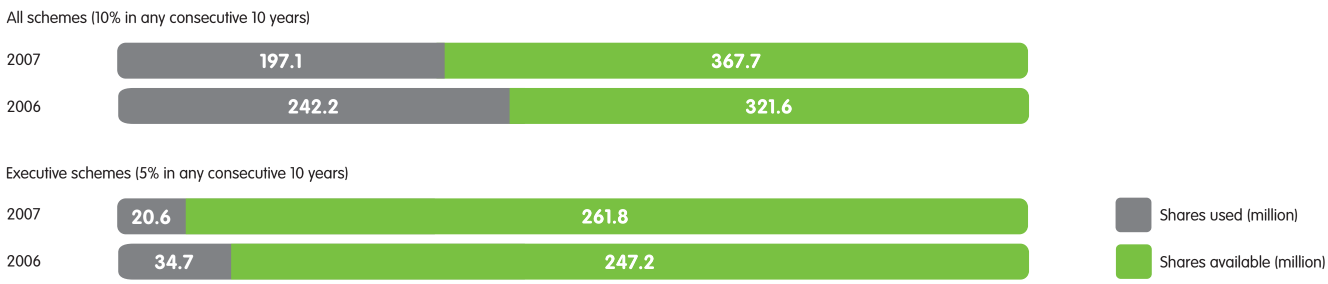
Details of previous long-term incentive plans are shown on pages 74 and 75.

Other share plans

The executive directors and the chairman are also eligible to participate in the Group's 'sharesave' scheme and the Group's 'shareplan'. These are 'all-employee' share schemes and performance conditions do not apply.

Dilution limits

The following charts illustrate the shares available for the Group's share schemes.



Pensions

Executive directors are either entitled to participate in the Group's defined benefit pension schemes (based on salary and length of service, with a maximum pension of two thirds of final salary), or the Group's defined contribution scheme (under which their final entitlement will depend on their contributions and the final value of their fund). The defined benefit schemes are closed to new entrants on recruitment.

Service agreements

The Group's policy is for executive directors to have service agreements with notice periods of no more than one year. All current executive directors are entitled to receive 12 months' notice from the Group, but would be required to give 6 months' notice if they wished to leave. Executive directors normally retire at age 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65.

It is the Group's policy that where compensation on early termination is due, it should be paid on a phased basis, mitigated in the event that alternative employment is secured, and that bonus payments should relate to the period of actual service, rather than the full notice period and will be determined on the basis of performance.

Any entitlements under the pension scheme or equity plans will be in accordance with the scheme rules on leaving.

	Notice to be given by the Company	Date of service agreement/letter of appointment
Sir Victor Blank	6 months	25 January 2006
J E Daniels	12 months	19 October 2001
M E Fairey	12 months	28 August 1991
T A Dial	12 months	23 May 2005
A G Kane	12 months	9 February 2000
G T Tate	12 months	29 July 2004
H A Weir	12 months	4 March 2004

Independent non-executive directors do not have service agreements and their appointment may be terminated, in accordance with the articles of association, at any time without compensation.

External appointments

The Group recognises that executive directors may be invited to become non-executive directors of other companies and that these appointments may broaden their knowledge and experience, to the benefit of the Group. Fees are normally retained by the individual directors as the post entails personal responsibility. Executive directors are generally allowed to accept one non-executive directorship.

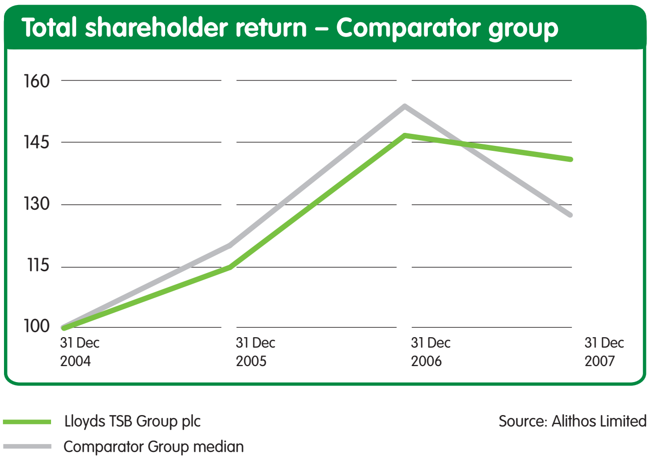
During 2007, Mr Fairey, Ms Dial and Mrs Weir received fees of £22,333, $38,000 and £42,500 respectively, which were retained by them, for serving as non-executive directors of other companies. In addition Mrs Weir received and retained £7,500 for serving as a member of the Accounting Standards Board in 2007.

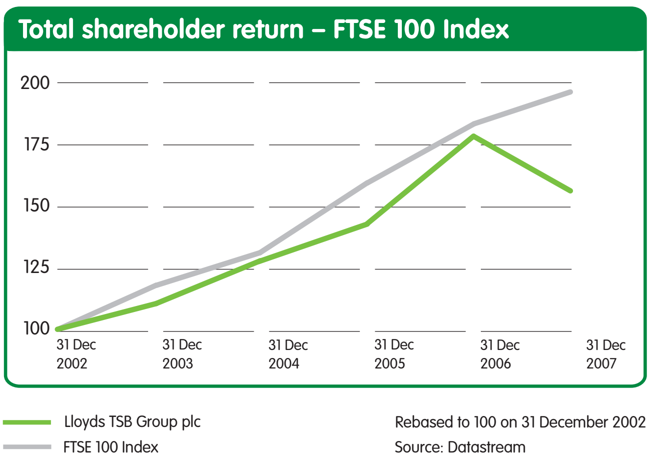
Performance graphs

The first graph compares the Company's TSR with the median TSR of the comparator group detailed on page 68. This is the comparator group used for the TSR performance conditions for executive share awards since 2005 (ie executive share options in 2005, performance share plan in 2005/06 and the long-term incentive plan since 2006).

The second graph illustrates the performance of the Group measured by TSR against a 'broad equity market index' over the past five years. The Group has been a constituent of the FTSE 100 index throughout this five year period.

Comparative TSR





Directors' emoluments for 2007

	Salaries/ fees £000	Other benefits Cash £000	Other benefits Non cash £000	Performance-related payments £000	2007 Total £000	2006 Total £000
Current directors who served during 2007						
Executive directors						
J E Daniels	960	105	8	1,811	2,884	2,444
M E Fairey	600	35	7	798	1,440	1,885
T A Dial	625	285	4	1,081	1,995	1,719
A G Kane	550	20	20	787	1,377	1,252
G T Tate	600	21	27	738	1,386	1,303
H A Weir	575	83	19	909	1,586	1,310
Non-executive directors						
Sir Victor Blank	600	20	11	30	661	405
W C G Berndt	90				90	72
Ewan Brown	151				151	134
J P du Plessis	80				80	67
P N Green	56				56	–
Sir Julian Horn-Smith	95				95	82
Lord Leitch	130				130	80
Former directors who served during 2007						
G J N Gemmell	97				97	121
D S Julius	27				27	68
Others						315
	5,236	569	96	6,154	12,055	11,257

Mr Fairey waived fees payable to him as a director of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £10,750 in 2007 (2006: £10,000 waived).

Mr Brown waived fees payable to him as a director and chairman of Lloyds TSB Group Pension Trust (No.1) Limited and Lloyds TSB Group Pension Trust (No.2) Limited, which totalled £15,500 in 2007 (2006: £14,750 waived).

Mr Gemmell left the board on 30 September 2007 but remained a director of Scottish Widows Group and received fees of £11,250 from that company for the period October to December 2007.

The cash column under 'other benefits' includes flexible benefits payments (4 per cent of basic salary), the tax planning allowances for Mr Daniels and Ms Dial, the housing allowance and pension scheme allowance for Ms Dial, payments to certain directors who elect to take cash rather than a company car under the car scheme and the cash balance of pension allowance for Mrs Weir. Sir Victor Blank has elected to take cash rather than a company car and the payment made to him includes a backdated payment in respect of the period May–December 2006.

The non cash column includes amounts relating to the use of a company car, use of a company driver and private medical insurance. It also includes the value of any matching shares which are received under the terms of shareplan, through which employees have the opportunity to purchase shares up to a maximum of £125 per month and receive matching shares on a one for one basis up to a maximum value of £30 per month, rounded down to the nearest whole share.

Performance-related payments relate to cash bonuses based on group performance and the attainment of pre-determined targets relating to profit before tax and economic profit. These payments also include the value of any award made under shareplan, the first £3,000 of which is made in the form of shares in Lloyds TSB Group plc. The payment made to Sir Victor Blank relates to his participation in the shareplan in 2007 and a backdated entitlement in respect of the period May–December 2006.

Directors' pensions

The executive directors are members of one of the pension schemes provided by the Lloyds TSB Group with benefits either on a defined benefit or defined contribution basis. Those directors who joined the Lloyds TSB Group after 1 June 1989 and are members of a defined benefit scheme, have pensions provided on salary in excess of the earnings cap either through membership of a funded unapproved retirement benefits scheme (FURBS) or by an unfunded pension promise.

Retirement pensions accrue at rates of between 1/60 and 1/30 of basic salary.

Directors have a normal retirement age of 60. However, following the implementation of The Employment Equality (Age) Regulations 2006, they may now choose to delay their retirement until age 65. In the event of death in service, a lump sum of four times salary is payable plus, for members of a defined benefit scheme, a spouse's pension of two-thirds of the member's prospective pension. On death in retirement, a spouse's pension of two-thirds of the member's pension is payable. The defined benefit schemes are non-contributory. Members of defined contribution schemes are required to contribute.

Ms Dial elected to become a member of a pension scheme for life cover only. She joined the Lloyds TSB Group on 1 June 2005. She receives a salary supplement of 20 per cent of basic pay as an alternative to an employer contribution to a pension scheme.

Defined contribution scheme members

Mr Tate is a member of a defined contribution scheme. During the year to 31 December 2007, the employer has made contributions to the defined contribution scheme in respect of him totalling £120,000.

Mrs Weir is a member of a defined contribution scheme. During the year to 31 December 2007, the employer has made contributions to the defined contribution scheme in respect of her totalling £52,708.

Defined benefit scheme members

	Accrued pension at 31 December 2007 £000 (a)	Accrued pension at 31 December 2006 £000 (b)	Change in accrued pension £000 (a)-(b)	Transfer value at 31 December 2007 £000 (c)	Transfer value at 31 December 2006 £000 (d)	Change in transfer value £000 (c)-(d)	Additional pension earned to 31 December 2007 £000 (e)	Transfer value of the increase £000 (f)
J E Daniels	147	120	27	2,878	2,100	778	23	443
M E Fairey	322	287	35	7,499	6,024	1,475	25	577
A G Kane	306	265	41	5,701	4,415	1,286	31	573

The disclosures in columns (a) to (d) are as required by the Companies Act 1985 Schedule 7A.

Columns (a) and (b) represent the deferred pension to which the directors would have been entitled had they left the Group on 31 December 2007 and 2006, respectively (ignoring the two-year requirement to qualify for a deferred pension).

Column (c) is the transfer value of the deferred pension in column (a) calculated as at 31 December 2007 based on factors supplied by the actuary of the relevant Lloyds TSB Group pension scheme in accordance with actuarial guidance note GN11. The basic method used to arrive at the factors has not changed during the year, but the underlying basis has been strengthened to allow for mortality improvements and a reduction in the long-term post-retirement investment return.

Column (d) is the equivalent transfer value, but calculated as at 31 December 2006 on the assumption that the director left service at that date.

Column (e) is the increase in pension built up during the year, recognising (i) the accrual rate for the additional service based on the pensionable salary in force at the year end, and (ii) where appropriate the effect of pay changes in 'real' (inflation adjusted) terms on the pension already earned at the start of the year.

Column (f) is the capital value of the pension in column (e).

The disclosures in columns (e) and (f) are as required by the UK Listing Authority listing rules. The requirements of the listing rules differ from those of the Companies Act. The listing rules require the additional pension earned over the year to be calculated as the difference between the pension accrued at the end of the financial year and the pension accrued at the start of the financial year less the increase in the pension earned over the year solely due to inflation. The transfer value in column (f) can differ significantly from the change in transfer value as required by the Companies Act because the additional pension accrued over the year calculated in accordance with the listing rules makes allowance for inflation and the change in the transfer value required by the Companies Act will be significantly influenced by changes in the assumptions underlying the transfer value calculation at the beginning and end of the financial year.

Members of the Lloyds TSB Group's pension schemes have the option to pay additional voluntary contributions: neither the contributions nor the resulting benefits are included in the above table.

Major changes to the legislation governing the provision of pensions in the UK (known as pension simplification) came into effect in April 2006. Benefits from an approved pension scheme will be limited to the Lifetime Allowance, currently £1.6 million which is equivalent to an annual pension of £80,000. Any benefit in excess of this amount will incur a tax charge for the individual. The Group has agreed that if an executive director has benefits in excess of the Lifetime Allowance they may cease to accrue benefits in the Scheme and receive a salary supplement as an alternative. This will not cost the Group more than the current arrangements. The Group will not compensate any individual in respect of any increased tax liability arising from pension simplification. To date, the executive directors affected have elected to continue to accrue benefits in the approved scheme.

Directors' interests

The interests, all beneficial, of those who were directors at 31 December 2007 in shares in Lloyds TSB Group were:

Shares	At 1 January 2007 (or later date of appointment)	At 31 December 2007	At 21 February 2008*
Executive directors			
J E Daniels	165,174	166,023	166,099
M E Fairey	82,864	83,914	83,943
T A Dial	577	1,138	
A G Kane	136,078	137,000	137,076
G T Tate	4,139	8,112	8,187
H A Weir	6,255	10,511	
Non-executive directors			
Sir Victor Blank	100,000	200,000	
W C G Berndt	96,000	170,000	
Ewan Brown	4,469	4,677	
J P du Plessis	10,000	10,000	
P N Green	–	5,000	
Sir Julian Horn-Smith	5,000	5,000	
Lord Leitch	10,000	10,000	

* The changes in beneficial interests between 31 December 2007 and 21 February 2008 related to 'partnership' and 'matching' shares acquired under the Lloyds TSB Group shareplan.

Interests in share options

	At 1 January 2007	Granted during the year	Exercised/ lapsed during the year	At 31 December 2007	Exercise price	Exercise periods From	Exercise periods To	Notes
J E Daniels	599,239		**599,239**	–	394.25p	21/2/2006	20/2/2013	d, i
	305,232		**305,232**	–	430p	14/8/2006	13/8/2013	d, i
	939,177			939,177	419.25p	18/3/2007	17/3/2014	d, g
	521,876			521,876	474.25p	17/3/2008	16/3/2015	e, h
	2,236			2,236	418p	1/6/2009	30/11/2009	a, h
M E Fairey	48,000			48,000	859.5p	15/5/2001	14/5/2008	b, f
	57,000			57,000	817p	2/8/2002	1/8/2009	b, g
	85,896			85,896	549.5p	6/3/2003	5/3/2010	c, g
	10,931			10,931	615.5p	8/8/2003	7/8/2010	c, g
	42,884			42,884	655p	6/3/2004	5/3/2011	c, g
	663,157		**663,157**	–	394.25p	21/2/2006	20/2/2013	d, i
	555,992			555,992	419.25p	18/3/2007	17/3/2014	d, g
	344,754			344,754	474.25p	17/3/2008	16/3/2015	e, h
	1,789			1,789	418p	1/6/2009	30/11/2009	a, h
T A Dial	464,134			464,134	474p	11/8/2008	10/8/2015	e, h
A G Kane	50,000			50,000	880p	4/3/2001	3/3/2008	b, f
	27,000			27,000	887.5p	4/3/2002	3/3/2009	b, g
	64,786			64,786	549.5p	6/3/2003	5/3/2010	c, g
	11,841			11,841	615.5p	8/8/2003	7/8/2010	c, g
	34,759			34,759	655p	6/3/2004	5/3/2011	c, g
	5,783			5,783	284p	1/6/2008	30/11/2008	a, h
	529,105		**529,105**	–	394.25p	21/2/2006	20/2/2013	d, i
	523,255			523,255	419.25p	18/3/2007	17/3/2014	d, g
	300,474			300,474	474.25p	17/3/2008	16/3/2015	e, h
G T Tate	348,837		**348,837**	–	430p	14/8/2006	13/8/2013	d, i
	268,336			268,336	419.25p	18/3/2007	17/3/2014	d, g
	195,409			195,409	403p	12/8/2007	11/8/2014	d, g
	300,474			300,474	474.25p	17/3/2008	16/3/2015	e, h
	3,851			3,851	418p	1/6/2011	30/11/2011	a, h
H A Weir	556,208			556,208	424.75p	29/4/2007	28/4/2014	d, g
	5,093			5,093	321p	1/11/2009	30/4/2010	a, h
	300,474			300,474	474.25p	17/3/2008	16/3/2015	e, h
Other share plan								
T A Dial	242,825			242,825	(see page 75)	1/6/2008	30/11/2008	h

a) Sharesave.

b) Executive option granted between March 1997 and August 1999.

c) Executive option granted between March 2000 and March 2001.

d) Executive option granted between February 2003 and August 2004.

e) Executive options granted from March 2005.

f) Exercisable.

g) Not exercisable as the performance conditions had not been met.

h) Not exercisable as the option has not been held for the period required by the relevant scheme.

i) These share options lapsed as the performance condition had not been met.

The market price for a share in the Company at 1 January 2007 and 31 December 2007 was 577.5p and 472p, respectively. The range of prices between 1 January 2007 and 31 December 2007 was 451.25p to 614p.

None of the other directors at 31 December 2007 had options to acquire shares in Lloyds TSB Group plc or its subsidiaries.

The following table contains information on the performance conditions for executive options granted since 1997. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Options granted	Performance conditions
March 1997 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the retail price index plus two percentage points for each complete year of the relevant period plus a further condition that the Company's ranking based on TSR over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the retail price index plus three percentage points for each complete year of the relevant period.
February 2003 – August 2004	That the Company's ranking based on TSR over the relevant period against a comparator group (17 UK and international financial services companies including Lloyds TSB) must be at least ninth, when 14 per cent of the option will be exercisable. If the Company is ranked first in the group, then 100 per cent of the option will be exercisable and if ranked tenth or below the performance condition is not met. At the end of 2007 Lloyds TSB Group was ranked 9th after four years of the performance period for options granted in 2004. Options granted in 2003 lapsed as the performance condition had not been met.
March 2005 – August 2005	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds TSB) must be at least eighth, when 30 per cent of the option will be exercisable. If the Company is ranked first to fourth position in the group, then 100 per cent of the option will be exercisable and if ranked ninth or below the performance condition is not met. At the end of 2007 Lloyds TSB Group was ranked 5th after the three year performance period for options granted in 2005.

Lloyds TSB performance share plan

Under the plan, executive directors were required to defer 50 per cent of their bonus awards in 2005 and 2006 into shares in the Company, known as bonus shares. The number of bonus shares awarded was calculated after the deduction of income tax and national insurance from the deferred element of the bonus. The bonus shares are held on behalf of the executive for a period of three years before release.

Executives received a further award of 'performance shares' on the basis of two performance shares for each bonus share. The receipt of the performance shares is dependent on the satisfaction of a TSR performance condition measured over three financial years of the Company.

The following bonus and performance shares relating to the bonus awards for 2004 and 2005 are available under the plan.

	Bonus shares		Performance shares			
	At 1 January 2007	At 31 December 2007	At 1 January 2007	At 31 December 2007	Award price	Bonus shares release and performance share award date
J E Daniels	57,737	57,737	195,720	195,720	479p	18/3/2008
	50,944	50,944	172,694	172,694	566.10p	20/3/2009
M E Fairey	31,901	31,901	108,140	108,140	479p	18/3/2008
	22,459	22,459	76,134	76,134	566.10p	20/3/2009
T A Dial	16,909	16,909	57,322	57,322	566.10p	20/3/2009
A G Kane	22,171	22,171	75,156	75,156	479p	18/3/2008
	20,531	20,531	69,598	69,598	566.10p	20/3/2009
G T Tate	22,710	22,710	76,982	76,982	479p	18/3/2008
	27,358	27,358	92,738	92,738	566.10p	20/3/2009
H A Weir	16,628	16,628	56,366	56,366	479p	18/3/2008
	20,062	20,062	68,008	68,008	566.10p	20/3/2009

The following table contains information on the performance conditions for performance shares. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

Performance shares awarded	Performance conditions
March 2005 and March 2006	That the Company's ranking based on TSR over the relevant period against a comparator group (15 companies including Lloyds TSB) must be at least eighth for any shares to be received. If ranked ninth or below no shares would be received. The maximum of two performance shares for each bonus share will be awarded only if the Company is first in the comparator group; one performance share will be awarded for each bonus share if the Company is placed fifth; and one performance share for every two bonus shares if the Company is placed eighth. Between first and fifth positions and fifth and eighth positions a sliding scale will apply. Whilst income tax was deducted from the deferred bonus before the conversion to bonus shares, where a match of performance shares is justified, these shares will be awarded as if income tax had not been deducted. This maintains the original design of the plan prior to the issue of guidance from HM Revenue & Customs in December 2004. At the end of 2007 Lloyds TSB Group was ranked 5th after the three year performance period for the performance shares awarded in 2005.

Lloyds TSB long-term incentive plan

The following are conditional share awards available under the plan. The share price for the 2007 award was 539p. Further information regarding this plan can be found on page 68.

	At 1 January 2007	Awarded during the year	At 31 December 2007	Year of vesting
J E Daniels	507,692		507,692	2009
		534,322	534,322	2010
M E Fairey	328,846		328,846	2009
		333,951	333,951	2010
T A Dial	328,846		328,846	2009
		347,866	347,866	2010
A G Kane	288,460		288,460	2009
		306,122	306,122	2010
G T Tate	297,114		297,114	2009
		333,951	333,951	2010
H A Weir	288,460		288,460	2009
		320, 037	320,037	2010

The following table contains information on the performance conditions for awards made under the long-term incentive plan. The remuneration committee chose the relevant performance condition because it was felt to be challenging, aligned to shareholders' interests and appropriate at the time.

LTIP award	Performance conditions
May 2006	For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the retail price index over the same period. If it is less than 3 per cent per annum the EPS Award will lapse. If the increase is more than 3 but less than 6 per cent per annum then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ends on 31 December 2008. For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for the Company's TSR to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where the Company's TSR is equal to median and vesting will occur on a straight line basis in between these points. Where the Company's TSR is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ends on 31 December 2008.
March 2007	For 50 per cent of the award (the 'EPS Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 1 January 2007 and ending on 31 December 2009. For the other 50 per cent of the award (the 'TSR Award') – the performance condition was as described for May 2006 with the relevant performance period commencing on 8 March 2007 (the date of Award) and ending on 7 March 2010.

Alithos Limited provided information for the testing of the TSR performance conditions for the Group's long-term incentive schemes. EPS is the Group's normalised earnings per share as shown in the Group's report and accounts, subject to such adjustments as the remuneration committee regard as necessary for consistency.

Other share plan

Lloyds TSB Group executive share plan 2005

Ms Dial is the only participant in this plan and holds an option, granted to her in June 2005, to acquire 242,825 ordinary shares in Lloyds TSB Group plc for a total price of £1. The option was granted as part of the remuneration package considered necessary to attract her from the USA and is designed to encourage her to remain with Lloyds TSB Group plc. The option is not, therefore, subject to any performance condition but will normally become exercisable only if she remains an employee, and has not given notice of resignation, on 31 May 2008. Full details of the plan were set out in the 2005 annual report.

None of those who were directors at the end of the year had any other interest in the capital of Lloyds TSB Group plc or its subsidiaries.

On behalf of the board

A J Michie
Company Secretary
21 February 2008

Report of the independent auditors on the consolidated financial statements

To the members of Lloyds TSB Group plc

We have audited the consolidated financial statements of Lloyds TSB Group plc for the year ended 31 December 2007 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes. These consolidated financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Lloyds TSB Group plc for the year ended 31 December 2007 and on the information in the directors' remuneration report that is described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union are set out in the statement of directors' responsibilities on page 63.

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

We report to you our opinion as to whether the consolidated financial statements give a true and fair view and whether the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the consolidated financial statements. The information given in the directors' report includes that specific information presented in the Overview and the Business Review that is cross referred from the principal activities, business review, future developments and financial risk management objectives and policies section of the directors' report.

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

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the annual report and consider whether it is consistent with the audited consolidated financial statements. The other information comprises only the Overview, the unaudited part of the Business Review, the directors' report, the corporate governance disclosures, the unaudited part of the directors' remuneration report and the shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2007 and of its profit and cash flows for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the directors' report is consistent with the consolidated financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
21 February 2008

Consolidated income statement

for the year ended 31 December 2007

	Note	2007 £ million	2006 £ million
Interest and similar income		**16,874**	14,108
Interest and similar expense		**(10,775)**	(8,779)
Net interest income	4	**6,099**	5,329
Fee and commission income		**3,224**	3,116
Fee and commission expense		**(600)**	(638)
Net fee and commission income	5	**2,624**	2,478
Net trading income	6	**3,123**	6,341
Insurance premium income	7	**5,430**	4,719
Other operating income	8	**952**	806
Other income		**12,129**	14,344
Total income		**18,228**	19,673
Insurance claims	9	**(7,522)**	(8,569)
Total income, net of insurance claims		**10,706**	11,104
Operating expenses	10	**(5,567)**	(5,301)
Trading surplus		**5,139**	5,803
Impairment	11	**(1,796)**	(1,555)
Profit on sale of businesses	12	**657**	–
Profit before tax		**4,000**	4,248
Taxation	13	**(679)**	(1,341)
Profit for the year		**3,321**	2,907
Profit attributable to minority interests		**32**	104
Profit attributable to equity shareholders		**3,289**	2,803
Profit for the year		**3,321**	2,907
Basic earnings per share	14	**58.3p**	49.9p
Diluted earnings per share	14	**57.9p**	49.5p

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

Consolidated balance sheet

at 31 December 2007

	Note	2007 £ million	2006 £ million
Assets			
Cash and balances at central banks		**4,330**	1,898
Items in the course of collection from banks		**1,242**	1,431
Trading and other financial assets at fair value through profit or loss	15	**57,911**	67,695
Derivative financial instruments	16	**8,659**	5,565
Loans and advances to banks	17	**34,845**	40,638
Loans and advances to customers	18	**209,814**	188,285
Available-for-sale financial assets	20	**20,196**	19,178
Investment property	21	**3,722**	4,739
Goodwill	22	**2,358**	2,377
Value of in-force business	23	**2,218**	2,723
Other intangible assets	24	**149**	138
Tangible fixed assets	25	**2,839**	4,252
Other assets	26	**5,063**	4,679
Total assets		**353,346**	343,598

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

The directors approved the consolidated financial statements on 21 February 2008.

Sir Victor Blank
Chairman

J Eric Daniels
Group Chief Executive

Helen A Weir
Group Finance Director

Consolidated balance sheet

at 31 December 2007

Equity and liabilities	Note	2007 £ million	2006 £ million
Liabilities			
Deposits from banks	27	39,091	36,394
Customer accounts	28	156,555	139,342
Items in course of transmission to banks		668	781
Trading and other liabilities at fair value through profit or loss	29	3,206	1,184
Derivative financial instruments	16	7,582	5,763
Debt securities in issue	30	51,572	54,118
Liabilities arising from insurance contracts and participating investment contracts	31	38,063	41,445
Liabilities arising from non-participating investment contracts	32	18,197	24,370
Unallocated surplus within insurance businesses	33	554	683
Other liabilities	34	9,690	10,985
Retirement benefit obligations	35	2,144	2,462
Current tax liabilities		484	817
Deferred tax liabilities	36	948	1,416
Other provisions	37	209	259
Subordinated liabilities	38	11,958	12,072
Total liabilities		340,921	332,091
Equity			
Share capital	39	1,432	1,429
Share premium account	40	1,298	1,266
Other reserves	41	(60)	336
Retained profits	42	9,471	8,124
Shareholders' equity		12,141	11,155
Minority interests		284	352
Total equity		12,425	11,507
Total equity and liabilities		353,346	343,598

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

Consolidated statement of changes in equity

	Attributable to equity shareholders					
	Share capital and premium £ million	Other reserves £ million	Retained profits £ million	Total £ million	Minority interests £ million	Total £ million
Balance at 1 January 2006	2,590	395	7,210	10,195	435	10,630
Movement in available-for-sale financial assets, net of tax:						
– change in fair value	–	(10)	–	(10)	–	(10)
– transferred to income statement in respect of disposals	–	(21)	–	(21)	–	(21)
Movement in cash flow hedges, net of tax	–	1	–	1	–	1
Currency translation differences	–	(29)	–	(29)	(4)	(33)
Net income recognised directly in equity	–	(59)	–	(59)	(4)	(63)
Profit for the year	–	–	2,803	2,803	104	2,907
Total recognised income for 2006	–	(59)	2,803	2,744	100	2,844
Dividends	–	–	(1,919)	(1,919)	(32)	(1,951)
Purchase/sale of treasury shares	–	–	(35)	(35)	–	(35)
Employee share option schemes:						
– value of employee services	–	–	65	65	–	65
– proceeds from shares issued	105	–	–	105	–	105
Repayment of capital to minority shareholders	–	–	–	–	(151)	(151)
Balance at 31 December 2006	2,695	336	8,124	11,155	352	11,507
Movement in available-for-sale financial assets, net of tax:						
– change in fair value	–	(436)	–	(436)	–	(436)
– transferred to income statement in respect of disposals	–	(5)	–	(5)	–	(5)
– transferred to income statement in respect of impairment	–	49	–	49	–	49
– disposal of businesses	–	(6)	–	(6)	–	(6)
Movement in cash flow hedges, net of tax	–	(15)	–	(15)	–	(15)
Currency translation differences	–	17	–	17	(1)	16
Net income recognised directly in equity	–	(396)	–	(396)	(1)	(397)
Profit for the year	–	–	3,289	3,289	32	3,321
Total recognised income for 2007	–	(396)	3,289	2,893	31	2,924
Dividends	–	–	(1,957)	(1,957)	(19)	(1,976)
Purchase/sale of treasury shares	–	–	(1)	(1)	–	(1)
Employee share option schemes:						
– value of employee services	–	–	16	16	–	16
– proceeds from shares issued	35	–	–	35	–	35
Repayment of capital to minority shareholders	–	–	–	–	(80)	(80)
Balance at 31 December 2007	2,730	(60)	9,471	12,141	284	12,425

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

Consolidated cash flow statement

for the year ended 31 December 2007

	Note	2007 £ million	2006 £ million
Profit before tax		**4,000**	4,248
Adjustments for:			
Change in operating assets	49(a)	**(16,982)**	(31,995)
Change in operating liabilities	49(b)	**21,541**	33,069
Non-cash and other items	49(c)	**2,784**	1,555
Tax paid		**(859)**	(798)
Net cash provided by operating activities		**10,484**	6,079
Cash flows from investing activities			
Purchase of available-for-sale financial assets		**(21,667)**	(23,448)
Proceeds from sale and maturity of available-for-sale financial assets		**19,468**	18,106
Purchase of fixed assets		**(1,334)**	(1,724)
Proceeds from sale of fixed assets		**982**	1,257
Acquisition of businesses, net of cash acquired	49(f)	**(8)**	(20)
Disposal of businesses, net of cash disposed	49(g)	**1,476**	936
Net cash used in investing activities		**(1,083)**	(4,893)
Cash flows from financing activities			
Dividends paid to equity shareholders		**(1,957)**	(1,919)
Dividends paid to minority interests	49(e)	**(19)**	(32)
Interest paid on subordinated liabilities		**(709)**	(713)
Proceeds from issue of subordinated liabilities	49(e)	**–**	1,116
Proceeds from issue of ordinary shares	49(e)	**35**	105
Repayment of subordinated liabilities	49(e)	**(300)**	(759)
Repayment of capital to minority shareholders	49(e)	**(80)**	(151)
Net cash used in financing activities		**(3,030)**	(2,353)
Effects of exchange rate changes on cash and cash equivalents		**82**	(148)
Change in cash and cash equivalents		**6,453**	(1,315)
Cash and cash equivalents at beginning of year		**25,438**	26,753
Cash and cash equivalents at end of year	49(d)	**31,891**	25,438

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

Notes to the group accounts

1 Accounting policies

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

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

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

(i) IFRS 7 'Financial Instruments: Disclosures'. This standard, which was effective from 1 January 2007, requires more detailed qualitative and quantitative disclosures about exposure to risks arising from the Group's financial instruments. As a disclosure standard, the application of this new standard has not had any impact on amounts recognised in the financial statements. The IFRS 7 disclosures are set out in these financial statements and in the business review on pages 36 to 51. IFRS 7 supersedes IAS 30 'Disclosures in the Financial Statements of Banks and Similar Financial Institutions' and the disclosure requirements previously contained in IAS 32 'Financial Instruments: Presentation'.

(ii) Amendment to IAS 1 'Presentation of Financial Statements – Capital Disclosures'. This standard, which was effective from 1 January 2007, requires additional disclosures of the objectives, policies and processes for managing capital, quantitative data about what the Group regards as capital, and compliance with capital requirements. These disclosures are set out in the business review on pages 48 to 56.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2007 and which have not been applied in preparing these financial statements are given in note 50.

The Group's accounting policies are set out below.

(a) Consolidation

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

(b) Goodwill

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

(c) Other intangible assets

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

(d) Revenue recognition

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

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

Dividend income is recognised when the right to receive payment is established.

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

1 Accounting policies continued

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

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

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

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

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

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

Debt securities and equity shares, other than those classified as trading securities or at fair value through profit or loss, are classified as available-for-sale and recognised in the balance sheet at their fair value; available-for-sale investments are those intended to be held for an indeterminate period of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Gains and losses arising from changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the financial asset is either sold, becomes impaired or matures, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement. Interest calculated using the effective interest method is recognised in the income statement.

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

(f) Loans and advances to banks and customers

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

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

(g) Sale and repurchase agreements

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

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

(h) Derivative financial instruments and hedge accounting

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

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

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

1 Accounting policies continued

(1) Fair value hedges

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

(2) Cash flow hedges

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

(3) Net investment hedges

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

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

Derivatives embedded in financial instruments and insurance contracts (unless the embedded derivative is itself an insurance contract) are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement. In accordance with IFRS 4 a policyholder's option to surrender an insurance contract for a fixed amount is not treated as an embedded derivative.

(i) Offset

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

(j) Impairment of financial assets

(1) Assets accounted for at amortised cost

At each balance sheet date the Group assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset or group of financial assets has become impaired.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss may include:

- Delinquency in contractual payments of principal and/or interest;
- Indications that the borrower or group of borrowers is experiencing significant financial difficulty;
- Restructuring of debt to reduce the burden on the borrower;
- Breach of loan covenants or conditions; and
- Initiation of bankruptcy proceedings.

The estimated period between a loss occurring and its identification is determined by local management for each identified portfolio. In general, the periods used vary between three months and nine months.

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

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

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

A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

1 Accounting policies continued

(2) Available-for-sale financial assets

The Group assesses at each balance sheet date whether there is objective evidence that an available-for-sale financial asset is impaired. In addition to the criteria for financial assets accounted for at amortised cost set out above, this assessment involves considering whether there has been a significant or prolonged decline in the fair value of the asset below its cost, reviewing the current financial circumstances (including creditworthiness) and future prospects of the issuer and assessing the future cash flows expected to be realised. If an impairment loss has been incurred, the cumulative loss measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that asset previously recognised, is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

(3) Renegotiated loans

Loans that are either subject to collective impairment assessment or individually significant and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans. In subsequent years, the asset is considered to be past due and disclosed only if further renegotiated.

(k) Investment property

Property held for long-term rental yields and capital appreciation within the long-term assurance funds is classified as investment property. Investment property comprises freehold and long leasehold land and buildings and is carried in the balance sheet at fair value, being the open market value as determined in accordance with the guidance published by the Royal Institution of Chartered Surveyors. If this information is not available, the Group uses alternative valuation methods such as discounted cash flow projections or recent prices on less active markets. These valuations are reviewed at least annually by an independent valuation expert. Investment property being redeveloped for continuing use as investment property, or for which the market has become less active, continues to be measured at fair value. Changes in fair value are recorded in the income statement.

(l) Tangible fixed assets

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

Premises (excluding land):

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

Equipment:

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

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

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

(m) Leases

(1) As lessee

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

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

(2) As lessor

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

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

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

(n) Borrowings

Borrowings (which include deposits from banks, customer accounts, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

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

1 Accounting policies continued

(o) Pensions and other post-retirement benefits

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

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

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

The Group's balance sheet includes the net surplus or deficit, being the fair value of scheme assets less the discounted value of scheme liabilities adjusted for the corridor. Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes.

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

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

(p) Share-based compensation

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

(q) Taxation

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

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

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

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

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

(r) Insurance

The Group undertakes both life assurance and general insurance business.

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

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

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

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

For accounting purposes the general insurance business only issues insurance contracts.

1 Accounting policies continued

(1) Life assurance business

(i) Accounting for insurance and participating investment contracts

- **Premiums and claims**

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

Claims are recorded as an expense when they are incurred.

- Liabilities

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

Liabilities of the Group's With Profit Fund, including guarantees and options embedded within products written by that fund, are stated at their realistic values in accordance with the Financial Services Authority's realistic capital regime. Further details on the realistic capital regime are given on page 54.

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

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

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs.

– insurance or participating investment contracts which are unit-linked

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

- **Unallocated surplus**

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

- **Value of in-force business**

The Group recognises as an asset the value of in-force business in respect of life insurance and participating investment contracts. The asset represents the present value of the shareholders' interest in the profits expected to emerge from those contracts written at the balance sheet date. This is determined using appropriate allowance for economic conditions and appropriate assumptions for future mortality rates and future persistency rates, making allowance for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets, including an explicit allowance for non-market risk. The asset in the consolidated balance sheet is presented gross of attributable tax and movements in the asset are reflected within other operating income in the income statement.

(ii) Accounting for non-participating investment contracts

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

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

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

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

(2) General insurance business

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

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

(3) Liability adequacy test

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

1 Accounting policies continued

(4) Reinsurance

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

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

(s) Foreign currency translation

(1) Functional and presentation currency

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

(2) Transactions and balances

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

(3) Group companies

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

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

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

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

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

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

(t) Provisions

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

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

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

(u) Dividends

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

(v) Cash and cash equivalents

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

2 Critical accounting estimates and judgements

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

Impairment of financial assets

Loan impairment allowances

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

At 31 December 2007 gross loans and advances to customers and banks totalled £247,067 million (2006: £231,117 million) against which impairment allowances of £2,408 million (2006: £2,194 million) had been made.

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

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

Impairment of available-for-sale financial assets

In determining whether an impairment loss has been incurred in respect of an available-for-sale financial asset, the Group performs an objective review of the current financial circumstances and future prospects of the issuer and considers whether there has been a significant or prolonged decline in the fair value of that asset below its cost. This consideration requires management judgement. Among factors considered by the Group is whether the decline in fair value is a result of a change in the quality of the asset or a downward movement in the market as a whole. An assessment is performed of the expected future cash flows expected to be realised from the asset, taking into account, where appropriate, the quality of underlying security and credit protection available. The movement in available-for-sale financial assets is shown in note 20. The reduction in the fair value of available-for-sale financial assets during the year was £483 million (2006: £10 million). Impairment losses in respect of available-for-sale financial assets transferred from reserves to the income statement totalled £70 million (2006: £nil).

Pensions

The net liability recognised in the balance sheet at 31 December 2007 in respect of the Group's retirement benefit obligations was £2,144 million (2006: £2,462 million) of which £2,033 million (2006: £2,362 million) related to defined benefit pension schemes. This liability excludes actuarial gains of £1,350 million (2006: £263 million) which the Group is permitted to leave unrecognised. The defined benefit pension schemes' gross deficit totalled £683 million (2006: £2,099 million) representing the difference between the schemes' liabilities and the fair value of the related assets at the balance sheet date.

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

Two important assumptions are the rate of inflation and the expected lifetime of the schemes' members. The assumed rate of inflation affects the rate at which salaries are projected to grow and therefore the size of the pension that employees receive upon retirement and also the rate at which pensions in payment increase. Over the longer term rates of inflation can vary significantly; at 31 December 2007 it was assumed that the rate of inflation would be 3.3 per cent per annum (2006: 2.9 per cent), although if this was increased by 0.2 per cent the overall deficit would increase by approximately £550 million and the annual cost by approximately £20 million. A reduction of 0.2 per cent would reduce the overall deficit by approximately £500 million and the annual cost by approximately £40 million.

The cost of the benefits payable by the schemes will also depend upon the longevity of the members. Assumptions are made regarding the expected lifetime of scheme members based upon recent experience, however given the rate of advance in medical science and increasing levels of obesity, it is uncertain whether they will ultimately reflect actual experience. An increase of one year in the expected lifetime of scheme members would increase the overall deficit by approximately £400 million and the annual cost by approximately £30 million; a reduction of one year would reduce the overall deficit by approximately £400 million and the annual cost by approximately £40 million.

The size of the overall deficit is also sensitive to changes in the discount rate, which is affected by market conditions and therefore potentially subject to significant variations. At 31 December 2007 the discount rate used was 5.8 per cent (2006: 5.1 per cent); a reduction of 0.2 per cent would increase the overall deficit by approximately £550 million and the annual cost by approximately £15 million, while an increase of 0.2 per cent would reduce the net deficit by approximately £550 million and the annual cost by approximately £40 million.

2 Critical accounting estimates and judgements continued

Goodwill

At 31 December 2007 the Group carried goodwill on its balance sheet totalling £2,358 million (2006: £2,377 million), substantially all of which relates to acquisitions made a number of years ago.

The Group reviews the goodwill for impairment at least annually or when events or changes in economic circumstances indicate that impairment may have taken place. The impairment review is performed by projecting future cash flows, excluding finance and tax, based upon budgets and plans and making appropriate assumptions about rates of growth and discounting these using a rate that takes into account prevailing market interest rates and the risks inherent in the business. If the present value of the projected cash flows is less than the carrying value of the underlying net assets and related goodwill an impairment charge is required in the income statement. This calculation requires the exercise of significant judgement by management; if the estimates made prove to be incorrect or performance does not meet expectations which affects the amount and timing of future cash flows, goodwill may become impaired in future periods.

Insurance

Life assurance business

The Group carries in its balance sheet an asset representing the value of in-force business in respect of life insurance and participating investment contracts of £2,218 million at 31 December 2007 (2006: £2,723 million). This asset, which is presented gross of attributable tax, represents the present value of future profits expected to arise from the portfolio of in-force life insurance and participating investment contracts. This is determined using appropriate allowance for economic conditions and appropriate assumptions for future mortality rates and future persistency rates, making allowance for the realistic value of financial options and guarantees. Each cash flow is valued using the discount rate consistent with that applied to such a cash flow in the capital markets, including an explicit allowance for non-market risk. These factors are inherently uncertain. If actual experience differs from that assumed this could significantly affect the value attributed. The process for determining key assumptions that have been made at 31 December 2007 is detailed in note 23.

At 31 December 2007 the Group also carried substantial liabilities to holders of life insurance policies in its balance sheet. The methodology used to value the liabilities is described in note 1 (r) (1). Liabilities arising from insurance contracts and participating investment contracts were £22,526 million and £14,874 million respectively (2006: £25,763 million and £15,095 million) and those arising from non-participating investment contracts totalled £18,197 million (2006: £24,370 million). Elements of the liabilities require assumptions about future investment returns, future mortality rates and future policyholder behaviour. The process for determining the key assumptions that have been made at 31 December 2007 and the impact on profit before tax of changes in key assumptions is detailed in note 31.

General insurance business

At 31 December 2007 the Group held a provision of £207 million (2006: £149 million) in respect of the estimated cost of claims notified but not settled and claims incurred but not reported at the balance sheet date. The provision for the cost of claims notified but not settled is based upon a best estimate of the cost of settling the outstanding claims after taking into account all known facts. In those cases where there is insufficient information to determine the required provision, statistical techniques are used which take into account the cost of claims that have recently been settled and make assumptions about the future development of the outstanding cases. Similar statistical techniques are used to determine the provision for claims incurred but not reported at the balance sheet date.

While management believes that the liability carried at year end is adequate, the application of statistical techniques requires significant judgement. An increase of 10 per cent in the cost of claims would result in the recognition of an additional loss of approximately £20 million. Similarly, an increase of 10 per cent in the ultimate number of such claims would lead to an additional loss of approximately £20 million; some relief would arise from reinsurance contracts held.

Taxation

Significant judgement is required in determining the Group's income tax liabilities. In arriving at the current tax liability of £484 million and deferred tax liability of £948 million at 31 December 2007 (2006: current tax liability of £817 million and deferred tax liability of £1,416 million), the Group has taken account of tax issues that are subject to ongoing discussions with HM Revenue & Customs and other tax authorities. Calculations of these liabilities have been based on management's assessment of legal and professional advice, case law and other relevant guidance. In these situations, the various risks are categorised and approximate weightings applied in arriving at the assessment of the expected liability. Where the expected tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax amounts in the period in which such determination is made.

Valuation of financial instruments

Trading securities, other financial assets and liabilities at fair value through profit or loss, derivatives and available-for-sale financial assets are stated at fair value. The fair value of these financial instruments is the amount for which an asset could be exchanged or a liability settled between willing parties in arm's length transactions. The fair values of financial instruments are determined by reference to observable market prices where these are available and the market is active. Where market prices are not available or are unreliable because of poor liquidity, fair values are determined using valuation techniques including cash flow models which, to the extent possible, use observable market parameters. The process of calculating the fair value using valuation techniques may necessitate the estimation of certain pricing parameters, assumptions or model characteristics. Changes in assumptions about these factors could affect reported fair values of financial instruments. The fair value movement on assets and liabilities held at fair value through profit or loss and gains in respect of instruments held for trading are disclosed in note 6. Movements in respect of available-for-sale financial assets, including those arising from changes in their fair value, are disclosed in note 20. The fair values of the Group's financial assets and liabilities are disclosed within note 47 on pages 141 and 142 together with an indication of the valuation technique used for each major asset or liability category.

3 Segmental analysis

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

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

Under the Group's transfer pricing arrangements, inter-segment services are generally recharged at cost, with the exception of the internal commission arrangements between the UK branch and other distribution networks and the insurance product manufacturing businesses within the Group, where a profit margin is also charged. Inter-segment lending and deposits are generally entered into at market rates, except that non-interest bearing balances are priced at a rate that reflects the external yield that could be earned on such funds.

For those derivative contracts entered into by business units for risk management purposes, the business unit retains the amount that would have been recognised on an accrual accounting basis (an amount equal to the interest element of the next payment on the swap) and transfers the remainder of the fair value of the swap to the central group segment where the resulting accounting volatility is managed though the establishment of hedge accounting relationships. Any change in fair value of the hedged instrument attributable to the hedged risk is also recorded within the central group segment. This allocation of the fair value of the swap and change in fair value of the hedged instrument attributable to the hedged risk avoids accounting asymmetry in segmental results, records volatility where it is managed and provides a fair presentation of the segments' operating performance. It is the basis on which the segments are managed and measured internally and is the basis of the Group's internal segmental reporting to the board.

	UK Retail Banking £m	General insurance £m	Life, pensions and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Inter-segment eliminations £m	Total £m
Year ended 31 December 2007								
Interest and similar income	8,018	23	1,040	1,063	9,834	1,097	(3,138)	16,874
Interest and similar expense	(4,235)	–	(527)	(527)	(7,316)	(1,835)	3,138	(10,775)
Net interest income	3,783	23	513	536	2,518	(738)	–	6,099
Other income (net of fee and commission expense)	1,797	554	7,643	8,197	1,773	362	–	12,129
Total income	5,580	577	8,156	8,733	4,291	(376)	–	18,228
Insurance claims	–	(302)	(7,220)	(7,522)	–	–	–	(7,522)
Total income, net of insurance claims	5,580	275	936	1,211	4,291	(376)	–	10,706
Operating expenses	(2,624)	(154)	(501)	(655)	(2,282)	(6)	–	(5,567)
Trading surplus (deficit)	2,956	121	435	556	2,009	(382)	–	5,139
Impairment	(1,224)	–	–	–	(572)	–	–	(1,796)
Profit on sale of businesses	–	–	272	272	385	–	–	657
Profit (loss) before tax	1,732	121	707	828	1,822	(382)	–	4,000
External revenue	9,132	1,235	8,854	10,089	10,082	300	–	29,603
Inter-segment revenue	1,012	49	181	230	1,559	1,302	(4,103)	–
Segment revenue	10,144	1,284	9,035	10,319	11,641	1,602	(4,103)	29,603
External assets	115,012	1,164	72,213	73,377	163,294	1,663	–	353,346
Inter-segment assets	5,093	361	3,777	4,138	91,246	64,654	(165,131)	–
Total assets	120,105	1,525	75,990	77,515	254,540	66,317	(165,131)	353,346
External liabilities	96,166	870	65,304	66,174	162,376	16,205	–	340,921
Inter-segment liabilities	20,321	12	5,930	5,942	86,159	52,709	(165,131)	–
Total liabilities	116,487	882	71,234	72,116	248,535	68,914	(165,131)	340,921
Other segment items:								
Capital expenditure	80	11	452	463	613	178	–	1,334
Depreciation and amortisation	205	14	37	51	374	–	–	630
Defined benefit scheme charges	114	3	26	29	92	(60)	–	175

3 Segmental analysis continued

	UK Retail Banking £m	General insurance £m	Life, pensions and asset management £m	Insurance and Investments £m	Wholesale and International Banking £m	Central group items £m	Inter-segment eliminations £m	Total £m
Year ended 31 December 2006								
Interest and similar income	6,913	24	820	844	8,598	994	(3,241)	14,108
Interest and similar expense	(3,271)	–	(741)	(741)	(6,421)	(1,587)	3,241	(8,779)
Net interest income	3,642	24	79	103	2,177	(593)	–	5,329
Other income (net of fee and commission expense)	1,621	594	9,893	10,487	2,035	201	–	14,344
Total income	5,263	618	9,972	10,590	4,212	(392)	–	19,673
Insurance claims	–	(200)	(8,369)	(8,569)	–	–	–	(8,569)
Total income, net of insurance claims	5,263	418	1,603	2,021	4,212	(392)	–	11,104
Operating expenses	(2,476)	(157)	(481)	(638)	(2,264)	77	–	(5,301)
Trading surplus (deficit)	2,787	261	1,122	1,383	1,948	(315)	–	5,803
Impairment	(1,238)	–	–	–	(308)	(9)	–	(1,555)
Profit (loss) before tax	1,549	261	1,122	1,383	1,640	(324)	–	4,248
External revenue	8,136	1,249	10,888	12,137	8,659	158	–	29,090
Inter-segment revenue	698	19	199	218	2,276	910	(4,102)	–
Segment revenue	8,834	1,268	11,087	12,355	10,935	1,068	(4,102)	29,090
External assets	108,381	1,115	84,959	86,074	147,836	1,307	–	343,598
Inter-segment assets	3,331	502	4,050	4,552	80,995	53,588	(142,466)	–
Total assets	111,712	1,617	89,009	90,626	228,831	54,895	(142,466)	343,598
External liabilities	87,327	875	77,633	78,508	150,779	15,477	–	332,091
Inter-segment liabilities	20,980	54	5,595	5,649	72,793	43,044	(142,466)	–
Total liabilities	108,307	929	83,228	84,157	223,572	58,521	(142,466)	332,091
Other segment items:								
Capital expenditure	82	7	845	852	647	143	–	1,724
Depreciation and amortisation	202	9	29	38	379	–	–	619
Defined benefit scheme charges	121	4	24	28	100	(140)	–	109

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

4 Net interest income

	Weighted average effective interest rate 2007 %	Weighted average effective interest rate 2006 %	2007 £m	2006 £m
Interest receivable:				
Loans and advances to customers	**6.89**	6.21	**13,209**	10,853
Loans and advances to banks	**5.14**	4.72	**2,025**	1,826
Lease and hire purchase receivables	**6.34**	5.97	**602**	622
Interest receivable on loans and receivables	**6.58**	5.94	**15,836**	13,301
Available-for-sale financial assets	**4.83**	4.39	**1,038**	807
Total interest receivable	**6.44**	5.82	**16,874**	14,108
Interest payable:				
Deposits from banks	**5.00**	4.67	**(1,919)**	(1,680)
Customer accounts	**3.58**	2.91	**(5,085)**	(3,738)
Debt securities in issue	**5.08**	4.67	**(2,680)**	(1,983)
Subordinated liabilities	**5.65**	5.72	**(741)**	(694)
Liabilities under sale and repurchase agreements	**4.81**	4.35	**(155)**	(260)
Interest payable on liabilities held at amortised cost	**4.24**	3.71	**(10,580)**	(8,355)
Other	**4.28**	9.68	**(195)**	(424)
Total interest payable	**4.24**	3.82	**(10,775)**	(8,779)
Net interest income			**6,099**	5,329

Included within interest receivable is £395 million (2006: £297 million) in respect of impaired financial assets. Net interest income also includes a credit of £1 million (2006: charge of £1 million) transferred from the cash flow hedging reserve (note 41).

5 Net fee and commission income

	2007 £m	2006 £m
Fee and commission income:		
Current accounts	**693**	652
Insurance broking	**648**	629
Credit and debit card fees	**536**	493
Trust and other fiduciary fees	**362**	331
Other	**985**	1,011
	3,224	3,116
Fee and commission expense	**(600)**	(638)
Net fee and commission income	**2,624**	2,478

As discussed in note 1(d), fees and commissions which are an integral part of the effective interest rate form part of net interest income shown in note 4. Fees and commissions relating to instruments that are held at fair value through profit or loss are included within net trading income shown in note 6.

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

6 Net trading income

	2007 £m	2006 £m
Foreign exchange translation gains	34	32
Gains on foreign exchange trading transactions	159	98
Total foreign exchange	193	130
Investment property (losses) gains (note 21)	(321)	631
Securities and other gains	3,251	5,580
	3,123	6,341

Securities and other gains comprise net gains arising on assets and liabilities held at fair value through profit or loss and for trading as follows:

	2007 £m	2006 £m
Net income arising on assets held at fair value through profit or loss:		
Loans and advances to banks and customers	23	29
Debt securities	673	1,181
Equity shares	2,422	4,046
Total net income arising on assets held at fair value through profit or loss	3,118	5,256
Net (expense) income arising on liabilities held at fair value through profit or loss – debt securities in issue	(153)	21
Total net gains arising on assets and liabilities held at fair value through profit or loss	2,965	5,277
Net gains on financial instruments held for trading	286	303
Securities and other gains	3,251	5,580

7 Insurance premium income

	2007 £m	2006 £m
Life insurance		
Gross premiums	4,937	4,308
Ceded reinsurance premiums	(98)	(189)
Net earned premiums	4,839	4,119
Non-life insurance		
Gross premiums written	632	608
Ceded reinsurance premiums	(23)	(17)
Net premiums	609	591
Change in provision for unearned premiums	(18)	9
Net earned premiums	591	600
Total net earned premiums	5,430	4,719

Life insurance gross written premiums can be further analysed as follows:	2007 £m	2006 £m
Life	1,998	1,831
Pensions	2,235	1,780
Annuities	689	681
Other	15	16
Gross premiums	4,937	4,308

7 Insurance premium income continued

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

	2007 £m	2006 £m
Credit protection	212	203
Home	412	394
Health	8	11
	632	608

8 Other operating income

	2007 £m	2006 £m
Operating lease rental income	393	422
Rental income from investment property (note 21)	227	313
Other rents receivable	31	28
Gains less losses on disposal of available-for-sale financial assets (note 41)	5	22
Movement in value of in-force business (note 23)	(93)	(199)
Other income	389	220
	952	806

9 Insurance claims

Insurance claims comprise:

	2007 £m	2006 £m
Life insurance and participating investment contracts		
Claims and surrenders:		
Gross	5,432	5,375
Reinsurers' share	(73)	(76)
	5,359	5,299
Change in liabilities:		
Gross	1,955	2,923
Reinsurers' share	20	(18)
	1,975	2,905
Change in unallocated surplus (note 33)	(114)	165
Total life insurance and participating investment contracts	7,220	8,369
Non-life insurance		
Claims and claims paid:		
Gross	250	198
Reinsurers' share	–	–
	250	198
Change in liabilities:		
Gross	58	2
Reinsurers' share	(6)	–
	52	2
Total non-life insurance	302	200
Total insurance claims expense	7,522	8,569

Life insurance gross claims can also be analysed as follows:

	2007 £m	2006 £m
Deaths	296	286
Maturities	1,516	1,385
Surrenders	2,994	3,081
Annuities	568	558
Other	58	65
	5,432	5,375

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

10 Operating expenses

	2007 £m	2006 £m
Salaries	2,127	2,117
Social security costs	167	161
Pensions and other post-retirement benefit schemes (note 35)	238	165
Other staff costs	372	298
Staff costs	2,904	2,741
Other administrative expenses:		
Operating lease rentals	250	254
Repairs and maintenance	154	165
Communications and data processing	462	499
Advertising	192	184
Professional fees	279	231
Settlement of overdraft claims (see below)	76	–
Other	620	608
	2,033	1,941
Depreciation of tangible fixed assets (note 25)	594	602
Amortisation of other intangible assets (note 24)	36	17
Total operating expenses	5,567	5,301

During the year ended 31 December 2007, operating expenses include a charge of £76 million (2006: £nil) relating to the settlement of customer claims for the repayment of overdraft fees, together with related costs.

The average number of persons on a headcount basis employed by the Group during the year was as follows:

	2007	2006
UK	67,616	74,079
Overseas	1,937	2,013
	69,553	76,092

During the year the auditors earned the following fees:	2007 £m	2006 £m
Fees payable for the audit of the Company's current year annual report	6.8	6.0
Fees payable for other services:		
Audit of the Company's subsidiaries pursuant to legislation	2.5	2.9
Other services supplied pursuant to legislation	2.7	4.7
Total audit fees	12.0	13.6
Other services – audit related fees	1.1	1.4
Total audit and audit related fees	13.1	15.0
Services relating to taxation	0.7	0.6
Other non-audit fees:		
Services relating to corporate finance transactions	0.7	1.0
Other services	0.1	0.4
Total other non-audit fees	0.8	1.4
Total fees payable to the Company's auditors by the Group	14.6	17.0

10 Operating expenses continued

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

	2007 £m	2006 £m
Audits of Group pension schemes	0.2	0.2
Audits of the unconsolidated Open Ended Investment Companies managed by the Group	0.4	0.4
Reviews of the financial position of corporate and other borrowers	2.8	1.6
Acquisition due diligence and other work performed in respect of potential venture capital investments	0.6	1.0

Other services supplied pursuant to legislation relate primarily to the costs associated with the Sarbanes-Oxley Act audit requirements together with the cost of the audit of the Group's Form 20-F filing.

The following types of services are included in the categories listed above:

Audit fees: This category includes fees in respect of the audit of the Group's annual financial statements and other services in connection with regulatory filings.
Audit related fees: This category includes fees in respect of services for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements.

Services relating to taxation: This category includes tax compliance and tax advisory services.

Other non-audit fees: This category includes due diligence relating to corporate finance, including venture capital transactions and other assurance and advisory services.

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

The Group has procedures that are designed to ensure auditor independence, including that fees for audit and non-audit services are approved in advance. This approval can be obtained either on an individual engagement basis or, for certain types of non-audit services, particularly those of a recurring nature, through the approval of a fee cap covering all engagements of that type provided the fee is below that cap. All statutory audit work as well as non-audit assignments where the fee is expected to exceed the relevant fee cap must be pre-approved by the audit committee on an individual engagement basis. On a quarterly basis, the audit committee receives a report detailing all pre-approved services and amounts paid to the auditors for such pre-approved services.

11 Impairment

	2007 £m	2006 £m
Impairment losses on loans and advances (note 19)	1,721	1,560
Other credit risk provisions (note 37)	5	(5)
	1,726	1,555
Impairment of available-for-sale financial assets (note 20)	70	–
Total impairment charged to the income statement	1,796	1,555

12 Profit on sale of businesses

	2007 £m	2006 £m
Profit on sale of Lloyds TSB Registrars	407	–
Profit on sale of Abbey Life	272	–
Other, including adjustments in respect of businesses sold in prior years	(22)	–
	657	–

During 2007 the Group completed the following transactions:

- The sale, announced on 21 May 2007, of the business and assets of Lloyds TSB Bank plc's company registration business, Lloyds TSB Registrars.
- The sale, announced on 31 July 2007, of Abbey Life Assurance Company Limited, a UK life operation which has been closed to new business since 2000.
- The sale, announced on 3 October 2007, of The Dutton-Forshaw Group Limited, a medium-size car dealership.

In addition, provision has been made for payments under an indemnity given in relation to a business sold in an earlier year.

The businesses sold in 2007 did not represent separate material lines of business and consequently they have not been treated as discontinued operations.

13 Taxation

(a) Analysis of charge for the year

	2007 £m	2006 £m
UK corporation tax:		
Current tax on profit for the year	763	1,024
Adjustments in respect of prior years	(30)	(137)
	733	887
Double taxation relief	(60)	(195)
	673	692
Foreign tax:		
Current tax on profit for the year	98	83
Adjustments in respect of prior years	(3)	(8)
	95	75
Current tax charge	768	767
Deferred tax (note 36)	(89)	574
	679	1,341

The charge for tax on the profit for the year is based on a UK corporation tax rate of 30 per cent (2006: 30 per cent).

The Group, as a proxy for policyholders in the UK, is required to record taxes on investment income, gains and losses each year. Accordingly, the tax attributable to UK life insurance policyholder earnings is included in income tax expense. The tax credit attributable to policyholders was £243 million (2006: £222 million expense), including a prior year tax charge of £5 million (2006: tax charge of £12 million).

In addition to the income statement current tax charge, a total of £131 million of current tax has been credited to equity (2006: a total of £17 million charged to equity); a credit of £3 million (2006: a credit of £15 million) in respect of share based payments, a credit of £103 million (2006: a charge of £33 million) in respect of foreign exchange differences and a net credit of £25 million (2006: a net credit of £1 million) in respect of the revaluation of available-for-sale financial assets.

(b) Factors affecting the tax charge for the year

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

	2007 £m	2006 £m
Profit before tax	4,000	4,248
Tax charge thereon at UK corporation tax rate of 30%	1,200	1,274
Factors affecting charge:		
Disallowed and non-taxable items	2	(8)
Overseas tax rate differences	(4)	(2)
Gains exempted or covered by capital losses	(274)	(78)
Policyholder interests	(173)	123
UK corporation tax rate change	(110)	–
Other items	38	32
Tax on profit on ordinary activities	679	1,341
Effective rate	17.0%	31.6%

The effective tax rate of the Group excluding the gross policyholder and Open Ended Investment Company interests from profit before tax and the tax charge and, in 2007, the profit on disposal of businesses from profit before tax and the impact on the year end deferred tax position of the UK corporation tax rate change was 28.3 per cent (2006: 28.0 per cent).

14 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year, which has been calculated after deducting 5 million (2006: 5 million) ordinary shares representing the Group's holdings of own shares in respect of employee share schemes.

	2007	2006
Profit attributable to equity shareholders	£3,289m	£2,803m
Weighted average number of ordinary shares in issue	5,637m	5,616m
Basic earnings per share	58.3p	49.9p

For the calculation of diluted earnings per share the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has dilutive potential ordinary shares in respect of share options and awards granted to employees. The number of shares that could have been acquired at market price (determined as the average annual share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options and awards is determined; the residual bonus shares are added to the weighted average number of ordinary shares in issue, but no adjustment is made to the profit attributable to equity shareholders.

	2007	2006
Profit attributable to equity shareholders	£3,289m	£2,803m
Weighted average number of ordinary shares in issue	5,637m	5,616m
Adjustment for share options and awards	46m	51m
Weighted average number of ordinary shares for diluted earnings per share	5,683m	5,667m
Diluted earnings per share	57.9p	49.5p

The weighted average number of anti-dilutive share options and awards excluded from the calculation of diluted earnings per share was 3 million at 31 December 2007 (2006: 7 million).

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

	2007 £m	2006 £m
Trading assets	**4,663**	5,756
Other financial assets at fair value through profit or loss	**53,248**	61,939
	57,911	67,695

These assets are comprised as follows:

	2007		2006	
	Trading assets £m	Other financial assets at fair value through profit or loss £m	Trading assets £m	Other financial assets at fair value through profit or loss £m
Loans and advances to banks	**29**	**1**	34	3
Loans and advances to customers	**756**	**403**	350	448
Debt securities:				
Government securities	**62**	**4,848**	180	8,626
Other public sector securities	**–**	**–**	–	44
Bank and building society certificates of deposit	**–**	**811**	–	573
Mortgage backed securities	**87**	**70**	451	87
Other asset backed securities	**122**	**1,805**	595	861
Corporate and other debt securities	**3,607**	**13,564**	4,146	13,170
	3,878	**21,098**	5,372	23,361
Equity shares:				
Listed	**–**	**23,598**	–	29,275
Unlisted	**–**	**8,148**	–	8,852
	–	**31,746**	–	38,127
	4,663	**53,248**	5,756	61,939

At 31 December 2007 £55,729 million (2006: £65,122 million) of trading and other financial assets at fair value through profit or loss had a contractual residual maturity of greater than one year.

Other financial assets at fair value through profit or loss represent the following assets designated into that category:

(i) financial assets backing insurance contracts and investment contracts which are so designated because the related liabilities either have cash flows that are contractually based on the performance of the assets or are contracts whose measurement takes account of current market conditions and where significant measurement inconsistencies would otherwise arise;

(ii) certain loans and advances to customers which are economically hedged by interest rate derivatives which are not in hedge accounting relationships and where significant measurement inconsistencies would otherwise arise if the related derivatives were treated as trading liabilities and the loans and advances were carried at amortised cost; and

(iii) certain private equity investments that are managed, and evaluated, on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

The maximum exposure to credit risk at 31 December 2007 of the loans and advances to banks and customers designated at fair value through profit or loss was £404 million (31 December 2006: £451 million); the Group does not hold any credit derivatives or other instruments in mitigation of this risk. There was no significant movement in the fair value of these loans attributable to changes in credit risk; this is determined by reference to the publicly available credit ratings of the instruments involved.

The carrying value of assets that are subject to stock lending arrangements was £1,450 million at 31 December 2007 (2006: £1,781 million) all of which the secured party is permitted by contract or custom to sell or repledge.

16 Derivative financial instruments

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

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

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

Credit derivatives, principally credit default swaps, are used by the Group as part of its trading activity and to manage its own exposure to credit risk. A credit default swap is a swap in which one counterparty receives a premium at pre-set intervals in consideration for guaranteeing to make a specific payment should a negative credit event take place. As discussed in note 18, the Group also uses credit default swaps to synthetically securitise £1,572 million (2006: £961 million) of commercial banking loans, and, in combination with external funding, to securitise a further £2,753 million (2006: £nil) of commercial banking loans.

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

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

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2007			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	150,450	1,759	1,285
Currency swaps	30,214	803	680
Options purchased	7,609	157	–
Options written	6,988	–	149
	195,261	2,719	2,114
Interest rate contracts:			
Interest rate swaps	332,361	2,765	3,250
Forward rate agreements	102,274	36	34
Options purchased	33,147	171	–
Options written	22,976	–	171
Futures	35,571	1	–
	526,329	2,973	3,455
Credit derivatives	63,444	1,838	1,057
Equity and other contracts	4,439	865	156
Total derivative assets/liabilities held for trading		8,395	6,782
Hedging			
Derivatives designated as fair value hedges:			
Interest rate swaps (including swap options)	50,734	263	460
Derivatives designated as cash flow hedges:			
Interest rate swaps	630	1	24
Derivatives designated as net investment hedges:			
Cross currency swaps	5,302	–	316
Total derivative assets/liabilities held for hedging		264	800
Total recognised derivative assets/liabilities		8,659	7,582

At 31 December 2007 £3,573 million of total recognised derivative assets and £4,112 million of total recognised derivative liabilities (2006: £3,068 million of assets and £3,412 million of liabilities) had a contractual residual maturity of greater than one year.

16 Derivative financial instruments continued

	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
31 December 2006			
Trading			
Exchange rate contracts:			
Spot, forwards and futures	116,255	794	1,432
Currency swaps	20,618	346	496
Options purchased	3,076	51	–
Options written	3,822	–	32
	143,771	1,191	1,960
Interest rate contracts:			
Interest rate swaps	331,852	2,980	3,149
Forward rate agreements	40,876	17	18
Options purchased	17,034	68	–
Options written	12,588	–	63
Futures	33,066	–	1
	435,416	3,065	3,231
Credit derivatives	13,212	25	39
Equity and other contracts	4,026	797	67
Total derivative assets/liabilities held for trading		5,078	5,297
Hedging			
Derivatives designated as fair value hedges:			
Cross currency interest rate swaps	80	10	–
Interest rate swaps (including swap options)	37,298	333	453
	37,378	343	453
Derivatives designated as cash flow hedges:			
Interest rate swaps	569	5	13
Derivatives designated as net investment hedges:			
Cross currency swaps	2,589	139	–
Total derivative assets/liabilities held for hedging		487	466
Total recognised derivative assets/liabilities		5,565	5,763

17 Loans and advances to banks

	2007 £m	2006 £m
Lending to banks	**5,892**	5,966
Money market placements with banks	**28,953**	34,673
Total loans and advances to banks	**34,845**	40,639
Allowance for impairment losses (note 19)	**–**	(1)
	34,845	40,638

At 31 December 2007 £5,773 million (2006: £15,259 million) of loans and advances to banks had a contractual residual maturity of greater than one year.

The Group holds collateral with a fair value of £9,109 million (2006: £6,837 million), which it is permitted to sell or repledge, of which £8,482 million (2006: £6,209 million) was repledged or sold to third parties for periods not exceeding three months from the transfer.

18 Loans and advances to customers

	2007 £m	2006 £m
Agriculture, forestry and fishing	**3,226**	2,905
Energy and water supply	**2,102**	2,024
Manufacturing	**8,385**	7,513
Construction	**2,871**	2,332
Transport, distribution and hotels	**11,573**	10,490
Postal and telecommunications	**946**	831
Property companies	**17,576**	12,896
Financial, business and other services	**29,707**	22,999
Personal:		
Mortgages	**102,739**	95,601
Other	**22,988**	23,025
Lease financing	**4,686**	4,802
Hire purchase	**5,423**	5,060
	212,222	190,478
Allowance for impairment losses (note 19)	**(2,408)**	(2,193)
	209,814	188,285

At 31 December 2007 £153,302 million (2006: £141,247 million) of loans and advances to customers had a contractual residual maturity of greater than one year.

The Group holds collateral with a fair value of £1,975 million (2006: £444 million), which it is permitted to sell or repledge, of which £1,818 million (2006: £238 million) was repledged or sold to third parties for periods not exceeding three months from the transfer.

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

	2007 £m	2006 £m
Gross investment in finance leases, receivable:		
Not later than 1 year	**620**	637
Later than 1 year and not later than 5 years	**1,917**	2,358
Later than 5 years	**5,339**	5,358
	7,876	8,353
Unearned future finance income on finance leases	**(2,875)**	(2,945)
Rentals received in advance	**(131)**	(163)
Commitments for expenditure in respect of equipment to be leased	**(184)**	(443)
Net investment in finance leases	**4,686**	4,802

The net investment in finance leases represents amounts recoverable as follows:	2007 £m	2006 £m
Not later than 1 year	**340**	234
Later than 1 year and not later than 5 years	**1,004**	1,232
Later than 5 years	**3,342**	3,336
	4,686	4,802

Equipment leased to customers under finance leases primarily relates to structured financing transactions to fund the purchase of aircraft, ships and other large individual value items. The allowance for uncollectable finance lease receivables included in the allowance for impairment losses is £16 million (2006: £7 million). The unguaranteed residual values included in finance lease receivables were as follows:

	2007 £m	2006 £m
Not later than 1 year	**–**	–
Later than 1 year and not later than 5 years	**17**	–
Later than 5 years	**159**	168
Total	**176**	168

18 Loans and advances to customers continued

Securitisations

Loans and advances to customers include balances that have been securitised but not derecognised, comprising both residential mortgages and commercial banking loans, the carrying values of which are set out below together with any related liabilities. Residential mortgages are not derecognised because the Group remains exposed to the majority of the risk of any default in respect of them; commercial banking loans are not derecognised because the Group has not transferred the contractual rights to receive the cash flows from those loans nor has it assumed a contractual obligation to pay the cash flows from those loans to a third party.

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

At 31 December 2007 the total amount of residential mortgages subject to securitisation was £46,284 million (2006: £14,927 million) in respect of which external funding at the year end amounted to £12,403 million (2006: £10,048 million); external funding is shown in debt securities in issue (see note 30). The Group participates in the securitisation through the provision of administration and other services, the provision of interest rate and currency swaps and in the form of unsecured loan financing which is subordinate to the interests of the floating rate note holders.

In addition the Group has entered into two securitisations of its commercial banking loans as follows:

– a synthetic securitisation of £1,572 million (2006: £961 million) utilising credit default swaps (CDSs);

– a securitisation of £2,753 million (2006: £nil) utilising a combination of CDSs and £98 million (2006: £nil) of external funding.

The CDSs are accounted for as derivatives and are included in derivative financial instruments (see note 16) and the external funding is shown in debt securities in issue (see note 30).

19 Allowance for impairment losses on loans and advances

	Loans and advances to customers					
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	Loans and advances to banks £m	Total £m
Balance at 1 January 2006	36	1,655	381	2,072	1	2,073
Exchange and other adjustments	1	–	(14)	(13)	–	(13)
Adjustments on disposal of businesses and portfolios	–	(27)	–	(27)	–	(27)
Advances written off	(9)	(1,338)	(142)	(1,489)	–	(1,489)
Recoveries of advances written off in previous years	2	170	18	190	–	190
Unwinding of discount	–	(100)	–	(100)	–	(100)
Charge to the income statement	12	1,558	(10)	1,560	–	1,560
At 31 December 2006	42	1,918	233	2,193	1	2,194
Exchange and other adjustments	–	–	2	2	–	2
Advances written off	(25)	(1,439)	(78)	(1,542)	–	(1,542)
Recoveries of advances written off in previous years	2	133	2	137	–	137
Unwinding of discount	–	(101)	(3)	(104)	–	(104)
Charge to the income statement	18	1,518	186	1,722	(1)	1,721
At 31 December 2007	37	2,029	342	2,408	–	2,408

The analysis of allowances for impairment between retail and wholesale has been prepared based upon the type of exposure and not the business segment in which the exposure is recorded. Included within retail are exposures to personal customers and small businesses, whilst included within wholesale are exposures to corporate customers and other large institutions.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss are disclosed in note 1(j). All impaired loans which exceed a certain threshold, principally within the Group's corporate banking business, are individually assessed for impairment having regard to expected future cash flows including those that could arise from the realisation of security. Included in loans and advances to customers were loans and advances individually determined to be impaired whose gross amount before impairment allowances was £684 million (2006: £428 million) and in respect of which collateral with a fair value of £193 million (2006: £186 million) was held.

20 Available-for-sale financial assets

	2007 £m	2006 £m
Debt securities:		
Government securities	**319**	393
Other public sector securities	**5**	189
Bank and building society certificates of deposit	**1,825**	1,615
Mortgage backed securities	**6,050**	5,662
Other asset backed securities	**4,071**	4,721
Corporate and other debt securities	**6,270**	4,817
	18,540	17,397
Equity shares:		
Listed	**1**	1
Unlisted	**28**	14
	29	15
Treasury bills and other bills:		
Treasury bills and similar securities	**1,608**	1,743
Other bills	**19**	23
	1,627	1,766
	20,196	19,178

At 31 December 2007 £15,265 million (2006: £13,779 million) of available-for-sale financial assets had a contractual residual maturity of greater than one year.

All assets have been individually assessed for impairment. The criteria used to determine whether an impairment loss has been incurred are disclosed in note 1 (j). Included in available-for-sale assets at 31 December 2007 are debt securities individually determined to be impaired whose gross amount before impairment allowances was £75 million and in respect of which no collateral was held.

The movement in available-for-sale financial assets is summarised as follows:	Carrying value before allowances for impairment £m	Allowances for impairment £m	Balance sheet value £m
At 1 January 2006	14,940	–	14,940
Exchange and other adjustments	(1,116)	–	(1,116)
Additions	23,448	–	23,448
Disposals	(18,106)	–	(18,106)
Amortisation of premiums and discounts	22	–	22
Changes in fair value (note 41)	(10)	–	(10)
At 31 December 2006	19,178	–	19,178
Exchange and other adjustments	**(715)**	**–**	**(715)**
Additions	**21,667**	**–**	**21,667**
Disposals	**(19,468)**	**–**	**(19,468)**
Amortisation of premiums and discounts	**36**	**–**	**36**
Changes in fair value (note 41)	**(483)**	**–**	**(483)**
Impairment transferred from reserves (note 41)	**70**	**(70)**	**–**
Disposal of businesses	**(19)**	**–**	**(19)**
At 31 December 2007	**20,266**	**(70)**	**20,196**

21 Investment property

	2007 £m	2006 £m
At 1 January	**4,739**	4,260
Exchange and other adjustments	**5**	–
Additions:		
Acquisitions of new properties	**302**	675
Additional expenditure on existing properties	**181**	75
Total additions	**483**	750
Disposals	**(271)**	(902)
Adjustments on deconsolidation of OEICs	**(881)**	–
Changes in fair value (note 6)	**(321)**	631
Disposal of businesses	**(32)**	–
At 31 December	**3,722**	4,739

During the year the percentage ownership of certain OEICs changed so that the Group no longer has control; as a consequence these OEICs have been deconsolidated.

21 Investment property continued

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

In addition, the following amounts have been recognised in the income statement:	2007 £m	2006 £m
Rental income	227	313
Direct operating expenses arising from investment properties that generate rental income	24	24

Capital expenditure in respect of investment properties:	2007 £m	2006 £m
Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements	111	85

22 Goodwill

	2007 £m	2006 £m
At 1 January	2,377	2,373
Acquisitions (note 48)	–	4
Disposals	(19)	–
At 31 December	2,358	2,377
Cost*	2,364	2,383
Accumulated impairment losses	(6)	(6)
	2,358	2,377

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

The goodwill held in the Group's balance sheet is tested at least annually for impairment. For the purposes of impairment testing the goodwill is allocated to the appropriate cash generating unit; of the total balance of £2,358 million (2006: £2,377 million), £1,836 million (or 78 per cent of the total) has been allocated to Scottish Widows and £510 million (or 22 per cent of the total) to Asset Finance.

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

The recoverable amount of Asset Finance has also been based on a value in use calculation using cash flow projections based on financial budgets and plans approved by management covering a five-year period and a discount rate of 12 per cent (gross of tax). The discount rate has been set at a premium over the Group's weighted average cost of capital to take into account the specific risk profile of the Asset Finance business. The cash flows for each of the businesses of Asset Finance beyond the five-year period are extrapolated using steady growth rates, in each case not exceeding 4 per cent nor the long-term average growth rates for the markets in which the respective businesses of Asset Finance participate.

23 Value of in-force business

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

Gross value of in-force insurance and participating investment business	2007 £m	2006 £m
At 1 January	2,723	2,922
Movement in value of in-force business	(93)	(199)
Disposal of business	(412)	–
At 31 December	2,218	2,723

Further information on the Group's life assurance business, including its available capital resources and regulatory capital requirements, the realistic value of its assets and liabilities and its capital sensitivities is given in note 31.

23 Value of in-force business continued

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

Economic assumptions

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

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

The risk-free rate assumed in valuing in-force business is 10 basis points over the 15-year gilt yield. In valuing financial options and guarantees the risk-free rate is derived from gilt yields plus 10 basis points, in line with Scottish Widows' FSA realistic balance sheet assumptions. The table below shows the range of resulting yields and other key assumptions at 31 December:

	2007 %	2006 %
Risk-free rate (value of in-force)	4.65	4.72
Risk-free rate (financial options and guarantees)	4.28 to 4.81	3.91 to 5.41
Retail price inflation	3.28	3.23
Expense inflation	4.18	4.13

Non-market risk

An allowance for non-market risk is made through the choice of best estimate assumptions based upon experience, which generally will give the mean expected financial outcome for shareholders and hence no further allowance for non-market risk is required. However, in the case of operational risk and the with-profits fund there are asymmetries in the range of potential outcomes for which an explicit allowance is made.

Non-economic assumptions

Future maintenance expenses, mortality, morbidity, lapse and paid-up rate assumptions are based on an analysis of past experience and represent management's best estimate of likely future experience.

24 Other intangible assets

	Customer lists £m	Software enhancements £m	Total £m
Cost:			
At 1 January 2006	–	147	147
Additions	54	51	105
At 31 December 2006	54	198	252
Additions	3	47	50
Disposals	–	(5)	(5)
At 31 December 2007	57	240	297
Accumulated amortisation:			
At 1 January 2006	–	97	97
Charge for the year	–	17	17
At 31 December 2006	–	114	114
Charge for the year	5	31	36
Disposals	–	(2)	(2)
At 31 December 2007	5	143	148
Balance sheet amount at 31 December 2007	52	97	149
Balance sheet amount at 31 December 2006	54	84	138

Software enhancements principally comprise identifiable and directly associated internal staff and other costs.

25 Tangible fixed assets

	Premises £m	Equipment £m	Operating lease assets £m	Total tangible fixed assets £m
Cost:				
At 1 January 2006	1,421	2,667	2,961	7,049
Exchange and other adjustments	–	(3)	(96)	(99)
Additions	92	286	552	930
Disposals	(25)	(101)	(551)	(677)
At 31 December 2006	1,488	2,849	2,866	7,203
Exchange and other adjustments	**–**	**2**	**(24)**	**(22)**
Adjustments on disposal of businesses	**(53)**	**(89)**	**–**	**(142)**
Adjustments on deconsolidation of subsidiaries	**–**	**–**	**(1,015)**	**(1,015)**
Additions	**60**	**286**	**549**	**895**
Disposals	**(58)**	**(177)**	**(945)**	**(1,180)**
At 31 December 2007	**1,437**	**2,871**	**1,431**	**5,739**
Accumulated depreciation and impairment:				
At 1 January 2006	601	1,796	361	2,758
Exchange and other adjustments	(1)	(1)	(63)	(65)
Charge for the year	82	248	272	602
Disposals	(7)	(83)	(254)	(344)
At 31 December 2006	675	1,960	316	2,951
Exchange and other adjustments	**–**	**2**	**(3)**	**(1)**
Adjustments on disposal of businesses	**(11)**	**(35)**	**–**	**(46)**
Adjustments on deconsolidation of subsidiaries	**–**	**–**	**(86)**	**(86)**
Charge for the year	**83**	**242**	**269**	**594**
Disposals	**(29)**	**(162)**	**(321)**	**(512)**
At 31 December 2007	**718**	**2,007**	**175**	**2,900**
Balance sheet amount at 31 December 2007	**719**	**864**	**1,256**	**2,839**
Balance sheet amount at 31 December 2006	813	889	2,550	4,252

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

	2007 £m	2006 £m
Receivable within 1 year	**259**	431
1 to 5 years	**271**	747
Over 5 years	**9**	30
	539	1,208

Equipment leased to customers under operating leases primarily relates to vehicle contract hire arrangements. During 2007 and 2006 no contingent rentals in respect of operating leases were recognised in the income statement.

In addition, total future minimum sub-lease income of £113 million at 31 December 2007 (£120 million at 31 December 2006) is expected to be received under non-cancellable sub-leases of the Group's premises.

During the year the Group entered into an agreement which transferred control over a number of its leasing subsidiaries to third parties. These subsidiaries have been deconsolidated and, consequently, operating lease assets and related accumulated depreciation in the amounts of £1,015 million and £86 million respectively have been derecognised.

26 Other assets

	2007 £m	2006 £m
Assets arising from reinsurance contracts held	**350**	451
Deferred acquisition costs	**212**	443
Settlement balances	**205**	285
Other assets and prepayments	**4,296**	3,500
	5,063	4,679

26 Other assets continued

At 31 December 2007 £1,781 million (2006: £1,521 million) of other assets had a contractual residual maturity of greater than one year.

Deferred acquisition costs:	2007 £m	2006 £m
At 1 January	443	429
Acquisition costs deferred, net of amounts amortised to the income statement	(22)	14
Disposal of businesses and other adjustments	(209)	–
At 31 December	212	443

27 Deposits from banks

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

	2007 £m	2006 £m
Domestic:		
Non-interest bearing	101	89
Interest bearing	32,335	28,405
	32,436	28,494
International:		
Non-interest bearing	46	31
Interest bearing	6,609	7,869
	6,655	7,900
	39,091	36,394

At 31 December 2007 £25 million (2006: £2,760 million) of deposits from banks had a contractual residual maturity of greater than one year.

Included in deposits from banks were deposits of £1,509 million (2006: £582 million) held as collateral, principally in relation to derivative contracts. The fair value of those deposits approximates the carrying amount.

28 Customer accounts

	2007 £m	2006 £m
Non-interest bearing current accounts	3,807	4,338
Interest bearing current accounts	45,726	43,064
Savings and investment accounts	71,905	66,151
Other customer deposits	35,117	25,789
	156,555	139,342

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

	2007 £m	2006 £m
Domestic:		
Non-interest bearing	3,407	4,002
Interest bearing	149,412	131,781
	152,819	135,783
International:		
Non-interest bearing	400	336
Interest bearing	3,336	3,223
	3,736	3,559
	156,555	139,342

At 31 December £1,949 million (2006: £2,077 million) of customer accounts had a contractual residual maturity of greater than one year.

Included in customer accounts were deposits of £777 million (2006: £462 million) held as collateral, principally in relation to derivative contracts. The fair value of those deposits approximates the carrying amount.

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

	2007 £m	2006 £m
Liabilities held at fair value through profit or loss (debt securities)	3,107	1,156
Trading liabilities	99	28
	3,206	1,184

At 31 December 2007 £2,032 million (2006: £1,144 million) of trading and other liabilities at fair value through profit or loss had a contractual residual maturity of greater than one year.

The amount contractually payable on maturity of the debt securities held at fair value through profit or loss at 31 December 2007 was £3,131 million, which was £24 million higher than the balance sheet carrying value (2006: £1,200 million, which was £44 million higher than the balance sheet carrying value). There was an £8 million (2006: £nil) decrease in the fair value of these liabilities attributable to changes in credit spread risk; this is determined by reference to the quoted credit spreads of Lloyds TSB Bank plc, the issuing entity within the Group.

Liabilities held at fair value through profit or loss represent designated debt securities in issue which contain substantive embedded derivatives which would otherwise need to be recognised and measured at fair value separately from the related debt securities.

30 Debt securities in issue

	2007 £m	2006 £m
Euro medium-term note programme	4,692	5,650
Other bonds and medium-term notes	14,497	10,157
Certificates of deposit issued	14,995	25,244
Commercial paper	17,388	13,067
Total debt securities in issue	51,572	54,118

At 31 December 2007 £18,604 million (2006: £15,020 million) of debt securities in issue had a contractual residual maturity of greater than one year.

Debt securities in issue at 31 December 2007 included £12,403 million (2006: £10,048 million) in respect of the securitisation of mortgages and £98 million (2006: £nil) in respect of the securitisation of commercial banking loans (see note 18).

31 Liabilities arising from insurance contracts and participating investment contracts

	2007 £m	2006 £m
Insurance contract liabilities	23,189	26,350
Participating investment contract liabilities	14,874	15,095
	38,063	41,445

At 31 December 2007 £35,603 million (2006: £38,297 million) of liabilities arising from insurance contracts and participating investment contracts had a contractual residual maturity of greater than one year.

Insurance contract liabilities

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

	2007			2006		
	Gross £m	Reinsurance* £m	Net £m	Gross £m	Reinsurance* £m	Net £m
Life insurance (see (i) below)	22,526	(340)	22,186	25,763	(425)	25,338
Non-life insurance (see (ii) below):						
Unearned premiums	456	–	456	438	–	438
Claims outstanding	207	(10)	197	149	(4)	145
	663	(10)	653	587	(4)	583
	23,189	(350)	22,839	26,350	(429)	25,921

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

31 Liabilities arising from insurance contracts and participating investment contracts continued

(i) Life insurance

The movement in life insurance contract liabilities over the year can be analysed as follows:	Gross £m	Reinsurance* £m	Net £m
At 1 January 2006	25,888	(511)	25,377
New business	1,045	(98)	947
Changes in existing business	(1,170)	184	(986)
At 31 December 2006	25,763	(425)	25,338
New business	**2,428**	**(18)**	**2,410**
Changes in existing business	**(1,316)**	**15**	**(1,301)**
Disposal of businesses	**(4,349)**	**88**	**(4,261)**
At 31 December 2007	**22,526**	**(340)**	**22,186**

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

The movement in liabilities arising from participating investment contracts may be analysed as follows:	£m
At 1 January 2006	14,068
New business	1,815
Changes in existing business	(788)
At 31 December 2006	15,095
New business	**491**
Changes in existing business	**(712)**
At 31 December 2007	**14,874**

Process for determining key assumptions

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

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

With Profit Fund realistic liabilities

The Group's With Profit Fund contains life insurance contracts and participating investment contracts. The calculation of With Profit Fund realistic liabilities uses best estimate assumptions for mortality, persistency rates and expenses. These are calculated in a similar manner to those used for the value of in-force business as discussed in note 23. The persistency rates used for the realistic valuation of the With Profit Fund liabilities make an allowance for potential changes in future experience as the guarantees and options within with-profits contracts become more valuable under adverse market conditions.

Other key assumptions are:

- Investment returns and discount rates

The realistic capital regime dictates that With Profit Fund liabilities are valued on a market-consistent basis. This is achieved by the use of a valuation model which values liabilities on a basis calibrated to tradable market option contracts and other observable market data. The With Profit Fund financial options and guarantees are valued using a stochastic simulation model where all assets are assumed to earn, on average, the risk-free yield and all cash flows are discounted using the risk-free yield. The risk-free yield is defined as 0.1 per cent higher than the spot yields derived from the UK gilt yield curve.

- Guaranteed annuity option take-up rates

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

- Investment volatility

The calibration of the stochastic simulation model uses implied volatilities of derivatives where possible, or historical volatility where it is not possible to observe meaningful prices. For example, as at 31 December 2007, the 10 year equity-implied at-the-money assumption was set at 25.5 per cent (31 December 2006: 20 per cent). The assumption for property volatility was 15 per cent (31 December 2006: 15 per cent), with swaption volatility of broadly 11 per cent (31 December 2006: broadly 13 per cent).

- Mortality

The mortality assumptions, including allowances for improvements in longevity for annuitants, are set with regard to the Group's actual experience where this is significant, and relevant industry data otherwise.

- Lapse rates

Lapse rates refer to the rate of policy termination and the rate at which policyholders stop paying regular premiums. These rates are based on a combination of historical experience and management's views on future experience taking into consideration potential changes in future experience that may result from guarantees and options becoming more valuable under adverse market conditions.

31 Liabilities arising from insurance contracts and participating investment contracts continued

Non-Profit Fund liabilities

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

- Interest rates

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

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

- Mortality and morbidity

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

- Lapse rates

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

- Maintenance expenses

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

Key changes in assumptions

During 2007, following a detailed review of the Group's current and expected experience, there has been a change in the key assumption in respect of lapse rates. The impact of this change has been to decrease profit before tax by £52 million; this amount includes movements in liabilities and value of the in-force business in respect of insurance contracts and participating investment contracts.

Sensitivity analysis

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

31 Liabilities arising from insurance contracts and participating investment contracts continued

	Change in variable	Increase (reduction) in profit before tax £m
Non-annuitant mortality	5% reduction	28
Annuitant mortality	5% reduction	(90)
Lapse rates	10% reduction	47
Maintenance expenses	10% reduction	79
Risk-free rate[1]	0.25% deduction	42
Guaranteed annuity option take up[2]	5% addition	(4)
Equity investment volatility[3]	1% addition	(5)
Widening of credit spreads[4]	0.1% addition	(65)

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

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

[1] This sensitivity shows the impact on the value of in-force business, financial options and guarantee costs, statutory reserves and asset values of reducing the risk-free rate by 25 basis points.

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

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

[4] This sensitivity shows the impact of a 10 basis point increase in corporate bond yields and the corresponding reduction in market values. Government bond yields and the risk-free rate are assumed to be unchanged.

ii) Non-life insurance

Gross non-life insurance contract liabilities are analysed by line of business as follows:	2007 £m	2006 £m
Credit protection	274	268
Home	385	314
Health	4	5
	663	587

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

The reserving methodology and associated assumptions are set out below:

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

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

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

Provisions for unearned premiums	Gross £m	Reinsurance* £m	Net £m
At 1 January 2006	447	–	447
Increase in the year	608	(17)	591
Release in the year	(617)	17	(600)
At 31 December 2006	438	–	438
Increase in the year	632	(23)	609
Release in the year	(614)	23	(591)
At 31 December 2007	456	–	456

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

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

31 Liabilities arising from insurance contracts and participating investment contracts continued

Claims and loss adjustment expenses	Gross £m	Reinsurance* £m	Net £m
Notified claims	120	(4)	116
Incurred but not reported	27	–	27
At 1 January 2006	147	(4)	143
Cash paid for claims settled in the year	(223)	–	(223)
Increase (decrease) in liabilities:			
Arising from current year claims	231	–	231
Arising from prior year claims	(6)	–	(6)
At 31 December 2006	149	(4)	145
Cash paid for claims settled in the year	**(275)**	**–**	**(275)**
Increase (decrease) in liabilities:			
Arising from current year claims	**341**	**(9)**	**332**
Arising from prior year claims	**(8)**	**3**	**(5)**
At 31 December 2007	**207**	**(10)**	**197**
Notified claims	**188**	**(10)**	**178**
Incurred but not reported	**19**	**–**	**19**
At 31 December 2007	**207**	**(10)**	**197**
Notified claims	127	(4)	123
Incurred but not reported	22	–	22
At 31 December 2006	149	(4)	145

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

Non-life insurance claims development table

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

Non-life insurance all risks – gross

Accident year	2003 £m	2004 £m	2005 £m	2006 £m	**2007 £m**	**Total £m**
Estimate of ultimate claims costs:						
At end of accident year	234	227	211	208	**317**	**1,197**
One year later	220	209	207	206		
Two years later	223	207	204			
Three years later	221	206				
Four years later	220					
Current estimate of cumulative claims	220	206	204	206	**317**	**1,153**
Cumulative payments to date	(216)	(202)	(194)	(186)	**(164)**	**(962)**
Liability recognised in the balance sheet	4	4	10	20	**153**	**191**
Liability in respect of earlier years						**6**
Total liability included in the balance sheet						**197**

The liability of £197 million shown in the above table excludes £10 million of unallocated claims handling expenses.

32 Liabilities arising from non-participating investment contracts

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

	Gross £m	Reinsurance* £m	Net £m
At 1 January 2006	21,839	(33)	21,806
New business	2,316	–	2,316
Changes in existing business	215	11	226
At 31 December 2006	24,370	(22)	24,348
New business	**2,413**	**–**	**2,413**
Changes in existing business	**(1,303)**	**22**	**(1,281)**
Disposal of businesses	**(7,283)**	**–**	**(7,283)**
At 31 December 2007	**18,197**	**–**	**18,197**

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

At 31 December 2007 £17,929 million (2006: £23,449 million) of liabilities arising from non-participating investment contracts had a contractual residual maturity of greater than one year.

33 Unallocated surplus within insurance businesses

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

	2007 £m	2006 £m
At 1 January	**683**	518
Change in unallocated surplus recognised in the income statement (note 9)	**(114)**	165
Disposal of businesses	**(15)**	–
At 31 December	**554**	683

34 Other liabilities

	2007 £m	2006 £m
Settlement balances	**445**	475
Unitholders' interest in Open Ended Investment Companies	**3,441**	4,583
Other creditors and accruals	**5,804**	5,927
	9,690	10,985

At 31 December 2007 £4,427 million (2006: £6,398 million) of other liabilities had a contractual residual maturity of greater than one year.

35 Retirement benefit obligations

Charge to the income statement	2007 £m	2006 £m
Defined benefit pension schemes	**158**	104
Other post-retirement benefit schemes	**17**	5
Total defined benefit schemes	**175**	109
Defined contribution pension schemes	**63**	56
	238	165

Amounts recognised in the balance sheet	2007 £m	2006 £m
Defined benefit pension schemes	**2,033**	2,362
Other post-retirement benefit schemes	**111**	100
	2,144	2,462

35 Retirement benefit obligations continued

Pension schemes

Defined benefit schemes

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

The latest full valuations of the two main schemes were carried out as at 30 June 2005; these have been updated to 31 December 2007 by qualified independent actuaries. The last full valuations of other Group schemes were carried out on a number of different dates; these have been updated to 31 December 2007 by qualified independent actuaries or, in the case of the Scottish Widows Retirement Benefits Scheme, by a qualified actuary employed by Scottish Widows.

The Group's obligations in respect of its defined benefit schemes are funded. The Group expects to pay contributions of some £500 million to its defined benefit schemes in 2008.

Amount included in the balance sheet	**2007 £m**	2006 £m
Present value of funded obligations	**16,795**	17,378
Fair value of scheme assets	**(16,112)**	(15,279)
	683	2,099
Unrecognised actuarial gains	**1,350**	263
Liability in the balance sheet	**2,033**	2,362

Movements in the defined benefit obligation	**2007 £m**	2006 £m
At 1 January	**17,378**	17,320
Current service cost	**302**	325
Interest cost	**866**	817
Actuarial gains	**(971)**	(434)
Benefits paid	**(555)**	(555)
Past service cost	**25**	32
Curtailment	**–**	(129)
Disposal of businesses	**(262)**	–
Exchange and other adjustments	**12**	2
At 31 December	**16,795**	17,378

Changes in the fair value of scheme assets	**2007 £m**	2006 £m
At 1 January	**15,279**	14,026
Expected return	**1,035**	942
Employer contributions	**446**	550
Actuarial gains	**139**	314
Benefits paid	**(555)**	(555)
Disposal of businesses	**(244)**	–
Exchange and other adjustments	**12**	2
At 31 December	**16,112**	15,279
Actual return on scheme assets	**1,174**	1,256

35 Retirement benefit obligations continued

Assumptions

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

	2007 %	2006 %
Discount rate	**5.80**	5.10
Rate of inflation	**3.30**	2.90
Rate of salary increases	**4.00**	3.93
Rate of increase for pensions in payment and deferred pensions	**3.10**	2.70

	Years	Years
Life expectancy for member aged 60, on the valuation date:		
Men	**25.9**	25.8
Women	**27.9**	27.8
Life expectancy for member aged 60, 15 years after the valuation date:		
Men	**27.1**	27.0
Women	**29.0**	28.9

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with the actual experience of the relevant schemes. The table shows that a member retiring at age 60 as at 31 December 2007 is assumed to live for, on average, 25.9 years for a male and 27.9 years for a female. In practice there will be much variation between individual members but these assumptions are expected to be appropriate across all members. It is assumed that younger members will live longer in retirement than those retiring now. This reflects the expectation that mortality rates will continue to fall over time as medical science and standards of living improve. To illustrate the degree of improvement assumed the table also shows the life expectancy for members aged 45 now, when they retire in 15 years time at age 60.

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

The expected return on scheme assets has been calculated using the following assumptions:	2007 %	2006 %
Equities	**8.0**	8.0
Fixed interest gilts	**4.6**	4.1
Index linked gilts	**4.2**	3.9
Non-government bonds	**5.1**	4.8
Property	**6.5**	6.4
Cash	**3.9**	3.7

The expected return on scheme assets in 2008 will be calculated using the following assumptions:	2008 %
Equities and alternative assets	**8.2**
Fixed interest gilts	**4.5**
Index linked gilts	**4.4**
Non-government bonds	**6.0**
Property	**6.7**
Money market instruments and cash	**4.8**

Composition of scheme assets:	2007 £m	2006 £m
Equities	**8,537**	9,677
Fixed interest gilts	**2,041**	1,114
Index linked gilts	**1,433**	921
Non-government bonds	**1,990**	1,543
Property	**1,666**	1,333
Money market instruments and cash	**445**	691
At 31 December	**16,112**	15,279

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

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields at the balance sheet date at a term and credit rating broadly appropriate for the bonds held. Expected returns on equity and property investment are long-term rates based on the views of the plan's independent investment consultants. The expected return on equities allows for the different expected returns from the private equity, infrastructure and hedge fund investments held by some of the funded plans. Some of the funded plans also invest in certain money market instruments and the expected return on these investments has been assumed to be the same as cash.

35 Retirement benefit obligations continued

Experience adjustments history (since the date of adoption of IAS 19):	2007 £m	2006 £m	2005 £m	2004 £m
Present value of defined benefit obligation	**16,795**	17,378	17,320	14,866
Fair value of scheme assets	**(16,112)**	(15,279)	(14,026)	(11,648)
	683	2,099	3,294	3,218
Experience losses on scheme liabilities	**(185)**	(50)	(69)	(126)
Experience gains on scheme assets	**139**	314	1,538	361

The expense recognised in the income statement for the year ended 31 December comprises:	2007 £m	2006 £m
Current service cost	**302**	325
Interest cost	**866**	817
Expected return on scheme assets	**(1,035)**	(942)
Curtailment	**–**	(128)
Past service cost	**25**	32
Total defined benefit pension expense	**158**	104

Following changes in age discrimination legislation in 2006, the Group ceased to augment the pension entitlement of employees taking early retirement; this change reduced the Group's defined benefit pension liability at 31 December 2006 by £129 million (£1 million of which was unrecognised) and resulted in a one-off credit to the 2006 income statement of £128 million.

Defined contribution schemes

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

During the year ended 31 December 2007 the charge to the income statement in respect of these schemes was £63 million (2006: £56 million), representing the contributions payable by the employer in accordance with each scheme's rules.

Other post-retirement benefit schemes

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

For the principal post-retirement healthcare scheme, the latest actuarial valuation of the liability was carried out at 30 June 2007; this valuation has been updated to 31 December 2007 by qualified independent actuaries. The principal assumptions used were as set out above, except that the rate of increase in healthcare premiums has been assumed at 7.43 per cent (2006: 7.02 per cent).

Amount included in the balance sheet:	2007 £m	2006 £m
Present value of unfunded obligations	**123**	110
Unrecognised actuarial losses	**(12)**	(10)
Liability in the balance sheet	**111**	100

Movements in the other post-retirement benefits obligation:	2007 £m	2006 £m
At 1 January	**110**	112
Actuarial loss (gain)	**2**	(1)
Insurance premiums paid	**(6)**	(6)
Charge for the year	**17**	5
At 31 December	**123**	110

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36 Deferred tax

The movement in the net deferred tax balance is as follows:	2007 £m	2006 £m
At 1 January	**1,416**	1,145
Exchange and other adjustments	**–**	(3)
Disposals	**(389)**	(281)
Income statement (credit) charge:		
Due to change in UK corporation tax rate	**(110)**	–
Other	**21**	574
	(89)	574
Amount charged (credited) to equity:		
Available-for-sale financial assets (note 41)	**(1)**	–
Cash flow hedges (note 41)	**(6)**	–
Share based compensation	**17**	(19)
	10	(19)
At 31 December	**948**	1,416

The 2007 Finance Act reduction in corporation tax rate from 30 per cent to 28 per cent resulted in a decrease in the Group's provision for deferred tax at 31 December 2007 of £110 million.

The deferred tax (credit) charge in the income statement comprises the following temporary differences:

	2007 £m	2006 £m
Accelerated capital allowances	**(32)**	175
Pensions and other post-retirement benefits	**134**	134
Investment reserve	**(30)**	59
Allowances for impairment losses	**42**	22
Unrealised gains	**(91)**	162
Tax on value of in-force business	**(108)**	(59)
Other temporary differences	**(4)**	81
	(89)	574

Deferred tax assets and liabilities are comprised as follows:	2007 £m	2006 £m
Deferred tax assets:		
Pensions and other post-retirement benefits	**(600)**	(739)
Allowances for impairment losses	**(101)**	(143)
Other provisions	**(15)**	(39)
Derivatives	**(178)**	(161)
Tax losses carried forward	**(409)**	(326)
Other temporary differences	**(169)**	(255)
	(1,472)	(1,663)

	2007 £m	2006 £m
Deferred tax liabilities:		
Accelerated capital allowances	**979**	1,252
Investment reserve	**119**	149
Unrealised gains	**342**	500
Tax on value of in-force business	**652**	875
Other temporary differences	**328**	303
	2,420	3,079

36 Deferred tax continued

Deferred tax assets

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

Deferred tax assets of £33 million (2006: £567 million) have not been recognised in respect of capital losses carried forward as there are no predicted future capital profits. Capital losses can be carried forward indefinitely.

In addition, deferred tax assets have not been recognised in respect of Eligible Unrelieved Foreign Tax (EUFT) and other foreign tax credits carried forward as at 31 December 2007 of £104 million (2006: £138 million), as there are no predicted future taxable profits against which the unrelieved foreign tax credits can be utilised. EUFT can be carried forward indefinitely.

Deferred tax liabilities

Deferred tax liabilities have not been recognised for tax that may be payable if earnings of certain subsidiaries were remitted to the UK. Such amounts are either reinvested for the foreseeable future or can be remitted free of tax. Unremitted earnings totalled £928 million (2006: £689 million).

Future transfers from Scottish Widows plc's long-term business funds to its Shareholder Fund will be subject to a shareholder tax charge. Under IAS 12, no provision is required to be made to the extent that the timing of such transfers is under Scottish Widows plc's control. Accordingly, deferred tax liabilities of £90 million (2006: £110 million) have not been recognised.

37 Other provisions

	Provisions for contingent liabilities and commitments £m	Customer remediation provisions £m	Vacant leasehold property and other £m	Total £m
At 1 January 2007	27	101	131	259
Exchange and other adjustments	–	–	6	6
Provisions applied	(3)	(54)	(13)	(70)
Amortisation of discount	–	–	3	3
Charge for the year	5	–	10	15
Disposal of businesses	–	(4)	–	(4)
At 31 December 2007	29	43	137	209

Provisions for contingent liabilities and commitments

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

Customer remediation provisions

In previous years, the Group has established provisions for the estimated cost of making redress payments to customers in respect of past product sales, in those cases where the original sales processes have been found to be deficient. During 2007 management have reviewed the adequacy of the provisions held having regard to current complaint volumes and the level of payments being made and are satisfied that no additional charge is required (no charge was made in 2006). At 31 December 2007 the remaining provisions held relate to past sales of a number of products, including mortgage endowment policies, sold through the branch networks of Lloyds TSB Bank, Lloyds TSB Scotland and Cheltenham & Gloucester and underwritten by life assurance companies within the Group and also by third parties. The principal assumptions that are made in the assessment of the adequacy of the provision relate to the number of cases that are likely to require redress, taking into account any time barring, and the estimated average cost per case. The ultimate cost and timing of the payments remains highly uncertain and will be influenced by external factors beyond the control of management, such as regulatory actions, media interest and the performance of the financial markets. However, it is expected that the majority of the remaining expenditure will be incurred over the next year.

Vacant leasehold property and other

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

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

38 Subordinated liabilities

	Note	2007 £m	2006 £m
Preferred securities			
6.90% Perpetual Capital Securities (US$1,000 million)	d, g	471	483
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)	a, b	593	587
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$1,000 million)	a, c	515	504
6% Non-cumulative Redeemable Preference Shares	o	–	–
Euro Step-up Non-Voting Non-Cumulative Preferred Securities callable 2012 (€430 million)	d, m	335	312
6.35% Step-up Perpetual Capital Securities callable 2013 (€500 million)	d, f, k	365	345
Sterling Step-up Non-Voting Non-Cumulative Preferred Securities callable 2015 (£250 million)	d, n	248	248
4.385% Step-up Perpetual Capital Securities callable 2017 (€750 million)	d, f, k	504	478
		3,031	2,957
Undated subordinated liabilities			
Primary Capital Undated Floating Rate Notes:	d, e		
Series 1 (US$750 million)		374	383
Series 2 (US$500 million)		249	255
Series 3 (US$600 million)		299	306
11¾% Perpetual Subordinated Bonds (£100 million)		100	100
5⅝% Undated Subordinated Step-up Notes callable 2009 (€1,250 million)	d, k	915	845
Undated Step-up Floating Rate Notes callable 2009 (€150 million)	d, e	110	101
6⅝% Undated Subordinated Step-up Notes callable 2010 (£410 million)	d, j	408	408
5.125% Step-up Perpetual Subordinated Notes callable 2015 (£560 million)	d, h	534	525
5.57% Undated Subordinated Step-up Coupon Notes callable 2015 (¥20,000 million)	d, l	111	107
5.125% Undated Subordinated Step-up Notes callable 2016 (£500 million)	d, j	449	475
6½% Undated Subordinated Step-up Notes callable 2019 (£270 million)	d, j	238	255
8% Undated Subordinated Step-up Notes callable 2023 (£200 million)	d, j	188	189
6½% Undated Subordinated Step-up Notes callable 2029 (£450 million)	d, j	444	447
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)	d, j	450	467
		4,869	4,863
Dated subordinated liabilities			
7¾% Subordinated Bonds 2007 (£300 million)		–	300
5¼% Subordinated Notes 2008 (DM 750 million)		281	260
10⅝% Guaranteed Subordinated Loan Stock 2008 (£100 million)	i	100	100
9½% Subordinated Bonds 2009 (£100 million)		100	99
6¼% Subordinated Notes 2010 (€400 million)		302	283
12% Guaranteed Subordinated Bonds 2011 (£100 million)	i	100	100
9⅛% Subordinated Bonds 2011 (£150 million)		149	149
4¾% Subordinated Notes 2011 (€850 million)		609	562
5⅞% Subordinated Guaranteed Bonds 2014 (€750 million)		591	560
5⅞% Subordinated Notes 2014 (£150 million)		149	149
6⅝% Subordinated Notes 2015 (£350 million)		316	330
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (£300 million)	e	300	300
Subordinated Step-up Floating Rate Notes 2016 callable 2011 (€500 million)	e	371	336
Subordinated Floating Rate Notes 2020 (€100 million)	e	73	67
5.75% Subordinated Step-up Notes 2025 callable 2020 (£350 million)		305	328
9⅝% Subordinated Bonds 2023 (£300 million)		312	329
		4,058	4,252
Total subordinated liabilities		11,958	12,072

These liabilities will, in the event of the winding-up of the issuer, be subordinated to the claims of depositors and all other creditors of the issuer. The Group has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during the period (2006: nil).

At 31 December 2007 £11,577 million (2006: £11,772 million) of subordinated liabilities had a contractual residual maturity of greater than one year.

38 Subordinated liabilities continued

a) Any repayment of preference shares would require prior notification to the Financial Services Authority. In certain circumstances, the shares may be mandatorily exchanged for qualifying non-innovative tier 1 securities. The Company may declare no dividend or a partial dividend on these preference shares. Dividends may be reduced if the distributable profits of the Company are insufficient to cover the payment in full of the dividends and also the payment in full of all other dividends on shares issued by the Company.

b) Dividends will accrue at a rate of 6.369 per cent per annum up to 24 August 2015, and, unless redeemed, at a rate reset quarterly equal to 1.28 per cent per annum above the London interbank offered rate for three-month sterling deposits thereafter. These preference shares can be redeemed at the option of the Company on 25 August 2015 or quarterly thereafter.

c) Dividends will accrue at a rate of 6.267 per cent per annum up to 13 November 2016 and, unless redeemed, at a rate reset quarterly equal to 1.035 per cent per annum above the London interbank offered rate for three-month sterling deposits thereafter. These preference shares can be redeemed at the option of the Company on 14 November 2016 or every 10 years thereafter.

d) In certain circumstances, these notes, bonds and securities would acquire the characteristics of preference share capital. Any repayments of undated subordinated liabilities would require prior notification to the Financial Services Authority. They are accounted for as liabilities since coupon payments are mandatory as a consequence of the terms of the 6% Non-cumulative Redeemable Preference Shares.

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

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

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

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

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

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

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

l) In the event that these notes are not redeemed at the callable date, the coupon will be reset to a margin of 1.60 per cent over the five year Yen swap rate.

m) These securities constitute limited partnership interests in Lloyds TSB Capital 1 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.375 per cent per annum up to 7 February 2012; thereafter they will accrue at a margin of 2.33 per cent over EURIBOR. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

n) These securities constitute limited partnership interests in Lloyds TSB Capital 2 L.P., a Jersey limited partnership in which Lloyds TSB (General Partner) Limited, a wholly owned subsidiary, is the general partner. Non-cumulative income distributions accrue at a fixed rate of 7.834 per cent per annum up to 7 February 2015; thereafter they will accrue at a margin of 3.50 per cent over a rate based on the yield of specified UK government stock. This issue was made under the limited subordinated guarantee of Lloyds TSB Bank plc. In certain circumstances these preferred securities will be mandatorily exchanged for preference shares in Lloyds TSB Group plc. Lloyds TSB Group plc has entered into an agreement whereby dividends may only be paid on its ordinary shares if sufficient distributable profits are available for distributions due in the financial year on these preferred securities.

o) Throughout 2007 and 2006, the Company has had in issue 400 6 per cent non-cumulative preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company.

39 Share capital

	2007	2006
Authorised share capital		
Sterling	£m	£m
6,911 million Ordinary shares of 25p each	1,728	1,728
79 million Limited voting ordinary shares of 25p each	20	20
175 million Preference shares of 25p each	44	44
	1,792	1,792
US dollars	US$m	US$m
160 million Preference shares of 25 cents each	40	40
Euro	€m	€m
160 million Preference shares of 25 cents each	40	40
Japanese yen	¥m	¥m
50 million Preference shares of ¥25 each	1,250	1,250

39 Share capital continued

Issued and fully paid ordinary shares	2007 Number of shares	2006 Number of shares	2007 £m	2006 £m
Ordinary shares of 25p each				
At 1 January	**5,637,964,437**	5,602,613,600	**1,409**	1,400
Issued under employee share schemes	**9,739,508**	35,350,837	**3**	9
At 31 December	**5,647,703,945**	5,637,964,437	**1,412**	1,409
Limited voting ordinary shares of 25p each				
At 1 January and 31 December	**78,947,368**	78,947,368	**20**	20
			1,432	1,429

Share capital and control

There are no restrictions on the transfer of shares in the Company other than as set out in the articles of association and:

- certain restrictions which may from time to time be imposed by law and regulations (for example, insider trading laws); and
- pursuant to the UK Listing Authority's listing rules where directors and certain employees of the Company require the approval of the Company to deal in the Company's shares; and
- pursuant to the rules of some of the Company's employee share plans where certain restrictions may apply while the shares are subject to the plans.

Where, under an employee share plan operated by the Company, participants are the beneficial owners of shares but not the registered owners, the voting rights are normally exercised by the registered owner at the direction of the participant. All of the Company's share plans contain provisions relating to a change of control. Outstanding awards and options would normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions at that time.

In addition, the Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

Information regarding significant direct or indirect holdings of shares in the Company can be found on page 159.

The directors have authority to allot and issue ordinary and preference shares and to make market purchases of ordinary shares in accordance with the articles of association. The authority for the Company to purchase, in the market, 571,750,770 of its shares, representing some 10 per cent of the issued share capital, expires at the annual general meeting. Shareholders will be asked, at the annual general meeting, to give similar authorities.

Subject to any rights or restrictions attached to any shares, on a show of hands at a general meeting of the Company every holder of shares present in person or by proxy and entitled to vote has one vote and on a poll every member present and entitled to vote has one vote for every share held. Further details regarding voting at the annual general meeting can be found in the notes to the notice of the annual general meeting.

Ordinary shares

The holders of ordinary shares (excluding the limited voting ordinary shares), who held 98.60 per cent of the total share capital as at 31 December 2007, are entitled to receive the Company's report and accounts, attend, speak and vote at general meetings and appoint proxies to exercise voting rights. Holders of ordinary shares (excluding the limited voting ordinary shares) may also receive a dividend (subject to the provisions of the Company's articles of association) and on a winding up may share in the assets of the Company.

Limited voting ordinary shares

The limited voting ordinary shares are held by the Lloyds TSB Foundations ('the Foundations'). The holders of the limited voting ordinary shares, who held 1.38 per cent of the total share capital as at 31 December 2007, are entitled to receive copies of every circular or other document sent out by the Company to the holders of other ordinary shares. These shares carry no rights to dividends but rank pari passu with the ordinary shares in respect of other distributions and in the event of winding up. These shares do not have any right to vote at general meetings other than on resolutions concerning acquisitions or disposals of such importance that they require shareholder consent, or for the winding up of the Company, or for a variation in the class rights of the limited voting ordinary shares. In the event of an offer for more than 50 per cent of the issued ordinary share capital of the Company, each limited voting ordinary share will convert into an ordinary share and shall rank equally with the ordinary shares in all respects from the date of conversion. Lloyds TSB Group plc has entered into deeds of covenant with the Foundations, under the terms of which the Company makes annual donations to the Foundations equal, in total, to 1 per cent of the Group's pre-tax profits (after certain adjustments) averaged over three years. The deeds of covenant can be cancelled by the Company at nine years' notice. This donation is payable on or before the last day of February in each year ('the payment date'). In the event of conversion of the limited voting ordinary shares, the Foundations shall be entitled to receive a donation, on the same basis as set out above, on the payment date following conversion.

Issued and fully paid preference shares

Throughout 2006 and 2007, the Company has had in issue 400 6 per cent non-cumulative redeemable preference shares of 25p each. The shares, which are redeemable at the option of the Company at any time, carry the rights to a fixed rate non-cumulative preferential dividend at a rate of 6 per cent per annum; no dividend shall be payable in the event that the directors determine that prudent capital ratios would not be maintained if the dividend were paid. Upon winding up, the shares rank equally with any other preference shares issued by the Company. The holders of the 6 per cent non-cumulative redeemable preference shares held less than 0.1 per cent of the total share capital as at 31 December 2007. In accordance with IFRS, these shares are reported within liabilities.

In addition, during 2006 the Company issued 600,000 Fixed/Floating Rate Non-Cumulative Callable Preference Shares of 25 pence each with a liquidation preference of £1,000 per share and 1,000,000 Fixed/Floating Rate Non-Cumulative Callable Preference Shares of 25 cents each with a liquidation preference of US$1,000 per share. Both issues of preference shares are perpetual, although the two issues can be redeemed at the option of the Company on or after 25 August 2015 and 14 November 2016 respectively and carry the right to non-cumulative dividends which are fixed until those first redemption dates. The terms of these two issues of preference shares are such that the Company cannot declare and pay a dividend on any other junior class of share (including the mandatory dividend on the 400 6 per cent non-cumulative redeemable preference shares mentioned above) until the coupon has been paid on these preference shares. As the Company is effectively committed to the payment of a coupon on these shares they are classified as liabilities on the balance sheet in accordance with IFRS (see note 38). The holders of the fixed/floating rate non-cumulative callable preference shares, who held less than 0.1 per cent of the total share capital as at 31 December 2007, do not have the right to receive notice of, attend, speak or vote at any general meetings other than on resolutions relating to the variation or abrogation of any of the rights or restrictions attached to the preference shares or the winding up or dissolution of the Company or if, at the date of the notice of meeting, the dividend payable at the immediately preceding dividend payment date has failed to be declared and paid in full. Upon winding up, the fixed/floating rate non-cumulative callable preference shares shall rank equally with the most senior class of preference shares and any other class of shares which are expressed to rank equally.

39 Share capital continued

Any repayment of the fixed/floating rate non-cumulative callable preference shares would require prior notification to the Financial Services Authority. The sterling fixed/floating rate non-cumulative callable preference shares can be redeemed at the option of the Company on or after 25 August 2015; at this call date, dividends will be reset at a margin of 1.28 per cent over 3 month LIBOR. The US dollar fixed/floating rate non-cumulative callable preference shares can be redeemed at the option of the Company on or after 14 November 2016; at this call date, dividends will be reset at a margin of 1.035 per cent over 3 month LIBOR. In certain circumstances, the fixed/floating rate non-cumulative callable preference shares may be mandatorily exchanged for qualifying non-innovative tier 1 securities and in certain circumstances and subject to compliance with certain requirements, the fixed/floating rate non-cumulative callable preference shares may be redeemed by the Company at certain times in the event that the FSA makes a decision that the preference shares can no longer qualify as non-innovative tier 1 capital. The Company may declare no dividend or a partial dividend on these preference shares; notwithstanding this discretion, in certain circumstances, the dividends on the fixed/floating rate non-cumulative callable preference shares will be mandatorily payable if the preference shares cease to be eligible to qualify as regulatory capital and the Company is in compliance with relevant FSA regulations regarding capital adequacy. Dividends may be reduced if the distributable profits of the Company are insufficient to cover the payment in full of the dividends and also the payment in full of all other dividends on shares issued by the Company. These securities were issued during 2006 primarily to finance the development and expansion of the business of the Group.

40 Share premium account

	2007 £m	2006 £m
At 1 January	1,266	1,170
Premium arising on issue of shares under share option schemes	32	96
At 31 December	1,298	1,266

41 Other reserves

	2007 £m	2006 £m
Other reserves comprise:		
Merger reserve	343	343
Revaluation reserve in respect of available-for-sale financial assets	(399)	–
Cash flow hedging reserve	(3)	12
Foreign currency translation reserve	(1)	(19)
	(60)	336

Movements in other reserves were as follows:	2007 £m	2006 £m
Merger reserve		
At 1 January and 31 December	343	343
Revaluation reserve in respect of available-for-sale financial assets		
At 1 January	–	29
Exchange and other adjustments	(1)	2
Change in fair value of available-for-sale financial assets	(483)	(10)
Deferred tax	1	–
Current tax	46	–
	(436)	(10)
Income statement transfer:		
Disposals (note 8)	(5)	(22)
Impairment	70	–
Current tax	(21)	1
	44	(21)
Disposal of businesses	(6)	–
At 31 December	(399)	–

41 Other reserves continued

	2007 £m	2006 £m
Cash flow hedging reserve		
At 1 January	12	11
Change in fair value of hedging derivatives	(20)	–
Deferred tax	6	–
	(14)	–
Income statement transfer (note 4)	(1)	1
At 31 December	(3)	12

Foreign currency translation reserve	2007 £m	2006 £m
At 1 January	(19)	12
Currency translation differences arising in the year	257	(108)
Foreign currency (losses) gains on net investment hedges	(342)	110
Current tax	103	(33)
	(239)	77
At 31 December	(1)	(19)

42 Retained profits

	2007 £m	2006 £m
At 1 January	8,124	7,210
Profit for the year	3,289	2,803
Dividends	(1,957)	(1,919)
Purchase/sale of treasury shares	(1)	(35)
Employee share option schemes – value of employee services	16	65
At 31 December	9,471	8,124

Retained profits are stated after deducting £75 million (2006: £87 million) representing 15 million (2006: 15 million) treasury shares held.

Value of employee services includes a credit of £30 million (2006: £31 million) reflecting the income statement charge in respect of SAYE and executive options, together with a related tax charge of £14 million (2006: tax credit £34 million). Purchase/sale of treasury shares includes a credit of £29 million (2006: £27 million) relating to the cost of other share scheme awards.

43 Ordinary dividends

	2007 Pence per share	2006 Pence per share	2007 £m	2006 £m
Final dividend for previous year paid during the current year	23.5	23.5	1,325	1,316
Interim dividend	11.2	10.7	632	603
	34.7	34.2	1,957	1,919

The directors have proposed a final dividend of 24.7 pence per share (2006: 23.5 pence per share) representing a total cost of £1,394 million (2006: £1,325 million) which will be paid on 7 May 2008.

The Bank of New York Nominees have waived the right to all dividends on the Lloyds TSB Group plc shares that they hold (holding at 31 December 2007: 10 shares, at 31 December 2006: 10 shares).

In addition, the trustees of the following holdings of Lloyds TSB Group plc shares in relation to employee share schemes retain the right to receive dividends but chose to waive their entitlement to the dividends on those shares as indicated: the Lloyds TSB Group Shareplan (holding at 31 December 2007: 931,478 shares, at 31 December 2006: 898,320 shares, waived right to all dividends), the Lloyds TSB Group Employee Share Ownership Trust (holding at 31 December 2007: 1,935,141 shares, at 31 December 2006: 1,138,311 shares, waived right to all dividends), Lloyds TSB Group Holdings (Jersey) Limited (holding at 31 December 2006 and 31 December 2007: 41,801 shares, waived right to all but a nominal amount of 1 penny in total) and the Lloyds TSB Qualifying Employee Share Ownership Trust (holding at 31 December 2006 and 31 December 2007: 1,364 shares, waived right to all but a nominal amount of 1 penny in total).

44 Share based payments

Charge to the income statement

The charge to the income statement is set out below:	2007 £m	2006 £m
Executive and SAYE schemes:		
Options granted in the year	6	6
Options granted in prior years	24	25
	30	31
Share incentive plan:		
Shares granted in the year	12	12
Shares granted in prior years	17	15
	29	27
	59	58

During the year ended 31 December 2007 the Group operated the following share based payment schemes, all of which are equity settled.

Executive schemes

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

Performance conditions for executive options

For options granted up to March 2001

Options granted	Performance conditions
March 1997 – August 1999	Growth in earnings per share which is equal to the aggregate percentage change in the Retail Price Index plus two percentage points for each complete year of the relevant period together with a further condition that Lloyds TSB Group plc's ranking based on shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.
March 2000 – March 2001	As for March 1997 – August 1999 except that there must have been growth in the earnings per share equal to the change in the Retail Price Index plus three percentage points for each complete year of the relevant period.

In respect of options granted between March 1997 and March 2001, the relevant period for the performance conditions begins at the end of the financial year preceding the date of grant and will continue until the end of the third subsequent year following commencement or, if not met, the end of such later year in which the conditions are met. Once the conditions have been satisfied the options will remain exercisable without further conditions. If they are not satisfied by the tenth anniversary of the grant the option will lapse.

For options granted from August 2001 to August 2004

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

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

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

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

44 Share based payments continued

For options granted in 2005

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

– the performance condition is linked to the performance of Lloyds TSB Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds TSB Group plc;

– if the performance condition has not been met at the end of the third subsequent year, the options will lapse; and

– the full grant of options becomes exercisable only if the Group is ranked in the top four places of the comparator group. A sliding scale applies between fourth and eighth positions. If Lloyds TSB Group is ranked below the median (ninth or below) the options will not be exercisable and will lapse.

Movements in the number of share options outstanding under the Executive share option schemes during 2006 and 2007 are set out below:

	2007		2006	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	32,459,593	459.84	43,977,411	485.35
Exercised	(267,650)	509.10	(328,218)	437.03
Forfeited	(11,570,169)	421.76	(11,189,600)	560.77
Outstanding at 31 December	20,621,774	480.57	32,459,593	459.84
Exercisable at 31 December	423,300	876.37	819,139	744.90

The weighted average share price at the time that the options were exercised during 2007 was 574.39 pence (2006: 552.29 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 6.2 years (2006: 6.8 years).

Save-As-You-Earn schemes

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

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

	2007		2006	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	90,220,144	335.94	114,459,474	314.17
Granted	10,759,688	432.00	19,301,716	418.00
Exercised	(9,473,792)	351.28	(35,148,982)	294.84
Forfeited	(3,447,524)	363.45	(3,440,257)	339.47
Cancelled	(1,822,417)	397.98	(3,984,599)	427.14
Expired	(562,872)	547.46	(967,208)	503.13
Outstanding at 31 December	85,673,227	342.49	90,220,144	335.94
Exercisable at 31 December	1,560,472	459.01	889,479	475.41

The weighted average share price at the time that the options were exercised during 2007 was 552.20 pence (2006: 524.36 pence). The weighted average remaining contractual life of options outstanding at the end of the year was 1.7 years (2006: 2.2 years).

The weighted average fair value of SAYE options granted during the year was £1.07 (2006: £1.00). The values for the SAYE options have been determined using a standard Black-Scholes model.

44 Share based payments continued

Other share option plans

Lloyds TSB Group Executive Share Plan 2003

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

	2007		2006	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January	357,123	Nil	268,918	Nil
Granted	214,444	Nil	165,395	Nil
Exercised	(203,170)	Nil	(77,190)	Nil
Forfeited	(59,679)	Nil	–	–
Outstanding at 31 December	308,718	Nil	357,123	Nil

The weighted average fair value of options granted in the year was £5.27 (2006: £4.58). The weighted average share price at the time that the options were exercised during 2007 was 539.77 pence (2006: 557.25 pence). No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 1.8 years (2006: 2.0 years).

Lloyds TSB Group executive share plan 2005

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

	2007		2006	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at 1 January and 31 December	242,825	Nil	242,825	Nil

No options outstanding at 31 December were exercisable. The weighted average remaining contractual life of options outstanding at the end of the year was 0.9 years (2006: 1.9 years).

Long-Term Incentive Plan

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

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

(i) For 50 per cent of the award (the 'EPS Award') – the percentage increase in earnings per share of the Group (on a compound annualised basis) over the relevant period must be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Price Index over the same period. If it is less than 3 per cent per annum the EPS Award will lapse. If the increase is more than 3 per cent but less than 6 per cent per annum then the proportion of shares released will be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2006 and ends on 31 December 2008.

(ii) For the other 50 per cent of the award (the 'TSR Award') – it will be necessary for the Group's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award will vest where the Group's total shareholder return is equal to median and vesting will occur on a straight line basis in between these points. Where the Group's total shareholder return is below the median of the comparator group, the TSR Award will lapse. The relevant period commenced on 1 January 2006 and ends on 31 December 2008.

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

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

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

	2007 Number of shares	2006 Number of shares
Outstanding at 1 January	5,788,108	–
Granted	7,884,787	5,852,386
Forfeited	(463,814)	(64,278)
Outstanding at 31 December	13,209,081	5,788,108

The fair value of the share awards granted in 2007 was £3.13 (2006: £2.96).

44 Share based payments continued

Performance share plan

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

	2007 Number of shares	2006 Number of shares
Outstanding at 1 January	1,849,102	826,438
Granted	–	1,035,564
Forfeited	(81,508)	(12,900)
Outstanding at 31 December	1,767,594	1,849,102

The fair value of the matching element of the performance shares awarded during 2006 was £1.92.

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

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2007									
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	1.4	551,543
£2 to £3	–	–	–	284.00	0.9	42,651,925	–	–	–
£3 to £4	–	–	–	353.10	1.9	15,775,539	–	–	–
£4 to £5	449.34	6.8	17,898,897	424.23	2.9	26,525,262	–	–	–
£5 to £6	551.09	2.2	815,965	563.65	0.1	720,501	–	–	–
£6 to £7	652.47	3.1	1,114,912	–	–	–	–	–	–
£7 to £8	–	–	–	–	–	–	–	–	–
£8 to £9	871.54	0.7	792,000	–	–	–	–	–	–

	Executive schemes			SAYE schemes			Other share option plans		
	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining life (years)	Number of options
31 December 2006									
Exercise price range									
£0 to £2	–	–	–	–	–	–	Nil	1.9	599,948
£2 to £3	–	–	–	284.00	1.8	45,234,578	–	–	–
£3 to £4	394.25	6.2	6,265,105	345.97	2.3	23,320,638	–	–	–
£4 to £5	444.24	7.7	22,497,465	422.94	3.1	20,125,284	–	–	–
£5 to £6	541.32	2.6	1,424,507	571.24	0.7	1,522,876	–	–	–
£6 to £7	652.98	4.2	1,332,177	–	–	–	–	–	–
£7 to £8	–	–	–	718.00	0.2	16,768	–	–	–
£8 to £9	873.12	1.7	940,339	–	–	–	–	–	–

44 Share based payments continued

The fair value calculations at 31 December 2007 are based on the following assumptions:

	SAYE	Other option schemes	Other share plans
Risk-free interest rate	5.35%	5.46%	5.19%
Expected life	3.7 years	1.4 years	3.0 years
Expected volatility	21%	17%	17%
Expected dividend yield	6.3%	6.0%	6.3%
Weighted average share price	£5.40	£5.73	£5.41
Weighted average exercise price	£4.32	Nil	Nil
Expected forfeitures	6%	4%	4%

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

Share incentive plan

Free shares

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

The number of shares awarded relating to free shares in 2007 was 6,784,201 (2006: 7,725,195), with an average fair value of £5.82 (2006: £5.28), based on the market price at the date of award.

Matching shares

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

The number of shares awarded relating to matching shares in 2007 was 2,073,018 (2006: 2,036,423), with an average fair value of £5.49 (2006: £5.40), based on market prices at the date of award.

45 Related party transactions

Key management personnel

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

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

	2007 £m	2006 £m
Compensation		
Salaries and other short-term benefits	15	14
Post-employment benefits	4	3
Termination benefits	–	–
Share based payments	4	3
	23	20

	2007 million	2006 million
Share options		
At 1 January	11	12
Granted (including options of appointed directors)	–	–
Exercised/lapsed (including options of retired directors)	(4)	(1)
At 31 December	7	11

	2007 million	2006 million
Share incentive plans		
At 1 January	4	1
Granted (including entitlements of appointees)	2	3
Exercised/lapsed (including entitlements of retirees)	–	–
At 31 December	6	4

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

	2007 £m	2006 £m
Loans		
At 1 January	2	3
Advanced	1	–
Repayments	(1)	(1)
At 31 December	2	2

The loans are on both a secured and unsecured basis and are expected to be settled in cash. The loans attracted interest rates of between 4.95 per cent and 30.0 per cent in 2007 (2006: 5.1 per cent and 19.9 per cent).

No provisions have been recognised in respect of loans given to key management personnel (2006: £nil).

	2007 £m	2006 £m
Deposits		
At 1 January	5	5
Placed	21	12
Withdrawn	(21)	(12)
At 31 December	5	5

Deposits placed by key management personnel attracted interest rates of up to 8.0 per cent (2006: 5.2 per cent).

At 31 December 2007, the Group provided guarantees totalling £6,154 in respect of one director (2006: £19,744 in respect of one director).

At 31 December 2007, transactions, arrangements and agreements entered into by the Group's banking subsidiaries with directors and connected persons included amounts outstanding in respect of loans and credit card transactions of £2 million with five directors and three connected persons (2006: £2 million with four directors and four connected persons).

45 Related party transactions continued

Subsidiaries

Details of the principal subsidiaries are given in note 8 to the parent company financial statements. In accordance with IAS 27, transactions and balances with subsidiaries have been eliminated on consolidation.

Other related party disclosures

At 31 December 2007, the Group's pension funds had call deposits with Lloyds TSB Bank plc amounting to £23 million (2006: £19 million).

The Group manages 107 (2006: 89) Open Ended Investment Companies (OEICs), and of these 40 (2006: 38) are consolidated. The Group invested £1,961 million (2006: £372 million) and redeemed £1,526 million (2006: £237 million) in the unconsolidated OEICs during the year and had investments, at fair value, of £2,233 million (2006: £1,746 million) at 31 December. The Group earned fees of £200 million from the unconsolidated OEICs (2006: £149 million). The Company held no investments in OEICs at any time during 2006 or 2007.

The Group has a number of associates held by its venture capital business that it accounts for at fair value through profit or loss. At 31 December 2007, these companies had total assets of approximately £3,184 million (2006: £1,625 million), total liabilities of approximately £3,182 million (2006: £1,609 million) and for the year ended 31 December 2007 had turnover of £2,136 million (2006: £2,409 million) and made a net profit of approximately £9 million (2006: net loss of £5 million). In addition, the Group has provided £609 million (2006: £460 million) of financing to these companies on which it received £23 million (2006: £20 million) of interest income in the year.

46 Contingent liabilities and commitments

Legal proceedings

During the ordinary course of business the Group is subject to threatened or actual legal proceedings. All such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of the Group incurring a liability. In those instances where it is concluded that it is more likely than not that a payment will be made, a provision is established to management's best estimate of the amount required to settle the obligation at the relevant balance sheet date. In some cases it will not be possible to form a view, either because the facts are unclear or because further time is needed properly to assess the merits of the case. No provisions are held against such cases; however the Group does not currently expect the final outcome of these cases to have a material adverse effect on its financial position.

On 27 July 2007, following agreement between the UK Office of Fair Trading (OFT) and a number of UK financial institutions, the OFT issued High Court legal proceedings against those institutions, including Lloyds TSB Bank plc, to determine the legal status and enforceability of certain of the charges applied to their personal customers in relation to requests for unplanned overdrafts. A preliminary issues hearing has now taken place and judgement is currently awaited. It is likely that further hearings will be required and, if appeals are pursued, the proceedings may take a number of years to conclude. Pending resolution, the Financial Services Authority has agreed, subject to certain conditions, that the handling of customer complaints on this issue can be suspended until the proceedings are concluded unless in the light of prevailing circumstances this would be inappropriate. The Group intends strongly to defend its position. Accordingly, no provision in relation to the outcome of this litigation has been made. Depending on the Court's determinations, a range of outcomes is possible, some of which could have a significant financial impact on the Group. The ultimate impact of the litigation on the Group can only be known at its conclusion.

There has been increased scrutiny of the financial institutions sector, especially in the US, with respect to combating money laundering and terrorist financing and enforcing compliance with economic sanctions. The Office of Foreign Assets Control (OFAC) administers US laws and regulations in relation to US economic sanctions against designated foreign countries, nationals and others and the Group has been conducting a review of its conduct with respect to historic US dollar payments involving countries, persons or entities subject to those sanctions. The Group has provided information relating to its review of such historic payments to a number of authorities including OFAC, the US Department of Justice and the New York County District Attorney's office which, along with other authorities, have been reported to be conducting a broader review of sanctions compliance by non-US financial institutions. The Group is involved in ongoing discussions with these authorities with respect to agreeing a resolution of their investigations. No provision has been made in respect of this matter. The Group does not expect the final outcome to have a material adverse effect on its financial position.

Contingent liabilities and commitments arising from the banking business

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

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

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

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

	2007 £m	2006 £m
Contingent liabilities		
Acceptances and endorsements	40	63
Other:		
Other items serving as direct credit substitutes	1,095	618
Performance bonds and other transaction-related contingencies	2,429	2,096
	3,524	2,714
	3,564	2,777

46 Contingent liabilities and commitments continued

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

	2007 £m	2006 £m
Commitments		
Documentary credits and other short-term trade-related transactions	306	374
Forward asset purchases and forward deposits placed	463	5,764
Undrawn formal standby facilities, credit lines and other commitments to lend:		
Less than 1 year original maturity:		
Mortgage offers made	4,639	4,071
Other commitments	52,791	49,731
	57,430	53,802
1 year or over original maturity	32,165	28,477
	90,364	88,417

Of the amounts shown above in respect of undrawn formal standby facilities, credit lines and other commitments to lend £53,036 million (2006: £51,288 million) was irrevocable.

Operating lease commitments

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

	2007 £m	2006 £m
Not later than 1 year	212	212
Later than 1 year and not later than 5 years	677	733
Later than 5 years	764	835
	1,653	1,780

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

Capital commitments

Excluding commitments in respect of investment property (see note 21), capital expenditure contracted but not provided for at 31 December 2007 amounted to £102 million (2006: £75 million). Of this amount, £96 million (2006: £74 million) related to assets to be leased to customers under operating leases. The Group's management is confident that future net revenues and funding will be sufficient to cover these commitments.

47 Financial risk management

As a bancassurer, financial instruments are fundamental to the Group's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by the Group.

The primary risks affecting the Group through its use of financial instruments are: credit risk; market risk, which includes interest rate risk and foreign exchange risk; and liquidity risk. Information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk and the Group's management of capital can be found on pages 36 to 56. The following additional disclosures, which provide quantitative information about the risks within financial instruments held or issued by the Group, should be read in conjunction with that earlier information.

Measurement basis of financial assets and liabilities

The accounting policies in note 1 describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

		At fair value through profit or loss						
	Derivatives designated as hedging instruments £m	Held for trading £m	Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2007								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	4,330	–	4,330
Items in the course of collection from banks	–	–	–	–	–	1,242	–	1,242
Trading and other financial assets at fair value through profit or loss	–	4,663	53,248	–	–	–	–	57,911
Derivative financial instruments	264	8,395	–	–	–	–	–	8,659
Loans and advances to banks	–	–	–	–	34,845	–	–	34,845
Loans and advances to customers	–	–	–	–	209,814	–	–	209,814
Available-for-sale financial assets	–	–	–	20,196	–	–	–	20,196
Total financial assets	264	13,058	53,248	20,196	244,659	5,572	–	336,997
Financial liabilities								
Deposits from banks	–	–	–	–	–	39,091	–	39,091
Customer accounts	–	–	–	–	–	156,555	–	156,555
Items in course of transmission to banks	–	–	–	–	–	668	–	668
Trading and other liabilities at fair value through profit or loss	–	99	3,107	–	–	–	–	3,206
Derivative financial instruments	800	6,782	–	–	–	–	–	7,582
Debt securities in issue	–	–	–	–	–	51,572	–	51,572
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	38,063	38,063
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	18,197	18,197
Unallocated surplus within insurance businesses	–	–	–	–	–	–	554	554
Subordinated liabilities	–	–	–	–	–	11,958	–	11,958
Total financial liabilities	800	6,881	3,107	–	–	259,844	56,814	327,446

47 Financial risk management continued

	Derivatives designated as hedging instruments £m	At fair value through profit or loss: Held for trading £m	At fair value through profit or loss: Designated upon initial recognition £m	Available-for-sale £m	Loans and receivables £m	Held at amortised cost £m	Insurance contracts £m	Total £m
As at 31 December 2006								
Financial assets								
Cash and balances at central banks	–	–	–	–	–	1,898	–	1,898
Items in the course of collection from banks	–	–	–	–	–	1,431	–	1,431
Trading and other financial assets at fair value through profit or loss	–	5,756	61,939	–	–	–	–	67,695
Derivative financial instruments	487	5,078	–	–	–	–	–	5,565
Loans and advances to banks	–	–	–	–	40,638	–	–	40,638
Loans and advances to customers	–	–	–	–	188,285	–	–	188,285
Available-for-sale financial assets	–	–	–	19,178	–	–	–	19,178
Total financial assets	487	10,834	61,939	19,178	228,923	3,329	–	324,690
Financial liabilities								
Deposits from banks	–	–	–	–	–	36,394	–	36,394
Customer accounts	–	–	–	–	–	139,342	–	139,342
Items in course of transmission to banks	–	–	–	–	–	781	–	781
Trading and other liabilities at fair value through profit or loss	–	28	1,156	–	–	–	–	1,184
Derivative financial instruments	466	5,297	–	–	–	–	–	5,763
Debt securities in issue	–	–	–	–	–	54,118	–	54,118
Liabilities arising from insurance contracts and participating investment contracts	–	–	–	–	–	–	41,445	41,445
Liabilities arising from non-participating investment contracts	–	–	–	–	–	–	24,370	24,370
Unallocated surplus within insurance businesses	–	–	–	–	–	–	683	683
Subordinated liabilities	–	–	–	–	–	12,072	–	12,072
Total financial liabilities	466	5,325	1,156	–	–	242,707	66,498	316,152

Interest rate risk

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

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

The Group establishes two types of hedge accounting relationships for interest rate risk: fair value hedges and cash flow hedges. The Group is exposed to fair value interest rate risk on its fixed rate customer loans, its fixed rate customer deposits and the majority of its subordinated debt, and to cash flow interest rate risk on its variable rate loans and deposits together with its floating rate subordinated debt. The majority of the Group's hedge accounting relationships are fair value hedges where interest rate swaps are used to hedge the interest rate risk inherent in the fixed rate mortgage portfolio. At 31 December 2007 the aggregate notional principal of interest rate swaps designated as fair value hedges was £50,734 million (2006: £37,378 million) with a net fair value liability of £197 million (2006: £110 million) (see note 16). The gains on the hedging instruments were £94 million (2006: losses of £288 million). The losses on the hedged items attributable to the hedged risk were £117 million (2006: gains of £266 million).

In addition the Group has a small number of cash flow hedges which are primarily used to hedge the variability in the cost of funding within the wholesale business. These cash flows are expected to occur over the next six years and the hedge accounting adjustments will be reported in the income statement as the cash flows arise. The notional principal of the interest rate swaps designated as cash flow hedges at 31 December 2007 was £630 million (2006: £569 million) with a net fair value liability of £23 million (2006: £8 million) (see note 16). In 2007, there is no ineffectiveness recognised in the income statement that arises from cash flow hedges (2006: nil). There were no transactions for which cash flow hedge accounting had to be ceased in 2007 or 2006 as a result of the highly probable cash flows no longer being expected to occur.

47 Financial risk management continued

Currency risk

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

The corporate and retail businesses incur foreign exchange risk in the course of providing services to their customers. All non-structural foreign exchange exposures in the non-trading book are transferred to the trading area where they are monitored and controlled. These risks reside in the authorised trading centres who are allocated exposure limits. The limits are monitored daily by the local centres and reported to Wholesale and International Banking Market and Liquidity Risk. Associated VaR and the closing, average, maximum and minimum for 2006 and 2007 are disclosed on page 43.

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

The Group hedges part of the currency translation risk of the net investment in certain foreign operations using cross currency swaps. At 31 December 2007 the aggregate notional principal of these cross currency swaps was £5,302 million (2006: £2,589 million) with a net fair value liability of £316 million (2006: asset of £139 million) (see note 16) and they were designated on an after-tax basis as hedges of net investments in foreign operations. In 2007, there is no ineffectiveness recognised in the income statement that arises from net investment hedges (2006: nil).

The Group's main overseas operations are in the Americas and Europe. Details of the Group's structural foreign currency exposures, after net investment hedges, are as follows:

	2007 £m	2006 £m
Functional currency of Group operations:		
Euro	95	76
US dollar	7	97
Swiss franc	70	70
Other non-sterling	208	188
	380	431

Credit risk

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

	2007 £m	2006 £m
Loans and advances to banks	34,845	40,639
Loans and advances to customers	212,222	190,478
Deposit amounts available for offset[1]	(6,206)	(6,392)
Impairment losses	(2,408)	(2,194)
	238,453	222,531
Available-for-sale debt securities and treasury and other bills	20,167	19,163
Trading and other financial assets at fair value through profit or loss	26,165	29,568
Derivative assets, before netting	8,659	5,565
Amounts available for offset under master netting arrangements[1]	(3,287)	(2,761)
	5,372	2,804
Assets arising from reinsurance contracts held	350	451
Financial guarantees	9,753	8,139
Irrevocable loan commitments and other credit-related contingencies[2]	56,600	54,065
Maximum credit risk exposure	356,860	336,721
Maximum credit risk exposure before offset items	366,353	345,874

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

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

A general description of collateral held in respect of financial instruments is disclosed on page 42.

Loans and advances to banks – the Group may require collateral before entering into a credit commitment with another bank, depending on the type of the financial product and the counterparty involved, and netting agreements are obtained whenever possible and to the extent that such agreements are legally enforceable.

Available-for-sale debt securities, treasury and other bills, and trading and other financial assets at fair value through profit or loss – the credit quality of the Group's available-for-sale debt securities, treasury and other bills, and the majority of the Group's trading and other financial assets at fair value through profit or loss held is set out below. An analysis of trading and other financial assets at fair value through profit or loss is included in note 15 and a similar analysis for available-for-sale financial assets is included in note 20. The Group's non-participating investment contracts are all unit-linked. Movements in the fair values of trading and other financial assets at fair value through profit or loss which back those investment contracts, including movements arising from credit risk, are borne by the contract holders.

47 Financial risk management continued

Derivative assets – the Group reduces exposure to credit risk by using master netting agreements and by obtaining cash collateral. An analysis of derivative assets is given in note 16. Of the net derivative assets of £5,372 million (2006: £2,804 million), cash collateral of £2,004 million (2006: £912 million) was held and a further £1,459 million was due from OECD banks (2006: £1,251 million).

Assets arising from reinsurance contracts held – of the assets arising from reinsurance contracts held of £350 million (2006: £451 million), £341 million (2006: £447 million) are due from insurers with a credit rating of AA or above.

Financial guarantees – these represent undertakings that the Group will meet a customer's obligation to third parties if the customer fails to do so. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Group is theoretically exposed to loss in an amount equal to the total guarantees or unused commitments, however, the likely amount of loss is expected to be significantly less; most commitments to extend credit are contingent upon customers maintaining specific credit standards.

Reverse repo and repo transactions – for reverse repo transactions which are accounted for as collateralised loans, it is the Group's policy to seek collateral which is at least equal to the amount loaned. At 31 December 2007, the fair value of collateral accepted under reverse repo transactions that the Group is permitted by contract or custom to sell or repledge was £10,300 million (2006: £6,446 million). Of this, £10,299 million (2006: £6,445 million) was sold or repledged as at 31 December 2007, including £768 million (2006: £1,099 million) in respect of repo transactions, accounted for as secured borrowings, where the secured party is permitted by contract or custom to repledge. The remainder has been held for continuing use within the business.

Loans and advances

	Loans and advances to customers				Loans and advances designated at fair value through profit or loss	Loans and advances to banks
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	£m	£m
31 December 2007						
Neither past due nor impaired	**99,828**	**29,850**	**73,475**	**203,153**	**1,189**	**34,845**
Past due but not impaired	**2,153**	**966**	**639**	**3,758**	**–**	**–**
Impaired – no provision required	**415**	**100**	**293**	**808**	**–**	**–**
– provision held	**343**	**3,600**	**560**	**4,503**	**–**	**–**
Gross	**102,739**	**34,516**	**74,967**	**212,222**	**1,189**	**34,845**
Allowance for impairment losses (note 19)	**(37)**	**(2,029)**	**(342)**	**(2,408)**	**–**	**–**
Net	**102,702**	**32,487**	**74,625**	**209,814**	**1,189**	**34,845**
31 December 2006						
Neither past due nor impaired	92,873	29,364	60,005	182,242	835	40,638
Past due but not impaired	1,943	1,005	374	3,322	–	–
Impaired – no provision required	658	92	158	908	–	–
– provision held	127	3,580	299	4,006	–	1
Gross	95,601	34,041	60,836	190,478	835	40,639
Allowance for impairment losses (note 19)	(42)	(1,918)	(233)	(2,193)	–	(1)
Net	95,559	32,123	60,603	188,285	835	40,638

The analysis of lending between retail and wholesale has been prepared based upon the type of exposure and not the business segment in which the exposure is recorded. Included within retail are exposures to personal customers and small businesses, whilst included within wholesale are exposures to corporate customers and other large institutions.

Loans and advances which are neither past due nor impaired

	Loans and advances to customers				Loans and advances designated at fair value through profit or loss	Loans and advances to banks
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	£m	£m
31 December 2007						
Good quality	**99,407**	**18,157**	**46,240**		**191**	**34,647**
Satisfactory quality	**378**	**8,964**	**25,013**		**670**	**190**
Lower quality	**1**	**665**	**2,034**		**327**	**7**
Below standard, but not impaired	**42**	**2,064**	**188**		**1**	**1**
Total	**99,828**	**29,850**	**73,475**	**203,153**	**1,189**	**34,845**
31 December 2006						
Good quality	92,472	16,940	35,659		513	40,418
Satisfactory quality	359	9,667	21,797		314	201
Lower quality	–	663	2,249		3	17
Below standard, but not impaired	42	2,094	300		5	2
Total	92,873	29,364	60,005	182,242	835	40,638

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47 Financial risk management continued

The definitions of good quality, satisfactory quality, lower quality and below standard, but not impaired applying to retail and wholesale are not the same, reflecting the different characteristics of these exposures and the way they are managed internally, and consequently totals are not provided. Wholesale lending has been classified using internal probability of default rating models mapped so that they are comparable to external credit ratings. Good quality lending comprises the lower assessed default probabilities, with other classifications reflecting progressively higher default risk. Classifications of retail lending incorporate expected recovery levels for mortgages, as well as probabilities of default assessed using internal rating models. Good quality lending includes the lower assessed default probabilities and all loans with low expected losses in the event of default, with other categories reflecting progressively higher risks and lower expected recoveries.

Loans and advances which are past due but not impaired

	Loans and advances to customers				Loans and advances designated at fair value through profit or loss	Loans and advances to banks
	Retail – mortgages £m	Retail – other £m	Wholesale £m	Total £m	£m	£m
31 December 2007						
0-30 days	**1,123**	**781**	**266**	**2,170**	**–**	**–**
30-60 days	**445**	**155**	**107**	**707**	**–**	**–**
60-90 days	**260**	**29**	**129**	**418**	**–**	**–**
90-180 days	**325**	**1**	**67**	**393**	**–**	**–**
Over 180 days	**–**	**–**	**70**	**70**	**–**	**–**
Total	**2,153**	**966**	**639**	**3,758**	**–**	**–**
Fair value of collateral held	**2,111**	**n/a**	**n/a**	**n/a**		
31 December 2006						
0-30 days	1,104	797	156	2,057	–	–
30-60 days	341	182	60	583	–	–
60-90 days	216	26	38	280	–	–
90-180 days	280	–	70	350	–	–
Over 180 days	2	–	50	52	–	–
Total	1,943	1,005	374	3,322	–	–
Fair value of collateral held	1,907	n/a	n/a	n/a		

A financial asset is 'past due' if a counterparty has failed to make a payment when contractually due.

Collateral held against retail mortgage lending is principally comprised of residential properties; their fair value has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in the Halifax House Price Index, after making allowance for indexation error and dilapidations. The resulting valuation has been limited to the principal amount of the outstanding advance in order to provide a clearer representation of the Group's credit exposure.

Lending decisions are based on an obligor's ability to repay from normal business operations rather than reliance on the disposal of any security provided. Collateral values for non-mortgage lending are assessed more rigorously at the time of loan origination or when taking enforcement action and may fluctuate, as in the case of floating charges, according to the level of assets held by the customer. Whilst collateral is reviewed on a regular basis in accordance with business unit credit policy, this varies according to the type of lending and collateral involved. It is therefore not practicable to estimate and aggregate current fair values of collateral for non-mortgage lending.

Renegotiated loans and advances

Loans and advances that were renegotiated during the year and that would otherwise have been past due or impaired at 31 December 2007 totalled £579 million (2006: £342 million).

Repossessed collateral

	2007 £m	2006 £m
Residential property	**73**	55
Other	**9**	10
Total	**82**	65

The Group does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable, generally at auction, to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

47 Financial risk management continued

Debt securities, treasury and other bills – analysis by credit rating

As at 31 December 2007	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
Debt securities held at fair value through profit or loss							
Trading assets:							
Government securities	62	–	–	–	–	–	62
Mortgage backed securities	–	28	51	8	–	–	87
Other asset backed securities	–	15	61	38	3	5	122
Corporate and other debt securities	268	1,268	1,390	103	59	519	3,607
Total held as trading assets	330	1,311	1,502	149	62	524	3,878
Other assets held at fair value through profit or loss:							
Government securities	4,808	6	15	1	–	18	4,848
Bank and building society certificates of deposit	42	548	53	–	–	168	811
Mortgage backed securities	61	–	–	–	–	9	70
Other asset backed securities	1,367	214	153	71	–	–	1,805
Corporate and other debt securities	5,118	1,606	2,868	2,528	340	1,104	13,564
Total held at fair value through profit or loss	11,726	3,685	4,591	2,749	402	1,823	24,976
Available-for-sale financial assets							
Debt securities:							
Government securities	310	–	–	–	–	9	319
Other public sector securities	–	–	–	–	–	5	5
Bank and building society certificates of deposit	–	1,683	125	–	15	2	1,825
Mortgage backed securities	5,880	14	10	–	–	146	6,050
Other asset backed securities	3,895	37	27	–	–	112	4,071
Corporate and other debt securities	3,822	1,170	186	–	–	1,092	6,270
Total debt securities	13,907	2,904	348	–	15	1,366	18,540
Treasury bills and other bills	31	1,596	–	–	–	–	1,627
Total held as available-for-sale assets	13,938	4,500	348	–	15	1,366	20,167

As at 31 December 2006	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
Debt securities held at fair value through profit or loss							
Trading assets:							
Government securities	148	–	–	–	–	32	180
Mortgage backed securities	235	57	114	35	5	5	451
Other asset backed securities	114	75	172	176	13	45	595
Corporate and other debt securities	345	1,773	1,616	59	6	347	4,146
Total held as trading assets	842	1,905	1,902	270	24	429	5,372
Other assets held at fair value through profit or loss:							
Government securities	8,558	30	32	1	–	5	8,626
Other public sector securities	13	–	6	–	–	25	44
Bank and building society certificates of deposit	16	345	47	–	–	165	573
Mortgage backed securities	56	–	–	–	–	31	87
Other asset backed securities	321	5	61	30	–	444	861
Corporate and other debt securities	5,870	1,598	2,915	1,597	153	1,037	13,170
Total held at fair value through profit or loss	15,676	3,883	4,963	1,898	177	2,136	28,733

47 Financial risk management continued

As at 31 December 2006	AAA £m	AA £m	A £m	BBB £m	Rated BB or lower £m	Not rated £m	Total £m
Available-for-sale financial assets							
Debt securities:							
Government securities	379	–	–	–	–	14	393
Other public sector securities	189	–	–	–	–	–	189
Bank and building society certificates of deposit	6	1,229	356	24	–	–	1,615
Mortgage backed securities	5,559	13	–	–	–	90	5,662
Other asset backed securities	4,598	80	27	6	5	5	4,721
Corporate and other debt securities	1,971	976	698	–	–	1,172	4,817
Total debt securities	12,702	2,298	1,081	30	5	1,281	17,397
Treasury bills and other bills	46	1,705	–	–	15	–	1,766
Total held as available-for-sale assets	12,748	4,003	1,081	30	20	1,281	19,163

There are no material amounts for debt securities, treasury and other bills which are past due but not impaired.

Liquidity risk

The table below analyses financial instrument liabilities of the Group, excluding those arising from insurance and participating investment contracts, on an undiscounted future cash flow basis according to contractual maturity, into relevant maturity groupings based on the remaining period at the balance sheet date; balances with no fixed maturity are included in the over 5 years category.

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2007						
Deposits from banks	35,466	2,218	1,480	26	–	39,190
Customer accounts	144,213	4,800	7,578	2,002	447	159,040
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	10,286	2,176	3,607	1,589	1,851	19,509
Debt securities in issue	20,307	6,047	9,529	13,202	6,197	55,282
Liabilities arising from non-participating investment contracts	18,197	–	–	–	–	18,197
Subordinated liabilities	27	210	1,067	6,371	14,292	21,967
Total	228,496	15,451	23,261	23,190	22,787	313,185
As at 31 December 2006						
Deposits from banks	28,376	3,707	1,722	818	1,942	36,565
Customer accounts	129,381	3,492	5,560	2,355	411	141,199
Derivative financial instruments, trading and other liabilities at fair value through profit or loss	8,928	2,037	2,600	663	887	15,115
Debt securities in issue	28,887	5,231	6,569	11,030	7,176	58,893
Liabilities arising from non-participating investment contracts	24,370	–	–	–	–	24,370
Subordinated liabilities	14	186	922	4,323	13,619	19,064
Total	219,956	14,653	17,373	19,189	24,035	295,206

Derivatives (other than those used in a hedging relationship) and trading liabilities are included in the up to 1 month column at their fair value. Liquidity risk on these items is not managed on the basis of contractual maturity as they are frequently settled on demand at fair value and therefore this is considered a better presentation of the Group's liquidity risk. Derivatives used in a hedging relationship are included according to their contractual maturity.

Cash flows for undated subordinated liabilities whose terms give the Group the option to redeem at a future date are included within the table on the basis that the Group will exercise its option to redeem.

The principal amount for undated subordinated liabilities with no redemption option is included within the over 5 years column; interest of approximately £223 million per annum which is payable in respect of those instruments for as long as they remain in issue is not included beyond 5 years.

47 Financial risk management continued

Liabilities arising from insurance and participating investment contracts are analysed on a behavioural basis, as permitted by IFRS 4, as follows:

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2007	**238**	**651**	**1,570**	**9,548**	**26,056**	**38,063**
As at 31 December 2006	247	716	1,852	9,682	28,948	41,445

The following tables set out the amounts and residual maturities of Lloyds TSB Group's off balance sheet contingent liabilities and commitments.

31 December 2007	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
Acceptances	**39**	**1**	**–**	**–**	**40**
Other contingent liabilities	**1,441**	**1,032**	**255**	**796**	**3,524**
Total contingent liabilities	**1,480**	**1,033**	**255**	**796**	**3,564**
Lending commitments	**60,981**	**13,759**	**10,634**	**4,221**	**89,595**
Other commitments	**466**	**78**	**108**	**117**	**769**
Total commitments	**61,447**	**13,837**	**10,742**	**4,338**	**90,364**
Total contingents and commitments	**62,927**	**14,870**	**10,997**	**5,134**	**93,928**

31 December 2006	Within 1 year £m	1-3 years £m	3-5 years £m	Over 5 years £m	Total £m
Acceptances	62	1	–	–	63
Other contingent liabilities	953	976	263	522	2,714
Total contingent liabilities	1,015	977	263	522	2,777
Lending commitments	56,019	11,310	11,050	3,900	82,279
Other commitments	5,945	109	23	61	6,138
Total commitments	61,964	11,419	11,073	3,961	88,417
Total contingents and commitments	62,979	12,396	11,336	4,483	91,194

Fair values of financial assets and liabilities

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

Wherever possible, fair values have been estimated using market prices for instruments held by the Group. Where market prices are not available, fair values have been estimated using quoted values for instruments with characteristics either identical or similar to those of the instruments held by the Group. These estimation techniques are necessarily subjective in nature and involve several assumptions.

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

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

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

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

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

The fair values of financial instruments quoted in active markets are based on quoted prices. The fair values of financial instruments that are not quoted in active markets are determined using valuation techniques including cash flow models which, to the extent practical, use observable market inputs such as interest rate yield curves, equities and commodities prices, option volatilities and currency rates that are either directly observable or are implied from instrument prices.

Derivative financial instruments

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

47 Financial risk management continued

Loans and advances to banks and customers

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

Available-for-sale financial assets

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

Deposits from banks and customer accounts

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

Debt securities in issue and subordinated liabilities

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

Trading and other liabilities at fair value through profit or loss

The fair values of financial instruments quoted in active markets are based on quoted prices. The fair values of financial instruments that are not quoted in active markets are determined using valuation techniques including cash flow models which, to the extent practical, use observable market inputs such as interest rate yield curves, equities and commodities prices, option volatilities and currency rates that are either directly observable or are implied from instrument prices.

Liabilities arising from non-participating investment contracts

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

Financial commitments and contingent liabilities

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

	Carrying value 2007 £m	Carrying value 2006 £m	Fair value 2007 £m	Fair value 2006 £m
Financial assets				
Trading and other financial assets at fair value through profit or loss	57,911	67,695	57,911	67,695
Derivative financial instruments	8,659	5,565	8,659	5,565
Loans and advances to banks	34,845	40,638	34,832	40,641
Loans and advances to customers	209,814	188,285	209,066	187,977
Available-for-sale financial assets	20,196	19,178	20,196	19,178
Financial liabilities				
Deposits from banks	39,091	36,394	39,063	36,383
Customer accounts	156,555	139,342	156,608	139,263
Trading and other liabilities at fair value through profit or loss	3,206	1,184	3,206	1,184
Derivative financial instruments	7,582	5,763	7,582	5,763
Debt securities in issue	51,572	54,118	51,312	54,070
Liabilities arising from non-participating investment contracts	18,197	24,370	18,197	24,370
Financial guarantees	26	49	26	49
Subordinated liabilities	11,958	12,072	12,128	12,767

48 Acquisitions

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

49 Consolidated cash flow statement

(a) Change in operating assets

	2007 £m	2006 £m
Change in loans and advances to banks	8,673	(11,063)
Change in loans and advances to customers	(20,796)	(13,910)
Change in derivative financial instruments, trading and other financial assets at fair value through profit or loss	(4,348)	(7,072)
Change in other operating assets	(511)	50
Change in operating assets	(16,982)	(31,995)

(b) Change in operating liabilities

	2007 £m	2006 £m
Change in deposits from banks	2,136	5,222
Change in customer accounts	17,172	8,523
Change in debt securities in issue	(2,450)	15,068
Change in derivative financial instruments, trading and other liabilities at fair value through profit or loss	3,840	556
Change in investment contract liabilities	(58)	3,795
Change in other operating liabilities	901	(95)
Change in operating liabilities	21,541	33,069

(c) Non-cash and other items

	2007 £m	2006 £m
Depreciation and amortisation	630	619
Revaluation of investment property	321	(631)
Allowance for loan losses	1,721	1,560
Write-off of allowance for loan losses	(1,405)	(1,299)
Impairment of available-for-sale securities	70	–
Insurance claims	7,522	8,569
Insurance claims paid	(6,669)	(7,509)
Customer remediation paid	(54)	(93)
Other provision movements	2	(19)
Net charge in respect of defined benefit schemes	175	109
Contributions to defined benefit schemes	(452)	(556)
Other non-cash items	870	104
Total non-cash items	2,731	854
Interest expense on subordinated liabilities	756	744
Profit on disposal of businesses	(657)	–
Other	(46)	(43)
Total other items	53	701
Non-cash and other items	2,784	1,555

49 Consolidated cash flow statement continued

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

	2007 £m	2006 £m
Cash and balances with central banks	4,330	1,898
Less: mandatory reserve deposits[1]	(338)	(300)
	3,992	1,598
Loans and advances to banks	34,845	40,638
Less: amounts with a maturity of three months or more	(6,946)	(16,798)
	27,899	23,840
Total cash and cash equivalents	31,891	25,438

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

Included within cash and cash equivalents at 31 December 2007 is £7,426 million (2006: £9,054 million) held within the Group's life funds, which is not immediately available for use in the business.

(e) Analysis of changes in financing during the year

	2007 £m	2006 £m
Share capital (including share premium account):		
At 1 January	2,695	2,590
Issue of share capital	35	105
At 31 December	2,730	2,695

	2007 £m	2006 £m
Minority interests:		
At 1 January	352	435
Exchange and other adjustments	(1)	(4)
Repayment of capital to minority shareholders	(80)	(151)
Minority share of profit after tax	32	104
Dividends to minority shareholders	(19)	(32)
At 31 December	284	352

	2007 £m	2006 £m
Subordinated liabilities:		
At 1 January	12,072	12,402
Exchange and other adjustments	186	(687)
Issue of subordinated liabilities	–	1,116
Repayments of subordinated liabilities	(300)	(759)
At 31 December	11,958	12,072

49 Consolidated cash flow statement continued

(f) Acquisition of group undertakings and businesses

	2007 £m	2006 £m
Net assets acquired:		
Loans and advances to customers	–	11
Other assets	–	1
	–	12
Goodwill arising on consolidation	–	4
Net cash outflow from acquisitions in the year	–	16
Payments to former members of Scottish Widows Fund and Life Assurance Society acquired during 2000	8	4
Net cash outflow from acquisitions	8	20

(g) Disposal and closure of group undertakings and businesses

	2007 £m	2006 £m
Cash and balances at central banks	37	–
Trading and other financial assets at fair value through profit or loss	10,999	–
Loans and advances to banks	1,150	–
Value of in-force business	412	–
Liabilities arising from insurance contracts and participating investment contracts	(4,349)	–
Liabilities arising from non-participating investment contracts	(7,283)	–
Unallocated surplus within insurance businesses	(15)	–
Other net assets and liabilities	(95)	–
	856	–
Profit on sale of businesses	657	–
Cash and cash equivalents disposed of	(37)	–
Consideration for 2005 disposal settled in cash	–	936
Net cash inflow from disposals	1,476	936

50 Future developments

The following pronouncements will be relevant to the Group but were not effective at 31 December 2007 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group, however, the initial view is that none of these pronouncements are expected to cause any material adjustments to reported numbers in the financial statements.

Pronouncement	Nature of change	Effective date
IFRIC 11 IFRS 2 – Group and Treasury Share Transactions	Clarifies the application of IFRS 2 Share-based Payment to certain share-based payment arrangements involving own equity instruments and arrangements involving equity instruments of a parent entity.	Annual periods beginning on or after 1 March 2007.
IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirement and their Interaction[1]	Provides guidance on the availability of refunds or reductions in future contributions for retirement plans and specifies how a minimum funding requirement might either affect the availability of reductions in future contributions or give rise to a liability.	Annual periods beginning on or after 1 January 2008.
IFRIC 13 Customer Loyalty Programmes[1, 2]	Addresses accounting by entities who grant customer loyalty award credits to customers as part of sales transactions and which can be redeemed in the future for free or discounted goods or services.	Annual periods beginning on or after 1 July 2008.
IAS 1 Presentation of Financial Statements[1, 2]	Revises the overall requirements for the presentation of financial statements, guidance for their structure and minimum content requirements. The revised standard requires the presentation of all non-owner changes in equity within a statement of comprehensive income.	Annual periods beginning on or after 1 January 2009.
IAS 23 Borrowing Costs[1, 2]	Requires interest and other costs incurred in connection with the borrowing of funds to be recognised as an expense excepting that those which are directly attributable to the acquisition, construction or production of assets that take a substantial period of time to get ready for their intended use or sale must be capitalised as part of the cost of those assets.	Annual periods beginning on or after 1 January 2009.
IFRS 8 Operating Segments[2]	Replaces IAS 14 Segment Reporting and requires reporting of financial and descriptive information about operating segments which are based on how financial information is reported and evaluated internally.	Annual periods beginning on or after 1 January 2009.
IFRS 2 Share-based Payment – Vesting Conditions and Cancellations[1, 2]	The amendment restricts the definition of vesting conditions to include only service conditions and performance conditions and deals with the accounting consequences of a failure to meet a condition other than a vesting condition including how to deal with cancellations by the counterparty and circumstances where neither the entity nor the counterparty is in a position to choose whether or not to meet a vesting condition.	Annual periods beginning on or after 1 January 2009.
Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation[1, 2]	The amendment requires some puttable financial instruments (being those which give the holder the right to put the instrument back to the issuer for cash or another financial asset) and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity.	Annual periods beginning on or after 1 January 2009.
IFRS 3 Business Combinations[1, 2]	The revised standard continues to apply the acquisition method to business combinations, however, all payments to purchase a business are to be recorded at fair value at the acquisition date, some contingent payments are subsequently remeasured at fair value through income, goodwill may be calculated based on the parent's share of net assets or it may include goodwill related to the minority interest, and all transaction costs are expensed.	Annual periods beginning on or after 1 July 2009.

50 Future developments continued

IAS 27 Consolidated and Separate Financial Statements[1, 2]	Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control; any remaining interest in an investee is re-measured to fair value in determining the gain or loss recognised in profit or loss where control over the investee is lost.	Annual periods beginning on or after 1 July 2009.

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

[2] Subject to any EU endorsement, the Group has not yet made a final decision as to whether it will apply these pronouncements in the 2008 financial statements.

51 Approval of financial statements

The consolidated financial statements were approved by the directors of Lloyds TSB Group plc on 21 February 2008.

Report of the independent auditors on the parent company financial statements

To the members of Lloyds TSB Group plc

We have audited the parent company financial statements of Lloyds TSB Group plc for the year ended 31 December 2007 which comprise the balance sheet, the statement of changes in equity, the cash flow statement and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report on pages 64 to 75 that is described as having been audited.

We have reported separately on the consolidated financial statements of Lloyds TSB Group plc for the year ended 31 December 2007.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the parent company financial statements in accordance with applicable law and International Financial Reporting Standards ('IFRSs') as adopted by the European Union are set out in the statement of directors' responsibilities on page 63.

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

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the parent company financial statements. The information given in the directors' report includes that specific information presented in the Overview and the Business Review that is cross referred from the principal activities, business review, future developments and financial risk management objectives and policies section of the directors' report.

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

We read other information contained in the annual report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the chairman's statement, the group chief executive's review, the Business Review, the directors' report, the corporate governance disclosures, the unaudited part of the directors' remuneration report and the shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2007 and cash flows for the year then ended;
- the parent company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the parent company financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southampton, England
21 February 2008

Parent company balance sheet

at 31 December 2007

	Note	2007 £ million	2006 £ million
Assets			
Non-current assets:			
Investment in subsidiaries	8	5,589	5,589
Loans to subsidiaries	8	2,820	1,723
Deferred tax assets	2	2	–
		8,411	7,312
Current assets:			
Derivative financial instruments		169	114
Other assets		165	146
Amounts due from subsidiaries	3	92	203
Cash and cash equivalents		58	1,213
		484	1,676
Total assets		8,895	8,988
Equity and liabilities			
Capital and reserves:			
Share capital	4	1,432	1,429
Share premium account	4	1,298	1,266
Retained profits	5	1,935	2,026
Total equity		4,665	4,721
Non-current liabilities:			
Subordinated liabilities	6	2,345	2,297
Debt securities in issue	7	50	–
		2,395	2,297
Current liabilities:			
Debt securities in issue	7	1,694	–
Current tax liabilities		28	43
Derivative financial instruments		29	–
Amounts owed to subsidiaries		–	1,850
Other liabilities		84	77
		1,835	1,970
Total liabilities		4,230	4,267
Total equity and liabilities		8,895	8,988

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

The directors approved the parent company financial statements on 21 February 2008.

Sir Victor Blank	**J Eric Daniels**	**Helen A Weir**
Chairman	Group Chief Executive	Group Finance Director

Parent company statement of changes in equity

	Share capital and premium £ million	Retained profits £ million	Total £ million
Balance at 1 January 2006	2,590	2,055	4,645
Profit for the year*	–	1,877	1,877
Dividends	–	(1,919)	(1,919)
Purchase/sale of treasury shares	–	(20)	(20)
Employee share option schemes:			
Value of employee services	–	33	33
Proceeds from shares issued	105	–	105
Balance at 31 December 2006	2,695	2,026	4,721
Profit for the year*	**–**	**1,855**	**1,855**
Dividends	**–**	**(1,957)**	**(1,957)**
Purchase/sale of treasury shares	**–**	**(19)**	**(19)**
Employee share option schemes:			
Value of employee services	**–**	**30**	**30**
Proceeds from shares issued	**35**	**–**	**35**
Balance at 31 December 2007	**2,730**	**1,935**	**4,665**

* No income statement has been shown for the parent company, as permitted by section 230 of the Companies Act 1985.

Parent company cash flow statement

for the year ended 31 December 2007

	2007 £ million	2006 £ million
Profit before tax	1,870	1,893
Dividend income	(1,957)	(1,918)
Fair value and exchange adjustments	10	3
Change in other assets	103	(44)
Change in other liabilities	(128)	156
Tax (paid) received	(32)	46
Net cash (used in) provided by operating activities	(134)	136
Cash flows from investing activities		
Capital lending to subsidiaries	(1,111)	–
Cash flows from financing activities		
Dividends received from subsidiaries	1,957	1,918
Dividends paid to equity shareholders	(1,957)	(1,919)
Proceeds from issue of debt securities	1,770	–
Proceeds from issue of subordinated liabilities	–	1,116
Proceeds from issue of ordinary shares	35	105
Repayment of subordinated liabilities	–	(250)
Repayment of amounts due to subsidiaries	(1,715)	–
Net cash generated by financing activities	90	970
Change in cash and cash equivalents	(1,155)	1,106
Cash and cash equivalents at beginning of year	1,213	107
Cash and cash equivalents at end of year	58	1,213

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

Notes to the parent company accounts

1 Accounting policies

The parent company has applied International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) in its financial statements for the year ended 31 December 2007. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee and its predecessor body. The EU endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements; the Company has not taken advantage of this relaxation, and therefore there is no difference in application to the Company between IFRS as adopted by the EU and IFRS as issued by the IASB.

The financial information has been prepared under the historical cost convention, as modified by the revaluation of all derivative contracts.

The accounting policies of the parent company are the same as those of the Group which are set out in note 1 to the consolidated financial statements, except that it has no policy in respect of consolidation and investments in subsidiaries are carried at historical cost, less any provisions for impairment.

2 Deferred tax assets

The movement in the net deferred tax asset is as follows:	2007 £m	2006 £m
At 1 January	–	21
Income statement credit (charge)	2	(8)
Amount debited to equity in respect of employee share schemes	–	(13)
At 31 December	2	–

The deferred tax assets relate to temporary differences.

3 Amounts due from subsidiaries

These comprise short-term lending to subsidiaries, repayable on demand. The fair values of amounts owed by subsidiaries are equal to their carrying amounts. No provisions have been recognised in respect of amounts owed by subsidiaries.

4 Share capital and share premium

Details of the Company's share capital and share premium account are as set out in notes 39 and 40 to the consolidated financial statements.

5 Retained profits

	£m
At 1 January 2006	2,055
Profit for the year	1,877
Dividends	(1,919)
Purchase/sale of treasury shares	(20)
Employee share option schemes: value of employee services	33
At 31 December 2006	2,026
Profit for the year	1,855
Dividends	(1,957)
Purchase/sale of treasury shares	(19)
Employee share option schemes: value of employee services	30
At 31 December 2007	1,935

Details of the Company's dividends are as set out in note 43 to the consolidated financial statements.

6 Subordinated liabilities

	2007 £m	2006 £m
Preferred securities		
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2015 (£600 million)†	593	587
Fixed/Floating Rate Non-Cumulative Callable Preference Shares callable 2016 (US$ 1,000 million)†	515	504
6% Non-cumulative Redeemable Preference Shares	–	–
Undated subordinated liabilities		
6% Undated Subordinated Step-up Guaranteed Bonds callable 2032 (£500 million)*	497	497
Dated subordinated liabilities		
$9^1/_8$% Subordinated Bonds 2011 (£150 million)	149	149
$5^7/_8$% Subordinated Guaranteed Bonds 2014 (€750 million)	591	560
	740	709
Total subordinated liabilities	2,345	2,297

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

* In certain circumstances, these bonds would acquire the characteristics of preference share capital. Any repayments of undated loan capital would require the prior consent of the Financial Services Authority. They are accounted for as liabilities as coupon payments are mandatory as a consequence of the terms of certain preference shares. At the callable date the coupon on these bonds will be reset by reference to the applicable five year benchmark gilt rate.

† Further information regarding the fixed/floating rate non-cumulative callable preference shares can be found in note 39 to the consolidated financial statements.

7 Debt securities in issue

These comprise the US$1,400 million Thirteen-Month Extendible Short-Term Notes and the US$1,725 million Thirteen-Month Extendible Short-Term Notes issued by the Company in May 2007.

8 Related party transactions

Key management personnel

The key management personnel of the Group and parent company are the same. The relevant disclosures are given in note 45 to the consolidated financial statements.

The Company has no employees (2006: nil).

As discussed in note 44 to the consolidated financial statements, the Group provides share based compensation to employees through a number of schemes; these are all in relation to shares in the Company and the cost of providing those benefits is recharged to the employing companies in the Group on a cash basis.

Investment in subsidiaries

The Company's investment in subsidiaries is carried at cost: there has been no movement in the carrying value during the year and there has been no impairment of the Company's investment in subsidiaries.

8 Related party transactions continued

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

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

† Indirect interest.

The principal area of operation for each of the above subsidiaries is the United Kingdom and the Channel Islands, except as follows:

Lloyds TSB Bank plc operates principally in the UK but also through branches in Belgium, Dubai, Ecuador, France, Gibraltar, Hong Kong, Japan, Luxembourg, Malaysia, Monaco, Netherlands, Singapore, Spain, Switzerland, Uruguay and the USA, and a representative office in China.

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

Loans to subsidiaries:	2007 £m	2006 £m
At 1 January	1,723	1,723
Exchange and other adjustments	(14)	–
Amounts advanced	1,111	–
At 31 December	2,820	1,723

In addition the parent company carried out all of its banking activities through its subsidiary, Lloyds TSB Bank plc (the 'Bank'). At 31 December 2007, the parent company held deposits of £58 million with the Bank (2006: £1,213 million). Given the volume of transactions flowing through the account, it is not meaningful to provide gross inflow and outflow information. In addition, at 31 December 2007 the parent company had interest rate and currency swaps with the Bank with an aggregate notional principal amount of £4,032 million and a net positive fair value of £140 million (2006: notional principal amount of £2,228 million and a positive fair value of £114 million), designated as fair value hedges to manage the Company's issuance of subordinated liabilities and debt securities in issue.

Related party information in respect of other related party transactions is given in note 45 to the consolidated financial statements.

9 Financial instruments

Measurement basis of financial assets and liabilities

The accounting policies in note 1 to the consolidated financial statements describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2007				
Financial assets:				
Cash and cash equivalents	–	–	58	58
Derivative financial instruments	169	–	–	169
Loans to subsidiaries	–	2,820	–	2,820
Amounts due from subsidiaries	–	92	–	92
Total financial assets	169	2,912	58	3,139
Financial liabilities:				
Derivative financial instruments	29	–	–	29
Debt securities in issue	–	–	1,744	1,744
Subordinated liabilities	–	–	2,345	2,345
Total financial liabilities	29	–	4,089	4,118

	Derivatives designated as hedging instruments, held at fair value through profit or loss £m	Loans and receivables £m	Held at amortised cost £m	Total £m
As at 31 December 2006				
Financial assets:				
Cash and cash equivalents	–	–	1,213	1,213
Derivative financial instruments	114	–	–	114
Loans to subsidiaries	–	1,723	–	1,723
Amounts due from subsidiaries	–	203	–	203
Total financial assets	114	1,926	1,213	3,253
Financial liabilities:				
Amounts owed to subsidiaries	–	–	1,850	1,850
Subordinated liabilities	–	–	2,297	2,297
Total financial liabilities	–	–	4,147	4,147

Interest rate risk and currency risk

The Company is exposed to interest rate risk and currency risk on its debt securities in issue and its subordinated debt.

As discussed in note 8, the Company has entered into interest rate and currency swaps with its subsidiary, Lloyds TSB Bank plc, to manage these risks.

Credit risk

The majority of the Company's credit risk arises from amounts due from its wholly owned subsidiary, Lloyds TSB Bank plc, and subsidiaries of that company. The credit ratings of Lloyds TSB Bank plc are disclosed on page 50.

9 Financial instruments continued

Liquidity risk

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

	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
As at 31 December 2007						
Derivative financial instruments	10	20	1,791	–	–	1,821
Debt securities in issue	8	15	1,740	50	–	1,813
Subordinated liabilities	11	21	97	516	3,195	3,840
Total	29	56	3,628	566	3,195	7,474
As at 31 December 2006						
Amounts owed to subsidiaries	1,850	–	–	–	–	1,850
Subordinated liabilities	11	21	96	512	3,271	3,911
Total	1,861	21	96	512	3,271	5,761

Fair values of financial assets and liabilities

The valuation techniques for the Company's financial instruments are as discussed in note 47 to the consolidated financial statements.

	Carrying value 2007 £m	Carrying value 2006 £m	Fair value 2007 £m	Fair value 2006 £m
Financial assets:				
Cash and cash equivalents	58	1,213	58	1,213
Derivative financial instruments	169	114	169	114
Loans to subsidiaries	2,820	1,723	2,856	1,825
Amounts due from subsidiaries	92	203	92	203
Financial liabilities:				
Amounts owed to subsidiaries	–	1,850	–	1,850
Derivative financial instruments	29	–	29	–
Debt securities in issue	1,744	–	1,744	–
Subordinated liabilities	2,345	2,297	2,134	2,217

10 Approval of the financial statements and other information

The parent company financial statements were approved by the directors of Lloyds TSB Group plc on 21 February 2008.

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.

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Information for shareholders

Analysis of shareholders

at 31 December 2007	Shareholders		Number of ordinary shares	
Size of shareholding	Number	%	Millions	%
1 – 99	61,157	7.52	2.1	0.04
100 – 499	321,403	39.49	106.3	1.88
500 – 999	254,040	31.21	170.9	3.03
1,000 – 4,999	141,656	17.40	275.9	4.88
5,000 – 9,999	20,099	2.47	136.4	2.41
10,000 – 49,999	13,404	1.65	240.9	4.27
50,000 – 99,999	688	0.08	46.2	0.82
100,000 – 999,999	959	0.12	329.9	5.84
1,000,000 and over	482	0.06	4,339.1	76.83
	813,888	100.00	5,647.7*	100.00

*Includes 887 million shares (15.7%) registered in the names of some 783,000 individuals. 274 million shares (4.8%) are held by over 61,000 staff and Group pensioners, or on their behalf by the trustee of the staff shareplan scheme.

Substantial shareholdings

At the date of this report, notifications had been received that Legal & General Investment Management Limited had a direct interest of 4.11% and Barclays PLC and The Capital Group Companies, Inc had interests of 3.84% and 4.86% respectively, in the issued share capital with rights to vote in all circumstances at general meetings. No other notification has been received that anyone has an interest of 3% or more in the issued share capital.

Share price information

In addition to listings in the financial pages of the press, the latest price of Lloyds TSB shares on the London Stock Exchange can be obtained by telephoning 09058 890 190. Visit www.londonstockexchange.com for details.

Share dealing facilities

A full range of dealing services is available through Lloyds TSB.

- Internet dealing. Log on to www.lloydstsbsharedealing.com
- Telephone dealing. Call 0845 6060560

Internet and telephone dealing services are available between 8.00am and 4.30pm, Monday to Friday.

Details of any dealing costs are available when you log on to the share dealing website or when you call the above number.

American Depositary Receipts (ADRs)

Lloyds TSB shares are traded in the USA through an NYSE-listed sponsored ADR facility, with The Bank of New York as the depositary. The ADRs are traded on the New York Stock Exchange under the symbol LYG. The CUSIP number is 539439109 and the ratio of ADRs to ordinary shares is 1:4.

For details contact: The Bank of New York, Investor Services, PO Box 11258, Church Street Station, New York, NY 10286-1258.
Telephone: 888 BNY ADRS (US toll free), international callers: +1 212 815 3700. Alternatively visit www.adrbny.com or email shareowners@bankofny.com

Individual Savings Accounts (ISAs)

The Company provides a facility for investing in Lloyds TSB shares through an ISA. For details contact: Retail Investor Operations, Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA. Telephone 0871 384 2244.

Corporate responsibility

A copy of the Group's corporate responsibility report may be obtained by writing to
Corporate Responsibility, Lloyds TSB Group plc, 25 Gresham Street, London EC2V 7HN.
This information together with the Group's code of business conduct is also available on the Group's website.

The Better Payment Practice Code

A copy of the code and information about it may be obtained from the BERR Publications Orderline 0845 0150010, quoting ref URN 04/606.
Alternatively, visit www.payontime.co.uk for details.

Shareholder enquiries

The Company's share register is maintained by Equiniti Limited.

Contact them if you have enquiries about your Lloyds TSB shareholding, including those concerning the following matters:

- change of name or address
- loss of share certificate, dividend warrant or tax voucher
- obtaining a form for dividends to be paid directly to your bank or building society account (tax vouchers will still be sent to your registered address unless you request otherwise)
- obtaining details of the dividend reinvestment plan which enables you to use your cash dividends to buy Lloyds TSB shares in the market

Equiniti operates a web based enquiry and portfolio management service for you to receive shareholder communications electronically. In addition, you can change your address or bank details and register proxy appointments and voting instructions on your shareholding online.
Visit www.shareview.co.uk for details.

Calls to 09058, 0871 and 0845 numbers are charged at 55p, 8p and 5p per minute, respectively, from a BT landline. Charges for calls from mobiles and other networks may vary.

Financial calendar 2008

22 February	Results for 2007 announced
5 March	Ex-dividend date for 2007 final dividend
7 March	Record date for final dividend
9 April	Final date for joining or leaving the dividend reinvestment plan for the final dividend
7 May	Final dividend paid
8 May	Annual general meeting in Glasgow
30 July	Results for half-year to 30 June 2008 announced
6 August	Ex-dividend date for 2008 interim dividend
8 August	Record date for interim dividend
3 September	Final date for joining or leaving the dividend reinvestment plan for the interim dividend
1 October	Interim dividend paid

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